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ZIMBABWE'S INFORMAL FINANCIAL SECTOR: AN OVERVIEW

by

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INTRODUCTION

Financial Institutions in most African countries fail to meet the credit needs of the rural poor, low income urban wage earners and those in the informal sectors. This is primarily because these institutions are designed to serve the middle and high income groups in both the urban and rural areas. In fact, in rural areas, financial institutions are physically almost non-existent.

In Zimbabwe, less than 10% of the smallholder farmers in communal areas have access to production credit, from the Agricultural Finance Corporation, the single largest public lending institution. Loans extended by the AFC are frequently inadequate. In 1984/85 109,146 applications for loans valued at \$216,926 were processed, after screening. The same corporation was only able to grant 96,708 or 89% of the requested number which was valued at \$104,755 or 76% of the requested amounts. The percentage shortfall in terms of the value of loans is clearly larger than that of the number of loans. These differentials seem to suggest that, either the corporation gave preference to request for smaller loans or it reduced the sizes of the requested loans. Whatever the situation was, demand for loans was way in excess of supply. Note that some applications did not reach head office because they were screened by fieldworkers.

Voluntary and church groups also extend agricultural production credit, but to a very limited extent. Most of them aim to provide

inputs that enable households to produce enough food for their own consumption. In other words, they only assist households to meet their subsistence requirements, but not for surplus production. Furthermore, they target their assistance towards specific favoured groups, such as those belonging to their church denomination.

Commercial banks and other financial institutions do not entertain any loan applications from smallholder farmers, who have no collateral, particularly since they do not even own the land they cultivate.

The situation is not very different for the urban low income wage earners and the majority of those in the informal sectors, i.e. vendors, market women/men, crafts sellers etc. They do not qualify for either production (investment) or even consumption credit extended by large department stores. These stores often demand evidence of income, such as pay slips. This requirement thus excludes most people in the informal sector.

Consumption credit, the only type available to some of the low income urban groups, is static rather than dynamic, since it does not increase the borrower's income or help him repay the loan when it becomes due. Formal financial markets, therefore do not help increase the earning power of low income urban dwellers.

The unresponsiveness of formal financial markets to the needs of the low income groups does not necessarily imply complete absence of financial mediation. It only means that people have to resort to alternatives.

Informal financial markets are a common feature of most third world countries. They complement formal markets by catering for clientele abandoned by formal financial institutions. Like formal markets, informal ones finance both consumer needs and productive investment. They thus have a very important role to play in third world economies.

This paper provides a descriptive analysis of the informal financial sector in Zimbabwe. It examines financial mobilisation and redistribution activities in the informal sectors of the urban and rural areas. The bulk of the data on the rural informal sector is based on research studies undertaken since 1981. The urban informal sector analysis is not based on any formal research work. It is based on informal discussions carried out with various individuals on an ad hoc basis. It proved very difficult to organise a formal survey in the short time within which this paper had to be produced. In addition, there is hardly any previous work done on informal finance in urban areas. This paper will thus present the scanty data that was drawn from the few available sources. It points to the need for research into urban informal finance which plays a very important role in the economy of

Zimbabwe in general and in the reproduction of labour in particular.

BACKGROUND: SAVING

This paper does not discuss the activities of rural savings clubs for the reason that there is already a detailed study available. It will thus suffice to point out that savings clubs are a key force in rural informal finance in Zimbabwe. They are grassroots organisations (predominantly women) which generate and save money primarily for investment in agricultural development. Although they are classified as informal financial institutions, they deposit their money in formal institutions and are therefore bound by the governing rules and regulations. Their informality is in their generation and mobilisation of finances i.e. how they organise themselves to jointly attain their goal.

The important factors to note are that savings clubs are small informal groups that do not hold a statutory position. They are autonomous, and therefore each one is designed to suit prevailing conditions. Members are in full control of their clubs. They are purely savings groups with no credit element in them. Each member only has access to her deposits.

