The Microcredit Sector in South Africa: An Overview of the History, Financial Access, Challenges and Key Players

1. Introduction

The intent of this report is to provide an overview of the microfinance landscape in South Africa. The scope includes the historical development of South Africa's microcredit sector, access to financial services by low income households, challenges for microlenders, a summary of prominent microfinance institutions and key issues for organizations providing microcredit in South Africa.

Information for this report was obtained from websites, policy papers, news articles and annual reports. As a result of the variety of sources and organizations referenced in this paper, the terms microcredit and microfinance will be used interchangeably, as will microlender, microcredit provider and microfinance institution (MFI). Source documents and websites for specific facts and figures are cited and html links provided when possible. A glossary of relevant terms and acronyms is provided at the end.

2. Historical Development of Microcredit in South Africa[1]

The modern microcredit market in South Africa began in the 1980's and has been driven by a confluence of forces, with for-profit companies, NGO's and government agencies all playing important roles. The growth of the industry can be separated into four distinct stages: Pioneer, Breakout, Consolidation and Maturity. (These stages exclude the mashonisas, or informal township-based moneylenders, who presumably have existed for much longer.)

The **Pioneer** phase (1980's to 1994) consisted of a few early not-for-profit and commercial lenders who launched microloan products and experienced initial success. These innovators were motivated by the gathering international excitement over microfinance, the need to promote microenterprises to absorb the growing urban labor force and the market opportunity arising from an increasing upwardly mobile population that was largely outside of the traditional bank credit system. These lenders generally functioned illegally, charging interest rates in excess of the ceiling prescribed in the Usury Act of 1968, but were too small to attract official attention.

The **Breakout** phase (1995 to 1999) consisted of the rapid expansion of the microlending market and occurred as the success of the early pioneers became more widely known. In addition, microcredit was effectively legalized in South Africa at the end of 1992 by an exemption to the Usury Act that removed price control on all small and shorter term loans. This enabled large flows of formal capital into the sector, which would not have happened if it continued to operate illegally.

In 1997, one of the first formal analyses of South African microlending estimated there were 3,500 formal MFIs, an increase of 192% over 1995; while loan volume had almost tripled from R3.6 billion to R10.1 billion over the same period[1]. No government support was given to the microcredit sector at this time. In fact, considerable official uneasiness existed over the high interest rates charged and the automatic deduction of loan payments from borrowers' bank accounts or paychecks (i.e., payroll lending).

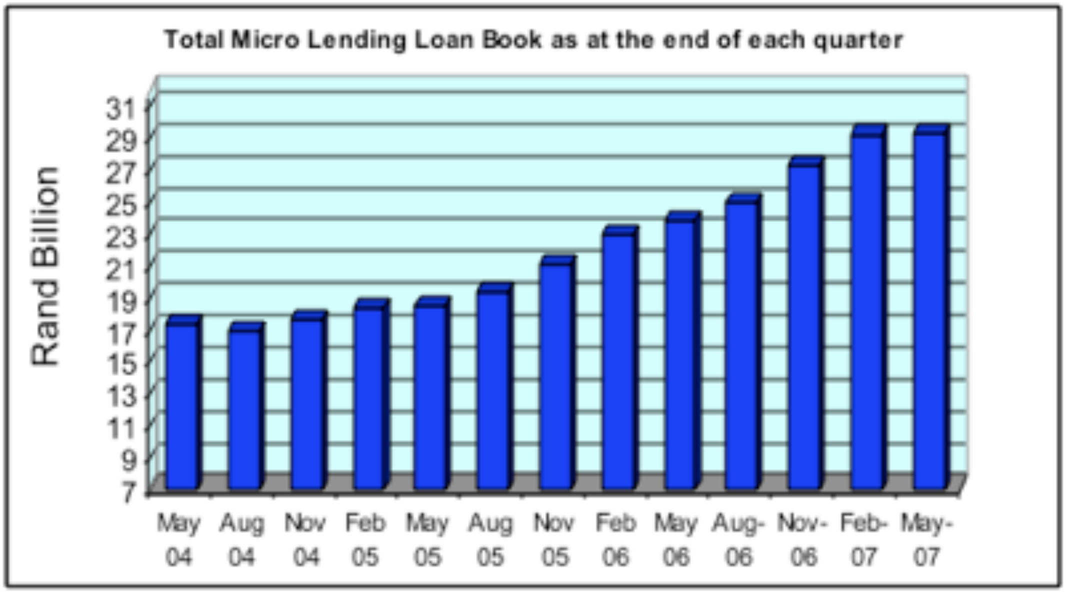
The **Consolidation** phase (2000 onwards) occurred as the rapid growth of MFIs could not be sustained because of two main factors. First, the finite number of credit-worthy borrowers resulted in increasing competition for clients among lenders, which lead to a lowering of profit margins and risk standards. Second, the government outlawed payroll lending and established the Micro Finance Regulatory Council (MFRC) as the regulator of microlending[2]. Decreased profits, the elimination of a stable collection mechanism and the costs of regulation compliance drove many lenders out of the market. Whereas there were an estimated 3,500 formal microlenders in 1997, only 1,334 registered MFIs remained in 2000.

