ARE MICROFINANCE INSTITUTIONS IN SOUTH AFRICA EFFICIENT? - A CASE STUDY IN THE LIMPOPO PROVINCE

(Examination Copy)

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A minithesis submitted in partial fulfillment of the requirements for the degree of Magister Commercii in the Department of Economics, University of the Western Cape.

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Are microfinance institutions in South Africa efficient? - A case study in the Limpopo Province.

Key Words

1. Microfinance
2. Savings mobilization
3. Rural credit scheme
4. Village banking
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8. Client outreach
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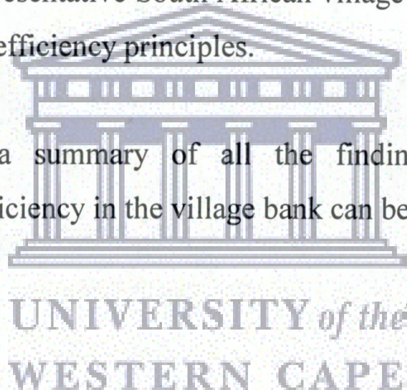
Abstract

This minithesis aims to determine whether South Africa's microfinance institutions are operating efficiently and whether efficiency can be enhanced. Using the United Nations model and framework for efficiency, it examines the key principles of operational efficiency in the South African microfinance context.

The paper begins with an overview of the literature relating to the principles of efficiency as underscored in the United Nations model.

The paper then evaluates a representative South African village bank to examine whether it is operating according to the efficiency principles.

The paper concludes with a summary of all the findings together with some recommendations as to how efficiency in the village bank can be enhanced.



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Declaration

I declare that *Are microfinance institutions in South Africa efficient? - A case study in the Limpopo Province* is my own work, that it has not been submitted before for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged as complete references.

Denver Kallis November 2002

Signed: ________________

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Table of Contents

List of Abbreviations. vii

CHAPTER ONE **1**

- Introduction. 2
- Aims and Objectives. 3
- Methodology. 4

CHAPTER TWO **6**

- Literature Review. 7
- Target the Poorest of the Poor. 7
- Mobilize Savings. 10
- Charge Interest Rates that cover Operational Costs. 12
- Market Research. 14
- Streamline and Decentralize Operations. 16
- Utilize Volunteer Staff. 19
- Target Women. 19
- Develop Monitoring and Assessment Tools. 21
- Confront Problems. 23
- Invest in Training. 24
- Utilize Pre-existing Organizations. 27
- Avoid External Dependency. 28
- The South African Microfinance Context – in brief 30
  - Historical development of the sector 31
  - Government policies 32

CHAPTER THREE **34**

- Map – Kgautswane 35
- The Research Site – background 36
- Kgautswane Village Bank Cooperative (case study) 42

CHAPTER FOUR **60**

- Research Findings 61
- Conclusion and Recommendations 65

LIST OF REFERENCES **66**

APPENDIX 1 **71**

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List of Abbreviations

FSA	Financial Services Association
FNB	First National Bank
FSC	Financial Services Cooperative
ICB	Integrated Community Building Program
KFSC	Kgautswane Financial Services Cooperative
MIS	Management Information System
MFI	Microfinance Institution
MPCC	Multipurpose Community Center
UN/OSCAL	United Nations Office of the Special Coordinator for Africa and the Least Developed Countries

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CHAPTER ONE

- Introduction
- Aims and Objectives
- Methodology

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Introduction

Poverty eradication is an integral component of the United Nations global mission, and microfinance[1] is increasingly recognized as an effective strategy towards this goal. When properly harnessed and supported, microfinance can be an indispensable part of the process of economic empowerment by which the poor can lift themselves from poverty. In that context and when enhanced and made efficient, microfinance can help solve macro problems associated with poverty eradication (United Nations, 2000).

Multilateral lending agencies, bilateral donor agencies, developed and developing country governments, and nongovernment organizations all support the development of microfinance. A variety of private banking institutions have also joined this group in recent years. As a result, microfinance services have grown rapidly during the last decade, although from an initial low level, and have come to the forefront of development discussions concerning poverty eradication.

According to the United Nations (2000), if microfinance institutions (MFIs) are to have a sustainable impact on poverty eradication, they must be efficient, financially viable institutions that can develop the financial leverage to expand outreach at a sustainable level. Adequate attention must be given to business practices to make MFIs financially sustainable in a reasonable timeframe. Efficient operation is essential in achieving self-determined development, as well as accountability to clients as well as donors.

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[1]Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their microenterprises. Three types of sources provide Microfinance services:

- Formal institutions, such as rural banks and cooperatives;
- Semiformal institutions, such as nongovernmental organizations; and
- Informal sources such as moneylenders and shopkeepers.

Institutional microfinance is defined to include microfinance services provided by both formal and semiformal institutions. Microfinance institutions are defined as institutions whose major business is the provision of microfinance services. (ADB 2000:2)

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The Asian Development Bank (2000:1) claims that providing efficient microfinance services is important for the following reasons:

- Microfinance can be a critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to smoothen their consumption, manage their risks better, build their assets gradually, develop their microenterprises, enhance their income earning capacity, and enjoy an improved quality of life. Microfinance can also contribute to the improvement of resource allocation promotion of markets, and adoption of better technology. Thus, microfinance helps to promote economic growth and development.
- Without permanent access to institutional microfinance, most poor households continue to rely on meager self-finance or informal sources of microfinance, which limits their ability to actively participate in and benefit from the development opportunities.
- Microfinance can provide an effective way to assist and empower poor women, who make up a significant proportion of the poor and suffer disproportionately from poverty.
- Microfinance can contribute to the development of the overall financial system through integration of financial markets.

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Aims and Objectives

By definition, the concept of efficiency is simple: to maximize output from a set amount of inputs. In order to expand outreach to the poor, it is essential that MFIs are as cost-efficient as possible. To that end, MFIs all over the world have created efficiencies in their daily operations that help boost productivity and minimize costs. The thesis examines the question of whether South Africa's microfinance institutions are operating efficiently, and whether efficiency can be enhanced.

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Methodology

Building on the United Nations Office of the Special Coordinator for Africa and the Least Developed Countries (UN/OSCAL) model and framework for efficiency in MFIs, the thesis looks at the key principles of operational efficiency in the South African microfinance context. A representative South African village bank in the Limpopo Province (formerly Northern Province) was chosen as the case study. The rationale behind this is that poverty is more pervasive and prevalent in the deep rural than urban areas of South Africa.

According to the United Nations (2000), African microfinance is as diverse as the continent itself. An array of approaches has been used ranging from traditional group based systems, to specialized lending by banks and funded by international non-governmental organisations financial intermediaries. Consequently, examples of African microfinance offer an array of lessons of what works and what does not work. Drawing from these lessons, and those from non-African examples, UN/OSCAL developed a Microfinance model. The model seeks to identify a microfinance methodology-model to Africa's specific needs for poverty eradication and is based on four principles[2]:

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1. Pooling together peoples resources.
2. Relying and building upon what people know (tradition).
3. Reinforcing microfinance to empower the African private sector.
4. Striving for efficiency.

The foundation of this research is derived from the fourth principle of the UN/OSCAL model, which is "striving for efficiency".

The research methodology was designed to be participatory, including the views of community members as far as possible. Primary information was obtained through an interviewer-administered questionnaire (see appendix 1). In addition, informal discussions were held with community members, as well as with development and field

[2] For further information, see: United Nations (OSCAL), 2000. Microfinance and Poverty Eradication: Strengthening Africa's Microfinance Institutions. New York: United Nations; and, Microfinance in Africa: Combining the Best Practices of Traditional and Modern Approaches towards Poverty Eradication. [Online]. Available http://www.un.org/esa/africa/microfinanceinafrica.pdf

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workers. This was done as a means of supplementing and explaining some of the responses that emanated from the questionnaire.

The thesis begins with a review of the literature relating to the efficiency principles, which is followed by a brief discussion of the South African microfinance context (Chapter 2). This will be followed by the presentation and discussion of the case study – Kgautswane Village Bank Cooperative (Chapter 3). The findings of the case study are then presented, followed by the conclusion and recommendations (Chapter 4).

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CHAPTER TWO

- Literature review

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The literature review analyses the key principles of operational efficiency as underscored in the UN/OSCAL model. These are:

- 1. Target the poorest of the poor.
- 2. Mobilize savings.
- 3. Charge interest rates that cover operational costs.
- 4. Market research.
- 5. Streamline and decentralize operations.
- 6. Utilize volunteer staff.
- 7. Target women.
- 8. Develop monitoring and assessment tools.
- 9. Confront problems.
- 10. Invest in training.
- 11. Utilize pre-existing organizations.
- 12. Avoid external dependency.

The aim is to describe and highlight the significance of each principle. According to the UN/OSCAL model, to be considered efficient, a microfinance institution has to operate according to these twelve principles. The literature review concludes with an overview of the South African microfinance context.

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Principle 1: TARGET THE POOREST OF THE POOR.

Microfinance is a means to poverty eradication, and not an end in itself. Efforts for operational sustainability must target not only the less poor capable of repaying loans, but include the otherwise marginalized poor (United Nations, 2000).

In order to know that they are doing business with the poor and poorest, MFIs have to identify and motivate them on the ground in a cost effective manner. This process of identification and motivation is often referred to as "targeting the poor". Normally, the poorest will not come forward themselves to apply for financial services, as they will not know nor believe the service is actually for them. Even when informed, many are likely to feel that it would be too risky for them to borrow. Only patient motivation work among them and convincing demonstration effect from neighboring poor and poorest households

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that do participate and benefit will encourage them to take advantage of the opportunity (Gibbons & Meehan, 2000:9).

While targeting the poorest is critical to the ultimate goal of poverty reduction, if a program is not able to undertake this activity in a cost effective manner, the potential for achieving financial sustainability might be greatly reduced or even eliminated – jeopardizing the long-term viability of a program. Hulme and Mosley themselves raise the concern that "...targeting on the poor of credit...imposes costs of research (finding out who is eligible), communication with the eligible and monitoring to prevent access by the ineligible, which may if pushed too far outweigh the benefits of poverty reduction" (Hulme & Mosley, 1996:36). Fortunately, proven, cost-effective strategies have been developed and refined which enable programs to identify the poorest, while also maintaining the quality measures necessary to ensure that only the poor and poorest are admitted to the program.

While the goal of this thesis is not to describe nor debate the costs and benefits of targeting strategies, given its acknowledged potential to reduce the ability of an MFI to achieve financial sustainability, it warrants a brief discussion. Two existing approaches to target the poor and poorest that are proven and cost-effective are the CASHPOR House Index (CHI) and the Small Enterprise Foundation Participatory Wealth Ranking (PWR) system.[3] The CHI uses the house and compound of the household as a crude indicator to eliminate non-poor households from initial consideration as potential members, in place of the more traditional costly and time-consuming household interview. Only after the CHI identifies potentially poor and poorest households do field staff visit house to house to verify the eligibility of the occupant households through a short interview that focuses on the value of their productive assets.

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Instead of using the house, PWR relies upon the knowledge of the villagers themselves to identify the poor and poorest among them, again eliminating the initial interview process.

[3] For more information, please refer to the manual Cost-Effective Targeting: Two Tools to Identify the Poor by David Gibbons and Anton Simanowitz with Ben Nkuna. CASHPOR: Seremban, Malaysia.

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Villagers are called upon to map the village and to rank the households into groups by poverty status, and only then does field staff interview those who have been identified as eligible. On average, both methodologies take about five minutes per poor and poorest household.

The targeting method chosen from the above should depend on local conditions and expertise. Whichever is chosen, however, it will be cost effective because care has been put into designing both methods so as to eliminate unnecessary expenditures. Time consuming; costly interviews to determine household income or expenditure, which are of dubious validity and reliability anyway, are not utilized in the initial stages. They are replaced by a quick survey of household productive assets, which takes only about five minutes on average, and these asset interviews are done only at the final stage of targeting, after most non-poor households have been eliminated. As most of the households identified through the CHI and PWR turn out to be eligible, the interview doubles as the first step in motivating poor and poorest households to take advantage of the financial services being offered.

By focusing their efforts exclusively on the poor and poorest, MFIs can use funds allocated for their use most effectively and efficiently. As these funds are normally limited in supply, it is vital to ensure they get into the hands of the intended beneficiaries. Leakage to the non-poor should be minimized.

There is a counter argument, however, that "it is scale, not exclusive focus, that determines whether significant outreach to the poor is achieved" (Christen et al, 1995:24). Programs serving several strata of clients, not just the poor and poorest, may be able to expand faster and reach larger numbers. If they do, large numbers of the poor and the poorest may benefit. Moreover, such programs have the possibility of cross-subsidizing lending to the poorest from their more profitable lending to the non-poor due to larger initial average loan size, and thus could achieve financial sustainability more rapidly.

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Whether or not such "mixed" programs benefit large numbers of the poor and the poorest is an empirical question. If they do, they are surely welcome, but they should not, under any circumstances, channel funds meant for the poor and poorest into the hands of the non-poor.

Principle 2: MOBILIZE SAVINGS.

