MICRO-FINANCE
FOR POVERTY ALLEVIATION
TOWARDS A PRO-POOR FINANCIAL SECTOR

The Economic Transformation Committee (ETC) of the ANC held a workshop on the theme 'Micro Finance for Poverty Alleviation: Towards a Pro-Poor Financial Sector" on 5 February 2005 in Johannesburg.

This report summarises the discussions of the workshop. This includes a consideration of our overall approach, questions and issues that require further research and debate, as well as some more specific policy recommendations.

Held in the context of the UN's Year of Micro-credit, the aim of the workshop was to generate inputs from a broad range of practitioners, academics and policy makers, including within government, the Alliance and civil society more generally. As such, this document does not necessarily represent the view of the ETC.

MICROFINANCE AND THE SECOND ECONOMY

Overcoming the two-economy divide requires us to transfer vast resources into the second economy. Wherever possible these resources must take the form of productive assets that enable our people to empower themselves in order to reverse the legacy of apartheid expropriation. This in turn requires that we transform the economic institutions that were constructed on the basis of apartheid fragmentation, and also create new institutions that are capable of meeting the urgent challenges of development.

Financial development and poverty alleviation

A central aspect of this programme is the development and transformation of the financial sector. Financial sector development is critical because access to financial services is an important factor in the accumulation of capital amongst our people and has been shown to reduce vulnerability to extreme poverty.

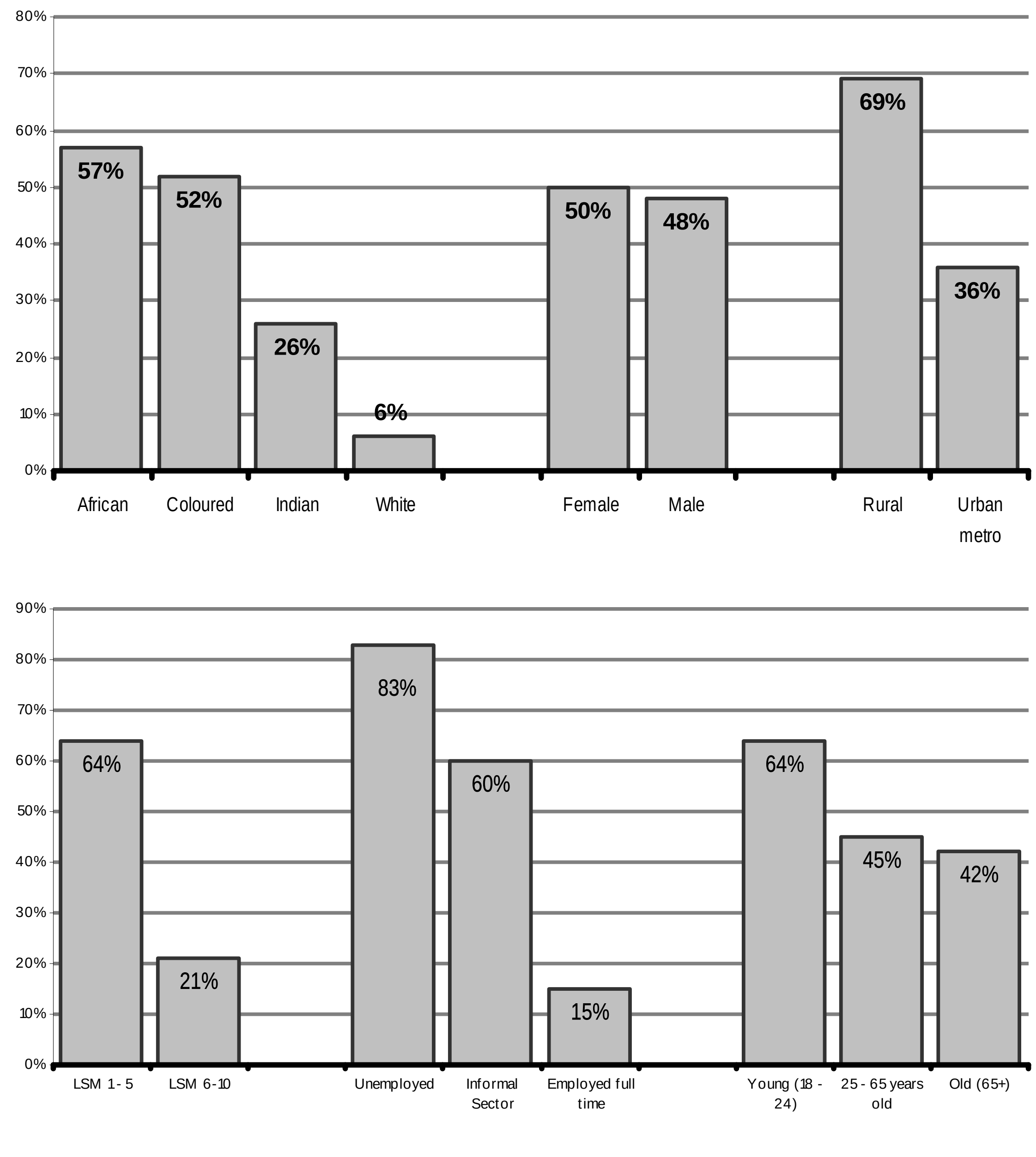
A large amount of research and practice has shown that the permanent deepening of financial markets in a manner that provides access to the poor can achieve the following outcomes:

