

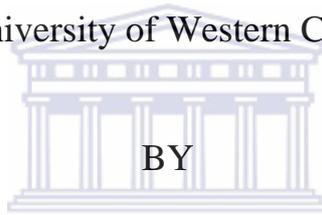
MICROFINANCE IN MASERU, LESOTHO:  
CHALLENGES AND PROSPECTS FOR POVERTY  
REDUCTION

Thesis

Submitted to

The Institute for Social Development

University of Western Cape



BY

UNIVERSITY of the

Mpatuoa Hlapi Letete (Student no 3066770)

In partial fulfilment for the requirements of the Award of the Masters of Arts in  
Development Studies

Supervised by

Dr. Leon G. Pretorius

May 2013

# DECLARATION

I declare that this work is my own and has not been previously submitted in whole or in part, for the award of any degree or whatever certificate of higher education. Where other people's works are used in this thesis, due citations and references are made accordingly.



## DEDICATION

I dedicate this thesis to my husband Emmanuel Letete. I am grateful for the encouragements, inspiration and support he gave me while I was busy with this study.



## ACKNOWLEDGEMENTS

I would like to pass my appreciation and thanks to my supervisor Dr. Leon G. Pretorius for his valuable suggestions and guidance in every step of this study. I would also like to thank the people who allowed me to interview them. I have learned a lot about my study. I am very grateful to my friends who were always available to listen to my problems. They were at all times there to comfort, support and offer advises.



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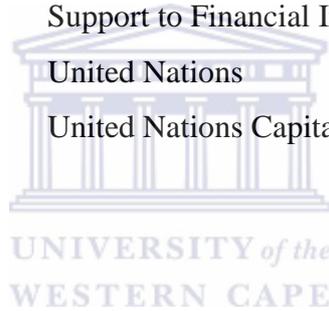
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# LIST OF ABBREVIATIONS

BEDCO	Basotho Enterprises Development Cooperation
CBL	Central Bank of Lesotho
CGAP	The Consultative Group to Assist the Poor
IBPRS	Indonesian People's Credit Bank
LNDC	Lesotho National Development cooperation
MFIS	Microfinance Institutions
MFSD	Ministry of Finance and Social Development
NGOS	Non-Governmental Organisations (e.g. Cooperatives)
SFIL	Support to Financial Inclusion in Lesotho
UN	United Nations
UNCDF	United Nations Capital Development Fund



# ABSTRACT

This study assesses the challenges of microfinance and its prospects for poverty reduction in Maseru, the capital of Lesotho. It further assesses the challenges faced by the regulators of microfinance in this economy. In doing so, the study informs the policy makers in Lesotho about strategies that could be adopted to improve the microfinance industry in the country for the benefit of a large sector of the population that does not have access to formal lending channels. The study examined ten informal and formal microfinance groups, five representatives of the formal institutions and two from the Government: the Central Bank of Lesotho (CBL) and the Ministry of Finance and Social Development. The results of the study reveal some fundamental lessons for microfinance industry in Maseru, Lesotho, which could be applicable to other developing countries as well. First, microfinance in Maseru has had a positive change on the lives of its participants as articulated by the interviewees in this study. Second, it has promoted entrepreneurship and enabled its participants to open small and medium enterprises. The results of which has been a shift in consumption patterns of participants and poverty reduction. Despite the positive impacts, microfinance in Maseru has had challenges. These challenges include unlawful practices undertaken by the informal microfinance institutions such as seizure of the assets from those who default on their loans. The lending risks faced by formal institutions as well as regulation challenges by the CBL. The policy implication of this study is that the CBL and the Ministry of Finance need to require informal groups to register for licences to eliminate the level of corruption and unlawful practices experienced in the informal microfinance industry.

## KEYWORDS OR PHRASES

- Microfinance
- Poverty reduction
- Maseru, Lesotho
- Formal and informal financial institutions
- Credit markets
- Low Income Earners
- Financial Services Community Empowerment
- Rotating Savings and Credit Associations
- Burial Societies.



# CHAPTER ONE

## INTRODUCTION

### 1.1 Background

The debate on whether microfinance—the supply of loans, savings and other basic financial services to the poor, is good for development and poverty alleviation continues in policy forums. Moreover, the factors that constrain its effectiveness as a strategy for poverty alleviation are not fully understood. In a number of developing countries, microfinance is claimed to have been successful in providing access to financial services by the poor population that often did not have access to formal financial markets. Microfinance is also claimed to have therefore played an instrumental role in poverty reduction<sup>1</sup>. These claims have been based on strong evidence provided in literature on the success case of Bangladesh which was a pioneer in microfinance to the poor.

The model that led to success in Bangladesh has been cited as a prototype model for other developing countries to follow<sup>2</sup>. In fact, policies for poverty reduction in many developing countries have focused on access to financial services as one of the most important strategies in the fight against poverty (Helms, 2006; Schreiner, 2002 and Terberger, 2003). Malawi and Kenya are two countries that have adopted this model. The policy implication for poor people in developing countries, including Lesotho, is that their ability to get out of poverty depends on access to microfinance.

Despite its apparent success, microfinance remains largely underdeveloped in most African countries to an extent that Al Jaffari and Saleem (2011) argue that microfinance has not yet reached a stage in which it can serve the poor at the required level. Much remains to be done in terms of understanding the challenges and prospects of microfinance in those developing countries. This paper attempts to contribute to the discussion with Lesotho as a case study. The choice of Lesotho as a case study is based on the fact that this country has continued to face increasing poverty levels over the past two decades and still does not have a well-

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<sup>1</sup> Note that the World Bank estimates that about 1.4 billion people live on less than US\$1.25 per day and a significant portion of them lacked access to financial services, (World Bank, 2008) hence many people in developing countries still live in extreme poverty..

<sup>2</sup> See Chapter 2 for a complete Review of Literature on this Model

developed microfinance industry. It therefore was necessary to assess the challenges and prospects of microfinance as a strategy for poverty alleviation for Lesotho economy.

## **1.2 The Lesotho Policy Context**

With reference to Lesotho, the genesis of microfinance dates back to the 1960s. During these early years, people came together as informal groups that helped each other in times of need. Over time, these informal groups evolved into more organised cooperatives. Although these groups were informal, they were organised arrangements. The informal arrangements have persisted to the present day and are still mainly used as means to extend credit to the poor. A formal effort was the establishment of the Lesotho Post Bank in 2004. The bank's aim was to bring financial services to the majority of the population and extend credit to the underserved rural population. This happened after it was realised that a large portion of the population was financially excluded from the formal financial banking system, which comprised of three foreign owned commercial banks concentrated in urban areas (The Lesotho Post Bank, 2010).

The difference between informal and formal microfinance is that in the former, people operate at the grassroots level basing their lending on trust. They sometimes use the bottom up demands for financial services. In the latter, there are laws governing the institutions and decisions on financial services for the poor, and these laws are made from the top and handed down to the poor without necessary involving inputs from the poor (Okojie; Emina and Osaghae, 2009).

In its 2007 report, the CBL stated that there were still mainly two types of informal microfinance institutions operating in Maseru: Burial Societies and Rotating Savings and Credit Associations (RoSCAS). These associations help people to save money and get small loans ranging from R500, depending upon how much the member has contributed (CBL, 2007:4). Members of these associations use the loans to fulfil their various needs such as taking turns to buy supplies to build homes.

With poverty looming in Lesotho, and an estimated 56.6% of the population living below poverty line (Bureau of Statistics Lesotho ( BoS, 2007), the Lesotho Government recognized that microfinance could serve as a strategy to fight poverty in this small economy. Hence, the government recognized the need to promote microfinance from informal arrangements to formal arrangement. Therefore in 2010, the Government, with the help of donors such as

United Nations Development Programme (UNDP), launched the Financial Inclusion Investment Programme. This programme was largely understood to be a microfinance programme with the potential to enhance lives of the poor by mobilizing domestic savings, aiding self-help projects for the job creation, and improving local livelihoods, both in the informal and formal employment sector. During the launch of this programme, the Chief Executive of the Private Sector Development and Financial Affairs stated, “this programme will primarily be in the form of microfinance instruments such as small loans, savings, insurance and agricultural finance” (UNDP,2004;9). He further mentioned that the programme was consistent with the National Vision 2020. It was also noted that such a programme would be in line with the United Nations Capital Development Fund (UNCDF) strategic objective.

### **1.3 Rationale for the study**

Despite the efforts by the Government to promote it, microfinance in Lesotho remains largely underdeveloped. In 2005, the Central Bank reported that Lesotho Post Bank had only taken in deposits and had not extended credit to anyone in spite of good intentions for which it was set up. The Financial Inclusion Investment Programme, although launched two years ago, has not yet started providing credit to the poor. The majority of the poor population that are in dire need of microloans are still served through informal channels such as unregistered money lenders, RoSCAS, and burial societies. The consequences of these informal arrangements are usually exorbitant interest rates far above market rates, which to a large extent have disadvantaged the poor (Al Jaffari and Saleem, 2011).

This research study seeks to understand why there is limited access to formal microfinance in Maseru and to determine the extent to which people access credit under the informal arrangements in Maseru. It seeks to assess how credit is obtained under such arrangements and document some of the consequences that result from these informal arrangements. The study further seeks to explore challenges faced by the government of Lesotho in its endeavours to promote formal microfinance in the country. Finally, this report aims at informing the Lesotho policy makers about strategies that could be adopted to graduate informal microfinance arrangements to formal arrangements.

## **1.4 Objectives of the Study**

Given the foregoing rationale, the primary objective of this research study is to explore challenges and prospects of microfinance for poverty reduction in Maseru, Lesotho. The specific objectives are:

1. To document the practice of existing microfinance institutions in Maseru
2. To identify factors that facilitate the formation of microfinance groups in Maseru
3. To Identify obstacles faced by microfinance groups in Maseru
4. To assess the extent to which people access credit under the informal microfinance arrangements in Maseru
5. To document some of the consequences that result from the informal microfinance arrangements.

## **1.5 Main Research Hypothesis**

The main research hypothesis is that microfinance can play a role in poverty alleviation in Maseru, Lesotho.



## **1.6 Research methodology**

To answer the foregoing research objectives, this study used a qualitative research approach based on the interviews conducted in Maseru among the microfinance participants and regulators of microfinance (see subsection 1.8 for detailed sample description). The approach was deemed appropriate because it involves studying human action in its natural setting and through the eyes of the actors themselves, together with an emphasis on detailed description and understanding of the phenomena within the appropriate context (Babbie and Mouton, 2007). This model has proven to provide reliable information about human behaviour. The face to face in-depth interviews were used for information collection. These interviews enabled the researcher to gain some important information through observing the behaviour of the respondents, and by interacting with them, probing in order to gain clarity.

## **1.7 Sampling method**

The sample method was based on a non-probability purposive sampling of 10 microfinance groups and five representatives from five formal institutions. The participants in the interview were selected based on availability and willingness to participate in the study. The researcher used a semi-structured interview method to conduct in-depth face-to-face interviews with 45 participants; recording 30 of those interviews using a voice recorder (Refer to appendices on page 97). This method enabled the researcher to gain an insider perspective and observe the participants in their natural environment<sup>3</sup>. The researcher chose the semi-structured form of interviews because it is flexible and enables the interviewees to express themselves without being restricted.

### **1.8 Data collection**

The face to face in-depth interviews were used to collect data from the respondents. The data was collected at the respondent's place of work. Some of the respondents worked outside the buildings in a noisy place so the researcher found a quiet place to interview them. The researcher started by introducing herself and explaining the purpose of the research to the respondents. If they agreed to be interviewed, then open ended questions were asked. These questions allowed the respondents to give flexible responses. At the end of the interview the researcher asked the respondents to give contact details of their group members. In some cases the group members worked in the same building or close by the first respondents. The researcher then moved on to interview those who were close to the first respondents. In cases where the group members were not at the same place, the researcher called some of the members and explained why she called them and where she got their numbers. When the group members agreed to be interviewed, the researcher made an appointment with them and went to their places of work for an interview. A tape recorder was used with the permission of the participants. The researcher also took notes. The use of a voice recorder allowed for a much fuller record of responses, supplemented by the notes.

### **1.9 Data analysis method**

The data analysis in this research followed Tesch's Approach to qualitative data analysis (Tesch, 1990). The researcher first transcribed from interviews. She read the entire scripts to gain understanding from the interviews and then re-read each transcript paying attention to important points made by respondents on each topic. The researcher then made a list of

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<sup>3</sup>See also De Vos, Strydom, Fouche and Delpont, (2007) for the appropriateness of the choice of the interview technique.

objectives and answers that were given under each question, putting major topics and answers on one side, unique answers on the other. The researcher then related topics and formed categories.

Main themes from the respondents' responses were categorised into different themes, categories and subcategories. The findings were subjected to rigorous analysis by comparing the findings in Maseru to studies on microfinance conducted in other countries as well as theories of microfinance.

### **1.10 Limitations of the study**

Since most microfinance in Maseru is informal, it was difficult to know the exact number of institutions in the capital city. The research does not claim to be representative, and inferences from the sample cannot be drawn for the whole of Lesotho.

### **1.11 Key ethical considerations**

De Vos (2007) define ethics as “a set of moral principles which is suggested by an individual or group and subsequently widely accepted, and which offers rules and behavioural expectations about the most correct conduct towards experimental subjects and respondents, employers, sponsors, other researchers, assistants and students”. In carrying out the study, the researcher was bound by the following ethical issues as outlined by Babbie and Mouton (2007).

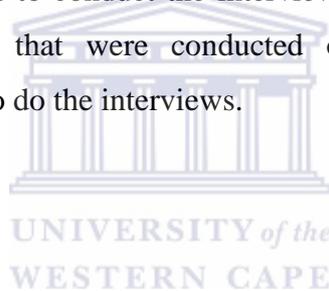
According to De Vos et al (2007), a researcher should thoroughly inform the participants beforehand about the potential impact of the interview. This researcher was sensitive in phrasing questions that sought to draw personal information in order to avoid discomfort to the participant. This researcher informed the participants of their right not to answer uncomfortable questions.

At the beginning of interviews, the researcher informed the participants of the goal of the investigation, the interview procedures, and ensured them of confidentiality of the results. The researcher explained that the study aimed at making policy recommendations to enhance the operations of microfinance in Lesotho and that could possibly argument government

policy on poverty alleviation. The participants were informed that they were free to withdraw from the study at any time.

Deception is deliberately misrepresenting facts and withholding information in order to make another person believe what is not true, thereby violating the respect to which every person is entitled (Babbie and Mouton, 2007). Accordingly, this researcher did not deceive participants about any aspects of the study that could affect their willingness to participate. The researcher further made sure not to deceive the participants about any benefits or whatever gains that they would get from the research project. The researcher informed the participants that the research was purely an academic exercise.

The researcher asked the respondents for permission to use a voice recorder. The researcher ensured the participants that they would remain anonymous not their real names will be used in the study. The researcher tried to conduct the interviews in a private room where it was possible. For those interviews that were conducted outside, the researcher and the respondents found a quiet place to do the interviews.



## **1.12 The Outline of the Thesis**

This thesis is structured as follows:

### **Chapter One: Introduction**

This chapter essentially sets the stage for the research. It contains motivation of the research which attempts to provide the why of the thesis. It provides research questions that are meant to guide the thesis and also provides objectives of the thesis. The Chapter ends up with a brief review of the Microfinance status in Maseru, Lesotho which forms the case study for this research.

### **Chapter Two: Micro-Finance in literature**

The chapter provides literature on microfinance. It reviews the past studies done in other countries on microfinance and its implications for poverty alleviation. The chapter also reveals some weaknesses of microfinance while disclosing the best strategies often applied to enhance microfinance. Furthermore the chapter dwells on how microfinance can best be made to work for the poor and ends with the synthesis of the literature.

### **Chapter Three: Supervision and regulatory framework of microfinance in Lesotho**

The chapter reviews the policy on microfinance in Lesotho and framework that is essential for microfinance to meet its objective adequately. It also reviews that challenges faced by the policy makers in ensuring the smooth operation of microfinance in the country.

### **Chapter four: Case study-current existing practices and analysis of data results**

The chapter presents the methodology adopted to meet the objectives and answers the research questions of this study. The chapter further uses the data collection methods explained in the methodology to record the current practices and procedures in the form of a case study. This chapter focuses its attention to analyzing data obtained from the interviews as well as linking it to the literature reviewed in Chapter 2. The methods set up in Chapter 3 are employed to try to understand the data from the case study. This chapter forms the main contribution of this research. The results interpretations and analysis are also presented.

### **Chapter five: Risks associated with lending in Maseru**

The chapter discusses the risks that the formal institution face when lending to the poor in Maseru. It discusses the strategies that the formal institutions have put in place in the attempt to reduce those risks

**Chapter six: The role of the Central Bank of Lesotho and the Ministry of Finance and Social Development in improving access to microfinance in Maseru.**

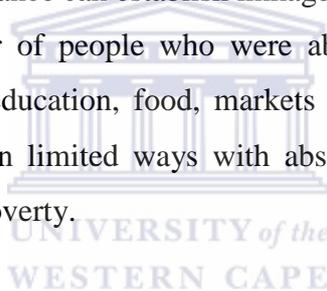
The chapter discusses the initiatives of the CBL and the Ministry of Finance in improving access to microfinance. It also discusses the challenges that the Central bank and the ministry of finance and social development in improving access to microfinance.

**Chapter seven: Prospects for poverty reduction**

The chapter discusses the need and demand for microfinance; it refers to the need to regulate the sector and the prospects of forming a microfinance association to which microfinance groups can belong. How microfinance can establish linkages and be integrated into the formal financial sector? How a number of people who were absolutely poor can as a result of microfinance now access jobs, education, food, markets etc. Microfinance is a survivalist strategy to help the poor cope in limited ways with absolute poverty, but alone it is not significant enough to eliminate poverty.

**Chapter eight: Conclusion and policy implications**

This last chapter of the research report draws conclusions from the analysis of data done in Chapter 4 and the literature reviewed in Chapter 2. Finally, policy implications of the study are identified, as are relevant recommendations based on the results of the study.



# CHAPTER TWO

## LITERATURE REVIEW

### 2.1 Introduction

Microfinance is a fast growing industry. It has attracted much attention from academic research, governments, policy designers, banks, developments agencies as well as donors across the world. The success of the Grameen Bank, founded by Muhammed Yunus, changed the view from the people in particular banks that the poor were unbankable. Today microfinance is seen as one of the strategies to fight poverty in developing countries (see Murdorch 2000; World Bank 2005; Woller and Brau 2004). Proponents for microfinance such as Murdoch (1999), Mosley (2001) and Robinson (1996) argue that it “*offers the poor the chance to improve their lives in ways that were never available to them*”. In developing countries, especially in Africa, the industry is spreading rapidly regardless of the fact that it is confronted with a number of obstacles (Latifee, 2008).

