Uganda Bankers' Association
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Decreasing the Cost of Doing Business in the Banking Sector in Uganda

SPECIAL REPORT
October 2021

Uganda Bankers' Association

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Acknowledgement

We would like to acknowledge Uganda Bankers' Association (UBA) and Makerere University Business School (MUBS) that shaped the scope and context of this research.

We would like to acknowledge with due respect the support and insights shared by different individuals and organizations that informed this timely research. In addition, we would like to thank the Executive Director Supervision- Bank of Uganda, Ministry of Finance Planning & Economic Development- Directorate of Economic Affairs, Department of Tax policy and Directorate of Financial Sector Development, Chairman- Uganda Bankers' Association (UBA), Executive Director- Uganda Bankers Association, Chief Executives of Member Banks, Heads of Finance, Legal, Compliance, Operations and Treasury in the Supervised Financial Institutions (SFIs), Financial Sector Deepening Uganda (FSDU), Staff of Uganda Bankers' Association, Executives in the Telecommunication companies, Chief Executives in Real Estate, Senior staff in Operations, Finance and Security departments in SFIs who volunteered information and time to participate in the research relevant to the banking industry and the economy at large. Without them, this report would not have been complete.

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Acronyms

No	Abbreviation	In Full
1	ABC	Agent Banking Company
2	AFI	Alliance for Financial Inclusion
3	AI	Artificial Intelligence
4	AML	Anti-Money Laundering
5	API	Application Program Interface.
6	ARC	Asset Reconstruction Company
7	ATMs	Automated Teller Machines
8	BOU	Bank of Uganda
9	BPR	Business Process Reengineering
10	Capex	Capital Expenditure
11	CEO	Chief Executive Officer
12	CFO	Chief Finance Officer
13	CIIP	Competitive Industries and Innovation Programme
14	CIO	Chief Information Officer
15	CIT	Cash in Transit
16	CMA	Capital Markets Authority
17	CRB	Credit Reference Bureau
18	CRR	Cash Reserve Ratio
19	CSR	Corporate Social Responsibility
20	CTI	Cost to Income
21	DSIB	Domestically Systematically Important Banks
22	ERP	Enterprise Resource Planning
23	FCY	Foreign Currency
24	FIA	Financial Intelligence Authority
25	Fintechs	Financial and Technology Companies
26	FSDU	Financial Sector Deepening Uganda
27	FX	Foreign Exchange
28	GDP	Gross Domestic Product
29	GoU	Government of Uganda
30	HR	Human Resources
31	ICAMEK	The International Centre for Arbitration and Mediation in Kampala
32	ICT	Information and Communications Technology
33	IRA	Insurance Regulatory Authority
34	IT	Information Technology
35	KYC	Know Your Customer
36	LCY	Local Currency

37	MDIs	Microfinance Deposit Taking Institutions
38	MNO	Mobile Network Operators
39	MoFPED	Ministry of Finance, Planning and Economic Development
40	MoU	Memorandum of Understanding
41	MUBS	Makerere University Business School
42	NGOs	Non-Government Organizations
43	NIRA	National Identification and Registration Authority
44	NITA	National Information Technology Authority
45	NPL	Non-Performing Loan
46	NPS	National Payments System
47	Opex	Operating Expenditure
48	OPM	Office of the Prime Minister
49	OTC	Over The Counter
50	POS	Point of Sale
51	PSFU	Private Sector Foundation Uganda
52	PWC	PricewaterhouseCoopers
53	ROE	Return on Equity
54	ROI	Return on Investment
55	SFI	Supervised Financial Institutions
56	SLA	Service Level Agreement
57	SME	Small and Medium Enterprise
58	STR	Suspicious Transaction Report
59	TAT	Turn Around Time
60	Telecoms	Telecommunication Companies
61	UBA	Uganda Bankers' Association
62	Ugx	Uganda Shillings
63	UBOS	Uganda Bureau of Statistics
64	UIA	Uganda Investment Authority
65	UIBFS	Uganda Institute of Banking and Financial Services
66	UMA	Uganda Manufacturers Association
67	UMRA	Uganda Microfinance Regulatory Authority
68	URA	Uganda Revenue Authority
69	URBRA	Uganda Retirements Benefits Regulatory Authority
70	URSB	Uganda Registration Services Bureau
71	USD	United States Dollar
72	USE	Uganda Securities Exchange

Executive Director Uganda Bankers Association

Foreword

The banking sector plays an important role in the economy with fundamental responsibility for safe custody of deposits, intermediation through lending, payments and facilitation of trade and investment among others. Banks and financial institutions as a whole undertake these intermediary roles in a regulated environment through a set of policies, rules, processes, procedures, and risk management frameworks.

The challenge around cost of delivering these services has always been a point of contention and debate both internally within the financial institutions themselves as well as for the end user beneficiaries of financial services i.e., the customers by way of the price at which they pay for these services (tariffs, service charges, interest rates etc.).

Whether consumers or businesses, customers are increasingly at the epicenter of the business & economy, especially how they are served. Financial institutions that survive the current disruption and position themselves for a sustainable future must focus on efficiencies and rationalizations that enable them manage cost, deliver value to the ever changing and demanding segments of customers, and remain resilient in the face of shocks.

The key strategic goals that define Uganda Bankers Association 2019-2021 strategic plan, include championing initiatives intended at driving down the average industry cost of delivering financial services in Uganda. (Lower cost income ratio as measure of efficiency). Understanding the factors that contribute to the high operating costs experienced in the banking/financial sector and determining the best means to reduce these costs is a cardinal mark-stone.

The strategy directorate at the secretariat undertook a research study in collaboration with Makerere University Business School to examine the above starting mark-stone and through its findings, contribute to;

1. Shading light on how to reduce the cost of doing business in the banking industry including the use of technology.
2. Highlight some of the key challenges supervised financial institutions (SFIs) face in implementing cost saving initiatives and making sustainable changes in their operating models.
3. Providing recommendations for alternative cost sharing initiatives and partnerships.
4. Ensuring that sustainable cost savings across the sector/industry result into,
    - Better service to customers at a lower cost,
    - Margin growth and sustained profitability and growth for all SFIs,
    - Ensuring the financial sector provides affordable financial services to all, including reaching the rural and underserved areas /customer segments and positively contributing to the goals of financial inclusion.

The report comes on the back of our submission to Bank of Uganda on the 15th of October 2021, the regulatory reforms report which was the output of a retreat we held way back in March 2019 when we gathered at Serena Kigo with the sector regulator and several other development partners to review the operating environment for regulated financial institutions and agreed to propose reforms, changes, adaptations, in the oversite and practice of banking operations. We do believe these two submissions will greatly supplement the many other efforts & reforms underway to shape the future of banking and financial services in Uganda.

On behalf of the leadership of the association made up the executive committee and all member CEOs, we convey our deep gratitude to the UBA strategy department and Makerere University Business School team who undertook this assignment and to all informants especially staff of our member SFIs who made input to this report.

We call upon all our member institutions to review and embrace this report, and more importantly put into effect the recommendations therein individually & collectively for the good of your institutions, the entire industry and for our customers & wider economy.

Wilbrod Humphreys Owor
Executive Director
18th October 2021

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Executive Summary

One of the key pillars of the National Development Plan (NDP) III and a pillar for national economic development is access to affordable finance. According to the National Financial Inclusion Strategy 2017 - 2022, access to formal financial services by the population can contribute to inclusive economic growth. Consequently, the promotion of financial inclusion, which refers to the process of ensuring access to timely, affordable, and adequate financial services to all citizens in the economy, has become a goal of public policy in developing countries including Uganda.

According to the FinScope Uganda Survey Report 2018, 78% of Ugandan adults are financially included. The low levels of financial inclusion exist because of various factors including high risk perception, high transaction costs, lack of infrastructure, and poverty, among others. A key challenge identified in The National Financial Inclusion Strategy 2017-2022 is the high cost of financial services which is limiting financial inclusion, partly due to relatively high operating costs of the Supervised Financial Institutions (SFIs) and other providers of financial services.

As at the end of December 2020, the commercial banks' cost to income (CTI) ratio was 65%, up from 61% in 2019, which is significantly higher than the average cost to income ratio in Kenya – the average cost to income ratio for banks in Kenya over a period of 7 years (2013 – 2019) was 42.7%. High bank business costs will often subsequently be passed to the consumer in the form of high lending interest rates, high bank charges accompanied by low saving interest rates, among others.

Thus, one of the key strategic intents of the Uganda Bankers Association is to champion initiatives intended at driving down the average industry cost of delivering financial services in Uganda through industry collaborations and partnerships and improved initiatives by the respective individual Supervised Financial Institutions (SFIs).

Understanding the factors that drive the high operating costs experienced in the banking sector and determining the best means to reduce costs is necessary for financial inclusion, the continued survival of the SFIs and the development of the financial sector and its ecosystem. In this challenging environment, cost management is a strong imperative for the entire banking industry. Thus, various stakeholders have contributed to understanding the drivers of cost, and in solutioning for cost management for the banking industry together and for the respective SFIs.

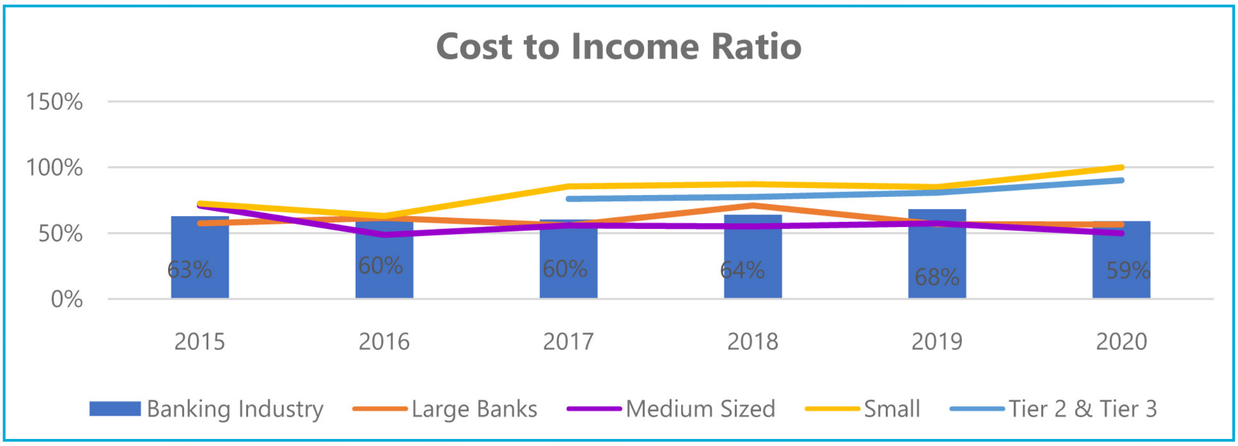
01 Introduction

"The lowest cost to income ratio for Tier 2 and 3 financial institutions supervised by the Bank of Uganda (BOU) in 2020 was **73%,** and the highest was **193%**, per SFI published financial statements. Comparatively, the average cost to income ratio for commercials banks in Kenya over a period of 7 years (2013 – 2019) was **42.7%**, with a high of **44.7%** and a low of **39.9%** in the same period".

According to the FinScope Uganda Survey Report 2018, 78% of Ugandan adults are financially included. The Survey report further revealed that financial inclusion is significantly skewed towards adults from urban areas (86%) vs. 75% for those residing in rural areas. Due to the COVID-19 pandemic, at least one million Ugandans will fall back into poverty, increasing the number of Ugandans who are financially excluded. According to the Uganda Bureau of Statistics (UBOS) Uganda National Household Survey 2019/2020, in rural areas, 23.4 percent of people live in poverty and the number of poor persons dropped from 7.1 million to 7 million year in year. In urban areas, the number of people living in poverty increased year on year from 9.5 percent to 11.7 percent and poor persons increased from 0.9 million to 1.3 million over the same period.

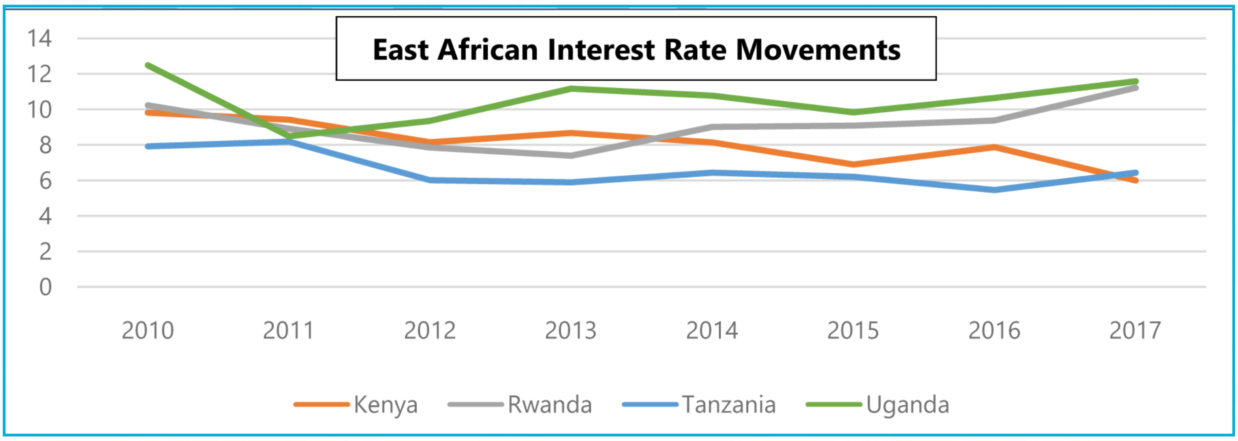
The low levels of financial inclusion continue to exist because of various reasons including risk perception, high transaction costs, lack of infrastructure, and difficult terrains and low density of population, particularly in the rural areas and among the poorer segments of the population as well as poverty. A key issue identified in The National Financial Inclusion Strategy 2017-2022 is the high cost of financial services which is limiting financial inclusion, partly due to relatively high operating costs of the Supervised Financial Institutions (SFIs) and other providers of financial services.

Despite all SFIs operating under the same macro-economic environment and prudential regulations, their cost to income ratios are very different, with the lowest commercial bank's cost to income ratio at 46% and the highest at 113% as at the end of the financial year 2020. The lowest cost to income ratio for Tier 2 and 3 financial institutions supervised by the Bank of Uganda (BOU) in 2020 was 73%, and the highest was 193%, per SFI published financial statements. Comparatively, the average cost to income ratio for commercials banks in Kenya over a period of 7 years (2013 – 2019) was 42.7%, with a high of 44.7% and a low of 39.9% in the same period.



According to Deloitte (2020), banks today face significant challenges from every direction including increased competition from Neobanks (online financial Institutions) and Financial and Technology Companies (Fintechs) which continue to nibble away at the edges of the traditional banking business, posing a constant threat of disruption.

The high costs & poor performance of several SFIs threaten Uganda's economic stability, as these institutions are vulnerable to exit. The latest bank to be closed in Uganda, Crane Bank, was closed due to insolvency. High bank business costs are often passed to the consumer in the form of high lending interest rates, high bank charges accompanied by low saving interest rates, among others. Interest rate spreads in Uganda are among the highest in the East African region and have remained so for the better part of the last two decades, with lending rates averaging 20 per cent (Figure 1)[3]



The high operating costs of SFIs thus have a detrimental effect on increasing financial inclusion in Uganda. FinScope[1] studies have shown that low levels of uptake and usage of financial services, especially in rural areas, is partly due to the high prices of financial services linked to high operational costs. In addition, the high operating costs disincentivize efforts by SFIs to implement financial inclusion initiatives such as providing low-cost bank accounts or investing in banking infrastructure in rural areas.

[1]https://bankersjournalug.com/mutebile-starts-crane-bank-liquidation-heres-what-is-going-to-happen/
[2]National Financial Inclusion Strategy 2017-2022.
[3]Jefferis, K., Kasekende, E., Rubatsimbira, D.K. and Ntungire, N., (2020). 'Exploring the Determinants of Interest Rate Spreads in the Uganda Banking System'. IGC Paper No. S-43434-UGA-1. Available here: https://www.theigc.org/publication/exploring-the-determinants-of-interest-rate-spreads-in-the-uganda-banking-system/
[4]https://fsduganda.or.ug/portfolio/finscope-research-survey/

Understanding the factors that contribute to the high operating costs experienced in the banking sector and determining the best means to reduce costs is necessary for financial inclusion. Importantly, it would increase the profitability of SFIs, enabling them to innovate, provide services at scale and at a low cost, ultimately strengthening the financial sector.

Several stakeholders in the financial sector have provided various reasons for the high operating costs including heightened performance expectations, uncertain regulatory environment, compliance and regulatory burden, changing customer needs, shrinking margins, technology advancement, costs of running legacy systems alongside new systems, high costs of change, legal and structural challenges and interdependence which have resulted into high cost to income ratios. Banks have attempted to decrease the costs of banking through optimizing the banking channels and reducing non-core expenses. This has however not been sufficient and has not achieved the expected impact of lower overall operation costs or prices for financial services.

In this challenging environment, cost management remains a strong imperative for the entire banking industry. Most banks continue to have very positive expectations for revenue growth and are using cost reduction as a tool to help fund their required growth investments. The cost reduction that should be undertaken by the SFIs must focus on sustainably reducing costs, without compromising service levels and commitment to key stakeholders including customers, staff, shareholders, the regulator, and the public at large.

Whilst the drivers and strategies to manage cost are different across the SFIs, there is a need for deliberate individual and industry collaborations and strategies to systematically manage and lower operating costs in a sustainable manner, to enable the translation of the cost saving to the benefit of its customers and all its stakeholders.

02 Statement of the Problem

> "Specifically, Uganda's commercial bank cost to income ratio is **62%** over the last five years (2016-2020), with a low of **59%** in 2020 and a high of **68.1%** in 2019. Comparatively, the average cost to income ratio for commercials banks in Kenya over a period of 7 years (2013 – 2019) is **42.7%**, with a high of **44.7%** and a low of **39.9**%."

Banking institutions generally face distinct challenges arising out of tight timelines, heightened performance expectations that might easily be unmet, unforeseen complexity, evolving regulations, changing customer needs, shrinking margins, technology advancement and interdependence which have resulted into high cost to income ratios and cost of doing banking business (Harle et. al, 2020; Mohammed, 2019; Mutebile, 2017; Wong, 2017). Specifically, Uganda's commercial bank cost to income ratio is 62% over the last five years (2016-2020), with a low of 59% in 2020 and a high of 68.1% in 2019. Comparatively, the average cost to income ratio for commercials banks in Kenya over a period of 7 years (2013 – 2019) was 42.7%, with a high of 44.7% and a low of 39.9.

The average cost to income ratio for tier 2 and 3 SFIs over the last 4 years (2017-2020) is 81.1%, with a low of 76.1% in 2017 and a high of 90.1% in 2020. In 2020, a total of seven (7) SFIs made losses, an improvement from 2019 where eight SFIs made losses. A total of 17 SFIs made profits after tax of less than Ugx. 3 billion in the year 2020, including 7 commercial banks (29%) and 7 tier 2 and 3 SFIs (78%).

With limited avenues for growth, banks have attempted to adopt broad-based cost efficiency measures aimed at continuing to operate profitably, efficiently and reducing their operating costs without compromising service delivery or customers' access to financial services (Oracle, 2017; Campino, Brochado & Rosa, 2020). Typically, most of the banking institutions are focusing on improving cost-effectiveness by optimizing the banking channels, improving, and digitizing processes and reducing operating and non-core expenses; but this is not sufficient and has not achieved the expected impact (Abel, 2020; PWC, 2020).

The regulatory, operational, process and structural factors at bank and industry level have been highlighted as the underlying drivers of the consequent high cost of doing business in the banking sector (Harle et al, 2020; PWC, 2019). This has certainly affected any attempt by banks to reduce their lending rates by legislation or operations (Mutebile, 2017). The rationale of reducing cost of doing business by banks has been supported by various arguments and actors in Uganda and across the globe (Ogden, 2019). With digital innovation emerging as a critical enabler for both cost reduction and business transformation, cost management remains a strong imperative for the entire banking industry in order to address the rising cost income ratio and consequent cost of funds incurred by the consumers as a result (BoU, 2020; Deloitte, 2019; Rafiq, 2019). Digital technologies can deliver dramatic improvements in competitiveness, performance, operating efficiency, and cost savings. They can also strengthen a bank's positioning for adverse future events, including economic downturns and digital disruption.

03 Goal and Objectives

3.1 Goal:

To unearth the right information and practices that can be individually and collaboratively adopted in order to reduce costs of doing business in the banking sector in Uganda, with consumer benefit in mind.

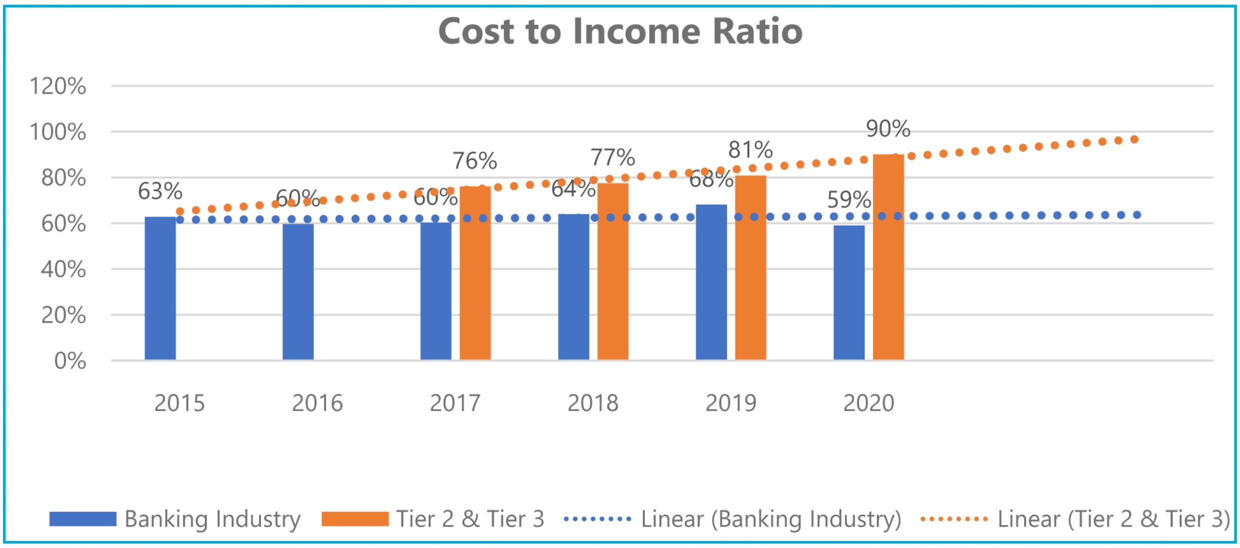
3.2 Research objectives:

1. Provide knowledge and guidelines on how to reduce the cost of doing business in the banking industry including the use of technology
2. Examine challenges SFIs face in implementing cost saving initiatives and making sustainable changes in their operating models
3. Explore and recommend alternative cost sharing initiatives and partnerships

04 Significance of the Study

> For every **Ugx 100** revenue earned over the last 6 years, commercial banks on average spend **Ugx 62** while Tier 2 and 3 SFIs on average spend **Ugx. 81** making the said profits".

The cost of business in Uganda's banking sector is substantially high, negatively affecting banks' profitability and constraining the ability of the sector to invest in technology and innovations, financial inclusion, and the overall sector development. For every Ugx 100 revenue earned over the last 6 years, commercial banks on average spend Ugx 62 while Tier 2 and 3 SFIs on average spend Ugx. 81 making the said profits.



