Kinks in the Links:
Financial Intermediation for Africa's Poor

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Abstract

This report summarizes the three EAGER/PSGE sponsored field studies carried out in support of policy research on financial intermediation for the poor (a comprehensive survey of the state of the art, a South African case study, and a Senegalese case study). In addition, it explores the implications of the findings for future policy formulation regarding financial intermediation for Africa's poor.

The report concludes we must build on the existing foundation and enhance the quantity and quality of financial intermediation for sub-Saharan Africa's poor. There is considerable scope for providing the poor with more and better choices, and letting them benefit from healthy competition for their business. This can best be achieved by helping the semi-formal microfinance organizations to scale-up and graduate to regulated financial institutions, and by assisting commercial banks to scale-down and include microfinance in their portfolio of products and delivery systems.

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I. INTRODUCTION

A. Background and Objectives

Over the past four years, the EAGER (Equity and Growth through Economic Research)/PSGE (Public Strategies for Growth and Equity) Project has sponsored a series of studies on financial intermediation for the poor in sub-Saharan Africa. EAGER/PSGE is a USAID (United States Agency for International Development) financed applied economic policy research project designed "to increase decision-makers' use of economic and social research on key issues relating to economic growth . . . The overall goal is to help African nations develop equitable and sustainable policies and strategies for promoting growth."[1]

EAGER/PSGE sponsored the following three field studies[2] in support of policy research on financial intermediation for the poor:[3]

- a comprehensive survey of the state of the art;[4]
- a South African case study;[5] and
- a Senegalese case study.[6]

The primary objectives of this paper are to:

- summarize the findings of the three studies noted above; and
- explore the implications of these findings for future policy formulation regarding financial intermediation for Africa's poor.

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[1] Strategic Analysis Division, Office of Sustainable Development, Africa Bureau, United States Agency for International Development, *EAGER/PSGE (Equity and Growth through Economic Research/Public Strategies for Growth and Equity) Brochure*, June 1998.
[2] All EAGER publications can be downloaded from www.eagerproject.com.
[3] These three studies were undertaken based on a detailed research design prepared by Eric Nelson, *EAGER/PSGE Financial Intermediation for the Poor: Final Design*, manuscript, December 1996.
[4] Eric Nelson, *Financial Intermediation for the Poor: Survey of the State of the Art*, EAGER Discussion Paper Number 10 (Bethesda, MD: Development Alternatives, Inc., 1999); this is summarized in EAGER Policy Brief Number 9, *Status of Financial Intermediation for the Poor in Africa*, January 1999.
[5] Nick Vink, Mohammad Karaan, and Catherine Cross. 1997. "Financial intermediation for the poor : South African case study". Development Alternatives, Inc. (DAI) USAID. Bur. for Africa. Ofc. of Sustainable Development (Sponsor). PN-ACL-669. Project No: 6980546. September.
[6] Hamet Ndour and Aziz Wane. 1997. "Intermediation financiere & pauvrete au Senegal - aspects institutionnels" (Financial intermediation and poverty in Senegal : institutional aspects) REMIX and Development Alternatives, Inc. (DAI), USAID. Bur. for Africa. Ofc. of Sustainable Development (Sponsor) USAID. Mission to Senegal (Sponsor). PN-ACE-852. Project No: 6980546. September.
Summarized in EAGER Policy Brief Number 5, *Financial Services and Poverty in Senegal*, January 1999.

B. Methodology and Disclaimers

The methodology of this paper is straightforward: a review and synthesis of the three studies noted above, interpreted with and enhanced by a general knowledge of current worldwide trends in the provision of financial intermediation for the poor. This includes identification of sound practices that might be applied and adapted to sub-Saharan needs and conditions, as well as acknowledgement of those practices that have either failed elsewhere, or may not be transferable to sub-Saharan Africa.

Nonetheless, this is strictly a desk review. No new field research has been undertaken in preparation of this paper, nor has any attempt been made to confirm, correct, clarify, or contribute to the data collected and presented by the authors of the survey study and the two case studies.