However, there are critiques against microfinance. These critiques range from the high interest rates that are often charged under microfinance lending (Hollis and Sweetman, 1998; Muhammed, 2010), to lack of convincing measurements for poverty reduction (Saleem, 2011). Engels (2010) argues for what he calls “the mission drift in microfinance”, that is institutions have departed from their social mission of providing financial services to the poor. They focus on making profit and being financially sustainable (Conning, 1999; Joshi, 2006). This has resulted in a shift away from the objective of creating systemic change in the field of microfinance worldwide (Muhammed, 2010).

The chapter discusses the evolution of microfinance, types, and the approaches used by different institutions under microfinance. It discusses the impact that microfinance has on the poor and the challenges that the industry face. It further discusses social capital and how it is used in microfinance; and the supervision and regulatory frameworks for microfinance institutions in Lesotho.

## **2.2 Definition**

The term microfinance is described differently by various scholars. Some scholars define microfinance narrowly as the microcredit that is given to poor people to promote entrepreneurship. Lashley (2004) explains that microfinance refers to lending small amounts of money to the poor for enterprise development to achieve a sustainable rise in income above the poverty line. According to Aliyev (2007) microfinance is the provision of financial services to people deprived of conventional banking and financial services due to their low income standing. These definitions worked in the 70s when microfinance was based on the provision of microcredit to the poor.

Microfinance today has grown and has developed into a broader concept which include providing savings, loans for consumption, insurance and other basic financial services to the poor (Robinson 2001). Ledgerwood (1999) describes it as provision of financial services to low income clients, credit and savings, insurance, payment services. Microfinance also offers financial intermediation, group formation, development of self-confidence and business training that lead to social intermediation (Ledgerwood et al 1999, Ali Jaffari 2011).

The definition used in this study is that microfinance is a provision of micro credits, savings, insurance and skills to the poor clients with the aim of helping them to improve their socio economic activities. It goes beyond improving the lives of the poor, building relationships among people by using their traditional models as a way of helping them.

## **2.3 Evolution of microfinance**

The evolution of microfinance can be traced back to 1800s years ago. During these early years Friedrich Wilhelm Raiffeisen established credit unions to assist the rural poor to break down their dependence on money lenders and improve their welfare (Beaudry, 2011). Since then, Germany's Village Bank and Chicago's Shore Bank were established; and later in Indonesia, the Indonesian People's Credit Banks (BPR) opened in 1895<sup>4</sup>. Over the years, the microfinance institutions such as the Rotating Savings and Credit Associations (RoSCAS) or savings clubs were established in the villages to help the poor with savings and small loans.

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<sup>4</sup> See also Kiva (2012)

In the 1970s, microfinance was dominated by non-governmental organisations (NGOs) and governments with the aim to extend credit to farmers in developing countries. At that time, farmers and entrepreneurs were lent money by the governments and development organisations (Brau, 2004). These schemes were unsuccessful because credit was unprofitable for rural poor farmers and the monitoring of loans was insufficient (Wright, 2001). Subsequently, this led to significant amounts of default, tremendous losses, recapitalization, and the eventual failure of the great majority of lending programs (Nourse, 2001). An alternative method to help the poor became necessary.

Therefore in the early 1980s, credit extension shifted focus from farmers to small business women to invest in micro businesses in few countries in Africa, Asia and Latin America. This credit to business women was not supplied by government; rather it came from organizations and individual lenders. Conning (1999) explains that the lending was done in the form of solidarity group lending. In this type of lending, group members guaranteed the repayment of all members (Buckley, 1997). In late 1980s, Mohammed Yunus, the founder of Grameen Bank in Bangladesh made such a great success in microfinance that the world began to realise that microfinance could be used as another approach to poverty reduction (Robinson 2001; Ottero 1999; Buckley 1997). Since then, microfinance has proven to be an efficient way of reaching, and tapping, the talents of the poor with the possibility of empowerment and promotion of entrepreneurship through the financial intermediation.

Today, various institutions such as self-help promoting institutions (Rotating savings and credit associations, Grameen and village bank) and NGOs are involved in changing the perception that the poor are incapable of changing their lives. Furthermore, formal microfinance does not only offer credit to the poor but has diversified into other important services such as savings and insurance (Bawer, Chytilova and Modurch, 2008).

## **2.4 Approaches to microfinance**

### ***2.4.1 Institution approach***

The institution approach is concerned with the financial stability of the institutions. The ‘institutionists’ argue that microfinance institutions should work towards being self sustainable and avoid financial assistance of any kind. The sustainability is reached when institutions are able to cover all administrative costs, loan losses, and financing costs

(Murdoch 2000; Conning 1999; Thapa, 2005). Joshi (2006) argues for a commercial approach to microfinance in which the future of microfinance is dominated by numerous large-scale, profit-seeking financial institutions that provide high quality financial services to large numbers of poor clients. This approach is supported by Hollis and Sweetman who in 1998 did a study on what made microfinance successful and sustainable on funds that were given to institutions in the 19th century in Germany, United Kingdom and Italy. They conclude that subsidized loan funds were more fragile and lost focus more quickly than those that obtained funds from depositors.

The approach also focuses on the breadth of outreach (number of clients) rather than the depth of outreach (levels of poverty) reached. Commercialisation of the institutions is supported by many organisations such as the World Bank, The Consultative Group to Assist the Poorest (CGAP), the (ACCION International) and the United States Agency for International Development (USAID). The majority of institutions therefore use this approach because of the influence that these organisations have on many microfinance institutions (Nugroho and O'hara 2008).

The institution approach is highly criticised for its preference to work with the entrepreneurs who are already able to provide for themselves. (It also charges high interest rates which the poor cannot manage to pay mainly because institutions want to be financially sustainable and make profit (Okojie, 1999). Many believe that funding subsidies remain necessary to accomplish the social missions of microfinance institutions (Morduch 2006; Woller et al 1999).

#### **2.4.2 Welfare approach**

Contrary to the approach of institutionists what institutionists, the welfare approach focuses on helping all poor people through microfinance to get out of poverty. 'Welfarists' such as Hulme and Mosley (1996) argue that a narrow insistence on cost recovery and the elimination of subsidies only forces microfinance institutions to shed the poorest from their portfolios of borrowers because they are precisely the most difficult and costly to attend. For them, this is not a good approach to microfinancing of the poor. Welfarists envision an industry characterized by a plurality of institutional types, including both profit-seeking and social-mission entities with different levels of commitment to social versus financial return, (Brau

and Moller 2004). As far as Murdoch (2000), Woller (1999) are concerned, it is possible for microfinance institutions to achieve sustainability without being self-sufficient. Welfarists do not throw away the importance of being self-sustainable but they disagree on the approach of doing it at the expense of the people they are serving.

The welfare approach focuses on reaching the poorest with their services. They even target the poor who are living below 1\$ per day compared to the economically active poor who are targeted by the institutionists. Dichter, (1997) Johnson and Rogaly (2003), argue that promoting sustainable microfinance by increasing interest rates like the World Bank suggests, may be doing more harm than good by increasing the indebtedness and vulnerability of the poor. Dichter (1997) believes that the money that institutions get from investors is to be used to alleviate poverty because social investors are not expecting to get any returns from the money they give.

The insistence on financial sustainability shifts the focus from helping the poor to focus on financial sustainability of institutions. In fact Remenyi (2008) argues that financial inclusion of the poor is the reason why microfinance was started in the first place. In developing countries, Nongovernmental organisations offer microfinance services to the majority of the poor in the rural areas. They have social mission rather than profit making which could be what developing countries need in order to reduce poverty.

However, the approach has reported low repayments rates as well as very high functioning costs leading to the failure and to the disappearance of some microfinance institutions (Hamed, 2004). As a matter of fact, many of the microfinance institutions are faced with obstacles of viability and durability which limits their development and their capability to contribute to the development of the person they help and to a poor performance (Otero and Rhyne, 1994; World Bank 2008 and Murdoch 2000).

## **2.5 Microfinance and social capital**

The success of microfinance has raised questions such as: why it is successful, what holds the groups formed under group lending together, what has kept informal microfinance operating for such a long time, and whether microfinance promotes economic growth. The answer to these questions is found in what Grootaert (1998) calls the missing link in development

theories, which is 'social capital'. Interest in the role of social capital and economic growth has been made famous by the work done by Coleman (1990) and Putnam (1993). Microfinance through the work of Muhammed Yunus proved that social capital can be used to promote not only social capital but economic growth.

People in communities develop relationships to help each other in financial and social needs. They use those relationships to share information, upgrade skills and support each other. (Coleman 1990; Putnam 1993; Grootaert 1998) refer to those relationships as social capital. Microfinance uses those relationships as a substitute of collateral to offer credit to the poor.

Putnam (1993:67) defines social capital as "features of social organization such as networks, norms and social trust that facilitates coordination and cooperation for mutual benefits". He distinguishes between three types of social capital: bonding, linking and bridging. Bonding social capital refers to relationships that a person has with family members. Linking social capital refers to relationships between those who are within societal levels and bridging social capital refers to relationships made between heterogeneous groups, the institutions outside the societal levels (Grootaert, 1998). The World Bank (2001) describes it as the institutions; relationships and norms that shape the quality of society's social interactions. Coleman (1990) goes a step further to distinguish between the horizontal and vertical linkages. Vertical linkages are the positive social networks to the overall productivity of the community such as volunteer organisations. Vertical linkages are the hierarchical relationships and unequal distribution among members (Grootaert, 1998).

Social capital is the basis for microfinance. It operates as an effective defensive strategy against poverty and is a necessary condition for development, be it economic or social development. Putnam (1990) and Coleman (1998) view social capital as an ingredient that provides societies with more efficient governance and dynamic economy and the glue that holds communities together and enables them to get things done (Minoque, 2002). In communities where there are high levels of social capital, development processes are much easier than in communities where there are low levels of social capital.

## **2.6 Informal institutions.**

Social capital is clearly seen in the informal institutions. People form groups based on the relationships they have with their family members, neighbours, work mates and church mates. According to Dasgupta (2002), people are willing to engage in mutual benefits of cooperation because they care about one another. They use that love and care for each other as collateral. La Ferrari (2003) argues that people lend each other money without expecting profit because they know that they will also need to be borrowed money sometime. The people lend money and they repay it because they value the solidarity relationship between them and the lenders. They try to avoid the social sanctions that they may receive if they default.

### **2.6.1 Group lending**

In the formal institutions, the important factor in dealing with credits is trust between the lender and the borrower. Microfinance in the formal institutions uses the relationships that are formed in informal institutions to lend to the poor. Rankin (2002) highlights the importance of the vertical relationships that are formed between the lenders and their clients; he explains that social capital is built between the institution and borrowers through the supervisions and meetings that are attended by lenders and the groups almost weekly or monthly. The Grameen model, which is used by many microfinance institutions, lends microcredits to the poor, especially women using social collateral (Mayoux 1997; Ledgerwood 1999; Murdorch 1999; Olomola 2002). Here social capital helps to correct imperfect information available on poor customers which reduces their credit worthiness. It promotes entrepreneurship because of encouragement that each member gets from other group members. It substitutes for collateral by ensuring against default through social sanctions and peer enforcement (Rankin 2002). Social capital in these groups is built through the meetings that members attend to share information, skills and encourage each other. Such meetings create bonding. Members develop a common goal such that everyone in a group feels obliged to conform to agreements made, and sees actions of default as disappointments to other members. This explains the high repayment rates that are reported by institutions such as the Grameen Bank (Anderson, Locker and Nurgent, 2002).

## **2.6.2 Individual lending**

The vertical linkages are clearly seen in the individual lending. The model is most used in many institutions to extend credit to mature clients who have demonstrated a clear credit history and are growing their businesses (Somanandha and Sigh, 2007). It is also used by institutions such as those in Lesotho, Kenya and Egypt that have failed in using group lending (Grootaert, 1998). Individual lending is the provision of credit to individuals who are not members of a group that is jointly responsible for loan repayment (Ledgerwood, 1999). According to Ismawan (2000), lenders will trust borrowers if they have some information about their creditworthiness. In order to make sure that the borrower will pay, lenders take the borrower's degree certificate, driver's license, or marriage certificate and use them as collateral (Somanadha and Sigh, 2007). In this type of lending, social capital is built through the personal relationships that the lenders make with the client after the money is lent. This is done through frequent meetings that are held between borrowers and individual clients. Thus in individual lending, social capital is not used as a way to enforce social sanctions to the defaulters, but the relationship between the borrower and the client is built as a way to encourage repayment. Social capital in individual lending therefore contributes to better economic performance and individual entrepreneurs with no or little financial collateral may benefit more from increased level of social capital (Basargekar, 2010).

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However creating strong social capital is not an easy task. It requires members to meet on a regular basis, communicate and help each other in times of defaults. Failure to meet the demands leaves members socially excluded from their groups. It creates tensions and promotes voluntary dropout which harm social capital among members. Sometimes strong social tiers can result to members not putting appropriate pressure to their members to repay (Caprillo, 2010).

## **2.7 Microfinance services**

### **2.7.1 Credit extension**

Microcredit is the extension of very small loans (microloans) to the unemployed and to poor entrepreneurs who are not considered bankable (Lapie, 1998; Helms, 2006). Borrowers do not have collateral so they are lent small amounts of money which seldom exceeds \$100 (Sengupta and Aubuchon 2008). To ensure that the groups repay, institutions use the social

collateral through the group lending. Group lending as explained by Van Maanen (2010) encompasses a variety of methods which are based on the principle of joint liability. In other words, the groups take over the underwriting, monitoring, and enforcement of loan contracts from the lending institution (Wrenner, 1995). The groups use the loans to start their own businesses to generate or sustain an income. In essence, they do anything that will help them build wealth and move out of poverty.

### **2.7.2 Savings**

Gudz 1999 defines savings as the residual remaining after an entrepreneur has paid household and business operating expenses. Institutions recognised that not all their clients are interested in being entrepreneurs but are interested in other financial services such as savings, money transfers and insurance, (CGAP, 2010). Nonetheless there have been very few accessible and safe options available to them until recently, when breakthroughs pioneered by the Grameen Bank have shown what is possible. (Alex as cited by Bill, 2010).

The savings services offered by microfinance institutions substitute for inefficient and risky mechanisms that the poor resort to such as investing in unproductive business assets, (Guds, 1999). Campion and White, (2001) argue that the impact which savings bring to both the institutions as well as borrowers cannot be ignored as savings contribute to the financial growth of the poor and output for the institutions.

In spite of the poor's needs to guard themselves against unforeseen problems, some institutions do not offer this service. According to Ugur (2006) non commercial institutions are not regulated. They therefore do not qualify to offer savings to their clients. For some institutions, savings is considered costly and risky relative to other sources of financing (Miller, 2003), for others such as Lesotho there is poor savings culture (WSBI, 2012). For those institutions which offer savings, they are used as a way to safeguard the repayment of their clients (Miller, 2003). This may be the reason why in many institutions such as the Grameen bank borrowers are required to deposit their money into the mandatory savings account instead of encouraging voluntary savings (Ruben,2007). Guds (1999) has noted that this results into people's resistance as in most cases savers do not even understand why they are forced to do so.

### **2.7.3 Insurance Provision**

Microfinance institutions are moving away from focusing only on what Churchill (2002) terms the product focused mentality. They are improving from providing loans to the poor to a more holistic approach which helps their clients to also manage risks. Microinsurance is the protection of low-income people against specific perils in exchange for regular monetary payments (premiums) proportionate to the likelihood and cost of the risk involved (Latortue, 2003). The poor can insure different events such as life, health, age, accident; credit and property (ILO STEP, 2002; Dror and Preker, 2002). Health and life insurance are the most prominent forms of microinsurance (Brown and Churchill, 1999).

However, not many institutions offer microinsurance. This is due to the fact that microinsurance has only recently been introduced in microfinance so, many institutions lack the resources to effectively offer insurance programmes (World Bank, 2001). In Lesotho for instance, commercial microfinance institutions have only recently started operating, there is lack of knowledge about providing microinsurance, lack of effective legal system to enforce contracts, (UNCDF, 2010). It might take a while before institutions provide microinsurance in an effective manner.

Murdoch (1999) explains that the institutions that have started offering insurance programmes have been successful even though they are operating on the limited scale. Several types of community based insurance groups have emerged in sub-Saharan Africa (Wiesmann and Juetting, 2000; Atim, 1998), Asia (Krause, 2000) and other regions (Bennett, Creese, and Monash, 1998; Jakab and Krishnan, 2001) and have also been successful. (Juetting and Ahuja 2000) explain that the community insurance based groups are often successful in guarding against risks in particular health. These groups are able to reach to the lowest income earners in the community and are always available to help in times of need. Churchill (2002) encourages microfinance institutions which have not started offering microinsurance to copy from the community based microinsurance models. He argues that having a multi-faceted relationship with the client can also strengthen customer loyalty or reduce desertion by making it expensive or difficult for clients to leave.

## **2.8 Impact of microfinance**

Microfinance in countries such as Bangladesh, India, Kenya and Ghana where it has been successful has proven that it is an effective tool that can be used in the fight against poverty. UNDP (2004) states that studies have shown that microfinance plays three major roles in reducing poverty. First it helps the very poor household to meet their basic needs. Second, it protects them against risks (Churchill, 2002). Third, it improves the household economic welfare by empowering women (Mordeno, 2010).

Scholars such as Littlefield and Elizabeth (2004), Murdoch and Hashemi (2003), Simanowitz and Brody (2004) and the IMF cited by Wrenn (2007), argue that microfinance has proved to be an effective tool in reducing poverty. With regards to the millennium development goals, it has proved to be one of the tools that can be used as it has already been useful in helping achieve many of the goals, (Murdoch, 2000).

### **2.8.1 Empowerment**

A large percentage of the world's poor is comprised of usually women and children. The social structure places them at a disadvantage because men are the bread winners and decision makers in the households. By acquiring access to financial capital and starting their own family businesses, women increase their decision-making power in the household and are able to possess skills in entrepreneurship and financial management (Mordeno, 2010). Arunachalam (2007) is of the view that microfinance has allowed women to have a collective bargaining mechanism at the local level. It has facilitated them to move beyond their households and build relationships with various stakeholders; and it has given them the platform to combat various oppressions. With microfinance, women are given the power to be entrepreneurs, make their own decisions and in their own ways to overcome poverty challenges.

