



**Paving the Way Forward for Rural Finance
An International Conference on Best Practices**

Case Study

Rural Finance Expansion: Experience in Commercialization

**Selected South African Micro Finance
Case Studies in Rural Financing**

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1. **Introduction**

This paper uses experiences of what went wrong in two micro finance institutions in South Africa, the practices of one development organization and the current unique Micro Enterprise Alliance HIV/AIDS workplace tool kit, to contribute to the theme of *Commercialization: Profitability versus quality*.

Hence, the write up will show the difficulties of attaining profitability faced by micro finance institutions in South Africa. A suggestion will be made on the importance of addressing the market failures by supporting the end market through the provision of well-directed business support services for their clients.

Lastly, MEA as the network organization of enterprise development practitioners in South Africa has developed a tool kit aimed at first making the small micro and medium enterprises to internalize the prevention of HIV/AIDS in the workplace and later to externalize the intervention to their client base. It is believed that with the current out reach of MFIs, this will result in a useful intervention which would reduce the impact of HIV/AIDS on poverty alleviation programmes, like micro finance and also to suggest ways how micro finance can reduce the HIV/AIDS pandemic.

As a case study of only one organization cannot deal with the issues, which should be shared, the paper will examine a number of experiences and information from different organizations in South Africa and in Southern African Development Community (SADC). This will add to the wealth of lessons in what needs to be done to make micro financing profitable and to be done in a quality manner to improve the worth of lives of the poor.

2.0 The South African Rural Micro Finance Context.

The South African economy is still dealing with the blow of the political legacy. This is evident in the existence of a concentration of big businesses. There is a missing critical mass of medium and a large number of small, micro, medium (SMMEs) enterprises with low levels of sustainability.

South Africa has a population of 42 million people and of these 49% live below the minimum living standard as calculated by the Bureau of Market Research (BMR)¹. From 1996 to 2000 the number of poor people is estimated to have increased from 17.1 million to 23.3 million. The worst poverty levels are in the Eastern Cape, Free State and Limpopo, which make 36% of the total population of the country.

However, on the supply side, South Africa only has five commercial banks, which control about 80% of the sectors assets. Access to financial services is clearly skewed with most of the population having no access to savings accounts while a small population has access to other formal financial services like credit. This small proportion is the people in urban areas where the providers of different forms of credit operate. This is supported by the Strauss Commission (1996), which concluded that the self-employed and especially those in the rural areas have very limited access to banking services.

The lack of interest by the commercial banks to provide other financial services like credit to the poor has been due to the high risk and high transactional costs of servicing small rural accounts. To solve this problem, the Government, created Khula as a wholesaler to provide loan capital and other services to the financial retail institutions. The Land Bank and the Housing Financial Corporation were at the same time created to provide loans for the development of the agriculture sector and the building of houses for the low-income households.

¹ The minimum living level for a family of five is R1,585 per month.

Sine the creation of Khula as a wholesaler intermediary, 60 retail finance institutions were created but to date only a paltry fourteen MFI and 15 micro credit organizations exist in operation and most of them hardly aimed at reaching the poor as their operations are confined to the urban small enterprises.

One reason given for the lack of growth within the micro finance institutions is that the markets in which they operate in are unsustainable. This suggests that there is currently a market failure both on the demand and supply side. Currently, there are visible programmes from the Bank Sector Educational Training Authority and the new apex fund to address this market disequilibrium by providing capacity building to MFIs and SMMEs. Only when this takes place will the small enterprise seen to be growing thereby being health customers of the micro finance institutions.

The case studies below aim at highlighting problems faced by rural retail finance institutions.

2.2 Provident South Africa.

Provident Financial is a financial services U.K based company, which has offered financial services for the last 120 years. It is a public company, listed on the London stock exchange and based in London, U.K. The main product lines are home credit and motor insurance. Provident South Africa operated as a subsidiary of International Home Credit. The original case study was drafted by the former CEO of PSA. Figures were with hold for confidentiality.