Savings clubs are basically local initiatives which have sprung spontaneously throughout the country since the 1960s. Their total membership is currently close to a million.

For a long time, classical economics has assumed that the rural population has a very low marginal propensity to save. This assumption has been based on the inappropriate methods of computing national statistics. In recent years, this thinking has been changing, with evidence of mobilisation of rural savings by groups such as Rotation Savings and Credit Associations (ROSCAs) and savings clubs. In Zimbabwe, these groups have been in operation for a long time. ROSCAs preceded savings clubs. They have been present in both urban and rural areas in varying forms.

ROTATING SAVING AND CREDIT ASSOCIATIONS (ROSCAS)

Historically rural women, particularly those who received cash remittances from spouses in wage employment, have always participated in ROSCAs. Male labour outmigration left women with the responsibility of providing for their families. They had to ensure household food security, availability of school fees, uniforms, books and other cash requirements. Although most spouses remitted cash or household items, their contributions were not sufficient to meet all household requirements. Women had to develop coping strategies in pursuit of a better future for their offsprings. ROSCAs proved to be an important strategy for capital accumulation.

In rural areas, ROSCAs operated in a simple manner. A group of

people with something in common e.g. from the same village extended family church group or organisation, would get together and each agree to pay a certain amount every month, two months or whatever period was agreed. The pooled money would then be advanced to one member of the group as a lumpsum. This process was repeated for all members of the group.

When each member got the lumpsum money, they aspired to invest it in some productive or durable item. It was seen as an alternative for acquiring durables on hire purchase. Some of the most common types of investments were, tea or dinner services, wardrobes, cutlery sets, blankets, pots etc. Frequently, this money was used to purchase school uniforms, books and pay school fees for children. In some cases it was used to meet some of the day to day needs. Each individual invested their money in the best way they could. However, it was always desirable to invest in productive or durable items which they would normally not be able to purchase from their personal savings.

ROSCAS were a form of voluntary forced savings. They motivated members to generate more cash income so that they would not default on their contributions. Each member was forced to set aside the agreed amounts regardless of any other demands. Contractual saving appears to be the prime mover of these associations.

with respect to ROSCAS in rural areas, each member received what

she put in at the end of each rotation. There was no interest charged or paid, neither would she get anything over and above her total contribution in one rotation. The procedures for carrying out these transactions were simple. In the majority of cases, all members of a group would meet, pay in their contributions, which would in turn be paid out to the recipient. There were hardly any administrative costs incurred. In fact, the occasion was a social one and people would normally make the transactions over a home brewed drink, tea or snacks. They would also sing and dance for entertainment.

This is the pattern that is still followed by the majority of ROSCAs . Some have modified their operations to create scope for generating cash income from group activities. This is an important development which has strengthened the financial base in low-income sectors. It also contributes to the sustainability of this informal finance programme. A stable or regular in-flow of funds is essential for the sustainability of these schemes.

It is important to note that ROSCA funds rarely get deposited in formal institutions, except when the item that the recipient wishes to purchase is not readily available. In some cases, excess money after purchasing one's requirements may be saved but not necessarily with formal financial institutions. In fact, with respect to rural ROSCAs, which are predominantly women's schemes, dealings with banks or building societies are minimal . This is

partly because it is not general practice for women to operate personal bank accounts. A large number of them are now doing it through savings clubs. Some ROSCA members are also members of savings clubs.

Another partial explanation to the limited dealings between rural ROSCA members and formal financial institutions is the inaccessibility of these markets, both physical and non-physical. On the whole, ROSCA funds are normally meant to be spent and not saved. Thus in many cases, by the time a member's turn to get all the contributions comes, she will already have planned her purchases or even committed all her money.