II. DEMAND FOR FINANCIAL SERVICES

A. Current Needs

Financial intermediation is the matching of idle funds with investment opportunities. Financial intermediaries, such as banks, finance companies, building societies, savings and loan cooperatives, insurance and pension funds, and unit trusts are all institutions that perform this function by channeling money from lenders to borrowers. Financial intermediaries can transform funds temporally and geographically, utilizing differences in deposit and loan maturities, and moving funds from surplus to deficit areas. They provide three fundamental financial services required by families and businesses: 1) facilities for saving or investing surplus funds; 2) credit facilities for borrowing funds; and 3) funds transfer facilities between service areas.

As noted in the EAGER/PSGE survey study,[7] these financial services:

- allow transfer of purchasing power from uses with low marginal rates of return to those with high rates;
- contribute to more efficient inter-temporal decisions about savings, asset accumulation, and investment;
- permit a less costly management of liquidity and accumulation of stores of value; and
- help individuals to manage economic risks.

According to both the South Africa and Senegal case studies, the demand by the poor for financial intermediation is substantial. They need secure, accessible places to save funds that they generate beyond their immediate consumption needs to help decrease their vulnerability

[7] Nelson, *Financial Intermediation for the Poor*, pp. 4-5.

during difficult times and to meet future lumpy expenditures. They require access to credit on terms and conditions compatible with their cash flow generation to allow them to take advantage of investment opportunities. They need electronic banking services to assist them with liquidity management and funds transfers.

The South Africa case study focuses on the rural poor, and notes that although “most rural people in South Africa will remain poor, at least relative to the rest of the country’s population, for some time. . . . most rural people save and invest, some borrow and all require access to services such as money transmission.”[8]

The need for funds transfer facilities is especially acute in South Africa, given the importance of remittances for the rural poor: “Better-off families use them for productive investment: trade, transport, construction and cattle, but only rarely for crop production, often because of constraints such as lack of access to land or water, etc. For poorer families, remittances cover current consumption needs.”[9]

The study concludes that the biggest problem of the rural poor is their lack of access to appropriate savings and lending institutions and instruments that are tailored to their liquidity needs: “Rural people manage risk by diversifying their sources of income, and by minimizing cash expenditure. However, they need to match the timeliness of income streams to erratic expenditure streams. Therefore, there is much evidence that shows that rural financial markets are best understood as markets for liquidity, rather than markets for credit or savings.”[10]

The findings of the Senegal case study are consistent with those of the South Africa case study, although the need for financial services among the poor is cast in terms of a poverty alleviation strategy by supporting revenue and wealth building capacities. The Senegal case study also attempts to quantify the demand by the poor for financial intermediation, and concludes that the potential target population for microfinance structures is 2.2 million.[11]

B. Target Group

It is important to note that neither the South Africa case study nor the Senegal case study focuses on financial intermediation for the poorest of the poor, that is, those without any income stream or asset accumulation. While these people certainly require assistance in the form of income transfers to meet their basic needs, they have no funds to save or transfer, and any credit extended would be consumed rather than invested in something that generated a return sufficient to repay the debt.

[8] Vink et al, *South African Case Study*, p. 9.
[9] Vink et al, *South African Case Study*, p. 9.
[10] Vink et al, *South African Case Study*, p. 9.
[11] Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 1, p. 9.

III. SUPPLY OF FINANCIAL SERVICES[12]

A. Savings and Transfers

In both South Africa and Senegal, the poor have much greater access to savings and transfer services than to credit facilities. This is due largely to the extensive retail network of postal savings systems in both countries, PostBank in South Africa and CNE/CCP (Caisse Nationale d'Epargne/Centre Cheques Postaux) in Senegal. Both of these institutions have offices in every region of the country (2,064 for PostBank and 132 for CNE/CCP), small deposits are welcome, restrictions are few, and transaction fees are low. As of 31 March 1995, PostBank had 2.4 million savings accounts with a total value of $301.4 million; as of 31 December 1996, CNE/CCP had 225,000 savings accounts.[13]

Other key providers of savings and transfer services for South Africa's poor are:

- the commercial banks, estimated to have more than 4,000 branches throughout the country, with a visible presence in all but the remotest rural areas - while banks offer both savings and loan services, the poorer or more remote the population base, the greater the role of deposit and transmission services;[14]

- TEBA (The Employment Bureau of Africa Limited) Cash, which provides savings and transmissions services tailored to the needs of mining employees and their off-site dependants (usually in distant, rural locations) – as of 31 December 1995, TEBA Cash was operating more than 700,000 savings accounts and processing more than 20 million transactions per annum;[15] and