There have long been concerns about high interest rates charged by financial institutions in Uganda. Interest rate spreads are relatively high in Uganda, for a variety of reasons, including high overhead and operating costs, high interest rates on government bonds, high levels of bank capitalization, costs of deposits including the liquidity premium and cash reserve margin, credit losses and non-performing loans and the bank profit margins. A variety of policy actions could help to reduce spreads, including decreasing the SFI's overhead and other operating costs.

The National Financial Inclusion Strategy (NFIS) 2017-2022 is Uganda's holistic strategy for promoting financial inclusion. Objective 3 of the Financial Inclusion Programme speaks to the importance of having the financial sector aligned to support the changing demography, technology, and attitudes in the country. Policy actions can lead to advancement of the financial sector and thus help consumers and businesses meet their own goals for investments, growth, and security.

A focused drive to ensure sustainable cost savings will result into better and cheaper services to customers, in an easier and efficient way of access, at a lower cost. Enabling the banking sector to provide cheaper and more efficient financial services to all including the rural areas will ensure the development of the financial sector, ultimately positively impacting financial inclusion, and sustained profits and growth for all SFIs.

05 Literature Review

"Uganda's financial system is dominated by the banking industry accounting for **83%** of assets in the financial system - **US$79.2 billion** as at June 2020. The other **17%** capital assets are comprised of the other non-bank entities that provide financing to individuals and enterprises".

5.1 Introduction

Banks remain uniquely and systemically important to the economy; they are highly regulated institutions; largely hold a monopoly on credit issuance and risk taking; are the major repository for deposits, which customers largely identify with their primary financial relationship; continue to be the gateways to the world's largest payment systems; and they still attract the bulk of requests for credit.

Given banks' special role in channeling funds from savers to investors, their cost efficiency has a significant effect on the supply of credit and, in turn, on the overall economic performance. In addition, inefficiency would affect banks' earnings, thus hampering their ability to withstand shocks (Wong et al., 2017). The issue of banks' cost efficiency is therefore of interest to policy makers, the banking sector, and the economy at large.

According to Oracle (2017), banks continue to face the challenges of shrinking margins, increasing competition from within and outside the banking sector, stricter capital requirements and demanding consumers – consequently a rising pressure on profitability. For any financial institution's shareholders, lower net interest margins are highly undesirable and unsustainable as they can adversely affect the bottom-line. Ensuring sustained profitability is the key issue in maintaining the sector's resilience today. Change from within to improve profitability essentially means improved operational efficiency and productivity - banks need to remain vigilant and keep costs well under control.

To continue being relevant for their customers, banks will have to keep the price of their products and services structurally acceptable. An acceptable price can only be realized if the product has a low-cost price as well as an appropriate margin on the cost price; low enough to keep the price acceptable and high enough to be sufficiently profitable for the bank and its shareholders.

With limited avenues for growth, banks across the globe are attempting broad-based cost efficiency measures aimed at boosting profitability including optimizing the banking channels and reducing operating and Information Technology (IT) expenses. Others are taking traditional routes, resorting to headcount cuts, and hiving off businesses to lower costs, according to Oracle (2017). While there are several potential strategies to manage costs, banks need to determine which is the most effective for them.

5.2 Overview of the Financing Eco-system in Uganda

Uganda's financial system is composed of formal, semi-formal and informal institutions including the supervised financial institutions, non- bank institutions and other institutions. The informal financial institutions include microfinance institutions, money lenders, Saving and Credit Cooperatives (SACCOs), Village Savings and Loan Associations (VSLAs) and Rotating Credit and Saving Associations (ROSCAs).

Other non-bank institutions in the financial ecosystem include insurance companies (19), pension funds (01), fund managers (07) and the capital markets (BOU, 2020). Further, there are other entities in the ecosystem including Uganda Securities Exchange (USE), private equity firms, venture capitalists, angel investors, impact investors and foundations. Other stakeholders in the financial ecosystem include agent banking companies and agents, Fintechs, integrators, aggregators and monolines, Information and Communications Technology (ICT) suppliers, manufacturers, distributors, retailers and suppliers, credit unions and cooperatives, mobile money operators and their agents, professional firms including auditors, lawyers, engineers, surveyors, valuers, Human Resources (HR) firms' money remittance companies, security firms, Cash in Transit (CIT) companies, among others.

Composition: Uganda's financial system is dominated by the banking industry accounting for 83% of assets in the financial system - USD79.2 billion as at June 2020. The other 17% capital assets are comprised of the other non-bank entities that provide financing to individuals and enterprises. The composition of assets is largely in the form of loans accounting for 46.8 percent, followed by government securities accounting for 20.0 percent of the total assets. In addition, Uganda's capital markets possess approximately USD 6.3 Million from listed companies. The informal sector which is comprised of over 1000 non-deposit taking microfinance entities plays an important role in the rural service provisions (Bank of Uganda Financial Sector Stability Report, 2020).

Regulation and Supervision; In Uganda, the supervision and regulation of the bank and non-bank institutions is devolved among several regulatory authorities including the Central Bank of Uganda (BOU), Capital Markets Authority (CMA), Insurance Regulatory Authority (IRA), Uganda Retirement Benefits Regulatory Authority (URBRA), the Financial Intelligence Authority (FIA) and Uganda Microfinance Regulatory Authority (UMRA).

Financial Instruments provided; Financial providers in Uganda mainly provide equity and debt funding instruments including credit line loans, over drafts, corporate bonds, invoice discounting, asset-based financing, cash flow-based financing, hire purchase, convertible loans, redeemable equity, among others (BOU, 2019).

Alternative financial sector players: Although private equity financing is a relatively nascent market to Uganda, quite recently, private equity, venture capitalists and impact investors are coming on board to provide alternative financing options for businesses (EFInA, 2016; Ntayi & Sejjaaka, 2014). These provide alternating financing instruments to businesses for instance; mezzanine financing; angel financing, crowd funding, venture capital, quasi-debt, quasi-equity, and grants. They are willing to bear more risk than formal debt providers with a view to attracting a larger pool of potential investee enterprises using a first-loss facility. These institutions possess a fund size ranging from $10million - $50 Million, investment size range of $250,000 - $5million, investment vehicles of 3-7years, interest rates of 0-20% and focus on risk and revenue sharing (CIIP, 2012).

Technology: There is also a continuing trend of the rising role of technology and digitization of the financial sector space in Uganda which has enabled innovations in the provision of financial services, improved efficiency, and financial inclusion (BOU, 2020; FSDU, 2020). It is evident that the technological innovations like the fintech and telecoms are being driven by mobile money payments technology, agency banking, and financial technology to enable greater financial access, use, facilitation of remittances and trade (BOU, 2020; FSDU, 2020).

Sectoral funding: The Financial Sector Stability Report (2021) analysis of sectoral funding allocation to the business sectors in Uganda indicates that the three largest sectors which are building, construction and real estate; trade and commerce; personal and household jointly accounted for the largest portion of banks' gross loans and advances. Table 1 presents the sectoral allocation of credit in Uganda for the periods 2019, 2020 and 2021. The expectation is that credit growth to the business sector will certainly remain robust to support the scaling up and growth of businesses which directly and significantly contributes to Uganda's Gross Domestic Product (GDP). The Bank of Uganda State of Economy Report 2021 further revealed an annual sectoral credit growth of personal loans, agriculture, real estate, and manufacturing sectors by 7.5percent, 8.4percent, 8.5percent and 17.9 percent, respectively. It was further noted that lending to the trade sector continued to decline and lending to service sectors subdued as some of the businesses remain closed over COVID-19 restrictions

Table 1. Sectoral Shares of Credit to the Private Sector in Uganda (percentage of total lending)

Sector	July 2019 (%)	July 2020 (%)	July 2021 (%)
Agriculture	13.2	12.5	12.1
Mining and Quarrying	0.6	0.3	0.3
Manufacturing	13.2	11.9	12.4
Trade	20.2	18.7	17.6
Transport and Communication	4.4	5.2	5.8
Electricity and Water	1.9	1.8	1.7
Building, Mortgage, Construction and Real Estate	20.4	20.1	20.5
Business Services	4.5	4.4	3.9
Community, Social and Services	3.4	7.7	6.7
Personal loans and Household Loans	18.3	16.6	18.4
Other services	0.3	0.9	0.6

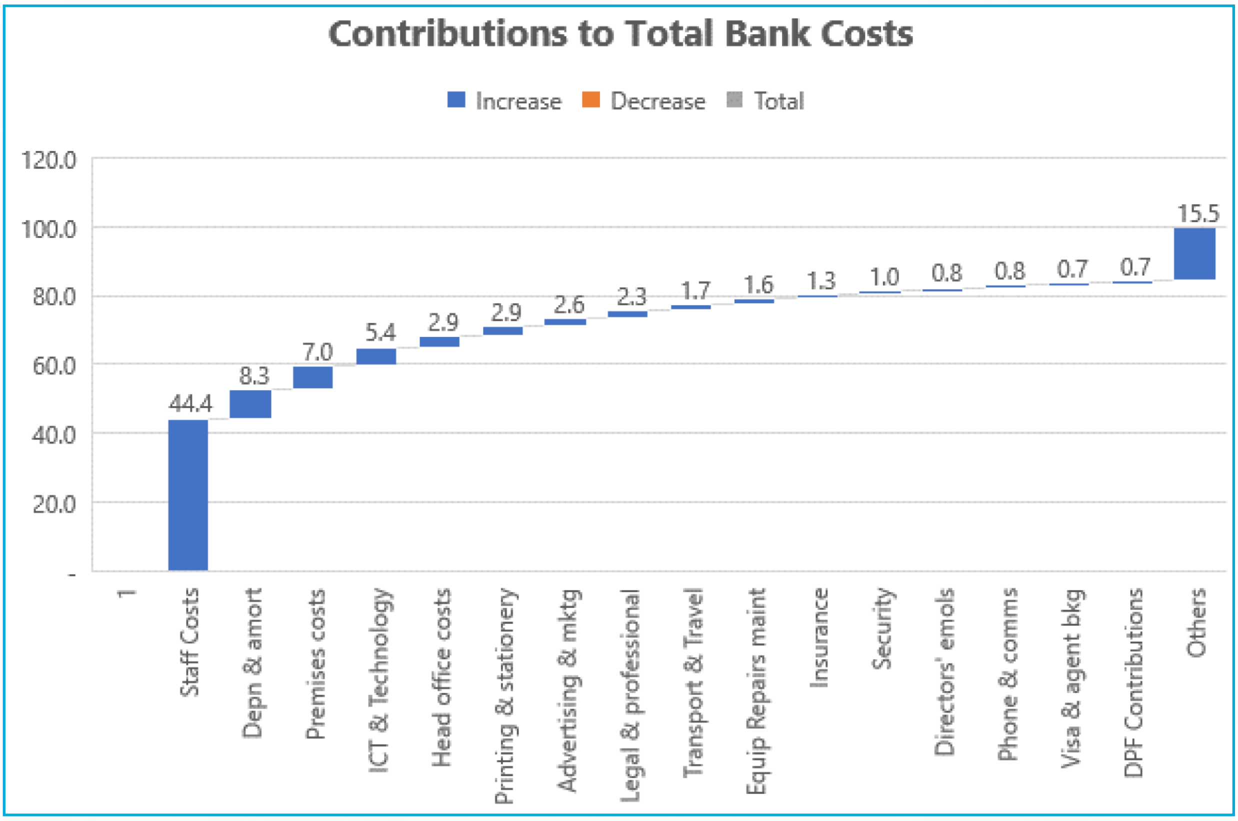
Source: Bank of Uganda (2021)

5.3 Bank Cost Classification and Drivers

5.3.1 Cost Classification

The major determinant of whether there will be continuity or discontinuity of any business is cost. Banks incur costs of financial intermediation such costs of credit including monitoring (PwC 2019), staff costs including salaries, training and development, health and safety costs, medical costs, staff benefits and associated legal and other staff costs, ICT costs including the digital channels, maintenance, investment and licenses, rental and occupancy costs including all costs to run those respective channel and equipment purchase, maintenance, and associated investments. All other operating costs are also shown in the diagram below – including audit costs, taxes, administration and service costs, utilities, bank charges, operating leases, fines and penalties and others.

Figure 1: Contribution to Total Bank Costs



Ioannidis, Pasiouras & Zopounidis (2010) argue that an increase in operating costs is expected to positively influence interest rate spreads. This consequently implies that high operating costs are likely to include costs due to inefficiency, leading to higher spreads and bank operational inefficiency. Therefore, a higher cost of financial intermediation will highly likely drive-up interest rates on loans while depressing interest rates on deposits.

Porter (1985) argued that from a strategic cost point of view, implementation of a firm's differentiation strategy leads to greater variety and operational complexity and hence higher costs – For example, if a bank decides to classify its customers into segments and provide differentiated services and products to the various segments, the costs associated with such delivery will be much higher than a bank that would do no or limited segmentation. Financial institutions must adopt a cost structure or approach that helps them manage their costs and pricing in the most efficient manner.

5.3.2 Cost Drivers

There are many activities within the bank's operations and processes that can contribute to the cost of delivering the bank products and services. Determining the cost drivers may be complicated because some of those activities are interlinked, diverse and may change over time. Additionally, the appropriate level of assigning cost drivers needs to be determined and the activities that drive cost aligned. Whatever determines the total cost of a particular activity should be analyzed - Cost drivers follow a cause-effect relationship, and if the relationship cannot be established, then a more relevant driver should be looked for.

Porter (1985), Riley (1987) and Shank (1989) argued that a set of structural drivers that drive up costs in financial institutions include scale, scope, and complexity of their operations. Economies of scale among supervised financial institutions occur when costs increase less than proportionately as output increases. Consequently, the economies of scope occur when the costs of combined production of multiple bank products is less than the sum of the costs of producing each product separately. We then begin to see production complexity resulting into increased demand for costly resources to balance activities, customers and product lines or facilities. Further, cost management studies (Johnson 1988; Cooper and Kaplan, 1990 Zimmerman, 1997) found that scale, scope, and complexity have a significant effect on the financial institution's overhead costs. This consequently results into declining margins and difficulty in competing with focused institutions (Johnson, 1988; PWC, 2020). Further key drivers of cost in the banking sector include:

(i) Level of digitisation - the more manual the operations, the more staff required for service delivery and customer satisfaction.

(ii) Number of employees - The more staff, the higher their overall associated costs.

(iii) Number of products provided to the customer - The more products, the more costs including staff costs to manage and deliver the said products.

(iv) Number of square feet – the larger, the higher the associated costs.

(v) Number of customer contacts - the more customer contact, the higher the costs of delivery of said service.

(vi) Number of customer orders - More customer orders per unit customer will have higher associated costs, with due respect to the channel of delivery of the said order.

(vii) Number of customer online orders - Total costs of operation will decrease with the adoption and use of digital channels.

(viii) Service breakdowns - the more the service breakdowns, the higher the costs of delivery associated with remediation, communication, and customer contact.

5.4 Bank Cost Structures and Approaches

Cost and pricing are vital to banks' conversation and day to day operations because of their impact on customer satisfaction and bank profitability (Diener, 2020; Hinterhuber, 2008). The changing demands and competitive nature of the banking sector has made it more apparent for banks to price their products and services appropriately which reflects on their general cost structure or cost of doing business (Datta, 2017). Further, the operating costs that banks incur are in most cases related to the nature, structure, and strategy of the respective financial institution. Karaduman (2014) and Datta (2017) indicated that banks' most significant costs are mainly; the maintenance and servicing of their extensive branch network and general operating (OPEX) and capital (CAPEX) expenses. In most cases, the margin generated by banks' core businesses merely compensates for risk-adjusted returns on equity and cannot support these additional costs.

Therefore, while banks can continue to provide some services free of cost, it has become necessary for them to re-evaluate their pricing strategies for value-added offerings in line with regulatory guidance and competitive environment within which they operate (Dolgui & Proth, 2010). In order to provide the value-added services, financial institutions must cost and price the value add in the overall customer offering, if they are to remain profitable and ultimately survive. Banks have and must adopt strategies or approaches to help them both grow considerably and survive especially within very competitive and risky spaces within which they operate – including appropriate price decisioning, deliberate costing, management of costs, and undertaking initiatives to increase efficiency whilst positively impacting customer service.

Since most banks and financial institutions adopt a traditional approach to determine the cost of developing new product lines, facilities, and marketing of these products, it is argued that the current estimates do not consider other associated costs (Chepkemoi, 2020). Some of these costs may include the cost of maintenance of infrastructure like the branches, Automated Teller Machines (ATMs), and call centres as well as technology, product launches and pilot tests for the products developed (Okeahalam, 2005). Fee-based income does not aid in the recovery of the cost of services, it merely compensates for risk-adjusted returns on the equity of the core lending business (Diener, 2020; PWC, 2019). The ultimate impact is increasing total cost of operation, without a supportive increase in revenue.

5.4.1 Cost-based pricing approach

The cost based-pricing approach determines prices primarily from both the fixed and variable costs incurred by the banks (Datta, 2017). The company determines a minimum and a maximum price for a product or service. The production, advertisement and distribution costs are required in order to compute the product cost. In the cost-based pricing approach, there is no assurance that the determined prices will appeal to consumers in the marketplace (Datta, U.K, 2017).

5.4.2 Competition based pricing approach

The competition-based pricing approach uses competitive price levels, anticipated, or observed actions of actual or potential competitors as a primary source to determine appropriate price levels (Netseva-Porcheva, 2017). Thi, Khanh, Thuy, & Thuy (2018) found that the main merit of this approach is that the competitive situation is considered. The company releases the product between the maximum and minimum prices by assessing the competition environment of market (Banker & Hansen, 2002). Estelami (2013) argued that the increasingly competitive nature of financial services, driven by the deregulation of the industry in recent years, has forced SFIs to pay closer attention to prices offered by their competitors. Competition-based pricing strategy is used in competitive environments where the price is decided based on competitors. This is common where there are low differentiations of the products like when banks or medium share companies are competing with high-share companies (Sammut-Bonnici & Channon, 2014).

However, majority use this pricing approach as means of increasing the number of and sustaining customers. The challenge with competition-based pricing, is that it is not reflective of the costs of operations, especially the marginal costs and will likely not cover the costs of innovation. It ignores demand functions which are critical in the pricing or costing process. It is important to evaluate the impact of the competition-based pricing strategy on profitability of the organization (Leon, 2015).

5.4.3 Customer Value-based Pricing Approach

Customer value-based pricing approaches use the value a product or service delivers to a predefined segment of customers as the main factor for setting prices (Netseva-Porcheva, 2017). This approach focuses on "How can we create additional customer value and increase customer willingness to pay despite intense competition?" Liozu, Boland, Hinterbuber & Perelli, (2015) found that the main advantage of this approach is that data on customer preferences, willingness to pay, price elasticity and size of different market segments are usually found and interpreted. A value-based pricing approach focuses on understanding the customers' willingness to pay a premium for products or services on the basis of the value offered.

SFIs can optimize their pricing and secure a larger share of customers' wallets with an increased focus on product innovation and customer analytics applications (Bett, 2018). Value-based pricing calls for a gradual shift from a product-centric mind-set to a customer-centric approach.

According to Cracknell & Messan (2006) one of the challenges that financial institutions face, is that the fees and charges of its competition change frequently, so there is likely to be a degree of misalignment of prices. The objective should not be to maintain exactly the same price structure, but to retain a pricing structure that is not far out of line with that of the competition.

5.5 Challenges to Bank Cost Reduction

5.5.1 Compliance Management

Financial institutions, like any other supervised entity, are mandated to comply to legal and regulatory procedures. Compliance management is necessary to ensure that SFIs are able to detect and prevent corporate crimes and errors, minimize the damage of arising issues, prevent recurrence, improve business, and control processes related to non-compliance (Benedek, 2012). The cost associated with compliance management is just one of many banking industry challenges impeding the financial institutions' cost reduction process and initiatives. The increasing cost of capital combined with sustained low interest rates, decreasing return on equity among other issues are all putting pressure on traditional sources of banking profitability (Benedek, 2012). Further, shareholder expectations remain unchanged despite these challenges. This has forced majority of the financial institutions to create new competitive service offerings, rationalize business lines, and seek sustainable improvements in operational efficiencies to maintain profitability.

5.5.2 Lack of Strategic Focus

Cost reduction efforts misaligned with the financial institutions' objectives can lead to wasted efforts and may instead incur further costs and losses. The problem may be as simple as failing to communicate the complexity and urgency of the initiative and how cost reduction objectives align with the company's strategic priorities at a given time (Deloitte, 2020). In other cases, it might not be clear to those charged with identifying the areas of cost reduction to enable the institution achieve the target. It must be clear to the institution that competing priorities do not override the importance of the cost reduction strategies it adopts in both the short and medium term.

5.5.3 The People

Edmonds (2011) analyzed the resistance to change in organizations, largely brought about by the fear of the unknown by people who may be staff or customers. He further argues that if the people are not managed correctly, using known and tested change management techniques, change and cost reduction strategies may fail. Self (2007) however states that the notion that people will resist change is ill founded. This is because people do not necessarily resist change out of hand. He further states that individuals rarely reject change that has obvious personal gain. He thus advises that we should understand the difference between resistance and readiness. In addition, Sterling (2003) argued that to engage the staff in the institution for the new strategy, they need to be prepared for change. Change is perceived as difficult and human tendency is to resist it, which may cause hurdles in the implementation no matter how good the intervention is (Okumus, 2003). Therefore, social, relationships, attitude and behavioral changes can be achieved over time by the irreversible structural changes (Waldersee and Griffiths, 2004).

5.5.4 Dynamic Business Models

The cost associated with the changing bank business models is another banking industry challenge forcing financial institutions to change the way they do business (Nosratabadi, Pinter, Mosavi & Semperger, 2020). This is mainly driven by their value proposition, core competencies, competition forces, financial aspects, business processes, target customers, resources, technology, customer interface, and partner network. Further, the increasing cost of capital combined with sustained low interest rates, decreasing return on equity, and decreased proprietary trading are all putting pressure on traditional sources of banking profitability (Nosratabadi et. al., 2020). These continued emergent factors have led many institutions to create new competitive service offerings, rationalize business lines, and seek sustainable improvements in operational efficiencies to maintain profitability. Failure to adapt to changing demands is not an option; therefore, financial institutions must be structured for agility and be prepared to pivot when necessary.

5.5.5 Customer knowledge and security of systems

This usually arises from a lack of diffusion capability, and the lack of investment in training for staff in the financial institution (Chircu and Kauffman, 2000). Secondly, security is another concern when using internet banking. A number of customers on the other hand have questioned how safe the internet systems are. This has led some into rejecting its adoption due to the risky nature of the internet and digital channels where hackers and fraudsters have penetrated into the systems. This is due to the fact that the technology is fairly new (Burnham, 1996).

5.5.6 Lack of Information Sharing and Trust

Despite information sharing becoming a frequently used term with a clear purpose in the financial sector space, actual information sharing is only partial and, in some cases, non-existent (Siboni & Klein, 2016). Within the context of this research, we found that not many financial institutions actively share information, while the volume of shared information and its relevance do not meet the needs of a given sector players (Arcuri, Brogi & Gandolfi, 2014).

A study by Gnyawali & Byung-Jin Par (2011) which examined the incentives and obstacles to sharing information about cyber threats found that the obstacles included economic ones, resulting from economizing, and concerns for the quality of the shared information, its value, competition, and its use. Song (2014) further highlighted the concerns and impediments about receiving information of poor quality, exposing information security incidents that are liable to affect an institution's reputation, and poor management. It also further emerged that organizations are also reluctant to share information, out of fear that the information could prove useful to their competitors or that information sharing could harm an institution's public image, by giving the impression that it is unable to protect its assets, leading to a drop in its sales and value (Doblas-Madrid & Minetti, 2009; Giannetti Jentzsch & Spagnolo,2010a).