Savings services not only provide a valuable financial assistance to low-income clients, but they also strengthen institutional self-sufficiency, membership commitment to microfinance initiatives, and build a sense of self-esteem, and well-being. When funds are internally generated rather than borrowed or granted by external sources, MFI members become more invested and participatory in the prudential administration of savings towards credit and other MFI services. If priced correctly, savings instruments can contribute to capital mobilization and wider market coverage (United Nations, 2000).

Savings are needed to provide a safety net for the poor so that in times of emergency (e.g., food shortage or illness) they have some funds to meet their needs and to smooth deficit months so that they do not have to turn to exploitative moneylenders. Appropriate savings facilities are of particular importance to poor women who need a secure place to keep surplus funds, but one to which they themselves have easy access. Weekly meetings of an MFI with its clients in their villages provide the opportunity to supply such savings services. Through them, clients can also build up their savings so as to be able to purchase the productive assets that can make their progress out of poverty sustainable, or to perform important social obligations. There is no doubt about the importance of savings to the poor.

Most MFIs also recognize the importance of savings for the institution and its business. Client savings, if partially blocked, can reduce the risk of lending to the poor. More important, savings can be a relatively cheap source of funds for MFIs, as interest rates that have to be paid to attract savings are usually less than those that have to be paid to borrow funds commercially. (Gibbons & Meehan, 2000:26)

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According to Gibbons and Meehan (2000:26), "major differences exist among MFIs, on the relative emphasis to be given to savings as compared to credit as tools for poverty-reduction, and on the timing of the emphasis." These differences are illustrated (see Gibbons & Meehan 2000) by CARD[4], being a Grameen bank replication/adaptation, gives primary emphasis to credit and only secondary attention to savings. Only small amounts of compulsory savings are required for the Group Fund for a few weeks to make clients eligible for much larger loans to finance income generation, the amount of which is not related to the amount saved. As its clients progress, however, CARD increases the amount of compulsory group savings and promotes individual, voluntary savings. FINCA[5] Uganda and CRECER[6], utilizing the village banking approach on the other hand, put primary emphasis on savings first. Only after saving regularly for several months does a poor household become eligible for a loan and the maximum that can be borrowed is restricted, at least in the case of FINCA Uganda, by the amount saved (five times).

Gibbons and Meehan (2000:26), also state that, "there are major moral and legal issues involved with savings." The moral issue has to do with the need for adequate protection of the savings of the poor, and the legal issue revolves around the responsibility that governments usually take, through their central banks or other regulatory agencies, for providing this protection. As a result, NGO-based MFIs are usually not able to legally mobilize deposits, even from their clients, not to mention from the public. However, many governments "close their eyes" to NGO-MFIs mobilizing deposits from their members, as they realize that most are sincerely trying to help the poor. However, the question of whether there is adequate protection for the deposits of the poor remains. And the possibility of legal action against deposit-taking NGOs is always there. Ultimately, such protection can only come from the capital adequacy of a MFI, but NGOs do not usually have any equity. For this reason the amount of savings MFIs can mobilize will, and should be restricted.

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[4] The Center for Agriculture and Rural Development (CARD), based in the Philippines.
[5] The Foundation for International Community Assistance (FINCA Uganda), a village-banking program based in Uganda.
[6] Credito con Educacion Rural (CRECER) a Freedom from Hunger Credit with Educatoin affiliate and village banking program based in Bolivia.

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Thus, if NGO-MFIs want to offer progressive lending to large numbers of poor households, savings cannot be expected to be the major source of funds, nor of institutional financial sustainability, for these MFIs. It could still be an important source of funds, however, and should not be neglected. Once a MFI becomes financially self-sufficient and builds up its equity through retained earnings, mobilizing deposits from the public could become its major source of funds for further poverty reduction.

Principle 3: CHARGE INTEREST RATES THAT COVER OPERATIONAL COSTS.

Successful microfinance schemes are characterized by non-subsidized interest rates linked to competitive market rates. Interest rates should allow to sustain the MFI operation. The administration of many small loans, including the processing and tracking services, is a costly operation. Consequently, MFIs need to charge higher interest rates than what commercial banks charge, yet can continue operations at rates that remain lower than the informal financial sector (United Nations, 2000).

An appropriate interest rate is one that will allow a MFI to cover all of its operating costs from its operating income within a reasonable period of time. Four to five years is thought to be the maximum time available as the patience of donors/investors providing grants and other "subsidized " funding is not likely to extend beyond that. As a cost plus measure (designed to cover costs plus provide a reasonable profit) in its most fundamental state, an appropriate interest rate will be determined primarily by how efficiently the organization is able to operate its business. However, that is not to discount the critical importance of the final component in calculating appropriate interest rates – profit, as measured by the capitalization rate. (Gibbons & Meehan, 2000:21)

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Without profit, continuation of financial sustainability will be impossible. Earning a profit allows MFIs to build their equity – a source of funding – in order to expand their outreach to the poor and poorest. As the equity position grows, the MFI will then be able to further leverage funds by raising debt or taking deposits from clients or the general

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public, and increase outreach even further, driving the program towards financial sustainability and beyond.

Setting appropriate interest rates is therefore a matter of estimating the unit costs of administration, loan loss, funds, and capital. A good set of guidelines is found in CGAP[7] Occasional Paper No. 1. There, it is noted that "the annualized effective interest rate (R) charged on loans will be a function of five elements, each expressed as a percentage of average outstanding loan portfolio: administrative expenses (AE), loan losses (LL), the cost of funds (CF), the desired capitalization rate (K), and investment income (II)" (CGAP Occasional Paper 1, Rosenberg, 1996:1):

$$R = [(AE + LL + CF + K) / (1 - LL)] - II$$

Typical ranges for MFIs in Asia on these items are:

	Administrative Expense	Loan Losses	Cost of Funds	Desired Capitalization Rate	Investment Income
Range	15% - 25%	2%	12% - 15%	8% - 10%	2%

Source: (CGAP Occasional Paper 1, p.1)

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Based on the above formula, this means that appropriate interest rates for MFIs working with the poor in Asia range between 35% and 51% per annum.

For all the reasons outlined above, achieving financial sustainability is of critical importance to MFIs if they seek to expand outreach to large numbers of poor households. However, as we are working with the poor and poorest, a balance must be struck when setting an appropriate interest rate. It is between early achievement of financial sustainability, and the institutional benefits this brings, and keeping the interest rate to be charged to clients manageable for them. This means that the interest rate must not be so high as to rule out the adequate profitability on the main income generating activities open to the poor. In other words, the pace of planned achievement of financial

[7] Consultative Group to Assist the Poorest.

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sustainability for a MFI must be consistent with the attainment of the overriding goal of poverty reduction. Most importantly, an impossible burden must not be placed on the shoulders of the early clients.

Principle 4: MARKET RESEARCH

Market research is an activity designed to understand the environment in which the MFI is operating and to identify the needs of the MFIs clients and potential clients. According to Write (2000:4), market research is usually conducted with a view to responding to those needs and opportunities by:

- Improving current marketing/ promotion/ outreach activities;
- Refining existing products;
- Developing new products;
- Re-engineering delivery systems.

Preliminary and ongoing research is an important investment for microfinance initiatives. MFIs typically break even on a customer only after the fourth or fifth loan (Brand & Gershick, 2000). And yet, many MFIs worldwide suffer chronic problems with clients leaving their programmes. Careful analysis of the reasons for these "drop outs" almost invariably points to inappropriately designed products that fail to meet the needs of the MFIs clients (see for example Write, 2000 & Hulme, 1999). Much of this problem is driven by the attempts to "replicate" models and products from foreign cultures and lands without reference to the economic or socio-cultural environment into which they are being imported.

Feasibility studies and ongoing research of the target population, geographic scope, and the local economy are vital to propose financial products and services that complement these realities. Market research helps to predict and control for costs (i.e. transportation and training), to better innovate and tailor services to the target population (i.e. develop effective selection, appraisal, and collection processes), and to maintain practical geographic coverage (i.e. ensure that loan officers are not overextended and can have effective follow-up with clients) (United Nations, 2000).

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According to Write (2000), "clients' needs are MFIs opportunities." Implicit in MFIs failure to assess the potential market in order to develop products in response to clients needs is the assumption that microfinance clients worldwide are essentially homogenous. Write claims, "A 'one product fits all approach' continues to dominate the industry." In reality however, the financial service needs of the poor are as diverse and complex as those of richer people. For forward thinking MFIs, these needs represent opportunities that can be met on a profitable basis.

Understanding and responding to these needs is more difficult than many MFIs believe. Throughout the industry, there is a tendency to copy other ideas without fully understanding them or tailoring them to the market (see Write, 2000). Savings are a case in point. The prevailing wisdom holds that poor people will need three basic types of savings product: the fully liquid (such as an open-access current account), the partially liquid (with restrictions on the number of withdrawals and a higher interest to compensate this) and the illiquid (such as a fixed or term deposit account). In reality however, this varies substantially from market to market.

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Market research usually results in a process of product refinement or development. The problem definition is usually driven by initial analysis of secondary data and then focuses the market research effort on the specific issues to be examined. This in turn allows the development of a qualitative market research plan typically involving a variety of qualitative research techniques including focus group discussions. The results of this work then allows the product development team to develop a product concept which is subjected to appropriate costing and pricing analysis to ready it for the process of refining the concept into a prototype. In some cases the product prototype is subjected to quantitative research to provide a final check of the marketability of the prototype before investing in the pilot test[8].

[8] For further details on the market research process see: MicroSave-Africa and Research International, (2001). *Market Research for Microfinance (A training Course)*. MicroSave-Africa; Write et al. (1999). *Participatory Rapid Appraisal for Microfinance*. MicroSave-Africa; Grant, B. (1999). *Marketing in Microfinance Institutions: The State of the Practice* Microenterprise Best Practice Project. Washington DC: DAI; Krueger, R. (1998). *Focus Groups: A Practical Guide for Applied Research*. California: Sage Publications Inc.

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Principle 5: STREAMLINE AND DECENTRALIZE OPERATIONS.

Lean, simple infrastructures utilizing basic design of microfinance products facilitate administrative procedures and increases operational efficiency. Simple and clear savings and loans criteria, preferably based on traditional mechanisms, are also easily understandable by local people. When possible, computerization instead of manual administration of accounts helps to reduce costs. Decentralization reduces costs associated with travel and disbursement of funds, and inefficiency associated with delays in communication (United Nations, 2000).

MFIs range in size and stage of institutional developmental. Therefore the organizational structure will undoubtedly vary from institution to institution. An ideal organizational structure does not exist. Growth is dynamic, not mechanic – it is a journey and a process. The design of a growing company must reflect these characteristics. As the marketplace and competition change, a company's structure and management practices will also change (Tomasko, 1993:18). To create a fluid, flexible structure, companies should consider a lean, flat and simple design that facilitates the flow of information and meets the requirements of the key stakeholders.

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Large companies around the world are downsizing, rightsizing, and reorganizing to cut costs and to establish organizational structures that are responsive to changes in the market. Despite the advantages of size, such as economies of scale, access to resources, and stability, size also has its drawbacks. Big companies are not as flexible or as agile as their smaller competitors. The larger the company becomes, the more it builds layers of bureaucracy and management. As a result, it may lose touch with its customers and no longer be able to innovate. To have flexibility to respond to rapidly changing customer demands, many companies are moving toward a flatter and leaner structure (Boyett & Conn, 1991:2-5).

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The simpler, the better. Growth in microfinance involves reaching as many people as possible. It is best to minimize the complexity of the institution to achieve this objective. By understanding the "flattening" of the corporate world, MFIs may be able to skip the stage where they might become fat and hierarchical with layers of unnecessary middle managers. Although few MFIs are currently bureaucratic, extensive growth could result in an inefficient organizational structure if institutions are not wary of the possibility. With their already high cost structure, MFIs certainly cannot afford to become top-heavy. Growth-oriented firms need to minimize the levels of management between senior executives and everyone else. Tall management hierarchies add overhead expense and distort the flow of information (Tomasko, 1996:209).

MFIs should remember that overhead is not necessarily bad. Tomasko suggests that there is good and bad overhead. The purpose of good overhead is to make things better, such as research and development and staff training (Tomasko, 1993:62-66)

In organizational hierarchies, the most difficult paths of communication are those that go up the chain of command. These paths are too congested with concerns about authority, accountability, dependency, evaluation, leadership, and status to serve as effective communication conduits. In most businesses, information – and rumors – flows fastest across the hierarchy, from peer to peer. Less energy and effort are required to move horizontally – the lesson for organizational design is to minimize the vertical height of the structure in favor of horizontal expanse (Tomasko, 1993:107-110).

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The organizational design should ensure that the right information gets to the right place at the right time. In a flatter organization, lower-level employees need to know more and understand more about their company. They need to understand its strengths and weaknesses with regard to the competition. They need to be familiar with their company's financial performance, the demands of the target market, and the company's efforts to satisfy these demands. Employees should know the company's five-year objectives and the role of the employee's work group in fulfilling those objectives. Priority should be placed on getting information into the hands of those who can use it most efficiently to

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change performance results – the workers themselves. If employees are given access to this information, they also may require additional staff training so they know what to do with the information (Boyett & Conn, 1991:49-54).