- the KwaZulu Finance Corporation, which has a very successful Ithala savings mobilization program throughout its home province.[16]

Other major providers of savings and transfer services for the poor in Senegal are:

- mutual savings and credit societies, similar to credit unions and cooperatives, some with voluntary savings schemes and others with mandatory savings systems – the seven largest mutuals had mobilized $4.3 million in savings from more than 53,000 members as of 31 December 1995;[17] and

[12] Unless otherwise noted, all figures converted to U.S. dollars in this paper use exchange rates per 31 December 1995, as follows: US$1 = CFAF 489 and US$1 = Rand 3.65.
[13] Vink et al, *South African Case Study*, p. 20 and Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 1, p. 44; the value of CNE/CCP savings is not available.
[14] Vink et al, *South African Case Study*, p. 17.
[15] Vink et al, *South African Case Study*, p. 20.
[16] Vink et al, *South African Case Study*, p. 13.
[17] Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 2, p. 36.

- Banque de Sandaga, the principal market in Dakar, whose foreign exchange and international transfer services are popular among small-scale merchants.

B. Credit

Most savings mobilized from the poor in South Africa and Senegal are channeled to larger-scale borrowers. Access to formal microcredit facilities appears to be quite limited. Thus, most credit for microentrepreneurs and poor households comes from unregulated financial institutions and traditional, informal local sources.

In South Africa, the two largest development finance institutions (DFIs),[18] the Agricultural Credit Board and the Land Bank, cater primarily to large-scale commercial farmers; their total loans outstanding at the end of 1995 were $2.97 billion. Of the remaining five DFIs, all regionally based, only one (the KwaZulu Finance Corporation) has any appreciable credit outreach for small-scale farmers, with loans outstanding totaling $176.6 million at the end of 1995. The combined loan portfolio of the other four DFIs (Agriwane, Ciskei Agricultural Bank, Agricultural Bank of Transkei, and Agribank of the Northwest Province) only totaled $30.1 million at the end of 1995.[19]

An alternative formal source of credit for the poor in South Africa, the development finance corporations (DFCs) established in the former homelands, serve medium-size enterprises, not small-scale farmers or microentrepreneurs. In peri-urban and semi-rural areas, the commercial banks provide a range of farm and off-farm credit such as small enterprise, personal, and home loans, overdraft facilities, hire purchase credit, and revolving credit plans. In some cases, the banks also make micro loans, usually to clients employed by firms repaid by regular payroll deductions. The combined value of all of these credit facilities for small and micro businesses is a very small part of the total loan portfolio of commercial banks.[20]

Thus, much of the credit needs of the poor in South Africa are met by traditional sources: stokvels (community-based savings and loan societies), supplier credits, and loans from family and friends.

However, to fill the gap in microfinance between services offered by regulated financial institutions and informal sources, a small loans industry has developed. There are now approximately 5,200 operators, mainly in urban areas, providing short to medium term loans to individual borrowers who fall outside of the formal banking network due to their inability to provide conventional collateral. All that is needed is proof of employment and a bank account. The borrower provides the small loans firm with a bank card and a PIN, and the firm withdraws payments according to the loan contract after each wage or salary deposit is made by the employer into the borrower's bank account. Estimated annual turnover in 1995 was $684.9 million for the 1,200 formal operators and $958.9 million for the 4,000 informal operators.[21]

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[18] The term "development finance institutions" includes South Africa's agricultural development banks.
[19] Vink et al, *South African Case Study*, pp. 13-15.
[20] Vink et al, *South African Case Study*, pp. 15-18.
[21] Vink et al, *South African Case Study*, p. 21.