---

[1] This section is primarily a summary of the following: Porteous, David (2003) "Is Cinderella Finally Coming To The Ball? SA Microfinance in Broad Perspective", www.finmarktrust.org.za/research

[2] The MFRC was replaced by the National Credit Regulator in 2006.

The **Maturity** phase of the microcredit industry has not been reached but appears to be in sight. This stage will occur when the industry growth rate reaches a long-term sustainable pace and a consistent regulatory framework is developed. The rate of microloan issuance has continued to increase, but at a slowing rate. As demonstrated in the following chart issued by the National Credit Regulator[3] for the 12 months ending May 2007, microloan disbursements grew by 16%, which represented a significant slow down from the year-on-year rates of 19% for February 2007 and 22% for November 2006. Longer-term data is necessary in order to determine whether this trend will continue.



Since its advent in 2006, the National Credit Regulator has been working to promote the development of an accessible credit market, with a particular focus on the needs of historically disadvantaged, low income and low density communities. The new National Credit Act (June 2007) removed the ceiling on loan size for MFIs, which was previously set at R10 000. Additional time must be allowed for market participants to adjust to the requirements and policies issued by this agency before determining the long-term impact on the microcredit sector.

3. Access to Financial Services by Low Income Households in South Africa

The South African financial services landscape includes both formal and informal providers. Formal financial services providers adhere to official laws and regulations. Examples of formal financial services include bank accounts, savings annuities and credit cards. Although widely available in South Africa's urban areas, formal services are often unsuited to the needs of the poor. This is partially attributable to the country's regulatory environment, but is also a result of the socioeconomic assumptions about clients around which South African banks are designed.

The informal financial services sector includes everything from rotating savings clubs (ROSCAs) and stokvels to burial societies and loans from mashonisas. This segment is defined by lack of adherence to any laws except those of natural selection – if it works for members/clients the scheme thrives; if it does not the scheme dies.

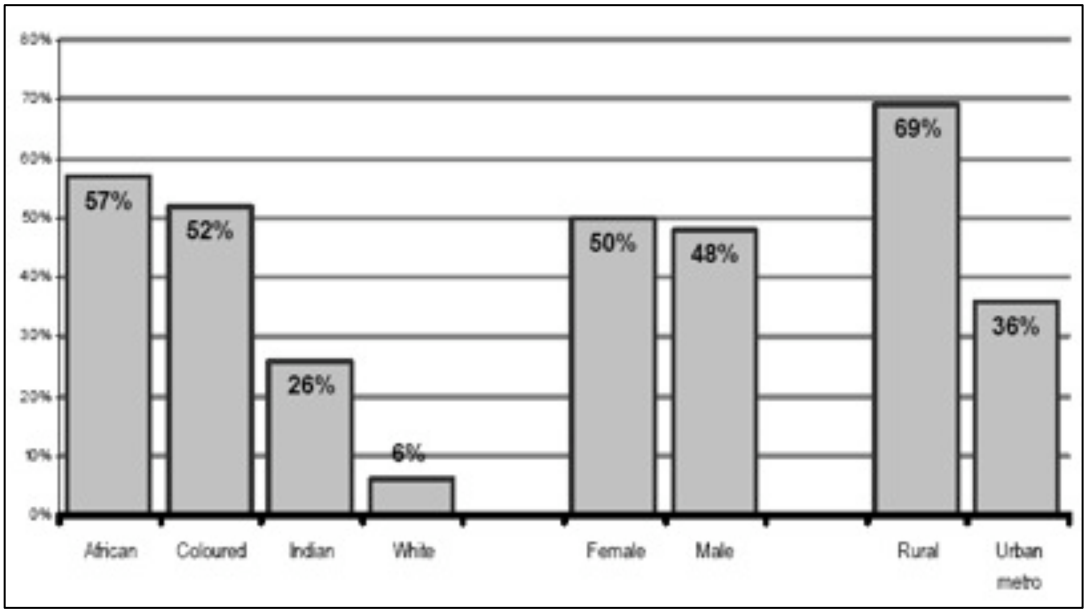
Research shows that an individual's relationship with formal and/or informal financial services is highly correlated to income[4]. In South Africa, income is closely related to race, and therefore to history and culture. Poor, mainly black households generally prefer the informality of the unregulated financial services segment, even if there are