5.5.7 The "Free Rider Problem"

Hardin (2013) describes this as a situation in which there is a lack of reciprocity among players in a sector or organization. In this case, often times competitors use the information received for their benefit, but do not contribute their own information to benefit others. Most of the studies like Gehrig & Stenbacka (2007); Hardin (2013); Gnyawali & Byung-Jin Par, (2011) describe impediments to information sharing that are common to the specific sectorial environments of the organizations. They further argue that institutions operating in a competitive environment like financial institutions find it difficult to launch information-sharing initiatives, even though it is clear to them that such sharing is useful to all the players in the industry.

Despite the stark growth and convincing arguments, many interbank collaboration initiatives fail to see the light of day, sometimes after substantial investments. Equally, those that are successful often take years of persistent effort to become established. The main reasons for failure are a large imbalance in the benefit distribution of the ecosystem between the participants, different point of views regarding the competitive nature of the business, competing internal initiatives or (investment) timings and the lack of trust between executives.

5.6 Banking Cost Determinants

5.6.1 Banks' Cost of and Use of Funding

The two major operations in the banking industry are asset and liability management. The goal of assets management is to use funds efficiently to effectively obtain revenues. The goal of liability management is to acquire funds cheaply - the major costs in the banking industry are related to these operations (Cole 1985; Cotter, Gill Reed, and Smith, =1984).

Typically, cost of funds is the cost incurred by banks and financial institutions to acquire capital and thus has significant impact on a financial institution's profitability since the spread between the cost of funds and the interest they charge on their borrowers governs their profits. An important determinant of lending rates is a bank's cost of funding. While other variables, such as the cost of equity, profit margins and the risks associated with lending will have a bearing on the interest rates customers are charged, the cost of funds will be major factor (Wong et al., 2012).

5.6.2 Asset Quality and Loan Loss Provisions

According to Drake et al (2006) banks with higher loan loss provisions appeared to be less efficient and indicate poor loan quality. This may call for higher operation costs relating to credit risk and loan loss management, such as credit approval control, foreclosing bad loans, debt recovery expenses, and other loan-restructuring expenses. Management, Board, and bank supervisors may ultimately require banks to increase their resources in credit assessment and approval thus increasing the bank's overall cost of operations.

As noted by Kwan (1997), the correlation between poor asset quality and inefficiency may be an indication of poor management of banks, or a direct consequence of the tendency of inefficient firms to make risky loans.

Information sharing reduces information asymmetries, moral hazard, and default rates, and increases borrower incentive to honor repayment of their financial commitments. With the existence of a historical register of borrowers' financial behavior that is accessible to the banking system, borrowers tend to fulfil the payment of their financial commitments (Arias et al, 2016).

Several papers support this rationale, suggesting a positive impact of information sharing, for example on increasing the volume of credit provided by banking institutions (Brown et al., 2009; Djankov et al., 2007), lowering the default rate (Jappelli & Pagano, 2002), decreasing the cost of credit (Brown et al., 2009), increasing corruption-related lending (Barth, Lin, Lin, & Song, 2009), influencing the level of constraint in financial access (Triki & Gajigo, 2014), impacting syndicated bank loans (Ivashina, 2009), influencing tax evasion (Beck, Lin, & Ma, 2014), and finally on how a greater degree of information sharing might actually contribute to triggering a banking crisis (Büyükkarabacak & Valev, 2010; Houston et al., 2010).

5.6.3 Financial Institution Size

Firm size has been considered as an important determinant of firm profitability. Larger firms are said to be able to produce goods more cheaply compared to small firms. This is because the former have achieved more learning, greater cumulative experience and they are able to spread their fixed costs over a greater amount of production (Kigen, 2014).

The level of efficiency of banks is found to be positively correlated with bank size. In other words, large banks are on average more efficient than smaller banks. This is consistent with Kwan (2006) and Drake et al. (2006a) that there is a strong size-efficiency relationship, with larger banks outperforming their smaller competitors.

5.6.4 Scope, Scale and Complexity of Banking Operations

Three primary drivers of costs are scale, scope, and complexity of operations. Several studies, including Banker and Johnston (1993) and Anderson (1995), document a link between complexity and operating costs. According to Porter (1985), from a strategic cost perspective, implementation of a firm's differentiation strategy leads to greater variety and operational complexity and hence higher costs.

According to the American Accounting Association et al; 1997 the strategic cost drivers of an organization include economies of Scale, economies of scope and product variety, and complexity of the bank's service system. It is possible to have economies of scale in banking due to the indivisibility of input, purchase volume discounts from supplies, material, overhead and advertisement, labor specialization or information (Clarke, 1988).

Panzar and Willig (1977) define economies of scope to be present if the total cost of producing multiple products jointly is less than the sum of the costs of producing each product separately - when there are cost complementaries between products. A unique source of scope economies in the banking industry is credit information for lending decisions. Clarke (1988) states: "Before lending decisions can be made, credit information must be gathered and analyzed... If the information can be used to make unrelated types of loans to the institution's customers, it may serve as a source of economies of scope." However, the reuse of credit information is only likely when banks have multiple products they can sell to the specific customer.

Porter (1985) states that the level of service offered, the type of buyer served, and the channels employed to market products and services all impact the firm's cost structure. Benston, Berger, Hanweck, and Humphrey (1983) argued that banks' operating costs depend more on the number of accounts than on the dollar amounts of deposits.

5.6.5 Distribution Channels

Distribution and infrastructure costs constitute a significant proportion of the cost base of banks (Oracle, 2017). Banks looking to optimize costs need to find ways to increase their distribution channel efficiencies, optimize distribution channels, and the costs related to them. Physical infrastructure and distribution channels including branches, customer contact centres, ATMs, deposit centres and loan processing centres need to be realigned and managed to minimize the associated overhead costs and allow banks to get more done, with less.

5.6.6 Cash Costs

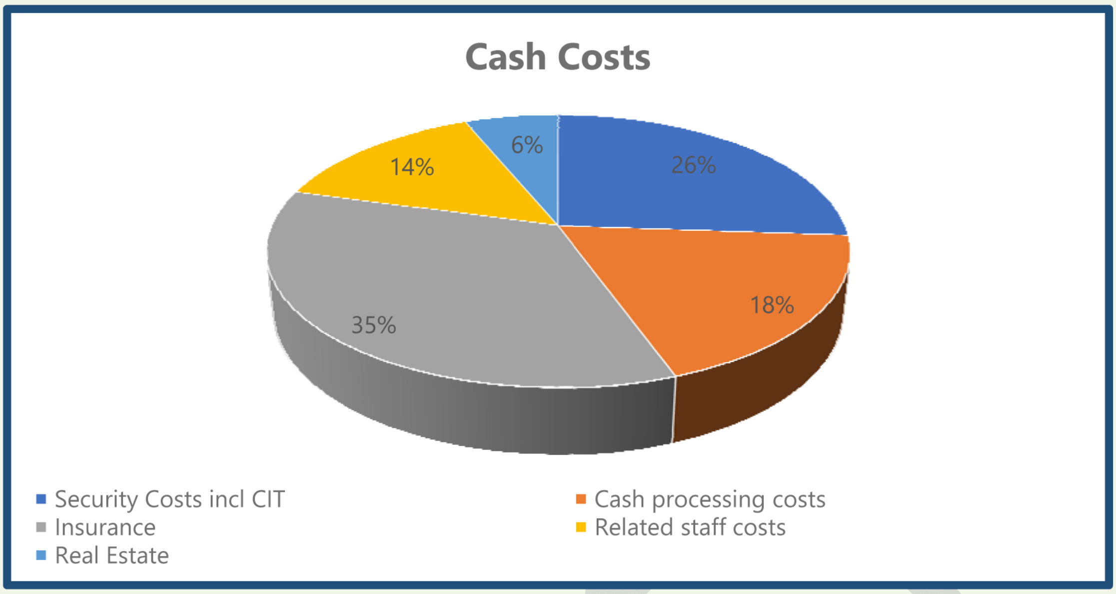
No matter the country, cash will be around for a long time and will not disappear completely (Brugge et al, 2018). On the contrary, social, and infrastructural factors keep cash resilient and convenient - despite its liquidity, cash will not be completely heading out with the bathwater just yet (Mastercard, 2020). According to the Mastercard analysis of Euromonitor data, globally, 85% to 90% of all consumer transactions are still made in cash, but this varies from 10% in Sweden to 99% in India. Consequently, banks need to maintain their cash services.

The lack of access to a formal financial institution in rural communities imposes a high cost of transferring money especially over long distances, often exacerbated by poor road conditions. Physical transfer of money is a common channel of remittances among the financially excluded rural communities despite the relatively high risk of theft and the high transport and time cost involved in this exchange mechanism (Mbiti and Weil, 2011).

Cash transactions come with significant costs along the value chain which is largely manual from the central bank to banks, to corporate and retail customers (Mastercard, 2020) including cash preparation (CIT companies, payments office costs and cash processing), conducting transactions (counterfeit money, faulty substitution, cash deposits and withdrawals), collection, storage and distribution (insurance, cash in transit companies and sale) and transferring money (bank fees and cash in transit) - everyone bears the high costs associated with volume cash handling. Total cost of cash to consumers is estimated to vary between 0.5% to 1% of GDP (Mastercard, 2020). Costs of handling deposits are a function of deposits transactions as more transactions demand higher handling costs (Banker et al, 1998).

In Uganda, the key drivers of cash costs per the respondents are security costs including cash in transit, insurance costs, cash processing costs, staff costs and real estate costs including machinery and utilities for the maintenance of cash. Details of the cash costs contribution to the total costs are shown in the chart below:

Figure 2: Uganda SFI Cash Costs



Mastercard, 2020 and the Central Bank of Nigeria (CBN) discuss the indirect costs of cash to include lost tax revenues, high risk of using cash, financial loss due to fire and flooding, inefficiency and corruption, leakages, and money laundering, amongst others. Incidences of ATM skimming now cost USD 8 billion annually and the worldwide cost of handling cash already exceeds $300 billion per year (Deloitte, 2020). According to Mastercard, (2020) cash prevalence has a high economic cost purely by virtue of its existence: the United States incur $200 billion annually to keep cash in circulation; 72 million hours is spent chasing down cash in New Delhi each year; and Mexico's small businesses are nearly twice as likely as large ones to be victims of cash fraud. The burden of excessive cash usage is estimated at between 3.2% to 4.5% of global GDP.

5.6.7 Human Resources Costs

Human Resources comprise the functions of staffing, development, motivation, and maintenance. In other words, hiring competent people, training them, helping them perform at high levels, and providing mechanisms to ensure that these employees maintain their productive affiliation with the organization (Reinke, 2016). Banking has been and will always be a "People Business" (Chakrabarty, 2012).

Often, faced by a bleak economic outlook, organizations adopt a knee-jerk reaction aimed at short-term cost-cutting. This could involve pruning the workforce, hiving off businesses, cutting down employee benefits, among others. However, these measures can end up being counter-productive once the organization recovers from the downturn, since these very measures can impede economic growth. Hence, the response to diminishing profits should not be ad hoc and reactive, instead should be proactive organization-wide attempt at improving cost efficiency (Oracle, 2017).

5.6.8 ICT Costs

A key cost component in the banking and financial services industry is IT expenditure including computer software and hardware, licenses, application maintenance, data centres, end-user services, network services, application development, security, data and data analytics, and IT skills development.

IT demands in financial institutions are escalating while pressures to keep costs down are intensifying, as banks cope with generally meager returns on equity. CIOs must look for ways to control costs through productivity gains to make room in their budgets for investments in critical technology -enabled changes and be true partners to the bank's business side (Kanagasabai et al, 2019). Optimizing IT expenditure can help banks manage costs and consequently improve profitability (Oracle, 2017).

5.6.9 Risk Management and Compliance Costs

Regulations and requirements set by the Central Banks for example capital requirements also impact the cost of banking. Despite the fact that higher capital requirements make the bank safer, they increase rent costs, reduce the amount that can be pledged to outsiders by the banker and also raise the bank's effective cost of capital (Diamond and Rajan, 2000). Also, capital requirements reduce the ability of banks to create liquidity, which is a cost to the bank since more deposits are held (Van den Heuvel, 2008).

According to Dhale Meyer and Neely (2016) and Dunkelberg and Scott (2018), regulatory burden has long been a concern within the banking industry with compliance costs weighing more heavily on smaller banks than their larger counterparts. Smaller banks incur higher costs than larger banks do in pursuit of the same performance standards - compliance costs can be spread more efficiently across larger banks than smaller ones. Anecdotal evidence from bankers indicates increased costs of complying with new regulations and rules when regulatory changes are made (Cyree, 2015).

The increasing focus on governance, risk and compliance has contributed to the declining profitability. As regulations become more and more stringent following the economic downturn of the last decade, banks and financial institutions are forced to dedicate more and more resources towards risk management and compliance. In effect, higher capital requirements, slow economic growth, and increasing regulatory demands have put tremendous pressure on the performance of banks (Oracle, 2017).

5.6.10 Legal and Institutional Environments

The soundness of legal environments matters for banking performance. Using a sample of 52 countries for the period 2005–2014, results show that a greater degree of legal protection and law enforcement are directly related to superior banking sector performance. Better regulatory quality positively affects banking industry performance (Arias et al, 2020).

The quality of legal environment also affects bank costs and profit margins especially when loans cannot be easily recovered as well as difficult and costly contract enforcement (Ahokpossi, 2013). Reserve and liquidity requirements and other lending restrictions through directed or supervised credit policies also make banks face implicit taxation (Demirgüç-Kunt and Huizinga, 1999).

Studies by Leaven and Majnoni (2005) find that better contract enforcement and a better judicial system play a key role in improving the net interest margins by reducing the cost of financial intermediation. Naceur and Omran (2011) provide similar evidence by suggesting that the regulatory and institutional framework seem to have a positive influence on bank performance. Said authors find that corruption increases costs of intermediation whilst an improvement in law enforcement reduces financing costs.

Demirgüc-Kunt and Huizinga (1999) analyzed a sample of 80 developed and developing countries and found that better enforcement of contracts and the legal system are related to less corruption, which is negatively associated with banking system performance.

According to the Transparency International Corruption Index report, Uganda has slipped in corruption ranking by five places from the 137th position in 2019 to 142nd position in the 2020, out of 180 countries that were ranked.

The differences between the legal protections offered to investors and to creditors are important in understanding why company financing structures differ across countries. Law and finance literature has evidenced the importance of the link between the legal system, investor protection and capital market development (Djankov, McLiesh, & Shleifer, 2007; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1999; Levine, 1998, 1999), and shows a positive influence where the main role of a stronger legal framework is to empower borrowers when fulfilling their contracts. This reduces the cost of external financing, the main mechanism through which an adequate legal framework favours financial development.

5.6.11 Marketing Expenses

Customers are becoming more sophisticated about their choice and quality of service being served to them. The place where things are swapped or say common needs are fulfilled is called the market. The efforts to make people aware of your offerings inspiring them to deal with you and let them believe that in doing so, they are fulfilling their needs at its best is called marketing (Mahtab and Abdullah, 2016).

Banks now cope with stiff competition in business and are forced to adopt various marketing techniques and approaches. Today, marketing in the banking industry is characterized by many innovations in products and services, use of advanced technology in product design, up gradation of delivery system, advertising, and sales promotion activities, whether in public sector or private sector (Tidke, 2017). All marketing initiatives entail significant expenses on market research, brand management, marketing campaigns, among others.

5.6.12 Product Management Costs

For several banks, aggressive expansion strategies, years of mergers, acquisitions, and add-ons to product lines have resulted in a massive, highly diversified product portfolio across several business lines. These portfolios present banks with a slew of problems. First, they are both complicated and expensive to manage, sell, and service. Second, the proliferation of products distributed under multiple brands, does little more than confuse customers. Third, product variations are often so slight, that they represent little real choice for customers - which negates the original intention of diversification itself. Although customers want a variety of banking products and services, an overly complicated portfolio can eat away at a bank's profits (Oracle, 2017).

In the front office, more products result in staff having to spend longer on customer interactions and process a greater variety of transactions - each with its own complexities. Not only does the complexity present a potential point of frustration for customers, but also dramatically increases the front office's time-to-serve, reducing overall sales efforts and efficiency. For the back office, a broader product base requires that staff maintain the entire portfolio for an indefinite period, to address potential customer queries about legacy products and historical transactions.

If banks need to derive greater business success, along with optimizing channels for service delivery, they need to reconsider the products that they deliver to their customers - a clearly rationalized product portfolio, with standard components and reusable features, as well as a clear understanding of the profitability of each product in the portfolio.

5.7 Technology and the Cost of Doing Business

Traditional banks are under attack from emerging specialist startups. Fintechs that focus on financial products and services have moved quickly, forcing incumbents to reorganize their core business models and embrace digital innovations. All types of companies, from startups to technology companies to established firms, are using fintech (Global Fintech Report 2019).

According to the Global Fintech Report 2019 by PwC, 88% of financial institutions are increasingly concerned of losing revenue to financial technology firms starting with payments, fund transfer and personal finance sectors. Larger banks are complicated matrix institutions with broad, diverse services and products that are backed by legacy IT systems. If banks are to ensure that their costs are within optimal boundaries, it is important to identify and act on multiple areas of optimization (Oracle, 2017).

In this challenging environment, cost management remains a strong imperative for the entire global banking industry. In today's increasingly digital world, more and more banks also recognize the need to transform their operations and capabilities with infrastructure investments in key digital innovations, such as robotic process automation, cognitive technologies, business intelligence, and cloud-based ERP systems (Deloitte, 2019).

5.7.1 Technology as a Business Enabler and Disrupter

Powerful forces are transforming the retail banking industry. Growth remains elusive, costs are proving hard to contain and ROEs remain stubbornly low. Regulation is impacting business models and economics. Technology is rapidly morphing from an expensive challenge into a potent enabler of both customer experience and effective operations. Non-traditional players are challenging the established order, leading with customer-centric innovation. New service providers are emerging, and customers are demanding ever higher levels of service and value. Trust is at an all-time low (PwC, 2020).

Digital technology and digital disruption have burst onto the scene as key levers for cost management and business transformation throughout the banking industry. Digital risks including digital disruption and cybersecurity rank among the top external risks for banks in all regions around the world.

The digital disruption has brought about a new dimension to the existing banking fraternity by utilizing the technological advances in areas such as Application Programme Interfaces (APIs), data intelligence, mobile, internet, Artificial Intelligence (AI), blockchain, telecommunications, machine learning, big data, and Internet of Things (IOT). Traditional banks that are not willing to change are bound to face fierce competition in terms of product differentiation, customer experience and price. This digital revolution has forced the banking sector to enter a new realm where technology and innovation paves the path towards tremendous growth in terms of revenue and customer base (Oracle,2017).

Banks should continue to explore how technologies such as cloud, machine learning, robotic process automation, and distributed ledger technology can simultaneously contribute to significant cost savings, whilst helping increase speed, improve accuracy, and provide scalability. Streamlining front-to-back data flows and deploying data analytics will remain prerequisites to achieve the desired efficiencies (Deloitte, 2021).

5.7.2 Role of Digitisation in Improving Efficiency

According to Machasio (2020), digitization of the economy via digital technologies fosters economic growth through inclusion, efficiency, and innovation. These digital technologies and innovations can deliver dramatic improvements in competitiveness, performance, operating efficiency and, increasingly, cost savings. Equally important, they can also strengthen a bank's positioning for adverse future events, including economic downturns and digital disruption (Deloitte, 2019).

Analysts estimate that Artificial Intelligence will save the banking industry more than $1 trillion. Financial institutions should expect a 22% cost reduction in operating expenses due to AI, with most of the savings coming from the front office. But it all hinges on the consumers' level of comfort with AI. Further, biometrics and workflow and compliance automation are other strong use cases for AI. To improve the consumer experience, AI can allow a bank or credit union to authenticate a mobile payment using a fingerprint or replace a numerical passcode with voice recognition.

To fully realize the digital promise in the front office, banks can elevate customer engagement by deploying an optimal mix of digital and human interactions, intelligent use of data, novel partnerships, and compelling service delivery models (Deloitte, 2021).

According to Messenbock, Gossy and Keller (2017) over the past decade, banks in developed markets have been struggling to cut their operating costs but with little success. Digital technologies and other advances such as artificial intelligence and robotics promise to change this and radically. They can improve efficiency and reduce the marginal transactions to zero. They also have the potential to strip most of the labour cost out of banking while improving customer service. Digitisation should be able to change the way work gets done by introducing self-service options, streamlining data flows and operations with automation, and restructuring for optimal service delivery (Deloitte, 2021).

5.8 Cost Reduction and Management Strategies

5.8.1 Business Process Transformation

"Business Reengineering is the fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical, contemporary measures of performance, such as cost, quality, service, and speed" – Michael Hammer and James Champy. It is an organization-wide transformation of business processes, technology, and management systems to align with the organization's short-term goals and long-term vision.

The basic premise of business realignment is to exit business lines that have low margins and instead move into lines that are inherently more cost-effective and increase bank profitability. Banks need to identify processes that are outdated, manual, costly or inefficient and eliminate, improve, or replace them with more efficient, customer-oriented frameworks. Cracking down on high-cost areas and implementing reduction strategies can allow banks to reallocate their resources into projects and initiatives that yield better ROI than current activities and potentially recapture a dwindling customer base (Oracle, 2017). Counterintuitively, these strategic transitions might require the bank to increase its investment and costs in the short term in order to realize improved margins and efficiency in the long term (Reimink, 2019).

A key component of business process reengineering is transformation of IT systems, driven by advances in technology, customer focus and evolution of customer expectations. To achieve the desired goal, improving service quality and satisfying its customers, the bank must implement Business Process Reengineering (BPR). To optimize costs in the back office, banks need to consolidate, simplify, and automate core processes, both within a single region and across multiple geographies.

The rapidly growing markets, information, and awareness in the world demand organizations to change their operational processes to compete globally. People have more knowledge and information, which has compelled banks to advance the quality of their customer service, lessen their operating cost and improve their performance especially in the developing countries (Ali et al, 2016). Banks need to rethink and design processes, procedures, products, and services that are cost efficient and effective with the aid of technology to remain competitive and profitable (Amanquah and Adjei, 2013). Rapid improvements in technology have forced the organizations to change their strategy, policies, and capacities (Ali et al, 2016). Cost saving strategies and changes in processes must however achieve long lasting cost reduction and improve the quality of customer experience.

Each bank needs to develop a clear strategy to deal with this transforming landscape. Whatever the chosen strategy, success will come from successfully executing the right balance with developing a customer-centric business model, optimizing distribution, simplifying business and operating models, obtaining an information advantage, enabling innovation, and the capabilities required to foster it and proactively managing risk, regulations, and capital (PwC, 2020).

5.8.2 Evaluate Alternate Operating and Simplify Delivery Models

According to PwC (2020), banks have developed staggeringly complex and costly business and operating models. Now they must simplify. Rising customer expectations, increasingly active regulators and stagnant shareholder returns demand it. Efforts to date have not been enough. Banks need to start with the customer and work backwards but simplifying the experience requires that products, channels, organization and operations, all simplify and change. This is a big deal but getting it right can deliver an improved customer experience, structurally lower cost, reduced levels of operational risk, improved profitability, increased customer base and shorter time to market.

Global shared services, built atop global enterprise architecture, can go a long way towards simplifying the IT operating model, via greater proliferation of open systems, common applications, and simplified application architecture. For achieving greater efficiency, banks can also evaluate repatriation of core activities from regional or global shared services to domestic jurisdictions (Oracle, 2017).