There are two main sources of microcredit in Senegal: the relatively new mutuals, and traditional sources that have existed for centuries. The role of commercial banks in providing credit to either the urban or the rural poor in Senegal is negligible. Introduction of mutual financial systems in Senegal dates from the mid-1980s. The functioning of mutuals is similar to credit unions, cooperatives, and other membership-based savings and credit organizations found around the world. The two largest mutuals are CMS (Crédit Mutuel Sénégalais) and ACEP (Alliance de Crédit et d'Epargne pour la Production), which together lent $9.2 million in 1995, comprising 91 percent of the total lent by all mutuals.[22] According to the International Monetary Fund, at the end of 1998, there were 320 registered microfinance institutions in Senegal, with a total credit outstanding of CFAF 14.1 billion ($25.1 million), equal to three percent of total formal sector credit outstanding, and total deposits of CFAF 9.8 billion ($17.4 million).[23]

There is also a plethora of informal sources of credit in Senegal. In addition to relatives, friends, suppliers, and moneylenders, the most common traditional source of credit in Senegal are the *ndawtal*, *nate*, and *fôte*. These are ROSCAs (rotating savings and credit associations), sometimes referred to as *tontine* in francophone Africa, whereby all members make regular contributions into a savings pool that is distributed periodically in some mutually-agreed upon order to each of the ROSCA members.[24]

In sum, although some encouraging initiatives have been undertaken in both South Africa and Senegal, most microentrepreneurs do not yet have access to credit facilities from formal financial institutions. They remain the unbanked majority.

IV. CREATING ENABLING ENVIRONMENTS

A. Macroeconomic Policies[25]

Both the supply and demand for microfinance services in sub-Saharan Africa depends on the effectiveness of macroeconomic policies. Financial intermediation for the poor contributes to poverty alleviation in that it allows a country's unrecognized but de facto economic base to participate in development opportunities. Economic growth provides many opportunities to increase one's income and wealth, and thus, stimulates the need for financial intermediation to save, invest, or transfer these gains. In contrast, economic stagnation or decline leads to dissaving and disinvestment to cover financial hardships and losses, which threaten the long-term viability of financial intermediaries.

The linkage between macroeconomic policies and financial intermediaries is two-way: microeconomic behavior affects macroeconomic performance, and macroeconomic policies have microeconomic consequences. This interaction can result in a virtuous cycle of financial services responding to and creating more economic growth opportunities, or a cataclysmic chain of events

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[22] Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 1, pp. 22-26 and vol. 2, p. 36.
[23] International Monetary Fund, *Recent Economic Developments*, August 20, 2000, p. 32. The dollar equivalents have been calculated using the end of 1998 exchange rate of US$1 = CFAF 562.
[24] Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 1, p. 26.
[25] See Carl-Johan Lindgren, Gillian Garcia, and Matthew I. Saal, *Bank Soundness and Macroeconomic Policy* (Washington, D.C.: International Monetary Fund, 1996) for a comprehensive review of these issues.

whereby banking problems arising from the economic environment rather than internal management weaknesses quickly create systemic risk and threaten real sector growth. The four most important macroeconomic policies affecting financial markets are fiscal, monetary, real sector, and external sector policies.

In addition to the generic macroeconomic policies noted above, macroeconomic policies in South Africa directly affecting financial intermediation for the poor are those tied to the government of national unity's urban and rural development strategies. Key components are: closure of the gap in access to education; promotion of school feeding and health care schemes; implementation of public works programs; and initiation of comprehensive land reform, including land restitution, land redistribution, and land tenure. The success or failure of these initiatives will help to determine how smoothly South Africa manages its social, political, and economic transition: "It is . . . too early to know what effect changed . . . development policies will have on the need for financial services among the poor in the country. However, an optimistic view leads to the conclusion that poor people will have greater access to economic opportunities, either through the formal labour market, or in the small and medium enterprise sector."[26]

The key macroeconomic challenge for Senegal that directly affects financial intermediation for the poor, in addition to the fundamental task of achieving sustainable macroeconomic growth, is addressing domestic food deficits by increasing agricultural productivity. The extremely low income and high vulnerability of households in food deficit zones makes financial intermediation very risky in these areas – there is little surplus generated for savings or investment, and a relatively low cost to the one-time borrower for violating loan contracts if loan proceeds are consumed rather than repaid.[27]

B. Regulatory and Supervisory Regimes

All three EAGER/PSGE-sponsored studies cite regulatory and supervisory obstacles to the development of financial intermediation for the poor in sub-Saharan Africa. The most severe constraints examined in these papers are barriers to entry and operational restrictions.

Barriers to entry result from basic banking laws that place microfinance intermediaries in legal limbo. There is no recognized legal status for microfinance organizations that would like to become regulated financial institutions because they are more commercially oriented than non-profit organizations, but do not wish to become conventional, full-service commercial banks. Indeterminate legal status results in a prohibition on savings mobilization from the public because these institutions are not banks, or adherence to very high capital requirements because they are banks.