Nevertheless, not all scholars have the same opinion on women's empowerment through microcredit. Mayoux (1999) and Van Maneen (2004) argue that women are not automatically empowered by receiving microcredit. They only get empowered if the cultural freedom to work and maintain a flexible household division of labour is already present (Mayoux, 1999). In communities where the cultural freedom is limited results may not be the same. According to Kevane and Wydick (2001) empowerment is linked to women's natural ability of

providing for their families but ignores the power dynamics in the families which sometimes result to women not controlling the microcredit but their husbands.

### **2.8.2 Social changes**

The social changes that microfinance brings to the societies can be observed through different aspects in people's lives. These include people's behavioural, cognitive and material change. Most microfinance institutions especially the 'welfarists' such as Woller and Dunford (2004), Vetrivel and Kumarmangalan (2010), see their role in enhancing the social development as more important than helping with savings and loans. Microfinance gives the poor an opportunity to view their poverty as an opportunity for improvement. Instead of being miserable, committing crime, blaming other people for their poverty, they use the prospects that they are given to change their lives economically and socially. Kowalik and Miera (2008) state that the income helps women to use the profits from their businesses to send their children to school, improve their families living conditions and nutrition, pay for medical services and expand their businesses. The improvements not only make an impact in their families but the communities they live in.

Rogaly and Johnson (2003) argue, however, that using social benefits to measure the impact of microfinance is inadequate because the precise source of the finance is not clear. According to them, social change can be brought about by other factors. They call for a broader analysis of the impact of microfinance than the social and economic benefits.

### **2.8.3 Improvement of self esteem**

Unlike the commercial banks which are almost exclusively based in towns, microfinance is found in most communities. Van Maanen (2010) observes that microfinance provides psychological benefits to the poor clients by promoting a sense of self-respect and dignity, much more than handouts and grants. Success, self-respect and dignity seem to be the motivation for the poor to work harder. Microfinance gives them hope that they are not just losers, born to fail. Knowing that they are able to take out a loan, start their own business, and repay the borrowed capital through their own efforts and hard work, the poor are convinced that they are capable of doing something that could certainly change their lives for the better (Mordeno, 2010). Moreover, financial support and welfare support are no longer needed because microfinance offers better ways for the poor to become self-sufficient. Becoming

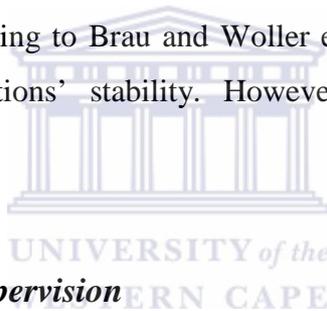
self-employed through their own businesses allows them to have a more stable source of income. If effectively managed, these businesses could potentially grow, resulting to a higher amount of earnings for the poor's household. And so, utilizing microloans to advance entrepreneurial endeavours makes the poor better off than simply relying on welfare and high-interest loans from money lenders (Robinson, 2001).

## **2.9 Challenges of microfinance**

Despite anecdotal stories of success and testimonies from borrowers, microfinance faces some challenges.

### **2.9.1 Sustainability**

The sustainability of the institutions is the major concern for scholars such as (Brau and Woller 2004; Robinson 2001; Moderno 2010). They argue that microfinance institutions have to commercialise their services in order to be sustainable and not rely on funding from governments and donors. According to Brau and Woller et al (2004) financial stability is a necessary condition for institutions' stability. However this is still lacking in most microfinance institutions.



### **2.9.2 Poor regulation and supervision**

Regulation and supervision of microfinance institutions is a major problem. Majority of microfinance institutions are not subject to government regulation (Ugur, 2006). This hinders the growth of the institutions. Unregulated institutions cannot take up people's deposits or offer insurance services (Staschen, 1999). For those institutions which are regulated, the supervision is very poor. Supervisors themselves lack the knowledge about the microfinance industry (Carrasco, 2006). For regulation and supervision of microfinance institutions to be effective, the regulators must understand the differences between traditional and formal microfinance (Campion, 2001). The understanding is important as it helps the regulators to know the kind of regulation they should apply for both types of microfinance.

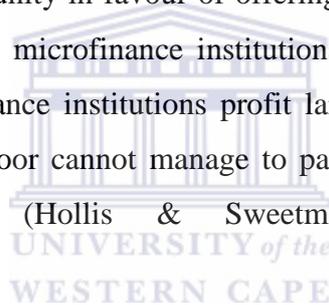
### **2.9.3 Lack of capacity in microfinance institutions**

Most microfinance institutions especially in developing countries lack the capacity to effectively manage microfinance, (Gallado, 2001). This as Campion (2001) argues is due to

the fact that most commercial microfinance institutions started as NGOs whose mission was to reduce poverty. Their transition to commercial microfinance institutions has resulted in problems of competent management team. Few microfinance institutions have the management capacity to successfully manage a commercial financial intermediary (Muhammed,2010). The fact that microfinance is gaining popularity does not help the prevailing situation as most microfinance institutions constantly lose their best employees to other institutions due to high competition in the industry (Batt and Tang, 2010). A competent team in microfinance is therefore vital.

#### ***2.9.4 Targeting of the active poor***

The problem with microfinance is that it seems to benefit the economically active poor more than it does with the poorest (Jonathan and Barbara 2002; Mordurch 1998, Dugger 2004). Avoiding the poorest in a community in favour of offering loans to the less-poor appears to be a common strategy for many microfinance institutions (Ruben, 2007). Criticisms from scholars put that some microfinance institutions profit largely from charging high interest rates which the poorest of the poor cannot manage to pay and this results to the financial exclusion of the poorest (Hollis & Sweetman 1998; Mordurch 1999).



#### ***2.9.5 High interest rate***

Hollis and Sweetman 1998; Joshi 2006; and Mordurch 1999 suggest that some microfinance institutions profit largely from charging high interest rates which the poorest of the poor cannot manage to pay. Orbuch (2011) states that India microcredit face a collapse from defaults because of high interest rates. The poor are therefore not able to repay the loans. This might happen to some banks especially those operating in developing countries if the situation does not change. Microfinance will therefore lose its primary objective of reducing poverty.

## **2.10 Summary**

The literature reviewed in the foregoing section argues that microfinance has come a long way. Over the past years the sector has fast proved to be an alternative to poverty reduction. It has managed to bring an alternative to the commercial banks that for a long time have been thought as the only formal way in which people could save and be loaned money. For continents like Africa, with a high poverty rate, it has proved to be improving the lives of many through its provision of small and medium loans and other important financial services. Microfinance institutions have proven that the poor are bankable even without the collateral. In fact it is because of the collateral that the poor are encouraged to work hard to improve their lives, save and pay their loans. Bolivia, Bangladesh, India, Ethiopia, Ghana and Kenya have proven this, although it has taken a lot of effort and the strong leadership.

Microfinance institutions need to be sustainable in order to effectively provide services to the poor. But whether or not institutions should all be commercial remains a debatable issue. Providing microfinance services to the poor is very important. Loans for the poor are not only to finance their investment, but also to protect their income against unpredictable shocks, such as harvest failure, sickness, and other social obligations, (Matin, 2002).

Social capital plays a very important role in microfinance. It gives lenders guarantee of repayments because where there are high levels of trust there are slim chances of default. It also helps to spread information about important things that affect the poor such as how they can access the services, which is lacking in formal banking.

The sector has realized its short comings and acknowledges the criticisms that have been levelled against it. The criticisms will however pave the way for microfinance to become better, and grow. There is much that has to be done to improve the sector. Microfinance with all the challenges it still faces is not the only answer to poverty reduction.

# CHAPTER THREE

## THE INSTITUTIONAL AND REGULATORY FINANCIAL FRAMEWORK OF LESOTHO

### 3.1 Introduction

This chapter discusses the importance of regulating microfinance institutions. It discusses the regulation and supervision approaches of financial institutions. It further discusses microfinance in Lesotho, its regulatory framework as well as challenges that are faced by Lesotho in regard to regulation and supervision of microfinance institutions. It ends with a summary of the main ideas discussed in the main text.

The acceptance of the role played by microfinance and the shift in the activities of such institutions means that regulation and supervision are necessary. In the past, Microfinance institutions used to only extend micro credit but lately microfinance institutions take deposits in the form of savings and provide insurance. This new shift in microfinance activities warrants regulations and supervision of microfinance institutions. Regulation is rules governing the conduct of legal entities and individuals while supervision is the external oversight aimed at determining and enforcing compliance with regulation (Gallado, 2001; Rhyne, 2002). The primary reason for regulating and supervising the financial institutions is to protect the consumers in financial institutions. Gallado (2001), states that in most cases the interests of the financial institutions are not compatible with the interests of the depositors or investors in the institutions. This therefore places the consumers at the disadvantage because they are not able to judge for themselves the soundness of the institutions (Arun, 2005; Jansson, 1997 and Gallado, 2001). The regulatory framework that is used by most countries is the framework from Basel Committee on regulation and supervision<sup>5</sup> (1988).

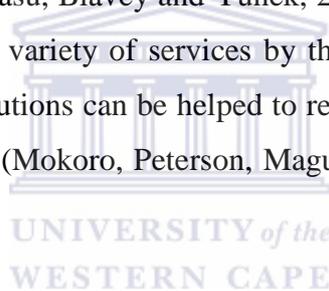
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<sup>5</sup> The Basel Committee on Banking Supervision is a committee of banking supervisory authorities which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. (BIS 2010).

The general regulations and supervision used to regulate both banks and microfinance institutions does not include and incorporate microfinance in all its diversity. Christen, Lyman, Lauer and Rosenberg et al (2011) argue therefore that there is a need for microfinance to have their own regulatory framework that will regulate and supervise the microfinance institutions in a way that balances financial access, financial stability, financial integrity, and consumer protection.

### **3.2 Why should microfinance institutions be regulated?**

Traditionally, microfinance operated on subsidies from governments and donations from organisations. Lately, they have shifted to a financial approach and offer a variety of services. This has attracted concerns for regulation and supervision of the institutions. The rationale for regulation of microfinance institutions is to support an ethical and healthy environment for microfinance activities, while not restricting the growth of the industry by imposing unnecessary requirements, (see Basu, Blavey and Yunek, 2004). Regulation for microfinance institutions increases access of a variety of services by the poor. It also develops a market system where microfinance institutions can be helped to reach financial sustainability and be included in the financial system, (Mokoro, Peterson, Magutu, 2010; Gallado 2001; Carrasco 2006).



Microfinance institutions differ in size and in the services they provide. Stiglitz, (2010), and Christen and Rosenberg (2000) argue that the extent and nature of regulation between banks and non-banks has to differ depending on the roles the non-banks play in the economy. For example, the regulation that is done on microfinance institutions has to be cost effective, be compatible with the regulation of the banks however it also must be flexible enough to accommodate the diverse nature of microfinance institutions, (see also Carasco, 2006). In most countries microfinance institutions are regulated under the regulatory framework of Banks. Countries such as Ghana and Peru which have for some time shown the success of microfinance in their countries have their own regulatory body that deals specifically with microfinance institutions in all their various forms. Sudan, Zimbabwe, Cape Verde have begun the process of drafting the microfinance specific legislation (CGAP, 2008).

### **3.3 Prudential regulation**

Prudential regulation is done by governments through the Central Bank to the institutions that accept people's deposits. This is done to protect the people's money especially the poor. It is also used to promote the sector, by putting the institutions that are already operating in line with the requirements that will help them grow, hence encourage the emergence of other institutions (BIS, 2010). Some countries such as Mozambique, Rwanda, and Uganda differentiate their microfinance institutions according to their function and use different approaches to their regulation such as the self regulation as well as special regulation. South Africa, Liberia, Lesotho and Tanzania among others do not differentiate and regulate all institutions under prudential regulation requirements (CGAP, 2008). Some of the prudential requirements include:

#### ***3.3.1 Minimum capital***

The first prudential standard is the minimum amount of liquid capital that Microfinance institutions should raise to enter the regulated market. The minimum capital serves as a protection in case microfinance institutions experience losses. It shows the commitment of the institutions before starting their business (Staschen, 2003). The minimum capital requirements vary across countries. For instance, in Pakistan it is \$27.9 million, while it is \$2.5 million in Bangladesh (Haq, Hoque and Paqan, 2008; 386). Fleisiq & Lapena (1996) argues that minimum capital requirements for the establishment of a new microfinance institution should be realistic and accommodative for microfinance institutions and small banks operating at a local level. This will help institutions to avoid situations such as in Nepal where institutions choose to register as credit institutions in order to avoid bank prudential minimum capital.

#### ***3.3.2 Capital adequacy***

The Basel Committee (1988) suggests that the risk weighted ratio of the international banks be 8%. This ratio is accepted worldwide and used as a minimum standard (Stiglitz, 2005). The standard differs in some countries as the distinction is made between microfinance institutions and the rural banks. For example, in Ethiopia, capital adequacy is 12 percent for all microfinance institutions, while in Ghana and Pakistan it differs according to the type of microfinance institution (Stiglitz, 2005). McGuire and Conroy, (2012) suggest however that

the capital ratio should be higher for small and rural microfinance banks because they reflect higher risk.

### ***3.3.3 Flexibility in Interest rates***

The regulations of interest rates differ from one country to another. Some countries such as Thailand have interest rate ceilings which are set by their central banks. Some countries such as Indonesia, Pakistan and Ghana have left the institutions to set their own interest rates but those institutions are monitored by the central banks in those countries (Haq, Hoques and Pathan et al 2008).

### ***3.3.4 Insider lending and operational restrictions***

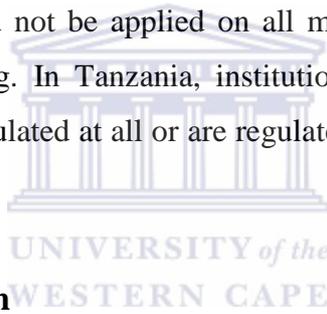
According to Staschen (2003) insider lending refers to the people directly or indirectly connected to the ownership or management of the microfinance institutions, including directors, officials, employees and shareholders. Insider lending creates the conflict of interest because lenders sometimes give themselves more favourable loans than the outsiders. Christen (2003) explains that this problem is huge in microfinance institutions in Africa. Bolivia and Nepal has banned the insider lending at all. Bangladesh, BRI in Indonesia and BAAC in Thailand have all developed standard management information system and procedures. Thailand requires the borrower to be handled by credit chief and depositors be recorded separately by the tellers. Ghana, Uganda and Indonesia loans are minimised to a certain percentage. Bangladesh requires the MFIs to maintain the system of internal control particularly in respect to loan management (Haq, Hoque and Pathan 2008; Staschen 2003; Yaron 2004; Christen et al, 2003).

The aim of internal controls of lending therefore is to monitor and manage risks, minimise fraud and irregularities, and control employee behaviour, (Rachmadi, 2004). This can be achieved when institutions apply proper business strategies. However Jansson (1997) argues that while it is important to prevent conflict of interest in the institution, microfinance institutions should be allowed the flexibility to run their businesses as they see fit.

### **3.3.5 Governance and ownership requirements.**

Good governance promotes well operated institutions. Owners of institutions are required to have a governance structure in order to overcome issues of internal controls as well as risk management. Proper government structure adds value to the institutions, some protection from government interference (Wright et al, 2001). People who are working together in management share experience and advice; they can help the institutions grow. It is argued that microfinance institutions, semiformal and informal, acting as deposit-taking institutions, should comply with similar banking requirements to ensure a good structure of corporate governance (Vogel & Loftdedt, 2000). Professional microfinance institutions' governance structures, such as those in the Grameen Bank in Bangladesh and Indonesia which have a board of directors and government representatives as well as shareholders, are needed.

However, (Stiglitz, 2001; Barbarch, 2012; and Gallado, 2001) argue that while prudential regulation is necessary, it should not be applied on all microfinance institutions especially those that are non-deposit taking. In Tanzania, institutions which are credit led, such as savings credit unions, are not regulated at all or are regulated under non prudential regulation (Yaron, 2004).



### **3.4 Non Prudential regulation**

Non prudential regulation is concerned with the good behaviour of the institutions, (Barbarch, 2001). The main focus of non-prudential regulation is protection of consumers of financial services. It enables operation of a range of institutions that provide a mix of appropriate products and services. It provides governments with information to carry out economic, financial, and criminal enforcement policy (CGAP, 2008). The non-prudential regulation is concerned with regulating rules on consumer protection, information disclosure, prevention of fraud and financial crime prevention. Regulating institutions under non prudential regulation does not mean that they are not important but that they may not need the same supervision like the one made for prudential regulated institutions.

### **3.5 Microfinance regulatory framework in Lesotho.**

Microfinance in Lesotho has been in existence since 1970s, with credit cooperatives being the oldest (CBL, 2004). Credit cooperatives administer savings among themselves and then extend the credits to those who need funds. However, the World Bank report in 2008 states

that the cooperatives in Lesotho have been very successful in the past, particularly by mobilising funds, but are continuing to fail in handling of credits, where they have had very poor performance.

In 1975, the government of Lesotho established Basotho Enterprises Development Cooperation (BEDCO). It was intended to operate as a subsidiary company of Lesotho National Development cooperation (LNDC). In 1980 it was made a parastatal, set up to help extend microfinance services to the poor and develop the indigenous economy. The objectives of BEDCO were to promote Basotho owned businesses and to offer microfinance services (BEDCO 2009). It operated in all ten districts of Lesotho. Many people, especially women, benefited from BEDCO: they acquired various skills such as sewing and tailoring, they were assisted with marketing of their businesses as well as business management training, (BEDCO, 2011). The microfinance function was not a successfully implemented function because many people defaulted on their loans. Ozer and Komat (2010) argue that the culture of Basotho also contributed to the failure because they fail to work in small groups.

The collapse of BEDCO in offering small loans to the poor led to more financial exclusion. Access to financial services for the poor has become a major challenge. The financial services which comprised of three foreign owned commercial banks were concentrated in urban areas only. In 2004, the Lesotho Post Bank was established. The bank's aim was to bring financial services to the majority of the population and extend credit to the underserved rural population, (The Lesotho Post Bank, 2010).

Prior to the establishment of the Lesotho bank, the Cooperatives Act was amended in 2000. After the amendment, the cooperatives such as Boliba and Letsema emerged and they have managed to show sustainability in their operations (Ozer and Kamat, 2012). Other microfinance institutions surfaced but were all concentrated in the urban areas particularly Maseru (UN, 2006).