5.8.3 Staff Optimization - Right-staff and Right-source

To manage staffing costs, banks need to adopt available tools and methodologies that can help them measure and manage staff performance, evaluate training needs, and encourage cross-selling and up-selling. A lean organization is more likely to allow its staff to concentrate on enhancing the customer experience by offering tailored investment advice, addressing potential queries and concerns proactively and essentially offering customers a personalized experience.

In addition to reducing process costs, automation tools can help improve staff productivity, enabling banks to handle more transactions and greater volumes of activity with the same number of personnel (Deloitte, 2020). Innovation is the single most important factor driving sustainable top- and bottom-line growth in banking. But banks today are not known as places where innovation thrives, nor are they the favored destination for top software engineers and other innovators. Banks need to organize and manage differently – protecting and enabling talent, becoming agile in their development processes and being open to partnerships with outside institutions. Developed market executives will need to take more of an innovative mindset (PwC, 2020).

Automation tools can help improve staff productivity, enabling banks to handle more transactions and greater volumes of activity with the same number of personnel but productivity improvement is not dependent on technology alone. Some of the most significant opportunities involve using established performance management techniques, such as clearly defined expectations and scorecards, improved motivation and rewards systems, and better training and supervision. Many institutions also find success in redefining job roles, using more flexible work arrangements, providing mobility for off-site work, and outsourcing more specialized activities (Reimink, 2019).

5.8.4 Optimize Banking Channels and Distribution

Historically, banks with the best branch footprint have dominated their markets, gaining outsized share. Now, all banks can be direct banks, and branch banking is changing fast - offering anytime, anywhere service, fully utilizing all banking channels in an integrated fashion. There is a need to re-imagine physical footprints, introducing new branch formats, expanding physical points of presence through third-party partnerships, driving sales, and cutting costs (PwC, 2020) – Making the optimization of channels critical.

The goal of channel optimization is to assess the various ways customers interact with a bank to create a cost-effective combination that is adapted to each bank's specific customer base. Given the rapidly changing nature of customer channel preferences, this process of optimization requires branches to be fairly aggressively closed, consolidated, sold, and bought as banks adjust their geographic presence. Many banks are also significantly reconfiguring roles, duties, and staffing within the branches and employing new metrics for analyzing branch performance and value (Reimink, 2019). Channel optimization should not be about branches alone, as contact centers, online and mobile banking, ATMs, and relationship managers also are important channels for customers.

As transactions and sales shift to digital channels, branches that cannot create incremental value will need to close or be transformed. Banks should find ways to shift the burden of routine transactional tasks away from branch staff and into lower-cost channels, such as call centers and the internet (Oracle, 2017). They must move away from highly manual customer contact centers to care platforms that offer a streamlined user experience. They must continue or begin to optimize their branch networks.

Most thought leaders in banking agree that developing an integrated multichannel optimization strategy is paramount to remaining competitive in terms of cost and customer acquisition and retention. Banks doing nothing risk being left behind as customer behaviors and expectations continue to rapidly evolve (Caulfiled, 2014). To deliver the best possible services to the consumers, the banking sector is shifting toward a customer-centric environment to ensure customer satisfaction and loyalty (Quantzig, 2017).

Convergence for banks means that they need to be present intelligently on devices, offer converged channels, revisit ageing infrastructure that is incapable of or inefficient at supporting the convergence, and refocus their attention on legacy processes and procedures that are a hindrance to capitalizing on this growth (Oracle, 2017). Embracing convergence enables cross selling by improving the customer experience, and can drive cost-effectiveness much more easily, by influencing the channels that customers use.

5.8.5 IT Rationalization and Enabling innovation, and the capabilities required to foster it

For most banks, a comprehensive review of IT expenditures can reduce demand significantly and deliver 5 to 10 percent savings in the short term. Some examples include prioritizing projects that are directly linked to the bank's strategic goals, reducing service levels to match real demand, reducing non-value-adding service levels, shifting workloads away from peak times, capping usage, purging historic data, matching the number of licenses to the number of users, and capping end-user usage. It is possible to automate 30 to 35 percent of activities across the IT value chain-particularly provisioning, testing, deployment, patching, and support. Agile ways of working allow companies take ideas to market and improve application development and maintenance efficiency by 20 to 30 percent, which banks can capture either as savings or as freed up capacity. A systematic, top-down simplification program can reduce applications by 30 to 40 percent and the cost of ownership of applications by 15 to 20 percent.

In response to high costs and regulatory priorities, banks are turning to the cloud to redefine the relationship between IT departments and business units, and to reduce operating costs (Oracle, 2017). Transitioning to public cloud can improve efficiency 30 to 40 percent compared to traditional hosting for some workloads. In particular, labor savings can reach up to 90 percent - Cloud also enables other transformation levers, such as infrastructure automation.

By optimizing core infrastructure components, banks can build a solid foundation for the other transformation levers and reduce their run costs. Mainframes can be managed by offloading applications or transactions, using a shared mainframe environment, or smoothing peaks - which together can reduce costs by 20 to 30 percent. Helpdesk and end-user computing costs can be reduced by automating common requests (for example, password resets), harmonizing device specifications, and through systematic root-cause analysis of the most common issues - which can reduce costs 20 to 30 percent. Network costs can be reduced through software-defined networking that responds to demand fluctuations rather than provisioning fixed capacity.

5.8.6 Managing Cost of funds

Funding costs matter for financial stability. A rise in funding costs reduces a bank's profitability and over time, a reduction in profitability could erode a bank's capital buffer, threatening its solvency and posing risks to financial stability (Beau et al, 2014).

Banks must take deliberate steps to manage the cost of funds which will ultimately impact their overall costs of operations, and importantly the cost of lending for its their customers. SFIs must deliberately source funds and look for the cheap and sticky deposits, manage liquidity requirements, cash, look at the historical source of funding and ultimately assess the risk associated with the banking funding sources.

Over and above the external and market-led developments, banks need to adopt the measures to ensure that cost efficiency is achieved in funding which include increased market capitalization over the long run, higher capital quality, better quality of credit, resilience to market volatility and improved market perception (Oracle, 2017).

5.8.7 Management of Cash Costs

Cash costs account for five to ten percent of bank operating costs, and are rising in absolute terms in most markets, even as usage is on the decline. Banks in all markets should take decisive steps to cut the costs of their cash operations by streamlining processes, eliminating excess cash stock, and optimizing distribution networks. In the long term, banks, industry associations, and regulators should focus on pursuing a national utility for cash handling (Brugge et al, 2018).

The three main levers banks can use to manage cash costs include making operations lean, optimizing of cash routes especially in the under and underserved areas, right sizing branch and ATM networks, and national pooling of resources to form a shared cash-handling utility, with due respect to the use of technology and analytics. Specifically, they must decide where to eliminate branches and ATMs while continuing to address the cash needs of consumers and retailers.

By consolidating resources, banks can save up to 35% in ATM costs through geographical optimization, combining bank activities, standardization, consolidation of IT development, fraud handling, increased standardization of hardware and software security infrastructure and through a national shared utility. Proven commercial business strategies reduce excess inventory, lower handling, and processing costs and improve operating efficiency (Deloitte, 2018).

It is ironic that cash should often come with a cost. Yet, the inextricable link between digitization and development has made cost-cutting initiatives quite literally cash-cutting ones. The situation holds true across governments, businesses, and consumers. Although governments and the private sector are already collaborating in many parts of the world to digitize economies, cash still represents 85% to 90% of consumer payments (Mastercard, 2020).

5.8.8 Rationalization of Product Portfolio

A key focus area for product portfolio simplification lies in the adoption of a customer-centric strategy. First, banks need to evaluate how many products they have, how many of the said products are profitable, which ones are important to maintaining their current customer base and determine which of their products will help expand on that customer base (Oracle, 2017). Rationalizing the product portfolio by kind of complexity and level of complexity, will allow banks to drive simplification initiatives more effectively and develop truly differentiated products that deliver actual value to customers.

The level of service provided, the number of products and options offered, and the channels employed all impact a firm's revenue stream. While increasing variety or product features may allow sellers to raise prices and command higher revenues (Chamberlin, 1962), increasing variety can lead to spiraling costs due to scope diseconomies and increasing complexity (Scherer and Ross, 1990). For instance, Porter (1985) states that frequently firms choose seemingly benign policies to differentiate themselves that ultimately prove costly once a policy's cost behavior is understood.

5.8.9 Establishment of an Industry Credit Register

Padilla and Pagano (2000) show that the historical register imposes greater discipline on borrowers since being known as a defaulter would entail punishment from institutions, reflected in a higher interest rate or in simply being refused access to the financial system. In this way, borrowers strive to maintain a good credit image, thus reducing default rates and interest and increasing the credit granted by the banking sector.

Several papers support this rationale, suggesting a positive impact of information sharing, for example, on increasing the volume of credit provided by banking institutions (Brown et al., 2009; Djankov et al., 2007), lowering the default rate (Jappelli & Pagano, 2002), decreasing the cost of credit (Brown et al., 2009).

5.8.10 Treat Regulations and Compliance as Enablers of Business

Today, not only are the rules much more complex, but regulators are more suspicious, and less flexible in their demands to improve compliance, reporting, and the underlying business processes and data. Leading banks are taking a different and more comprehensive approach to managing their regulatory obligations. This approach is pragmatic, proactive, and increasingly integrated into 'business as usual' (PwC, 2020).

While banks are investing a tremendous amount of resources into ensuring regulatory compliance, investments in compliance need not necessarily be separate from innovation and growth initiatives. Banks should be viewing the new regulations as an impetus to develop sophisticated approaches to steering financial resources. Moving beyond compliance and towards, perhaps, greater transparency and forecasting could result in a significantly higher ROI from regulation-oriented investments (Oracle, 2017). Clearly, improved transparency and greater insight is one of the goals of regulatory reforms. However, banks can do more with the technology they build if they seek to achieve an even greater degree of transparency and clarity, which will ease compliance and subsequently reporting.

Finally, the demands that regulation places on forecasting can allow banks to be more prepared and more agile. Banks can develop scenarios to understand the role of specific events in key regulatory and economic figures. These scenarios can be integrated by IT into models, and reporting capabilities extended further to provide forecast analysis, allowing the business side of a bank to steer resources and manage risk by developing and running scenarios as needed.

The bodies responsible for regulating and supervising the banking sector must focus their interest as much on promoting a set of good corporate governance practices in banking institutions as on providing an adequate legal and institutional framework to endow the banking system with stability and confidence, which is critical to the smooth running of the economy as a whole, including strengthening existing regulation, raising supervisory expectations for the risk management function, engaging more often with the board and management, and assessing the accuracy and usefulness of the information provided to the board. Supervisors should also have tools at their disposal to address governance improvement needs and governance failures (Arias et al, 2016).

5.8.11 Shared Networks and Resources

Shared networks and services are a key lever for reducing costs due to ability to their capitalize on size, leverage expertise, improve service quality and increase efficiency. The market standards on cost savings delivered by shared services range from 15% to up to 40%, mainly depending on industrialization of processes, level of automation and location of centers (Capgemini, 2015). With the adoption of the shared service center, the perpetuation of knowledge developed over time is achieved, allowing practices and processes in other areas and departments to be reused and a reduced dependence on third parties involved in the operation. As the processes are shared, information also brings more transparency and ease for continuous improvement and more effective performance monitoring.

Key utilities that can be shared include ATM networks, Customer Care Centres, branches, data bases including compliance information, data centres, disaster recovery centres, human resources facilities e.g., feeding centres, nurseries, canteens, etc.

5.8.12 Outsourcing

In today's business environment, banks are continuously facing challenges to reduce their overhead costs, enhance operational efficiencies, and improve their services. As a result, outsourcing of business functions has become an integral part of banking operations. In this context, the term outsourcing can be defined as use of a service provider by the bank to contract out part of its day-to-day banking activities to reduce its cost of operation, enhance customer satisfaction, utilize specialized skills, and reap other strategic/operational benefits (Deloitte, 2016).

Outsourcing and managed services are a way to delegate costly parts of their operational functions that external providers can manage more productively. The types of functions now being outsourced range from compliance processing tasks to critical day-to-day business activities (Deftereos, 2016). Whilst cost and time used to be the primary reason for outsourcing non-strategic functions like payroll or logistics, a surge in technological innovation and a fresh crop of enterprising Fintechs have given financial Institutions a wide range of new opportunities and reasons to outsource bigger and more important treasury functions.

Generally speaking, outsourcing enables organizations to improve operational performance, vastly improve speed, reduce operational risk, and increase efficiency through better consolidating and centralizing functions. Banks that strive to keep everything in-house typically end up developing a series of vertically integrated silos that result in extensive duplication and redundancy across businesses and markets (The Treasurer, 2019)

5.8.13 Vendor management

Improved vendor management does not mean simply pressuring vendors to lower their prices. Rather, it is a focused effort designed to derive the greatest possible value from a vendor relationship. Selecting vendors that closely align to the bank's business objectives is critical. Maintaining strong vendor performance is supported by service-level agreements and vendor scorecards to monitor performance issues such as system availability, response times, and direct expenditures. Such tools help to provide a more complete view of the vendor relationship (Reimink, 2019). Banks can reduce third-party expenditures by working more efficiently with vendors, moving vendors to alternative pricing models, renegotiating prices, and consolidating relationships. These efforts typically deliver 5 to 10 percent savings in the short term.

5.9 Impact of Macro Economic Factors on the Cost of Doing Business

According to Boyd, Levine and Smith (2001), there is a strong negative relationship between inflation and lending by the financial sector to the private sector, the quantity of bank assets and the volume of liabilities issued by banks. An increase in the rate of inflation reduces the real rate of return on both money and assets in general, which increases credit market frictions that cause rationing of credit - becoming more severe as inflation increases. Since higher inflation rates are associated with higher capital ratios of banks, inflation-induced economic uncertainty stimulates banks to restrict credit (Bohachova, 2008; Bank of Uganda, 2020), of which maintaining the deposit franchise requires banks to pay high operating costs (Schnabl, Savov and Drechsler, 2018). In addition, inflation leads to a high rate of loan defaulting by borrowers (Omondi, 2017) since it becomes expensive for borrowers to repay their loans.

Real exchange rate volatility affects banks directly, that is, when there is a currency or maturity mismatch between bank liabilities and assets, or indirectly when the exchange rate volatility leads to large losses for bank borrowers (Goldstein and Turner, 1996). In addition, fluctuating exchange rates may affect the ability of lenders to service their loans causing bad debts, which are a cost to the banks (Owoeye and Ogunmakin, 2013). Domestic currency depreciation increases credit risk incurred by a bank for loans to importers while it decreases the risk for loans to exporters (Lindgren, Garcia and Saal, 1996), which can be explained by the fact it becomes expensive for importers to service their loans, increasing default rates and non-performing loans. According to Taiwo and Adesola (2013), fluctuating exchange rate may affect loan management by banks thus increasing bad debts.

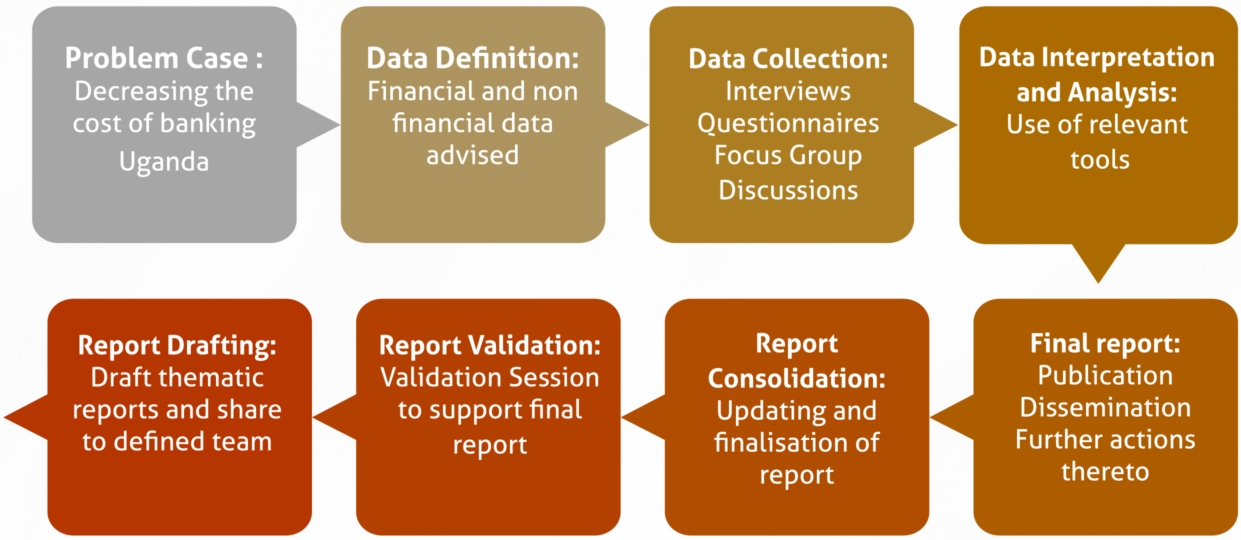
Economic growth and activity influence banking costs whereby weaker economic activity can lead to an increase in loan losses and decrease in asset quality (Bank of Uganda, 2020). In addition, slowdown in economic growth causes increase in the stock of non-performing loans, which reduces the asset quality of banks and thus increases the cost of banking, depresses real estate prices, and increases the bank's credit risk, which decreases the asset quality of banks (Bank of Uganda, 2020). However, during periods of strong economic growth, fewer loan defaults occur (Alexiou and Sofoklis, 2009) thus reducing costs like loan recovery costs. According to Lindgren, Garcia and Saal (1996), in a weakening economy, there is a likelihood of few new bankable projects whereby businesses, households and governments might have difficulty in paying back their existing loans. Fluctuations in the real sector conditions, especially the enterprise sector affect the quality of loan portfolios, loan losses and therefore reduce the level of bank capital and reserves of the bank. Also, sharp deteriorations in the economic environment invalidate the assumptions on which loans and investments were originally made.

Higher interest rates lead to losses on banks' securities portfolios, lead to higher loan losses and increase loan default probabilities due to higher debt service burdens (Borio and Hofmann, 2017). In addition, increase in interest rates encourage consumers to store their money instead of taking loans since the loans become expensive and thus banks incur higher interest expenses since payments on deposits increase (Desiderio et al., 2019). Most banks which have higher lending rates usually have higher non-performing loans (NPLs), a small market share as well as a large number of micro borrowers (Bank of Uganda, 2020). High interest rates increase the cost of borrowed funds, making it hard for borrowers to repay their loans and also increase risks for the banks (Saif-Alyousfi, 2019).

06 Methodological Approach

> “The **methodological approach** for this study is presented based on the research objectives, activities and expected outcomes as elaborated ”.

The research involved collecting data and/or information from supervised financial institutions, Bank of Uganda, telecommunication companies, Fintechs, development agencies, Ministry of Finance Planning and Economic Development, real Estate Companies, and academicians. The methodological approach for this study is presented based on the research objectives, activities and expected outcomes as elaborated below.



6.1 Desk/Literature Review:

The team collected, organized, and synthesized the available literature about the banking sector operations, operating cost drivers, cost reduction strategies, and the role of technology in driving costs among other existing models/ interventions. The desk review generated a list of complementary factors, strategies, and models to get a general picture of the phenomenon and develop the groundwork to follow the study.

6.2 Secondary data collection:

The investigators screened and selected literature (published and non-published) policies, collaboration strategies, bank and industry performance reports, protocols, regulations, and other related documents relevant to the banking sector. In addition, relevant literature from different agencies like the Bank of Uganda, bank platforms and databases, agent banking companies, Fintechs, FSDU, AFI, PWC, among others identified were reviewed. Experienced finance and banking experts on the team jointly agreed on which reports to select for in-depth qualitative analysis. The team spoke to chief executives and senior managers in the supervised financial institutions in the departments of finance, credit, compliance, operations, legal, treasury, information and communication technology and security who are directly involved in budgeting and cost management decisions in their respective financial institutions.

6.3 Discussions and Consultations with Key Banking Experts:

Expert consultations were undertaken regarding experiences, views, and perceptions of high costs of doing business in the banking sector generally and more specifically on factors identified through secondary data and literature surveys. These consultations (through one-on-one engagements, stakeholder workshops and roundtable discussions) helped to find the most important resource complementary insights, factors, and their usefulness to the study context and to the design of instruments. The consultations involved Key Informant Interviews (KIIs) with various stakeholders including the regulator, government, the SFIs, academia, and real estate specialists among others on the key components of cost of doing business in the banking sector.

6.4 Survey:

After a comprehensive desk literature review, in-depth interviews and stakeholder consultations, a survey and interviews were conducted to prove and build on the gaps that were identified about drivers of high operating costs, structural factors at firm and sector level, strategies for cost reduction, technology effects and collaborative resource sharing in the banking sector among other aspects we may have found relevant to the context. A questionnaire was designed to address the research questions. The questionnaires and interview guides that were customized to each segment were tested for clarity and shared amongst the team members and selected industry players to confirm meaning and purpose of each of the questions. In addition, validity (content and context), reliability, usability, objectivity, practicability, and measurability were ensured through such consultations. We targeted 36 SFIs including 25 commercial banks, 2 development banks, and 9 Tier 2 and Tier 3 financial institutions as well as other key entities that are relevant to the research context to attain more robust results.

6.5 In-depth interviews & Focus Group Discussions (FGDs):

These were conducted to gather data that informed the evaluators on how to reduce the cost of doing business in the banking industry including the use of technology; exploration and recommendation of alternative cost sharing initiatives and partnerships; challenges SFIs face in implementing cost saving initiatives and making sustainable changes in operating models and benchmarking other sectors or entities to achieve successful cost cutting initiatives. A thematic analysis schedule was developed that aligned the interview questions with the research goals. Interviews were conducted with the Chief Executive Officers (CEOs), Chief Finance Officers (CFOs), compliance, legal, credit, treasury, operations, IT heads and managers, telecommunication companies, Fintechs, FSDU, and Ministry of Finance, Planning and Economic Development (MoFPED). Focus group discussions were held with MoFPED and senior Executives of SFIs. The questions that guided the interviews and focus group discussions are available in appendices below. Greene's (2006, pp. 397–398) clusters of stakeholders was adopted to select the key stakeholders, that is; into four groups: (a) people who have decision authority over the banking industry (b) strategy and decision making in the banking industry (c) people who have direct responsibility for implementation of initiatives and recommendations (d) beneficiaries of the research study outputs. With the consent of the respondents, many of the interviews were conducted virtually and audio recorded.

6.6 Reliability and Validity Verification:

To ensure reliability and validity during the qualitative and quantitative assessment, we adopted some of the recommended strategies and verification mechanisms by Creswell & Miller (2000) and Meadows & Morse (2001) at every step of inquiry to construct solid research. These include characteristics of the investigator in terms of adaptability to circumstances, sensitivity abilities, clarification and summarization, peer debriefing, prolonged and persistent engagement of interviewees, audit trails to member checks.

6.7 Synthesis of the Findings from the Research Assessment:

Synthesis of the findings from the desk review, expert consultations, interviews, and survey led to insights on key issues for instance the specific cost drivers at both firm and sector level, business cost management challenges and sector intervention and management strategies/recommendations. In addition, frequencies for each factor (key drivers, strategies, challenges, recommendations, etc.) for each SFI response was determined and plotted from thematic analysis of each segment's respondents. After computing the frequencies from the thematic analysis, we sorted attached percentages to each response. This enabled the evaluations, design and implementation of intervention strategies and recommendations that are unique to each SFI and sector collectively. The outputs will focus on the following:

(a) Define SFIs and sector cost of doing business anatomy/structures

(b) A basis for building cost shared operations and partnerships

(c) Definition and list of cost reduction opportunities, recommendations, and integration of shared opportunities

(d) Technology opportunities among SFIs – perhaps with reference to specific business cases

(e) Identification of the greatest costs of doing business in the banking sector

(f) Challenges and existing gaps in the sector that inhibit operating cost reduction

Further, we adopted and modified Accenture's cost reduction analysis approach which involves three steps.