[3] National Credit Regulator (2007) "Micro Lending Industry Overview: 1 March 2007 to 31 May 2007", www.ncr.org.za/Statistical_releases.html. NB: the NCR no longer publishes microlending statistics. This data has been incorporated into the general statistics of the broader consumer credit market in South Africa.

[4] Community Microfinance Network (2004) "The Developmental Microfinance Sector in SA: Update 2004", www.finmarktrust.org.za/research

opportunity costs and risks, because its products are more convenient and better understood than those of the formal segment.

As of 2005, more than 13 million of the 27 million adults in South Africa (more than 48%) did not have basic bank transaction facilities[5]. Of those lacking formal banking services, 11 million were Africans within the bottom half of the distribution of income. Among the unemployed, 83% did not have a bank account, while 60% of those who worked in the informal sector were unbanked. The following chart shows the percentage of each demographic group that did not have a bank account[5]:



Low income households devote considerable time and energy to managing their finances across a large number of formal and informal methods. In South Africa, households use an average of 17 different financial instruments per year in their financial portfolios[6]. On average this includes 11 credit sources, 4 savings instruments and 2 insurance policies. Of these financial sources, approximately 70% are from informal providers and 30% are from formal institutions.

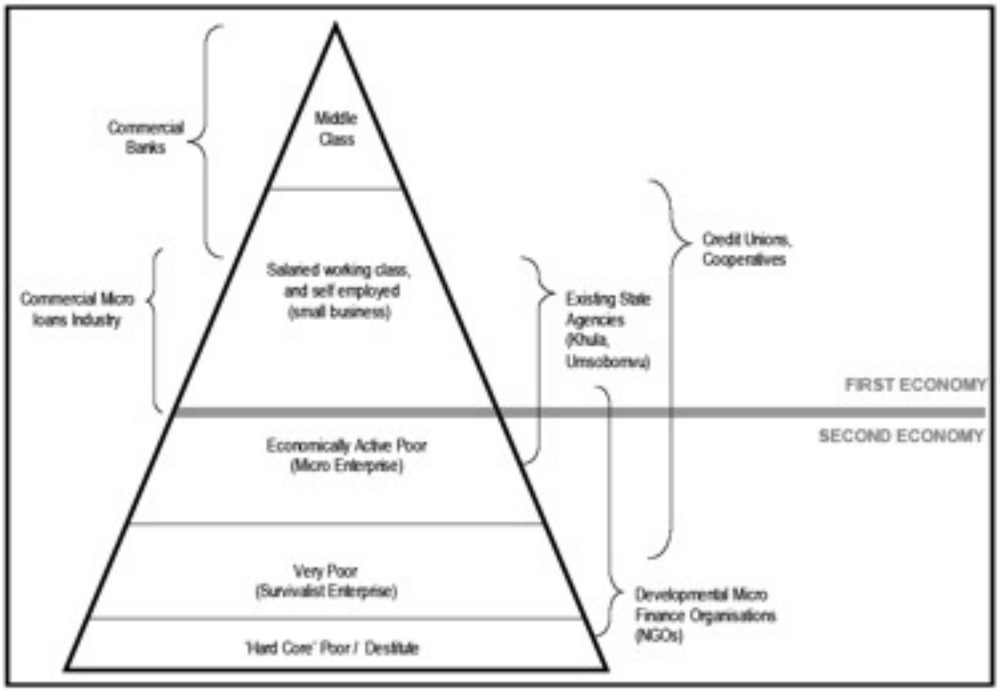
The most significant gap in low income household financial portfolios is savings instruments geared towards unexpected events such as funerals, serious injury/illness and being a victim of crime. Low income households that have bank savings accounts tend to use them for transactions rather than as a means for long-term savings accumulation. Instead, the most important financial sources in times of hardship are personal relationships that can be called on to help meet unexpected expenditures.