In 2010, the Government of Lesotho, with the help of donors such as United Nations Development Programme (UNDP) and United Nations Capital Development Fund<sup>6</sup>

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<sup>6</sup> UNCDF is a United Nations Organisation that makes investments in the least developing countries. The investments are designed to helpless developing countries to reduce poverty and achieve the Millennium Development Goals (UNCDF, 2006).

(UNCDF) launched the Financial Inclusion Investment Programme. It adopted inclusive finance strategy as an effective tool for promoting access to financial services. It was largely understood to be a microfinance programme that would have the potential to enhance lives of the poor by mobilizing domestic savings, aiding self-help projects for the job creation and improving local livelihoods, both in the informal and formal employment sector.

Recently, the microfinance sector has been growing and informal financial institutions, in the form of RoSCAS as well as burial societies, have gained popularity. Today there are various microfinance institutions in the country. They comprise commercial banks, insurance companies, money lenders and nongovernmental organisations. However microfinance in Lesotho is still highly informal.

### **3.6 Supervision and regulatory framework in Lesotho**

There is no specific microfinance policy in Lesotho and specific regulation pertaining to microfinance. However, microfinance institutions are regulated by the Central Bank of Lesotho under various statutes. These statutes include a number of Acts and Regulations, CBL (2004). These are the Financial Institutions Act 1999; Money Lenders Act 1989, Cooperatives Societies Act, 2000, as well as the Companies Act of 1967.

#### ***3.6.1 Financial institutions Act 1999***

The licensed financial institutions in Lesotho are regulated under the Financial Institutions Act of 1999 and microfinance institutions fall under these Act. The minimum capital that is required from the institutions before they are granted the license to work is ten million Maluti<sup>7</sup>.

The insider loans are not allowed to be on terms and conditions more favourable than the general terms and conditions applicable to other borrowers. The lending limits of the insiders are regulated to 25 percent of the capital.

The banks and microfinance institutions are required to have 25 % liquid assets which are to be in the form of total currency held, surplus funds at the Central Bank, deposits with local

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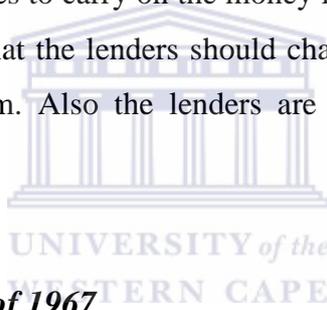
<sup>7</sup>Maluti is pegged to the Rand 1:1 ratio i.e one Maluti equal to one Rand

banks , and government securities. The reserve balance should not amount to less than 3% of deposit liabilities. Again banks are required to have clear policies stating how they plan to deal with matters such as liquidity management, management information systems, Central liquidity control, diversification of funding resources as well as contingency planning.

The adequacy assets on risk weighted assets are 8%. This percentage is based on the suggestions of the Basel Committee 1988, (CBL, 2008).

### ***3.6.2 Money Lenders Act of 1989***

The law prescribes that money lenders licensed under the act may not advertise their business, or operate the business in more than one address. It empowers the Commissioner of Financial Institutions (CBL), to revoke a licence if the holder fails to commence operations within a period of one year; fails to comply with the conditions of the licence; is in breach of any provision of this Act; or ceases to carry on the money lending business. There is no fixed percentage for the interest rate that the lenders should charge however the Act states that it may not exceed 25% per annum. Also the lenders are not in any way allowed to take deposits.



### ***3.6.3 Companies Act No.25, of 1967***

The Companies Act makes provision for the constitution, incorporation, registration, management, administration and winding up of companies and other associations. The Companies Act stipulates that foreigners are only able to register companies if they have local counterparts. All registered institutions are requested to submit the audited reports to the central bank, or the commissioner (depending on the type of institution it is registered in) every six months and at the end of the financial year. They are obliged by the law to show assets and liabilities so they could be protected in cases of defaults by borrowers, (Central Bank of Lesotho 2004).

### ***3.6.4 Cooperatives Act of 2000***

The Cooperative Societies Act of 2000 request deposits from non-members up to the maximum of one million rand. This differs with the law in Money Lenders Act which does not allow the institutions to accept any money from the public or funds from the public. The

law empowers cooperatives to enlarge their outreach particularly in the most difficult parts of the country where rural communities live.

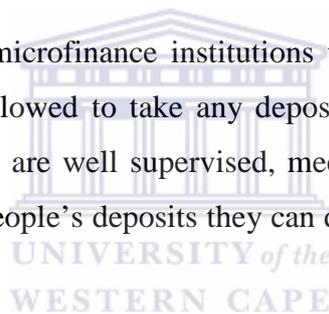
### **3.7 The supervisory responsibility of the Central Bank of Lesotho**

#### ***3.7.1 Licensing of Banks.***

Microfinance institutions which only accept deposits are to be licensed under the financial Institutions Act of 1999 (FIA, 1999). However there is no microfinance institution that is licensed under this Act. Institutions choose to be licensed under other Acts as they are avoiding the difficult requirements of the Act, particularly the minimum capital requirement, (CBL, 2008).

#### ***3.7.2 Money lenders***

Money Lenders Act applies to microfinance institutions that deal in credit business (CBL 2003). Money lenders are not allowed to take any deposits. Most institutions are licensed under this Act. If money lenders are well supervised, meets the requirements and wants to operate as institutions that take people's deposits they can do so but will then need to register under the FIA 1999 Act.



### **3.8 Assessment of regulation and supervision of microfinance institutions in Lesotho**

The Financial Institutions Act of 1999 is the only Act that regulates and supervises financial institutions in the country. It is also the only Act among other Acts that seem to be in line with the prudential regulation requirements that are used by banks as well as other formal microfinance institutions worldwide. However, it lacks some important factors such as the regulation on the governance and management of these institutions and the interest rates.

The Central Bank (2008) noted that microfinance institutions started operating formally and taking a more commercial approach to offering their services yet no institution is registered under this Act. This means that even though institutions are supervised they cannot fully operate as banks since the other Acts which they are registered under prohibits them from expanding through taking people's deposits and offering insurance services. Furthermore the insurance providing institutions are licensed under a different Act that deals specifically with

insurance provision. This means that insurance provision in Lesotho is not treated as part of microfinance.

The CBL stated in 2004 that the multiplicity of Acts that the microfinance institutions use cause problems in regulation. Institutions which offer the same services are regulated under different regulations and Laws. This makes it difficult for the CBL to have a clear record of the progress of the institutions. Institutions conveniently prefer to be licensed through laws that pose the least regulatory burden to them (CBL, 2004).

Majority of microfinance institutions in Lesotho operate as nonbank institutions. Their licensing requirements fall under non prudential regulation. Even though they are licensed and recognised as formal institutions, they are left to operate their institutions at their own discretion. The only supervision they get is meant to make sure that they comply with the Act requirements, that they do not charge exorbitant interest rates especially the money lenders.

### **3.9 Challenges of regulation and supervision of Lesotho**

The absence of the regulatory and supervision of microfinance pose some challenges to the Central Bank. The following are the challenges as described by (CBL, 2004).

#### ***3.9.1 Outdated legal framework***

The legal framework that is used needs to be revised as the Acts are too old, and they lack most of the important clauses that are applicable to the present experiences. The informal providers of microfinance such as the burial societies, rotating and savings credit association are excluded from the regulatory framework because they are not required to register. They need to be licensed and supervised. This will help to graduate them from the informal to formal institutions. Microfinance institutions take advantages of the loopholes in the regulation and are being involved in illegal operations with borrowers.

#### ***3.9.2 Lack of capacity***

The Central Bank of Lesotho lacks the capacity to effectively supervise microfinance institutions. Supervision of the banks has for a long time been its focus. It started supervising other types of microfinance institutions only in 2004. This extension in supervision has

created a number of problems for the bank. In the 2005 Central Bank report, the Bank states that it does not have the capacity to supervise all institutions. This hinders the growth of the institutions and may result into many microfinance institutions operating as illegal. This will eventually lead to the failure of the supervision framework.

### **3.9.3 Supervision cost**

Furthermore the costs of supervising Microfinance institutions are greater than those for commercial banks. The Central Bank (2004) states that it is costly to carry out the supervision of the institutions effectively especially in the rural areas. (Arun, 2005; Kirkpatrick and Maimbo, 2002) add that it is more costly to design and implement regulations for the microfinance industry than to leave it unregulated, especially when the more numerous and small MFIs outnumber the banks (Gallado, 2005). In this case the Central Bank has to extend their regulations to the microfinance institutions, In most cases the Central Bank does not have budget for such institutions.

### **3.10 Summary**

The shift in the functions of microfinance institutions means that regulation is important. Microfinance institutions have started operating their institutions formally. They are being regulated and supervised like other financial institutions such as banks. A lot of progress is made by most institutions with regard to separating the regulation and supervision of microfinance institutions and formulating the policies that deal with only microfinance institutions. They have advanced from using only one regulatory framework for all institutions to separating institutions according to their functions.

The prudential and non-prudential approaches to regulations provide the space for the growth of the industry. It allows those small non-bank institutions which do not yet qualify to be regulated as heavily as those which operate as banks a chance to grow. They are supervised and still offer other important services even though they cannot operate as deposit taking institutions. The greatest challenge still faced by microfinance institution with regard to regulation in a majority of countries is the supervision of the institutions. As Christen, Lauer, Lyman and Rosenberg (2011) note, “supervision of microfinance institutions is very costly to the supervisor, as well as the supervised institutions”. This results in countries leaving small,

no deposit taking institutions to self-regulate themselves ( Mokoro, Nyaoka, Magutu and Osongo 2011; Yaron 2004; Gallado 2005).

While regulation and supervision of the industry does not guarantee that there will be development for the industry, it serves as a facilitator to limit opportunistic behaviour and enhance growth. It protects the industry itself and the poor consumers' money. It also encourages fair competition of the institutions and promotes discipline to those dealing with the poor people's money. Much effort is still required by microfinance institutions and governments to promote the industry further and encourage the informal institutions to register and operate as formal institutions. In this way the depth of outreach of poverty alleviation will be achieved.



## CHAPTER FOUR

### PRESENTATION AND DISCUSSION OF FINDINGS

#### 4.1 Introduction

This Chapter presents and discusses the findings of the research. The chapter is divided into four parts. The first part discusses the impact of microfinance on the livelihoods of the participants. The second part discusses factors that have facilitated the formation of informal microfinance groups in Maseru; Lesotho the third part discusses the consequences resulting from informal microfinance. The fourth part discusses the microfinance services that are provided both in the informal and formal institutions. Finally the chapter discusses the challenges faced by informal institutions.

#### 4.2 Field description

The research was conducted in Maseru, the capital city of Lesotho. It is located near the Mohokare River, next to Lady Brand: a town in South Africa in the Free State Province. Many of the poor people living in Maseru come from the other nine districts of Lesotho and usually have come to search for jobs in the urban area. In particular, they seek jobs in the textile industries owned by Chinese and Asian traders (FINSCOPE, 2011). However, because of excess supply of labour to these industries, the majority of these people remain unemployed or self-employed. The challenge of those who are self-employed is to get finance to boost their business or start the new setups. Consequently, these people use self-financing or obtain finance from the so called money lenders or self-help groups known as rotating savings and credit associations (ROSCAs) which in most circumstances are the informal microfinance groups. Therefore, in an attempt to answer some of the questions of this study, interviews were conducted using the sample from these people who are self-employed and who participate in microfinance lending. Four members from each group were chosen through selective sampling in which the researcher went to the small entrepreneurs at their businesses in Maseru town and they in turn gave names and contacts of their group members (see Chapter 1 for detailed discussion on methodology). The names of the participants quoted in the analysis and names of their groups have been changed in order to maintain confidentiality.

### **4.3 Description of Rotating savings and credit associations and burial societies in Maseru**

#### ***4.3.1 Rotating savings and credit associations***

The ROSCAs in Maseru are local institutions that are made up of people from the same communities, friends and relatives. The membership from the groups that were interviewed ranges from 6 to 18 members. Most of these groups are made up of women. All the groups have names; the researcher interviewed a group named Lishoeshoe with 12 members, Raohang Basali with 8, Kopanang bomme with 6, Banna khotla with 12 and Women in Solidarity with 18. More than six of the groups that were interviewed have been in existence for more than five years; the oldest group was Lishoeshoe, which is made up of members who are between the ages of 40 and 50, and have been together for 11 years. The youngest group was only one year old, and consists of women who are in their middle twenties, new in the business and are helping one another other grow in the business.

The majority of groups function in a similar manner. Members pay contributions each month and the money rotates until all members have had their share. Members are also given credit which they pay back with interest. On top of the contributions, an amount of money that ranges from M100 to M500<sup>8</sup> is paid by members at the beginning of the year and used to provide credit. In other types of RoSCAs, contributions are in the form of shares. The more shares the member buys, the more money she/he gets, and the more contributions he/she pays. Credits are also given in this type of a ROSCA and paid with interest.

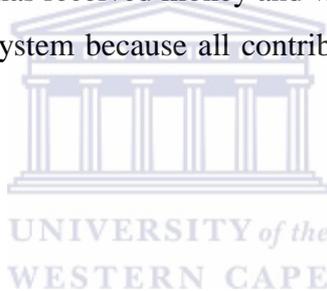
The amount of money that is contributed in each cycle is decided by the members. They make the decision themselves, based on the number of members, the average each member earns, and the purpose of the ROSCAs. For example, the highest contributions are paid in Iketsetseng Basali Group. They contribute M5000 a month because their objective is to help each other buy building material for the houses they are building. Banna khotla, on the other hand, contribute M200 because that is the amount that most of their members can afford, and they do not have specific goals for their savings.

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<sup>8</sup>One Loti M1.00 is equivalent to one South African Rand; it is equivalent to \$0.11.

There are different methods in which receivers of money are chosen. In some ROSCAs members are given the money depending on who is in most need of the money; however, proposals are given in advance, and the group decides in the last meeting in a cycle who will get the money in the next. In some groups, receivers are chosen in the form of lottery names of the members are written and put in a box, one person is chosen to draw the names, and the first name drawn gets the money first. In others groups, members decide in the first meeting who will get the money and when, so that members know in advance the month when they will receive money.

Members hold meetings on the last Sunday of the month. The meetings are held at one of the members place and they rotate until all members have hosted meetings. The host buys refreshments and the meetings normally start in the early afternoon and last until 6 or later. All ROSCAs do not have a committee; rather, one member is chosen to keep records of who has paid, who is borrowing, who has received money and who is in line to receive the money. Some do not use the save/bank system because all contributions go to the person chosen to receive the money in that cycle.



#### **4.3.2 Burial societies**

Interestingly, all the people in the ROSCAs are also members of burial societies. Burial societies are also formed by people that live in the communities and are relatives or friends. Burial societies are formed by people who have realised that they are not able to afford the financial costs of their own burials and those of their relatives. Burial societies are also used for social acceptance because people who are not members do not get the assistance they need from community members in times of funerals. People want to escape abuse they get from communities when they are not able to meet societal expectations of a decent burial.

Each member in the group provides a list of the people he/she wants to cover. It is normally the person's family: husband/wife and kids, parents from both sides, and two other dependants. There is a committee that is responsible for the contributions, made up of the person who records all the contributions and the money that is paid, two treasures responsible for the depositing and withdrawal of the money from the bank.

The contributions range from M50 to M2000 a month. When there is a funeral or one of the relatives is dead, the members are expected to attend the funeral, especially if it's near. Women help with the cooking, and men slaughter animals and dig the grave. They also help with the equipment that will be used at the funeral such as chairs, plates, and tables. An extra M50 is paid by each member to help with the immediate needs such as groceries that are needed before the actual burial day. The amount paid out varies from M5000 to M15 000 depending on the contributions of each member and the number of members in the burial society.

#### **4.4 The impact of microfinance on the livelihoods of the participants in Maseru, Lesotho**

In this part, findings from this study relating to the impact of microfinance on the livelihoods of the participants in Maseru are discussed.

##### ***4.4.1 Microfinance has enhanced social relations***

All the respondents explained that their involvement in microfinance has strengthened their social relations (friendships). One of the respondents named Polo claims that being “in microfinance is like being in a new family with new group members”. She explained further that the members of her microfinance group support her in ways that her own biological family members have never done for her. The other respondent by the name Moipone explained that being in the microfinance group for more than three years with the same group members has enabled them to “get closer” and understand each other more. One other respondent named Mathato even calls her group mates “sisters” as in the case for Tshehlo who calls his group members “brothers”. In their own words, they expressed the benefits of microfinance as:

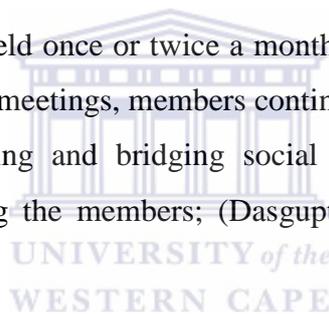
*“These brothers have taught me more about brotherhood, and neighbourhood. I now understand what the Bible explained about that guy who asked Jesus who his neighbour is (Laughing)”. They are my true friends and neighbours now”,* Tshehlo claimed.

Lineo also experienced the extent of her group's friendship when she lost her husband. She explains that the group members were there to support her during the mourning period and expressed herself as:

*“.....So now I know I am closer to these women than ever before, I have had more cherished relationships with them beyond explanation. We share everything, pain, jokes, and problems,” Lineo.*

The group meetings enhance the social and bonding capital because members interact and get to know each other better (Rohini, Erica, and Feigenburg, 2010, IFMR 2011). The researcher attended a meeting of one formal institution with its clients. After the meeting, two of the officers went to a clients' houses to check on the husband whose legs had been amputated. The researcher learned that the officers do more than hold meetings with their clients. They have a personal relationship with their clients and understand their struggles. Bastelaer (2000) explains that the personal relationships work in the favour of the lenders because the loan officers gradually acquire information about the borrower's creditworthiness, which can be used in enforcing repayment schedules and other program decisions.

Group repayment meetings are held once or twice a month in Maseru as is the case in many microfinance groups. In between meetings, members continue to interact with each other. It is in those interactions that bonding and bridging social capital are formed. The regular interactions enhance trust among the members; (Dasgupta, 1988) hence strengthen social relationships.