- Economic growth and job creation can be stimulated, as small business development and access to housing finance generates new cycles of accumulation and contributes to higher levels of effective demand.
- Poverty can be reduced, as access to finance, in the form of savings and credit in the hands of the poor can enable them to build assets, while these and other services such as insurance can play a vital role in 'smoothing' the income of the poor, and so reducing their vulnerability to financial and economic shocks. These factors are a key in building viable communities and contributing to the sustainable livelihood strategies of poor households.

▪ Social exclusion, of which the apartheid system was a most extreme form, can be overcome as the divide between financial 'insiders' and 'outsiders' is eradicated.

Currently, of the 27 million adults in our country, more than 13 million do not have basic transaction facilities. Of these 13 million unbanked South Africans, 11 million are Africans who fall within the bottom half of the distribution of income, reflecting the continuing realities of apartheid's legacy. Amongst the unemployed, 83% do not have a bank account, while 60% of those who work in the informal sector remain unbanked.

FIGURE 1: The 'unbanked' in South Africa
% of each demographic group that does not have a bank account



SOURCE DATA: PORTEOUS/HAZELHURST, 2004

Experience and Challenges over Ten Years of Freedom

One of the unexpected processes that coincided with South Africa's transition to democracy has been the rapid growth of the high street lending industry. A commercial micro lending sector can make an important and positive contribution to our economic vision. Millions of black people who could not access loans and other financial services before can now do so, providing them with the opportunity to accumulate income-generating assets. However, these developments have had contradictory and complex outcomes.

In 1992 the last apartheid Minister of Trade and Industry granted an exemption to the Usury Act for institutions providing loans below R6,000. The following year Persal (the state salary administration) provided codes for the commercial micro-lending industry, enabling them to deduct payments directly from the salaries of public servants. These interventions led to the explosive growth of the commercial micro-lending sector in a largely unregulated environment, posing significant dangers to overall financial stability.

It also unleashed the prospect of financial sector mal-development, with adverse consequence for our developmental objectives. Rather than promoting asset creation, an unregulated micro lending industry can promote the liquidation of assets to support consumption. Rather than promoting employment and economic security it could promote unemployment and economic insecurity by thriving on the extension of unsustainable debt burdens amongst low-income workers, thus generating economic disempowerment. These possibilities arise, in the first instance, because of unequal power relations between the lender and the borrower. A second and related problem is the lack of knowledge of how to manage finances amongst the borrowers, especially in our context, where the vast majority had been denied access to financial services for so long.

It fell to the democratic state to respond to these dangerous and unpredictable developments. In 1999 a revised exemption to the Usury Act was passed, which established the basis for the regulation of the industry in the form of the Micro Finance Regulatory Council. The revised exemption also outlawed the practice of retaining the ATM card and pin code of clients. The following year the state withdrew access to the Persal system.

Also in response to the burgeoning micro lending industry, the mass movement in our country, most notably at the initiative of the SACP, led a series of popular mobilisations designed to deepen the financial sector in favour of the poor and combat negative tendencies on the part of micro lenders. As a result of these efforts, the NEDLAC declaration on the financial sector was signed in 2002. This in turn gave birth to the financial services charter, which promises to significantly expand access to financial services amongst the working class and the poor.

