3

Access to Financial Services

3.1 ZIMBABWE

In this chapter, the section on Zimbabwe is drawn almost entirely from a recent report by Vulindlela Micro and Development Finance Consultants for ZAMFI that was executed in 2000. Ebony Consulting has adjusted some of the findings marginally and added information from other surveys. Ebony Consulting assessed the work and found it to be of good quality and appropriate to base planning for support of the sector.

The purpose of the survey was to review the micro-finance sector in Zimbabwe in order to streamline initiatives, understand the constraints and assess the financial gap. It is envisaged that this survey would provide the baseline information for a series of annual surveys to follow.

3.1.1 Country Overview: Zimbabwe

The demand for micro-finance services continues to grow as more and more people enter the informal sector to supplement their incomes. At the same time, profit margins are becoming smaller owing to cut-throat competition in the sector, shrinking of consumers' disposable incomes and general increase in input costs.

It is generally agreed that the micro-finance industry is as yet in its infancy in Zimbabwe and therefore delicate. The sector still needs technical and financial support as the numerous micro-finance institutions (MFIs) are young and treading uncharted waters. Although there has been a general increase in the number of suppliers of micro-finance, the real growth in portfolio sizes has been very slow. Against that background, it is sad to note that the level of external financial support has gone down as a result of a shift in policy and priority by national governments represented in Zimbabwe. Rough estimates indicate a financial gap of over Z$3 billion in loan capital to meet the demand of the MSE operators. In order to manage that level of funding, another Z$700 million is required to sustain the operations of the MFIs. It is foolhardy for any investor to push through loan capital and not invest in the human and technical elements of the MFI as this eventually determines the success of the venture.

One major aspect noted during this study was that the government has been positive about the growth of the micro-finance sector, as evidenced by the existence of facilities such as the Social Development Fund on-lending window. At the time of this report, the government has been applauded for making specific mention of micro-finance in the budget, with a provision of Z$200 million. However, it is regrettable that it is not putting maximum priority on co-ordinating the creation of an enabling environment and formulation of a policy framework for the sector.

There is a definite need for concerted efforts among key stakeholders in making micro-finance a success in Zimbabwe. Solid, financially sustainable institutions need to be built to deliver loans in an efficient manner and in large volumes. The challenge for stakeholders in the micro-finance sector, therefore, is to ensure that funds are channelled to MFIs with potential for growth. Such funding should not be restricted to loan capital but extended to institutional building as well. Secondly, by investing in governance development and general human resource development, stakeholders may be able to build a recognized industry. Thirdly, private sector participation should be encouraged to ensure that the sector becomes more market oriented, competitive and professional. Fourthly, the fragmented policy framework needs to be addressed. Stakeholders need to begin reviewing the regulatory environment, investigate options and engage government in a consistent dialogue to resolve the various impediments constraining the industry.

Rural finance in Zimbabwe suffers greatly from the current political situation and the recent restructuring of the AFC into Agribank and the Agricultural Development Fund has not shown any promise in improving the plight of rural entrepreneurs and small farmers.

Constraints to Micro-Finance Development in Zimbabwe

Development of the micro-finance sector in Zimbabwe is constrained in two major ways, i.e. organizationally and environmentally.

- Lack of sufficient funds for training and capacity building: In the MicroStart Project Document[1], areas of support listed for Zimbabwe include capacity building, institutional strengthening and capacity development for micro-finance. There is a realization that before money can be invested in the sector the capacity of the institutions needs to be developed to enable them to manage resources properly. While investors are expecting professional delivery of service, most MFIs can neither attract nor afford professionals. The major constraint to the growth and development of the micro-finance sector is the lack of institutional capacity within existing MFIs. Most are still battling with pertinent issues of human resource management, governance, systems development and financial management (including delinquency management). These are the key issues that make or break MFIs anywhere in the world. Institutional capacity building should be a national programme. The UNDP MicroStart programme was a good initiative, but was withdrawn, being applied for only one year instead of three.

- *Donor demands not consistent with MFI vision:* The ZAMFI sector survey showed that 40% of MFIs considered donor requirements difficult to comply with, noting that their visions were not necessarily the same. Among the constraints are issues of reporting requirements, reporting schedules and strategic focus. With regard to strategic focus, issues to consider include male/female emphasis, as well as urban/rural focus. It is believed that this leads to programmes being donor driven.

- *Lack of private sector investment:* Privately owned MFIs get funded through the sale of shares or by holding companies. There has been little participation by the private sector in funding MFIs with a focus on business loans. Many privately owned MFIs are involved in consumer lending rather than enterprise lending. Once enterprise lending proves successful, many private investments may be channelled in that direction. Some success stories are needed to enable the private sector to appreciate the economic benefits in the sector. These can be championed in a number of ways,

[1] Pearson, R. Peters, M. MicroStart Zimbabwe project document, December 1997

such as building an MFI in collaboration with leading technical service providers. Through such collaboration, the technical service providers would mentor the MFI and impact on its management skills. In some cases, resident advisors are co-opted by the MFIs and it is hoped that during this association a lot of capacity building could be done. The MicroStart project in Zimbabwe is but one example of such collaboration.

- *Savings not a legal source of funding:* The majority of MFIs who are not members of SACCOs cannot utilize savings of their clients to on-lend. The “savings” can arise, for example, in the form of collateral deposit. What tends to happen is that the MFI collects these “collateral deposits” and places them with a financial institution until they are returned to the client when he or she repays the loan. Perhaps some linkages with financial institutions could provide a win-win situation between the MFIs, the banks, as well as entrepreneurs.

- *Regulatory framework:* While there is a clearly streamlined policy framework for the formal financial institutions, with different acts governing specific activities, there is no such instrument for the micro-finance sector. However, one wonders what form and nature the micro-finance regulatory framework should take. Given that the industry/sector is still young, there is still a lot of experimentation and shaping up, so enough time should be allowed to ensure that the sector develops with minimum regulatory constraints. Thereafter, the framework may be instituted through a dialogue process. In South Africa the various stakeholders, including the government, agreed to the formation of a self-regulatory body, the Micro Finance Regulatory Council (MFRC)[2]. Countries such as Ghana, Bolivia and Peru are quite advanced as they already have passed laws that promote formation of Private Financial Funds, as well as their regulation. One caution should be added, however. The process is lengthy and highly participatory – anything short of that may result in the creation of a monster that will further constrain the industry. The major regulatory issues that need to be addressed urgently are registration and the interest rate cap.

- *Client mobility:* institutions prefer dealing with clients of fixed abode as security for their investment. The clientele for the micro-finance sector either changes residence within a city or relocates to other places in search of better markets. This causes the

[2] MFRC comprises the Department of Trade & Industry, Banking Supervision Department of the Reserve Bank, National Housing Finance Company, the Land Bank, the Alliance of Micro Enterprise Development Practitioners and the Micro Lenders Association. The MFRC accredits and ensures protection of consumer rights, as well as discrediting practitioners who may not be complying with the stipulated requirements.

lending institutions to incur huge operational costs as costs for follow-ups and tracing are high.

- *Credit bureau:* With the MFIs increasing in number, a clearing facility to screen defaulters has become imperative. Already a number of MFIs have been funding the same defaulters, thereby affecting their loan books. It is therefore apparent that the lack of such a facility is a constraint to the development of the micro-finance sector. Furthermore, such a facility would provide those clients with a good credit history with the opportunity to build a record that becomes an asset even for accessing larger loans from formal financial institutions.

- *Harsh environment:* The macro-economic environment is very harsh, demanding highly competent managers who are innovative and can respond quickly to market demands and changes. With inflation of above 60%, if MFIs have to operate within the provisions of the Moneylenders Act, they would actually be charging negative real interest rates!

- *HIV/AIDS pandemic:* The Ministry of Health & Child Welfare estimates that 1 200 people die every week due to the AIDS pandemic in Zimbabwe. The disease affects the sector in that some clients or their relatives are its victims. In addition, some staff members of micro-finance institutions are either suffering from the disease or have died as a result of it. The sector thus incurs the cost of funerals, recruiting and training new staff and loss of productivity.

- *Political stability:* Volatile political situations negate the growth and development of the micro-finance industry anywhere in the world. The period since the beginning of 2000 in Zimbabwe bears testimony to that. After the referendum in February and parliamentary elections in June, there was much uncertainty about the political future of the nation. MFIs operating in areas where the situation is politically hostile are forced to reduce their operations, thereby reducing business output. Monitoring and business procurement by loan officers can be suspended, stopped or slowed down in areas that become political hot beds. Clients' businesses are equally affected. Markets are lost and debts are not collected.

- *Political interference within MFIs:* Political interference that influences who should receive credit and how the MFI should be managed has affected the growth of the sector as operations tend to be managed at the expense of the laid out procedures, with damaging results. Through political interference, loan beneficiaries often ignore repayments. In some instances, there is political interference with the appointment of board members of NGO-based MFIs.

- *Lack of incentives:* Currently, there are no incentives to attract serious players into the market. If the government perceives this sector as a high development priority with potential to create jobs and increase household incomes then there should be incentives for participants. Examples would be tax breaks for the first five years, as is the case with enterprises at growth points.

It is clear that the micro-finance sector in Zimbabwe is riddled with many problems that need to be addressed. At the moment, it is very difficult for any institution to operate efficiently in the Zimbabwean context, let alone institutions with as many internal constraints and weaknesses as those in the micro-finance sector.

3.2 CHIMANIMANI

3.2.1 Formal Sector Financial Services

Formal financial institutions in Chimanimani are:

- Four Post Office Savings Banks (POSBs), which provide savings facilities only. These are in Ngorima, Ndima, Nyanyadzi and Cashel Valley.
- Two commercial banks, viz. the Commercial Bank Of Zimbabwe (CBZ) and Beverley Building Society, are situated in Chimanimani urban. CBZ has up to now managed to provide loans through the guarantee of SAFIRE to 12 members who are moulding bricks using river sand. The building society is concentrating on mobilizing savings deposits rather than providing loans for any other purpose, except the construction of low-income housing projects.
- Credit Against Poverty (CAP), although registered, is considered an informal MFI. It is a non-deposit taking institution operating in Chimanimani, with offices in Chipinge. Its outreach to date is about 450 clients in Chimanimani. The typical loan size is Z$5 000. Loans are given to women clients only for agriculture and non-agricultural enterprises.
- The Grain Marketing Board (GMB) also provides loans to dry land and irrigation maize growers in the district. So far, it has given loans to 80% of the Nyanyadzi irrigation farmers and 20% of the dry land farmers. GMB's average loan size is Z$10 000. The loan is given in kind, i.e. in the form of maize inputs.

The Agricultural Finance Corporation, which used to be the major source of credit, and SEDCO are no longer operating in the area. This means the bulk of the savings are exported and used outside the district. Savings and credit co-operatives are non-existent in the area and the few women-based rotating savings and credit programmes have minimum coverage, usually confined to villages.

The banks that provide better financial services like the commercial banks and building societies are in Mutare (Z$1 000 return bus fare) and Chipinge (Z$600 return bus fare). With savings clubs and burial societies providing insignificant services to the community, the POSB perceived as unfriendly, and other banks several bus fare dollars away; there is definitely a gap in the area for savings facilities. The community leadership expressed the need for easily accessible, friendly savings facilities.