Loan officers, for example, need information about the performance of their own portfolio so they can control delinquency and manage their own growth. No one will disagree with that. However, they also should have access to information about the performance of their peers, the profitability of the branch, the status of research and development activities, and the success of the entire company in achieving its short-term and long-term objectives. When employees have access to the same information as managers, they are more likely to understand the decisions about needed changes in the workplace and to work cooperatively to implement those changes. Alternatively, withholding information creates adversarial relationships between staff and managers, promoting distrust, suspicion, and resistance to change (Boyett & Conn, 1991:49-54).

Another challenge is to break down communication barriers between different functional units in the business, such as between marketing and product development, or between the finance and operations departments. This is necessary to build teamwork and cooperation within the organization and to increase productivity and responsiveness to the market. Working together builds a shared sense of the business as a whole, rather than as one of individual parts, and will enable the company to provide better customer assistance (Ross & Kay, 1994:39).

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The organizational design should also consider the flow of communication across the membrane of the firm, between employees on the inside and customers and suppliers on the outside. Boyett suggests that the strongest structure is one built without walls – walls between people, walls between business units, and walls between businesses and their customers (Boyett with Boyett, 1995:63-64). The structure should facilitate communication between staff at all levels and the appropriate stakeholders outside the organization, especially customers. The deeper someone is within the organization, the harder it is for him or her to know and understand the customer. A flatter structure

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reduces the number of people who are hidden deep within the organization, therefore increasing the number of people who have opportunities to know and understand the customer.

Principle 6: UTILIZE VOLUNTEER STAFF.

Voluntary staff and profit sharing from revenues are effective strategies for reducing operational costs. This is especially true in disadvantaged and rural areas, offsetting the additional costs arising from such constraints. Training can promote the transfer of otherwise costly administrative responsibilities to volunteer staff. This is not only cost effective, but it also reinforces commitment to and sustainability of microfinance initiatives, empowering people to be more self-reliant and take initiative in their development. Furthermore, volunteer staff people are typically intimately familiar with their area serviced, offering valuable knowledge and commitment (United Nations, 2000).

Principle 7: TARGET WOMEN

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In Africa, women are a better credit risk than men and more responsible managers of meager resources. Furthermore, they are more committed to using their loans for the benefit of their household rather than self-gratifying consumption (as common among men) (United Nations, 2000). The most compelling reason for MFIs to prioritize women is to assist the poorest, which are disproportionately women. As Sharma (2002:197) notes:

> "Microfinance programs provide a handy, potentially cost-effective, and politically feasible tool for moving toward gender equality."

The premises behind targeting women are twofold: (1) that microfinance is an effective tool in improving women's status, and (2) that the overall household welfare is likely to be higher when microfinance is provided to women rather than men.

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Women's status, household welfare, and microfinance interact in the following ways (see Sharma 2002):

- A woman's status in a household is linked to how well she can enforce command over available resources. Increased ability to tap financial resources independently enhances her control, and, therefore, her influence in household decision making processes.
- Newly financed microenterprises open up an important social platform for women to interact with markets and other social institutions outside the household, enabling them to gain useful knowledge and social capital. Many microfinance programs organize women into groups, not just to reduce transactions costs in credit delivery, but also to assist in building and making effective use of these opportunities.
- Women's preferences regarding household business management and household consumption goals differ from men's, particularly in societies with severe gender bias. In such situations, placing additional resources in the hands of women is not a mere equalizer: it also materially affects both the quality of investments financed by the microfinance programs and how extra income is spent.
- Women are thought to make better borrowers than men: timely repayment of loans is more likely to take place when women borrow.
- Loans are not simple handouts. If microfinance programs are designed to cover all costs, a potential win-win situation emerges. Development goals related to women's empowerment and improved household welfare are self-financing and no subsidies are required.

However, as stated by Johnson (1999:1), "Microfinance, no more than any other intervention, is not blessed with the ability to right the power imbalances which result from inequalities in the way society treats men and women." Inequality benefits some people, so societies may oppress some groups. To distinguish the oppressed from the oppressors requires indelible marks, usually visible physical features such as skin color, age, or sex. Women differ visibly from men. Visible differences, combined with differences in physical strength allowed men to use violence to impose their will on

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women. Thus poor women in developing countries carry water, gather wood, cook, clean and care for children.

Interest in microsavings – beyond just microcredit – has grown just as microfinance practitioners have come to understand that small loans are not always appropriate for poor women (Kabeer, 2001 & Rahman, 1999). After all, a loan becomes debt, and the poor are exposed to crisis if an expected source of funds for repayment evaporates.

Thus, borrowing is often riskier than saving. For example, a woman could save or borrow to buy a sewing machine. If a child falls ill, savings could be tapped to pay for medicine; debt repayment might preclude medical treatment. Furthermore, although not all people are creditworthy or want debt, all people are deposit worthy and want assets. Of course, saving requires current sacrifice, and with saving, unlike borrowing, the sacrifice precedes reward. On the other hand, saving offers flexibility, and while borrowers pay interest, savers earn interest. Both savings and loans have a place, but saving is often a better choice for poor women. As stated by Johnson and Kidder (1999:6), not all poor people are "budding entrepreneurs…for people living in poverty, perhaps it is access to a savings account… that needs to be the core service on offer."

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Principle 8: DEVELOP MONITORING AND ASSESSMENT TOOLS.

Credible and reliable mechanisms to monitor and evaluate MFI operations improve overall institutional efficiency and effectiveness. Assessment tools allow for the generation of systematic information to identify and address weaknesses in MFI services and management systems, streamline procedures, and improve user friendliness of programmes. Reliable monitoring also fosters accountability, raising the investment attractiveness of MFI's (United Nations, 2000).

Access to timely, accurate, and detailed information on the overall performance of an MFI is required if efficiency and sustainability are to be achieved. Management

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information systems (MIS)[9] – whether manual, computerized through spreadsheet, or computerized through advanced computer-programming software – must be introduced and then updated as both financial and operational management techniques become more sophisticated. Though costs are involved in developing such systems, they are absolutely required by all to reach and serve with quality large numbers of poor and poorest households.

A cost effective MIS should generate both financial and operational information. On the financial side, full financial statements, including the Income Statement, the Cash Flow Statement and the Balance Sheet should be prepared regularly, at least on a quarterly basis, though monthly statements would be preferable. Financial statement monitoring report formats[10] that facilitate the analysis of financial sustainability and efficiency, among other important performance indicators, are now available to MFIs worldwide. As these new tools greatly enhance the ability of MFIs to monitor financial performance, they should be adopted.

On the operational side, portfolio-at-risk[11] has replaced the repayment rate as the leading measure of loan portfolio quality, following the lead of traditional commercial banks. This relatively new and valuable measure of loan portfolio quality compares the remaining outstanding balance of loans with at least one installment overdue for a specified period (e.g. 1 week, 1 month, 90 days) to the total loan portfolio. It is an indication of the proportion of loans outstanding that may not be able to be recovered in the future. It does not replace the repayment rate (amount collected over the amount due for a specified period), a historical measure, which shows what proportion of principal and interest due during a specified period actually was collected. Portfolio at Risk should

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[9] For further details, refer to CGAP's *Handbook for Management Information Systems for Microfinance Institutions*, February 1998, by Nick Ramsing and Chuck Waterfield.

[10] See the final version of the CGAP's *Format for the Appraisal of Microfinance Institutions*, 1997, the SEEP Network's paper on "Financial Ratio Analysis for Microfinance Institutions", 1995, and CASHPOR's revised manual Tracking Financial and Operational Performance (1999).

[11] A measure of loan portfolio quality, which considers not just, missed repayments of delinquent clients, but the remaining outstanding balance of loans, which are at risk of not being repaid. The determination of when a loan is at risk is based on the age of the arrears and can vary among MFIs. Prudent managers should use a cut-off of 30 days or 4 weeks, whichever is more appropriate. The ratio is calculated as follows: (total loan portfolio / arrears older than 4 weeks) / total loan portfolio.

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be monitored on a weekly basis at the branch level and on a monthly basis for each field staff. In addition, the aging arrears are done to calculate portfolio at different levels of risk (i.e., with arrears overdue for different lengths of time, e.g., number of days or weeks), and can be used also for calculating MFI-specific loan loss provisions.[12]

With such information, managers are able to make informed and timely decisions about performance, allowing for identification of areas where performance improvements must be made before small problems become crises (see the following efficiency principle "confront problems"). Without such information, and verification of this data through both internal and external audits, MFIs will not be in a position to make decisions that can facilitate operational efficiency and financial sustainability.

Principle 9: CONFRONT PROBLEMS.

Problems are inevitable, and when they do escalate, it is imperative to identify them and respond immediately before they become serious. This entails developing performance standards, monitoring tools, an institutional integrity to identify and address weaknesses and problems in their infancy (United Nations, 2000). The accomplishment of this principle is dependant on the quality and effectiveness of the MIS as a monitoring and assessment tool, and the information that it can produce at any given time. By receiving the right information at the right time, MFIs can take preventative measures and solve problems in their infancy. Proper planning and infrastructure development (i.e. training) can prevent or defuse problems before they become serious.

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[12] For guidelines on calculating portfolio at risk and using it to determine the appropriate loan loss provision, see CGAP (1997) and Christen (1997).

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Principle 10: INVEST IN TRAINING.

Microfinance training is an investment capable of reducing recurring costs and improving operational efficiency, sustainability, and outreach. Well-trained staff cultivates a sense of ownership and investment in the MFI mission that transfers to the client base, creating client loyalty. Financial and business training in savings and credit utilization, basic management, bookkeeping, and marketing ensure that clients effectively invest microfinance funds into productive income-generating initiatives (United Nations, 2000).

Although most of the information presented below is drawn from the corporate business literature, it has direct bearing on all MFIs, regardless of their institutional type.

Microfinance is a service industry. As such, it is possible to consider the firm's employees as its products. If MFIs do not have well-trained staff in the right place at the right time, the MFIs run the risk of being out of stock. They have the potential to expand rapidly, but will not be able to do so without the necessary human resource infrastructure. Although employees in MFIs may be more important than they are in most business, most MFIs are non-profits, which have a tendency to short-change their human resources. NGOs are usually constrained by a lack of financial resources, which influences decisions regarding human resource development.

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The addition of new staff must meet with the institution's ability to train and deploy human resources. An expanding institution requires systems to produce a large volume of well-trained frontline staff. Following the principles of standardization, the most recently hired staff must employ the same methodology as the first. Staff training is an ongoing process throughout the entire relationship between the employee and the firm.

The firm needs to orient new employees to its vision, strategy, and culture. When the orientation is done properly, new employees sense the unique nature of the business and what makes it tick. The orientation is not just designed to inform new employees where the bathrooms are or when payday is – the orientation should strive to ensure that new staff understands the firm, what it does and how it does it, and get new employees to buy

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into the firm psychologically. The most successful firms thoroughly indoctrinate employees into the core ideology of the company, creating cultures so strong that they are almost cult-like. This includes creating a sense of elitism so that new employees feel they are joining something that is special and superior (Collins & Porras, 1994:71).

In a rapidly growing business, where an increasing percentage of employees are new to the firm, orientation plays a critical role in promoting and sustaining the institutional culture. If employees cannot buy into to the unique and special nature of the company, they should leave. At Disney, for example, if you do not embrace the idea of "wholesomeness" and "magic" and "Pixie dust," and make yourself into a "clean-cut devotee," you probably should not work at Disneyland (Collins & Porras, 1994:121). The most successful businesses ensure a tight fit between the employees' values and the corporate ideology.

Harper suggests that the chief executive officer should participate in the orientation session for new employees, to welcome them to the firm, to share with new staff the chief executive officer's vision for the business, and to indicate how they will benefit if they are committed to making that vision a reality (Harper, 1995:178-210). Tomasko states that firms invest in growth by investing in people – the more people there are in the company who can imagine what it can become, the more likely it is to get there. New employee orientation is just the first step in aligning corporate and employee values and objectives (Tomasko, 1996:243).

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Initial staff training usually includes two components (Harper, 1995:208): classroom training for groups of new recruits and on-the-job training. During the classroom phase, new recruits receive an overview perspective of the organization and see how their roles fit into the bigger picture. This setting is used to indoctrinate new employees into the core values of the business, such as a commitment to quality and customer service, and to teach them the theoretical aspects of their jobs. Much of the training curriculum will depend on the organizational structure. For example, if the business is organized around teams or groups of employees, it will be necessary to teach interpersonal and problem

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solving skills. If the organization relies on the self-management of front-line staff, new staff will also be taught how to read and interpret performance indicator reports.

The on-the-job phase, which may last several months, allows new staff to learn the technical aspects of the job and the tricks of the trade from experienced personnel. In microfinance, many of the skills of field staff, such as client selection and delinquency management, can be learned best through experience. In many MFIs, it is often expected that new staff will make mistakes, and learn the hard way about to whom not to lend and what arguments and methods are effective in convincing delinquent clients to repay their loans. However, if the on-the-job training is properly organized and sufficient in duration, new recruits can learn many of the nuances of microlending without having to make mistakes. Unfortunately, in the rush to make new staff productive, perhaps because of poor planning at the outset, MFIs may limit the on-the-job training to one or two weeks. It is not likely that new staff can develop healthy portfolios after such short exposure.