Provident South Africa (PSA), was one of the leading providers of finance between 1998 and 2001. Operating in the Northern province in South Africa, it covered 60% of the province within three years. After the initial trial period, it was allowed to operate as a profit center by the mother company.

By the end of December 2001, PSA had served over 100,000 clients in four branches. Had some 150 employees and 600 self employed agents mainly women who they used

for loan collections. Amid competition from the other institutions like TISHA, Small Enterprise Foundation and Aghishana, PSA prided itself of having the capability of growing its loan book weekly compared to the others. Indeed, most of these organizations found it very difficult to function in the Northern province due to the operations of PSA.

However, by the end of 2001 signs were setting in showing a decline in growth. This was due to financial resource constraints, internal weaknesses and threats from the macro environment. These are explained later in the paper.

2.3 PSAs Business Concept

PSA operated as a commercial credit provider in the Northern Province across many communities using its tried and tested home credit concept of “home delivered, home collected”.

Well-trained managers supported this strategy and well-trying systems used by the parent company in U.K, in debtor management, control, training and productivity efficiency systems.

As the process of implementation took place, more people were trained for managerial positions. More experienced and trained managers were therefore used to implement the various projects in designated areas. Provident Finance (PF) U.K provided all the support and needed coaching and full training was done before each product launch. The rest of staff and the managers also operated within incentive compatible frameworks, thus making them jointly responsible for failure and success.

2.4 Clientele

PSA clients were often the poor self-employed rural people with very low levels of education and most of them were women (80%). The average age of the clients was 36 years, they were black, female, and lived in rural dwellings. Only 4% of the clients had bank accounts suggesting under banking in the area.

Whilst in U.K the loans were used to assist the low-income people to smooth out income during periods of low earnings, in South Africa loans were usually meant to finance enterprises. 95% of the loans went to finance businesses, 2% for consumption and 1% each for housing materials, school fees and other needs. The nature of the business undertakings was varied to include market stalls selling fruit and vegetables to sewing enterprises.

2.5 Product

The clients started with a small loan, which if they repaid satisfactory qualified them for bigger loans. The table below gives a summary of the product characteristics.

Description	Product 1	Product 2	Product 3
Lending methodology	Individual	Individual	Individual
Loan size	R700-1,500	R1,500-R3,000	R3,000-R7,500
Interest rate	14.5% /month	9.5% /month	7.5%/ month
Repayment cycle	Weekly	Weekly	Weekly
Collateral	None	None	None
Repayment period	14 weeks	23 weeks	33 weeks
Savings	None	None	None

The PF model was used but heavily adapted to suit the South African circumstances. This entailed that managers were recruited in the areas in which micro finance services were being provided. One thing that is apparent is that there was no understanding of the social and cultural context in which the product was provided.

The local managers usually recruited 12 local agents who were mostly women. After some training, the local agents recruited customers within a five-kilometer radius. As the agents were from the same village, success depended on their local knowledge to use in screening customers and collecting repayments. The system further required that the home visits were made and close relationships preserved.

Progress and approaches were evaluated every year to ensure that performance did not drastically depart from plan.

2.6 Results

Though hard data was withheld by the Board of Directors, towards the end of 2001, PSA would not meet its operational and financial targets. From a review that was conducted, a number of problems were revealed by the various audit diagnostic tools. These can be identified broadly as;

- Poor collection performance
- Unacceptable levels of bad debt
- Uncontrollable fraud.