Over the years, Chimanimani has been unable to access institutional credit services from MFIs until the introduction of Credit Against Poverty in 2001. CAP was founded in 1995 from seed capital supplied by Grameen Bank of Bangladesh. It is a relatively small organization, with one officer in the neighbouring Chipinge district providing credit facilities to clients in Copa, Mutsvangwa, Paidamoyo, Tonhorai (irrigation scheme), Ndima, Hotsprings, Mawamba, Nhowe and Chakohwa irrigation scheme. To date, 200 clients have received loans from CAP in Nyanyadzi and Mhakwe wards, although the loan officer claims to have managed to recruit and establish some 140 groups with 560 members. The loans are given to women clients for both agricultural and non-agricultural activities – gardening, vegetable and fruit vending, general dealers, sewing, jam and fruit canning, buying and selling. The gender discriminatory policy, however, disadvantages male clients, who are the majority plot holders in Nyanyadzi. The absence of a resident loans officer who is easily accessible to the clients has greatly disadvantaged CAP in the area. Clients' questions on CAP are only attended to during repayment sessions. Discussions with some clients indicate very little knowledge of CAP despite the five-day training undertaken. The repayment for the first round of loans is 100% and demand outstrips supply.

The Grain Marketing Board (GMB) provides credit facilities to the farmers in Nyanyadzi Irrigation scheme in form of crop inputs. The average loan size is Z$10 000 and is paid back soon after harvesting and marketing. Some 80% of the irrigation farmers and 20% of the dry land farmers have received such loans. ADAF, which used to be resident at Nyanyadzi, providing loans to Ndima, Ngorima tea and coffee growers and Nyanyadzi irrigation scheme farmers, has since closed its offices.

The Post Office Savings Bank (POSB) is another state-initiated parastatal that provides savings facilities to small savers through a network of almost 200 post offices around the country. It offers demand and fixed deposit facilities to small, medium and micro-enterprises in rural areas. The bulk of the money is invested in government securities and placements within commercial banks. This means that money deposited through POSB is a net withdrawal from the rural areas to investments elsewhere. It has to be noted, however, that since the financial liberalization, deposits into the POSB have been steadily declining but steadily increasing in commercial banks (ICC, 1999). This has been attributed to the fact that POSB does not provide lending facilities and imposes stringent withdrawal arrangements.

3.2.2 Chimanimani: Informal Financial Services

The high potential areas receive a lot of income from fruit and vegetable production annually. However, the money is received as and when the marketing intermediaries come to buy. Although some regular buyers have established a routine for their purchases every week, by and large the income comes irregularly. This has created a need for easily accessible savings and credit facilities.

There is at least one rotating savings club initiated by women in each area. Small “stokvel” amounts are saved and passed to one member of the group each month, which is normally used for purchasing kitchen utensils. At least one burial society exists in each ward, normally initiated through churches like the United Baptist Church. Small amounts ranging from Z$5 to Z$50 per month are saved. There is a common understanding in the villages that everyone contributes Z$5 and 2kg mealie meal once a member of the village dies. These social obligations honoured through the generations negate the usefulness of burial societies in the area.

3.2.3 Main Implications for Micro-Finance (Chimanimani)

- Access to credit for micro-enterprises in Chimanimani is very limited. The few formal sector lending institutions that exist either do not cater for clients without adequate traditional collateral security or do so only for specific needs, such as seasonal agricultural input requirements.
- Informal sector lenders are reported to be few and, in general, small and weak. In addition, such savings and credit associations as there are – whether co-operatives (SACCOs) or rotating – are confined to lending only to their own members.
- One registered micro-lender has now begun to operate in about half of the wards in the district, but is still very small, lends only to women on a group basis, and has yet to prove its viability.
- Given the substantial and increasing demand for micro-loans from the informal sector (see 2.1.5), there is an urgent need for sustainable expansion of micro-lending in Chimanimani.
- There is also an urgent need for new, more widely distributed and more user-friendly savings facilities – formal or informal. While meeting this need could be combined with responding to the demand for more micro-loan facilities, linking the two would probably be the slower, less effective path, particularly for advancing credit.

- A more enabling public policy framework – engineered jointly by regulatory authorities, wholesalers/donors and retail micro-financiers – would be an important step in accelerating the growth of sustainable MFIs.
- In addition to capitalization, donors can contribute most effectively to helping build the industry by:
  - assisting only MFIs that demonstrate real potential for sustainable growth;
  - funding and providing technical assistance for human resource development – probably best achieved by supporting training initiatives independent of but geared to the needs of MFIs;
  - ensuring the closest possible alignment of their own and indigenous partners' objectives and needs; and
  - maintaining their support for the industry during the current political turbulence.
- It is an exceptionally difficult time at which to attempt to launch new business initiatives, but also an exceptionally valuable one if it can be done successfully.

3.3 MOZAMBIQUE

The section on Mozambique is largely drawn from a recent study by ICC (Mozambique) on "Micro-Finance in Mozambique". The report was executed for MICRONET, the Mozambique Micro-Enterprise Network. With support from CARE Mozambique, and in collaboration with the Ministry of Agriculture & Rural Development (MADER) and UNDP/UNCDF, the Mozambican Micro-Finance Facility (MMF) commissioned the present study to document developments in micro-finance since the 1998 study. Micro-finance institutions (MFIs) are defined as NGOs, associations, co-operatives, individuals or other institutions that provide financial services of credit and/or savings in monetary form and of values less than US$1 000. Therefore, credit in kind is not analyzed in this study.

The objectives of the study were to:

- assess the level of development of the sector in Mozambique;
- analyze and document how the micro-finance sector has evolved since 1998;
- compare current practices with recognized good micro-finance business practices;
- identify challenges and constraints for the sustainable development of the sector.

Ebony Consulting felt that this was a comprehensive study and would serve as a good basis on which to do any planning for interventions in the micro-finance sector in Mozambique. Additional sources were added where necessary.

3.3.1 Country Overview: Mozambique

This overview is a summary of the main points, which shows that a professional business approach is needed. Micro-finance is a high-volume/low-margin business; MFIs must therefore develop products and systems that maximize outreach to achieve economies of scale and scope.

Positive returns on assets are achievable but require vision, commitment and financial innovation by management. Achieving commercial viability requires that providers and donors change the way they do business: from a poverty alleviation project perspective to one that builds viable financial services at the micro retail level; from a project document to a strategic business plan; from arbitrary pricing of products defined by donors to financial pricing of products that meet changing demand; from projects managed and staffed by development specialists to institutions managed and staffed by professionals who understand finance and business; and from project reports to monitor impact to financial statements and reports used to monitor profitability, etc.

This drive for commercial viability has important implications in a number of areas, namely: governance structures, ownership, management and financial transactions with the funding partners. The thrust of the business needs to be clarified to establish what are the trade-offs between poverty alleviation and the drive for financial sustainability. Funding strategies need to be defined to leverage donor equity to achieve scale and financial viability.

Performance measures need to be put in place to track the performance of the institution towards commercialization. Outreach (which measures business volume and market penetration), portfolio quality (which measures the health of the MFIs main asset, its portfolio), efficiency (which measures staff productivity and efficiency of operations) and profitability (which measures its ability to cover costs and operate without subsidies) need to be monitored constantly by the MFIs and their partners.

These guiding principles were used in analyzing the evolution of the micro-finance sector in Mozambique over the last three years.

The preliminary results of the study highlighted major changes in the micro-finance sector in Mozambique and indicated that the sector is still in a growth stage. The number of individual initiatives/operations providing financial services to the poor in Mozambique is virtually unchanged since 1998. However, the turnover rate has been enormous: many operators stopped their micro-finance activities (e.g Help Age, Helvetas, ISCOS, Oxfam and Papir) and many new ones have also been started (e.g. CCDR, CCM, ILRP/CARE, Karibu, Kulima, Kwaendza, Novo Banco). This "sector restructuring" is partly due to increased awareness of good micro-finance practices among donors and operators alike. This has pushed some operators to evaluate their involvement and comparative advantage in micro-finance, and to decide either to start a micro-finance operation or cease operations.

In 1998, most operations were projects of the government or international NGOs. Today, there is a larger presence of local legal entities, with some becoming independent institutions. Most programmes are still very dependent on expatriated management or on foreign technical assistance but, in some cases, they are taking measures to create local capacities.

In June 2000, there were 16 000 active clients, about three times as many clients as in 1998. Given that these clients are being served by virtually the same number of institutions as in 1998, the average outreach has also increased. Most institutions are serving the poor (with average outstanding loan balances of less than 20% of GNP per capita) and providing mainly credit services, although 22% are providing savings, but few provide related services such as insurance or training.

The geographic dispersion is much wider than in 1998. Most provinces have at least one initiative in operation, while some operators are now serving the rural areas ("distritos"). Clearly, the rural areas are still not adequately covered but expansion is underway and, at least in the case studies, seems to respond to identified market opportunities rather than from external pressures. This is encouraging as it provides the path to serve rural areas in a sustainable way. Furthermore, according to the operators' plans, the number of active clients will surpass 60 000 by 2002.[3] With most of the operators planning to expand to new districts (more than 70%) or new target groups (more than 50%) the geographic coverage should increase significantly.

Unlike in 1998, the operators are targeting most market segments using a variety of methodologies, terms and conditions. On average, women represent 57% of the customers and are mainly involved in informal trade (40%), agriculture (25%), small industries (25%) or services (10%).

In general, most products seem to be adapted to the needs of the market and apply good micro-finance business practices. It is interesting to note that the products offered are

[3] ECI considers this estimate over ambitious as many aspects militate against reaching these figures. These aspects include a lack of access to funding, a lack of capacity in institutions to make the leap to commercialization and an underdeveloped overall financial infrastructure in the country to assist the outreach of institutions, while improving the sustainability. The situation is even worse in rural areas.

mainly in credit, with few savings or insurance offerings. The most widespread methodology is the solidarity group with self-selected members.[4] The terms, conditions and procedures vary. Initial loan sizes are US$20-30 (300-500 000 meticais), which can increase in subsequent cycles to $300-600 (5-10 million meticais), with repayment periods from three to six months. Some operators offer larger loans to small groups of farmers or small enterprises.

Interest rates are from 3% to 6% monthly, usually charged on a flat basis. In most cases, these are set based on the prevailing market rate, which indicates that they are not subsidized. Non-traditional guarantees are widely used, with most operators using solidarity groups as a pressure mechanism in place of real warranties. This is good as it allows significant outreach while reducing costs. Some operators demand savings or other types of compulsory contributions or goods as a warranty, particularly in the case of individual lending.

In relation to 1998, the number of operators offering savings seems to have increased. In total, these institutions have 4 213 customers with savings and a total of US $112 500 (1,8 billion meticais) in deposits, which represents an average saving of $27 (400 000 meticais) per person.

The good business practices in micro-finance seem to be better known than before. In 1998, most operations were projects of international NGOs or the government; today, there are a significant number of local institutions with an independent legal entity. Furthermore, there is a trend, particularly clear in the case studies, towards becoming truly independent local financial institutions. Also, over half the operators have a board of directors and have developed a business plan in the last year.