It is clear that low income households require and use a mix of financial services that includes savings, transaction services, credit and insurance. Yet there are few formal institutions providing these services to the poor, particularly savings and credit. Access to financial services can be thought of as an economic pyramid of incomes and the financial institutions that serve each level (see figure on the following page)[5].

At the top of the pyramid is the First Economy. Here the financial needs of the middle class are serviced by the big four banks (ABSA, FNB, Nedbank and Standard Bank), which provide a wide variety of credits, savings and insurance services. The salaried working class and those earning regular income from formal self-employment are also able to access commercial banks, albeit to a lesser extent, as well as commercial microlenders, government agencies and credit unions.

[5] Southern Africa Regional Poverty Network (2005) “Micro-Finance For Poverty Alleviation: Towards A Pro-Poor Financial Sector” www.sarpn.org.za/documents/d0001107/P1238-ANC_ETC_Feb2005.pdf

[6] Collins, Daryl and Morduch, Jonathan (2008) “Banking Low-Income Populations: Perspectives From South Africa”, www.financialdiaries.com/key_findings.htm



The greatest deficit in financial services is amongst the Second Economy. There are few financial institutions serving the economically active poor (who engage in microenterprise in the informal economy), the very poor (many of whom supplement remittances and government grants with survivalist, or household-based, microenterprises) and the hard core poor/destitute. Microlenders provide limited to access to loans for enterprise development, but few offer savings and insurance services.

There is an on-going debate regarding what role developmental MFIs should play in providing financial services to South Africa's poor. Principally, is microcredit best directed at the economically active poor who are already engaged in some form of microenterprise, with the hope that they will eventually grow into fully-fledged formal businesses and thus contribute to economic development and job creation? Or should the focus of developmental MFI activity be at the very bottom of the pyramid, targeting the hard core poor directly in order to alleviate poverty and build assets that can minimize economic vulnerability and exclusion?

This debate does not mean that financial resources are limited and one target group must be chosen and the other ignored. In fact, scarcity of capital is not the constraint, but rather an insufficient number of appropriate organizations that can deploy this capital effectively as part of a poverty reduction strategy. (The underlying causes of the shortage of developmental MFIs are discussed in Section 4 "Challenges for Microcredit Providers in South Africa.") Regardless of which target group they serve, developmental MFIs need to be clear about whom they intended to reach in order to best tailor their products and services to meet the needs of their clients.

4. **Challenges for Microcredit Providers in South Africa**

Providers of microcredit in South Africa face multiple challenges resulting from the country's first and third world economies, financial regulatory environment and social history. These challenges include the following:

- Economic Dualism – MFIs in South Africa must pay first-world salaries to skilled employees (e.g., loan officers) while earning revenues from third-world loan sizes. As a result of the employment cost to loan size disparity, South African MFIs have among the highest proportional salary burdens in the world.

- Formal Competition – MFIs face significant competition for borrowers with good credit from formal lenders such as commercial banks, who offer a broader array of financial products and greater number of locations.

- Informal Competition – low-income households can access credit through informal sources such as stokvels and mashonisas. Microloans typically have more advantageous terms such as lower interest rates and/or longer loan repayment periods, but these benefits must be communicated to target borrowers, who are often skeptical of more formal financial providers.

- Higher Loan Sizes – loan capital amounts must be greater in South Africa than other emerging markets to compensate for borrowers' higher operating costs. As a result, all else being equal, MFIs in South Africa can issue fewer loans and are less able to diversify their risk than their counterparts in less economically developed markets.

- Banking Fees – many South African banks charge a minimum fee rather than a fixed percentage to accept cash deposits. This can substantially erode profitability for MFIs that deposit high volumes of small loan repayments.