#### ***4.4.2. Microfinance has promoted information sharing***

All respondents stated that their groups serve as a place where they communicate important issues such as health, businesses and family issues. Malikhabiso explains that in her group they do anything, from teaching each other how to cook, to sewing and singing. Some groups such as “women in solidarity” explained that they have even advanced to the point where they invite different experts to train and educate them on financial, health and social issues. Some respondents explained their group functions in the following manner;

*“One never knows which business she will want to do next, so it helps to know a little bit of everything (smiling)”*, Bokang.

*“I look forward to the next meeting, because I know I will not come back the same. Those women never disappoint me”*, Mamosia.

As explained in Chapter 2, the literature argues that microfinance promotes social networks. These networks enable people to even share information regarding business strategies/models

and best practices in business ventures. The sharing of information helps to upgrade skills of those who enter microfinance without adequate skills. The evidence discussed above show that indeed microfinance goes beyond standard business information sharing to personal relations and support of each other (Coleman, 1988, Putnam, 1993, Grootaert, 1998). Indeed informal groups serve as a platform for the poor to learn and be involved in finances. The groups allow the poor to overcome some of the constraints such as access to credit by the poor. Members share experiences, opinions and information with other group members. The implications of the networks formed through microfinance are therefore the promotion of entrepreneurship and businesses in the economy.

#### ***4.4.3 Microfinance has improved the social feeling of solidarity for its participants to assist one another in times of need***

Sometimes these groups are formed because people just want to help each other, not only with money, but also with other social needs that become defined once the groups have started working. In the case of Ithabeleng's group, they were already a circle of friends that met most weeks to discuss everything from gossip to life challenges and needs. *"We used to help each other every time there was need, basically we are giving each other the needed support"* explains Nthabiseng, one of the group members.

For Maneo and Puleng, the fact that their friends were able to give each other support in important events such ceremonies was the main reason why they started a group.

*"Starting a group for us was just a way of formalising an informal group, to raise money in order to carry on the support that we had already being giving each other",* Maneo.

*"Mxm, my group members are there for each other. In all things, whether in parties, or funerals everywhere, without them things cannot go smoothly, so, starting a burial society for us was easy, we had seen how the help and support are needed in situations like that",* Mohajane.

Interestingly, the study found out that some microfinance groups were formed as a result of the social need for the respondents to help each other in times of hardships. Under these types of microfinance groups, the borrowed funds were mostly channelled towards financing ceremonies (i.e. marriage, traditional ceremonies) and funerals. Part of the borrowed funds is used to assist/support friends and family members in times of financial swings. These

microfinance groups were more of social network groups formed specifically on the basis of social trust. Each respondent within such groups regarded each other as a member of his/her own family with very strong ties.

Within these groups, small finance is usually provided by the group members whenever any misfortune falls on the household of any of the members of the groups. The assistance extended usually takes monetary support or physical presence by members of the groups to give their support during tragedies. It was noted that this form of microfinance has actually been in existence for a long time, even before microfinance as it is understood today emerged. Microfinance within such groups is understood as a form of insurance against unforeseen catastrophic events.

The horizontal networks in this situation are already in existence, and as (Ito, 1998) observes people use those networks to improve their lives. Even though the groups are formed as part of helping each other, they end up offering microfinance services because an amount of M 50, M100, and M150 from each member is saved every month. Loans are given and the groups also act as insurance. They protect the members against risks such as death, and keep members from getting into debt from ceremonies such as weddings and graduations.

#### ***4.4.4 Microfinance empowers women in Lesotho***

The discussions in the previous chapters show that most people involved in microfinance are women. The findings in Maseru correspond with the literature. During the interviews the women explained that microfinance has provided them with an opportunity to become entrepreneurs and be financially independent. Lerato explained that before she started being in the microfinance she did not see the possibility of her being an entrepreneur, but due to the money and skills she acquired from group members she is now a business woman. This was also confirmed by one respondent who in her own words stated.

*“Once women are given the credits, those who have a sense of entrepreneurship try in all ways to make sure that the money is used in projects that will generate income”*,  
Makhopolo.

Since the interviews were conducted mostly in the respondents' place of work, the researcher was able to confirm that indeed women were empowered and were running their own businesses. Some had even become employers with at least one person working for them.

The literature on the impact of microfinance on women explains that borrowing by a woman has a greater impact on per capita household expenditure on both food and non-food items (Yunus 2003, Khandker 2005, Murdoch 1999, Smith 2002, Pitt and Khandker 1998). It also shows that health care of women improves. The existence of microfinance in Maseru has empowered women entrepreneurs.

The financial education that is being offered by the CBL and the government of Lesotho has equipped them with more knowledge on how to improve their lives. They are now able to make informed decisions in regard to how they access finances and how to spend it. This was evident in the businesses that they run and the testimonies they gave on how microfinance has empowered them to improve their livelihoods and deal with their everyday challenges.

#### ***4.4.5 Microfinance has relaxed financial constraints for its participants***

It was revealed during the interviews that microfinance has relaxed financial constraints faced by its participants. Today a number of these participants feel that being a member of the microfinance groups has allowed them to borrow money to finance even their traditional celebrations such as burials and weddings. In fact, a number of those that borrowed for burial purposes felt that microfinance has enabled them to bury their deceased with dignity. This is expressed in the words of one of the interviewees:

*“I do not know what I would have done, when my mother passed away, Thabo’s father (her husband) and I were not working at that time”, Alice.*

Malerato adds that being in a society eliminates the stress that one would have if their loved ones were to die and they had no money to bury them.

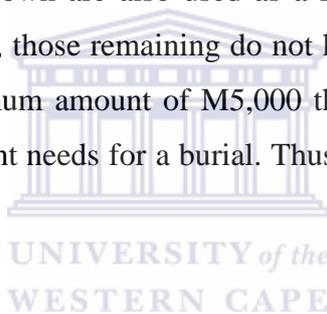
*“At least I know the casket and the vegetables are taken care of; it allows me to mourn and not worry about what I am going to do”, Malerato.*

Although paying monthly contributions remains a challenge to more than half of the participants in these groups, particularly the poor, Maneo who is about 50 years old claimed that she could not afford to miss being a member of the burial society; put in her words she said *“who is going to bury me when I am dead?”* She explained that although she does not work, she uses the money she receives from her children to pay her monthly contributions.

The other two women who are about the same age with Malineo, explained that they use the money from government social grants “(which they call the Mosisili’s money) to pay for their monthly contributions. They express their feelings as follows:

*“ I always make sure that as soon as I come back from getting the Mosisili’s money, I send my children to pay the contributions, I do not want to be buried like a nobody, I worked hard while I has money. I need a decent burial.”* Mapaballo.

The discussions in the forgoing paragraphs are in line with the arguments raised by DGR SA (2003) and Croome, Nyanguru and Molisana (2007) that in many African societies people consider their ability to bury their loved ones with dignity as a very important cultural event, hence microfinance facilitates the undertaking of such important cultural events. It was noted during the discussions with the interviewees that almost everyone who is a member of a Rotating savings and credit association (ROSCAS) is also a member of a Burial society in Maseru. Burial societies in this town are also used as a form of insurance against risk. At least when a family member dies, those remaining do not have to sell their assets in order to pay for funeral costs. The minimum amount of M5,000 that members get from their burial societies covers much of important needs for a burial. Thus, microfinance has also been used as insurance for the poor.



#### ***4.4.6 Microfinance has improved the livelihoods of its participants***

There seems to be a consensus in all participants in microfinance in Maseru that the formation of microfinance groups has enabled them not to struggle to support their families like they did before joining such groups. The evidence discussed in the following paragraphs shows that the livelihoods of the people have improved. For women, being able to take care of their children’s needs such as school fees seemed to be what made them happy to be in their groups as expressed in the words of one of the participants below:

*“My child no longer owes school fees, I make sure that I have the money, if it’s not my turn to get the contribution I take a loan from the members.”* Thoriso.

Another participant by the name Lineo added that being able to get loans from the group helps because in case of emergencies one knows where to get money,

*“I do not need to wait for the next morning to go to a bank and get charged interest rates that I do not even understand.” Lineo.*

The findings concur with the studies done on microfinance and its impact especially on women. That microfinance enables Women to support their families, improve their entrepreneurship skills and improve their decision making (Moderno, 2010, Aruchanalan, 2007 Kristen, Lauer, Lyman and Rosenberg (2007) CGAP (2011), Modurch (1999) and the World Bank (2000)). The evidence given in the previous discussions show that microfinance in Maseru has changed many lives of the people involved in it in various ways. Access to microfinance services especially credit has improved women’s ability to stand up for themselves at the business level as well as in their families. Because of that ability, they run their own small businesses without depending on their spouses for everything. The realisation of their ability to contribute in their family welfare is what empowers them, and motivates them to do more.

#### ***4.4.7 Microfinance has enhanced entrepreneurship in Maseru***

Half of the respondents stated that being in the rotating savings and credit associations (ROSCAs) has enabled them to become entrepreneurs. They were able to get start up capital from their groups and they started businesses. Some of the respondents, who were already involved in businesses but could not expand their business because of the lack of finance, explained that the ROSCAs helped them to overcome such constraint. In their own words, these participants who find microfinance so valuable express it this way:

*“....I decided I was not going to spend the money on useless things, I went straight to lady brand (the nearest town to Maseru in South Africa) to buy stuff and started selling in my community.” Mpho.*

*“When I saw how the women in my group succeeded in their businesses with the loans from my group, I had no option but to do something that would benefit my family.” Reabetsoe.*

*“My business is no longer seasonal, I operate through out, I know I can always borrow money from my group whenever my business is not doing well” Limakatso*

*“I was able to expand my business, I earn a living and I am also an employer now, two people now work for me.” Mamotselisi.*

It therefore becomes evident from these claims that microfinance does indeed provide access to credit that promotes entrepreneurship. This finding is in line with other studies on the impact of microfinance in countries such as Bangladesh, Ghana, India and Bolivia. These studies show that people who have access to microfinance are able to start businesses and earn a living (see Khawari, 2004; Pitt & Khandker, 1998; Gallardo, 2001; Murdoch, 1999; ACCION, 2003 and Navajas & Conning, 2003). Evidence from our interviews show that most people in the informal groups in Maseru are not educated, without formal employment there is not much they could do to earn a living other than to start their own businesses. Access to microloans either in formal institutions or ROSCAs provides an opportunity for them to change their lives through businesses. Most women have started their small businesses with credits starting from M100 to M500 depending on the type of business they wanted to establish.

However, one limitation raised by Bayrasli, (2012) is that access to credit does not automatically make people entrepreneurs. 20 of the respondents still did not have businesses and some businesses have failed despite the efforts of their owners. Many of those that failed were due to lack of entrepreneurial skills, and some were just not interested in businesses so they did not apply enough effort to see their businesses succeed.

#### ***4.5 Consequences resulting from informal microfinance***

Although informal microfinance institutions have proved relatively successful in meeting the credit needs of small enterprises in Maseru, there are limitations associated with informal microfinance lending. These limitations impact on the effectiveness of microfinance in meeting their intended goals. The limitations are not only restricted to their limited resources, which, restrict the extent to which they can effectively and sustainably satisfy the credit needs of the entrepreneurs/participants, but also the outcomes on the participants in these institutions. The discussions that follow outline some of the consequential effects of microfinancing under informal lending in Maseru, Lesotho.

##### ***4.5.1 Unlawful practices***

20 statements from the respondents showed that they have been involved in the unlawful practices in their groups and with money lenders. Majority of the respondents admitted that

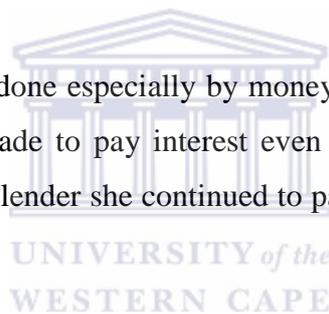
money lenders take their important belongings such as passports and bankcards when they borrow money. Five of the ten groups admitted that there have been some unlawful practices done to some of their members when they tried to recover their money from the defaulters. Mathabo (one of the respondents involved in informal groups) explained that just two months before the interview they had gone to one of their members' house. This is how she expressed herself:

*“And we took all some valuables especially from her furniture, she owed us, we had to sell her stuff to get back our money”*, she happily explained.

It seemed this happened in other groups also because Palesa also admitted to have beaten one of their ex members who had defaulted with their money

*“It was the only way we could show her our seriousness; that we wanted our money back.”* Palesa.

There is also a lot of corruption done especially by money lenders. One respondent referred to an incident where she was made to pay interest even when she knew she had finished paying. Out of fear of the money lender she continued to pay until one of the relatives took it upon himself to rescue her.



Often money goes missing in groups because people who are entrusted to keep records and money sometimes use it for their own purposes. The following statement of one of the respondents confirms that some people do use money for their personal purposes.

*“Mathato borrowed herself our money and could not return it on time before we could see it. When she could not account for it there was nothing we could do except take her belongings and expel her from our group .....”* Lerato.

Bhatt and Yung tang (2010) explain that in the event where borrowers are not able to pay; group members and money lenders resort to extreme and often inhumane methods to recover their loans. In some places such practices may even entail physical injury or personal bondage (Jaeger and Pereira, 1986). The majority of respondents attested that they were tortured in one way or another by the moneylenders. However it is in rare cases where members actually go to their member's houses to take their belongings.

#### **4.5.2 Debt trap**

Fifteen of the respondents interviewed were highly indebted in banks, moneylenders, family/relatives. They stated that they struggle to pay their monthly contributions, as well as the interest on their loans. The indebtedness comes because of the high interest rates at which members borrow from the money lenders. For instance during the interviews, it was noted that interest rates charged by the money lenders were threefold more than those charged by commercial banks (35% per month compared to banks that charged 10%). In cases where the groups fail have enough money to lend to members, they again sought out money lenders for borrowing.

*“Every month when the groups are meeting, and contributions are needed, I borrow money from money lenders especially Thabo and give my sisters their contribution. He even knows me now (laughing), seriously” Mathabo.*

*“The thing with borrowing money from the ‘machonisas’ (money lenders) is that they take our important belongings. For six months I could not even go to Lady Brand (a town next to Maseru) the machonisa had taken my passport, bank card and my phone. I struggled a lot to pay him and ended up borrowing money from group members to support my family” Tshehla.*

Makhoka, Rarugia, Staal & Kosura (2000), Moderno (2010) argue that women entrepreneurs have financial social demands that compete with business capital, leading to a diversion of capital away from business needs. Most women take micro credits from formal institutions in order to start businesses but end up using the money for consumer purposes. Sometimes entrepreneurs overestimate their business capacity and end up taking big loans that they are not able to repay. Such instances explain the coexistence of formal and informal microfinance. Once borrowers are not able to pay the loans from the banks; they borrow from their informal groups. At month end when they do not have money for contributions they borrow from family or money lenders hence indebtedness.

The study revealed that because money lenders have information about their borrowers. They normally raise interest rates for such borrowers. They know that they are desperate, and will borrow the money regardless of how the interest rates are. This worsens the debt of these borrowers. As a result businesses collapse and the vulnerability of these people increases.

### **4.5.3 High interest rates are an obstacle to growth**

Twenty three respondents explained that they borrow money from money lenders to cover for the immediate needs. However the interest rates are as high as 30% and often clients remain indebted because they are not able to pay the interest. Respondents are aware of this but still continue to borrow from them. The response by one of the interviewees below shows that the borrowers know about the high interest rates they have to pay the money lenders.

*“once a person borrows money from money lenders chances are they will not be able to finish paying the loans, the interest rates are just too high for us”* Mapallo.

Ithabeleng, Lintle and Mohaja are also aware of high interest charged by money lenders but they keep borrowing money from them. The respondents who borrow from money lenders expressed themselves this way;

*“Eish, when I borrow from them (money lenders) I do not worry about the interest rates, but about the emergency that I have to attend to with the money they borrow me”* Mohajana

*“Err, it’s embarrassing to always ask money from family, so ‘machonisas’ (money lenders) are better because they won’t talk about my debt to other people, which makes paying their high interests bearable”* Ithabeleng.

Given the forgoing evidence, borrowers willingly borrow and pay the interest rates of the money lenders. When they weigh the choices between not having access to credit and getting the credit and paying high interests rates, they choose the latter. The World Bank (2000) states that the lending relationships that moneylenders cultivate with the borrowers are of a long-term nature, they are usually based on a pattern of personal interactions with the borrowers and their families. Borrowers feel comfortable borrowing from them than they do with the formal financial institutions. In Maseru as is the case in other countries studied in the literature, money lenders live with borrowers in the communities. They are therefore able to have more detailed knowledge about their borrowers. Thus trust is the basis for many money lenders’ loans.

However for most people who are trapped in the debt of paying interest to money lenders, microfinance does not bring the desired impacts. It brings more poverty and stagnation. Borrowers struggle to grow their businesses; the money they use to pay interests to the loans

could be used to grow their businesses. It also leads to more unlawful practices by the borrowers who are struggling to pay their debt. One common practice that was revealed by the interviews is that women turn to prostitution; they have multiple partners whom they use for money in order to escape from poverty. The information asymmetry about banks also contributes to these. If the information is clear and people are educated about microfinance in the informal sector they would be able to avoid paying such high interest rates that do more harm than good.

#### **4.6 Factors that necessitated the formation of microfinance groups in Maseru.**

As discussed in Chapter two, the formation of microfinance groups in Maseru dates back to the 1960s. These informal groups have persisted to the present. The research has identified four basic reasons for the formation of these informal arrangements: (1) Provision for an easy access to finance; (2) Provision of affordable loans (loans granted at lower interest rates); (3) Absence of collateral as required by commercial banks (4) Information asymmetry about services that commercial banks offer.

##### **4.6.1 The need for loans given at lower rates.**

Respondents stated that they wanted to have access to loans that are given at a lower rate. They believed that forming a group would enable them to have access to loans with lower interest rates.

*“I needed a place where I would be involved in decision making of how much the interest rates should be depending on how much we can all afford to pay.”* Lipholo.

All the respondents do not qualify to get loans from the banks; to them forming groups with people of similar income to theirs was the solution to their needs of loans with lower interest rates.

*“We always hear of cases where people are not able to pay loans because of high interest rates from banks, we didn’t want that, we formed our group so we could work in a safe environment and pay interest rates according to how much we earn”* Mamotselisi.

*“Our interest rates would have to be lower than that of banks, so that we could all be able to repay our loans”* Limpho.