Procedures, policies and systems have also improved. Most operators provide regular training to their staff and some, particularly those of the cases studies, have an incentive scheme for credit officers. In terms of their Management Information Systems (MIS), the results of the study are mixed. Few operators could provide information about their portfolio quality, their income or their operating costs, which is an indication of an inadequate MIS. However, the case study MFIs have invested or are in the process of investing significant efforts and resources in designing or adapting an MIS suitable to their needs. They were able to provide standard financial information.

4 Note that we could not obtain figures on dropouts from these programmes. Our experience in Africa indicates high dropout rates, especially in solidarity programmes. Dropout rates as high as 50-70% have been recorded in similar programmes in East and Southern Africa. The experience is that these dropout rates are caused mostly by inappropriate product design and delivery, so we question the statement on the well-adapted products offered by these institutions.

All these are important steps towards becoming an independent, commercially minded, self-sufficient institution. However, the study also shows that the majority of intermediaries are at the start-up phase, with only a few at the consolidation phase. Most of the operators in Mozambique are very young: only two have been in the market for more than six years and only ten for more than three years. They are still subsidy dependent, have a small outreach, weak financial management skills, weak ownership and governance structures, and weak operational systems and business planning.

Although the number of active clients has grown substantially, it is still small for a country of Mozambique's size and population. Only one operator, FCC, has more than 4 000 active clients and another four each have more than 1 000 active clients. Only one, SOCREMO, has an active portfolio of about US$500 000 (eight billion meticais). Another four have an active portfolio around $100-200 000 (1,5 to three billion meticais), while the remaining operators' portfolios are below $50 000 (0.8 billion meticais). Although these numbers represent a significant improvement since 1998, they are clearly small and below those needed to become self-sustainable.

The performance of the six institutions of the case studies is still below that of other small African MFIs (as reported in the September 2000 issue of the MicroBanking Bulletin). Their portfolio quality is, in general, adequate as indicated by portfolio at risk below 5% of the total outstanding portfolio, but they generally have a lower portfolio yield and are further away from operational sustainability. Only SOCREMO has a similar coverage of its operating costs and portfolio related income to its African colleagues. At the time of the study, only one institution, TCHUMA, financed part of its operations with commercial sources. However, according to the plans presented, most have the objective of reaching operational sustainability and accessing commercial sources of funds in the next five years.

Since 1998, the Bank of Mozambique (BM) has issued a decree to regulate micro-credit activities. While this is an important first step, it is not clear why only some operations have been registered and why those that are registered do not submit the required financial performance information to BM. In any case, it is obvious that additional efforts on behalf of BM are needed to enforce compliance and establish explicit performance indicators and thresholds for obtaining a formal licence, specifically designed for micro-finance operations.

In summary, it could be concluded that micro-finance institutions in Mozambique are typically not yet viable but still dependent on donors. In understanding the challenges that MFIs face it is important to distinguish between local MFIs and MFIs with strong support from international partners. The latter, in general, tend to be bigger, are usually registered with the Bank of Mozambique, have some sort of MIS system with which they can produce frequent reports to monitor their portfolio and costs, and use a selection of ratios to monitor their performance. They usually have some business projections and plan to reach sustainability sometime in the future (five to ten years). Their challenge is to increase their size significantly to reach sustainability by building local human and management capabilities, improving their current systems, policies and procedures and accessing additional funds. This trend suggests the importance of continued technical support being provided by the international partner.

The local MFIs, particularly those with no “permanent” technical partner, tend to be smaller, are not usually registered with the Bank of Mozambique, have weak or no MIS and do not use financial information to monitor their performance. They usually do not know or do not apply micro-finance professional standards. Their challenge is to develop systems, policies and procedures and to build their capacities before trying to increase their outreach. Acquiring the technical input to address these institutional weaknesses will depend on the commitment, as well as entrepreneurial spirit and ability of the operators.

As in 1998, it is important for all stakeholders to commit to this process of becoming professional. Donor support, whether under the new programmes – MicroStart[5] and the Mozambican Micro-Finance Facility (MMF) – or directly, should be conditional on the MFIs complying with BM registration and minimum reporting requirements.

It is clear that we are looking at a young, fledgling industry, that has a long way to go in terms of capacity, maturity and outreach. The industry has a low market penetration and limited outreach, and these institutions are not generally self-sustainable.

3.4 CHIMOIO

3.4.1 Formal Sector Financial Services

Banks located in the district of Chimoio are Banco Internacional de Moçambique (BIM), Banco Comercial de Moçambique (BCM), Banco Austral and Banco Standard e Totta de Moçambique (BSTM). Except for Banco Austral, which has more than one branch and is strongly represented outside Chimoio city, and BCM, which has small centre presence, they are present only in the provincial capital.

[5] The MicroStart programme in Mozambique is managed by ECI.

Five NGOs are known to operate some form of micro-finance service in Chimoio:

- Small Industry Foment Fund
- Concern Manica
- UCAMA
- Kwaedza Simukai Association
- CRESCE

Of the five, information has so far been traced only on CRESCE, a licensed MFI started in 1996 by CARE Mozambique. The information is drawn from a report on five MFIs selected for a detailed study because:

- their level of outreach and portfolio size are significantly greater than average for Mozambique;
- they are run along business principles;
- they have relatively sound operating systems, policies and procedures;
- they are striving to become independent self-sustaining financial institutions; and
- they show signs of accessing commercial sources of funding.

These characteristics provide a useful thumbnail description of the organization and suggest that, although its operational sustainability is only at about 41% (still the second highest in the group), it has the potential to fulfil a considerable part of the district's needs for micro-credit.

In addition to in Chimoio city itself, CRESCE operates in the neighbouring small urban centres of Gondola and Manica, as well as in Zambezia and Sofala provinces and in the large urban areas of Beira and Quleimane. An emphasis on developing the business more on market opportunities than on the availability of donor funds is evident.

The total client base is currently about 2 000, a little over 40% of whom are women. No figures are available for Chimoio specifically. Most clients reside in or near urban centres or markets and could be classified as middle-income earners. Average loan size is about one million meticais (just over R500 or US$50), while the average time period varies between from two and a half to five months. To increase the size of its target market, CRECSE may need to write more small loans, as does its largest and most self-sustaining rival, SOCREMO. The most common use of loans is to provide working capital.

To overcome the general lack of traditional asset-based collateral security and to reduce information and transaction costs, CRESCE – in common with the other four institutions in the study – lends mainly to individuals who are part of solidarity groups, demanding only a 10% upfront savings deposit. Recovery rates are reported to be exceptionally high, with less than 2% of the portfolio being more than 30 days in arrears and less than 1% more than 90 days behind. At 1% per week, the effective interest rate is about 87% per annum – more or less in the middle of the group.

3.4.2 Chimoio: Informal Sector Financial Services

Local rotating savings and loan groups are known to operate in the district, though no information is available about numbers. Best known are those called *Xitique*, whose members are mostly women. The rotating payout is sometimes used for start-up capital for micro-enterprises. Further information about other sorts of informal financial groups, such as burial societies, is awaited.

3.4.3 Main Implications for Micro-Finance

- Data collected in Chimoio indicates that very few micro-enterprises in the district have been able to access micro-credit. Those formal sector MFIs that do operate there tend to have quite specific, limited target markets, which exclude many categories of micro-enterprise. Given the growing reliance on informal sector employment, there is an urgent need to broaden access to micro-finance.

- Much more research is required to assess the extent of informal sector MFI activity. But however extensive it is, access to credit can be expected to be confined to members of relatively small savings groups.

- Access to formal sector savings facilities is also limited, with banks operating branches in only the largest urban centres. At this point, lack of adequate information about informal sector MFIs prevents firm conclusions about the need for additional micro-savings facilities.

- The growth strategies adopted by the larger, better established MFIs suggest that the industry as a whole is moving towards far greater outreach and sustainability. It should be remembered, however, that this is from a very low base. A great deal remains to be done to realize the potential now becoming apparent. In particular, institutional strength needs to be gathered as a first priority, with less emphasis being placed at this stage on client and product expansion.

- Public policy needs to be reformulated to provide for the evolution of MFIs into a wider, more flexible range of institutional forms than the present two options – commercial bank or savings co-operative – and to incentivize MFI-private sector partnerships.

- Donors can play an important catalytic role, for instance, by:
  - selecting only MFIs with real potential for sustainable growth for partnership/support;
  - helping capitalize micro-lenders, who, by law, may not take deposits to raise capital and who, for the most part, are not yet able to borrow in the commercial market;
  - providing technical assistance and training to enable local MFIs to develop their institutional capacity;
  - aligning their own objectives, criteria and operating requirements as closely as possible with those of their local partners, whose agenda should be driven by the market rather than donors; and
  - assisting with the enforcement of public MFI regulations.

3.5 SOUTH AFRICA

In this section, a comprehensive overview of the rural finance situation in South Africa has been provided, drawing on several data sources.[6] Firstly, an overview of the micro-finance market in general is provided. The services supplied to rural people and specifically to small farmers are then highlighted. However, it is clearly impossible to ascertain the exact use of loans disbursed in terms of location and target group. This will represent a general view and an overview of the supply side of the market. Secondly, the situation is presented from the demand side. This will be based on the results of recent small farmer and rural surveys, specifically a survey executed in 1997 and a 2000 survey on informal credit.

3.5.1 Country Overview: South Africa

The demand for banking services by the lower income strata of the population in South Africa is growing rapidly, due to a variety of factors. These include the current low frequency of use of formal banking services by the poor and MSE[7] market; increased income of the lower income strata; income redistribution in favour of lower income people; urbanization; rising consumer aspirations; the rapid growth of the informal

6 Ebony Consulting based large parts of this section on work executed for the Department of Trade & Industry while doing an interest rate study in 2000 and subsequent work for the DGRV on rural finance in South Africa. Both studies contributed substantially to the knowledge on these issues in South Africa.

7 Micro and Small Enterprise (including small farmers).

business sector; and, perhaps most importantly, the relaxation of the Usury Act on loans below R6 000 in 1992 and more recently to loans below R10 000. As a result, there has been considerable growth in the micro-finance sector. The biggest source of growth is from the micro-lending sector. The conventional, formal banking sector seems inappropriately structured to satisfy this rapid growth in demand and chooses not to engage in it directly. The "new" commercial banks (those that were formed recently through acquiring shells of banks with licences or by other methods) are emphasizing the micro-finance market, and are posting quite remarkable results.

The micro-finance sector is still quite small compared to the formal banking sector, but growing much more rapidly. Its contribution to the national economy is probably not accurately reflected in the national data as a result of the informal sector nature of many of the industry members, which leads to an underestimate of its size and contribution to GDP. The finance, insurance, real estate and business services sector is a significant contributor to the South African economy, providing approximately 15% of total GDP in real terms in 1998. The total assets of the banking sector at the end of 2000 were R800 billion, with advances totalling nearly R650 billion. In 1999, the size of the micro-finance industry was estimated at R10 to R15 billion, with advances at R10 billion (Econometrix, 1999). Recently, a comprehensive analysis of the sector estimated its size on the basis of current portfolios to be R14 billion and the value of loans written per year to be R25.8 billion. This analysis divided the sector correctly according to loan term and other characteristics, and then compiled an exposure on the basis of annualized figures. From the figures it appears that the micro-finance sector now contributes approximately 2% of the overall financial sector in rand terms, although it is clear that this sector touches the lives of most South Africans in terms of numbers.