ROSCAS in urban areas operate along similar lines. They are generally formed by groups of working people, who are either friends, relatives or colleagues at work. Unlike rural based ROSCAs, urban based ones do not always spend their money on some durable or capital item. They may do so sometimes but frequently they use some of the money to alleviate their cash flow problems and then save the balance. Cash needs, which include accommodation rentals, electricity bills, transport etc can sometimes be so pressing that ROSCA members end up allocating their payouts to some of these expenditures.

The important role of ROSCAs in urban areas is to stabilise cash flows which have a tendency of fluctuating

Informal Lending

Commercial informal lending is not very common in rural areas. The bulk of the informal lending that takes place is between relatives, friends and the local retailer and customers. This is not on a commercial basis because there is no interest charged neither are there any charges for late payment.

Transactions are based on mutual trust and confidence, since there is no collateral neither is there any legal obligation. Because there is nothing to protect the lender against defaulting, such transactions are often arranged between people that know each other very closely. Confidence in the borrower is the most important criterion for lending.

It is not unusual to find people repaying such cash loans in kind. They can either repay them with their own labour or use some of their agricultural produce. This often happens in situations where borrowers are having difficulty with their repayments. This arrangement is often arrived at through negotiations. In all these instances, there is no interest paid. In fact, non-commercial rural lenders lend at negative rates, since there are no time restrictions and inflation is not taken into account. The activity

is thus not an income earning one. As a result, lenders in this group do not make a special effort to mobilise finances or savings.

Smallholder farmers are generally said to be risk averse, so that they shun from borrowing on commercial markets. The uncertainty of future income levels forces them to accept current lower returns than risk the unknown. This point is supported by the correlation that is observed between reliability of income and tendency to use commercial credit in some parts of Zimbabwe's rural areas.¹ This relationship is however very difficult to substantiate because several factors determine demand for credit. These would include the availability or scarcity of credit funds and lending policies.

On the contrary commercial money lending is rife in the urban sector, particularly among the low and lower middle level income groups. These informal financial markets cater for the cash flow problems of groups which comprise of people in wage employment and in the informal sector.

A credit market is generally said to be informal if there are no facilities for mobilising funds and there are no formalised procedures for applying. For Zimbabwe, it is not entirely true that there are no facilities for mobilising funds in the informal

¹Preliminary results from research undertaken by the author.

credit market. An examination of Zimbabwe's informal credit markets brings to surface certain features which suggest that money that is used on the informal credit market is mobilised within the same market. This paper will discuss these features in as great a depth as is possible. We will first examine lending activities in the informal market before looking at the mobilisation of funds. Data on this issue is very scanty.

The informal financial sector is heterogeneous, reflecting the diversity in individuals involved. Income variance in the individuals partially explains the heterogeneity in the financial markets. This is a market where operators are individuals, flexibility, rapidity and ease of transactions are the order of the day. There are no regulations operating in these markets. The informal sector finances both consumer needs and productive investment.

The general assumption about the informal financial sector is that interest rates are considerably higher. Furthermore, demand is said to be inelastic to interest rates. Because of scarcity of financial resources, demand for loans is always way in excess of their supply. This is true of the bulk of urban informal financial markets. In Zimbabwe, these include those popularly known as Chimocho. In these markets, the lender takes a very high risk. Transactions may be between two individuals that do not know each other very well but have made contact through a third party. The

contact person provides the guarantee for repayment, although this is not legally binding. What is essential is that the intermediary be held in trust and confidence by the lender. Furthermore, this intermediary should possess persuasive tactics to ensure that in case of repayment problems he or she can persuade the borrower to honour his or her debt.

REPAYMENT

Methods of ensuring repayment vary widely depending on the size of loan, whether the borrower is in wage employment or is self-employed. When a lender experiences difficulties recovering her or his money from someone in wage employment, the easiest course of action is to take it up with the employer. On pay day, it is common for lenders to come to borrowers' work places and demand repayment. To avoid getting into trouble with the employer, by ensuring that the work place is orderly and there are no disruptions from outsiders, borrowers always try to settle their debts quietly. Some borrowers, however, try to avoid honouring their debts, even when the lender comes to the workplace to make his demands. In such cases, the lender ends up seeking assistance from the employer or supervisor.