South Africa's Banks Act is a good example: "The main object of the Act is to create a framework for the regulation and supervision of the business of accepting deposits from the general public, in order to safeguard the investments of depositors and to protect the integrity of the broad banking system." The Banks Act prohibits an institution from taking deposits from the

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[26] Vink et al, *South African Case Study*, p. 27.
[27] Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 1, pp. 6-12.

public unless registered as a bank. This places non-banks at a great competitive disadvantage on the liability (sources of funds) side of their balance sheet.[28]

Two measures have been adopted in South Africa to address this barrier to entry:

- Stokvels and credit unions have been exempted on condition that they are members of an umbrella body such as the Savings and Credit League of South Africa or NASASA (National Association for Stokvels in South Africa).

- A Mutual Banks Act was passed to accommodate non-traditional lenders, allowing them to take deposits from the public with less stringent capital adequacy requirements – the organization and administration of mutual banks is similar to the former permanent mutual building societies.[29]

While the first measure essentially "grandfathered" official recognition of existing membership-based financial intermediaries, the second measure has not had a major impact, for the following six reasons given by non-traditional institutions – this explanation highlights the links between initial barriers to entry and their subsequent operational constraints:

- independence could be comprised by being placed under the sometimes politicized Registrar of Banks;

- legitimacy to low-income customers could be diminished because of popular perceptions of banks as not being client friendly;

- staffing, reporting, and other cost implications;

- a capital adequacy requirement that is still too high;

- sterilization of funds due to liquidity requirements; and

- general discomfort with the formal banking culture.[30]

The situation is similar in Senegal. The Banking Law of 1990 provides the legal foundation and regulatory parameters for banks and financial institutions in Senegal, and is based largely on risk management principles designed to protect depositors. This was deemed especially important in light of Senegal's fiscal and banking crisis of the 1980s, which led to the liquidation of six banks and a loss of confidence in the banking system.[31] As in South Africa, the high capital adequacy requirements and strict prudential norms applied to registered banks have led to a

[28] Vink et al, *South African Case Study*, p. 79.
[29] Vink et al, *South African Case Study*, p. 80.
[30] Vink et al, *South African Case Study*, p. 80.
[31] According to the International Monetary Fund's Recent Economic Developments (August 20, 2000, p. 31), depositors lost CFAF 25.5 billion, equivalent to $94 million at the 1990 exchange rate.

complementary law for mutuals and non-mutualist savings and credit organizations, the PARMEC Law of 1995.[32]

There is another interesting parallel between South Africa and Senegal regarding regulatory barriers to financial intermediation for the poor. Both countries have legislated interest rate ceilings on loans.

In South Africa, the Usury Act sets the maximum lending rate at 26 percent for loans over R 6,000 and 29 percent for loans under R 6,000:[33] "The Act is most complex, and difficulty is often experienced in complying with its provisions. Moreover, the limit imposed on the amount of finance charges has a direct impact on the profitability of lenders, particularly those operating in high risk fields such as the provision of rural credit." There is currently an exemption from the provisions of the Act for loans under R 6,000, provided that a variety of other conditions are met, but the Minister of Trade and Industry published his intention to withdraw the exemption in 1994.[34]

In Senegal, the Usury Law sets the interest rate ceiling for all loans at twice the central bank's discount rate. This proved especially difficult for microfinance institutions when the Central Bank reduced its discount rate from 14.5 percent in 1994 to 6.0 percent in 1997, making the maximum interest rate margin insufficient to cover lending costs.[35] Unfortunately, the law governing credit unions mentioned earlier (PARMEC Law of 1995) abolished a temporary decree that had permitted credit unions to charge a higher interest rate than banks. Consequently, credit unions and other semi-formal institutions have been required to reduce their interest rates to the maximum rate charged by banks.[36]

These barriers to entry and operational constraints imposed by regulatory and supervisory regimes can best be addressed by:

- Introduction of a special class of regulated financial institutions between full-service commercial banks and semi-formal microfinance organizations. These institutions have lower capital adequacy requirements than conventional banks, but are usually restricted in either service area, like village banks, or in portfolio of banking services, for example excluding foreign exchange transactions and participation in the payments system.