- Formal Employment Market – due to high unemployment most South Africans are entrepreneurs out of necessity rather than choice, and many will switch to formal employment if it becomes available. Thus, adverse selection results in microloan borrowers being largely those that lack employable skills.

- Cost of Regulation – South Africa's first-world regulatory environment imposes compliance costs on MFIs that are substantially higher than countries with less formal government agencies.

- Limited Entrepreneurial Training – operating small enterprises was prohibited during apartheid in order to ensure a large, inexpensive labor force was available for those in power. As a result, today's emerging entrepreneurs lack role models in older generations from whom to learn business skills.

- Urbanization and Immigration – the substantial demographic shift to urban centers and influx of foreigners from neighboring countries results in a highly transient population in many cities (especially Johannesburg). These individuals lack long-term relationships, and the associated bonds of trust, through which to secure solidarity-based loans. This is somewhat mitigated in older townships.

5. Key Microcredit Organizations

This section provides an overview of select organizations that play prominent roles in South Africa's microcredit sector. The Small Enterprise Foundation, Marang Financial Services Women's Development Businesses are among the largest MFIs in South Africa. For comparative purposes, an overview of Paradigm Shift's microcredit program is also presented.

Small Enterprise Foundation

Small Enterprise Foundation (SEF)[7] is South Africa's oldest and best-known pro-poor MFI. SEF has been active since 1992 and targets residents of rural villages in the Limpopo and Mpumalanga, where poverty levels are amongst the highest in South Africa. As of June 2009, SEF had 57,425 clients and an outstanding loan portfolio of R89 million (average loan size of R2023 per client).

SEF provides small loans through two programs: the Microcredit Program (MCP) and the Tšhomišano Credit Program (TCP). Both use the Grameen methodology of solidarity groups of five members, but TCP specifically targets the poorest women whereas MCP does not. SEF originally started with MCP, but in 1996 discovered the poorest members of target communities were not participating and instead better-off people dominated in hopes of obtaining larger loans at a later stage.

In response, SEF developed the Participatory Wealth Ranking (PWR) to identify the poorest members of a community. This approach, regarded as a major contribution to poverty targeting worldwide, identifies households earning less than half of the poverty line and only the women of these households are eligible to join TCP.

[7] www.sef.co.za

The terms of SEF's microloans are summarized below[8]:

Minimum Loan Size	Max 1st Loan Size	Max Loan Size	Loan Term (Months)	Repayment	Interest Rate
R500	R1200	R12 000	4, 6 or 10	Biweekly or Monthly	80.7%

It is compulsory for every SEF client to save at every biweekly meeting (savings are held at Post Savings Bank branches[9]) but clients may withdraw whenever they wish. The minimum amount saved is R10 per person per biweekly meeting. After the first loan, 10% of subsequent loans is required as up-front savings.

Social performance monitoring is performed by SEF through the participatory method of interviewing clients before each loan cycle about their food consumption and housing. Also measured are each client's savings in stokvels and burial societies and a loan officer's estimate of the value of the client's business. This approach encourages the loan officer and client to have in-depth conversations about the client's financial progress. The results of these conversations are summarized in quarterly reports.

Marang Financial Services

Marang Financial Services[10] is a non-profit MFI dedicated to making financial services accessible to poor households in South Africa. The organization grew out of the collapse of the Get Ahead Foundation and Rural Finance Facility in 2000 and built upon the experience, infrastructure and personnel of the two organizations. Marang serves approximately 24,000 clients, mainly women, via 23 branches and 19 satellite offices in five provinces (Eastern Cape, Gauteng, KwaZulu Natal, Limpopo and Mpumalanga).

Marang currently offers group enterprise loans using the solidarity lending methodology. These loans are offered to groups of between five and eight women between the ages of 18 to 70 who are unable to secure loans from the formal financial sector due to a lack of acceptable collateral.

An individual enterprise loan is being developed. Both women and men will be eligible for this loan product provided they are South African citizens ages 21 years or older and have operated their business for at least 24 months. Marang is also considering offering a microinsurance product that will insure clients and their families against death, disability and other possible mishaps.