So far the type of lender we have looked at is one who values peace and harmony and does not like violence. This is often common in dealings with lower middle income people, with an assured flow of income. The lender's risk in such a case is not very high because

there are a number of ways of ensuring repayment. On the other hand the risk is greater with the lower income groups and those in the informal sector. Sometimes lower income groups borrow considerably large sums of money which they are not able to repay under the agreed conditions. They then try to avoid repaying, to the extent of absenting themselves from work. In such cases, it is not unusual to find lenders organising gangs that pursue these borrowers and intimidate them into repaying. Sometimes violent tactics are used but often times, once the borrower is familiar with the recovery technics of these gangs, they avoid unnecessary confrontation. Fear of these gangs frequently forces borrowers to borrow some more in order to repay other debts. This creates a vicious circle.

Other ways of reducing the risk of defaulting is by confining lending activities to a group of people working in the same geographical area or for the same employer. Lenders would include some of the relatively senior employees, or those with other sources of income who can spare cash for the informal financial markets.

Because these people are constantly in contact with each other and people's images are very important in such communities, borrowers make a special effort to honour their debts. The rate at which violent tactics are used to recover loan funds are thus very low.

Informal financial markets in which risks are lowest are those which are managed through the employer. These operate along similar lines as ROSCAs except that, members of the group can withdraw or borrow amounts greater than their deposits. In this system, agreed stoporders are effected on members' salaries, and every month these deductions are made and funds deposited in financial institutions where they accrue interest. Individuals receive rotating payouts of agreed amounts. In addition, they can borrow amounts which exceed their total stoporders by an agreed percentage. For example, they may be allowed to borrow an additional \$40.00 for every \$100.00 they deposit. In other words with savings that have accumulated to \$100, one can secure access to credit worth up to \$40. However, one is expected to repay the \$40.00 with interest, within an agreed period. With this type of financial market, there are procedures and regulations. Despite these characteristics, these markets are classified as informal. This is partly because they operate illegally. Although one could argue that these markets operate in the interest of people who would otherwise not have any access to alternative sources of finance, their activities are still regarded as illegal because they are not covered by any statute. Their framework of operation is thus not officially well defined.

These schemes could easily be equated to credit unions and there is no reason why they should not be registered. Since they are not operating legally, it is not very clear what government's view

is on their being registered as credit unions. In fact, in most government circles, their existence has either been ignored or has gone unnoticed. Their illegal existence is not an issue that has been debated in public.

On the other hand, those people involved in such schemes have not expressed an interest in being registered as credit unions. The few who agreed to informal interviews indicated that they preferred to continue operating the way they were, because, it allowed them more control over their scheme. They were able to easily modify their operations to suit prevailing conditions. Flexibility is essential to this group because their low incomes place them in frequent financial crises which can only be dealt with effectively on an individual basis. Because their incomes can barely cover their subsistence, they do not want to be involved in a scheme with rigid rules, which do not take into account the special circumstances they are faced with.

Management, which assists in the operation of the schemes, sees some advantages. Firstly, companies can continue to pay their employees low wages, with little fear of unrest resulting from cash flow problems. They help mobilise surplus employee income to temporarily alleviate cash flow problems, creating a more stable and harmonious environment at work. It is the responsibility of the accounts departments to effect the stoporders, put them in separate accounts, keep records of stoporders, withdrawals and

interest accrued. Information on these transactions was very difficult to gather because people in management were reluctant to divulge anything on these activities which were regarded as illegal. Employees who benefitted from this scheme did not show any reservations in discussing it. In fact, it appeared that most of them did not realise that these operations did not have formal recognition or acceptance.