- Adaptation of prudential norms to microfinance operations, i.e., classifying loans with group guarantees as secured, placing them in a lower risk category for capital provisioning, and streamlining staffing and reporting requirements.

[32] Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 1, pp. 13-21.
[33] It is not clear which rate applies to loans for exactly R 6,000.
[34] Vink et al, *South African Case Study*, p. 81.
[35] Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 1, pp. 48-50.
[36] Nelson, *Financial Intermediation for the Poor*, pp. 14.

- Replacement of prescriptive usury laws with laws based on transparency and consumer information, sometimes referred to as "truth in lending" laws.[37]

V. IMPROVING INSTITUTIONAL SUSTAINABILITY AND IMPACT

A. Internal Cost Containment and Service Enhancement

The key to improving the institutional sustainability and impact of financial intermediation for the poor in sub-Saharan Africa, as vividly demonstrated in both South Africa and Senegal, is the development of products and delivery systems that meet client needs at prices that cover all costs of providing these financial services.

Formal financial institutions are relatively adept at mobilizing funds from the poor and lending these resources to larger-scale clients, while unregulated microfinance organizations excel at channeling foreign assistance and government resources to group members and project participants. Banks have not yet discovered how to make micro loans in a cost-effective manner, so their credit outreach is up-market and urban; semi-formal microfinance institutions have neither national retail distribution networks nor a market-based source of funding, so their credit coverage is local and unsustainable.

For example, in South Africa, loans from the formal banking system follow slow and tedious application procedures, processing is slow and bureaucratic, and access is limited to large and well-known borrowers. This model clearly is not cost-effective if applied to relatively small, short-term loans for microenterprises; thus, "these hurdles usually exclude the majority of rural people, the less educated, most women and nearly all the poor." While informal credit systems allow for character-based loans, streamlined application procedures, and flexible loan terms and conditions, their coverage is restricted primarily to the local, low end of the microcredit market: the limited supply of very short-term, extremely small working capital loans in geographically confined areas.[38]

The authors of the South African study conclude: "In summary, state and parastatal institutions are perpetually subsidy-dependent, private sector institutions [that] provide only savings facilities, and NGO institutions lack sufficient outreach. International experience has shown, however, that it is possible to provide such services on a commercially sustainable basis. Any remedial recommendations have to take this institutional weakness into account."[39]

Similarly, in Senegal the commercial banks are more skilled at savings mobilization than credit allocation, as indicated by the post-reform funds and credit figures: from 1993 to 1995, deposits grew by 44 percent in nominal terms, but credit fell by 16.5 percent, and short-term credit dropped by over 50 percent. This risk averse selectivity, coupled with interest rate ceilings,

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[37] For a more detailed discussion of suggested reforms, see Jay K. Rosengard, Ashok S. Rai, Aleke Dondo, and Henry O. Oketch, *Microfinance Development in Kenya: Transforming K-Rep's Microenterprise Credit Program into a Commercial Bank*, (Washington, D.C.: Equity and Growth through Economic Research/Public Strategies for Growth and Equity Project), November 1999.
[38] Vink et al, *South African Case Study*, p. 74.
[39] Vink et al, *South African Case Study*, p. 4.

makes it even more difficult for microentrepreneurs to obtain bank loans. Although mutuals and other semi-formal and informal savings and credit organizations compensate somewhat for the lending bias of banks, their coverage is minimal and their operations are highly subsidized.[40]

B. External Linkages

In addition to the above-summarized respective strengths and weaknesses of commercial banks and unregulated microfinance institutions, another constraint to the development of financial intermediation for the poor in sub-Saharan Africa is the extreme fragmentation of the financial services market as a whole. There is no clear strategic or operational linkage between formal, semi-formal, and informal microfinance institutions in either South Africa or Senegal. While the market is segmented, complementarities between the different providers of credit are not utilized, such as the channeling of commercial bank micro loans via membership-based savings and credit organizations, or the graduation of members of mutuals and cooperatives to commercial bank clients.