In terms of the charter, the financial sector has committed itself to "substantially increase effective access to first-order retail financial services to a greater segment of the population, within LSM 1-5." Amongst other important the targets, this means that 80% of those within LSM 1- 5 should have access to transaction banking within 20 kilometres of their home by the year 2008.

This is a major victory for us as a democratic movement, and must be welcomed by all those interested in pro-poor financial sector development. But we should not underestimate the awesome nature of the challenges posed by this victory.

A second challenge we face is to tighten our regulation of the commercial micro lending sector in order to prevent over-indebtedness, and to redress the power imbalances between lenders and borrowers through regulation and education. The recent Policy Framework for Consumer Credit Law and the Consumer Credit Bill seek to do just this.

Nevertheless, the commercial micro lending sector has rapidly reached the limit of its expansion. The nature of its business model is such that it can only extend financial services to the salaried workforce. As we have said, the vast majority of the 'unbanked' fall outside this category. Furthermore, the objectives and institutional culture of the high street lender can hardly be considered appropriate for the implementation of an asset-based community development strategy.

Livelihoods and financial services in the Second Economy

Livelihood strategies comprise the assets (including both material and social resources), the capabilities and activities that are required to secure a means of living. A livelihood is considered to be sustainable when it can cope with and recover from stresses and shocks and maintain or enhance its capabilities and assets both now and in the future, while not undermining the natural resource base. Among the determinants of a household's ability to achieve increased well-being is its access to capital, defined broadly to include natural, physical, financial, human and social capital.

As a policy intervention, micro-finance seeks to:

- Reduce poverty by increasing the access of poor people to savings and credit so that they can invest in physical capital to increase the productivity of existing assets,
- Provide working capital for the purchase of inputs, and
- Allow for consumption smoothing, enabling major expenses such as health treatment or funeral costs to be met.

Micro finance therefore forms part of an asset-based community development strategy as follows:

- Savings: With savings facilities available to them, the poor are able to accumulate cash surpluses, which could be turned into productive assets and make a significant contribution to household livelihood strategies. Cash surpluses can also create a barrier for the foreseen and unforeseen expenses of the future, thus reducing vulnerability to the debt traps.
- Transaction Services: Given the historic legacy of the migrant labour system, transaction services are an especially important issue in South Africa. The programme outlined in the financial services charter takes us some way forward in addressing the access to transaction banking, and the recently launched Mzansi account is a major leap forward in this regard.
- Credit: In the right circumstances credit can assist the poor in building assets and 'smoothing' the up-and-down nature of their income. Like savings, credit can assist in converting very small, irregular incomes into a large lump sum, which can augment livelihood strategies and reduce vulnerability.
- Insurance: Like savings and credit, properly managed insurance services can 'smooth' income. Our people have organised themselves into popular insurance enterprises in the form of burial societies, which indicates the importance of insurance services to the poor.

There are few institutions providing these services to the poor, particularly savings and credit. The current state of access to these services can be thought of in terms of a pyramid of financial institutions (see figure 2). At the top, the middle class is fully serviced by the big four banks. The salaried working class, and people earning a regular income from self-employment and small business, are also able to access savings and loans through the commercial banks and the micro lending industry.

At the bottom of the pyramid are the millions who unemployed and live without any steady income stream, except for social grants and remittances from family members in full time employment. These millions lack any form of income-generating asset and are forced to adopt a range of livelihood strategies to secure their own survival.