INTEREST RATES

Interest rates in informal markets vary widely. There is no standard set of factors that determine them. However, what emerged from the few informal interviews the author was able to conduct was that the ease with which the lender can recover her on his money is a very important factor. Secondly, the length of the repayment period is another determinant of interest rates. Another important factor, which probably influences interest rates indirectly is the time of the year i.e such events that occur in the course of the year as Christmas celebrations which demand increased expenditure.

In earlier discussion it was noted that some lending schemes involved higher risks than others. This is particularly true of those that involve individuals that do not have a prior relationship but get to know of each other through an intermediary. Some of these intermediaries are actually agents who inform the clientele of the available facilities. In such schemes, the recovery of loan funds sometimes brings in more individuals so that it imposes additional costs on the lender. When the lender gives

gangs to intimidate borrowers into repaying their loans, she or he has to pay these members of his gang. In the process of chasing after her/his clients, he or she sometimes incurs transport costs. Such costs, which can be equated to administrative ones, have to be met by the lender from interest collected. Where repayment problems are anticipated, interest rates are often pegged at relatively high levels.

In majority of cases, the repayment period is set at one month. The usual arrangements are that people borrow to meet immediate financial obligations, with the intention of repaying on receipt of their wages, at the end of the month. In one scheme, run by a woman who services over forty clients, the interest rate is normally 50% if the borrower repays within the agreed month. If the borrower is not able to honour the debt within the agreed period and extends it to two months, the interest rate doubles. It can triple or quadruple depending on how long it takes to repay. Note that these stringent rules are frequently applied to clients that are not regular and on new ones. This supports the view that confidence in a client is an important driving force in informal financial markets.

In schemes that involve people who know each other well and probably are work mates or have regular contact, interest rates are relatively lower and sometimes fixed, regardless of the length of the repayment period.

Renegotiations are quite common and sometimes lenders make special concessions to certain individuals. However, most people do not like to be given special concessions because they affect future borrowing adversely. Lenders are often reluctant to lend to such clients and often avoid future dealings with them. This factor partly explains the high rate of repayment among this group.

There are periods of the year when interest rates are generally higher because of high levels of defaults recorded. During the period of December to February, most people experience cash flow problems. The level of expenditure at Christmas is always higher than most people can afford. Following Christmas, in mid January most parents have to pay school fees, buy uniforms and books. By mid January, the majority of households are experiencing serious cash-flow problems and they have to resort to credit, for basic needs such as food. Repayment of such loans is normally at the end of January and February.

Money lenders are aware of the high demand for credit during this period. They therefore, behave like rational business people and raise the price of their commodity in response to the increased demand. In addition, the risk involved at this time is greater because most clients are not able to completely recover from these cash-flow problems until about April. There is thus a tendency for them to keep postponing their repayments. For those lenders who have to pay other people to ensure recovery, their costs are

higher, and they thus have to raise the price of their commodity to ensure that they meet all costs including their profits.

In the few interviews conducted, money lenders could not say exactly what their rates of interest are. What seems to emerge was that there were differential rates for the different types of clients. The longer established regular and more dependable clients tended to pay relatively lower interest rates than those who did not borrow on a regular basis and the new clients.

The price of money in urban informal markets generally reflects its opportunity cost to the lender. In urban situations, where there are many other uses to which it could be put profitably, it is logical to assume that when lenders decide on their interest rates, they take account of the alternative uses. Similarly borrowers are also aware of the alternative opportunities available to the lender. That is partly why they accept the price.

The informal sector offers other options for those who cannot be accommodated by the formal sector. A very large proportion of urban women are engaged in "informal" economic activities. A lot of unemployed men are also absorbed by the informal sector. Within this sector, there is a diversity of economic opportunities for both those already absorbed in wage employment plus those outside the formal sector. This is not to suggest that all the surplus labour is absorbed. There are still high rates of real

unemployment in Zimbabwe's urban areas. The informal sector frequently sustains the unemployed in a variety of ways, since welfare services are limited.