However, any estimate of the size of the micro-finance market should also consider the definition of the market. For the purposes of this study the micro-finance market is defined as the market reflecting transactions by poorer South Africans on loans below R10 000. Poorer people are considered to be those described in marketing studies as in and below Living Standard Measurement (LSM) 6.

FIGURE 3.1 Classification of Living Standard Measurement Categories

LSM	Number (16+)	%	Female (%)	Unemployed (%)	Monthly Income (R)	Savings (%)	Biggest Problem	People in Household
1	3 738 000	15	59	80	659	4	Unemployment	3.2
2	3 560 000	15	52	74	776	7	Unemployment	3.0
3	4 294 000	18	54	72	929	7	Unemployment	2.9
4	3 314 000	14	51	65	1 244	8	Unemployment	2.9
5	2 041 000	8	52	62	1 664	8	Crime	2.9
6	1 888 000	8	58	61	2,264	6	Crime	3.2
7	2 534 000	10	50	49	5 675	5	Crime	2.5
8	3 246 000	13	49	37	9 752	5	Crime	2.4

Source: Eskom Consumer Surveys, 1998

Micro-finance also refers to the savings transactions of the poorer portion of the population. It is important to consider both savings and credit as this provide a far more comprehensive picture of the financial market within which poor people operate. Of course, there are other financial products pertinent to this stratum of the financial market. Most important after savings and loans are the transmission facilities that are an integral part of the lives of poor people, where support systems and sources often do not reside within the household. In addition, insurance products in many guises are also considered important financial products that will be demanded by the poor.

The present usage of banking and financial services by MSEs (including small farmers) is very small, with a minute section of the market – estimated at less than 1% – currently being reached. This is the most unbanked area of micro-finance, and an area that is still in the introductory phase in the micro-lending industry. No study exists which provides a comprehensive overview and analysis of overall supply to the lower income and MSE market. Existing studies provide an overview of the institutions active in this market, but do not quantify supply in terms of clients reached. This study necessitates an overview of outreach, and therefore an indicative (rather than exhaustive) summary is provided in the table below. In the next section, the institutional forms notes in the table are discussed in more detail, focusing on their future role in the lower income and MSE market. The purpose of this overview is to gauge future formal support to this stratum of the financial sector. After this, an attempt is made to estimate the rural portion of clients served by each institutional format.

Aggregate Supply

The present supply of micro-finance services in South Africa is presented in Figure 3.2 on the next page.

FIGURE 3.2 Summary of Retail Outreach in the Micro-Finance Market in South Africa (1999/2000)

Retail Institutions	Loans Rm	Savings Rm	Outlets	Estimated % Rural	Loan Accounts	Savings Accounts
Public Sector	330	1 646	2 440	36	78 000	2 840 000
Land Bank	30		25	80	43 000	
Provincial Parastatals	300	600	50	80	35 000	840 000
Post Office Outlets		1 046	2 365	35		2 000 000
Private Sector	12 599	4 661	17 132	38	7 951 580	4 740 100
NGOs	108	5	30	35	66 000	
Village Banks		1	10	100		1 100
Credit Unions	9	10				6 000
Co-operatives			1 200	80		
Commercial Banks	12	4 000	4 000	33		4 000 000
Retail Stores	5 000		1 000	35	2 173 913	
TEBA Cash	130	600	172	40	86 667	700 000
Private Sector	40	45	20	100	25 000	33 000
Registered Small						
Loans Industry	7 000		5,700	35	5 600 000	
Pawnbrokers	300		5 000	35		
Informal Sector	400	1 760	1 150 000	35	0	14 750 000
Mashonisas	150		25 000	35		
Burial Societies		1 560	325 000	35		6 500 000
Stokvels	250	200	800 000	35		8 250 000
Total	13 329	8 067	1 169 572	35	8 029 580	22 330 100

Public Sector

Land Bank

The Land Bank has largely reformed itself in terms of its political positioning. However, its systems and products, as well as clarity on mandate, have not materialized as clearly. In the micro-finance arena, the Land Bank managed to launch its Step-Up product successfully in April 1998. It is currently approaching 43 000 clients and the repayment level is around 80%. The product is handled by the Start-Up group in Cape Town and the payments and accounts system by First National Bank and the Post Office Savings Bank (Post Bank). The intention is to expand this product. It starts at loans of R200 and the ceiling of the last repeat level has recently been increased to R20 000. The mere fact that the Land Bank is entrusting this product to an agent indicates its approach to co-operation and its use of third parties. It lacks a service structure since it has only 25 branches. These branches service its biggest income sources, namely individual farmers and co-operatives. The Land Bank does extend loans (maximum R50 000) to emerging commercial farmers in its bronze range of products.

Provincial Parastatals

A wide array of failures and limited success is a good summary of the state of the provincial parastatal financial institutions (previously homeland institutions). We concentrate only on those providing financial services. The majority of the retail development finance institutions at provincial level are experiencing severe financial problems, based on a combination of inefficiency, bad policy and strategy, and a severe decrease in government transfers.

One successful institution is the Ithala Development Finance Corporation in KwaZulu-Natal. This institution is the second biggest public sector mobilizer of savings (after the Post Bank). Most of the rest of the parastatals are in decline. This will leave a tremendous vacuum, and there is already a large number of clients with no access to services. In the Eastern Cape a small rural bank has been formed from the ashes of two conventional homeland agricultural banks that were closed recently. The problem with most of these institutions is a lack of physical premises and outreach (i.e. they have no branch network).

The reformed parastatal banks are increasingly similar in their approaches to the enterprise lenders, except that they have a far greater existing investment and base from which to build. Some have savings as a resource (like Ithala, with approximately 800 000 clients) and others have institutional investors, which provides them with cheaper access to capital. Some of the largest lenders include Land Bank (which now has a micro-lending portfolio of 43 000 clients, but an outstanding book of only about R30 million) and Ithala.

Post Office Savings Bank

The Post Bank has the second largest reach to commercial banks on a national scale, but not all branches of the post office provide saving services.

FIGURE 3.3 Summary of Type, Number and Volume of Accounts at the Post Bank (Aug 98)

Products	Number of Accounts	Share (%)	Balance (Rm)	Share (%)	Distribution (Mostly)
Savings Bank	1 755 880	85.9	699.6	73.5	Rural
Telebank	224 173	11.0	43.6	4.6	Urban
Savings Certificates	63 507	3.1	208.7	21.9	Urban
Total	2 043 560	100.00	951.9	100.0	

The Post Bank has recently completed an investigation into the feasibility of providing loans to existing savings customers. This report has not yet been implemented.

Private Sector

NGOs

NGOs form an important part of the financial market fabric in rural areas around the world. The problems of conventional development finance policy appear to make NGOs a promising option in the field of financing small and micro-enterprises. This view is based on a belief in the ability of NGOs to reach the target clients and capitalize on the vacuum left by the closure of many specialized credit institutions in developing countries. The NGO lobby became quite strong and NGOs have been elevated to the status of saviours of the poor.

However, experience shows that NGOs providing financial services generally need continued subsidization, which reflects their inability to provide answers to the retail financial services problem. This does not necessarily imply that NGOs are bad institutions. They simply are not the right instruments to be applied in expanding retail financial services on a substantial scale. This view is echoed in the Strauss Commission's Final Report (Strauss Commission, 1996)

FIGURE 3.4 Profitability of NGOs in South Africa compared with a Latin American Survey

	Small Enterprise Foundation	Get Ahead Foundation**	Rural Finance Facility**	Latin American Comparison*
Loan volume per staff member (R)	26 807	26 138	96 145	54 000
Interest earned/average portfolio	46	42	34	45
Interest paid/average portfolio	14	47	15	29
Gross financial margin	32	–5	19	16
Non-interest exp./average portfolio	134	153	120	72

* Adapted from Schmidt and Zeitinger (1995) and Strauss Commission (1996). An exchange rate of R3.00 = US$1 was used for the 1992 figures. The interest earned/average portfolio percentage is based on an assessment of interest in real terms. The use of the Latin American comparison is indicative; these are averages based on a study of 15 NGOs in the region.

** Closed recently

Although the coverage of NGOs by the Strauss Commission was not exhaustive, it was concluded that NGOs have very limited coverage in rural areas. The Commission also calculated that these institutions have high operational costs, which impacts negatively on their sustainability. When comparing local financial services NGOs with international surveys, indications of higher efficiency in the international institutions are visible.

Micro-enterprise lenders are a special group in the micro-credit industry. Around the world, micro-finance is associated with enterprise development finance, though in South Africa micro-enterprise finance accounts for a very small portion of the micro-credit market. Though some "consumption" lending may go towards financing productive activities, micro-enterprise finance comes largely from NGOs and trusts. There is very little overt micro-enterprise finance from the commercial banking sector in South Africa, which has put a floor of R50 000 on enterprise lending. Khula is the major financier of enterprise finance and reports that there was R108 million outstanding among about 26 lenders, accounting for loans to 66 000 micro-enterprises. This is a tiny portion of the entire industry. Average loan sizes among the micro-enterprise lenders are in the range R3 000 to R6 000.

Village Banks

In 1994, the first Village Bank in South Africa was established in the North West Province. This was the initiative of the International Fund for Agricultural Development (IFAD) and the African Rural & Agricultural Credit Association (AFRACA). A village bank is in essence a savings and credit co-operative. Two more Village Banks were formed by 1996, after which growth in numbers was dormant until 1999/2000, when two institutions, Finasol and the Financial Services Association (FSA), started a concerted effort to increase the numbers of village banks. Registrations now stand at 60 covering five provinces.

These two institutions work independently with various sponsors and support groups to increase the number of Village Banks. FSA is the original institution that was involved in the formation of the North West Province village banks (albeit in a much less formalized format). FSA is being financed by the Department of Welfare to establish the infrastructure to support Village Banks and to ensure more Village Banks are formed. The United States Aid Agency (USAID) is financing Finasol with much the same objective. Finasol had its origin in an endeavour of the South African Sugar Association to reform or restructure its Financial Aid Fund.

It appears that there is considerable demand for collective action formats at grass-roots level in South Africa. This is indeed the premise on which most of the activities of FSA and Finasol are based. Its recent success with the formation of more groups is evidence of this local demand for financial services.

Credit Unions

Credit unions have a long history in South Africa. After restructuring, the Savings and Credit Co-operative League of South Africa (SACCOL) has now been active in financial co-operative development in SA for the past three years. Currently, 21 savings and credit co-operatives (SACCOs) are registered with SACCOL. South Africa's SACCOs have a combined membership of over 6 000, with member's savings of just over R10 million. The loan book has a balance of R9 million. All loans are issued to members who are also saving. The development of the movement has happened with minimal donor or government support. For the past three years SACCOL has received no donor support, which, while admirable, has constrained its ability and capacity to serve the "poorest of the poor", owing to the high start-up and servicing costs involved in rural development.