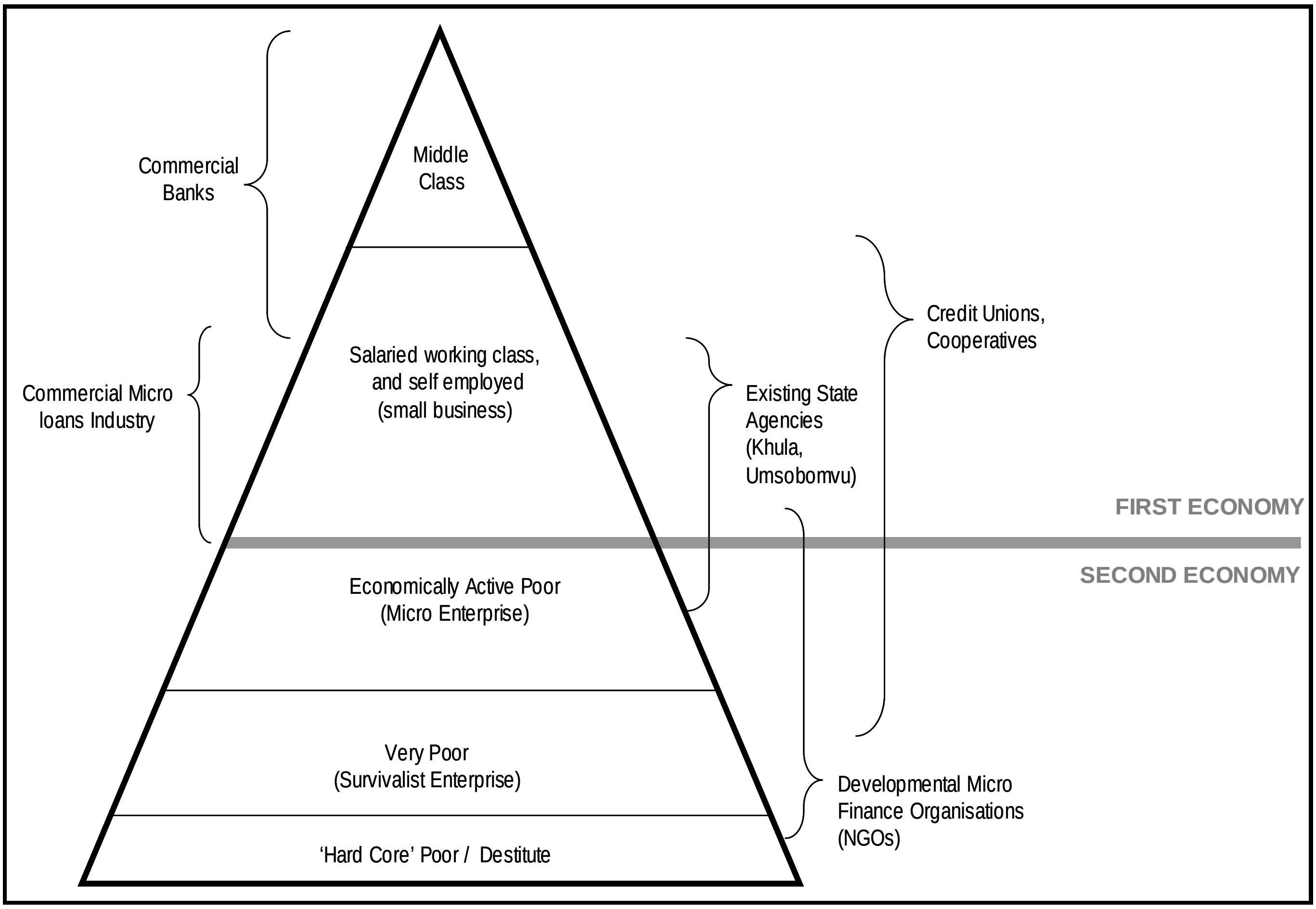
The existing state agencies, such as Khula and Umsobomvu, do not reach deeply into the second economy. Certainly, the promotion of small business finance and entrepreneurial development amongst the relatively more affluent of our people is a vital programme, and we must continue to broaden the base of our economy through such institutions.

But the deficit in our interventions is amongst the economically active poor (who engage in micro-enterprise in the informal economy), the very poor (many of whom supplement remittances and grants with survivalist, or household based micro-enterprises) and the 'hard core' poor, or destitute.

The extension of social security over the last ten years has had a radical impact on the levels of poverty in the second economy. Furthermore, state transfers (which will continue to expand over the coming years) contribute significantly to the creation effective demand in poor communities. But remittances, grants and survival strategies do not necessarily lead to the accumulation of income generating assets, and it is this that our micro-finance interventions need to address.

The challenge is to create institutions that are able to work with the existing strengths and assets of communities in the second economy, and progressively scale these up, usually through some form of social mobilisation in the community.

FIGURE 2: Pyramid of Financial Institutions



SOURCE: Adapted from Rau, 2004

KEY ISSUES AND QUESTIONS

Our determination to provide financial services to the second economy raises a number of important issues and questions that require further clarification. These include: the target group identified for particular interventions, the types of institutions required to provide these interventions, particularly at the retail level, the sustainability of these institutions and the appropriate role of government subsidies.