The terms of Marang's microloans are summarized below[11]:

Minimum Loan Size	Max 1st Loan Size	Max Loan Size	Loan Term (Months)	Repayment	Interest Rate
R500	R1500	R10 000	4 to 9	Monthly	Not Available

Ten percent of the loan amount must be deposited into the loan group's bank account as an initial compulsory savings. Subsequently, clients are expected to regularly deposit a minimum of R20 into this account. The money belongs to the clients but should not be withdrawn during the duration of the loan unless the group experiences repayment problems beyond its control.

Women's Development Businesses Group

[8] Micro-Credit Ratings International Ltd. (2008) "Social Rating of Small Enterprise Foundation", www.sef.co.za/files/2009-02-13%20-%20SEF%20Social%20Rating.pdf

[9] Post Bank is a division of the South African Post Office that provides basic banking services at over 2,000 Post Office branches.

[10] www.marang.co.za

[11] www.marang.co.za/loan_products.asp

Women's Development Businesses Group[12] (WDB) is composed of three organizations: WDB Micro Finance, the WDB Trust and WDB Investment Holdings. All three groups work together to help South African women build a sustainable way out of poverty. The primary development tool is microcredit for the poorest. WDB was established in 1991 and has 27 branches operating in Eastern Cape, KwaZulu Natal, Limpopo and Mpumalanga.

The core business of WDB Group is WDB Micro Finance, which provides microcredit to women in rural South Africa in order to improve their livelihoods through economic empowerment. As of year end 2009, WDB Micro Finance currently served over 45,000 clients through two microloan programs.

The Poverty Alleviation program engages the poorest of the poor in income generating activities to enable them to lift themselves out of poverty. This program offers basic financial skills and credit management training and loans of between R300 to R4000. The Enterprise Development program is designed for women who are ready to graduate from basic income generation to operating a business or enterprise. The women in this program are assigned a business mentor and receive more substantive business skills training. The program provides loans of between R5000 to R10 000.

The terms of WDB Micro Finance's microloans are summarized below:

Minimum Loan Size	Max 1st Loan Size	Max Loan Size	Loan Term (Months)	Repayment	Interest Rate
R300	Not Available	R10 000	Not Available	Not Available	Not Available

The WDB Trust is responsible for capacity building and fund raising for the WDB Group and creating development projects to improve the lives of poor rural women. The WDB Trust developed an ICT program that links women to technology through computer based literacy training as well as a Business Development program that provides women entrepreneurs with skills to help them run their businesses more efficiently.

WDB Investment Holdings manages a portfolio of investments and distributes the profits to the WDB Trust for disbursement to the Group's social development programs. Since 1997 the group has distributed over R45 million to the Trust. WDB Investment Holdings also ensures the economic empowerment of women within its underlying investments through placements, skills transfer and supply chain opportunities for SMMEs.

<u>Paradigm Shift</u>

Paradigm Shift[13] is a non-profit, Christian organization based in the United States. Paradigm Shift is committed to empowering churches and ministries to provide meaningful Christian discipleship and economic development in South Africa. Paradigm Shift's mission is to train churches in developing countries to provide business training, microloans, mentoring and discipleship to the urban poor. Paradigm Shift functions much like a consulting firm by providing curriculum, training, reporting and ongoing support to the partner church.

The microcredit portion of the Paradigm Shift program offers microloans to entrepreneurs to be invested in income generating activities. In order to receive a loan, an entrepreneur must own and operate a small business for at least three months, complete an introductory business training course, socially collateralize the microloan with four to seven other entrepreneurs and commit to attending 18 weekly meetings.

The terms of Paradigm Shift's microloans are summarized below:

Minimum Loan Size	Max 1st Loan Size	Max Loan Size	Loan Term (Months)	Repayment	Interest Rate
R1500	R1500	R3000	4	Weekly	18%

[12] www.wdb.co.za

[13] www.shiftingparadigms.org

Paradigm Shift's goal is to see the Gospel message communicated by partner churches as they focus on meeting both physical and spiritual needs in their communities. The purpose of the program is two-fold: to create opportunities for entrepreneurs to develop and expand their small businesses so they can better provide for their families and to offer intentional avenues of discipleship which communicate God's hope, love and redemption for participating entrepreneurs. This integrated approach is designed to have a long-lasting impact on the life of each church volunteer, entrepreneur and his/her family.