Co-operatives

The dominant form of co-operatives in South Africa is agricultural producer co-operatives. Most of these provide financial services to members, mostly commercial farmers, who are not entirely the focus clientele of this study. However, some 40 of these producer co-operatives have initiated project-based endeavours to assist small farmer development. Some of these services encompass financial services in the form of production loans to small farmers.

The extensive infrastructure and existing member base of these co-operatives provide opportunities in the provision of financial services to members. One opportunity exists where commercial banks do not acknowledge the asset value of milk producers' quotas provided by a sizeable local dairy co-operative. It makes sense for the dairy co-operative to attach a value to milk quotas and this presents an opportunity for linking this asset value with other financial services. The interest in financial co-operatives goes wider as farmers in the Eastern Cape/Karoo area have already expressed interest in the joining together of nearly 1 000 farmers in a financial co-operative with the objective to negotiate more favourably priced funds for production than is possible by individual farmers.

Owing to the overemphasis of producer co-operatives and the retail financial services offered by commercial banks in the past, very little attention has been given to financial co-operatives and their potential in commercial agriculture, or to extending these services to developing agriculture. The declining importance of agriculture in the portfolios of commercial banks and the costs associated with the provision of retail financial services in rural areas may provide opportunities for collective action in the form of financial co-operatives in rural areas. In effect, the withdrawal of commercial banks in Canada from some farming areas gave rise to the formation of the strong Canadian Credit Union movement. This is something that may hold true for South Africa in the near future.

Commercial Banks

In the drive towards growth and high profits, many commercial banks have merged with or acquired other institutions in order to grow market share. The five largest banks in South Africa (Standard Bank, ABSA, First National Bank, Nedbank, and BOE) presently hold over 80% of the market share. Although the mergers and acquisition approach is in line with international banking trends, closer analysis shows that for South Africa the bigger banks do not exhibit economies of scale. The banking environment itself has changed significantly during the last few years, with a clear move towards ATM and Internet banking, away from the bricks and mortar approach of the past. Old delivery channels of service are on the decline. In the market for deposits, the banks are losing ground to smaller niche banks, which are more flexible and which can target specific segments more efficiently than the larger banks.

Commercial banks only provide a limited range of services in rural areas, although they have the highest incidence of branches in the rural areas, together with the Post Office (Strauss Commission, 1996). South Africa also has a higher ratio of branches per population than elsewhere in Africa. However, this higher incidence of branches is skewed, with approximately double the number of people per branch in rural areas than in urban areas. A sharp decline in rural branches is also evident. It is estimated that whereas in 1995 approximately 50% of the South African population had easy access to commercial bank facilities, this number has declined recently to approximately 30%.

South African commercial banks are comparable in terms of development and technology to the commercial banks of Europe and the United States. Although there may be efficiency differences, South African banks are quite advanced in most aspects. It would therefore be possible to assess international trends in retail banking and expect similar trends from South African banks. Studies show that retail banking will change considerably in the future. Several issues have an impact on commercial banks. Little evidence exists to substantiate scale economies at a “macro” level for consumer banks and financial institutions. This explains the fragmented condition of the sector at present. The shape of retail banking at present seems to confirm that those forces pulling banks into smaller, more fragmented units appear to be relatively balanced with those that would naturally lead to consolidation. Consolidation is therefore slow, owing to the fact that limited exploitation of scale economies is taking place. The number of products offered by banks is increasing, which drives up the total management cost. It seems that retail banking is inefficient in its current form.

Technology is providing a counter to this trend of inefficiency. Technology revolutionizes the movement and storage of money and the distribution of bank products. In addition to decreasing the costs of current bank practices, new technologies are also creating alternative distribution channels for retail banking products. These result in far cheaper ways to reach customers than by retail branches (for instance, in the United States telephone banking is more than 50% cheaper than branch banking), and these non-traditional channels are gaining market share. It is especially younger customers who are abandoning conventional branches for the alternative technology driven outlets.

The question of the impact of these trends on rural finance also arises. The process and speed of adjustment and transformation of commercial banks will differ among countries. With increased globalization, the main constraints on change will be country-specific regulations and the ability to take up and apply technology. The banks that change the fastest will be recognizable in that they will sharply diminish their branch network, keeping only those branches with upscale or high net worth demographics. They will segment their client base and cross-sell only to those that clearly offer profit potential. They will increasingly interact with clients through electronic devices (the personal computer, telephone, Internet), and will clearly diminish the focus on rural areas, especially remote rural areas. Areas without high net worth demographics, electricity and communication channels will not be part of the new way of banking. To all intents and purposes no major expansion of commercial bank activities should be expected in rural areas. One would only expect banks to show more interest in rural communities once technology has been made accessible to rural people.

Small farmers and rural people in general will still save with commercial banks, but it will become increasingly costly to do this as bank branches decrease in number in rural areas. Commercial banks do invest in the micro-finance market, but they do so indirectly through purchasing shares in banks with micro-finance portfolios (the case of ABSA and Unibank) or by striking strategic alliances with commercial banks with micro-finance portfolios (as in the case of Standard Bank and African Bank).

To summarize:

- conventional commercial bank presence in rural areas will decline at an increasing rate;
- the farming portion of the commercial bank portfolio will further decline over time;
- emphasis will be on the agribusiness sector and larger producers; and
- financial services to farmers will be provided by the broad retail sections of banks and farm-specific portfolios will decline. This will be based on the diverse income sources of future commercial farmers.

Retail Stores

Furniture and retail store lenders are the latest entrants to the micro-finance market, primarily arriving since the creation of the Micro Finance Regulatory Council (MFRC). The furniture industry is already a R15 billion industry per year in South Africa, with about R10 billion of that being sold on credit. Historically, furniture sales have been made under the Credit Agreements Act, which restricted interest rates to the ceiling of the Usury Act, while allowing the seller to retain ownership of the goods sold as collateral. However, with the advent of the MFRC and a clearer, more transparent regulatory environment for micro-lending, many of the furniture lenders, as well as other retail stores such as Woolworths, have also entered the market. They have registered branches as micro-lenders and are actively promoting micro-loans to their regular, well-known clients. These lenders have a solid credit history on their clients and rely on a credit scoring methodology to assess risk without requiring debit orders or other deductions at the source. Most of their clients, however, are salaried employees.

TEBA Cash

Teba Cash is the institution responsible for handling the payments system of mineworkers in South Africa. It has 172 offices over Southern Africa. As they have a large compliment of savings accounts and an immediate market (the mineworkers), a banking licence has been granted recently to TEBA. It provides over-the-counter loan products (very similar to those envisaged for the Post Bank) and has a current loan book of around R130 million.

Private Sector Agricultural Firms

Started by the Financial Aid Fund (now called Umthombo Agricultural Finance) of the South African Sugar Association 20 years ago, the trend towards the establishment of private sector processors has been boosted recently by cotton ginners, vegetable processors and agents. Farmers are provided with crop establishment capital and, in some instances, production credit. Some institutions also provide extension services. This method of finance is quite common in non-farm MSEs and in contract farming. It has potential for development on a vast scale in the agricultural sector, especially if commercial farmers can be convinced to contract small farmers to ensure throughput and turnover.

Registered Small Loans Industry

The rapid growth of the micro-loans industry is the result of a gap in the market for small loans. Micro-lenders are active in making short to medium term loans available to individual borrowers who normally fall outside the formal banking network because of their inability to provide conventional collateral. This gap has been filled by institutions that combine easy access arrangements with home-grown collateral models. These operators provide credit services to clients who can supply them with proof of employment and a bank account. The small loans firm withdraws the payments according to the loan contract after each wage or salary deposit made by the employer into the borrower's bank account. This is an urban-based product that does not fit the profile of rural people, who often have inconsistent income patterns. It is not seen as a major growth industry in rural areas, except in larger rural towns.

There are major drives to organize this industry. Several associations have been formed and registration with the newly established Micro Finance Regulatory Council is compulsory if operators decide to conduct business within the exemption to the Usury Act[8]. It is expected that some of the larger more formalized operators (some of which are already listed on the stock exchange) will investigate the formation of banks soon.

The available information in South Africa fails to differentiate accurately between rural and urban micro-finance. There are several different segments in the industry:

- formal registered firms, which include commercial banks, financial institutions, Section 21 (not for profit) enterprise lenders, developmental lenders, and the larger short-term moneylenders;
- semi-formal moneylenders, which include small unregistered moneylenders who are doing it as their main livelihood, and pawnbrokers, who are not yet formally included in the money lending statistics; and
- purely informal moneylenders, such as township moneylenders (mashonisas) and stokvels, burial societies, and rotating savings and credit associations (ROSCAs).

These different lenders can be regrouped into different categories based on the type of lending in which they are involved. The first four are focused on "consumption" lending and lend only to customers with bank accounts and regular salaries (thus, they are urban orientated). The other lenders, either developmental or enterprise lenders, generally base their repayments on cash flow from productive activity. The source of repayment is the main differentiating factor between the two groups of lenders.

Short-Term Cash Lender

The short-term cash lender focuses on loans up to 32 days, or the next pay period. On average, these lenders charge an interest rate of 30% per month, all fees included. They comprise the largest number of individual institutions, but each branch tends to be relatively small in size, with loan books of between R50 000 and R500 000. Their target

[8] Government Gazette of Pretoria, 1 June 1999 (Vol. 408), Department of Trade & Industry, Notice in terms of Section 15A of the Usury Act, 1968 (Act No. 73 of 1968), No. 713.

market is clients with a net income of up to R2 000 per month. The average loan for these firms is about R500, taking into very strict consideration the capacity of the borrower to repay at the end of the month. Capital resources come mainly from their own sources, and occasionally from illegal loans from friends (illegal because this is not allowed under South African law).

It is important to note that the rate charged by 30-day cash lenders applies to all loans less than that period or which are repaid on a weekly basis. This raises the effective interest rate of the loan. Very important to note is that even with bankcards and pin numbers as security measures, the default rate on loans was in the neighbourhood of 2.5% to 5%. Now that the use of bankcards and pin numbers has been eliminated, this rate has tended to double among the lenders.

Medium-Term Cash Lenders

There is often some overlap between term lenders and firms lending for period of one to six months. They have a mix of products that are mostly 30-day loans, but also a range of slightly longer-term loans reserved for better clients. Average loans in the one-to-six-month category can increase to a multiple of the person's actual net take-home pay, as they have more time to pay it off. Historically, these lenders have also used bankcards with pin numbers as the repayment mechanism. With the restriction of the use of bankcards, many lenders are experimenting with other forms of collection.

Interest rates vary according to the term of the loan, but are usually discussed as a flat rate on a declining balance, which increases the effective rate. The nominal interest rate may be between 30% (for 30 days) and 12.5% (per month for the period), but the effective interest rate is always greater than 20% per month. Because these loans are made to better-known clients, the default rate is generally lower, about 2.5%, without the bankcard.