1. **Diagnostic:** Validating and identifying opportunity areas for cost reduction and sector collaboration initiatives across operating functions then map the current reduction state

2. **Solution:** Map cost reduction opportunities to current state operating models and recommendations
3. **Roadmap:** Detail & prioritize strategies and quantify high level cost to each initiative or cost reduction strategy. The initiative sequence was then categorically defined.

6.8 Data Capture, Storage & Analysis:

This involved organizing the raw data into a form that reveals basic patterns so that primary intended users can understand the findings and make sense of the evidence generated by the data. Principles of analysis and tips highlighted by Patton, (2012) for organizing & presenting findings which are utilization focused were used in order to facilitate quick understanding & engagement with the results for their intended purpose.

6.9 Developing a framework:

Also known as coding or indexing, here we did identify broad ideas, concepts, behaviors, or phrases and assigned codes to them for example, coding concepts such as the specific responses to a question. Coding was helpful in structuring and labelling the data.

Identifying patterns and connections - Once the data was coded, we identified themes, looking for the most common responses to questions, identifying data or patterns, and finding areas that can be explored further. The data was analyzed to answer the research questions and objectives, drawing on each of the virtual recordings. Thematic analysis was then applied manually using excel, based on coding and categorizing slices of text into themes and translated into quantitative frequencies and descriptive statistics.

Further, various tools for analysis were employed including content analysis and prioritization framework.

Content analysis, which is a method for gathering data from the texts created by individuals or organizations to generate measures that can then be used in subsequent statistical analyses, was employed in determining the saliency of the key drivers and recommendations of managing the high operating costs.

The prioritization framework was used to identify the most important or key factors and drivers of doing business in the banking sector that perhaps explain the mismatch. Frequencies of the factors, drivers, and strategies/recommendations among other variables for reducing the cost of doing business and how they vary over specific aspects were determined. Gaps and pathways were identified from the data. These pathways were determined to stimulate more discussion and justifications.

6.10 Report Writing:

Based on the interviews, survey and analysis, a draft report to present the information and recommendations or strategies that can be adopted in order to reduce the cost of doing business in the banking sector was developed. A validation workshop is planned to discuss the finding and the report, which is purposed to improve the draft resulting into an updated report. The final report will then be disseminated to a wider audience of key stakeholders including the regulators, SFIs, government, development partners, academicians, among others.

6.11 Research Dissemination:

The dissemination will be in a variety of forms including, reports, policy briefs, UBA information platform for members, stakeholder dialogue sessions, conference presentations and academic research publications. We shall ensure that the dissemination outputs will be visually attractive including infographics and understood by non-specialists.

Outcome indicators: Evidence-based policy and regulatory

Banking sector ecosystem opportunities, strategies and initiatives, gaps identified and recommendations alluding to opportunities through technology and partnerships

Output indicators: Research, evidence, and capacity building

Research products- reports, publications, usable shared technology-based models

6.12 Implementation of Recommendations

Workplans resulting into the implementation of the recommendations are expected as part of the information dissemination, after consultation with the key stakeholders and ensuring commitment thereto.

07 Key Findings and Insights

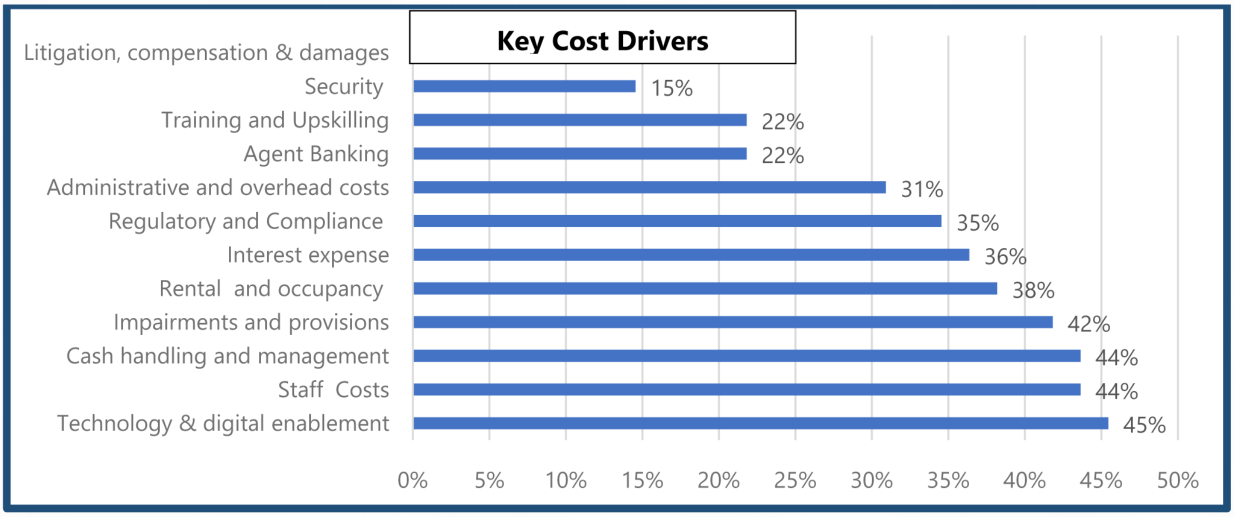
> "These cost drivers have inadvertently affected their respective **SFI** operating model and channels of distribution, strategic focus on revenue growth, cost reduction, product profitability, technology implementation, and digital enablement as shown".

7.1 Objective 1: Research to provide knowledge and guidelines on how to reduce the cost of doing business in the banking industry

1. Key Cost Drivers

The survey results indicate that the staff costs, technology and digital related costs, occupancy costs (costs for running distribution channels), cash handling and impairments and provisions as the most prevalent key cost drivers among the SFIs. All interviewed SFIs' executives are burdened by varying cost drivers that affect their profitability and their customers as informed by their size, strategy, level of digitisation and distribution channels used. These cost drivers have inadvertently affected their respective SFI operating model and channels of distribution, strategic focus on revenue growth, cost reduction, product profitability, technology implementation, and digital enablement as shown in figure 3 below:

Figure 3: Key Cost Drivers



Whilst technology and digital enablement are key cost drivers in the SFIs, they are key investment which if selected appropriately and deployed optimally will ensure faster digital adoption and usage by both staff and customers, will increase efficiencies, reduce operational and eventually total costs.

2. Costs that can be Managed Down or Removed by SFIs

The costs that can be managed down or removed by SFIs vary among the SFIs according to their strategy and key cost drivers, as articulated above. The executives interviewed think that managing down occupancy costs, IT, and digital related expenses as well as staff related costs which were top-rated will be key to reducing the overall cost of doing banking business in Uganda. These costs account for about 54% of the total bank costs, and thus a key driver to cost management. The focus cost lines are shown in table 1:

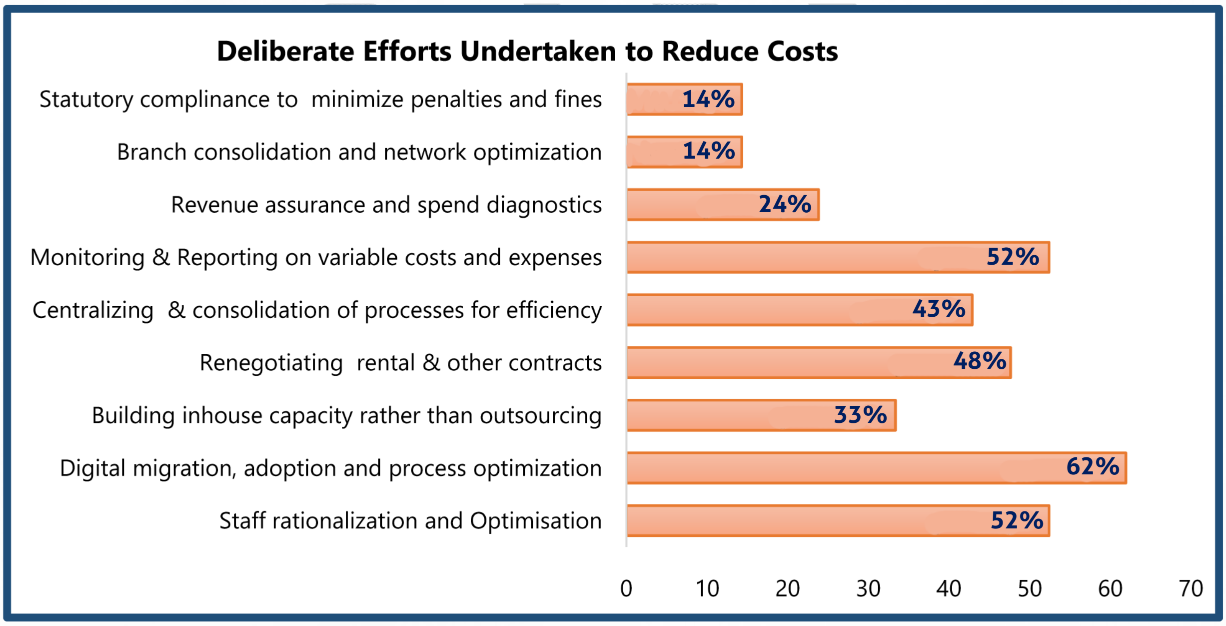
Table 2: Costs that can be managed down or removed by SFIs

Icon	Costs that can be Managed Down or Removed	% Of respondents
	Administrative and channel Operating Costs	50%
	Rental and Occupancy Costs	44%
	Staff costs	44%
	Technology and Digital Enablement Costs	38%
	Training and Upskilling	25%
	Regulatory, compliance and reporting related expenses	25%
	Cash In Transit	19%
	Agent Banking costs	13%

3. Deliberate efforts SFIs have undertaken to Reduce Costs

Our survey showed that 62% of executives interviewed have incorporated digitisation, adoption of, and process optimization technology as a deliberate strategy to reduce costs. In addition, more than half of participating SFIs have incorporated staff rationalization initiatives which entail cutting down on staff numbers, stringent salaries, and remuneration, merging roles, postponing team building activities, limited travel, replacement with online engagements, digitizing repetitive tasks and generally closely watching and monitoring variable costs as well as renegotiating rent and other occupancy contracts as shown in figure 4 below:

Figure 4: Deliberate Efforts Undertaken to Reduce Costs

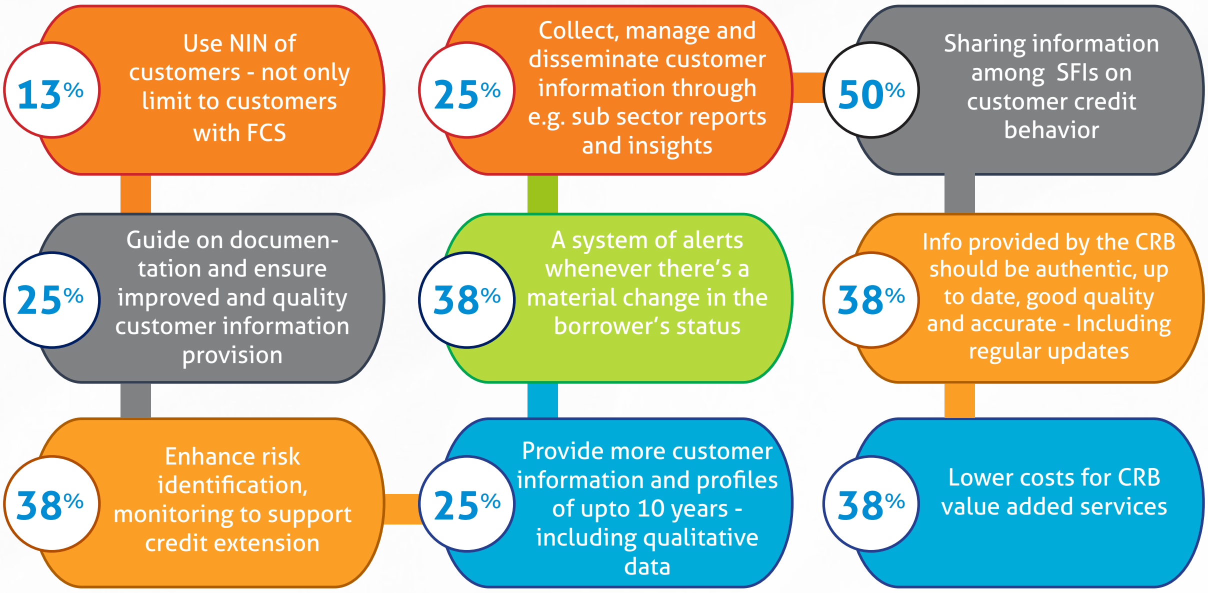


The efforts undertaken so far have not resulted into significant and sustainable cost savings in the banking industry, calling for the need to take further steps to ensure that the overall cost of banking in Uganda drops significantly.

4. Value that the Credit Reference Bureau (CRB) can add to the SFIs' credit process

50% of the interviewed executives feel that while the CRB is instrumental in the loan process the sharing of information among the SFIs on customer credit behavior is key and would add extra value to the credit process while minimizing information asymmetry, adverse selection and consequently the associated moral hazard. Other key value areas that the CRB would add to the SFI credit process are highlighted in figure 5 below, including enrolling most Ugandans onto the CRB, even those not borrowing from SFIs.

Figure 5: Extra value from the Credit Reference Bureau (CRB)

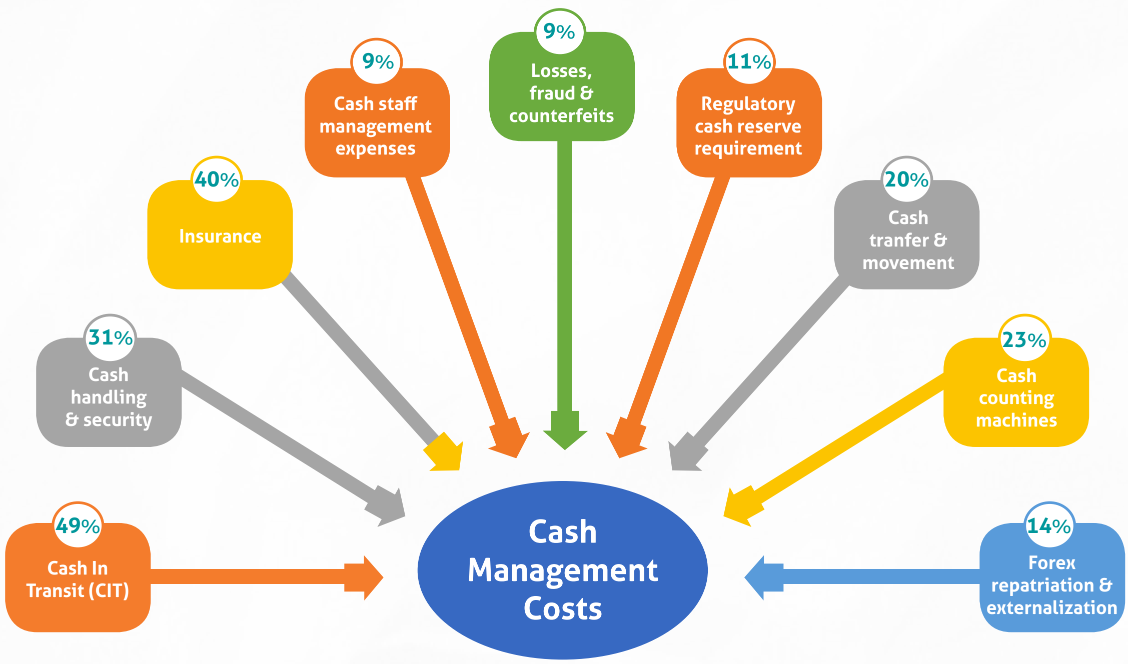


With the trove of data that the CRBs have built over the years, including new data in the new and evolving sectors, the CRBs should be able to undertake analytics that can provide industry information and inform on trends for decision making, mitigating risk, new products, and services, enhancing security, and streamlining processes.

5. Cash Management Costs

Cash is a key cost driver for the SFIs and cutting cash costs remains crucial for the SFIs looking to reduce costs and stay competitive whilst promoting cash efficiency. Our findings indicate that 49% of the respondents indicated CIT as the highest cost associated with cash followed by insurance (31%) and cash security (31%) – This is consistent with the financials as presented in 5.6.6. above. Other costs are also presented in figure 6 below.

Figure 6: Cash Management Costs



6. How cash costs can be sustain ably managed

Ensuring that cash costs are sustainably managed whilst ensuring SFIs meet their operational and legal requirements, plan for future payments, maintain adequate financial stability and survival is critical. Key strategies highlighted by the respondents regarding managing cash costs include encouraging use of digital and mobile banking channels, as well as establishment of fully fledged cash processing centres and recyclers. Other short- and long-term recommendations are also highlighted in the table 2 below.

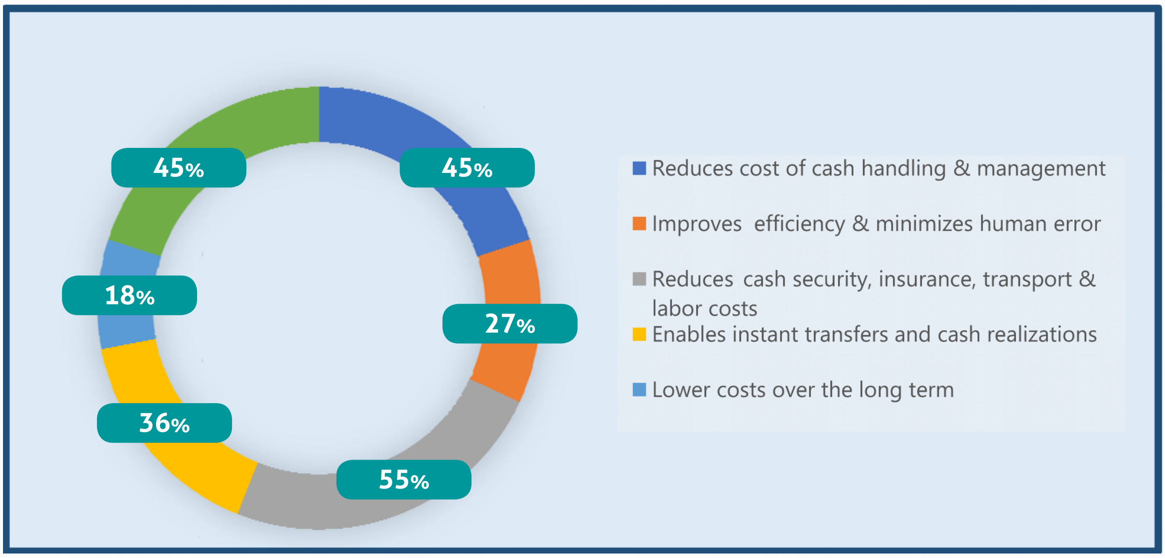
Table 3: Management of Cash Costs

Short Term	%	Long Term	%
CIT vans and routes - Cash collaborative route sharing	73%	Digitization and Mobile banking channels	64%
Encouraging use of digital and mobile banking channels	64%	New regulations governing FCY domiciled deposits	45%
Enhancing use of agent banking model	55%	Establishment of fully fledged cash processing centers and cash recyclers	45%
Standardized price set by BOU on foreign currency deposits factoring in repatriation charges	45%	Cash collaborations between banks to avoid regulator processing fees	36%
Optimizing branch and ATM networks	45%	Outsourcing cash management to a third party	27%
Centralized cash sorting and processing	27%		

7. Role of technology in Management of Cash Costs

It is apparent that technology is affecting financial services in a multitude of ways. The executives indicated that technology plays a significant role in management of cash costs through the reduction of cash use, better security, insurance and transport planning and routing, and labour costs (55%) which are the key cost drivers. Other perceptions are also presented in the figure 5 below.

Figure 7: Role of Technology in the Management of Cash



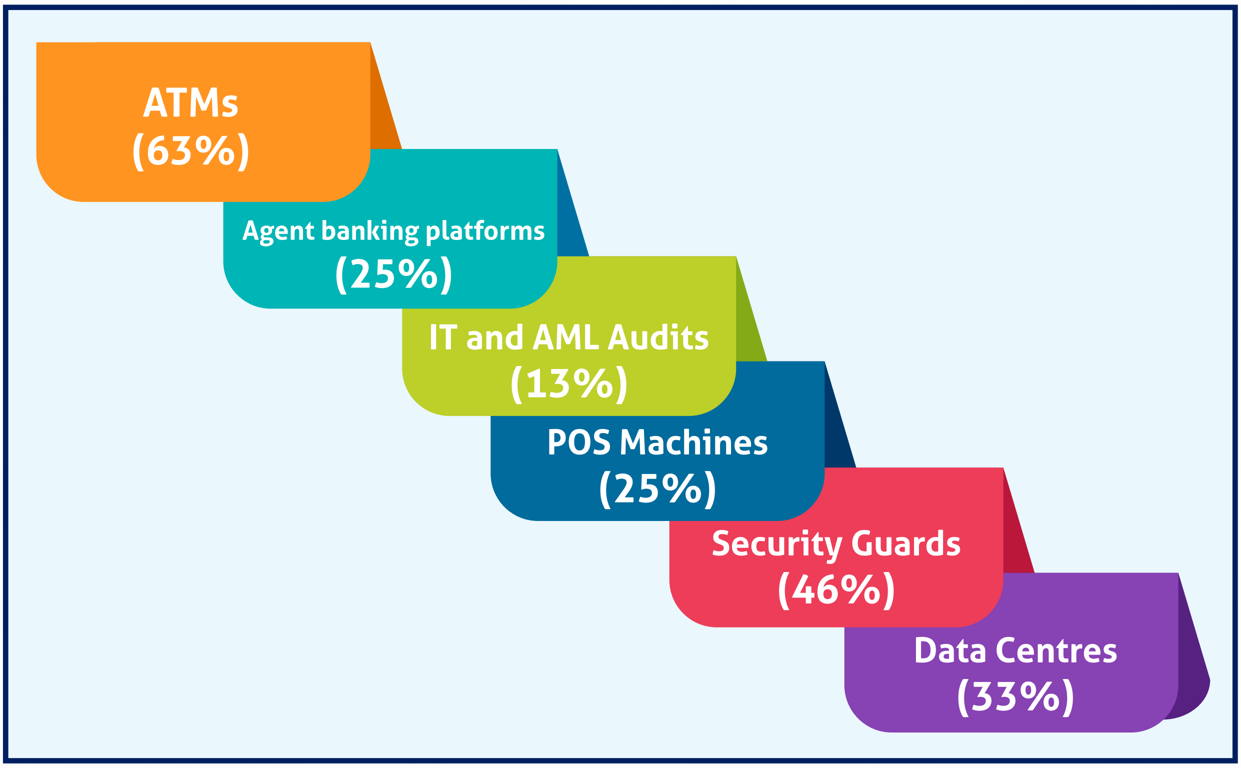
8. Duplication of the infrastructure in the banking sector

All SFIs acknowledged that there is a high rate of duplication of infrastructure in the banking sector which contributes to the high industry cost to income ratio.

The challenge with the duplicated infrastructure is the significantly high sunk costs in respect of technology, as well as premises uplift and kitting up for usage that the respective SFIs have sunk into these investments e.g., the disaster recovery centres and the ATM networks. Further, some of the infrastructure is a significant competitive advantage for the respective SFIs, barring their willingness to share or support the creation of any such industry utility. These are great barriers to making changes and a methodology has to be sought that will enable the recouping of the same, and compensation with due respect to the various SFIs.