In a growing business, staff training does not end after these initial phases. Ongoing training is required to help employees grow as business grows. This involves planning to identify the new skills that employees need to fulfill personal and corporate objectives. Training in growing companies often involves cross training so people can perform a variety of jobs. This reduces the business' vulnerability to absenteeism and attrition, and creates flexibility. Cross training can also enhance the ability of staff to participate meaningfully in redesigning work procedures to accommodate growth because employees can see the work environment from various perspectives (Harper, 1995:210). In microfinance, cross training at the branch level would mean that field staff would learn to perform multiple functions, and therefore be more valuable employees. For example, if loan officers specialize in delivering specific products, once they perfect the provision of one product they learn how to deliver another product.

Some companies plan the regular rotation of key employees throughout the organization to spread new techniques and to understand different perspectives (Tomasko, 1996:244). In microfinance, staff rotation can facilitate the transfer of innovations between branches

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and assist in preventing fraud. It is important to the success of microfinance for loan officers to build long-term relationships with their clients. This relationship improves the quality of business assessment and has a positive effect on delinquency management. However, a tight relationship between loan officers and their clients also makes MFIs vulnerable to staff turnover and fraud. Some MFIs rotate loan officers' portfolios within an office every two years to reduce fraud risk. Other MFIs rotate loan officers between offices to transfer lessons and innovations.

Principle 11: UTILIZE PRE-EXISTING SUPPORT ORGANIZATIONS.

Utilize pre-existing support organizations, such as the Special Unit for Microfinance (SUM), CGAP, Women's World Banking (WWB), the World Council of Credit Unions (WCCU), and establish linkages with other NGO networks, bankers associations, and international groups. For example, United States Agency for International Development's (USAID) Microenterprise Innovation Project provides exchange visits and exposure trips for policy makers and MFI senior officers to learn from Microenterprise Best Practice models. Women's World Banking affiliates leverage their successful experience in direct lending to microenterprise clients and expanding capital bases to negotiate credit lines with local banks, scaling up their micro loan programmes. The African Development Funds Microfinance Initiative for Africa is working with MFIs, host country governments, formal financial sector actors, and international organizations. Their goal is to engage in policy reform dialogue and build appropriate and transparent legal and regulatory structures that provide a conductive framework for the delivery of microfinance services (United Nations, 2000).

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Principle 12: AVOID EXTERNAL DEPENDENCY.

Whereas donor funding can play an essential role in the start-up of a microfinance initiative, if MFIs are to make a lasting impact, they cannot remain dependant on donor funding, but must become self-sufficient. Self-reliant MFI's are better able to maintain their identity, autonomy, and mission (United Nations, 2000).

The argument for institutional financial self-sufficiency is well known:

> "... as MF[I]s begin to wean themselves away from their dependence on subsidies and start to adopt the practices of good banking they will be forced to further innovate and lower costs. Not only may this ultimately mean better service for the poor borrowers, but more importantly, it is argued that as MF[I]s become profitable they will be able to increasing[ly] tap into the vast ocean of private capital funding. If this happens the microfinance sector as a whole will soon be greatly leveraging the limited pool of donor funds and massively increasing the scale of outreach in ways that is hoped could begin to make a truly significant dent on world poverty." (Conning, 1998:2)

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In a sense, donors in microfinance can be seen as genetic engineers – their job is to speed the evolution of the sturdy MFIs. This is worthwhile because it is believed evolution by trial and error in a *laissez-faire* market would take too long. For example, donors can disseminate lessons learned by MFIs as they try to strike a difficult balance between outreach and sustainability. This cross-pollination not only helps MFIs to learn from others mistakes, but it also helps to replicate the strong features of good MFIs, while deepening the pool from which healthy MFIs can emerge.

Donors have limited comparative advantages in quickening the evolution of stout MFIs. Donors are good at giving funds, measuring progress, and spreading good practice through technical assistance. Donors husband microfinance by creating and environment that rewards success and punishes failure. To encourage microfinance organizations to

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strike a healthy balance between sustainability and outreach, donors must lubricate entry and exit (Von Pischke, 1991).

Society encompasses all the people in the world. The goal of society is to maximize social welfare. Social welfare is social benefits less social costs. A MFI is worthwhile from the point of view of society if its social benefits exceed its social costs. Donors get funds taken by governments from rich taxpayers in high-income countries or sectors, and give them microfinance organizations selling to the poor in low-income countries or sectors. Society may weigh benefits for the poor more than costs for the rich.

Sustainability is important because society cares about the poor both now and in the future. Unsustainable MFIs might help the poor now, but they will not help the poor in the future because the MFI will be gone. Unsustainable MFIs might not even help the poor now (Adams et al., 1984). Unsustainable MFIs might be worse than no MFIs at all because they may hurt exactly those they wanted to help (Krahnen & Schmidt, 1994).

Sustaining performance requires profits even after accounting for all subsidies. Of course, just as infant firms need venture capital, infant MFIs need subsidized resources from donors. However, fledgling MFIs need to be weaned quickly because donors will soon abandon them in the marketplace. Access to subsidized resources waxes and wanes as donors tire, and as political moods swing. Donors are unpredictable, and they will withdraw. Without profits, a MFI will probably shrink and die in a short time.

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Even if subsidies were permanent, sustainability would still help to fulfill the goal of society. After all, the poor are plenty but the donor dollars are few. Without profits, MFIs cannot attract private capital and so cannot saturate the market for microfinance (Rosenberg, 1994). Selfish investors will not start MFIs from scratch unless subsidized MFIs are profitable. If MFIs were so profitable they attracted private investors, then outreach would burgeon. Social benefits would amplify, and social costs shrivel. Social welfare would improve.

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The South African Microfinance Context[13]- in brief

South Africa is a middle-income country, with a well-developed industrial and manufacturing base and physical and social support services. There is a dichotomy between the formal and informal economy, where the concentration of the manufacturing base lies in the formal economy and has all but excluded small-scale enterprise. In the informal economy, the dominant activities are retail and services. At the lower end of the scale survivalist and micro enterprises struggle in a highly concentrated sector, where there is limited differentiation of products and services at low levels of profitability (Van de Ruit, 2001: p.10). There is little accuracy in measuring the size and scale of the informal economy. Current data estimations are that there are 1.7million people working in the informal economy in South Africa (October Household Survey, 2000). Torres et al calculate that 45% of the informal workers are poor, of which 60% are women, and Africans comprise 72% of those categorized as poor (Torres et al, 2000: p. 81).

South Africa's financial sector also reflects this apartheid legacy. Financial services are available to salaried workers, but the majority of South Africans, particularly people living in rural areas, are without access to financial services. Studies show that instead of widening scope of services by state and commercial enterprises in rural areas, there has been a contraction in provision (Coetzee & Cross, 2001). The challenge in South Africa is therefore to extend financial services to all South Africans.

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Informal finance in South Africa is a R13 billion industry (Micro Finance Regulatory Council, 2001). The commercial cash lending industry is responsible for the bulk of the sector, most of which is consumption loans. Credit for enterprise development, provided by NGOs, makes up 4% of this total (Micro Finance Regulatory Council 2000). Savings institutions range from informal savings clubs or stokvels, through to NGOs using village-banking models offering savings and credit. Microfinance policies, debates and institutions are situated almost exclusively in the context of Small Medium Micro

[13] For further information see: Marsh, D., Saran, N. (1999). *Access to Credit for the Poor: The Borrowers Perspective. A Focus on Money Lending in South Africa.* Black Sash Trust. Unpublished Report; Bonti-ankhomah, S. and Chamba, C. (2000). *The Structure and Constraints of Rural Microfinance in Southern Africa.* NIEP Occasional Paper Series No.18.

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Enterprise (SMME) development. The Department of Trade and Industry (DTI) has the mandate to support the microfinance sector. Beyond SMME development, government ministries such as the Department of Welfare and the Department of Agriculture have an interest in microfinance. The South African Reserve Bank has overriding powers in regulating the sector.

HISTORICAL DEVELOPMENT OF THE SECTOR

Until the transition to democratic governance and the end of apartheid, small and micro enterprise activities in the former homelands were supported by NGOs. Some of the early NGOs were the Rural Finance Facility, The Get Ahead Foundation, and the Small Enterprise Foundation. Many of these institutions had an activist base and incorporated credit into their profile of activities. Donors such as USAID were instrumental in establishing and funding these projects.

The policy process began in the early 1990's. A series of task teams funded by the Fredrich Ebert Shiftung were established to conduct research and formulate policy for the sector. The National Small Business Act of 1995 was one of the earliest pieces of legislation to emerge, highlighting the priority both donors and the ANC accorded to the SMME sector. The main focus of the Act was to establish the two wholesale service providers, Ntsika Enterprise Services, catering for the non-financial support services, and Khula Financial Corporation providing wholesale financing to the microfinance sector. The Act stipulated that donor funding be channeled through these institutions rather than dispersed to the various projects as they had previously supported directly.

Khula Finance started in 1996. It had the mandate to provide wholesale financing enterprises ranging from survivalist to medium sized entities. Khula supports small and medium enterprises through credit guarantee schemes and has a venture capital facility. Support to survivalist and micro-enterprises are through the MFIs. The UNDP introduced the micro-start scheme, which Khlula remodelled to suit group lending in rural conditions, and were known as Khula Starts. At the outset, Khula supported 38

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established microfinance institutions and 22 Khula Start organizations (Roussos and Ferrand, 1999).

During 1995 and 1996 important research was undertaken by the Strauss Commission to document the scale of rural financial services (Coetzee and Cross, 2001). One of its recommendations was for the Land Bank to play a leading role in microfinance provision. In 1997, the Land Banks Step Up scheme came into being. To date it has over 40 000 clients with a repayment rate of 80% (Coetzee and Cross, 2001). Another innovation was the introduction of village banks supported by the Department of Welfare in 1998, namely the Financial Services Associations (FSA) and the Finasol, funded by USAID.

GOVERNMENT POLICIES

The White Paper (1995) and subsequent National Small Business Act of 1995 situates support to the SMME sector in relation to a number of policy directions including: poverty alleviation, women's empowerment, black empowerment, employment creation and economic growth. Support mechanisms to the SMME sector included finance, skills development and training, technology transfer, addressing the regulatory framework and access to markets. The White Paper (1995) sought to locate innovative solutions to meet the challenges facing the sector.

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The micro-lending industry is currently being regulated by the Micro Finance Regulatory Council (MFRC), a private body that has been given powers by the government to regulate the industry. The Usury Act of 1991, and amended in 1999, is the main regulatory instrument. The Usury Act allowed an exemption of interest rate ceilings on loans up to R10 000 (1999). For loans greater than R10 000, service providers have to lend at the prime lending rate determined by the Reserve Bank. The purpose of a Usury Act in any country is to place specific limitations and responsibilities on a lender of money. It is essentially to protect the population from "usurious" exploitation by lenders. However, the exemptions of interest ceilings have opened the sector to commercial (often unscrupulous) cash lending businesses, largely concerned with consumption lending

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(Marsh et al, 1999). The MFRC has subsequently imposed restrictions to curb unscrupulous lending.

Initiatives of the Reserve Bank include its participation in several forums at which the concept of village financial service cooperatives (FSCs) was discussed. This initiative may be an important vehicle to broaden the access of rural communities to banking and financial services. FSCs are member-owned and member-controlled cooperatives, which provide easy and safe access to much needed financial services in rural communities. Village FSCs in South Africa were exempted from the Banks Act, 1990, since their institutional activities do not fall within the definition of " the business of a bank". This exemption was recently extended to 31 December 2003.[14]

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[14] SA Reserve Bank 2000.

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CHAPTER THREE

▪ The research site (Case Study): Kgautswane Financial Services Cooperative

People formally interviewed (May 2002):

- Clara Masinga: Manager of MPCC & Community Leader
- Simon Motumi: Vice Chairperson – KFSC
- Betty Mafulele: Board Member – KFSC
- Bertha Mkhondo: Administration Worker – KFSC
- Luckey Mokweng: Client – KFSC
- Also, informal discussions with people living in the community including clients/members of the village bank.

All information on Kgautswane and the village bank (Kgautswane Financial Services Co operative) was generated through in depth interviews, unless otherwise quoted.

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South Africa

South Africa

BOTSWANA

ZIMBABWE

NAMIBIA

MOZAM.

SWAZILAND

LESOTHO

Atlantic Ocean

Indian Ocean

Kalahari Desert

Tropic of Capricorn

0 150 Miles

0 150 Kilometers

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Background

Kgautswane, located in South Africa's Northern Province (recently renamed Limpopo), is described as "deep rural". That means it lies beyond the reach of the national electricity and telephone grids, sufficiently remote to place it out of radar range of regional development planners.

The electricity grid passes nearby en route to more substantial towns in the north, but Kgautswane is unlikely to have electricity for several years because the state owned electricity utility, ESKOM, considers it a low-priority village.

Limpopo Province lies within the great elbow of the Limpopo river, and is a province of dramatic contrasts – from true bushveld country to majestic mountains, primeval indigenous forests, latter-day plantations, unspoilt wilderness areas and a patchwork of farm land.

Capital:	Pietersburg
Principal Languages:	Sepedi 52.7%
	Xitsonga 23%
	Tshivenda 15.5%
Population:	4.929 million
% Of total:	12.10%
Area (km²):	123 910
% Of total:	10.20%
GGP* at current prices (1994):	R14, 158million
% Of total GDP:**	3.70%

Source: (South Africa yearbook, 1999)

*GGP (gross geographical product) = GDP of a region.