Specifically these can be outlined as follows:

2.7 Personnel Issues

- a. Limited size of quality labour in the Northern Province caused by the exodus to cities by the young men and women
- b. Lack of commitment and loyalty by the agents leading to fraud
- c. Inadequate field support after training of the agents. This led to poor customer care needed by the type of product, “home delivered home collected”.
- d. Ineffective staff and agent recruitment processes leading to the wrong people being recruited
- e. Ineffective management control systems

2.8 Field Operations

- a. Poor management of the rapid outreach due to the profit motive, growth was over emphasized at the expense of quality.
- b. Over flexibility in delinquency management, loans were rescheduled and this hurt repayment rate.
- c. Inconsistent territories in terms of size making it difficult to manage given the low capacity of field officers. Some areas were too large for effective territory management.
- d. Irresponsible lending by staff and field officers as they were paid on commission
- e. Inadequate fraud management systems

2.9 Marketing Issues

- a. Mono product phobia which led to the provision of credit only hence not meeting the diverse financial needs of the poor
- b. Inadequate adaptation of the various PF U.K models to the South African cultural, social, technology, political and technological environment
- c. Poor customer orientation leading to low levels of satisfaction and low retention levels
- d. Needs of clients were not well communicated and incorporated in the training programmes of agents

2.10 Social – Cultural and legal Issues

- a. Lack of a repayment and savings culture²
- b. Dependence syndrome from the previously disadvantaged communities arising from the legacy of apartheid, leading people to expect government to provide.
- c. The problems faced in the South African legal and justice system making it difficult to deal with defaulters

2.11 Strategies used to Meet the Challenges

A lot of information was collected to assist in solving the encountered problems. The following were done to address the problems;

- a. Maturity periods of the loan was shortened but this tended to increase the burden of repayments on the clients
- b. Tightened lending and field operations criteria
- c. Dealt with poor performing agents through training or layoffs
- d. High level of police, political and community leaders involvement
- e. Greater accountability
- f. Reducing costs and controlling these better
- g. Introduction of Visit Control systems
- h. Territories were reorganized

² Though when compared to Southern African countries, S.Africa is much better.

- i. Recruitment and training improved
- j. Internal and external communications improved
- k. Introduction of post office banking

However, regardless of what was done, not much impact was created to reverse the bad situation, which prevailed. The private investors in PF also did not help the situation as they saw the South African environment as high risk.

The closure of the organization was eminent at the end of December 2001. After engaging into heavy consultations to ensure that the lives of employees were not badly affected. A management buy out was finally arranged between PF and the local managers. A new organization was formed to mainly collect and turn things around but after operating for a few months the new company also closed.

3. **Policy Recommendations: Lessons Learnt**

This section will integrate the lessons learnt from PSA, and other organizations to address issues of how micro finance and business development support can be profitable, and what the Micro Enterprise Alliance is doing to mitigate the impact of HI/AIDS on micro enterprise finance.

Generally, access to finance is a major problem to entrepreneurs throughout South Africa which tend to be common among development lenders. This is more the case in rural areas and in particular amongst women. PSAs product was directed at these with an innovative product, which might not have been well adapted to South Africa. Despite the uptake in market share, which existed PSA was not profitable.

With hindsight, one can clearly identify problems of a commercial MFI in South Africa. It is against this background that the author and the CEO of PSA draw the critical lessons. The following are critical lessons, which can be learned;

3.1 Managing Outreach.

It would seem that the profit motive in the commercial micro finance institutions might lead many to increase out reach without ensuring that the loans given out perform. Increasing the number of people who receive loans is not a good proxy for doing well as the ultimate test is the quality of the loans. Surprisingly, this was “ignored” by PSA.

Apparently a few institutions in South Africa are moving towards commercialization and some of them are currently operating nationally. If this outreach is not managed properly, problems will quickly set in as was the case with PSA.

3.2 Market led Micro Finance with Business Development is Vital.

Micro finance has been identified as being predominantly product oriented and what we see in PSA vindicates this. Information was collected from consumers but not translated into critical interventions. This problem is a typical case in most South African micro finance institutions (except a few big ones) where information is collected by the field officers when they are in the field but this is filed away and is not used to educate the delivery of financial services to the poor.