In South Africa, "the existence of a private sector, of NGOs, of the wide range of other institutions and local voluntary collective action, are all major advantages. However, neither public monopoly with subsidies to targeted groups, nor unstructured private development, can compensate for the absence of efficient rural financial services. Local lenders face covariant risks[41] and are reluctant to lend to the poor because of high transaction costs. Large formal lenders face lower covariance, but lack local knowledge. While such information problems have been addressed by many NGOs, these institutions reach only a small proportion of the rural poor. More will benefit if public, private and NGO providers cooperate in a seamless system of rural financial services provision."[42]

Senegal faces a similar challenge. One of the principal recommendations presented in the case study is to increase bank efficiency through partnerships with financial intermediaries. The experience in India is cited as an example to be emulated, whereby banks have lowered transaction costs of serving the poor by using financial intermediaries such as cooperatives or non-governmental organizations. This is a kind of wholesaling model. The commercial bank serves as an apex organization that lends to a non-bank financial intermediary, which in turn functions as a credit retailer by on-lending the funds to local microentrepreneurs, at a mark-up that should in principle but often does not cover finance costs, operational expenses, and loan losses.[43]

The EAGER/PSGE-sponsored state of the art survey reaches a similar conclusion: "It is essential to develop stronger linkages among sectors (informal finance; semi-formal approaches including NGO and donor programs, cooperatives, credit unions and others; and the formal financial sector). Each sector has its own relative strengths as well as weaknesses, but none can provide by itself the full range of services required for sustainable services to the poor and efficient

[40] Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 2, pp. 34-40.
[41] According to the authors of the South African study, the covariant risks are lending to the poor combined with concentration in a single-sector, agriculture.
[42] Vink et al, *South African Case Study*, p. 26.
[43] Ndour and Wane, *Intermédiation Financière & Pauvreté au Sénégal*, vol. 1, p. 51.

financial intermediation to transform idle funds to high-value uses. Thus any approach must be inclusive and pluralistic, rather than attempting to encompass all needs within a single organization or instrument."[44]

VI. CONCLUSION

A. Pitfalls

The pitfalls on the path to the development of financial intermediation for sub-Saharan Africa's poor are many: hostile policy and regulatory environments; discriminatory banking laws; inappropriate prudential norms and guidelines; interest rate ceilings and directed credit targets; fragmented services; dependency on subsidized, external resources; and inappropriate products and delivery systems.

The South African and Senegalese case studies present detailed accounts many of the mistakes that have already been made. They offer warnings about potential future missteps. The lessons offered are instructive, and might allow South Africa and Senegal to avoid the costly errors of others. Nonetheless, sound practices used elsewhere must be adapted to the specific market conditions of South Africa and Senegal. This requires experimentation, which is inevitably painful at times. The potential gains justify the pain.

B. Potential

Despite the above-noted pitfalls, the unmet effective demand of sub-Saharan Africa's poor for financial intermediation is enormous. The potential for the provision of savings, transfer, and credit facilities to low-income households and microenterprises is extremely promising. The market is both large and heterogeneous. It can accommodate, in fact it requires multiple approaches to the provision of microfinance services. The key to success is identifying the appropriate institutional model for each market niche.[45]

Pieces of microfinance service provision are already in place in sub-Saharan Africa. Efforts at funds mobilization have been especially successful, which is encouraging given that the demand for voluntary savings services consistently exceeds the effective demand for credit facilities by a ratio of 7:1.[46] There are also several encouraging initiatives, albeit local and very small scale, to develop appropriate credit products and delivery systems for microentrepreneurs.

The challenge is to build on this foundation and enhance the quantity and quality of financial intermediation for sub-Saharan Africa's poor. There is considerable scope for providing the poor with more and better choices, and letting them benefit from healthy competition for their business. This can best be achieved by helping the semi-formal microfinance organizations to

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[44] Nelson, *Financial Intermediation for the Poor*, pp. 42.

[45] For a detailed discussion of alternative microfinance models, see Jay K. Rosengard, *Doing Well by Doing Good: The Future of Microfinance via Regulated Financial Institutions*, Paper Presented at the III Inter-American Forum on Microenterprise, Barcelona, 17-20 October 2000.

[46] Nelson, *Financial Intermediation for the Poor*, pp. 42 – this is a common finding throughout the microfinance literature.

scale-up and graduate to regulated financial institutions, and by assisting commercial banks to scale-down and include microfinance in their portfolio of products and delivery systems.

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