**GDP (gross domestic product)

Limpopo is the gateway to the rest of Africa. It is favorably situated for economic cooperation with other parts of Southern Africa as it shares borders with Botswana, Zimbabwe and Mozambique.

Pietersburg is the capital city and lies strategically in the center of the province. The Gateway International Airport at Pietersburg was opened in March 1996 and is being

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developed as a major economic growth project to be a gateway to the rest of the continent.

The Great North Road through the center of the province strings together a series of interesting towns. Warmbaths, with its popular mineral spar, is near the southern border of the province. Then, going north, follow Nylstroom with its table grape industry and beautiful Waterberg range, Potgietersrus, Pietersburg, Louis Trichardt, at the foot of the Soutpansberg Mountain range, and Messina, with its thick-set baobab trees.

The crossing into Zimbabwe is at Beit Bridge, where the South African section of this important route north into Africa ends.

Other important Northern Province towns include the major mining centers of Phalaborwa and Thabazimbi, and Tzaneen, producer of tea, forestry products and tropical fruits.

A new major route will be the Muputo Corridor, which will link the province directly with the Mozambique port, creating development and trade opportunities, particularly in the southeastern part of the province. This province is in the Savannah biome; an area of mixed grasslands and trees, which is generally known as Bushveld. A trip through this summer-rainfall area soon convinces one that this is tree country. The northern and eastern parts of this summer rainfall region are subtropical with hot humid summers and mist in the mountainous parts. Winter throughout the province is mild and mostly frost-free. The biggest section of the Kruger National Park is situated along the eastern boundary of the Limpopo Province with Mozambique.

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Limpopo is rich in minerals, including copper, asbestos, coal, iron ore, platinum, chrome, diamonds and phosphates. The province is a typical developing area, exporting many primary products, and importing manufactured goods and services. It has a high potential and capacity with the right kind of economic development and is an attractive location for investors. (South Africa yearbook 1999)

In September 1998, the Premier of Limpopo said that 41% of the province's economically active inhabitants were unemployed. The Government was the largest employer, contributing 25% of economic output. (South Africa yearbook, 1999)

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Resources such as tourism, rain-fed agriculture, minerals and the abundant labour force available in the province are far from optimally utilized and thus offer excellent investment opportunities. (South Africa yearbook, 1999)

Kgautswane residents have modest expectations in life. They have demonstrated how a community who are determined to start their own process of development can improve themselves socially, economically and culturally. The ethnic composition encompasses Northern Sotho, Zulu and Shangaan. The village and its surrounds support a population of about 60 000, most of them reliant on subsistence farming as a means of survival. Although not destitute, the economy is largely an informal one, with mainly a number of general convenience stores as well as a few examples of service and utility shops (e.g. hairdressers, liquor stores and car repair locations). Shops and businesses are spread throughout the villages. Like many rural villages in South Africa, a high percentage of able-bodied men and women are forced to seek work elsewhere – in cities such as Johannesburg or Pretoria, several hundred kilometers away, or in Lydenberg, the nearest major town, about 70 kilometers distant. Children are often raised by the grandparents or extended family members who remain behind and rely on financial support (remittances) from those who leave to seek work elsewhere.

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These are people and communities, which may be considered "poor" in the accepted financial sense, but have shown themselves to be rich in faith, vision, action, compassion and cooperation, and by taking their own initiatives have gained in self respect, self confidence and self reliance.

The area is well served by schools. There are some 10 primary schools and seven secondary schools – one of these lying sufficiently close to the grid, has electricity. The rest rely on daylight and candles. Some of these ill equipped schools are performing outstandingly well against all odds – in the case of one school, achieving a nearly 90% final year pass rate.

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Given the social, economic and environmental handicaps and constraints that confront inhabitants, the people of Kgautswane have learnt to be self-reliant very successfully. Determined to start their own process of development, a community leader, Clara Masinga began by attracting a number of women around her to start a children's crèche from which grew the Kgautswane Development Center. The activities of the community and this center had attracted the respect and sponsorship of many institutions and companies, including the Beehive[15], Safmarine and Old Mutual who nominated her as one of the 12 national Community Builders of the year. Several years ago, the Integrated Community Building (ICB) program[16] was formed to conceive and implement projects aimed at community improvement. Led by Clara Masinga, the ICB program has achieved some commendable successes. "What we learned in the ICB programme course is that the success of any community, lies in good leadership skill, coupled with consultative abilities," said Clara.

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[15] Beehive Entrepreneurial Development Centre was established in 1992 in the region of Mpumalanga in South Africa, when a group of church, business and welfare leaders came together to address the high problem of unemployment. In 1994 the organisations focus changed from that of technical skills training to entrepreneurship development. This the Beehive did in collaboration with other NGOs namely the Small Business Development Corporation. The assistance of the Development Bank of South Africa allowed Beehive to start its microfinance program in 1996. Its main partner, Khula Enterprise Finance, came later (1997) with seed capital and business loans. It serves mostly rural areas, but also semi-urban and even urban areas.

[16] ICB is a community based development structure developed in collaboration with Technicon SA. The purpose is to help the community: uncover their own inner strengths and build greater self-worth and self confidence; improve community management for development by identifying legitimate leaders; improve levels of communication and information by establishing a multipurpose community resource and information centre; undertake their own reconstruction and development by implementing principles of community economics for self reliance and generate wealth and job creation by providing and improving skills and quality of decision making, planning and project management, interpersonal relations and standards of presentation of projects and business plans.

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The people of Kgautswane have shown increased social and economic activity over the past few years. Through their Development Centre, formally known as the Kgautswane Multipurpose Community Centre (MPCC), they have the following projects operating:

> **Village bank**, aged/older peoples project, crèches – 17 centres in the surrounding villages, disabled project, library, computer centre, cooperative, juice project, atchhar project, tourism, carpentry, tree planting/nursery, gardening, poultry, catering and catering for tradition, brick making, tile making, drug and alcohol forum, primary health care, fence making, cooking and baking, art and craft, sewing, and a cultural village 8 kilometers from the MPCC.

The motto of the Kgautswane Development Centre is:
"The more we come together and discuss, the more light will prevail and problems will be solved."

The MPCC had its grand opening on the 8th May 1998, which attracted more than 400 people of Kgautswane, Chief A.T. Kgoete (traditional leader), representatives from the surrounding villages (also called Indunas), school principals and leading figures in the community, as well as business representatives.

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Clara Masinga, the Director of the Kgautsane MPCC stated, "We have done all these activities because Technicon SA taught us to work together. The most important thing is that myself, the Chief, Indunas and other traditional and political leaders in other villages work together."

The Premier of Limpopo Province was so impressed by this community that the Provincial government made R6million available for roads, and other public sector projects including water reticulation, sports amenities, a clinic, and school upgrading. The World Bank was attracted by their initiative and success, and in 1999, made

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available $50million to assist in the installation of computers to bring much needed training and commercial information to this rural pilot community.

Led by Clara Masinga, the ICB program has achieved some commendable successes, one of which is the Kgautswane Information Communication and Technology (ICT) Centre, a seemingly modest project comprising no more than an IBM server, three workstations, two uninterruptible power supplies and a colour printer/scanner – situated within the MPCC.

Power to the MPCC is supplied from a 5 500 watt gas-fuelled generator, which runs 18 hours a day – such is the demand for the service. There is insufficient current from the generator to power light bulbs, so visitors are treated to the incongruous spectacle of high-tech computers being operated by candlelight after dark. The centre is owned and run by the ICB, with generator fuel paid for by renting the computers to locals who use it to lend a professional touch to business plans or school reports.

Paul West, director of the Centre for Lifelong Learning at Technicon South Africa, one of the sponsors of the project, is of the opinion that the centre is changing the life of Kgautswane residents in other ways. "For one, levels of computer literacy have been markedly raised. Most people in Africa will never own a computer in their lifetimes. Therefore, other ways will have to be found to introduce them to the information society. This project is introducing the people of Kgautswane to the information society and bridging the digital divide." (Interview May 2002).

Since the launch of the Kgautswane ICT Centre in 1999, the village has become a font of entrepreneurial energy. Typed business plans pour out of the centre in search of finance and partners. Teachers are issuing students with professionally presented rather than handwritten papers and committee minutes are now committed to print.

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Kgautswane Village Bank

The concept of Village Banking in South Africa[17] is based on simplified banking systems at low cost, beyond the reach of commercial banks. It has been developed with two basic elements – community ownership and linking with commercial banks.

A village bank is a community-managed facility that operates as a Financial Services Cooperative[18] (FSC), and plays a multiple role of:

- Encouraging the natural inclination of poor people to save for their own benefit;
- Establishing a community capital base for the community to access funds;
- A means of handling and managing housing, welfare and agricultural subsidies;
- It is a means of ensuring not only that financial resources are delivered adequately and effectively into the community, but also that accountability is at the point of delivery.

A FSC is a rural based institutional structure linked to the formal financial market in a commercially viable manner, through which the rural community can have access to much needed financial services. The sustainability of a rural based institutional structure depends on effective community participation through which ownership, and control is accepted by the community.

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[17] Information on village banking in South Africa was also taken from a presentation by Wezi Ximiya, CEO of the Financial Services Association. [Online]. Available: http://www.wsp.org/english/afr/mpumalanga/ximiya.pdf

[18] Cooperatives are based on one member, one vote, and one share. Savings and credit cooperatives (SACCOs) are mutual self-help financial cooperatives. They are permanent structures in most cases based in communities where people live or work. These are made up of members who benefit by saving together and lending money from the accumulated pool of savings. These bodies offer much more sophisticated savings and lending services than the savings clubs or stokvels. They are run more professionally, as they are subject to audits and established accounting procedures. A key focus of a SACCO is the education of its members. With greater emphasis on savings, rather than borrowing, SACCOs try to develop a culture of financial responsibility in their membership. SACCOs differ from banks, in that when a person becomes a member, he/she also becomes an owner and partner in the financial cooperative. Profits are therefore returned to members as dividends on shares, rather than to outside shareholders.
The advantage of the non-traditional savings and lending models is that they promote a culture of savings toward self-reliance of members. This is in contrast to the formal banking sector where the focus is on lending. This is reflected in the lower interest rates paid by banks for savings and their high rates of interest on loans (Fair Share, 2001:3).

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It is not intended to be in competition with the formal or informal sector, nor is it intended to replace or substitute any current community structure. The link between the FSC and the commercial banks will enable the FSC to extend the services in a financially viable manner. Any service that needs to be channeled to the formal financial sector will be effected through a link bank of the community's choice. Village banking is not sector, but community based and targets rural and remote areas.

A FSC is therefore, directed towards provision of effective financial services to the Kgautswane community in support of sustainable economic development, to be achieved by:

- The provision of a comprehensive range of financial services including, savings, transfers, loans, and insurance services;
- The development of credit capacity for the community and its members;
- The effective utilization of local and foreign economic resources;
- The development of effective institutional capacity within the community thus, ensuring sustainability for development projects.

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Development of the Village Bank

Typically, FSCs are MFIs with a board overseeing a manager and staff with accounting and loan tracking and monitoring capabilities. FSCs serve as retail financial providers to micro-enterprise customers, who are shareholders of the FSC. The physical structure that accommodates the FSC is provided for by the community, through the tribal or local authority, and this forms part of the community contribution to the process of establishing the FSC. The establishment process takes place in two phases,

1. ***Pre- launch,*** with following elements:
   - Community organization, that will secure maximum community participation and establishment of community ownership, this includes: Election of liaison committee, representative of community structures; Feasibility study; Development of a business plan; Membership drive with pledged commitment; Election and training of Board members from founder members.
   - Identification of a link bank (commercial bank of their choice) and opening of a bank account.
   - Registration with the Registrar of Cooperatives and affiliation with the Financial Services Association.
   - Appointment of FSC staff and securing first year operational systems (subsidy provided for by the Financial Services Association).
   - Opening of the FSC for business.
2. ***Operational phase*** - which involves operationalizing of the FSC by the Board and FSC management. The elements of this phase include:
   - Interpretation and application of the statues;
   - Delivery of services, reading client needs and responses, and perfecting products;
   - Portfolio and investment management;
   - Acquiring financial viability through social viability.

The next phase is general management and maintenance of operations, and this takes place in the second year.

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In October 1999 the community of Kgautswane attracted the attention of Wezi Ximina, the chief executive officer of the Financial Services Association, who addressed them on the methodology of opening their own village bank. Within two weeks they had collected the names of 350 shareholders and thereupon formed their required Board of Directors and Management team. Shares in the bank were sold for R10. The date for the official opening of the bank was set for 11th December 1999 to be performed by the premier of the Limpopo Province. The previous village banks in the North West Province had taken many months to publicize and establish, but the ICB Programme had already engendered an understanding of the meaning, responsibility and benefits of their having their own banking facility.

On the 2nd of December the Board decided they have a bank to open. A local builder together with voluntary help set about constructing a new building, which was completed just in time for the ceremony. It consists of a small public space fitted with carpet tiles and curtains, with two teller cubicles and a safe room. A special plaque was fitted to commemorate the occasion. The village bank is situated within the Kgautswane MPCC.

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The Premier of the Limpopo Province was not able to attend, but assigned the Head of the Department of Finance, Economic Affairs and Tourism, Mr. Ben Mphahlele to speak on his behalf and perform the ceremony. He was specially interested in, and supportive of the enterprise shown by the Kgautswane community. Other speeches were made including that of Chief Kgoete who gave his full support.