Target Groups

Those within the second economy are not a homogenous group. Would our resources be best directed at the more affluent and educated, those already engaged in some form of micro-enterprise, with the hope that these will eventually ‘graduate’ into fully-fledged formal businesses, and thus contribute to broader goals of economic development and job creation? Or, as others believe, should the focus of our activity start right at the bottom of the pyramid, targeting the ‘hard core poor’ directly in order to alleviate poverty and build assets that can minimise vulnerability and exclusion?

Another way of putting this question is to ask: should micro finance be aimed primarily at supporting sustainable livelihoods, or should it seek to augment productive investment for job creation?

This does not imply that one target group should be chosen and others ignored. Indeed, it is not necessarily the scarcity of capital that constrains our choice, but the absence of appropriate institutions that can deploy this capital effectively as part of an asset based poverty reduction strategy. But when we design our interventions we should be clear about which target group a particular intervention is intended to reach. Failure to specify these targeted beneficiaries often leads us to impose unreasonable expectations on ourselves.

Retail Institutions

The critical challenge we face is not primarily the creation of an apex institution for wholesale financing. The experience of Khula and other apex-type institutions over the last ten years shows that the real challenge is not wholesale, but retail.

There are four institutional types that we could broadly conceive of as providing retail financial services to the poor. The role of the state is looked at in the next section, leaving three potential non-state institutional models.

- The first is a **commercial, profit driven model**. However, it seems clear from our own and international experience that ‘market failure’ would preclude the extension of micro financial services beyond the salaried working class, at least without some form of direct subsidy. Another problem of private sector providers is that they will tend to focus on financial services alone, without building the requisite social assets in the community that are required to effectively absorb finance as part of an asset building poverty reduction strategy.
- The second approach is that of **Micro Finance Organisations** (MFOs). Various models of MFO have been development internationally, the most famous of which is the Grameen Bank in Bangladesh. Over the last ten years many of these models have been adapted to the South African context. However, few have yet attained a scale of operation that is required. Even fewer have succeeded in becoming financially sustainable. While there may have been regulatory impediments to achieving these ends, there are also some who argue that such institutions are inappropriate to the South African context. One the other hand, some of the existing MFOs have a refined methodology and a track record in the second economy. While there are only a handful of successful pro-poor NGOs, each has something to offer and is addressing market failure in a unique way. Organisations such as the Small Enterprise Foundation, which have attained financial sustainability, should be emulated wherever possible.

- Another type of institution is the **Savings and Credit Cooperative** (SACCO), also known as a credit union. SACCOs, in addition to providing a collective approach to the mobilisation of savings and credit, also actively promote the education of their members in the mutual self-help principles on which they are founded. An advantage of the cooperative approach is that it builds upon our traditions of democratic and popular organisation, since they are often built around existing structures such as unions or residents groups. However, there are questions about whether financial cooperatives are appropriate for reaching the poorest people.

The current size of the non-government, not-for profit sector is estimated in table 1. The Savings and Credit Cooperatives League (SACCOL), which brings together the credit unions has around 8,000 clients in 27 branches. MFOs, which include traditional NGO-type models as well as the Homeless Peoples Federation, currently have around 115,000 members. Research conducted by the MFRC shows that not for profit institutions currently account for 27% of micro-business loans.

Table 1: Not-for-profit micro finance sector in 2003

Institution	SACCOL	MFOs	TOTAL
Savings	R 20,000,000	R 14,053,447	**R 34,053,447**
Principle Outstanding	R 16,000,000	R 40,628,800	**R 56,628,800**
Clients	8,000	115,600	**123,600**
Branches	27	2,917	**2,944**

Source Data: CMFN, 2004

Table 2: Estimate of Potential of Developmental Micro Finance Sector in 2010

	Scenario		
	High	**Middle**	**Low**
Cumulative Savings	R 493,130,398	R 293,268,319	R 253,161,339
Principal Outstanding	R 823,306,549	R 496,265,851	R 370,480,261
Clients	1,436,382	840,000	637,278

Source Data: Bay Research, 2002

The Community Micro-Finance Network (CMFN) estimated a number of scenarios for the growth of the sector up to 2010, which are given in table 2. The key driving forces defining the scenarios are policy variables. Even in the worst-case scenario, without any policy support, this model projects that the SACCOs and MFOs could collectively upscale their current activities by more than 500%.