6. Conclusion: Key Issues for Organizations Offering Microcredit in South Africa

The advent of microcredit in South Africa is relatively recent, yet the industry has already experienced significant growth and consolidation. The market continues to absorb lessons from successes and failures and appears to be progressing toward a sustainable maturity phase. Organizations offering microcredit in South Africa should give the following areas careful consideration:

- Target Market – developmental MFIs target the economically active poor operating microenterprises and/or the very poor engaged in survivalist enterprises. Both groups may benefit from microloans but require substantially different loan structures. Microcredit providers must clearly identify which group(s) they intend to serve and tailor their loan sizes, interest rates and repayment periods accordingly.

- Limited Urban Microcredit – the disparity of first-world operating costs and third-world loan sizes is a significant challenge for MFIs in South Africa. As a result, many microcredit providers operate only in rural locations in order to reduce the salary burden. However, there is significant unmet demand for financial services among urban microentrepreneurs. Providers of microcredit are urged to consider creative solutions, such as Paradigm Shift's use of volunteers to operate its program, in order to reach this underserved market.

- Social Performance Assessment – demonstrating the social performance of microlending is challenging due to the difficulty of quantifying its affect on the lives of loan recipients. Nevertheless, this monitoring is vital in determining whether a mircocredit program is achieving its desired outcomes. It is recommended that microlenders identify specific objectives and develop social performance assessments tools that gauge the impact of their programs in these areas.

- Additional Financial Services – low income households are especially vulnerable to unexpected financial events such as death, major health issues and being the victims of crime. Informal methods of savings and insurance have been developed among members of poor communities but are often operated for periods of less than one year and do not accrue on a long-term basis. Organizations offering microcredit should evaluate borrowers' access to long-term savings and insurance products and consider offering these services or partnering with organizations that provide them.

- Patient Organizational Development – investors have become increasingly impatient and require microcredit providers to quickly grow their borrowers and loan portfolios in order to become financially self-sustaining. This has led to low tolerance for the slow, painstaking business of institution building and to a focus on immediate returns on investments with little regard for long-term consequences. Microcredit providers should take care not to rush the development of their microlending operations, as many of today's most successful MFIs required years to reach sustainability.

7. Glossary

ASCA - Accumulating Savings and Credit Association; voluntary association in which members make regular deposits and the money accumulates for a pre-agreed period (usually six months or a year). During the accumulation period the money is managed by members through activities such as extending loans and investing. The fund and its accrued profit are then distributed among the members.

Burial Society – Informal groups averaging 50 to 80 members that insure each other against funeral costs of deceased relatives. Contribution amounts vary widely and are made on a periodic basis (usually monthly).

Mashonisa - Informal moneylender based predominantly in black townships that charges usurious interest rates (often 30% per month).

Medium Enterprise - Up to 200 employees, mainly owner managed but decentralized management structure with division of labor, operates from fixed premises with all formal requirements.

Microenterprise - Between one to five employees (usually the owner and family), informal and unregistered, basic business skills and training.

ROSCA – Rotating Savings and Credit Association; voluntary association in which participants make regular deposits to a fund and then take turns in receiving the total amount of the deposits (usually monthly). None of the contributions remains in the pool and the funds are depleted at the end of a cycle.

Small Enterprise - Less than 100 employees, formal and registered, fixed business premises, owner managed but more complex management structure than micro enterprise.

SMEs – Small and Medium Enterprises.

SMMEs – Small, Micro and Medium Enterprises.

Stokvel - South African version of a rotating savings scheme. Also known as amafellas, gooi-goois, mahodisanas, makgotlas and umgalelos.

Survivalist Enterprise – No employees, little or no collateral, often purchases supplies for periods of less than a week.

Founded in 2007, Paradigm Shift is a non-profit, Christian organization based in the United States. The mission of Paradigm Shift is to train churches in developing countries to provide business training, microcredit, mentoring and discipleship to the urban poor.

Greg Skowronski serves as the National Director of Microcredit for Paradigm Shift. He equips Microcredit Coordinators from Paradigm Shift's partner churches to develop South African entrepreneurs and their businesses.

Paradigm Shift
Johannesburg, South Africa
Tel.: +27 011 431 1880
Email: Greg@shiftingparadigms.org
www.shiftingparadigms.org