The village bank was officially named the 'Kgautswane Financial Services Cooperative,' and is registered with the Financial Services Association (FSA).

The FSA is a non-profit making organization, which acts as a regulatory body for village banks. It is one of only three regulators of village banks in South Africa. FSA was formed in February 1996, by the Department of Welfare and coordinated by a seconded official in the Department of Agriculture. The FSA commenced operations as an organization in 1999, when it was given a grant of R7 million by the Micro Save Program. The South

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African Reserve Bank granted the FSA authority to regulate its member village banks. FSA is incorporated under the Companies Act of 1993.

The vision of FSA is the creation of a sustainable village banking system that will result in a fully-fledged and vibrant commercial and cooperative banking network in South Africa. The mission is to empower rural, remote and poor communities, to become economically independent through financial and social support programmes, as well a to enhance the quality of life of the people by providing financial and non-financial corporate services at local level (FSA Annual Report 2001).

Objectives of the FSA include:

- Formulation and coordination of a national village banking programme, policies and procedures, research, collection and dissemination of information.
- Facilitation and strengthening of village banks through capacity building and training, in order to impact upon local economic development, job creation and welfare.
- Facilitate registration, licensing and regulation of village banks, according to the statutes and exemption from the Reserve Bank.
- Receiving, evaluation and consolidation of financial statements of member village banks for submission to the registrar of banks.
- Development and marketing of products.
- Mobilization of programme funds nationally and internationally.

(FSA Annual Report 2001)

One of the requirements set by the FSA was that the Village Bank develops a link with the established commercial bank, First National Bank (FNB), one of the oldest and biggest commercial banks in South Africa. The bank is situated in Lydenberg, approximately 70 kilometers from the village. Part of the sustained success of the Kgautswane Financial Services Cooperative (KFSC) must be attributed to its excellent working relationship with the link or "mentor" bank, that provides training in operational systems, sound business practices, technical assistance as well as general empowering, facilitation and monitoring role and service. As part of the social compact between the

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FNB and KFSC, the largest part of deposits made with the village bank, are held at FNB. Therefore the success of KFSC is important to both KFSC and FNB because both benefit from this synergistic relationship.

The establishment of the village bank in Kgautswane in such a short period of time was a significant achievement – it was the first village bank in South Africa to be launched in three months. During the first six months of operation, savings, fixed deposits, and shares (investment) in the village bank was offered. After only six months, the village bank established itself to such an extent, that it was able to offer credit/loan, and funeral benefit services. Although a village bank initiative like the KFSC is essentially concerned with the empowerment of people, livelihoods and structures of civil society of the local community, it will be erroneous and short sighted not to extend the potential benefits and positive impact of these institutions on inter alia household poverty levels. It is therefore encouraging that the board members of the KFSC has decided that their bank will be open to anyone who meets the minimum requirements set by the bank.

The KFSC was formed for various reasons including:

- Distance from commercial banks. Especially for older people, who are unable to travel long distances. In some cases, the transportation costs of traveling to the commercial banks exceed the amount to be deposited or withdrawn.
- The need for financial management amongst both individuals, organizations and micro- and small enterprises.
- To accommodate the unemployed and the so-called "unbankable" who have no surety and collateral to offer formal or conventional credit and lending institutions. To open an account, the village bank only requires a valid identity document and a minimum deposit of R10.
- Empowerment of women in the rural community.
- Job creation. To create career opportunities and empowerment within the local community.
- The need for funeral and insurance benefits. Funerals are a huge expense and without coverage, families are faced with a financial burden, which they often

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cannot afford. The severity of HIV/AIDS has a dramatic impact on the mortality rate, creating havoc with already poor households budgets.

- High risk in carrying cash on journeys.
- Educate the rural community in managing their finances.

The goals of KFSC are to empower people in the community, increase the client base of the bank, become completely self sufficient, and attain and sustain the operational standards of commercial banks.

Funding

The primary funding during the start up process was granted by the FSA. These funds were used to cover costs to establish the bank, i.e. to purchase stationary and equipment, and to pay the wages of the administrator for the first year of operation. Thereafter, the KFSC was responsible for all its expenses.

The KFSC received an unexpected and substantial financial windfall when Clara Masinga, who was the initiator and driving force behind the founding of the village bank, was awarded a prize from the World Bank in Washington DC in 2000 for fighting poverty. The prize money was US$60 thousand. The project was officially called "DEVELOPMENT MARKETPLACE PROJECT #463 Leveraging Savings for Development – Village Banking".

The project's main objective and strategy was to facilitate the process whereby the community's ownership and the capital base of local savings is built up for local development purposes through the integration of the village banking system into community-identified development plans. In addition, management and control of funds are strengthened in order to minimize the risk of fraud. The project extended three existing Village Bank projects in the North West Province of South Africa, as well as commences two new projects in KwaZulu-Natal and complete Kgautswane training requirements.

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The three major implementing agencies were Technicon SA, which was responsible for most of the training and procurement and installation of equipment; FSA for some technical training and management support and InterPlan Africa, which was responsible for course design and overall project coordination. KFSC used the prize money to buy a computer, printer, and for training.

At present, KFSC is operating without any external funding. However, the village bank relies on the FSA and Technicon SA for it's training and auditing requirements. No monetary funding is granted to the village bank. The initial start up funding was, however vital for the smooth operation of the bank. Even though the village bank is currently sustainable without external funding, additional funds are required for:

- Improving general operational standards.
- Development of facilities e.g. computerization of transactions, a more secure building, and 24 hour security.
- To develop its capital base in order to provide more/larger loans, especially to farmers and business people.

In order to decrease the level of dependency on donors, the bank had to develop its income base. This it did by charging its clients administration fees, as well as through interest earnings from the savings deposit kept at its link bank (FNB).

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Staff and Structure of the Village Bank

Organizational Hierarchy:

Board of Directors
Chairperson
Vice-Chairperson
Secretary – Treasurer
Admin Staff
Security Guard
Clients/Members

There are eleven Board members of which seven are women. All board members are volunteers. About 50% of the staff members are women and all reside within the local community. The administration staff consists of one woman. When the bank becomes busy, the board members voluntarily assist. The staff receives a very low income and most work on a voluntary basis, thereby demonstrating their commitment to developing their community. The Board of Directors makes all decisions concerning the village bank. All proposals, initiatives etc. must therefore go via the board, where a democratic decision is made. Critical decisions are however decided on in collaboration with the FSA.

Although all of the residents within the community are marketed for membership and volunteer involvement, the recruitment emphasis is placed on leaders of local community organizations and pensioners. These individuals are ideal candidates for volunteer workers, board-, or staff members.

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The recruitment process takes place as follows:

- Board of Directors conducts interviews.
- Individuals who can read, write and are good in mathematics are short-listed.
- They must be permanent residents within the Kgautswane Village.
- They must also be unemployed, as one of the main objective of establishing a village bank is to create employment.
- Those who are selected will receive training through the link bank and the FSA.
- More than one volunteer will be trained to ensure that at least two people are working in the bank at all times.

Staff Training

Continuous and regular training of all staff and volunteers involved in the running of the bank is regarded by the Board as essential to the efficient functioning of the bank. Staff undergoes training at least once every two months. Experts from the FSA in collaboration with Technicon SA conduct this training free of charge. The objective of the training is to increase the overall level of professionalism, which will enhance the credibility of the village bank. This will hopefully lead to more people embracing and partaking in the bank. By building skills in more people, information becomes common property. This again discourages fraud and mal-practices because information is not concentrated around few people.

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The training is challenged formally, on the job, during meetings, participation in FSA activities and audit feedbacks. Training is conducted in such a way that the staff can become trainers themselves. The new trainers are all from the local villages and also, only local villagers are drafted to be trained as workers at KFSC. This model of training and policy of recruitment of new workers, ensures that meaningful empowerment, capacitation and subsequent career development occurs within the community. This will ultimately lead to more stable career opportunities, higher income, and the eradication of abject poverty in the households of the beneficiaries.

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The Board of Directors was trained in cooperative governance skills. Many shareholders in the KFSC have no banking experience. To educate them, FSA, Technicon SA, and staff from KFSC conduct quarterly meetings at which the products and services of the village bank are explained in easy and accessible language. These meetings cover investment and credit counselling, effective budgeting, and banking facilities.

Clients

The bank targets the poor living in the surrounding rural villages. However, anyone meeting the minimum requirements is able to utilize the bank. It is exactly this easy accessibility and non-discriminatory entrée to a village bank, that makes it such a well-designed and appropriate concept and tool to use in both the process of empowerment of ordinary people, as well as in the battle against rural poverty.

KFSC current service and client structure:

Type of service	Number of clients
Shareholders	295
Savings deposits	247
Funeral benefits	72
Loans	11

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About 80% of the clients are women, as the men usually bank in the bigger and better resourced towns where they work.

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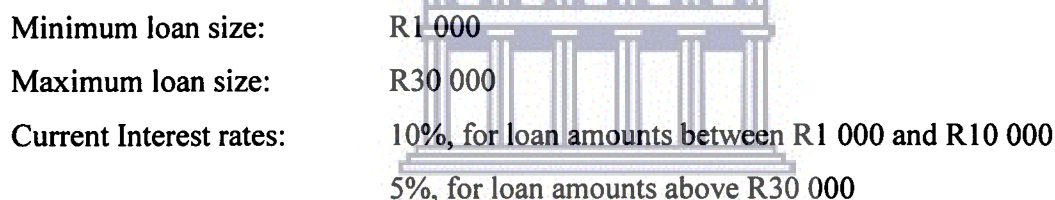
Services Offered by the Village Bank

GROUP LOAN SERVICE

This product offers loans to groups of four to five members, who operate in the form of a stokvel[19]. Currently the bank does not have any group loan clients. Various other stokvels also operate in the area, such as: Naledi Group, Dipitsi Group, and Refemaatla Group. Other groups are informal and unknown. KFSC interacts with six of the known groups by providing advice and consultation concerning the financial operations of the groups.

INDIVIDUAL LOAN/CREDIT SERVICE

Once the bank establishes its loan portfolio, it anticipates that loans will generate the bulk of income necessary to support operations and the communities demand for additional financial services. The interest rate charged is subject to the Usury Act. Loan size varies as follows:



Minimum loan size:	R1 000
Maximum loan size:	R30 000
Current Interest rates:	10%, for loan amounts between R1 000 and R10 000
	5%, for loan amounts above R30 000

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In most cases, borrowers do not have collateral. Loans are therefore granted in the following instances:

- Borrowers must be members of KFSC, i.e. shareholders.
- Borrowers must provide a motivation for the loan, e.g. a business plan, or feasibility study.
- Board members take a decision on whether to grant the loan.
- Borrower signs a contract committing him/herself to make all repayments.
- The borrower stands a better chance of a larger loan if he/she has a good track record.
- Borrowers must attend a course in business skills and basic financial management at the MPCC.

[19] A stokvel is a type of credit unit, by which a group of people enters into an agreement to contribute a fix amount of money to a common pool, weekly, fortnightly or monthly. Members either in rotation or in a time of need may withdraw depending on the particular stokvel. Stokvel is the South Africa version of Rotating Savings and Credit Association (ROSCA) (LAPC, 1993).

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According to the vice chairperson of KFSC, smaller loan amounts will be granted in the future, for example someone with a good track record may borrow R250, over a short period.

Interest income covers part of the operational costs, for example administrative staff salary, stationary and so forth. The remainder of the operational costs is financed by bank charges for example when a withdrawal is made. With a loan portfolio of only eleven, illustrates the meager resources on which the village bank is sustaining itself. The default rate at present is zero percent. If clients default on their repayments, the following measures may be taken:

- Board members of the village bank make visits and enquire;
- Measures to recover costs e.g. liquidate businesses, reposes farmers stock etc.

SAVING SERVICE

Open account:

This is the short-term service account. It benefits members by providing a secure place for the safe keeping of their cash balances. The balances earn interests, which provides an incentive for increasing services.

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Savings in the open account are easily accessible and can be withdrawn at a client's convenience, up to an amount of R2000. The client needs to give notice if he/she requires anything above R2000. This is because the bulk of the banks money is kept at the link bank. The village bank therefore has to arrange with the link bank for the excess funds. This as well as the transportation of the money takes time.

The interest rate on savings deposits is 10% per annum. There is a R3 charge for any withdrawal made up to R500. For larger amounts of cash, there is a R6 service charge.

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Fixed deposits:

This product is a long-term investment. Money is committed to an investment for a given period of time, e.g. 3 months, 6 months, or 12 months. Because money is committed for a fixed period, members earn higher interest rates than they would in an open account. Although the product is offered, the bank does not have any clients with fixed deposits.

Shares:

A share gives the member ownership rights in the village bank. Ownership entitles the member to vote and receive dividends. Members use their votes to elect board members, change by-laws, set board-meeting dates, and determine policy. Shares are available for as little as R10.

KFSC uses the accumulated savings of clients to:

- Develop its capital base;
- Grant loans;
- Deposit in interest earning account at the link bank;
- Once substantial amounts of savings have been accumulated, the bank intends to invest in local community development programs.

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Other means of saving within the community include saving at home, which is not safe, and stokvels.