The general belief among the respondents was that, informal groups offer loans which are charged at lower rates than in the formal institutions like commercial banks. Contrary to this belief, the researcher learned that interest rates (borrowing rates) in informal groups were charged at no less than 15% per the amount of money borrowed over the period of three months. The lending rates were as high as 25% in some groups. The interest rates in some of the groups are even higher than interest rates at the formal institutions. Furthermore, the time given for the repayment of loans under informal microfinance is shorter than under formal credits arrangements, which is usually a year or more. Interviewees were however content about the interest rates charged in their groups. They still regard the interest rates low. This may be caused by the general belief among the low income earners that banks are expensive and not for the poor. They do not take time and learn about how banks operate. The issue and belief about loans given at low interest under informal microfinance arrangements seemed a common place across all groups interviewed. It is perhaps not practically correct, given that commercial banks' lending rates ranged from 12% to 15% per annum during the time of the research/interview.



#### ***4.6.2 The need for easy access to finances***

All people interviewed claimed that the basic reason why they entered into this informal microfinance has been the need for easy access to finance. They indicated that for quite a long time, banks in Lesotho were not willing to extend credit to people without collateral or those that did not have steady regular means of income generating activities like formal employment. The people interviewed claimed that it was after they realized that they could not get any assistance from commercial banks that they formed the informal microfinance groups. Such groups were deemed convenient for every person involved. In these ROSCAs the element of trust was not that important, people came together and formed a group because their income is the same, some are in the similar jobs while some have the same background such as single parents but the objective is the same, to have easy access to finances. The following statements show how Stacey and Bokang joined their group,

*“We work in the same building with Lerato, but I can’t say she was a friend, one day she came to our house (a rented place where she sews traditional attires ‘lishoeshoe’ and proposed that we form a group that will help us to have a quick access to finances as she was complaining that banks are taking a lot of her money” Lebesa.*

*“We needed a place where we could get money whenever we wanted it, so forming a group with my friends that would help with quick finances was the better idea”,*  
Bokang.

Studies done by Modurch and Conning (2011), Robinson (2001), Ledgerwood, (1999) suggest that the poor are not included in the formal banks this is why they seek finance in informal institutions. The key finding here is that the poor in Maseru are financially included in the formal sector and some

of the interviewees reported that they have access to finance in the formal commercial banks. On the contrary, people are in the informal microfinance because they want to have an extra place where they get can get easy access to their finances. The groups have around the clock availability, are easy to process and have flexible loans which the poor prefer. In the informal groups members can borrow even the smallest amount of M500 or less at anytime, without the extensive paperwork.

#### ***4.6.3 Lack of collateral required in informal groups.***

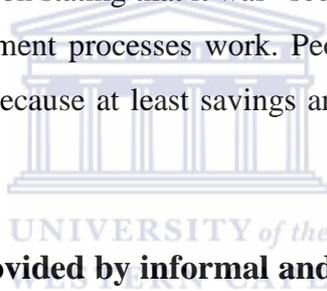
The research further discovered that twenty respondents formed or joined informal microfinance groups because of the collateral free lending system under informal microfinance groups. They regarded the fact that there is no requirement for collateral when one borrows under such informal arrangement as one of the principal reasons why they participate in informal microfinance. They also believed that “no collateral requirement” is the most significant factor explaining the success of their groups. The absence of collateral requirement in times of borrowing seemed to suit the poor most, who work hard to repay the loans because those groups are the only places where can borrow money to meet their needs without any collateral requirement.

#### ***4.6.4 Information asymmetry about banking services.***

Although, all respondents stated that they knew about banking services, and some are even clients in various commercial banks, they had little idea about conditions of loans offered by commercial banks such as the rates of the interest charged by commercial banks as well as the administrative fees that they have to pay. That little knowledge about services offered by commercial banks has led to the formation of the informal groups. Respondents believed that

informal microfinance borrowing is less costly relative to formal commercial banks borrowing.

Subsequently, formal institutions were interviewed about services they provide. The researcher learned that in some groups, the operation costs and the interest rates in the formal institutions were less than the costs in some informal groups. Information asymmetry about banks is caused by a number of reasons such as poor bank outreach where banks concentrate mostly in urban centres with little effort given for such outreach to rural areas; the failure of people in microfinance to seek information from commercial banks time and gain; the failure by commercial banks to make available information about their services in native language which could be understood by most people that cannot read English language. Some of the banks are not transparent and honest with the terms and conditions of their loans. Only two of the institutions were frank with the researcher on how much interest they charge their clients, the rest refused with the information stating that it was “secret”. This means clients take loans and are not clear how the repayment processes work. People therefore save and get credit from sources outside the banks because at least savings and interest rates are discussed and agreed upon by all members.



#### **4.7 Microfinance services provided by informal and formal institutions**

Informal microfinance institutions provide the same services as those provided by the formal financial sector. Even though the methods used to deliver the services differ, the essential services which are credits, savings and insurance are the same. The research discusses the three categories of services provided in these institutions which are (1) Savings. (2) Credits and (3) Insurance.

##### ***4.7.1 Savings***

In the informal groups, there is an amount of contributions that members pay at the beginning of the year. The contributions differ according to the level of people in each group. People in the groups pay an agreed amount of money every month. The money is collected and given to each member at a time and the money rotates until all members have had their turn. Majority of the respondents explained that they find that being in their groups helps them to save a lot of money. About half of the respondents used the word “push” to explain how paying contributions help them to save. Two women Nteboheleng and Moipone say that they are

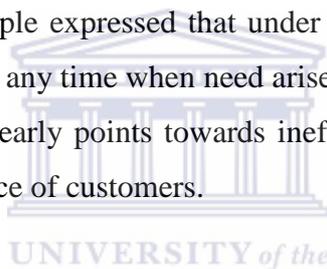
able to save now which is something they did not do before joining their groups. This is how they expressed themselves:

*“I am now pushed to pay contributions in my group; I find I save a lot of money which I could have used for useless things sometimes”* Makhopolo

*“Hmkk, I do not have to worry and feel guilty that the month has passed and I did not save”* Thato.

*“Saving has become part of my life now, I can’t live without paying my monthly contributions for I know the benefits that come with it, I just can’t, hahaha (laughing)”* Moipone

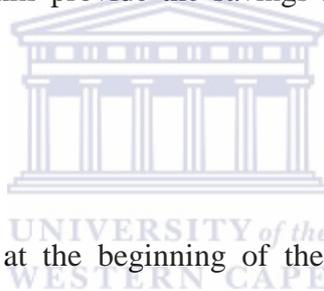
Ten interviewees felt that that was a need for them to save part of their wind fall money for the future unforeseen events; however, they never had knowledge on how to open bank accounts. Consequently the best way to have their savings was to put them in informal microfinance. Some of these people expressed that under such informal arrangements, they could easily access their saving at any time when need arises without having to join long queues at the commercial banks. This clearly points towards inefficiency of the banking system in terms of provision of timely service of customers.



Savings provided by the formal financial sectors requires the people to be the customers first. Two institutions out of five that were interviewed offer savings services to their clients. Clients are required to have an account and deposit some money in those accounts weekly, or monthly. Savings are provided in forced and voluntary savings. As Brau and Woller (2004) explain, forced savings presumably teaches financial discipline and provides the MFI with additional information about clients. Formal institutions also use these form of savings as a form of collateral (Nourse, 2001; Ledgerwood, 1999). Through the savings, banks screen clients which can be loaned money and be able to pay. The researcher learned that less than half of the respondents did not save with the commercial banks, for the same reasons that have been discussed above. Fifteen of those who are clients felt that the savings did not work for them because they withdraw the money a few days after it is deposited. This therefore does not serve the purpose that it is supposed to serve. At the end of every month their accounts are empty. Other respondents saved with the formal sector and were happy with their savings and the way the banks operate.

Savings is an important part in microfinance as it helps the poor to save guard themselves against unforeseen risks such as health (Ledgerwood, 1999; CGAP, 2012). In the case of entrepreneurs it helps boost their businesses. Many people use the savings to start their businesses and they take loans to help boost their businesses. For a person who is in a ROSCA that pays R200 a month with eleven members M2400 can start a small business. This is the main reason why the poor save in the first place, to have enough money that can enable them to do something to improve their living.

It is not that the saving in the commercial bank is not successful, but people themselves lack discipline as in most cases they withdraw the money every time they feel they need to do something (FINSCOPE2012) Savings end up being used for consumption instead of business growth. WSBI (2008) adds that there is a very poor savings culture among the Basotho this is why there is no consistency in their saving. It will take time for Basotho to learn how to save. Moreover not all commercial banks provide the savings services so the poor's choices are limited.



#### **4.7.2 Credits**

The contributions that are paid at the beginning of the year are used to give Credit to members. One or two people are allowed to borrow money in a group and return it with interest for a period of three months. Interest rates differ according to the agreement each group make. For Tshehla, Matseliso and Malerato's groups, the interests that are charged add to the amount of money that is shared at the end of the year by all members.

*“This is why every member in the group is encouraged to get credit, the more you borrow, the more money you make for yourself” Poone.*

*“Hmm, even though paying the interest rates, loan plus contribution is difficult, I borrow the money as many times as I can, I'm in a way saving because that means more money for me at the end of the year”, Lerato.*

For Moliko and Palesa's group the interest is used to increase the amount of money that members are credited with. In their own words, they explained the reasons for paying the interest like this;

*“Getting a M1000 at the beginning of the year is not possible, there is no money, but once one or more people have borrowed money and returned it with interest the amount increases”, Ithabeleng.*

*“Paying the interest helps to increase the number of borrowers, just last month, three people borrowed money, it’s in the middle of the year, we have made some savings through the interests that early borrowers have paid” Palesa.*

Loans in the formal institutions are also given but only to the people who are already members of those institutions. Members are allowed to borrow any amount of money provided the institutions are content that they will be able to pay it over a period of specified time. However an amount of M20 0000 or more is difficult for the poor to get because one needs assurance which most poor borrowers do not have.

*“We do lend our clients small amounts of money of about M5000, it is not a big deal to us as long as we are convinced that they will pay back” Thabiso.*

*“We prefer to borrow our clients a lot of money, it bears less costs compared to the small amounts of about M 2000”, Lebeko.*

Almost all the respondents fully agreed that access to credits is the reason why they are in the informal microfinance. They feel it is only in their groups where they get access to credits. Unlike in the formal institutions, members are allowed to borrow money against what they earn without collateral and are given a reasonable time to repay it. They also feel like they are part of the decisions made in regard to their loans because all agreements on how the loans should be repaid are made by the group, whereas in the formal institutions they have to adhere to the decisions already made by the banks.

Very few respondents, about ten of them did not feel like credits are important for them, they cited fear of debt as the reason why they do not take the credits. The researcher noted that some of the respondents especially those that did not want to take credits are afraid of taking risks, they are so content with where they are that they do not want to improve their situations by borrowing against what they can afford to pay.

The study conducted by Sebstad and Chen (1996) suggest that women in the informal sector may have access to credit but do not have control over their loans. The majority of respondents especially married ones stated that they give their money to their husbands to

make decisions on how the money should be spent. This therefore affects the way in which women spend their loans.

The methods of credit delivery are divided into two categories in the formal institutions; Group and individual lending methods. The group lending is offered by only two institutions and at a very low interest rates. The interviewees from these institutions explained that group lending is not as successful in Maseru because the clients are not able to work together. The banks have also failed to use the joint liability to their advantage hence experience defaulters from this kind of lending. The other institutions explained that they have not even tried it; the researcher learned that most of the respondents did not even understand how the group lending works. As a result the method used by all institutions is individual lending.

Unlike in the informal institutions, not everyone is eligible for loans in the formal sector. Loans are given to those people who are screened from the savings history, and the active poor. The majority of respondents agreed that interest rates in the formal sector are too high. They also explained that they do not understand the extensive paper work that they go through before getting loans; therefore they have opted to stay with informal loans. The processes of lending money in the formal sector exclude many poor people who do not have collateral hence the only place they feel offers them the opportunity is in their informal groups.

Hulme and Mosley (1996) show that when loans are associated with an increase in assets, borrowers are encouraged to invest in low-risk income generating activities and when the very poor are encouraged to save; the vulnerability of the very poor is reduced and their poverty situation improves. A microcredit from either the commercial banks or the ROSCAs make a big difference in the income generating activities of the poor. They get about M1 000.00 up to about M5 000.00 and with these amount they are able to start businesses, pay their debt and grow those businesses. Most of the women sew traditional attires (Seshoeshoe), and many are hawkers. Microcredit works best to those who are able to identify an economic opportunity and are in a position to capitalize on that opportunity (CGAP, 2012).

### 4.7.3 Insurance

The rotating and savings groups do not have the insurance services. Insurances are done mainly in the burial societies. Almost all of the people interviewed in the ROSCAs belonged to burial services either in their communities or with the other groups they have formed with different members for that. Only two of the groups were both ROSCAs and burial societies.

The insurance services in commercial banks are provided by the insurance institutions. Many people seem to have burial insurances and a small number of people take other insurances. Monethi, one of the insurance providers explains that lately Basotho seem to be taking education insurance as well.

*“People who have burial insurance have less stress; they know that should their loved ones die, they will be able to bury them. Instead, they will give them decent burials and that what makes Basotho proud, burying their loved one with dignity”* Monethi.

The issue of insurance in Maseru is a bit complicated in the sense that when interviewees talk about insurance, they are only referring to the burial societies not other forms of insurance such as health, house and education. Only three out of ten groups that were interviewed offer burial society schemes together with their RoSCAs. The research found that there are benefits and disadvantages in this kind of arrangements. Firstly, both forms of schemes require some level of trust and friendship among members, members do not need to go start building trust in other groups that offer burial societies, they have that already. Secondly, bonding social capital is strengthened. Members deal with each other in matters that improve their lives as well as through difficult times and needs.

However, having the two schemes operating in one group is complicated because the practice of the two schemes differs. This therefore indicates that more than one meeting is held in one month. This can be time consuming for members and results in members not attending meetings as well as they should.

The other majority of respondents, 18 of them explained that they have burial societies in other groups which are different from their RoSCAs. The respondents explained that having burial societies is a must for everybody. In fact, the researcher observed that the interviewees valued being members of burial societies more than being in the RoSCAs.

Even in the formal sector insurance, all respondents explained that they are members of the burial societies there. About half of the interviewees had education insurance. None of them had health and house insurances. When asked why this is the case, the respondent from one of the insurance providers explained that all types of insurance required some form of money to be paid. Their customers choose insurance based on which ones they think are important and they always opt for burial societies. It seemed the respondents lacked an understanding of what insurance is, and the importance of insuring for anything rather than death.

The studies done by Churchill (2002), Chang (2010) and Acha (2012) show that insurance in the informal microfinance is underpenetrated when compared to other services. The insurance companies in Maseru do try to educate their clients about the importance of other insurances. However the clients are only keen to insure for the funeral of their loved one. Here the culture of Basotho plays a major influence in the sense that funerals take a major priority. The clients do not have an interest in other types of insurance.

#### **4.8 Challenges faced by informal microfinance institutions**

The respondents agreed that while there are many positive impacts brought by their groups. They face challenges such as (1) conflicts within groups, (2) Difficulty to pay contributions (3) death and (4) Poor attendance of meetings.

##### ***4.8.1 Poor attendance of meetings***

Meetings are held at least once a month, members are supposed to be there every time. Meetings are held to ensure transparency and discussions about who gets how much, and people who want to make loans are discussed. In some cases however members do not go to those meeting or come very late for meetings.

*“By the time they arrive, the important stuff has been discussed, they want us to go back and explain what has already been discussed. When will we finish the stuff to be discussed that day if we go back and forth to accommodate late comers?”*  
Masetsoana.

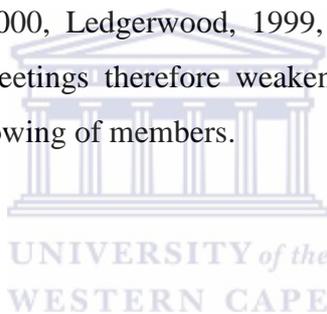
*“It (time keeping) is a problem; some people have made it a habit. We are even thinking of charging them extra every time they come late for our meeting”,* Likeleli.

Regular meetings are held for burial societies also. To ensure that all members pay and discuss some suggestions, queries that are there.

*“It is bad when a member decides to just disappear and not come for meetings after her members are buried. This happens a lot in my group and I have seen it happen in other burial societies in my village” Masetsoana.*

*“It’s so frustrating when some people do not come for meetings, the meetings lose a sense of togetherness that’s supposed to be build for the success of the groups”,  
Maneo.*

The studies done on the impact of social capital in microfinance groups (Olomola, Ismawan (2002), Mordeno, (2010,)) suggest that regular meetings by all members strengthens the bonding social capital, people get to know each other well. It also provides an atmosphere for collective self-interest. When people are close they tend to pay their loans because of the peer pressure in groups (Murdoch, 2000, Ledgerwood, 1999, Schurmann and Johnston 2009). Absence of some member in meetings therefore weakens the bonding social capital and threatens the repayment and borrowing of members.



#### **4.8.2 Conflicts within groups**

All interviewees mentioned conflicts and gossips as their biggest challenge which hinders the growth of the groups. Polo described that gossips discourages other members as they do not want to be part of those groups anymore. It also becomes difficult to build trust among members when it’s gone because of the gossips. In her own words she describes the situation below;

*“You know I hate people who gossip but you know us women, that’s how we are, sometimes people gossip about a person, and when that person finds out (iyoh yoh making a serious face) it becomes bad, and some members withdraw from the groups for some time, it’s bad” Moipone*

Two women Alice and Mampho have been victims of gossips in their groups. They both used the word “irritated” to explain how they felt when they heard about the gossips.

*“I heard about the gossip from a friend of mine who was also in a group, I was irritated and angry at the same time do you understand what I’m saying? For two*

*months I did not go to the meetings, I send my contributions through my friend”.*

Alice

*“I was so irritated with my friends for having gossiped about me, why did they not ask me about my life? I would have told them” Mampho*

A study on Grameen Bank suggests that women participants in credit programmes are more conscious of their rights, better able to resolve conflicts (Chen, 1992). In this study, the researcher found that contrary to the findings in Grameen Bank women groups had more conflicts that they barely dealt with than men and mixed groups. Women in these groups are competitive and gossips among themselves are the causes of conflicts. These conflicts impact on the developments of such groups especially their trust towards each other.

#### **4.8.3 Difficulty to pay contributions**

All respondents reported that they struggle a lot to make ends meet when the contributions go to other group members but are all paying contributions because they know that their turn to receive the money is coming.