The respondents indicated that ATM infrastructure and security costs, particularly guards were duplicated and can certainly be shared at industry level. Other duplications that could be shared as industry utilities are also presented in figure 8 below.

Figure 8: Duplication of Infrastructure

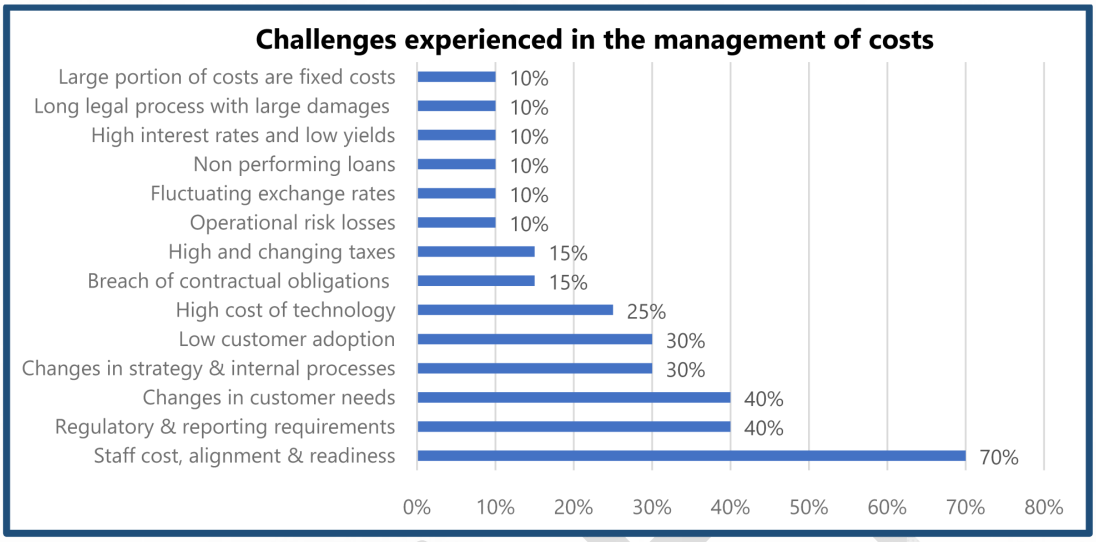


7.2 Objective 2: Challenges SFIs face in implementing cost saving initiatives and making sustainable changes in their operating models

1. Challenges in sustainable cost management

SFIs experienced a wide variety of challenges in management of costs with limited sustain traction in cost decrease. All the SFIs interviewed have in the last 3 years undertaken various cost saving initiatives whose success has varied widely, with many of the respondents citing staff related costs, culture, and lack of staff readiness, high and changing regulatory requirements including automation and reporting as well as changing customer needs challenged by low digital adoption as key challenges. See the challenges experienced by the SFIs in cost management in Figure 9 below:

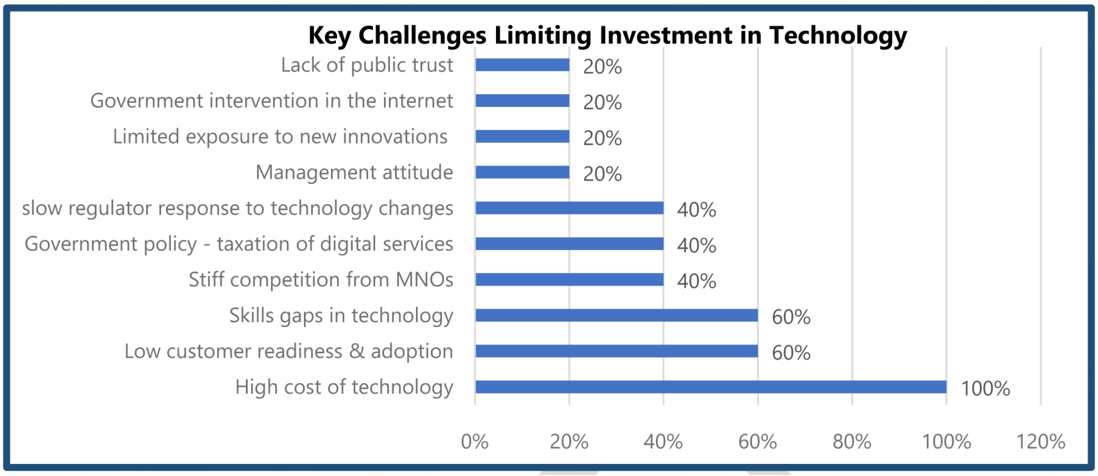
Figure 9: Challenges experienced in the management of costs



2. Limitations in Investment in Technology

All the executives interviewed recognized the importance of technology in the sustainable dropping of operating costs and in ensuring customer safety and satisfaction. They however experience challenges in the investment and use of technology and digitalization including the high cost of purchase, use and maintenance of IT, the low customer readiness and adoption which leads to an overall low usage and the low staff skills gap & need for regular upskilling in technology. Below are further challenges in Figure 10:

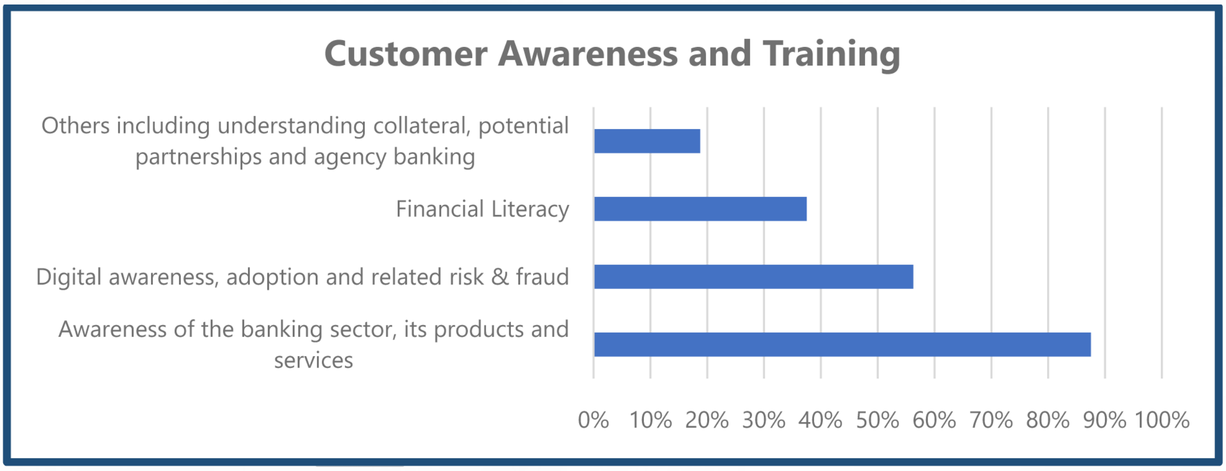
Figure 10: Key challenges limiting investment in technology



3. Customer Awareness and Training

Customer awareness and training are recognized as a key enabler of digital adoption, selection and management of appropriate bank products and services and Non-Performing Loans (NPLs). Below are the recommended customer awareness and training areas.

Figure 11: Customer Awareness and Training



4. Management of the challenges to ensure seamless implementation

In order to ensure seamless implementation, buy in and total commitment must be sought and gotten from the relevant SFIs at executive level, and the following aspects seen to before the commencement of any industry collaboration and/or partnership. The majority of the respondents agreed that signed and executed agreements are critical, supported by detailed implementation plans, mandates, and a communication framework.

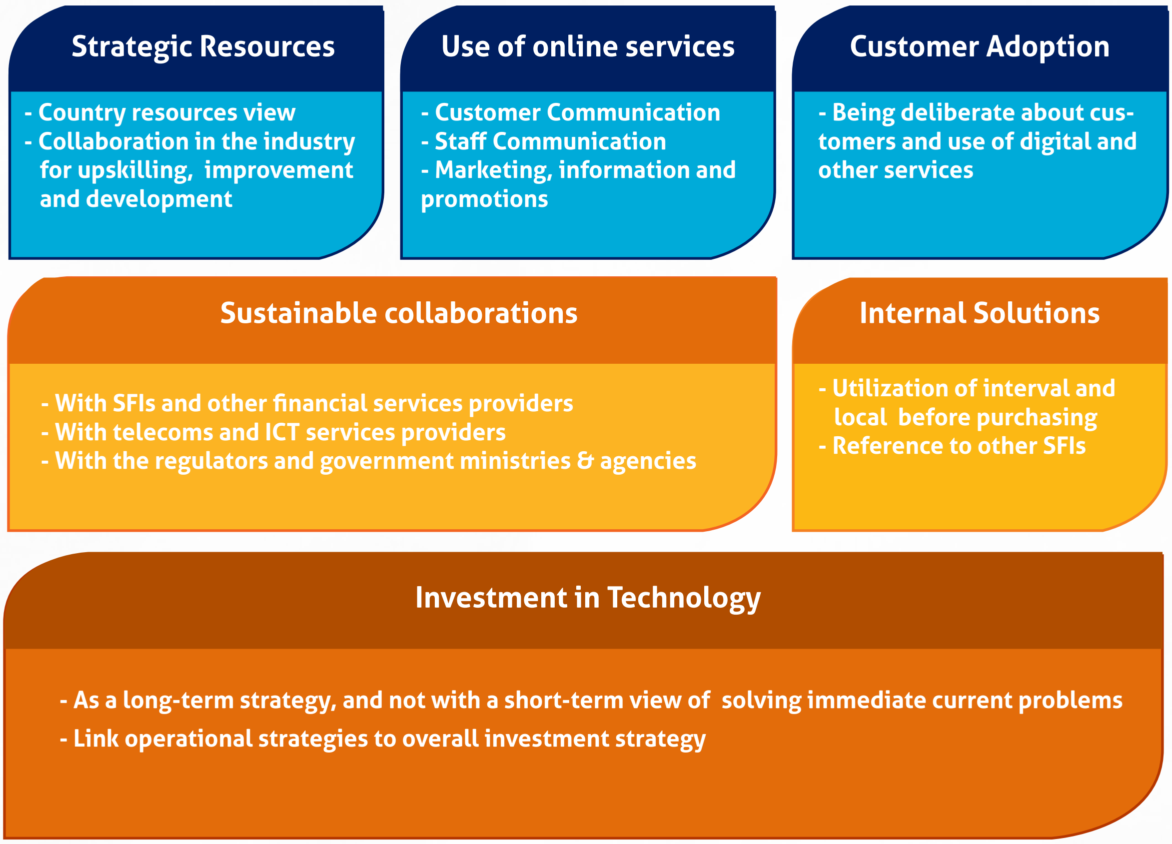
Table 4: Management of the challenges to ensure seamless implementation

Icon	Consideration	% Of respondents
	Signed and executed agreements by collaborating – supported by detailed implementation plans, mandates, and communication framework	82%
	Ability to have networked core banking systems and a centralised payment switch	64%
	Agreement on shared services costs in advance and management thereof during and post implementation – Joint contracting is a key aspect of the implementation	36%
	Collaboration with MNOs and Fintechs as key service providers and business partners	27%
	Customer awareness and public sensitization to ensure increased adoption, customer safety and due care	27%
	Regular staff communication, training, and development	27%
	Joint contracting of vendors to benefit from the economies of scale in purchase and management of services	27%
	Regular interactions with the regulator	18%
	8% of the respondents advised including: ▪ Use of open-source solutions ▪ Increased investment in IT by the government of Uganda ▪ The liberation of the control of the IT space.	9% each

5. Balancing the strategy business and the cost of doing business

Due to the rate of changes in the economy and customer tastes and preferences, the SFIs undertake continuous reviews of strategy with changing implementation plans that have a high impact on cost. There is a need to balance the new evolving strategy with the associated costs of doing business, with due consideration to sunk costs and legacy systems and their support policies and procedures. Other considerations are articulated in Figure 12 below:

Figure 12: Balancing the strategy business and the cost of doing business



6. Bank regulations that should be eased to decrease the overall associated costs whilst ensuring prudential regulation

(i) In-country primary data centre, given that data can be stored and processed out of the country supported by cloud computing with due respect to the appropriate security measures, access and regulatory framework.

(ii) Credit rating requirement - Banks may be required to obtain and maintain a current credit rating from an approved credit rating agency, and to disclose it to investors and prospective investors.

(iii) Government securities maturing in longer than 91 days being excluded from liquid assets.

(iv) Review of Cash Reserve Ratio (CRR) as a monetary tool as well as including foreign deposits when calculating CRR- Recognize forex deposits for which payments can be cleared locally as part of the CRR. Further reduce CRR by at least 1% to reduce cost of liquidity and harmonize with neighbors (Kenya at 5.25%, Tanzania at 6%). Further, BOU should allow reserving in foreign currency rather than only LCY, which is the case.

(v) Need for a law or regulation on netting positions. The regulations should permit SFIs to bilaterally net off positions on financial market instruments.

(vi) Include FX swaps in the admissible collateralized products to support borrowing under the Lombard window as well as funding SWAPS with BOU.

(vii) Computing provision for bad debts – inclusion of collateral value

(viii) Cloud computing – pronounce specific guidelines and requirements that will enable SFIs who are ready to implement cloud computing

(ix) Organizational structure – review the need to have executives for the 3 functions (compliance, audit, and risk) with due respect to the size of the organization – focus on the spirit of compliance and ease guidelines.

(x) Separate and ad-hoc audits – focus is on ICT and AML audits with requirements for foreign resources which is a high cost.

(xi) Centralised management of unclaimed balances in all financial sectors including insurance

(xii) Reconciliation of the different laws, guidelines, and requirements from the different regulators – one point or view of compliance and removal of duplications as well as review of laws and regulations including Agency Banking 2017, Deposit Protection Guidelines, NPS Act 2020, BOU Act 2020, FIA 2014, MDI Act.

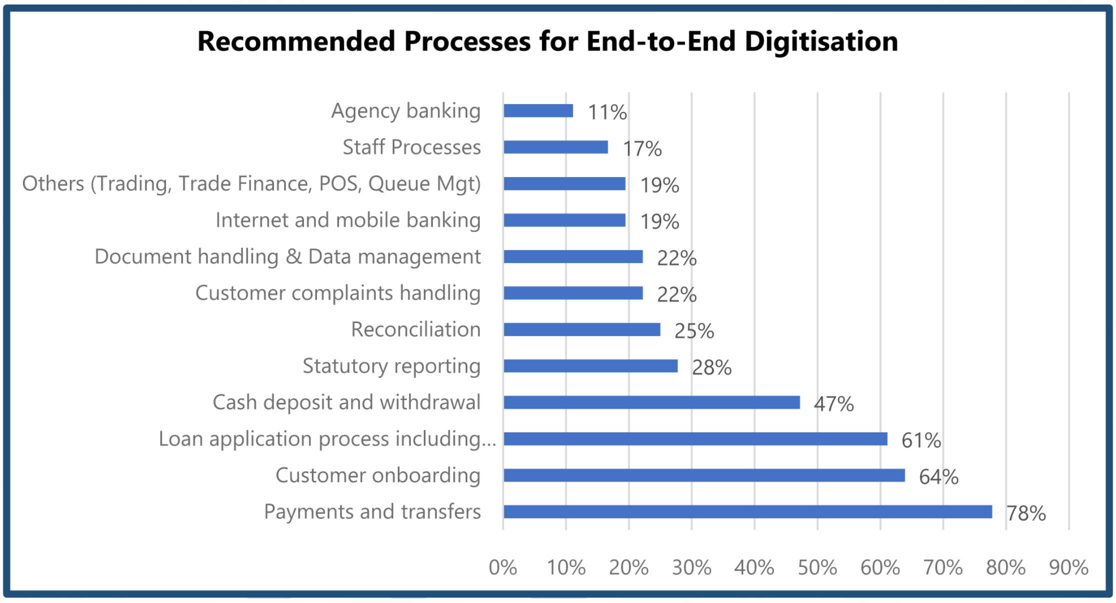
The review of banking and related laws and regulations were undertaken in 2020/2021 as part of the regulatory review exercise. Report to be presented to BOU by the end of September 2021.

7. Recommended Processes for Digitisation end to end

All the executives and stakeholders interviewed recommended digitisation as a solution for SFIs to sustainably cut costs and change their operating models with positive impact on the customer. The respondents advised various processes that their respective SFIs should digitize end to end - The recommendations so made are dependent on the level of digitisation in the respective SFIs, their strategic and customer focus in the intermediate term.

The key processes recommended for digitisation included payments and transfers, customer onboarding and loan application process from the customer application, through profiling, approval, monitoring, collection, and remediation. Other recommended processes for digitisation are also shown in Figure 13 below:

Figure 13: Recommended Processes for End-to-End Digitisation



The Reasons given for the digitisation of recommended processes include:

(i) Provision of a seamless customer service with better access to bank products and services - culminating into improved customer experience. This will ease the way in which customers transact – can safely transact from the safety of their homes and business premises.

(ii) Makes it easier for customers to raise issues, give and provide feedback.

(iii) Improvement in operational efficiencies and overall turnaround time (TAT)

(iv) Removal of manual, mundane, repetitive, and time-wasting tasks & processes with associated paper, staff, delays, remediation, errors in delivery & associated costs.

(v) Reduced credit risk with better decisioning, monitoring, reduced fraud & collusion, incidences of potential loss and overall improved and consistent judgement.

(vi) Creation of more capacity for staff to focus on more complex and value-added transactions and processes including advisory and support services.

(vii) Ability to collect data – analytics can inform better product development and execution.

(viii) Better and comprehensive compliance at the commencement of transactions – removing the burden of retrospective compliance.

(ix) Decongestion and optimization of branches, service centres and offices, ultimately resulting into the reduction of occupancy and related staff costs.

(x) Extended outreach that will increase financial inclusion and reach in a cheaper and more consistent way.

(xi) Easier and faster reconciliations taking less time, less resources and resulting into better returns.

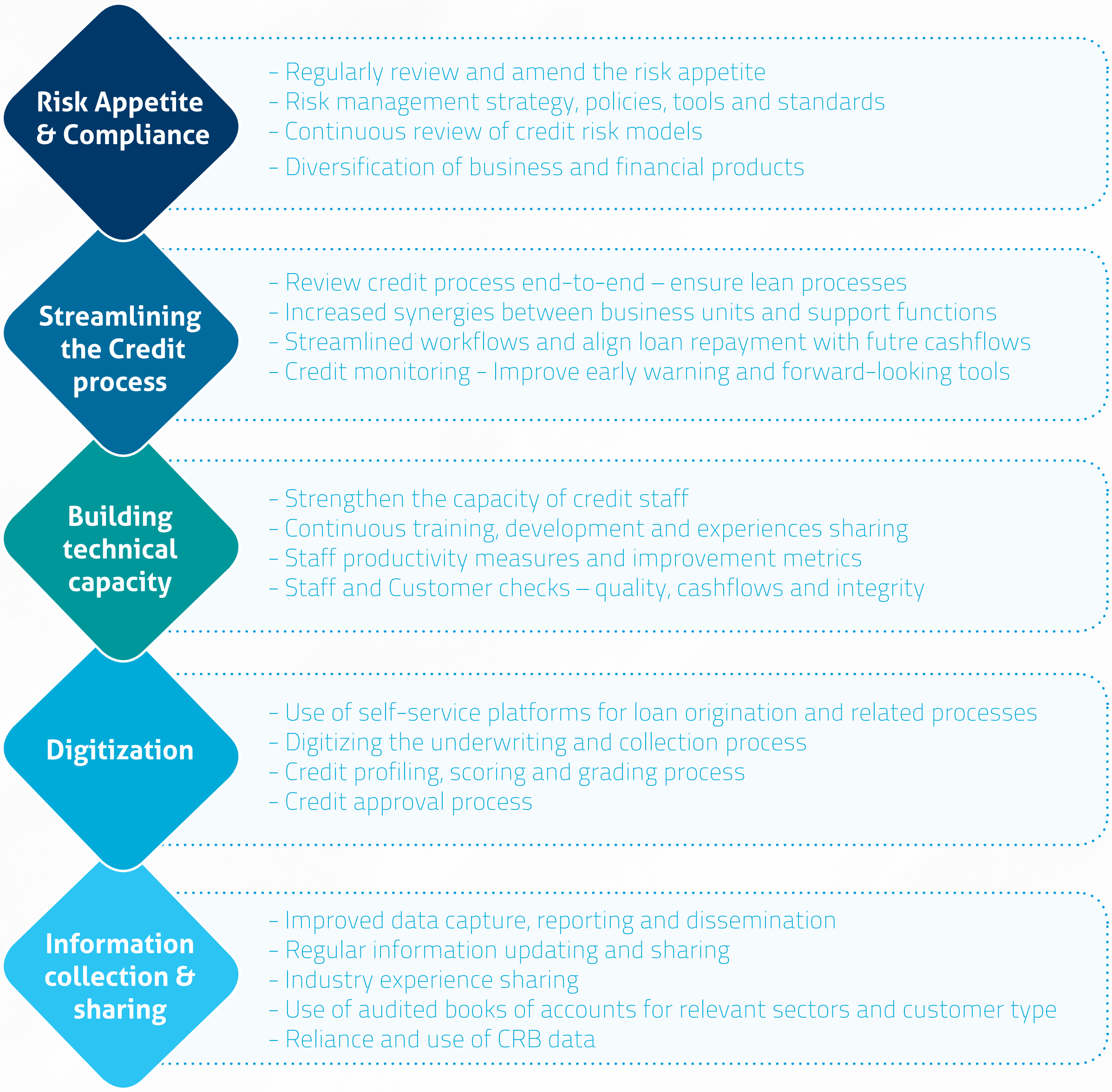
(xii) Reduction in cash and cash handling costs and overall better cash management.

(xiii) Better staff service and interaction including payroll accuracy and management.

8. Recommendations on how to sustainably decrease Non-Performing Loans (NPLs)

NPLs and associated costs are an increasing concern especially in light of COVID-19 and adverse impact on the bank books. Below are the recommendations made by the executives on ways in which SFIs can sustainably decrease NPLs and manage the associated costs.

Figure 14: Sustainably Decreasing NPLs

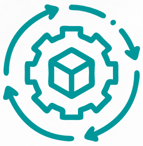
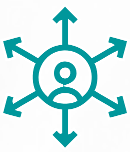


9. Internal Structural Changes

Whilst changes must be made as an industry to decrease the costs of banking, it is important for the responding SFIs to assess their respective institutions and recommend changes that would ensure sustainable cost changes with positive impact on customers.

81% of the respondents recommended the adoption of digital service channels end to end and leveraging technology for better effectiveness in their organizations – with due respect to the level of digitization in the respective organization. The key aspect here was customer communication and training to enable increased adoption and utilization. The recommendation is purposed to decrease the overall costs of provision of such services, decreasing channel cost and activities, decreasing the risks associated with service provision, increasing customer ease of service delivery and impact. Other internal structural changes recommended are also presented in Table 4 below:

Table 5: Internal Structural Changes

Icon	Recommendations	% Of respondents
	Adoption of Digital service channels, increase the avenues for self-service and leverage technology for better effectiveness	81%
	Process simplification, redesign and automation of processes end to end to reduce waste and improve efficiencies - Key processes recommended are payment processes.	64%
	▪ Staff and structural realignment, resource audit, gap analysis and enablement to ensure staff are focused on high value processes ▪ Enable cost optimization including resource audit and gap analysis	42%
	Centralize operations into processing centres - including setting up of the pre-requisite governance and control structures	28%
	Adoption and use of agency banking	11%
	Outsourcing of non-core value process	6%
● ● ● ●	Others including: ▪ Research ▪ Information sharing ▪ Infrastructure management ▪ Security for cash ▪ Project management - leverage data for analytics Harmonizing core banking systems	61%

7.3 Objective 3: Explore and recommend alternative cost sharing initiatives, collaborations & partnerships that will result into a decrease in operating costs

1. Industry wide changes and structural changes that may result in lower costs

In order to have an industry wide impact on costs and customers, SFIs must make changes jointly and consistently at industry level, but with due consideration to the operating models and level of development of the respective SFIs. There must be a meeting of minds, information sharing and a consensus between the participating SFIs to adhere to the terms of the agreements, for any of the collaborations planned, to realize benefits.