FUNERAL BENEFITS

The importance of this service lies in the fact that one death can cost a family up to R5000 for the funeral service. This is very expensive and usually beyond the capacity of the poor villagers. It however does not deter them, as it is a matter of great traditional pride to bury the beloved in the greatest honor possible. The funeral benefit scheme offered by the village bank is a cost-effective way of insuring themselves against the financial effects of an unexpected death. For funeral benefits, a joining fee of R20 is payable by all new members and an additional R30 is paid as premium month.

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In the case of a death, benefits are as follows:

- Parents receive R5000.00
- Children 14 – 21 years R3000.00
- Children 7 – 13 years R2000.00
- Infants 0 – 1 year R1000.00
- Stillborn R500.00

The prevalence and incidence of HIV/AIDS amongst all sectors of the rural population of South Africa has taken on crisis proportions and has resulted in the funeral benefit scheme becoming an indispensable necessity. A sudden death, or even worse, multiple deaths due to AIDS, can completely deplete a households financial reserves and lead to protracted financial hardship. The funeral benefit scheme offered by village banks is of strategic importance, not only in the strict financial sense, but also in a sociological context. It allows households to bury their family members with dignity and according to cultural norms, prescriptions and rituals.

EDUCATING CLIENTS OF THE VILLAGE BANK

In collaboration with the MPCC, clients are educated in:

- Management and other business skills
- Vocational training and entrepreneurship
- Basic education and literacy programs
- Leadership programs

Trainers from the local community, as well as experts from outside conduct these training courses. The FSA pays for this service. Training takes place at the MPCC.

There are no competitors or other similar financial institutions offering the services outlined above, in the in close proximity to KFSC.

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Management Information System

KFSC uses both manual and computerized management information systems. Due to a lack of electricity, and therefore an unreliable computer system, manual recording of all transactions is vital. Data is also computerized and stored on a floppy disk. However, until the computerized system is deemed reliable, the main MIS remains manual.

The MIS can produce data/information at any given time. However, under the manual system, someone must physically go through all the files/records and this makes auditing and drawing up financial reports a lengthy process.

Monitoring and Assessment Tools

The FSA monitors the village bank through financial reports, and on site visits – people from the FSA come to audit the village bank every two months. KFSC however, also has its own auditor, a local schoolteacher who teaches accounting. Once the schoolteacher has completed his audit, a copy is sent to the FSA, Technicon SA, and the World Bank. KFSC is therefore audited internally as well as externally.

This informs the system on the following:

- Compliance with license standards.
- Performance and non-performance.
- Effectiveness and weaknesses of internal controls.
- Business management and process.

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Other monitoring and assessment tools, include effective budgeting (vital when working with meager resources), physical visits to borrowers, reporting on daily activities, daily financial recording, governance system (controlled by the board of directors), staff monitoring, and system monitoring (both done by the chair and vice chairperson, as well as the FSA).

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These monitoring and assessment tools aim to identify problems while still in their infancy. A common example is when a client's handwriting is illegible. This needs to be checked and rectified, as it can lead to other larger problems.

Marketing and Promotion

The initial marketing and promotion was crucial to the success of KFSC. It was, and still is conveyed to the target market, that this is a serious credible effort that is worthy of the residents' support and trust. Great emphasis was from the outset placed on the cooperative, member-owned nature of the village bank.

Other concepts that were emphasized include:

- Every member is an owner of the institution regardless of income level or position held.
- Every resident within the target area has an opportunity to become a shareholder and the village bank cares about its members and their well being.

These ideas are marketed in the following manner:

- Members of the village bank in collaboration with the MPCC conduct seminars and workshops. The aim of this is to address outreach, publicity, education, training, and resource development. Feedback from these seminars and workshops are used to improve the services provided by the village bank.

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Linkages with Other Institutions

Kgautswane Financial Services Cooperative has formal linkages with the FSA, Technicon SA, Link Bank – FNB, ROSCAS/Stokvels, Schools, the Landbank[20], the Beehive and other village banks such as Mathabatha Village Financial Service Cooperative. KFSC collaborate with these organizations in terms of funding, human resources, sharing technologies and expertise, and various other ways as already

[20] In South Africa, the Land Bank acts as the national agricultural development bank. It was established in 1912 as an autonomous parastatal, with the state as the sole shareholder, to assist in realizing government's agricultural policy. The Land Bank finances its business by borrowing on the money market (Land Bank, 1998).

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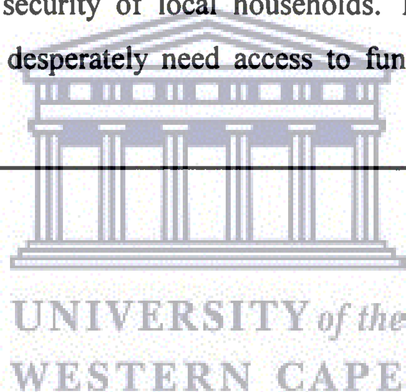
mentioned. This contact is viewed as crucial to the smooth and efficient operation of the village bank.

Constraints of the Institution

Constraints confronting the village bank that were identified by the research range from the lack of the most basic amenities and facilities like piped water, a constant electric source, a more secure building and a more accessible road system, to a serious lack of resources, notably funds, to enable the bank to extend its service to the community of small scale and emerging farmers in the villages. Small-scale agriculture forms the backbone of the local communities economy. The development and fortification of this sector will have an immediate and sustained beneficial impact on the income, and therefore on the status and security of local households. The same applies to small business in the villages that desperately need access to funds in order to expand and improve their business.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CHAPTER FOUR

- Research Findings
- Conclusion and Recommendations

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Findings in Terms of the Efficiency Principles

Having evaluated KFSC, the research findings are as follows:

EFFICIENCY PRINCIPLE	ACCOMPLISHED?
Target the poorest of the poor.	Yes
Mobilize savings.	Yes
Charge interest rates that cover operational costs.	No
Market research.	Yes
Streamline and decentralize operations.	Yes
Utilize volunteer staff.	Yes
Target women.	Yes
Develop monitoring and assessment tools.	Yes
Confront problems.	Yes
Invest in training.	Yes
Utilize pre-existing organizations.	Yes
Avoid external dependency.	No

- Target the poorest of the poor.

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The location of KFSC is considered to be "deep rural," where the majority of the inhabitants are poor. The target market is officially the poorest of the poor. However, the village bank does not only target the poorest of the poor, as anyone who meets the minimum requirements can become a member of the cooperative. As stated in the literature review, this is evident of a "mixed" program, which may be able to expand faster and reach larger numbers. As long as funds meant for the poorest of the poor are not channeled to the non-poor.

- Mobilize savings.

FSCs, like all banks are based on savings mobilization. Within a period of six months, KFSC mobilized enough savings in the form of shares, as well as personal savings, in order to offer a credit service. These funds were internally invested, rather than borrowed externally. Members are therefore more invested in the village bank and this allowed the

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cooperative to extend its services to provide credit and funeral benefits. As stated in the literature review, KFSC operates similarly to FINCA Uganda and CRECER, where primary emphasis is placed on savings first. This is typical of a village-banking model.

- Charge interest rates that cover operational costs.

The interest rates charged are relatively low compared to the commercial banking sector. KFSC is currently in its development stage, and has not generated enough capital to grant many loans. The loan portfolio is therefore diminutive and not enough interest income is generated to cover all operational costs. Operational costs are consequently covered by interest income from loans, as well as service charge income from the saving service. According to the vice chairperson of KFSC, it is anticipated that interest income will cover all operational costs, as the loan portfolio increases and more interest income is generated in the future. As stated in the literature review, a reasonable timeframe in which interest rates should cover operational costs is four to five years.

- Market research.

The initial research on the feasibility of KFSC and the financial services that it offers was done by the FSA. KFSC staff, with assistance from the FSA conducts ongoing market research through seminars and workshops in the Kgautswane community. In this way products or services offered are tailored to satisfy the needs of current as well as potential clients. Marketing and promotion via the seminars and workshops has also improved the credibility of KFSC.

- Streamline and decentralize operations.

The organizational design is a traditional hierarchy. Because the organization is still small, with few staff, the structure does not seem to pose any problems in terms of flow of information. There is no managerial layer of management between the vice chairperson and the administrative staff member. In this way, the traditional hierarchy has been streamlined. According to the literature, lean, simple infrastructures utilizing basic design of microfinance products facilitate administrative procedures and increases operational efficiency.

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- Utilize volunteer staff.

As explained in the literature review, volunteer staff can reduce operational costs significantly. The sustainability of KFSC can partly be attributed to staff that work on a voluntary basis, consequently reducing the overhead expense of the village bank. All staff members are Kgautswane residents, and receive training, which further contributes to empowerment within the rural community.

- Target women.

A woman initiated the establishment of KFSC; the majority of the staff are women; the majority of the clients are also women, as men usually bank in the towns where they work. Evidently women form a large part of the target market. This corresponds to the literature review, which states that the most compelling reason for MFIs to prioritize women is to assist the poorest, which are disproportionately women.

- Develop monitoring and assessment tools.

The major drawback of KFSC is that it is operating without electricity. Even though the latest computer facilities are available, it cannot be relied on as it receives electricity from a low capacity generator. Monitoring and assessment is therefore done using manual procedures to store client information, compile reports, audits, and so on. The system is time consuming and thus hampers the flow of information. Although a limitation to institutional efficiency and effectiveness, the village bank is still successful using a manual MIS.

- Confront problems.

A manual MIS makes it more difficult to anticipate problems in their infancy, as opposed to a computerized MIS. For that reason, although successful, this principle can be improved.

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- Invest in training.

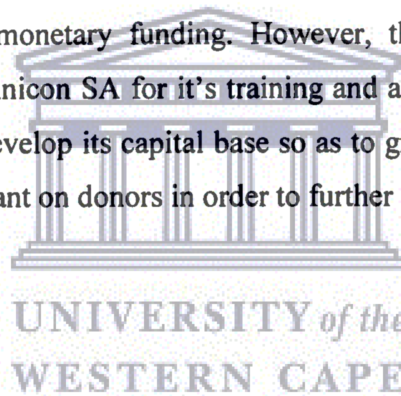
As explained in the case study, staff receives professional training on a regular basis. This, as stated in the literature is an investment capable of reducing recurring costs and improving operational efficiency, sustainability, and outreach.

- Utilize pre-existing organizations.

As outlined in the case study, KFSC is affiliated with a number of support organizations, such as the FSA, FNB and Technicon SA.

- Avoid external dependency.

Donor funding played an essential role in the start-up of KFSC. The bank is currently operating without external monetary funding. However, the bank still relies on the support of the FSA and Technicon SA for it's training and auditing requirements. KFSC currently requires funds to develop its capital base so as to grant more loans. The village bank is therefore still dependant on donors in order to further develop.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Conclusion and Recommendations

The research findings indicate that KFSC is operating fairly efficiently, as ten of the twelve efficiency principles are achieved. Albeit, two of the ten achieved principles (monitoring and assessment tools; and confronting problems), which can be improved.

Given the fact that KFSC is still in its development stage, may be the reason why two of the efficiency principles (charge interest rates that cover operational costs; and avoid external dependency) have not been achieved.

Efficiency may be enhanced in the following ways:

1. Concerning monitoring and assessment tools; and confronting problems:
   - Implement a computerized management information system. The will enhance efficiency by improving the way the village bank is monitored and assessed, and thus allows the bank to effectively confront problems in their infancy. The impediment however is the lack of electricity. Until ESKOM electrifies Kgautswane, computerization will not be a viable option.
2. Concerning the efficiency principles not achieved:
   - Increase the loan portfolio with the aim of earning enough interest income to cover all operational costs. This however will require additional funding from a donor in order to build up the capital base, so as to grant more loans. The result would be a further delay in achieving the last efficiency principle "avoiding external dependency". Once KFSC has developed its capital base, and is generating sufficient interest income to cover operational costs, emphasis should be placed on becoming entirely self-reliant and profitable. According to the literature review, if MFIs were so profitable they attracted private investors, outreach would burgeon, social benefits would amplify, and social costs shrivel, leading to an improvement in social welfare.

To sum up, KFSC is operating quite efficiently, and the above recommendations would place the village bank on the path to enhanced efficiency in its operations.

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Appendix 1

QUESTIONNAIRE

1. Name of the organization:
2. Names of the interviewee:
3. Position of the interviewee in the organization:
4. Location of the organization:
5. Date of interview:
6. Name of the researcher:

A. BACKGROUND INFORMATION

1. What type of institution is your organization?
    a. Microfinance business
    b. Credit Union
    c. Community based organization
    d. Village Bank
    e. Commercial Bank
    f. Other. Please specify

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2. What kind of services do you offer? *(Mark all that apply)*
    [ ] a. Credit [ ] b. Savings [ ] c. Training/counseling
    [ ] d. Insurance. Specify type
    [ ] e. Other. Specify type
3. For what reasons did you start this organization?
4. How long has the organization been operating?
5. What is the mission statement of your organization?
    Have no mission statement.
6. What are the goals of your organization?
7. Do you work in
    a. Urban areas
    b. Rural areas

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c. Rural and urban areas

8. Who started this organization?

   a. Government

   b. Private Non- governmental organizations

   c. Individuals

   Please specify.