*“When the money is going to other members not me, I struggle a lot to meet my family’s daily needs. I end up borrowing from other members just to be able to pay the contribution,” Tshehla*

*“Since we are self employed my sister, we struggle a lot with contributions. You find that at times such as June, July when the demand for Lishoeshoe (traditional attires) is very low we are not able to pay on time or some even pay the money in halves. This causes problems for us as a group because that’s when the complaints start,” Alice.*

The contributions that the respondents pay in their groups range from M300 to M500 per month for RoSCAS and from M20 to M100 for burial societies. The credits that people are allowed to borrow range from M1000 to M5000. On top of the monthly contributions of M300, borrowers have to repay their loans in three months plus 10 or 25% interest. Often the members are small entrepreneurs. They do not earn money on a monthly basis; they sometimes go for weeks having earned just enough to feed their families. The borrowers end up borrowing money from their informal groups to pay the banks and do likewise in order to pay contributions. This in the end leads to the borrowers not being able to achieve their goals of improving their lives because they are most of the time in debt.

#### 4.8.4 Death

Out of the ten groups that have been interviewed, six of them have lost a member or more due to death. This has caused problems for some groups. All of them did not have a plan on how to deal with cases such as those until after they were affected. One of the respondents explains her experiences in this way;

*“Mathabo (one of the group members) died shortly after we gave her our money; I think it was about two months after she received it. Then we did not have a constitution that explains what should happen in cases like that one. I made a loss that year because my money came short of one person’s contribution”, Mathabiso.*

Mapule, Malerato and Ralejone explain that when a member dies, there is a sense of loss and that disturbs the function of the group. Mapule explains that it takes time to get to know, understand and trust a new member who replaces the deceased.

*“Finding a new member which we all trust to fill in the space left by the deceased member is not easy” Pontso.*

*“We never allowed a new member to join our group after Rethabile’s death, anybody could never fill her space,” Makhopolo.*

For the two groups that are both ROSCAs and a burial society, the idea of starting a burial society came after they lost a member. They explained that the “embarrassment” of their members’ funerals propelled them to start burial societies.

*“Our friend was buried with just samp and meat (whispering). I don’t want to be buried like that; we had to do something to prepare for our funerals” Mathato.*

*“Our group contributed money for the funeral but it was not enough, a lot is needed for a decent burial you know, that’s why we decided to include burial society as a separate thing from what we have been doing” Thejane.*

Lesotho’s life expectancy has deteriorated from 48 years in 2001 to 37 years today (LBS 2010). It is one of the worst countries affected by the HIV/ AIDS epidemic (FINSCOPE 2011). The HIV/ AIDS pandemic affects mostly the working group which makes the challenges of being in the informal groups greater. Death among the group members disturbs the function of the groups. If one member dies, and the group members operate for some time

without a new member the amount that the remaining members are going to get are sometimes reduced.

#### **4.9 Summary**

Microfinance has positive impacts on the people in the informal microfinance. It has improved their livelihoods, and given them the self-esteem and the skills to become entrepreneurs. These changes in the poor people's livelihoods are brought by various reasons that facilitated the formation of the microfinance groups, however all those reasons had one goal in common and that is to enhance the members' lives by having access to finance.

Microfinance provides a number of services which all contribute to the well-being of the poor. Those services are provided in both the informal as well as formal microfinance. However there are a number of challenges that the groups face such as conflicts and poor attendance of meetings. The challenges hinder the progress of microfinance and the effective function of the groups.



# CHAPTER FIVE

## RISKS ASSOCIATED WITH MICROFINANCE

### LENDING IN MASERU, LESOTHO

#### 5.1 Introduction

Formal microfinance in Maseru is associated with a number of risks. The risks discussed in this chapter are (1) lending to the poor who lack entrepreneurial skills (2) Absence of the regular income of the poor. The chapter also discusses the risks that the institutions come across due to the circumstances of the country that they are operating in, and those are (3) Absence of the credit bureau, (4) the use of passports instead of national identities and (5) absence of physical addresses in Maseru.

#### 5.2 Lack of entrepreneurial skills

The formal institutions expect their clients to use the loans to start businesses or develop the businesses that are already in existence; however, institutions say most of their clients use the loans for personal purposes. Khabisi and Thabo explain that about 90 percent of their borrowers have loans in all microfinance institutions. One would expect to see high levels of entrepreneurship but it remains very low. According to the providers of microfinance, lack of entrepreneurship skills is what constrains businesses despite the availability and provision of finance. This constraint expressed in one of the respondent's words goes like:

*“This lack of entrepreneur interest or skills is what causes the high default rate, once the client uses the money for personal reasons, where is he going to get money to pay us and the interest?”* Thabo.

The research revealed that there is little or no effort applied by the institutions in Maseru to encourage interest in entrepreneurship to their clients. Namusonge (2006) explains that entrepreneurial education and training play a key role in stimulating entrepreneurship and self-employment of the poor. However in Maseru entrepreneurs are not given the necessary entrepreneurial training. Instead the skills are given to the rural entrepreneurs in other rural districts of Lesotho by the government through their rural financial inclusion education, and Non-Governmental organisations such as the Catholic Relief Services and CARE Lesotho.

This lack of attention to the poor clients by the government and formal institutions results to the low rates of successful businesses of the poor hence failure to repay loans.

### **5.3 Absence of regular income.**

The formal institutions explained that giving credit to lower income people puts the institutions at a risk of losing those loans. They pointed out that the poor are not even able to save regularly. One of the interviewees explains the situation in this manner;

*“There are times when they (the clients) save money in their accounts, there are also times when money is not deposited in those accounts for months sometimes”* Tshehla.

One of the respondents from the formal institutions stated that most of these clients are unemployed. This means they have irregular income. He explained that they prefer to give loans to people who have won tenders from the government, especially the schools feeding scheme. However this has proved to have problems also because they sometimes lose those loans due to unforeseen circumstances such as death. In his words Tshehla explains the situation below;

*“In many cases those borrowers have died even before the government could pay all the money, how do we recover all the money we have invested in such a person? We don’t, it’s a loss.”* Tshehla.

Thus, considering that borrowing to these people is risky, the institutions have opted to use another method to lend to the poor. They require clients who do not have regular income but are entrepreneurs, to bring someone who has a regular income, and has a good savings history to act as a guarantor to the borrower. In this way institutions depend on the guarantor to act as collateral for the borrower. (Berensmann, Barstel, Losse, and Majewski, 2002) state that a guarantor either provides information about a borrower or have more successful means than the moneylender to induce him to repay. The respondents revealed that they were considering using the same criterion even in lending to the people who have government tenders so that the person who is registered as the next of kin will be able to repay the loan in case the borrower dies.

## 5.4 Absence of credit bureau

All institutions explained that the absence of credit bureau in Lesotho complicates their lending. They explained that they spend a lot of money in trying to find information about their borrowers and making sure that the information that the borrowers are providing is legitimate. The situation expressed in one of the respondent's parlance goes as follows:

*"You know we always lend them money and hope that they will pay as they promise because we can't get their credit history..."* Mapulane.

In order to minimise the risks of borrowing to people with no credit history, some institutions have begun to work together. They hold meetings where they exchange information about their good and bad clients. This helps them to gain a little information about borrowers. When a client borrows money they visit the information they have to see if the client is a good or a bad borrower.

Other institutions even go to the extent of sending their employees to find information about clients to verify that it is correct. This is however a problem for these institutions as articulated in the quote below by a member of one of the institutions.

*"...But it is very costly and we don't have that kind of money, but what can we do, we try to prevent defaults on the loans"* David

Institutions have even started asking for small collateral to guard themselves against defaulters,

*"...What can we do, it is the only way we can protect ourselves from making huge losses,"* Tshehla.

The absence of the credit bureau in Maseru means that the institutions do not have a place where they get the borrower's history. They are not able to screen the possible defaulters, or borrowers who have a bad credit history. Consequently they run a huge risk by lending to people who are sometimes bad payers. Stiglitz (2001), Campion (2001) and Luoto, Mckintosh and Wydick (2002) argue that credit bureau decreases the problem of credit debt and slow loan repayments that are often a result of borrowers lending money in all lending institutions. It provides the lenders with borrowers' information. Microfinance in a number of institutions in Maseru is a bit different from what Robinson (2001), Murdoch (1999), Woller

and Brau (2005), and World Bank (2005) explain it because the institutions in Maseru require small collateral from the borrowers. The circumstances that they operate microfinance in are the reason behind asking for collateral from borrowers. They are trying to reduce the risks of lending to people who are unemployed.

### **5.5 Absence of national identities**

In Lesotho passports are used as a form of identity; there are no national identity cards. This creates a challenge for institutions to track down the borrowers. All the interviewed institutions explained they use passports to get information about their clients. The clients sometimes take a different passport with a different name and use all the passports to borrow money. The following responses show the challenge that the commercial banks face;

*“many women have passports in their married and maiden names, Some have up to about three passports and use them to borrow money either in the same institution or in other banks the or money lenders” David.*

The use of passports as national identity documents complicates lending in Maseru. The evidence given above suggests that, peoples’ identities are easily changed by the unlawful passports that they possess. It is almost impossible for the institutions to get their loans back if they lend money to the borrowers who hold more than one passport. This therefore explains why most institutions are reluctant to borrow money to clients who do not have businesses, or are unemployed.

To solve this problem institutions do not rely on passport only as the only form of identity. They need borrowers to bring forth proof of the businesses they are already engaged in, and proof that their businesses are making some form of a profit. They also need references from the chiefs to verify that the borrowers are who they claim to be. For the employed borrowers they need payslips and references from employers. With these information they are able to trace the defaulters rather than relying on passports and physical addresses.

### **5.6 Absence of physical addresses**

There seemed a consensus among respondents from formal institutions that lack of physical addresses holds the microfinance industry back in Maseru. The respondents stated that even when their borrowers are not able to repay loans, they are not able to look for them in the in the communities because of the absence of physical addresses. They explained that they ask

for the addresses from their borrowers and sometimes they lie about their addresses, and sometime they do not, however finding them is extremely difficult. Some of the respondents explained:

*“Sometimes chiefs help, because at least they know their people so when we are looking for somebody we go through them first for assistance,”* Mapulane.

*“We sometimes lose the money as a result of this (absence of physical addresses)”*

David

*“We have failed so many times we have stopped trying, without proper addresses our people will always disappear with our money,”* Tshehla.

Goldberg (2005), Murdoch (1999) and argue that successful repayments of loans can be achieved when officers hold meetings, and visit their clients’ businesses to monitor progress. Without physical addresses loan officers have difficulty finding some of the places where their clients live especially when they have to collect payment for the loans. The researcher learned that this has contributed to some of the reasons most institutions in Maseru do not monitor their borrowers and hold meetings with them. Conning and Murdoch, (2011) explain that lack of regular meetings with clients promotes defaults. In Maseru preventing defaulters by regularly monitoring their progress and making sure that they pay regularly is made very difficult by the absence of the physical addresses. Unfortunately, this is one challenge that the institutions do not have control over.

## **5.7 Summary**

The borrowers in informal institutions and the government make the lending in informal institutions very risky. The use of national passports instead of national identities, the credit bureau and physical addresses are issues that the institutions have no control over. They can only be dealt with by the government. Others such as the misuse of national identities and the fact that people use lack of physical addresses as ways in which they can dodge to pay loans are caused by borrowers.

# CHAPTER SIX

## THE ROLE OF THE CENTRAL BANK AND THE MINISTRY OF FINANCE AND SOCIAL DEVELOPMENT IN IMPROVING ACCESS TO MICROFINANCE

### 6.1 Introduction

This chapter discusses initiatives that the government through the Central Bank of Lesotho and the Ministry of Finance and Social Development have taken to improve the microfinance sector in Lesotho. It discusses the challenges that affect those initiatives.

### 6.2 Challenges faced by The Central Bank and the Ministry Of Finance and Social Development

There are some challenges faced by the Central bank as regulators of the institutions and the government as policy makers. Those challenges are (1) lack of understanding by the formal institutions of what microfinance is (2) unregistered microfinance institutions (3) Lack of transparency of formal institutions.

#### 6.2.1 *Lack of understanding of what microfinance is by formal institutions*

Both the Central Bank and the Ministry of Finance mentioned that the institutions providing microfinance services do not quite understand microfinance and its unique features. The ministry of finance and social development explained that a lot of money is used in conducting workshops that help promote the sector and help those institutions to have a better understanding of the industry. The Central Bank and the Ministry of Finance explained that many of the people in the institutions know little about microfinance.

Muhammed (2010) explains that the working and efficiency of banking sector as well as Microfinance institutions largely depends on knowledge of the person who is responsible to run that system. Lack of skilled people, who understand microfinance and its unique

characteristics, leads to further exclusion of the poor in accessing finances. It also makes it difficult for the institutions to understand why they should be regulated hence they hide some significant information from the regulators. In the same manner policies are made but the lack of skilled human resource impacts negatively on microfinance and its growth.

### **6.2.2 Unregistered microfinance institutions**

The CB and the MFSD stated that the biggest challenge in dealing with the institutions is that the majority of them in particular the money lenders are not regulated. This means “*they still carry on charging exorbitant interest rates*” Matseliso stated. The ministry of finance added that the informal institutions make it difficult for the government to make policies that help the industry to grow.

*“They (unregistered institutions) do not comply with the rules that govern the industry”* Maja.

As discussed in chapter three, financial institutions are regulated to correct imperfect market failures which could disadvantage the consumers if the markets are left unchecked (Christen, Lawer, Lyman and Rosenberg, 2011, Basel committee on banking supervision, 2010, and Yaron, 2004). The fact that the majority of institutions are unregulated in Maseru poses a threat to the consumers. It shows that they are running a risk of paying high interests and losing their money.

### **6.2.3 Lack of Transparency**

The Central Bank explained that lack of transparency from the institutions hinder the regulation process. They explained that formal institutions in particular money lenders do not provide clear records about their operations. The explanation by Matseliso below shows why there is lack of transparency.

*“I think to them regulation means arrest or cancellation of their licences so they hide some things which they think might lead to that”* Matseliso.

This affects the supervision of the banks because regulators are not able to know the extent to which the consumer’s money is protected. The lack of transparency also leads to the Central Banks’ inability to know when there are problems and when such institutions need help.

This lack of transparency by the institutions means that the institutions are not properly regulated. It causes information asymmetry which the Central Bank is trying to minimize. As a result of this, consumers and the Central Bank have inadequate information about some of the institutions. Hulme and Moore (2006), CGAP (2008) and Gallardo (2001) argue that lack of transparency of the institutions leads to consumer's exploitation. The consumers and the Central Bank are denied the opportunity to assess the quality of services, the safety and soundness of those financial institutions.

### **6.3 The initiatives of the Central Bank and the ministry of social development in improving access to microfinance**

The ministry of finance and social development (MFSD) together with the Central Bank (CB) explained that they provide the financial education in all districts of Lesotho especially the rural areas. They teach people in the communities about money, how to save not only for burials but to invest for the future. They also act as credit guarantees for the poor. This means that the MFSD acts as a mediator between commercial banks and the poor. They help rural microfinance groups to get access to credit from commercial banks.

There has also been an initiative called the Support to Financial Inclusion in Lesotho (SFIL). It was done in collaboration with the UNDP and UNCDF and the government of Lesotho (The CB and the MFSD). The initiative's mission is to strengthen the inclusive finance, regulatory and policy environment. The government is working towards establishing a microfinance resource for the industry, including a sector data base meant to track progress and performance of financial service providers. Matseliso from the Central Bank explained that since the beginning of 2012, potential financial service providers were assisted and others will be promoted to microfinance deposit taking institutions from the beginning of 2013.

#### ***6.3.1 Promotion of the Lesotho's banking sector***

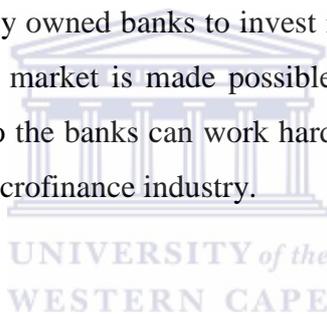
The Central Bank and the ministry of finance and Social Development are of the opinion that the development of the banking sector in Lesotho will grow because of microfinance. Matseliso from the Central Bank explained that they are working hard to make sure that all microfinance institutions especially money lenders are registered. In that way they will be

regulated and the owners will be able to enter the formal banking. They expressed their opinions in the following manner

*“we are hoping that once they understand microfinance and comply with the requirements they will grow to become banks and help spread the services all over the country” Matseliso*

*“We foresee growth of the existing banks in the microfinance sector and emergence of many new formal financial institutions” David*

Microfinance as a new industry in Maseru provides an opportunity for the growth of the banking sector. As people begin to understand microfinance and how it operates more entrepreneurs in the banking field will emerge. The draft of the new regulatory framework that was in progress at the time of the interview, promises to take into account the unique features of microfinance and regulate the financial sectors depending on their level. This provides an opportunity for locally owned banks to invest in banking and attend to the needs of the poor. This huge untapped market is made possible by the fact that microfinance in Maseru is still largely informal so the banks can work hard to attract as many clients as they possible can from the informal microfinance industry.



#### **6.4 Summary**

The Central Bank as well as the Ministry of Finance and Social Development face challenges that impact on the way the institutions are regulated. Those challenges also have a negative impact when it comes to formulating policies that will help develop the microfinance sector in Lesotho. The initiatives employed by the government are meant to improve the operation of the microfinance industry in Lesotho and some of the initiatives they have started providing to the people are proving to improve the understanding and access to microfinance services.

# CHAPTER SEVEN

## PROSPECTS FOR POVERTY REDUCTION

### **7.1 Introduction**

This chapter discusses the need and demand for microfinance; it refers to the need to regulate the sector and the prospects of forming a microfinance association to which microfinance groups can belong. How microfinance can establish linkages and be integrated into the formal financial sector. How a number of people who were absolutely poor can as a result of microfinance now access jobs, education, food, markets etc. Microfinance is survivalist strategy to help the poor cope with absolute poverty.

To an extent that microfinance has impacted positively on the lives of its participants in Maseru, the evidence is provided that there is a need for an extension and further development of microfinance in Maseru as an alternative approach to poverty reduction. In that way microfinance will continue to empower the poor in Lesotho. The development of microfinance could be achieved through several policy strategies as discussed below.

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#### ***7.1.1 Enactment of an enabling regulatory framework***

Microfinance has been under the same regulations with formal financial sector in Lesotho; this has placed constraints on the development and opportunities for microfinance institutions to expand its services further. The capital requirement of M10 million by the government has been a serious constraint for the willing new participants into microfinance industry. This has resulted into problems in this industry. People monopolise the industry, as a result charge interest rates that do not reflect the genuine cost of borrowing or risk premium per se. Therefore relaxation of this high capital requirement to the minimum level is needed. However the relaxation has to allow for the stability in the sector which will allow for more microfinance establishments which will increase competition and result in reduction in the cost of borrowing. Such reduction in the cost of borrowing is bound to further improve the welfare of consumers in the economy, thereby meeting the first important objective of poverty reduction.