Key recommendations made by the respondents include interventions with the legal process, standardization of processes, documentation and charges, as well as customer awareness and support campaigns, among others as shown in table 5 below:

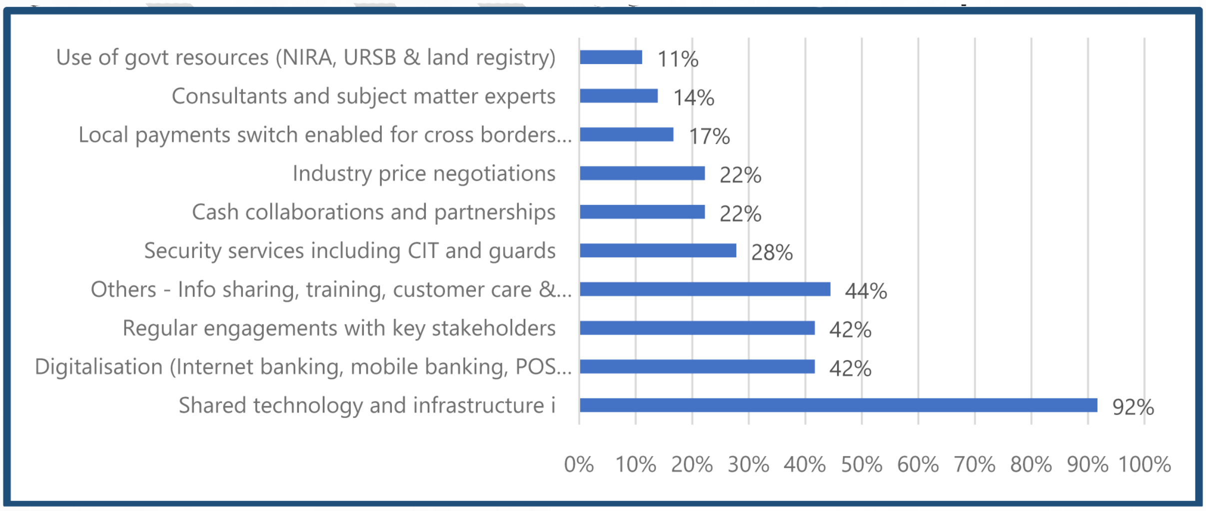
Table 6: Recommended Industry Wide Changes

Icon	Recommendations	% Of respondents
	Creation of industry wide databases & information sharing on: * Suspicious Transaction Reports (STRs) * Fraud related matters * Staff disciplinary issues and resolution thereof * Distressed asset management house * Blacklist * Delinquent customers	50%
	Lobby for improvement of legal due process including: * Prioritization of mediation clauses in SFIs' legal letters of offer * Improve TAT * Ensure appropriate due resolution * Provision of training of the judiciary * Revising current laws -netting, securities, borrowing, etc.	50%
	Standardization of key aspects in the industry including: * Charges across the industry for ATMs * OTC charges for cash deposits and withdrawals * Account opening requirements and documentation	38%
	Introduction of a centralized national payments switch to enable local and international payments at a much lower cost	38%
	Elimination of the usage of cheques	25%
	▪ Intensive customer awareness ▪ Cashless transactions ▪ Strategic plans to manage IT costs ▪ Data and information systems sharing ▪ Competitor benchmarking ▪ Industry Credit staff academy including loan rehabilitation, recovery, fraud awareness and collusion detection. ▪ Lobby UIA to allow banks enforce foreclosure with mortgages on government land	13% each

2. Recommended collaborative engagements and partnerships to reduce cost of banking and improve efficiency

In order to decrease the cost of banking, the members of the banking fraternity must collaborate and jointly execute key cost driving processes in order to benefit through economies of scale and learning transfer. 92% of the respondents recommended shared technology and infrastructure including ATMs, agency banking, Know Your Customer (KYC) verification, off-premises IT services and disaster recovery sites, among others. Other recommendations are also shown in figure 15 below:

Figure 15: Recommended collaborative engagements and partnerships



The infrastructure that was recommended by at least half of the executives for creation of an industry utility with benefits resulting into economies of scale include:

(i) Agents and sub agents

(ii) ATM Network could be shared through switching

(iii) CIT services

(iv) ICT support services e.g., data centres

3. Partnerships outside the banking sector and in the financial ecosystem that would enable operating efficiencies and ultimately a decrease in the overall op erating costs

In order to manage the costs of banking, the banking industry must create sustainable relationships with key players in the banking ecosystem. 100% of the respondents recommended the creation of partnerships with financial services providers including insurance firms and brokers, fund managers, MNOs, Fintechs, among others, whilst 95% of the respondents recommended the creation of partnerships with industry service providers including security firms, MNOs, technology providers, marketing agencies, social media firms, among others as shown in table 6 below.

Table 7: Partnerships outside the banking sector

Icon	Recommendations	% Of respondents
	Financial services providers including insurance firms and brokers, fund managers, MNOs, Fintechs, etc.	95%
	Industry services providers including security firms, MNOs, technology providers, marketing agencies, social media firms, etc.	83%
	Government agencies, ministries and departments including the Judiciary, NIRA, URSB, Immigration, Lands Office, OPM, NITA, etc.	80%
	Regulators including Bank of Uganda, FIA, UBRA, MOFPED, CMA and GOU	28%
	Development partners, multinational organizations, and non-governmental organizations	20%
	Key stakeholders in key catalytic sectors including agriculture, education, housing, climate change, etc.	13%
	Local Communities, Cultural and Religious institutions	10%
	Customer groups including KACITA, PSFU, UMA, trade unions, etc.	5%
	Other partnerships recommended include: ▪ Providers of long-term capital – reduce over reliance on customer deposits ▪ Debt restructuring companies – take over bad debts	3% each

On completion of the work and due process, the respondents advised low hanging fruit which would be areas of initial focus and commencement of the industry collaborations, and subsequent partnerships in table 7 below:

Table 8: Low Hanging Fruit

Icon	Recommendations	% Of respondents
	Research, benchmarking, knowledge sharing and transfer to ensure effective and consistent practices in the industry	53%
	Sharing of infrastructure including ATMs and agency banking and reducing the overall associated costs thereto	53%
	Creation of joint banking platforms and direct Integrations and collaborations with MNOs and Fintechs	47%
	Security services including CIT contracts and guards	33%
	Centralized cash management center and cash collaborations – including industry negotiation of CIT contracts	33%
	Customer training and awareness of digital products, financial literacy, cashless payments, and safety of the solutions provided by the banking sector.	27%
	Culture focused on continual improvement and adaption including Staff training and credit academies including lessons learnt	27%
	Standardizing account opening requirements and documentation to ease the account opening process across all SFIs and enable seamless financial inclusion – with due respect to customer type and categorization.	13%
	Reserving in Foreign Currency and SWAPS with the central bank as a funding mechanism	13%
	Sharing of resources including valuers, subject matter experts and consultants	13%
	Other low hanging fruit recommended for a few SFIs include: ▪ Syndications ▪ Data - modeling and storage to enable automated decision making ▪ Shared security services for banks in the same location ▪ Rationalization of key bank costs with a focus on infrastructure costs	7% each

4. What could ensure that any planned collaborations and partnerships may be that more successful

Any banking industry initiatives and collaborations will be successful if due care is taken in advance and commitment given by the participating SFIs at executive level to the said interventions. Key considerations to ensure successful preparation for the project are shown in figure 14 below:

Figure 16: Project Conception and Decisioning

Project Conception and Decisioning		
Decisioning:	**Considerations:**	**Preparation:**
1. Choose the projects with a significant impact on cost and thus big savings. 2. Focus on the easier projects to undertake first to test the process and ensure the industry acceptability and dynamics 3. Building of a priority matrix – considering recommendations made. 4. Economics of the proposal must be done and must make sense for all participating SFIs - Equity is key rather than equality. 5. CEs of participating SFI must sign off the project and commit organization in advance . 6. Outsourcing services - ensure the vendor has the experience & ability to undertake the volume of work and has inbuilt capacity for increased volume without compromising quality.	**1.** Regulatory compliance and a no objection from the regulator 2. Acceptance level ground that all participating SFIs can agree to. 3. Individual SFI Considerations - Some changes may be relevant to just some SFIs and not all. 4. Overall costs and cost sharing model must be clear and communicated before commencement of project. 5. Customer confidentiality, data privacy and relevant governance. 6. Remove the myth of inequality in advance and lack of trust 7. Discourage the feeling of competition and need for one SFI to benefit over and above all.	1. Collaboration framework and MOUs – with SLAs, workplans and performance measurement framework. 2. Ensure readiness and commitment of each participating SFI and staff in advance - Individually, the institutions must do that which is best for them before the project and comply to the project guidelines and expectations. 3. Define process owner - Centralised ownership through UBA will help avoid conflicts of interest. 4. Information sharing - Development of information sharing platform and methodology 5. Location of shared premises - Key for co-located premises or activities. 6. Role of staff – Define the expectations of relevant staff and how their performance will be measured.

During the preparation and implementation of the project, below are the considerations that will ensure that the expected benefits are realized:

Figure 17: Project Implementation

Project Implementation		
Pre-Implementation	**Implementation**	**Early Life**
1. Proof of concept in some - Informs decisions and affirms the business case especially as it relates to cost sustainable cost saving. 2. Trust, active participation and sign off by relevant SFIs including independent body to ensure equity 3. Compliance requirements and compliance - including good relationship with regulator. 4. Resourcing - Dedicated staff to bring the project into fruition.	**1.** Regular collection, collation and analysis of data. 2. Regular performance tracking and reporting – Management reporting pack to relevant senior management. 3. Changes can be done in a step-by-step manner – Built in process to ensure seamlessness - Openness to options and evaluation of each. 4. Late entrants – Build collaboration to accept late entrants who may not have been ready at the time of commencement of the project. It is critical that a model is built in to enable them uptake the startup and learning costs	1. Role of staff – Value will only be achieved with the commitment of the relevant staff and regular and open communication with a spirit of issues resolution. 2. Changing technology, security and associated costs - Need to build in methodology to make changes if there is a business case to support the same. 3. Changes can be done in a step-by-step manners, part of a process scope or a process undertaken end to end - Openness to options and evaluation of each is critical. 4. Data collection and analysis on an ongoing basis - help further decision making and enable learning as an industry

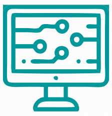
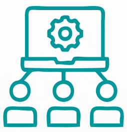
The banking industry must be a learning industry - Post project implementation and learning for a better subsequent cycle is important. Setbacks and challenges should not be a discouragement, but a lesson and a challenge to spur progress.

08 Research Insights and Recommendations

1. Further Insights on decreasing the cost of banking

The executives and participating interviewees had further insights into this research, as articulated in table 8 below:

Table 9: Further Insights on decreasing the cost of banking

Icon	Recommendations
	SFIs leveraging the latest business technology will have a key advantage in the digital transformation race and better customer impact.
	Embracing digital solutions, technology, and automation end-to-end in key value processes in the SFIs is a must.
	Partnerships with fin tech companies and MNOs is providing alternate channels that enhance customer experience, value; and have a potential to decrease costs.
	▪ Big data when appraised properly facilitates quicker decision making and drives relevant innovation and product provisioning. ▪ Available data - Integration with NIRA, URSB, URA, insurance providers, immigration etc. will enable easier proof and less movement for bank customers. ▪ Data and analytics - Versatile information collection, collation and sharing are fundamental
	Need for valuers to provide timely, consistent, and reliable valuations.
	Collaborative approach in early detection of deteriorating credits and reporting to CRB is invaluable.
	▪ Collaborations and partnerships are a journey which will gain traction with the commitment of the relevant stakeholders and a sound workplan to support the implementation. ▪ Synergies and economies of scale of working together must be leveraged. ▪ Importance of customer sensitization and training – This cannot be over emphasized. ▪ The banking industry needs a focused building of public confidence and goodwill - maintaining relationship with regulator and government is critical

2. Overall Research Recommendations – Industry Collaborations:

Please see in table 9 below the overall recommended industry collaborations that will result into sustained dropping of costs:

Table 10: Overall Research Recommendations

Recommended Industry Collaborations	Short Term	Medium Term	Long Term	Stakeholders
Establishment of industry utilities including: * ATMs * Agents and super agents * Industry databases * Customer care centres		✓	✓	a. SFIs b. BOU c. Relevant service provider d. ABC e. Telecoms f. Service providers including security, transport, ICT services, servicing, etc. g. Legal firms
Industry negotiations - Focus on key cost lines including: * IT services – maintenance, IT licenses, Visa and Reuters Services * Rental space * Equipment service and maintenance * Professional services including legal, valuers, surveyors, HR, insurance, ICT consultants, etc. Telecommunication services	✓	✓	✓	a. SFIs b. BOU c. Relevant service provider d. Telecoms e. Service providers including security, transport, ICT, equipment maintenance, servicing, cleaning etc. f. Professional firms
Security services including: * Guarding Services at ATMs and branches * Alarm monitoring and security support * Cash In Transit	✓	✓		a. SFIs b. Security companies c. Landlords d. Legal firms
Procurement and alignment of key maintenance activities for regional services including: * Transport and related services * Cleaning services * Maintenance and Servicing * Courier services	✓	✓		a. SFIs b. Relevant service provider c. Legal firms
Outsourcing and cash processing and management including: * Cash processing * Cash recycling and storage * Cash in Transit * Equipment leasing and maintenance * Cash encashment between banks * Exporting cash	✓	✓	✓	a. SFIs b. BOU c. Relevant service provider d. Service providers including security, transport, ICT services, servicing, etc. e. Legal firms

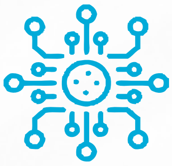
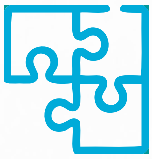
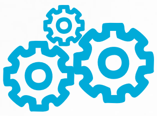
Changes in laws and regulations - per regulatory review undertaken by consultants			✓	a. SFIs b. BOU c. MOFPED d. Parliament of Uganda e. President of Uganda
Creation of industry information database & information sharing framework including: * Staff fraud and misconduct * Customer fraud * Credit and delinquent customers * Agents fraud and misconduct * Cybercrime - actual and attempts * Suspicious transactions * Distressed assets and property * Property and area valuations * Blacklist * KYC verification	✓	✓	✓	a. SFIs b. BOU c. Relevant service provider d. Legal firms
Engagement with the legal fraternity and judicial system for better throughput: * Use of ICAMEK * Commercial court enabled to support the banking sector * Continuous training for the judiciary * Review of laws and regulations * Lobby UIA to allow banks enforce foreclosure with mortgages on government land	✓	✓	✓	a. SFIs b. BOU c. Judicial system d. ICAMEK e. Legal firms
Standardization of key aspects in the industry including: * ATM Charges * Agent banking charges * Account opening requirements * Agent banking communication * Agent banking services *Bank Agents	✓	✓	✓	a. SFIs b. BOU c. FIA d. Relevant service provider e. ABC f. Relevant Service providers. g. Legal firms
National payments switch		✓	✓	a. SFIs b. BOU c. Relevant service provider
Payments process review including: * Elimination of the use of cheques * Clearing between SFIs - netting off without due respect to the clearing house and currency		✓	✓	a. SFIs b. BOU c. Relevant service provider d. ICT services providers

Industry engagements including: * Customer awareness and training * Digital awareness and security * Agency banking awareness and security * Cash use vs digital channels * Impact of the banking sector - including laws and regulations that govern it	✓	✓	✓	a. SFIs b. BOU c. Customer Groups and customers d. General public e. Relevant Service Providers
ICT services including: * Data centres * Integrators * Fintechs * Recovery sites		✓	✓	a. SFIs b. BOU c. Relevant service provider d. ICT services providers e. Legal firms
Industry Credit staff academy including loan rehabilitation, recovery, fraud awareness and collusion detection. Credit Academy through UIBFS.	✓			a. SFIs b. BOU c. Relevant service provider d. CRBs e. Legal firms
Change of value processes to include the following as part of due process: * ICAMEK - intermediation in respect of set limit per SFI of delinquent credit * Use of small claims court - with due respect of set limit per SFI of delinquent credit * Use of alternative security - with due respect to URSB	✓	✓	✓	a. SFIs b. BOU c. ICAMEK d. The Judiciary e. URSB f. Legal firms
Build in processes to use databases and resources of government agencies including: * NIRA * URSB * Land registry * URA	✓	✓		a. SFIs b. BOU c. NIRA d. Land Registry e. URSB f. Legal firms g. URA
Establishment of various branch models – with due respect to a no objection by the regulator e.g., agency model branch		✓		a. SFIs b. BOU c. Relevant service providers d. Legal Firms

3. Specific SFI Recommendations for Decreasing the Cost of Operations:

Due to the different strategies, level of development, level of investment in technology and overall operating models and focus, the various SFIs will have specific recommendations that apply to them, further to the recommended industry collaborations. Please see suggestions for the various SFIs to review and undertake in a bid to decrease their overall cost of banking in table 10 below.

Table 11: Specific SFI Recommendations

Icon	Recommendations
	**Digitalization:** ▪ Digitalization of key value products and services – Forward looking investment decisions with a step-by-step approach for optimization. ▪ Review of the ICT processes, products, maintenance, and investments with a view of optimization. ▪ Seek professional assistance to ensure the right decisioning and implementation.
	**Mergers and Acquisition:** ▪ Mergers and Acquisitions – In order to leverage the benefits of size from economies of scale, there is a need for some SFIs to look at merging and consolidating to ensure better efficiencies and economies of scale. ▪ Representative offices – Option of representative offices to ensure business without the heavy cost associated with a fully-fledged operating license and physical establishment.
	**Business Process Transformation including:** ▪ Review and alignment of key value processes – those with the biggest impact on both cost and customer satisfaction, without necessarily digitizing the processes. Removal of waste in processes including resources and time
	**Process Centralization or Decentralization:** ▪ Review where to centralize or decentralize key processes focusing on the key value processes with highest customer impact and cost. ▪ Decision of what to apply and when is critical - model as is relevant and based on analysis Consider centralization and outsourcing of key value and specialized processing including: ▪ Payments ▪ Customer care centre ▪ Trade finance – Specific back-office evaluations & processing ▪ Credit collections ▪ Specialized and low volume credit evaluations, etc.
	**Sourcing and management of funds:** Long term strategies for the sourcing and management of funds which is a key cost for some SFIs.

Staff Optimization – Right Staff, Right Source, Right Skills & Right Use

- Staff review – Structure, roles, and responsibilities
- Integration of working from home model and management thereof
- Regular and ingoing staff training and development – Reliance on the industry & SFIs for specialist skills training & support at a lower cost.

Outsourcing:

- Determine the extent to which the respective SFI can and should outsource, and which part of the value processes can be outsourced with value add
- Analysis and evaluation are key to ensure the anticipated cost decrease is realized – Post analysis to prove the business case
- Outsourcing key functions e.g., compliance and risk would remove the fixed cost and expose the SFI to world best practice and learnings.

Active vs Inactive and Dormant Account – Unit cost impact

There is a need to look for ways of increasing the banking sector number of active accounts - viz a vis inactive and dormant accounts.

Project Management:

- Right resourcing - When undertaking projects or key changes, assign proper resources at the right level and with executive blessing and support in order to ensure a sound business case and execution.
- Ensure proper governance and due process in advance of project implementation.
- Performance evaluation and reporting metrics must be inbuilt and tracked on an ongoing basis.

Agency Banking:

- Evaluate the agency banking model - and find ways to decrease the related SFI costs in order to realize the business case.
- Evaluate the brick-and-mortar strategy and align it to the agent banking business case.

Joint Programmes with BOU:

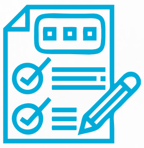
- Joint programme with the regulator in order to build public confidence in the tier 2 and tier 3 SFIs

Vendor Review and Management:

- Review vendor contracts and relationships – including changing the mode of contracting.
- Establish and Maintain Vendor relationships - SLAs and sharp contracting critical here

Group vs Localized Services:

- In respect of regional and international banks and with due respect to the relevant group guidelines – establish what can be done locally at a lower cost whilst still leveraging the benefits of belonging to a group.
- Review value processes and documentation that can be localized to ensure responsiveness to the customer including customer care, project management, product development, marketing, and branding, etc.

	Channel optimization supported by a review of the channels including: ▪ Size of branches – re-size and downsize ▪ Model branches – pre-define the size of branches ▪ Location of ATMs – options of malls and petrol stations with overall lower and pre-defined costs ▪ Relocation of ATMs – from low transaction areas ▪ Increased use and sharing of bank agents
	Review of operating model with due respect to best practice. ▪ Key aspects identified in the review include: ▪ Credit profiling ▪ Data analytics ▪ Credit monitoring ▪ Credit collections ▪ Underwriting specialized products and services ▪ Customer care centre ▪ Staff review and optimization
	Product Rationalization and Simplification ▪ Review of the legacy products and retire the non-profitable products ▪ Simplify products with less options for customers ▪ Deliberately decrease product back-office processes and related costs
	IT Architecture Simplification ▪ SFIs are burdened by legacy systems and layered, complicated systems ▪ Need to de-couple the systems and free the capacity and investment costs to the digitisation journey. ▪ Customer impact will be a driving force. ▪ Use of experts and consultants is important
	Use of Compliance Databases for: ▪ Forecasting and analysis ▪ Easing of industry account opening and customer movement from one SFI to another

4. Transfer of benefits to the customer

When the SFIs have realized cost savings, many of the executives recommended the transfer of some of the savings to the customers. The recommended areas for benefits sharing included:

(i) Customer sensitization and training.

(ii) Lending at lower rates and decreasing/removal of some bank charges.

(iii) Community CSR projects.

(iv) Support to vulnerable groups including women, youth, and SMEs.

(v) Support to key catalytic sectors including agriculture and education.

5. Recommended Areas for Further research

(i) Benchmark other sectors like the telecommunications sector, institutions and associations with successful cost cutting initiatives.

(ii) Agency banking – operating model to decrease the overall cost of the agency banking channel and increase customer adoption and use.

(iii) Customer onboarding – Resulting into the standardization of account opening for personal and business customers and ease the transfer of customers between SFIs.

(iv) Digitalization and ways of increasing customer use and adoption of the digital channels.

(v) Cash management – Decreasing the use of cash and optimizing the cash management processes in Uganda.

(vi) Different models of branches that can be deployed – decreasing overall brick-and-mortar deployments in support of the financial inclusion mandate

(vii) Benchmarking key industries and transfer of operating models that increase efficiency, decrease cost, and have better customer impact and service.

09 Ethical Issues

The following ethical considerations were considered by both UBA and MUBS:

1. Confidentiality throughout the data collection process, report writing and submission
2. Compliance to agreed study protocol
3. Sensitivity to cultural norms, beliefs, and practices.

Before data collection began, due care was taken to ensure that **informed consent** was obtained from all respondents **(even for photographs)**. The informed consent included explanations about the purpose and objectives of the research study, the benefits and risks that could accrue from the study, the rights of the respondents and reassurance on confidentiality.