Ultimately it is the test of practice that will decide what is the most appropriate institutional form for South Africa. Those institutions that are able to sustainably provide financial services to the poor in South African conditions must be supported to test their ability to do so. Our regulatory environment, and the apex institutions we create to support micro finance for the poor, should create the conditions for a thousand flowers to bloom.

Our people have already built successful models that are closest to the poor such as burial societies. These solutions developed by the poor themselves must be respected and strengthened where possible. Government's role is to create a platform or system for these processes to be streamlined and leveraged. The challenge is to recognise, protect and nurture them and ensure that our regulatory framework does not impose additional burdens on these structures.

Sustainability, Subsidies and Time Lines

At the centre of the institutional challenge is the question of sustainability. Not only must we ask what type of institution can provide finance in a manner that builds wealth amongst the poor. We must also ask what type of institution would do so most efficiently. Only efficient institutions can low the high cost of servicing small and irregular incomes on a sustainable basis. These lower costs can in turn be passed on to the poor in the form of low finance charges. In other words, what type of institutions can reach out to millions of people but can also sustain themselves financially, at least in the long run?

In the short run, however, the reality of ‘market failure’ means that any retail institutions in the second economy are likely to require some form of subsidy. For believers in ‘market fundamentalism’ any form of subsidy is regarded as bad. It may be more useful for us to ask what form of subsidy we deploy in the short to medium term in order to generate dynamic efficiencies, such as sustainable institutions, in the long run that would otherwise not emerge.

Also important would be to assess the opportunity cost of a subsidy. For example, if the poor had bank accounts, government could transfer welfare payments directly. The money saved in terms of administration costs could be used to subsidize these banking facilities. On the face of it, the state could save money by extending such a subsidy through private institutions, enabling them to expand their reach into the second economy.

A final question is the time frame that we define. When we expect a retail institution to become financially sustainable in the long run, what time frame do we have in mind? Should it be one year, or five years, or ten years? What is the cut-off point where we say, clearly we are barking up the wrong tree and we need to divert our resources in to more useful pursuits?

FIGURE 3: Institutions involved with micro finance for poverty alleviation

Government	Social Capital	Civil Society	Popular institutions
SARS	Khula	HPA	Cooperatives
SARB	ODA	CMFN	Stokvels
Courts and the CJS	Land Bank	NCASA	Burial Societies
FSB	IDT	SACCOL	Churches
MFRC	DBSA	DTCC	Informal Networks
DTI	SAMAF		
Treasury	Umsobomvu		
Department of Social Welfare	uTshani Fund		
Department of Communications	Post Bank		
Post Office	MAFISA		
Dept of Agriculture/Land Affairs	Provincial DFIs		
Parliament	Private Donor Funds		
Provincial government			
Local Government			

CMFN: Community Micro Finance Network, CJS: Criminal Justice System, DFI: Development Finance Institution, DTI: Department of Trade and Industry, DBSA: Development Bank of Southern Africa, DTCC: Dora Tamana Cooperative Centre, FSB: Financial Services Board, HPA: Homeless People's Alliance, IDT: Independent Development Trust, MFRC: Micro Finance Regulatory Council, NCASA: National Cooperatives Association of South Africa, ODA: Official Development Assistance, SACCOL: Savings and Credit Cooperatives League, SARB: South African Reserve Bank, SARS: South African Revenue Service, SAMAF: South Micro Finance Apex Fund

THE ROLE OF THE STATE AND POLICY RECOMMENDATIONS

There is a long history of state involvement in the provision of **credit** to the poor through retail institutions. In many instances state retail institutions have failed. Among the reasons for this is that the state is often regarded by its citizens as providing entitlements. In our own case, for example, the state interacts with millions of poor people through the welfare system. Where the state has sought to extend credit directly, it has been the experience of many that the wires of welfare 'entitlement' and credit extension get crossed, resulting in large debt defaults from citizens that equate state-led credit extension to welfare handouts.

On the other hand, the state could play a greater role in the extension of the **infrastructure for savings** and transacting facilities. This could be through an existing state infrastructure, such as the post office or through an enhanced set of institutions functioning in the Multi-Purpose Community Centres.

On the other hand, rather than establishing institutional capacity, the state could intervene by providing some form of **subsidy** in order to lower the cost of savings and transaction services to the poorest clients. Through such mechanisms the state could play an important role in realising the challenges of access posed by the financial sector charter.