It has also been identified that external communication to stakeholders is weak among some MFIs and that deliberate attempts need to be made to improve client relationships. To assume that clients need credit and they will do anything to get it, is a big mistake as leads the organization to the organization ignore the need of doing all in its power to meet the financial needs of consumers.

There are many organizations, which can be sited to have used the provision of business development services as a way of reducing the risk of doing business among the poorest of the poor especially in countries where an entrepreneurial culture does not exist. Where efforts of empowering the poorest of the poor have been done, micro credit has been described as an intervention with a human face.

These are organizations like Kgetsu Ya Tsie in Eastern Botswana, GAPPI in Mozambique etc.

3.2.1 Kgetsu Ya Tsie

KYT is a classical case of how some USA NGOs like ACENET, Appalachian by Design community development models have been used in Southern African Development Community SADC. (This is not surprising as USAID is one of the funders of KYT).

KYT was established in 1996 as a community Trust, which has the objective of socially and economically empowering the women of the Tswapong Hills in Eastern Botswana. KYT is a joint venture between the funder USAID and the women of Tswapong Hills. John Pierce (2002)¹ reported that when the project was being set up, it was called Phane Project, which aimed at assisting women to get a better price for their mopane worms. At the time KYT emphasized on “micro enterprise to encourage them to set up their own small businesses and micro lending to provide them with the capital to do so”.

The long-term aims of KYT are

- a. To continuously develop the skills of members to run the Trust for themselves.
- b. To ensure the long-term sustainability of the Trust.
- c. Continuously improving the sustenance of the members of the Trust
- d. Continuously enhancing the ability of the members to play an active role in their communities.
- e. Resource management for conservation.

Of significance, here is the fact that it is not credit that leads the way but micro credit is used as an ingredient in making the rural women to start and grow their small businesses. Indeed under the Phane Project, women were empowered to “ get a better price for their product, through improved processing, storage, packaging, marketing and distribution. It

¹ John Pierce (2002)

also assisted them to market and sell other natural resource products.² These are the areas of business in which the clients of the micro finance institutions need to be engaged in for them to sustain their businesses. In addition, the rural women are encouraged to get into the peripheral areas such as baking, sewing, spazas. It provided access to loans through a loan revolving fund (using the Grameen Bank Model):

The PSA model did not have any collateral built in as it used an individual lending model. Could this have been an aspect which needed to be adapted from the individualistic U.K society to the group based African Society?

A proper structure of setting units just as the Grameen unit was set up at KYT. Here, KYT served as the head quarters to provide a project coordinator, a production manager and three part time staff to responsible for making morula oil and soap, quality controlling, packaging and labeling products ready for dispatch.

KYT illustrates the opposite of the mistaken efforts of many MFIs in increasing debt for the poor as opposed to create assets for communities to sustain their livelihood.

3.3 Assisting Customers to Make the Best use of the Product is Essential

The experience from PSA and ACAT, Beehive, NICRO, Nations Trust, ARTPAC all point out to same point that as credit is provided to clients, it is important to empower the clients on how to use this prudently. This is done through business skills transfers to the clients. This is the angle that the Umusobomvu Youth Fund is trying to address through its voucher programme.

The difficulties many micro finance institutions face at present is not because of anything but that the clients they serve cannot sustain their operations. Many providers of micro finance argue that they are dealing with the poorest of the poor and hence do not expect to be sustainable or to profitably use a commercial approach in micro finance. But if the client market is greatly enhanced / improved, this will have positive impact on MFIs.

² Ibid

This is the main reason why micro finance should ensure that the risk of doing business with this sector is reduced through the provision of business development services. In South Africa, the issue has been brushed aside and no attempts by some of the MFIs have included business development services as a necessary ingredient for their clients.

The above has meant that ACAT looks at the client from a holistic point of view and especially the clients entrepreneurial development as a critical aspect before micro credit is extended. ACAT's approach is simple and involves the following;

- a. Identify the target group and use poverty identification model to focus on the poor of the poorest
- b. Promote, teach and facilitate Household Food Security so that the money from other enterprise undertakings is not used for consumption
- c. Stimulating economic activities and establishing profitable businesses.
- d. Promoting the establishment of Entrepreneurial Groups, Business Co-operatives and Financial Services Co-operatives (village banks).