Short-term and medium-term cash lenders are often lumped together in the same category since branches often do both, so it is difficult to differentiate between them. Overall, the estimates from credit bureaux specializing in cash borrowers are that there are now roughly 3 500 to 4 000 storefronts in the country. This figure is down from an estimated 6 000 two years ago, and is expected to continue declining this year to a ceiling of 2 500 storefronts by the end of the year.[9]

9 Conversations with Compuscan and Micro-Lenders Credit Bureau (MLCB).

Term Lenders

Term lenders make loans for periods between six and 36 months. The industry started through the use of Persal, the government's central payroll system, which used debit orders to extract repayment at the source before the borrower actually had a chance to see the money. Now that these lenders are saturating the market, they are branching out to establish credit service relationships with the larger private companies. This is the most rapidly growing segment of the industry, but one that has often been restricted by cash to lend. The commercial banks are becoming increasingly involved in this segment of the market, buying up the large term micro-lenders to develop their access to the market, while reducing the financial constraints on their lending partners.

Housing Lenders

Housing lenders are closely associated with term lenders. Most long-term mortgage loans are greater than the ceiling set for micro-loans and fall outside the exemption. Nonetheless, many micro-loans are made in the name of housing, as it is the basis of access to a Persal code that greatly facilitates repayment. Housing loans can also be secured by provident funds, effectively bringing the risk to almost zero. Large banks are involved in housing finance, as well as small, specialized lending boutiques. The National Housing Finance Corporation has a number of programmes to assist retail lenders to access finance to on-lend to borrowers for housing improvement.

The NHFC promotes both urban housing and rural housing. Lenders in the housing industry include micro-lenders, small banks, social housing programmes and non-bank financial institutions such as NGOs. Methods of security include: none (unsecured), provident fund, payroll and mortgages. The Rural Housing Loan Fund programme works with micro-lenders financing housing in the rural areas with unsecured loans. For this, interest rates of 40% (on a declining balance) are common. For provident-backed loans, margins above the cost of money are typically between 4% and 5%.

Pawnbrokers

Pawnbrokers comprise one of the oldest industries in South Africa. They use durable and semi-durable goods as collateral against money which they advance to individuals in need of short-term funds (generally less than 30 days). These are often used to finance emergencies or short-term cash flow deficiencies in their daily lives and businesses. The advances are made against the pledged item(s) at a rate of 25–30% per month, and the borrower has up to three months to reclaim his items by paying off the advance, otherwise he forfeits them. Between the time the pawnbroker makes the advance and the time the client comes to reclaim the item, the pawnbroker must store and maintain the item in original condition. If the client forfeits the item, it then belongs to the pawnbroker and he is free to sell it second-hand. Roughly 35% of all pawned items are not paid off and collected.

While there are many debates about the value applied to items that are pawned compared to their real value, the pawnbroker must incur many costs. The pawnbroker must appraise the item, transport it to his shop, store it for up to three months (with the opportunity cost of capital), and, if the item is not collected, proceed with the sale, which could take several months, depending on the demand.

There are some 5 000 pawnbrokers in South Africa, according to the Association of Pawnbrokers, which officially represents 1 500 of them. Pawnbrokers are registered under the Second-Hand Goods Act, so are already regulated and pay VAT on all transactions. The cost structure for pawnbrokers differs radically from that for micro-lenders, owing to their primary operation of storing and selling the second-hand goods. Most loans are for one month or less. Estimating that the average portfolio outstanding is about R60 000 per pawnbroker, there is an outstanding monthly balance of about R300 million. Taking an average term of one month (which may be too long), this translates to an annual turnover of R3.6 billion.

Informal Sector

Mashonisas

Mashonisas are informal sector lenders who operate completely outside the formal sector. When there was no other alternative for borrowers, the mashonisas provided the solution. Mashonisas specialize in short-term loans, generally for 30 days. Interest rates run in the range of 50% per month, though no additional interest is charged if the borrower is late, effectively reducing the cost of borrowing. Mashonisas are often women with no other means of support. Clients borrow an average of R150 to R250 at a time. Individually, the mashonisas are extremely small players, but there are an estimated 25 000 to 30 000 around the country. Monthly earnings are often quite small in absolute terms – in the range of R2 000 to R3 000 per month. Interestingly enough, it appears that most mashonisas are close to their clients, who are loyal to them.

The best estimate of the number of township moneylenders is approximately 30 000. This is the figure that has been developed by Du Plessis and is most commonly referred to by researchers. The research by Jimmy Roth on township moneylenders in the Grahamstown area can be taken as a proxy for the average lender. This was confirmed by a recent survey in the North Province, which found similar statistics. The typical lender has about 15 to 20 clients, with a total outstanding book of about R5 000. Using this as a proxy, township lenders account for about 600 000 clients on a monthly basis, equal to the number from formal moneylenders, although at some R150 million, their outstanding book is significantly smaller. On an annual basis this translates to R1.8 billion.

Stokvels and Burial Societies

Here, the term “stokvel” refers to the various informal financial institutions that capture member savings and then either save them or on-lend them to some of the members of the group on a rotating basis. These include the Stokvels, properly stated, burial societies, and rotating savings and credit associations (ROSCAs). According to the National Association of South Africa of Stokvel Associations (NASASA) there are an estimated 800 000 such institutions, comprising about 8.25 million adults and accounting for some R200 million a month in savings. They are governed under the Banks Act under the Stokvel exemption. This allows for stokvels as member based organizations providing services only to their members, and who are members of NASASA, to be regulated by NASASA. Only 15 000 groups are officially registered with NASASA, but in reality all stokvels are providing services only to their own members so are considered to be safe.

There are very few costs. Management of the associations is voluntary, and most of the funds are normally distributed to members at the time of the group meeting and deposit of funds. Since all repayments, with any interest, go back into the group fund for redistribution to the members, the interest rates serve more as mechanisms for forced savings for the members. Interest rates may or may not be charged, depending on the group and its operating procedures.

The Eskom consumer survey of 1998 confirms the existence of numerous burial societies. It estimates 6.5 million South Africans are members of burial societies. We estimate on a conservative basis that if each member contributes R20 per month for a year the accumulated total will be R1.56 billion. This is a severe under-estimate as many of these societies have monthly contributions per member far in excess of R20. However, we also consider the reality that much of these savings would be deposited with commercial banks, the Post Bank or other formal savings facilities. Thus, double counting may be possible and the total savings figure should be treated with caution.

Access to Financial Services for Rural Households and Small Farmers

Figure 3.5 provides adequate information on which to assess the scope of rural and small farmer finance. As stated, it would be virtually impossible to do a clear delineation between rural and urban micro-finance. It is estimated, however, that approximately

37% of 19 500 formal retail outlets where a client could enter into either a loan or a savings transaction are in rural areas. It is also estimated that approximately 35% of the 1 150 000 informal "outlets" in South Africa can be found in rural areas.

If we turn to financial services for small farmer agriculture it is even more difficult as it is expected that many diversions of loan funds occur as a result of the general unavailability of sources of small farmer agricultural credit. Much of small farmer agricultural activity is also cyclical in nature and many "small farmers" will leave farming if economic conditions improve and wage income opportunities are more available. On the other hand, one can also assume that a sizeable proportion of small farmer credit also gets diverted because of the simple fact that many "small farmers" are forced to obtain the credit for small farmer purposes, albeit that they have other needs than for agricultural production. Without entering the minefield of definitions of exactly who is a small farmer, this table serves as an indication of the confusion surrounding the concept of small farmers.

FIGURE 3.5 Selected Results from Farm Household and Small Business Surveys in Two Provinces (1997)

Item (%)	Small Farmers Surveys		Small Business Surveys	
	Northern Province (n=150)	KwaZulu-Natal (n=152)	Northern Province (n=270)	KwaZulu-Natal (n=225)
Agricultural income as % of gross income:	3.4	2.8	1.0	8.5
Percentage who used loan finance to finance:				
Durables/assets	4.0	9.9	14.0	16.0
Farm inputs/other inputs	7.3	9.0	7.0	11.0
Savings at (in % of respondents):				
Formal institution (average distance km) [a]	(60.7)	(45)	92.0	77.0
Informal institution (average distance km) [b]	80.7 (0.0)	29.6 (19)	64.0	76.0
Sources of finance for establishment of business:				
Personal savings			93	73
Retrenchment package			30	12
Pension			17	1
Loan from family or friends			10	5
Loan from development corporation			6	6
Income from other business			4	13

a. The institutions with highest use

b. Information not available for small business surveys

The table confirms the fact that rural people have diverse income streams that may include farming as a source. This is not entirely surprising as it represents one of the numerous ways in which poor people manage risk, i.e. by diversification of income sources. When interviews are conducted on the basis of stereotyped notions of small farmers, it may be found that a "small businessman" has a higher income from farming activities than a "small farmer" or that the majority of small farmers may be female.

However, it is assumed that, since agriculture plays such a small part in the household income streams of most small farmers, loans for agriculture are quite scarce and targeted towards those that are full-time farmers (ironically the higher risk farmers). To refer to small farmer finance may therefore be somewhat incorrect, whereas the concept of rural finance is non-sector specific and emphasises rural areas as the locality of financial transactions.

It is estimated that less than 1% of the portfolio of the Land Bank is for small farmer financing (loans below R10 000 in accordance with our definition of micro-finance). Approximately 30% of the outstanding small business finance book of provincial parastatals is for small farmer finance. This will decline and should not rise above 25% as most of these banks capped their exposure to agriculture after the restructuring of these institutions.

It is expected that a leakage to farming activities exists in the portfolios of some institutions without specific farming loan products. These institutions include NGOs, Village Banks, agricultural co-operatives, TEBA Cash, stokvels and even the micro-lending sector. It is, however, very difficult to assess the magnitude of this leakage.

What is the demand by rural people for financial services? Note that demand equates to expressed demand since no comprehensive demand study with respect to rural finance has yet been executed in South Africa, barring the analysis of the Strauss Commission that qualitatively derived demand from a description of economic activities in rural areas. Figures 3.6 and 3.7 reflect the results of a survey executed in 1997 to serve as an indication of the characteristics of rural households and their use of financial services.

It is clear from the tables that farming plays a small role in terms of income, although many small farming and small business households (thus rural households) cultivate the land and produce crops. Very little of the crops or livestock are sold and the majority of the households are deficit producers (Van Zyl & Coetzee, 1990). The majority of households in all the surveys do not (or are unable to) access credit services, while most households are engaged in savings activities.

A rich fabric of informal financial arrangements was identified, although not at a comparable frequency to that of urban areas. Under the conventional approach clients would have been bombarded with credit, while in the circumstances outlined in the surveys they do not demand a high level of credit. The clients in these surveys accessed loans from development corporations (or provincial parastatal financial institutions) and the informal markets. This may indicate an inadequate supply of formal credit, either in the form of lack of access or as a result of inappropriate financial products on offer. Most people who save money have commercial bank accounts. This indicates an effort to deposit savings since the majority of rural branches of commercial banks are in medium to larger towns, which are normally far away from these clients. The Post Bank and NGOs did not feature in the survey results. In the case of the Post Bank, this may be due to the fact that not all rural Post Office branches offer savings facilities. It may also indicate the provision of inefficient services based on outdated savings product technology (something which has recently been addressed by computerizing the manual centralized processing system of the Post Bank). Very few financial NGOs are active in rural areas in South Africa and the penetration of the rural finance market by NGOs is therefore negligible.