The new regulatory framework needs to establish an independent regulator to deal with issues of microfinance which in most cases are different and unique from those under commercial formal financial institutions such as banks. The regulations of microfinance issues such as interest rates regulation, deposit taking collateral and liquidation issues in terms of default need to be dealt with by specialized regulatory institution.

### ***7.1.2 Demand for microfinance***

The evidence provided in the study clearly reflects that there is an unmet demand for microfinance services in Maseru. This is reflected by a number of informal groups formed by participants of micro-finances for services such as insurance and savings. Low income earners have also extended these demands to the formal institutions. For instance, during the conduct of interviews, long queues were often observed at lending microfinance institutions. The microfinance institutions therefore need to diversify services offered to the clients which will aid in the creation of inclusive financial systems in order to meet these demands. The industry is still at growth stage, where it is still developing and reaches only a few numbers of the poor in the country the inclusive financial system will help to meet the demand of those in the other regions of the country particularly in the rural areas. This shows that there are still a lot of opportunities for the institutions to develop and grow. To achieve this, a number of changes need to be made and new structures put in place. This will enable the industry to achieve its full potential.

### ***7.1.3 Coordination of stakeholders in microfinance.***

The microfinance prospects in Lesotho are further affected by lack of trust among participants, lack of coordination between informal microfinance institutions and lack of representation on government policy forum on issues relating to microfinance. The prospects of microfinance will be reached when trust is promoted among microfinance participants, and linkages between the stakeholders are put in place formations of microfinance central associations to provide representation for microfinance players on issues affecting them. To achieve this, the stakeholders can hold workshops and discuss their plans. The institutions need to be included in the policy decision making. In this way, the stakeholders in microfinance will feel part of the developments.

The study further revealed that the formal institutions are lacking behind in providing microfinance services compared to the informal institutions in Maseru therefore linkages between the two institutions are necessary. Linkages will help bridge the gap of mistrust between the formal and informal institutions hence build trust between them so much that the informal institutions will feel secure enough to work with formal institutions. These will also eliminate the rate of conflicts which may be caused by the competition among them.

#### ***7.1.4 Establishment of microfinance associations.***

The challenges that are facing microfinance have been promoted by the fact that there are few associations in microfinance. This has caused various challenges in both the participants and providers of microfinance. Absence or weak associations mean that institutions are not included in the policy decision making. Participants views and needs are not known by the institutions. This therefore promotes discrepancy because institutions provide services which may not be addressing the participants' needs. The establishment of associations is vital therefore because they will act as a body that helps to shape the image, reputation of the industry. Associations are also at a better situation to influence decisions, norms and practices, stipulate best practices and suggest strategic responses to industry threats and opportunities. People in the associations have similar visions, objectives and goals about the services they need. Whatever they agree upon can be seen as representing an organisational need and therefore they can enforce changes and adjustments.

#### ***7.1.5 Microfinance allows its participants to generate income.***

The World Bank in their efforts to reduce poverty and promote microcredit through microfinance has given the countries such as Lesotho an opportunity to tap into the microfinance industry. The low income earners who for a long time have been poor with fewer options on how to be out of poverty have now become entrepreneurs. This has in turn given the unskilled poor an opportunity to be employed; to an extent that many parents are able to send their kids to schools and are able to provide for their basic needs. Above all the stress levels in the households which lead to various diseases has decreased. The continuous access to microfinance services will enable low income earners to grow and generate more income for themselves.

### ***7.1.6 Creation of markets***

The evidence given in chapter four clearly indicates that Basotho entrepreneurs can go extra miles. They are able to establish small businesses and expand with time while creating employment in the process. What they require is to be helped in the creation of the markets where they will sell their products. They can also come up with the strategies of marketing their products so that they can expand their services to other regions of the country as well as in other neighbouring countries such as South Africa, Botswana and Swaziland meaning they can go international.

### ***7.1.7 Skills development***

Education and skills development is the key factor in opening doors of opportunities and growth in the microfinance industry. With education on microfinance the participants are equipped with the knowledge on how to develop themselves. This will help them to make informed decisions on the services they want. It is equally important to develop the skills of those who already participate in providing microfinance. Staff training is required to help employees to develop themselves so that they can have positive impacts towards the growth of the business. It also brings about improved productivity, saves costs. In this manner outsourcing is eliminated. Above all if the business grows due to the employees' development in microfinance, both employees and employers reap the rewards of better work satisfaction and quality productivity. The prospects of microfinance will be more sustainable when the human resource in the industry is equipped with the necessary skills that will make them feel more empowered to do more, and deliver quality services.

### ***7.1.8 Microfinance provides business opportunities***

Microfinance as a developing industry provides an opportunity for the growth of the banking sector and new innovations. As people begin to understand microfinance and how it operates more entrepreneurs in the banking field will emerge and there is an opportunity of locally owned banks to invest in banking and attend to the needs of the poor. This huge untapped market is made possible by the fact that microfinance in Maseru is still largely informal so the banks can work hard to attract as many clients as they possible can from the informal microfinance industry. The creation of the favourable environment for entrepreneurs will

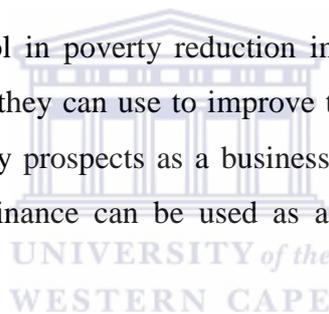
empower them to come up with new innovations that can help to shape and develop their businesses.

### ***7.1.9 Utilisation of local resources***

With the anticipated increase of the microfinance participants in the future, there will be a need for the poor people with small credit to start utilizing local resources; this can effectively help entrepreneurs to have comparative advantages within their region. In this way quality jobs especially of the unskilled labour will be created hence livelihoods improved. It will also promote social capital because there will be a high interaction with in communities.

### ***7.2 Summary***

Microfinance acts as driving tool in poverty reduction in the country of Lesotho, since it enables them to have credit that they can use to improve their livelihood. The microfinance industry in this country has many prospects as a business and as a service provider for the poor. If used effectively microfinance can be used as a survivalist strategy to deal with absolute poverty.



# CHAPTER EIGHT

## CONCLUSION AND RECOMMENDATIONS

### 8.1 Introduction

This study sought to achieve four basic interrelated objectives: to explore the extent to which people access credit under the informal microfinance arrangements in Maseru, Lesotho; to document the existing practice of microfinance institutions in the country; to identify factors that facilitate the formation or present obstacles faced by microfinance groups in this country, and to explore consequences that result from these informal microfinance arrangements, in particular as relates to poverty reduction. The study further aimed to find out challenges faced by regulators of these informal arrangements in Lesotho and to assess policy options available at their disposal.

To achieve the foregoing objectives, the study surveyed 45 participants in microfinance, of whom 35 were from informal groups and five were from formal institutions with two from the Central Bank and the remainder from the Ministry of Finance and Social Development. The survey included ten microfinance groups. The survey adopted purposive sampling to carry out 45 interviews. Of these interviews, 30 were recorded and 25 were only transcribed. The findings were compared to the discussion in the literature review on the relationship between social capital and microfinance and other studies on microfinance as discussed in the literature review in chapter two.

The findings of this study reveal that microfinance has positively impacted the lives of its participants in Maseru, Lesotho. In particular, the study showed that microfinance has strengthened the social relationships of people in these groups; they are close and that closeness has resulted into group members helping each other even in social matters. They give each other advises and share the skills. Many of the people involved in microfinance in Maseru Lesotho have become small entrepreneurs. This has enabled them to improve their livelihoods and boost their confidence, and this to some extent has shifted them out of poverty. These findings are in agreement with the predictions of the literature that argues that microfinance improves the lives of the poor who are involved in it.

In terms of promotion of savings behaviour among microfinance participants, the findings of the study point towards enhancement of savings behaviour among participants. The study found out that ROSCAs in Maseru offer flexible but forced savings. It is from these savings that ROSCAs extend credit to its participants. These savings further are used as protection (insurance) against unforeseen events such as deaths by the poor (participants) since during the advent of such events; participants borrow from ROSCAs at flexible rates without any collateral requirements.

With regard to women empowerment, the findings from this study revealed that microfinance has provided women in Maseru Lesotho with an opportunity to become entrepreneurs. It has also boosted their confidence both in dealing with household matters and with businesses. It was noted that among the interviewees, the majority of them were women. Indeed, most of microfinance participants in this country are women, mostly widows and single parents, come from diverse social backgrounds characterized by poverty and struggle for financial independence: factors that would make one lose confidence. However, having been in microfinance has boosted confidence of these women. Today, they confidently express their self-reliance and financial independence. This finding validates the thesis in literature that argues that microfinance has major impacts on women, and that they are major players in microfinance.

The findings further reveal that microfinance in Maseru has promoted social capital among participants. It facilitates access to finance among the poor as people find it easy to lend money from relatives, workmates and friends. The same cannot be said though about social capital in the formal institutions. The formal institutions are failing to use the same social capital that seems to work well in the informal microfinance to work for them to encourage repayment of loans. Even when the individual lending is used, social capital still fails to be strong between the lenders and clients so that lenders feel compelled to repay their loans.

Despite its positive impact on its participants, microfinance in Lesotho has as well had negative side. The study revealed that the informal microfinance practice is faced with some negative consequences such as debt and unlawful practices. These consequences are one of the factors that hinder the progress of the poor people involved in it. In some cases the consequences have resulted into some people being worse off than before they got involved

in informal microfinance. These consequences unfortunately affect the finance sector particularly the regulatory and supervision in that there are many illegal operations that are done and the government is not able to control them.

The research also revealed that formal microfinance institutions are operating under serious risky circumstances. These circumstances affect the way they offer microfinance. Some of these risks are beyond their capacity while some are a result of the lack of human resource that is knowledgeable enough on issues of microfinance that could help them to deal with some risks.

In an attempt to eliminate some of these risks and promote the microfinance industry, the Ministry of finance and social development is working with the formal institutions to educate people on the available options for them in regard to accessing microfinance in the formal institutions. These initiatives are not enough though, the formal institutions need more intervention from the ministry particularly from the policy point of view which the ministry has not been able to provide so far.

A lot of debate is made in the literature about the importance of regulation in microfinance, on how to regulate the microfinance institutions and which institutions need regulation. Microfinance institutions in Maseru are regulated and supervised by the Central Bank of Lesotho and they are regulated with the same regulation as that of banks. Nevertheless, the absence of a regulatory framework for microfinance institutions holds the industry back as most of institutions do not meet the requirements needed for them to operate legally as financial institutions. This has therefore resulted in the majority of the institutions operating as informal.

The researcher concludes that the poor people in Maseru have access to microfinance services, both in the formal and informal institutions. However microfinance in the formal institutions is still at the early stages. In fact the reason why both institutions are operating is that the formal sector in Maseru is still developing. This is seen by imbalance supply of services, where insurance and savings are still lacking behind. The informal sector then can be said to compensate for this imbalance. However the informal sector is also inadequate and lacks in many ways than one. In spite of these challenges that face both institutions,

microfinance continues to empower many of the poor people. The involvement of women in microfinance has seen them become entrepreneurs and creating work for other women.

The circumstances in the formal microfinance have forced institutions to require collateral from their borrowers. This has driven away many of the clients as most of them still do not have enough collateral to give in order to obtain credits. They therefore decide to stay in their groups. Even small entrepreneurs prefer to obtain credit from RoSCAS for their business for the same reasons of avoiding collateral that is needed from the formal institutions.

In spite of all the challenges that microfinance in Lesotho face, there are many prospects for the industry. Microfinance still has an opportunity to develop and become one of the best strategies that can be used to help the poor deal with poverty. The institutions have got a chance to tap into the industry and have thriving businesses while helping the poor to avoid absolute poverty.

## **8.2 Recommendations**

Microfinance is without a doubt a growing industry. The interest of the banks and non-banks in providing microfinance services means that attention has to be given to it in order to ensure sustainability. The following suggestions are made for the policy makers as well as the formal institutions.

### ***8.2.1 Policy recommendations***

**Setting of realistic capital requirements for non-bank financial institutions:** The central Bank must consider regulating microfinance institutions with different regulation from that of banks. The regulation for microfinance financial providers must be enacted and the capital requirements for non-banks must be revisited and adjusted to allow for more financial providers to operate legally as such. The microfinance regulation framework must also allow non-bank financial institutions to take savings.

**Registration of informal groups:** In order to eliminate the level of corruption and unlawful practices experienced in the informal microfinance industry, the government must encourage

groups to register. In doing so, they will be able to get access to financial institutions, and be regulated. This will protect their rights as consumers.

**Create the credit bureau:** The credit bureau will enable microfinance institutions to have access to the credit history of the clients so that they can see the defaulting borrowers and to prevent them from borrowing from one financial provider to another.

**Capacity building for microfinance products:** The conducive environment must be created to increase the number of institutions that offer microfinance services. Capacity building of microfinance institutions that enables them to build and develop flexible microfinance products that meet the needs of the poor and increase their access to credit is needed.

**Declaration of interest rates:** Institutions must declare the interest rates they charge their borrowers. This will create competition and lower the rates as institutions will be competing to get clients. On the other hand, borrowers have clear information about the interest rates charged in the institutions and can choose those that best suit them.

**Creation of an environment that provides markets for entrepreneurs:** The government must promote laws, business services, infrastructure to enable small entrepreneurs to expand their market opportunities.

### ***8.2.2 Formal institutions recommendations***

**Invention of institutions' own approaches:** Institutions must do research about their target population. The research will help them determine the needs, demands and capacity of the people they want to serve. Then they must invent their own microfinance approaches that best help their clients. In that way their approaches will enable them to overcome some of the challenges they face instead of following models from other countries that do not particularly suit their and borrowers' needs.

**Training of staff:** Staff training will improve service quality; promote sustainability and knowledge of the industry. The staff must be trained in all levels, provision of credit, savings and insurance to the poor, on information systems as well as good conduct for those officers who have to go to the fields to monitor borrowers.

**Entrepreneurial training for microfinance clients:** Borrowers must not only be given credit without being trained on how they should spend it. They must be trained on issues such as bookkeeping, dealing with clients, and finding markets for their products and other issues of management.

### **8.3 Further research**

Based on the findings, further research, similar to the one studied must be done in other parts of the country especially in rural areas. Research is also needed to establish the challenges faced by formal institutions in providing microfinance to the poor and how those challenges can be reversed.



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## Appendix I: Questionnaires

		INSTITUTE FOR SOCIAL DEVELOPMENT	
University of the Western Cape			
<i>Private Bag X17, Bellville 7535, Cape Town, South Africa</i>			
<i>Telephone : ( 021) 959 3858/6 Fax: (021) 959 3865</i>			
<b>E-mail: <a href="mailto:pkippie@uwc.ac.za">pkippie@uwc.ac.za</a></b>			
<b>Letter of Consent:</b>			
Accessing Microfinance in Maseru Lesotho: Challenges and prospects for poverty reduction			
<b>Participants Consent Form- Adults</b>			
I, ....., hereby agree to participate in the research conducted by Mrs. Mpatuoa Hlapi-Letete “ <i>Accessing Microfinance in Maseru Lesotho: Challenges and prospects for poverty reduction</i> ”.			
I have received a briefing on the research and understand the purpose and methods for this research.			
I have been given the opportunity to ask any questions regarding the research before consenting to it.			
I agree to participate in an interview/discussion with the researcher.			
I understand that the nature of this interview/discussion is confidential between me, the researcher and other participants, where necessary. Therefore I understand that I may not divulge anything that I have mentioned or heard of, outside of this interview/ discussion.			
I reserve the right to withdraw from the research at any stage.			
I reserve the right not to answer any questions without giving reasons for doing so.			
I was given the assurance that my identity will be protected and not made public without my consent in writing.			
With that I also understand that this consent form, with my name and signature on it, will be locked away and will not be used to divulge my identity.			
I do not expect any form of payment or other direct benefit from my participation in this research.			
.....			
Name (print)			
If you have any questions concerning this research, feel free to call me (Mpatuoa Hlapi-Letete) on +27 721 9625 86 or by e-mail to <a href="mailto:mpatuoa.letete@gmail.com">mpatuoa.letete@gmail.com</a> . Alternatively, you may contact my supervisor (Dr. Leon G. Pretorius ) through the School of Government, on telephone number: +2721 959 3851 or e-mail: <a href="mailto:lpretorius@uwc.ac.za">lpretorius@uwc.ac.za</a> .			

## **Interview questions**

### **Groups**

1. How did you form this scheme?
2. Why?
3. How does the scheme operate?
4. How easy is it to get R1000 credit compared to getting R5000 or more?
5. What are the common challenges in your group?
6. How do you deal with them?
7. What are the things that being in the scheme has enabled you to do, that you were not able to do before joining the scheme?
8. What kind of opportunities does your group have?
9. Do you have anything to add?

### **Questions for the Institutions**

1. Which services do you provide?
2. How do you provide them?
3. Do you have group lending?
4. If yes what is its relative size to the overall lending?
5. If no, why is it that you do not have group lending?
6. How easy is it to lend 5 000 Maluti compared to 10 000 or more?
7. What are the challenges that you face as microfinance institutions in regard to
  - I. your beneficiaries
  - ii. Government and regulation?
8. What do you perceive to be the opportunities of microfinance in Maseru?
9. How have microfinance impacted on your beneficiaries?



### **Questions for the Central Banks**

1. How would you describe microfinance in Maseru?
2. Could you specify the regulations that govern microfinance institutions?
3. What are the specific purposes for regulating these institutions?
4. What regulation and supervision challenges are you faced with in dealing with microfinance institutions?

5. What do you perceive to be the consequences that result from the informal microfinance in Maseru?
6. What do you perceive to be the opportunities of microfinance in Maseru?
7. Which other role apart from regulation and supervision does central bank play in improving access of microfinance to the institutions in Maseru?

**Questions for the Ministry of finance**

1. Indicate the activities if any that the ministry has undertaken in the past five years to promote microfinance in Maseru.
2. If no, please indicate why they have not been undertaken
4. What do you perceive to be the consequences that result from accessing credits in the informal microfinance?
5. What are the policy challenges that you are faced with in regard to microfinance?
6. What opportunities do microfinance institutions have?