The state must also play a key role in the **coordination of institutions** to create synergy across the developmental micro finance sector. Lack of coordination is a key weakness in our efforts up till now. The large number of institutions that would need to be coordinated is illustrated in figure 3, which is itself not an exhaustive list.

Linked to the above is the role of the state in **mobilising and directing social capital** towards the pro-poor, developmental micro-finance sector. This includes the institutions directly accountable to the state, the parastatal development finance institutions, as well as non-state actors, including official and private donors. In other words, in addition to the new initiatives like SAMAF and MAFISA, there already exist a large number of apex-type institutions in both the public and private sector, which require improved coordination.

Last, but perhaps most importantly, the state needs to create a **regulatory environment** that supports the development of a pro-poor finance. This involves a delicate balancing act between the need to police the negative tendencies that are bound to arise among profit seeking agents, while at the same time creating the regulatory space for development-oriented interventions to significantly upscale their work.

In terms of more specific policy recommendations, the workshop identified the following:

1. Institutions in the first and second economy

The challenge of addressing 'market failure' in the second economy is essentially a challenge of building appropriate institutions. Many 'first economy institutions' are not 'second economy friendly'. This has three implications:

First, we must reform 'first economy institutions' so that they can maximize their outreach to the second economy. The financial sector charter is one instance of a programme to do just this.

Second, we must act to build the potential of popular institutions in the second economy, such as burial societies, and be mindful of ensuring that legislative interventions nurture and support them. This would require the review of the Friendly Society Act of 1956 and improvement on draft legislation covering co-operative banks.

Third, we must build new institutions that can operate effectively in the second economy.

2. Speed up implementation and 'Learning by Doing'

It is vital that we intensify the pace of implementation. There are no 'off the shelf' models for the implementation of micro-finance for poverty alleviation in South African conditions. It is important that we proceed to implement pilot programmes as soon as possible, so that we can benefit from evaluation and 'learning by doing' on our own soil.

3. Develop an overarching conceptual framework

An overarching conceptual framework is needed to drive these interventions in a consistent manner. Such a framework would locate our micro-finance interventions within our broader approach to both poverty alleviation and financial development. It would outline the strategic objectives of our efforts in the medium term and the contributions that various initiatives make to achieve these objectives.

It should be remembered that the development of such a framework is long overdue, and therefore the implementation of solutions will have to happen simultaneously with the development of a guiding policy.

4. Build synergy across government departments and agencies

A wide range of government agencies are responsible for various facets of micro-finance development. It often appears as though these interventions are not adequately coordinated, which could lead to overlapping responsibilities and a failure to capitalise on the potential for synergies between our programmes.

In order to guard against resource waste (both human and financial) we should be clear on the relation between Mafisa and the Apex fund, since both are aimed at similar objectives but accountable to different departments.

Also, we need to pay more attention to the question of the relation between micro-finance interventions and other anti-poverty programmes, such as the EPWP, ISRDS and URP. The role of government-owned infrastructure, including the post office, Transnet and Eskom also needs further deliberation.

There is a need to devise institutional means, possibly through an IMC on micro-finance, to build these synergies within government. There may also be a need to designate (or create) a central office within the executive which is dedicated to the monitoring and reporting on the developmental micro-finance sector as a whole.

5. Ensure complementarity of legislative frameworks

The key legislative initiatives currently in motion are the Dedicated Banks Bill, the Cooperative Banks Bill and the Consumer Credit Bill. We should consider this legislation with a view to building synergies, and also be mindful of the implications for the institutional arrangements we seek to foster in pursuit of pro-poor micro-finance. The impact of this legislation in terms of 'regulatory burden' on the sustainability of developmental Micro Finance Organisations also requires further thought.

The ANC's parliamentary caucus will have a key role in evaluating the draft legislation.

6. Build partnerships

There is a need for much better communication around these various initiatives, particularly the establishment of the apex fund, amongst both parastatal and non-state actors. We must also ensure that government institutions, such as the Apex, give high priority to building broad unity in action amongst developmental micro finance institutions in the implementation of its programmes.

Partnerships are also required with local government, trade unions and other organisations for reaching out to our people and mobilising them around member-based micro-finance institutions, such as financial co-operatives.

7. Build Capacity

The role of the banking SETA in building capacity for development-oriented micro-finance needs to be enhanced. This may require the SETA to re-evaluate its current role and programmes.

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