FIGURE 3.6 Illustrative Profile of Farming Households based on Surveys in Two Provinces

	Northern Province (N=150)	KwaZulu-Natal (N=152)
Household characteristics:		
Male household head (%)	68.0	72.4
De facto female household head (%)	99.3	66.4
Household size	–	8.8
Land tenure:		
Cultivate all land (%)	79.3	58.6
Leased land out (%)	8.0	9.9
Borrowed farm land (%)	9.3	13.8
Services and energy use (% of households):		
Use grid electricity	7.3	61.8
Use flush toilet	1.3	1.3
Cook with fire wood	95.0	78.9
Water source unprotected	83.3	66.4
Public standpipe	44.0	19.1
Gross annual income (R):		
From farming	394	637
From wages	9 308	14 157
From micro enterprises	149	1 294
From remittances	974	4 251
From pensions	1 489	2 667

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Figure 3.6 *continued*

		Northern Province (N=150)		KwaZulu-Natal (N=152)	
Farm assets – % of households with:					
Car/Bakkie		5.3		22.0	
Tractor		5.3		2.0	
Trailer		2.0		1.3	
Plough		4.8		6.0	
Credit used to purchase durables (% of households):	Main source of credit:				
Car/Bakkie	Commercial bank – CB	3.3	CB	9.9	PS
Generator	Private supplier – PS	1.3	–	2.6	–
Refrigerator		4.0	CB	32.9	PS
Television		2.0	–	19.7	–
Savings facilities used (% of households):	Distance to institution (km):				
Banks		30.0	60.07.0	48.7	45.0
Money keeper		0.0	0.0	3.9	21.0
Informal		80.7		29.6	19.0
Farm inputs financed on credit (% of households):					
Fertilisers		7.3		9.0	
Seed		6.0		5.0	
Farm equipment hired		2.7		0.0	
Chemicals		0.7		6.0	
Veterinary medicines		0.7		0.0	
Livestock feed		0.0		0.0	
Ploughing services		0.0		9.0	
Transportation services		8.0		10.0	
Credit source used to finance farm inputs and implements (% of households):					
Local moneylender		0.7		0.7	
Friend or relative		4.7		3.3	
Development corporation		10.0		0.0	
Miller		0.0		0.0	
Stokvel		0.0		0.0	
Savings club		0.0		0.0	
Input supplier		0.0		2.6	
Commercial bank		0.0		0.0	

Source: Adapted from Ouattara and Graham, 1997

FIGURE 3.7 Illustrative Profile of Small Business Households based on Surveys in Two Provinces

	Northern Province (N=270)	KwaZulu-Natal Province (N=225)
Average age	26	46
Female (%)	21.6	22.9
Women who can sign contract without husband's permission (%)	33.0	70.7
Number of years in operation	8.3	10.0
Number of workers at start	3.2	4.5
Average value of business at start (R)	5 612	4 509
Number of current employees	3.5	4.6
Sector of operation (%)		
Construction	37.8	35.5
Manufacturing	26.3	26.7
Services	35.6	37.8
Multiple sources of financing business at start (%)		
Personal savings	93.3	73.3
Retrenchment package	29.6	12.0
Pension	17.4	0.9
Loan from family or friends	10.0	4.9
Loan from development corporation	5.9	6.2
Income from other business	4.1	13.3
Sole ownership (%)		
Registered business (%)	87.4	93.8
	33.0	22.7
Place of work (%)		
Home	37.0	34.7
Adjacent to home	7.4	5.3
Market	50.4	33.3
Place of delivery of service	5.2	26.7
Selected income, input and output indicators (R)		
Average wages received per month	1 326	1 102
Average remittances received per month	739	1 360
Average pensions per month	414	438
Average business income for business 1 per month	3 601	2 057
Average business income for business 2 per month	3 796	1 979
Average business income for business 3 per month	7 721	2 800
Average annual agricultural income	1 250	10 886
Average value of physical assets on hand	17 913	12 995
Average value of inputs per annum	1 067	12 703
Average value of output per annum	92 031	58 044
Average labour expenditure per annum	25 360	41 380

Figure 3.7 *continued*

	Northern Province (N=150)	KwaZulu-Natal (N=152)
Use of loans (%)		
Asset finance: Cash loans	10.0	10.0
Asset finance: Hire purchase	14.0	16.0
Supplier credit	7.0	11.0
Customer advance	16.0	29.0
Customer loans	18.0	16.0
Shopkeeper loans	56.0	–
Savings (%)		
Formal: Mostly commercial banks	92.0	77.0
Informal: Stokvel	26.0	76.0
Informal: Burial society	64.0	22.0
Electronic banking	35.0	18.0
Handling of shocks or misfortunes (%)	21.0	52.0
Main principle cause: Stolen equipment (% of shocks)	52.0	31.0
Main fallback mechanism: Personal savings (% of shocks)	67.0	24.0

3.6 NYANDENI

3.6.1 Formal Sector Financial Services

Lying just outside the western border of the greater Nyandeni district is Umtata, capital of the former apartheid "state" of Transkei. Most of the bus services in the district originate or end in Umtata, which is the regional hub. Even the farthest parts of the district, such as Port St Johns on its eastern extreme, lie within two hours' bus ride of Umtata.

Although there are few branch offices within Nyandeni's borders, almost all of the formal sector institutions operating in the micro-finance market outlined in section 3.5 are within reach of micro-entrepreneurs in the district. Indeed, those that use local agents to extend their outreach, such Land Bank's Step-Up micro-loan programme, operate actively in parts of the district.

No data regarding the activities of these institutions in the Umtata region has been gathered, but it can reasonably be assumed that many households in the Nyandeni district have accounts with them, especially those providing consumer credit.

The Land Bank has been largely restructured based on the proposals of the Strauss Commission (1996). It has struggled to reposition itself and still occupies a somewhat ambiguous position within the broader financial market and specifically in terms of competition with commercial banks. The bank offers four groups of products:

1 The Step-Up loan scheme, with approximately 60 000 clients across all the provinces, is a scheme where borrowers are promoted to bigger loans based on their repayment of loans. The scheme offers loans from R200 to 20 000

2 Bronze products are aimed at small farmers and people graduating from the Step-Up scheme. It provides loans up to R50 000.

3 Silver products are for commercial small farmers.

4 Gold products are for large commercial farmers.

The Land Bank has acted as an apex institution in the past (i.e. wholesaler of funds) by granting loans to traditional agricultural input and marketing co-operatives (and later co-operatives/companies) who, in turn, have on-lent seasonal input loans to their members. However, with the recent shift in its mandate to expand the financial frontier to include more disadvantaged clientele, this apex role is being expanded into alternative channels of agents and intermediaries, thereby facing some of the same challenges as an apex like Khula or the NHFC.

The outreach potential of the Step-Up programme is high. This programme is likely to generate the largest numbers and possibly reach the poorest clients. In July 2001, after a little more than three years of operation, it has incorporated over 43 000 borrowers with a net loan book of roughly R12 million and an on-time loan recovery over 80%. The average loan size is around R500. In time, these borrowers will be able to “step-up” into larger loan sizes each time they repay their six-month loans on time (or earlier). Interest and fees are 3% a month. Borrowers can continue for nine loan cycles, currently to a maximum loan size of R20 000 at the end of which time they can continue at this level (or at some smaller amount) or else graduate into a Land Bank agricultural loan product.

There are several distinct features of this programme. First, it is largely rural in focus in contrast to the urban-based Start-Up programme in Cape Town (which follows a similar format). Second, it is not necessarily targeted to agricultural loans, but is more inclusive in its mandate, accepting rural non-farm activities as well as farming. Trading, shop keeping and similar village-based activities are facilitated, many of which are related to handling agricultural products.

The programme creates interesting potential for graduates to shift into small-scale agricultural loans as they undertake agricultural activities. It is important for the Land Bank to avoid becoming too rigid in applying the “agricultural” criterion in deciding whether to grant loans to clients at this level. Frequently, low-income households are engaged in multiple activities to diversify their risks, with non-farm and off-farm activities complementing their agricultural activity. The bank, in effect, makes a loan to a household rather than for a specific activity within the household.

Initially, loan officers from the Land Bank branches disseminated the particulars of the programme, which requires very little from the lender or the borrower. Interested borrowers must have a valid ID document and open a bank account at the nearest First National Bank branch with a R50 deposit to secure their first Step-Up loan of R200 It is possible to open an account in a different bank in their locale, but it must have electronic transfer linkages with the First National Bank branch to which their monthly repayments plus interest will be transferred for each six-month loan. Prospective borrowers are also expected to attend a short Step-Up presentation at their local Land Bank branch. Finally, they must have a contactable postal address for communication purposes.

The lender engages in no loan evaluation or creditworthiness exercise, so costs are low. Nonetheless, the bank believes that carrying out initial promotion efforts and follow-up monitoring for delinquent borrowers drains too much loan officer time from other duties, so branches in district areas select independent agents. The key incentive feature in the agents contract is that he only receives his commission on each loan (currently designed at R40) after it has been completely repaid at the end of its six-month term (or earlier if the borrower repays early). Only R10 per loan is made upfront to the agent for all loans successfully registered in the programme. Another advantage is that no money passes through the agent’s hands, thereby reducing the scope for possible abuse (i.e. opportunistic behaviour) by agents.

Another feature stimulating reasonable loan recovery is the personal incentive for borrowers to stay in the programme so they can automatically benefit form future “step-up” or larger loan sizes. This is a strong inducement for borrowers to repay to protect their access to future loans. This built-in voluntary contract enforcement is in effect a collateral substitute. Nevertheless, the programme is still young and the effectiveness of the agent network has yet to be tested.

The programme represents a savings on capacity building expenses (since none are needed here) and administrative overheads typical of other lending programmes that engage in client evaluation tasks. Finally, there is no need to worry about ownership and governance structures since the Land Bank is working through individual agents rather than intermediaries. In the end, this micro-finance initiated by the Land Bank could prove to be an innovative vehicle to reach hitherto excluded poor rural constituencies. Risks to the Land Bank, low at present, will increase over time as more borrowers graduate into the higher “steps” of borrowing.

Formal Sector Services at Nyandeni and Libode

The two magisterial districts of Nyandeni Municipality, Libode and Ngqeleni, have no formal banking facilities and none of the major banks is operating in these towns. A newly formed community bank is called Financial Services Co-op but apparently it has not yet started operating. Since there is no bank in Ngqeleni, people use banks in Umtata, which is about 30km away. Some people in the area bank with the Post Office.

There are a number of service provider organizations in Libode town. These include an NGO called *African Co-operative Action Trust (ACAT)*, which has its head offices in Umtata and services a number of projects in Libode (see the table below).