An opportunity was availed to each respondent to ask questions and/ or seek further clarification before they were engaged in an interview. Respondents were free to refuse to participate in the study and this will not affect their right to benefit from the project interventions. Confidentiality and integrity of all respondents (including children) was observed throughout the course of the study.

Key informants were not directly linked to the comments made during the survey so as to give them freedom to express their views frankly and freely. All data records were securely kept and confidentiality during data collection and analysis was maintained.

10 Appendices

10.1 **Appendix 1:** Literature Review Framework

Overview of the Financing Ecosystem in Uganda

(BoU 2020, 2019; BoU Financial Sector Stability Report 2020, 2021; FSDU 2020; EFInA 2016, Ntayi & Sejjaka 2014; CIIP 2012; BOU State of the Economy Report, 2020

Bank Cost Classification and Drivers

(PWC 2019, 2020; Ioannidis et al 2010; Porter 1985; Riley 1987; Shank 1989; Johnson 1988; Cooper & Kaplan 1990, Zimmerman 1987)

Bank Cost Structures and Approaches

(PWC, 2019; Diener 2020; Hinterhuber 2008; Datta 2017; **Karaduman** 2014; Dolgui & Proth 2010; Chepkemoi 2020; **Okeahalam** 2005; Banker & Hansen 2002; Estelami 2013; **Netseva-Pocheva** 2017; Thi et al 2018; **Sammut-Bonnici** & **Channon** 2014; Leon 2015; Liozu et al 2015; Bett 2018, **Cracknell & Messan 2006)**

Challenges to Bank Cost Reduction

(**Benedek** 2012; Deloitte 2020; Edmonds **2011**; Self 2007; **Sterling 2003**; Okumus 2003; **Chircu & Kauffman, 2000**; Burnham 1996; Arcuri et al 2014; Sing 2014; Hardin 2013; **Waldersee & Griffiths** 2004; Nosratabadi et al 2020; **Siboni & Klein** 2016; Gnyawali & **Byung-Jin Par** 2011; Doblas-Madrid **& Minetti** 2009; Giannetti et al 2010a; Gehrig **& Stenbacka** 2007)

Banking Cost Determinants

(Dhale et al **2016**;Wong, 2017; Cyree 2015;Tidke 2017; Reinke 2016; Kanagasabai et al 2019; Arias et al 2020; 2016; Naceur & Omran 2011; Mbiti & amp; Weil 2011; Drake et al 2006, 2006a; Cole 1985; Cotter et al 1984; Wong et al 2012; Barth et al 2009; Ivashina 2009; BoU 2010; Kigen 2014; Banker et al 1993, 1998; Anderson 1995; Clarke 1988; Benston et al 1983; Brugge et al 2018; Kwan 1997, 2006; Brown et al 2009; Djankov et al 2007; Japelli & Pagano 2002, Brown 2009; Triki & Gajigo 2004; Beck et al 2014; Houston 2010; Porter 1985; American Accounting Association et al 1997, Panzar & Willig1977; Oracle 2017; Mastercard 2020; Büyükkarabacak & Valev 2010; Chakrabarty 2012; Diamond & 2000; Van den Heuvel 2008; Dunkelberg & Scott 2018; Ahokpossi 2013, Demirgüç-Kunt & Huizinga 1999; Leaven & Majnoni 2005; La Porta et al 1999; Mahtab & Abdullah 2016; Oracle 2017)

Technology and Cost of Banking

(Oracle, 2017; PWC, 2017, 2019, 2020;
Deloitte 2017, 2019, 2020, 2021; Mckinsey 2019; Boston Consulting Group;
Global Fintech Report 2019; Messenbock et al 2017)

Cost Reduction and Management Strategies

(Oracle, 2017; **Capgemini** 2015; Reimink 2019; Chaithanya 2014; **Ali et al 2016**; Deloitte **2016**, 2018, 2020; Amanquah & Adjei 2013; Oracle 2017; **Caulfiled** 2014; Quantzig 2017; Padila & Pagano 2000; **Brown et al 2009**; **Jappelli** & Pagano 2002; Beck et al 2014; Houston et al 2010; The Treasurer 2104; Deftereos, 2016; Beau et **al 2014**; Brugge et al 2018; Mastercard 2020, **Chamberlin** 1962; Scherer & Ross 1990; **Djankov** et al **2007**; Triki & Gayig 2014; Barth et al 2009; Ivashina 2009; Buy et al 2010; Saif-Alyousfi 2019; Desiderio et al 2019; PwC 2020; Porter 1985; Arias et al 2016; Boyd et al 2001; Bohachova 2008; BOU 2020; Schnabl et al 2018; Omondi 2017; Goldstein & Turner 1996; Borio & Hofmann 2017; Alexiou & Sofoklis 2009; Taiwo & Adesola 2013 Lindgren et al 1996

10.2 **Appendix 2** - Interview Guides and Questionnaires

CFO: Interview Guide

1. In your view, what are the key cost drivers of your organization? Which of these costs can be removed or managed down and how can this be done?
2. Does your SFI have cost management KPIs? Do you have a department or position tasked with monitoring cost performance? What kind of reporting do they do and what actions are undertaken thereafter? Do you have specific policies in place to prescribe key spend lines?
3. What deliberate efforts has the bank undertaken to reduce cost? How successful have the interventions been? What challenges have you experienced thereto?
4. Digitisation is one of the key enablers of cost management and efficiency in the banking industry. What 5 key processes would you recommend digitizing end to end and why?
5. Bank regulation has led to high and increasing costs of banking. Please guide which aspects of bank regulation should be eased to decrease the overall associated costs whilst ensuring maintenance of the purpose of compliance and risk management.
6. What structural changes would you recommend in your organization in order to be more efficient, responsive to customer and business needs and to manage costs?
7. Cash operations in the banking sector have high costs associated with them. Please advise the detailed cash costs and ways in which the same can be managed down in the short and long term.
8. NPLs in the banking sector are likely to increase in the short and intermediate, with associated costs. Please advise changes that may need to be made at SFI and industry level to better manage NPLs and the costs associated with them.
9. Duplication of the infrastructure in the banking sector has led to higher costs of operations both directly and indirectly – What infrastructure would make sense to share for benefits of economies of scale and what must be taken into consideration when making such recommendations and implementing them?
10. What more can the CRBs do in terms of adding value to the overall credit process?
11. What industry initiatives should the UBA undertake to improve customer awareness and appreciation, as well as uptake and use of digital products and services?
12. What industry wide collaborations would you recommend to decrease the overall cost of banking? What are the low hanging fruits that we should prioritize and begin with? What do we need to take into consideration to ensure that the collaborations are successfully implemented? What challenges do you anticipate in execution of the said collaborations?
13. What sort of partnerships can we make with key players outside the banking industry that would result into efficiencies in the banking sector, lower costs of banking and improved CTI overall?
14. With an overall drop of operating costs at SFI and industry level, there may be a call to transfer some of the benefits to customers. How do you think this should be done, and where should the focus be?
15. Please advise any further insights and recommendations that may help manage the costs of banking at SFI level and industry level.

Head of Compliance - Questionnaire

Decreasing the cost of doing business in the banking sector in Uganda

Name of Organization: ____

1. In your view, what drives the compliance costs in your organization? (Scale: 1-Highest to 10-Lowest)

	Cost Driver	Rating
1		
2		
3		
4		

b. Which aspects off these costs can be removed or managed down & how can this be done?

	Which Costs can be removed or managed down?	How can this be done?
1		
2		
3		
4		

2. What deliberate efforts has the bank undertaken to reduce cost? To what extent has your organization cost reduction targets been met as planned (Use rate below)

(a) Less than 10%
(b) 10% - < 20%
(c) 20% - 40%
(d) 50% - 70%
(e) 70% - 90%
(f) 100%

	Deliberate efforts undertaken by your organization to reduce cost	Rating
1		
2		
3		
4		

b. What challenges have you experienced thereto?

	Challenges experienced in cost reduction	Ranking
1		
2		
3		
4		

3. Digital transformation is one of the key areas of focus for transforming the banking industry and cost management and efficiency for customer focus in the banking industry. What 5 key processes would you recommend your organization digitally transforms and why?

	Key Processes to Digitally transform	Why?
1		
2		
3		
4		

4. Bank regulation has led to high and increasing costs of banking. Which bank regulations should be eased to decrease the overall associated costs whilst ensuring prudential regulation?

	Recommended Changes in Bank Regulation or guidelines
1	
2	
3	
4	

5. NPLs in the banking sector are likely to increase in the short and intermediate, with associated costs. Please advise changes that may need to be made at SFI and industry level to better manage NPLs and the costs associated with them. What role can the compliance function play in supporting the recommended changes?

Changes that need to be made to manage NPLs		
	SFI Level	Industry level
1		
2		
3		
4		
Role of the Compliance Function		
1		
2		
3		
4		

6. Duplication of the infrastructure in the banking sector has led to higher costs of operations both directly and indirectly – What infrastructure would make sense to share for benefits of economies of scale and what must be taken into consideration when implementing such interventions?

Infrastructure that could result in economies of scale	
1	
2	
3	
4	
Considerations that would ensure seamless implementation	
1	
2	
3	
4	

7. Indicate any internal structural, industry changes and collaborative engagements that can be undertaken to reduce cost of banking and generally improve efficiency in the banking sector

Internal Structural Changes	
1	
2	
3	
4	
Industrial Changes	
1	
2	
3	
4	
Collaborative engagements	
1	
2	
3	
4	
Low Hanging Fruits	
1	
2	
3	
4	

8. What sort of partnerships can we make with key players outside the banking industry that would result into efficiencies in the banking sector, lower costs of banking & improved CTI overall?

Potential partnerships outside the banking sector	
1	
2	
3	

Questionnaire: Head of IT

Decreasing the cost of doing business in the banking sector in Uganda

Name of Organization: ____

1. The institution has deliberately taken on cost reduction initiatives.
   (a) Agree
   (b) Disagree
   (c) Unlikely to
   (d) Not at all

2. The organization's key strategic focus for the next 12 months is on.
   (a) Balance sheet management
   (b) Technology implementation
   (c) Digital enablement
   (d) Cost reduction
   (e) Product profitability
   (f) Sales growth
   (g) Organizational talent
   (h) Others (please advise) ____

3. Rate the above strategy according to the organization's focus **(Highest 1- 10 Lowest)**

	Key Strategic Focus	Rating
1		
2		
3		
4		

4. What deliberate efforts has the bank undertaken to reduce cost? To what extent has your organization cost reduction targets been met as planned (Use rate below)
   (a) Less than 10%
   (b) 10% - < 20%
   (c) 20% - 40%
   (d) 50% - 70%
   (e) 70% - 90%
   (f) 100%

	Deliberate efforts undertaken by your organization to reduce cost	Rating
1		
2		
3		

What challenges have you experienced thereto?

	Challenges experienced in cost reduction	Ranking
1		
2		
3		

4. How do you rate the organization's digital usage and performance?
   (a) Digital Pioneer
   (b) Digital shy
   (c) Digital laggard
   (d) Other...
   Briefly explain your choice...

5. Digital transformation is one of the key areas of focus for transforming the banking sector and cost management and for efficiency and customer impact. What 5 key processes would you recommend your organization digitally transform and why?

	Key Processes to Digitally transform	Why?
1		
2		
3		
4		

6. What are the key challenges limiting the investment in technology in Uganda today? How can these challenges be managed? What recommendations would you make to enable the balance between cost and the business imperatives?

Key Challenges Limiting the investment in technology	
1	
2	
3	
How these challenges be managed?	
1	
2	
3	
Recommendations on balancing cost and business imperatives	
1	
2	
3	
4	

7. Bank regulation has led to high and increasing costs of banking. Which bank regulations should be eased to decrease the overall associated costs whilst ensuring prudential regulation?

	Recommended Changes in Bank Regulation or guidelines
1	
2	
3	
4	

8. Cash operations in the banking sector have high costs associated with them. What role can information technology play in managing the costs of cash?

Role of technology in the management of cash costs	
1	
2	
3	
4	

9. Duplication of the infrastructure in the banking sector has led to higher costs of operations both directly and indirectly – What infrastructure would make sense to share for benefits of economies of scale and what must be taken into consideration when implementing such interventions?

Infrastructure that could result in economies of scale	
1	
2	
3	
4	
Considerations that would ensure seamless implementation	
1	
2	
3	
4	

10. Indicate any internal structural, industry changes and collaborative engagements that can be undertaken to reduce cost of banking and generally improve efficiency in the banking sector

Internal Structural Changes	
1	
2	
3	
4	

5	
Industrial Changes	
1	
2	
3	
4	
5	
Collaborative engagements	
1	
2	
3	
4	
5	
Low Hanging Fruits	
1	
2	
3	
4	
5	

11. What sort of partnerships can we make with key players outside the banking industry that would result into efficiencies in the banking sector, lower costs of banking and improved CTI overall?

Potential partnerships outside the banking sector	
1	
2	
3	
4	
5	

Questionnaire: Head of Legal
Decreasing the cost of doing business in the banking sector in Uganda
Name of Organization: ____

1. In your view, what drives the legal costs in your organization? **(1-Highest to 10-Lowest)**

	Cost Driver	Rating
1		
2		
3		
4		

b. Which aspects off these costs can be removed or managed down & how can this be done?

	Which Costs can be removed or managed down?	How can this be done?
1		
2		
3		
4		

2. What deliberate efforts has the bank undertaken to reduce cost? To what extent has your organization cost reduction targets been met as planned (Use rate below)

(a) Less than 10%
(b) 10% - < 20%
(c) 20% - 40%
(d) 50% - 70%
(e) 70% - 90%
(f) 100%

	Deliberate efforts undertaken by your organization to reduce cost	Rating
1		
2		
3		
4		

b. What challenges have you experienced thereto?

	Challenges experienced in cost reduction	Ranking
1		
2		
3		

3. Who are the key stakeholders the banking industry should partner with to make the legal process shorter, more seamless and cost effective? What key changes must the SFIs undertake to ensure a better result in terms of cost, customer impact and due process?

Key stakeholders to partner with to lower the legal costs and improve the legal process	
1	
2	
3	
4	
Key changes the SFIs should make to ensure sustainable changes	
1	
2	
3	
4	

4. Digital transformation is one of the key areas of focus for cost management and efficiency in the banking industry. What 5 key processes would you recommend your organization digitally transforms and why?

	Key Processes to Digitally transform	Why?
1		
2		
3		
4		
5		

5. Bank regulation has led to high and increasing costs of banking. Which bank regulations should be eased to decrease the overall associated costs whilst ensuring prudential regulation?

	Recommended Changes in Bank Regulation or guidelines
1	
2	
3	
4	
5	

6. NPLs in the banking sector are likely to increase in the short and intermediate, with associated costs. Please advise changes that may need to be made at SFI and industry level to better manage NPLs and the costs associated with them. What role can the Legal function play in supporting the recommended changes?

Changes that need to be made to manage NPLs		
	SFI Level	Industry level
1		
2		
3		
4		
5		
Role of the Legal Function		
1		
2		
3		
4		
5		

7. Duplication of the infrastructure in the banking sector has led to higher costs of operations both directly and indirectly – What infrastructure would make sense to share for benefits of economies of scale and what must be taken into consideration when implementing such interventions?

Infrastructure that could result in economies of scale	
1	
2	
3	
4	
5	
Considerations that would ensure seamless implementation	
1	
2	
3	
4	

8. Indicate any internal structural, industry changes and collaborative engagements that can be undertaken to reduce cost of banking and generally improve efficiency in the banking sector

Internal Structural Changes	
1	
2	
3	
4	
Industrial Changes	
1	
2	
3	
4	
Collaborative engagements	
1	
2	
3	
4	
Low Hanging Fruits	
1	
2	
3	
4	

9. What sort of partnerships can we make with key players outside the banking industry that would result into efficiencies in the banking sector, lower costs of banking and improved CTI overall?

Potential partnerships outside the banking sector	
1	
2	
3	
4	
5	

Questionnaire: Head of Operations

Decreasing the cost of doing business in the banking sector in Uganda

Name of Organization ____

1. What are the key cost drivers of operations costs in your organization? How would you rate them in terms of their effect on the organization's expenses? **(1-Highest to 10-Lowest)**

	Cost Driver	Rating
1		
2		
3		
4		

2. Which aspects off these costs can be removed or managed down and how can this be done?

	Which Costs can be removed or managed down?	How can this be done?
1		
2		
3		
4		

3. The institution has deliberately taken on cost reduction initiatives.
   (a) Agree
   (b) Disagree
   (c) Unlikely to
   (d) Not at all

4. What deliberate efforts has the bank undertaken to reduce cost? To what extent has your organization cost reduction targets been met as planned (Use rate below)
   (a) Less than 10%
   (b) 10% - < 20%
   (c) 20% - 40%
   (d) 50% - 70%
   (e) 70% - 90%
   (f) 100%

	Deliberate efforts undertaken by your organization to reduce cost	Rating
1		
2		
3		

5. What challenges have you experienced thereto?

	Challenges experienced in cost reduction	Ranking
1		
2		
3		
4		

6. How do you rate the organization's digital usage and performance?
   (a) Digital Pioneer
   (b) Digital shy
   (c) Digital laggard
   (d) Other ....
   Briefly explain your choice ....

7. Digital transformation is one of the key areas of focus of transforming the banking sector and better cost management and efficiency for customer impact. What 5 key processes would you recommend your organization digitally transform and why?

	Key Processes to Digitally transform	Why?
1		
2		
3		
4		

8. Bank regulation has led to high and increasing costs of banking. Which bank regulations should be eased to decrease the overall associated costs whilst ensuring prudential regulation?

	Recommended Changes in Bank Regulation or guidelines
1	
2	
3	
4	

9. Cash operations in the banking sector have high costs associated with them. Please advise the detailed cash costs and ways in which the same can be managed down in the short and long term. What role can technology play in these changes?

Cash Costs		
1		
2		
3		
4		
How they can be managed		
	Short Term	Long Term
1		
2		
3		
4		
Role of technology in the management of cash costs		
1		
2		
3		
4		

10. Duplication of the infrastructure in the banking sector has led to higher costs of operations both directly and indirectly – What infrastructure would make sense to share for benefits of economies of scale and what must be taken into consideration when implementing such interventions?

Infrastructure that could result in economies of scale	
1	
2	
3	
4	
Considerations that would ensure seamless implementation	
1	
2	
3	
4	

11. Indicate any internal structural, industry changes and collaborative engagements that can be undertaken to reduce cost of banking and generally improve efficiency in the banking sector

Internal Structural Changes	
1	
2	
3	
4	
Industrial Changes	
1	
2	
3	
4	
Collaborative engagements	
1	
2	
3	
4	
Low Hanging Fruits	
1	
2	
3	
4	

12. What sort of partnerships can the banking sector make with key players outside the industry that would result into efficiencies in the banking sector, lower costs of banking and improved CTI overall?

Potential partnerships outside the banking sector	
1	
2	
3	
4	
5	

Questionnaire: Head of Treasury

Decreasing the cost of doing business in the banking sector in Uganda

Name of Organization: ____

1. Consider the top key drivers of costs in your organization and make recommendations of how these costs can be managed down or removed?

	Which Costs can be removed or managed down?	How can this be done?
1		
2		
3		
4		

2. The organization's key strategic focus for the next 12 months is on.
   (a) Balance sheet management
   (b) Technology implementation
   (c) Digital enablement
   (d) Cost reduction
   (e) Product profitability
   (f) Sales growth
   (g) Organizational talent
   Others (please advise) ____

3. Rate the above strategy according to the organization's focus **(Highest 1- 10 Lowest)**

	Key Strategic Focus	Rating
1		
2		
3		
4		
5		

4. What deliberate efforts has the bank undertaken to reduce cost? To what extent has your organization cost reduction targets been met as planned (Use rate below)
   (a) Less than 10%
   (b) 10% - < 20%
   (c) 20% - 40%
   (d) 50% - 70%
   (e) 70% - 90%
   (f) 100%

	Deliberate efforts undertaken by your organization to reduce cost	Rating
1		
2		
3		
4		
5		

5. What challenges have you experienced thereto?

	Challenges experienced in cost reduction	Ranking
1		
2		
3		
4		
5		

6. Digital transformation is one of the key areas of focus for transforming of the banking industry and cost management - for improved efficiency and customer focus in the banking industry. In this light, what 5 key processes would you recommend your organization digitally transforms and why?

	Key Processes to Digitally transform	Why?
1		
2		
3		
4		
5		

7. Bank regulation has led to high and increasing costs of banking. Which bank regulations should be eased to decrease the overall associated costs whilst ensuring prudential regulation?

	Recommended Changes in Bank Regulation or guidelines
1	
2	
3	
4	

8. Cash operations in the banking sector have high costs associated with them. Please advise the detailed cash costs and ways in which the same can be managed down in the short and long term. What role can technology play in these changes?

Cash Costs		
1		
2		
3		
4		
5		
How they can be managed		
	Short Term	Long Term
1		
2		

3		
4		
5		
Role of technology in the management of cash costs		
1		
2		
3		
4		
5		

9. Indicate any internal structural, industry changes and collaborative engagements that can be undertaken to reduce cost of banking and generally improve efficiency in the banking sector

Internal Structural Changes	
1	
2	
3	
4	
5	
Industrial Changes	
1	
2	
3	
4	
5	
Collaborative engagements	
1	
2	
3	
4	
5	
Low Hanging Fruits	
1	
2	
3	
4	
5	

10. What sort of partnerships can we make with key players outside the banking industry that would result into efficiencies in the banking sector, lower costs of banking and improved CTI overall?

Potential partnerships outside the banking sector	
1	
2	
3	
4	
5	

Questionnaire: Head of Credit

Decreasing the cost of doing business in the banking sector in Uganda

Name of Organization:____

1. What are the top 5 drivers of credit cost in your organization? How would you rate them in terms of their impact on your organization's expenses? **(1-Highest to 10-Lowest)**

	Cost Driver	Rating
1		
2		
3		
4		

2. Evaluate the credit process of your SFI end to end and advise changes that may be made to the process in order to improve efficiencies with customer impact and decrease the costs of credit.

Changes in the Credit Process	
1	
2	
3	
4	

3. Digital transformation is one of the key areas of focus for transforming the banking industry and decreasing the overall cost of operations. What top 5 key processes would you recommend your organization digitally transforms and why?

	Key Processes to Digitally transform	Why?
1		
2		
3		
4		

4. What extra value can the CRB add to the credit process? What sort of input or feed can they provide to SFIs to add more value to their view of the customer?

Value the CRB can add to the credit process	
1	
2	
3	
4	
5	
Input the CRB can provide to improve view of the customer	
1	
2	
3	
4	
5	

5. NPLs in the banking sector are likely to increase in the short and intermediate, with associated costs. Please advise changes that may need to be made at SFI and industry level to better manage NPLs and the costs associated with them. What role can the Credit function play in supporting the recommended changes?

Changes that need to be made to manage NPLs		
	SFI Level	Industry level
1		
2		
3		
4		
5		
Role of the Credit Function		
1		
2		
3		
4		
5		

6. What key stakeholders external to the banking industry should the banking industry proactively court and manage in order to ensure a drop in credit costs and seamless execution?

Key External Stakeholders	
1	
2	
3	
4	
5	

7. What collaborations and partnerships can the supervised financial institutions jointly undertake to better manage the overall credit costs?

Collaborations in the Banking Sector	
1	
2	
3	
4	
5	

8. What considerations must we have in mind so that any planned collaborations and partnerships may be that more successful?

Collaborations in the Banking Sector	
1	
2	
3	
4	
5	

9. Please share any further insights and considerations on how the banking industry on a whole can improve efficiencies in the credit process

Key External Stakeholders	
1	
2	
3	
4	
5	

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