B. FUNDING

(If your organization does not receive outside funding, proceed to the next section)

1. Did your organization receive any outside funding when it started?
2. If yes to the above question, from whom?
3. What type of funds are these?

   a. Grants b. Share capital c. Other, specify.

   b. What are these funds used for in the organization?

   c. Grant loan capital

   d. Grants for operating expenses

   e. Donation of building or equipment

   f. Other, specify.

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4. Does the organization at present still receive funding from an outside donor?
5. If yes to Q5, please indicate the following:

   6.1 Name of the funder:

   6.2 The size of the donation:

   6.3 How the funding is used in the organization:

6. How important is outside funding to the working of this organization?

   a. Very important

   b. Important

   c. Of very little importance

   d. No importance

   Please explain your answer.

7. What are you doing to decrease the level of dependency on donors (e.g. charging for training and administration costs)?

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8. Do your donors set conditions for funding?
9. If yes to Q9, what are these conditions?
   a. Geographical location of clients
   b. Level of poverty of clients
   c. Economic activity of clients
   d. Other, specify
11. Do the donors monitor your organization through: *(mark all that apply)*
   [ ] a. Financial reports
   [ ] b. On site visits
   [ ] c. Performance appraisal
   [ ] d. Other. Please specify
12. In your opinion, will this organization be able to function well without any outside funding in future? a. Yes b. No c. Uncertain
13. Additional comments regarding funding.

C. STAFF AND STRUCTURE OF THE ORGANIZATION

1. How many people are working for this organization at the moment?
2. How many are from the local community?
3. Briefly explain the structure of your organization? (Decentralized; centralized management).
4. Explain the decision making process.
5. What percentage of your staff are women?
6. What percentage of the management of the organization are women?
7. Do the staff of this organization
   a. Receive salary/wage
   b. Are all volunteers
   c. Combination of the above two
8. Where do staff reside? (Voluntary; non-voluntary)
9. How often does the staff undergo training?
   a. Very often (+/ - once a month)
   b. Often (+/- every two months)

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c. Seldom (3 - 4 months)

d. Very seldom (+/- once a year)

e. Never

10. Describe type of training programs that the staff received.

11. Who conducts the training courses?

a. Trainers from local area who do it free of charge

b. Trainers from local area who charge a fee

c. Experts from outside who do it free of charge

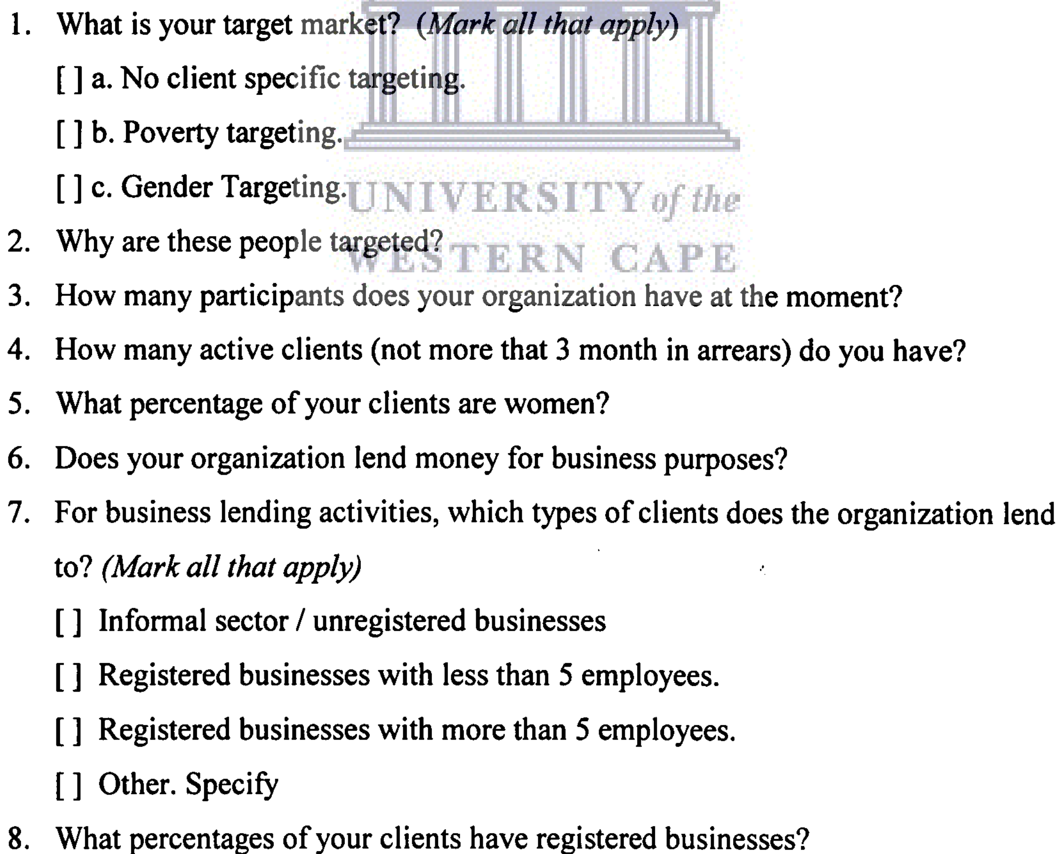
d. Experts from outside who charge a fee

12. In your opinion, does the training help the organization to do its work better?

a. Yes b. No c. Uncertain

Please motivate/explain.

D. THE CLIENTS



1. What is your target market? *(Mark all that apply)*

[ ] a. No client specific targeting.

[ ] b. Poverty targeting.

[ ] c. Gender Targeting.

2. Why are these people targeted?

3. How many participants does your organization have at the moment?

4. How many active clients (not more that 3 month in arrears) do you have?

5. What percentage of your clients are women?

6. Does your organization lend money for business purposes?

7. For business lending activities, which types of clients does the organization lend to? *(Mark all that apply)*

[ ] Informal sector / unregistered businesses

[ ] Registered businesses with less than 5 employees.

[ ] Registered businesses with more than 5 employees.

[ ] Other. Specify

8. What percentages of your clients have registered businesses?

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9. Do you screen/evaluate prospective clients/participant that want to join your organization?

   If yes, please explain the criteria's you use.

10. Do you recommend your clients for higher loans to formal financial institutions?

    a. Yes b. No

    Explain your answer.

E. GROUP COMPOSITION

1. Do you provide: a. group loan b. individual loans

   (If the answer to Q1 is b, please proceed to the 2nd part of this section directly)

GROUP LOAN

2. What is the average size of a group?
3. How many groups do you currently have?
4. Are the groups registered?
5. Are you aware of informal or traditional groups already existing in local area?

   E.g. Stokvels. a. Yes b. No

   If yes, name them

6. Do you work with already existing groups? a. Yes b. No

   If yes, how many are they?

   Please explain your interaction with the groups

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7. Do you facilitate group formation?

   a. Yes b. No

   Please explain your answer

8. How many new groups are established in your organization?
9. Do you get your groups to register after they are formed? a. Yes b. No

INDIVIDUAL LOAN

10. What kind of collateral do you demand from your individual clients?

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F. SERVICES

CREDIT SERVICE

1. Do you provide loans for: *(mark all that apply)*

   [ ] a. Start ups

   [ ] b. Working capital

   [ ] c. Consumption

   [ ] d. Other specify

2. What is the loan size? Minimum Maximum
3. What is your rate of interest?
4. What costs does your interest rate cover? *(Mark all that apply)*

   [ ] a. Operational costs [ ] b. Inflation

   [ ] Other. Specify

5. Are there any competitors (other similar institutions) in the area?
6. If yes, do they have an influence on the interest rate charged?
7. What systems do you use to track your loans?

   a. Manual b. Computerized

8. If computerized is it

   a. Package developed for your organization

   b. Ready made package used by other organizations as well

9. Can your MIS produce loan data at any given time (e.g. loan repayment rate, arrears, and bad loans)?

   a. Yes b. No

10. Any other monitoring and assessment tools? E.g. Effective budgeting; physical visits to borrowers; reporting on daily activities; daily financial recording; audits; governance system; staff monitoring; system monitoring.
11. Do monitoring and assessment tools or the management information system help identify problems in their infancy? a. Yes b. No

    Please explain your answer.

12. Did you conduct any market research before you started your lending activities?

    a. Yes b. No

13. If Yes to Q12, What type?

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a. Used questionnaire or interview schedule

b. Used participatory method

c. Both a. and b.

d. Other, specify

14. How is the institution promoted/advertised?

15. What kind of market research is undertaken?

16. Do you feel that marketing the institution is beneficial in terms of outreach?

17. Do you offer any kind of incentive to insure repayment of loans?

a. Yes b. No

If yes, Specify.

18. What is your default rate?

19. In your opinion, what are the most common causes of default?

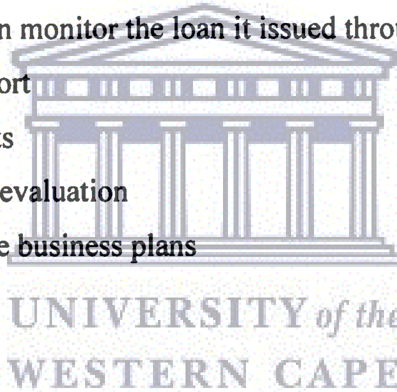
20. Does your organization monitor the loan it issued through: *(mark all that apply)*

[ ] a. Financial report

[ ] b. Physical visits

[ ] c. Performance evaluation

[ ] d. Advice on the business plans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<u>SAVING SERVICE</u>

21. In your organization, is saving

a. Compulsory b. Voluntary

22. Are savings generated

a. Internally, from members.

b. Externally, from non-members.

c. Both externally and internally.

23. Do clients earn interest on their savings deposits?

a. Yes b. No

If yes, how much?

24. What does your organization do with the accumulated savings of clients?

a. Use for on lending

b. Deposit them in interest earning accounts

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c. Invest in local community development programs

d. Invest in outside communities

e. Other specify

25. Are the savings easily accessible to clients on demand?

a. Yes b. No

If not, explain why

26. Do you have any knowledge of traditional informal or other formal of ways of saving used by your clients? a. Yes b. No

If yes, please list them down:

TRAINING

27. What type of training do you offer to clients? (Mark all that apply)

[ ] a. Management and other business skills.

[ ] b. Vocational training and promote entrepreneurship.

[ ] c. Basic education and literacy programs

[ ] d. Leadership programs

[ ] f. Other, specify.

28. Who conducts the training courses?

a. Trainers from local area who do it free of charge

b. Trainers from local area who charge a fee

c. Experts from outside who do it free of charge

d. Experts from outside who charge a fee

29. Do the groups provide an input in training in terms of traditional know-how and expertise? a. Yes b. No

If yes, Please explain.

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G. LINKAGES WITH OTHER INSTITUTIONS

INFORMAL INSTITUTIONS

1. Do you have any linkages with other informal financial-related institutions (e.g. ROSCAs)?

   Please list down their names
2. If Yes to Q1, where are they situated?
3. What kinds of services do they offer
4. Do you have any linkages with other informal non financial-related institutions? a. Yes b. No

   If yes, Please explain who they are
5. In what way do you collaborate with these organizations? *(Mark all that apply)*
   - [ ] a. Human resources
   - [ ] b. Sharing technologies expertise
   - [ ] c. Sharing information
   - [ ] d. Others. Please specify.
6. How often do you meet with these institutions?
   a. Very often (+/- once a month)
   b. Often (+/- every two months)
   c. Seldom (3 - 4 months)
   d. Very seldom (+/- once a year
7. Do you participate in any of the local community development programs?

FORMAL INSTITUTIONS

8. Do you have any linkages with other formal financial institutions (e.g. banks)?
9. If no, can you explain why not?

   (If yes answer questions from 11 to 21)
10. If yes to Q9, Please list down their names
11. Where are they situated?
12. What kinds of support services do they offer your organization?

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13. In what way do you collaborate with these organizations? *(Mark all that apply)*

    [ ] a. Funding

    [ ] b. Human resources

    [ ] b. Sharing technologies expertise

    [ ] c. Sharing information

    [ ] d. Others. Please specify.

14. Do you have any linkages with other formal non-financial? a. Yes b. No

    If yes, Please explain who they are

15. In what way do you collaborate with these organizations? *(Mark all that apply)*

    [ ] a. Human resources

    [ ] b. Sharing technologies expertise

    [ ] c. Sharing information

    [ ] d. others. Please specify.

16. Is your institution supervised by central bank or any other supervision agency?

(Questions 19-21 are applicable to money lending institutions only)

17. Is your organization a member to Microfinance regulatory council (MFRC)?
18. If yes, how has the MFRC regulations benefited your current operations?
19. Are they any regulations that paused constraints to your organization?
20. If your organization is not affiliated to the MFRC, why not?

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H. CONSTRAINTS OF THE INSTITUTION

1. What would you say are the major constraints to reaching financial sustainability?
2. What assistance does your organization require at the moment?

   (Mark all that apply)

   [ ] a. Financial

   [ ] b. Management

   [ ] c. Marketing

   [ ] d. Training

   [ ] e. Bookkeeping

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[ ] d. Other. Specify

3. What would you say are the major constraints to increasing your ability to reach the poor
4. What would you say are the major constraints to increasing your ability to reach women?
5. Are there any legal/regulatory barriers hampering the organization?

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