FIGURE 3.8 ACAT Community Projects in Libode District

Nature of Project	Number of Projects	Project Membership	Range
Vegetable gardens	13	173	4–30
Baking	4	31	6–10
Leather	1	10	–
Candle making	2	9	3–6
Sewing clubs	15	73	2–12
Piggery	3	28	8–12
Handcrafts (disabled)	1	16	–
Brick making	1	10	–
Poultry	10	79	5–14
Poultry & candle making	1	10	–
Traditional wear	1	18	–
Netting wire	1	3	–

LIBEC (Libode Business Enhancement Centre) is an organization that helps people or communities in the area with training and micro-finance. It was started in 1998. The branch of LIBEC responsible for training of communities is funded by the Ntsika Enterprise Promotion Agency. It also assists individuals to apply for funds from the Land Bank in East London on a step-up programme (step up loan ladder), whereby individuals are given loans ranging from R200 to R18 000 to start their own projects or businesses. Most people who borrow from this fund are apparently hawkers who would like to set up businesses, such as selling apples, chickens, etc.

The micro-finance branch of LIBEC promotes borrowing by groups rather than individuals. An interested group of people (3–10) can apply for a loan, following which the facilitating officers visit the group to verify everything stated in the application. Those borrowing for the first time get loans ranging from R300 to R600 per person in the group. They are allowed a period of four months in which to pay back the loan at an interest of 2.5%. After paying back the loan, they qualify for another ranging from

R600 to R1 500 per member in the group for a period of six months, also at an interest rate of 2.5%. If the same group would like to borrow for a third time, it would qualify for a bigger loan of R3 500 per member of the group, for a period of 12 months, at an interest rate of 2.5%.

LIBEC only operates in two of the three districts, i.e. Ngqeleni and Libode. It obtains its funds from KHULA, which is an agency of the Department of Trade & Industry.

When a group qualifies for a loan, it opens a bank account into which the money is deposited. All members of the group are asked to be present when the cheque is handed to the project's leader – to avoid some members claiming not to have received the money. The group repays the money to LIBEC through the Standard Bank branch in Umtata.

So far, some 55 groups have been funded by LIBEC. There are few new projects because the organization is now more cautious about screening applicants in an effort to minimise problems regarding repayment.

NUBIAN has been advertising for agents to represent the bank and will soon start to operate in Libode.

Libode Farmer Support Centre was started in 1997 as part of the Presidential Project Team (PPT). Funding was obtained to open a farm-input outlet, which requires those interested to pay a joining fee and an annual subscription fee. Paid-up members receive a discount of 5% on every purchase. Individuals pay a once-off joining fee of R50 and an annual subscription fee of R20. Groups wanting to benefit from the services of the centre pay a joining fee of R250 and annual subscription of R150. "Non members" may purchase from the centre, but do not receive any discount. The centre provides services like input supply and advice to farmers from Tsolo, Qumbu, Ngqeleni, and Port St Johns. The current membership is about 50.

There is *one post office* that provides both postal and banking facilities. This is especially useful for old people who find it difficult to travel to Umtata, 30km away.

Libode Community Advice Centre was started in 1998 with funding from a Swedish organization, International Commission of Jurists. It provides communities with information of various kinds, and collaborates with an organization called Legal Resources, based in Grahamstown, to deal with problems such as: delayed receipt of pensions and other grants like unemployment benefits; suspension of disability grants; etc. As with most NGOs, funding to keep the centre afloat is becoming a major problem.

Tombo Enterprise Development Centre in Tombo, 20km from Port St Johns, was started in 1996, but became operational in 1997 with funds from the Presidential Project

Team. The centre provides services such as support to entrepreneurs in terms of business advice, training and information dissemination. It also facilitates funding for potential entrepreneurs by referring them to the Eastern Cape Development Corporation and the Land Bank. The activities of the centre are subdivided into: SMMEs, youth activities, women's projects, and farmers' groups. Overall, the centre services about 90 project groups, which range from sewing, baking, farming, piggery, poultry, arts and crafts. The National Development Agency has also assisted by funding some of the projects.

The size of loans are small at R250 per person in a group of at least five people, though some individual business people have borrowed large amounts up to R50 000.

Burial Societies

Burial societies in Libode town include Chithibunga, Mantolo, AVBOB and Khululani. All are formal businesses that send out agents to canvas and recruit members both in towns and villages. They operate on a provincial or national level. However, there are also informal clubs in the villages, which are called burial or burial and social clubs. The majority of membership of both burial societies and clubs are old people. The club members organize themselves in a group to pool money to assist members with funerals or weddings.

Chitibunga Burial Society. A member pays a joining fee of R60, and a monthly fee of R55. These amounts cover both spouses and dependants below the age of 21 years. Dependants over 21 pay R45 a month. New members pay the monthly fee for six months before qualifying for benefits.

Benefits: When a "member family" is bereaved of an adult (anyone over 14 years of age), the administrators of the society collect the body and prepare it for burial. They provide a coffin and pay the family R2000 to buy sheep, and another R800 for groceries. They also provide the family with tents used as shelter at the family home together with public address system coupled with preparation of the grave. After a year, the society "donates" a tombstone to the family. In the case of a child under 14 years, the family receives R500 sheep, R300 for a coffin, R200 for groceries but no tombstone.

Mfolozi Burial Society. There appears to be no joining fee, just a monthly fee of R20. Members must pay their monthly dues for six months before they can claim benefits.

Benefits: in the case of bereavement, the family is given four sheep, R1 500 for groceries and a coffin worth R2 000. If members use the society's tent, the fee is R600. If not, the family receives R600. No tombstone is provided.

Quma Burial Society. The joining fee is R55 and the monthly fee R25. As with Mfolozi, age determines how much a member pays.

Benefits: three sheep, R1500 for groceries and a coffin worth R2 000.

In the Nyandeni region, Quma has teamed up with a local businessman, who owns a grocery shop, known as Codesa, by which Codesa supplies and transports the groceries and the sheep to the bereaved family's home. This alleviates the trouble the family would have gone through shopping and transporting the goods. In turn, Codesa receives payment by cheque from the society administrators. This has apparently attracted more people to the society.

Other Associations and Institutions

According to a study conducted by Jordan (1999) in the Wild Coast Spatial Development Initiative (SDI), there are many institutions/organizations involved in development in the area. Among these were the TRC, TLC, SANCO, traditional authorities, a hawkers' association, farmers' association and SDI committee. Membership of these institutions ranged from 11 to more than 200, with those that are community-based having less than 50 members. Half of the institutions relied on self-funding while the rest relied on government and funds from the ratepayers.

Most were involved in collaborative work such as cleaning campaigns, crime fighting, road construction in the villages, running workshops on conflict resolution and financial management, etc. Members of the institutions claimed to have been trained in agriculture, housing/road construction, electrification, resource management, conflict resolution, financial management, candle making and arts and crafts. There were a number of projects in the area, especially along the coast.

Formal Sector Services: Port St. Johns

Standard Bank Group Scheme. They charge a joining fee of R50, and a monthly fee of R35. There are a number of benefits: On the death of the head of family or his spouse, the scheme pays R10 000. On the death of children, the scheme pays an amount of R5000 to R6 000.

Many informal village based burial clubs have collapsed due to competition from the formal societies. The formal societies organize impressive funerals, which serve as advertisements for them. As a result, some members of the locally based clubs opt to join the formal societies.

3.6.2 Informal Sector and Occupations

Moneylenders

About three moneylenders in the area closed early in 2001. The majority of people are said to depend on uZonesegistered loan sharks, who demand interest rates ranging from 30% to 50% per year.

Burial Clubs

Many informal village based burial clubs have collapsed due to competition from the formal societies. The formal societies organise impressive funerals, which serve as advertisements for them; as a result, some of the members of the locally based clubs opt to join the formal societies.

3.6.3 Main Conclusions and Implications for Micro-Finance

- South Africa has a large, well established, rapidly expanding micro-finance industry. However, the centre of gravity of the industry is firmly in urban areas, in consumer finance and in the salaried employee market.

- Although as much as 35% of micro-finance activity is estimated to take place in rural areas, the overwhelming bulk of it is through informal sector savings groups. Micro-credit for rural households and micro-enterprises is much more difficult to access. Even in the nearest city or large town, these categories of borrowers – especially micro-entrepreneurs – are not well catered for, as relatively few are regular salaried employees and most micro-loans are geared to consumer needs. Very few NGOs offering financial services are located in rural areas. Unless rural communities expand their own initiatives, access to micro-finance – particularly micro-credit – can be expected to deteriorate rather than improve in the foreseeable future.

- Notable potential counterforces are the Land Bank, TEBA-Cash, Ithala Bank (all of which are institutionally and financially strong and committed to operating in rural areas), and the village banking movement, which, though still small, appears to be expanding on a sound basis after an indifferent start.

- Only a small percentage of micro-enterprises (urban or rural) use micro-credit – estimated at no more than 1% currently. The main source of loans for micro-enterprises is trade credit in some form and the purpose to which it is put is to fund working (as opposed to fixed) capital requirements. Almost no start-up capital for micro-enterprises is borrowed from MFIs.

- Though unemployment levels are high, especially in rural areas, most rural households are able to draw on income from a range of sources. Locally earned wages are on average the most important source, but remittances from household members employed elsewhere and welfare payments (chiefly pensions and disability grants) also contribute substantially. From recent surveys, it is evident that the average rural household generates no more than about 5% of its income from agriculture. Significantly, domestic micro-enterprises bring in almost the same. This diversity of income sources adds greatly to rural households' ability to cope with income volatility and, consequently, to their creditworthiness.

- The popularity of informal savings groups is explained by the long distances to formal sector savings facilities recorded in the same surveys (30–80km on average). While a proportion of these savings is on-lent, it is almost always only to members of these groups, either on demand or on a rotating basis. Much of the balance of the savings is channelled through formal sector deposits away from the rural economy. Very few formal sector bodies offering rural savings facilities also engage in micro-lending in rural areas – TEBA-Cash and Ithala Bank (in KwaZulu-Natal) being the main exceptions.

- The picture in Nyandeni does not appear to differ significantly from this countrywide rural perspective. At present, no formal sector MFIs are recorded as having branches in the district, although one NGO and one parastatal have provided start-up and other grants for a range of informal sector employment projects and assisted the projects in obtaining finance from other sources, such as the Land Bank. One formal sector bank offering micro-credit is reported to be planning to open in Libode.

- However, just outside the district's western border is Umtata where a broad range of formal and informal micro-finance services is available. It can safely be assumed that many Nyandeni residents make use of these facilities, though, as already noted, not often for micro-enterprise finance.

- For donors whose objective is to increase access to micro-finance – particularly microcredit – in rural areas, the key strategic choice in Nyandeni seems to be:
  - whether to try to assist existing indigenous savings-based groups to "upscale" their activities and, in particular, to expand their lending to borrowers who are not necessarily also savers (with the group) – a major psychological, operational and legal challenge;

- or to work with an established micro-lender – such as the Land Bank, TEBA-Cash or the village banking movement – to expand their operations into the district in a way that meets both parties' objectives.

- In both instances, all of the considerations regarding selection, capitalization, technical support and monitoring and evaluating that were raised in respect of Chimanimani and Chimoio (see 3.2.3 and 3.4.3) also apply here.