This approach is scoffed by many as unsustainable micro finance but micro finance is a tool for poverty alleviation and is not an end in itself. And it being only one method of poverty alleviation should lead the MFIs to use it in conjunction with other methods, which reduce the high risks inherent among the poorest of the poor.

Currently, many Sector Education Training Authorities (SETAs), which have targeted SMMES for the transfer of skills might make the needed difference as they will be improving the capacities of small entrepreneurs to do business. Hence, once loans are provided to these clients, business failure will be reduced resulting in higher loan performance, as the clients will know how to run their businesses.

For example project RAVE under the Wholesale and Retail SETA aims at transferring business skills to retrenched from the sector and the existing spaza owners. This project is of particular importance because the trainees are the potential and current clients of the

MFIs both in urban and rural areas. Once, these are skilled, the MFIs will be dealing with people who know how to conduct business hence reducing the business risk. These interventions are in the various SETAs and they need to be encouraged as they are addressing the demand side of the market failure currently being experienced in South Africa.

It should be pointed out that MFIs do not need to have the capacity to pass on the business skills. Government and the donors need to intervene to correct the market failure until a time that a vibrant SMME sector emerges in South Africa. The former CEO of South Cross Business Development Trust pointed out, “ How can MFIs be expected to sustain their operations and meet their financial obligations to the wholesale financiers if they are operating in unsustainable markets?”

3.4 Reducing the Impact of the HIV Pandemic

To break the cycle which fuels the prevalence of HIV/AIDS, micro finance has been regarded as useful as it aims at reducing poverty. It can also be argued that HIV/AIDS negatively impacts on micro finance in numerous ways. If this risk is not minimized, clients will fail to repay their loans as money from the businesses is used for medical costs, burial expenses, looking after orphans etc.

Some direct risk reduction methods include targeted products to assist the HIV/AIDS affected clients. These could include school fee loans, funeral or burial schemes, savings schemes etc. This entails that the product portfolio of MFIs reflect the actual situation their clients find themselves in. There is a need for the South African MFIs to reflect this reality in their product portfolios. Currently one identifies the existence of stockvels within the group lending methodologies where voluntary savings are made by the various groups, but more needs to be done.

Along side this recommendation; the Micro Enterprise Alliance has taken a bold step to introduce the HIV/AIDS workplace prevention Tool Kit. This product is aimed at encouraging SMMEs to begin to address the pandemic in their organizations first and

later to extend the intervention to their clients. The tool kit, which will be affordable to the SMMEs will deal with issues such as developing a HIV/AIDS company policy, overview of HIV/AIDS, Sexually Transmitted Diseases and Opportunistic Infections, Condom use, voluntary counseling and Testing, Stigma and discrimination, on going counseling, support groups, employee benefits etc.

The expected impact of the programme is to preserve the valuable human resources in the MFIs and to further extend the benefits to the rural women served by the MFIs.

Conclusions

Though commercialization seems to be formed by many as a way of improving operations of a micro finance institution this should not be regarded as a panacea. A commercial micro finance PSA demonstrates that managing the quality of doing micro finance is more important. Issues of correctly adapting foreign methodologies to suit the local environment is critical and this will require conducting on going market research to quickly detect changes and problems taking place in the market.

The paper also strongly suggests that the markets in which MFIs operate in need support through the provision of business development services as credit only has led to many MFIs into unresolvable problems.

The last point the paper makes is that introducing HIV/AIDS workplace prevention programmes in MFIs for them to extend it to their clients, could be an innovative way of reducing the negative impact HIV/AIDS has on micro finance.

For all these interventions, it will be critical to get the full support of donors and government as MFIs might not have the skills, capacities or time to do all.