SOURCES OF FUNDS IN INFORMAL FINANCIAL MARKETS

As stated earlier, operators in the informal financial sector are generally individuals. This applies to both borrowers and lenders. The bulk of the funds are also generated within this sector by the same individuals. In order to fully understand and appreciate the operations of informal financial markets, it is imperative to have a full grasp of the sources of funds or how surplus, that is made available to borrowers is mobilised.

This paper cannot claim to provide adequate coverage of the sources of funds and how surpluses are generated. This is an area that requires rigorous research, as there is hardly any information documented and some of the operators in these markets are reluctant to divulge information.

This paper is therefore only able to provide a rough picture of the set up.

In urban informal financial markets, lenders are diverse in their

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backgrounds and the economic activities they engage in. Generally, lenders are involved in the informal sector or in the formal business sector. They are people engaged in activities which have a regular in flow of cash and not a periodic one like wage-earners. Lenders' economic activities often provide them with cash at times when wage earners are experiencing cash problems. Such lenders include marketeers, people involved in the sale of crafts, smiths, self-employed mechanics, beer sales (popularly known as shapeens) etc. A point of interest. Credit funds used on the purchase of beer and cigarettes represent quite a large proportion of the total loan funds circulating in the informal financial sector.

The majority of money lenders in the informal markets do not own large sums of money. What is more important is that they have money at the right time, i.e when everybody else is having cash-flow problems. This is why there are very few wage employees involved in money lending.

Note that some wage earners who are actually paid on a monthly basis are big money lenders. One common feature among them is that in addition to their regular jobs, they are also engaged in income earning activities in the informal sector. They thus have a supplementary income which comes on a regular basis.

Another type of lender is that who is also involved in ROSCAs. This is however, a very small proportion but of some interest and

relevance. Although they lend on a very small scale, they have the potential to expand.

Members of ROSCA's are periodic money lenders. Those concerned normally lend out during periods of their payout. Instead of using their lumpsum for the purchase of capital or any other items, they lend it out so that it can generate more money. Interest earned is either used in the same manner as other ROSCA funds or is again lent out. In this case, participating in ROSCA's provides an opportunity for individuals to mobilise funds for informal credit schemes. This is contrary to the popular view that informal markets do not have facilities to mobilise funds. Because the informal markets generate their own funds, both credit and savings markets are inter-linked. The credit aspect of one party is the reciprocal of the other. Mobilisation of funds is thus part and parcel of processes operating within the informal financial markets. It appears that the conclusion that informal markets do not mobilise funds was reached in the absence of a sound database.

From the little evidence found in Zimbabwe's informal sector, existing informal financial markets act as intermediaries for mobilising funds. This is a characteristics that explains their sustainability.

SUMMARY AND CONCLUSION

This paper has attempted to give an overview of Zimbabwe's informal financial sector. It has examined both the rural and urban markets. Although they are markets that both cater for the lower income groups, they each display different characteristics. Rural informal markets tend to operate on a non commercial basis. Money lenders lend to friends and relatives at zero or negative interest rates. A verbal promise is frequently accepted as collateral. Confidence, trust and mutuality are the bases on which the lending and borrowing relationships are established. A persons image or reputation is very important.

ROSCAs involve friends, relatives and people in regular contact. In fact, kinship networks find expression in them. Contractual saving is the prime mover of these associations.

One of the major differences between urban and rural informal financial markets is that urban markets are generally highly commercialised, except with groups such as ROSCAs and savings clubs. Money lenders charge relatively high interests and are often strict with their recovery techniques.

They generate surplus funds which they redistribute in their communities in the form of credit. The bulk of these surplus funds are mobilised from the informal sector. Financial self-reliance

in this sector is at a high level and it has been to a large extent responsible for the sustainability of the system. Any attempt at improving the efficiency of the operation of these markets should start with or pay more attention to the generation and mobilisation of funds. Such an attempt should however, ensure that the flexibility and informality which characterise these markets are maintained so that they can respond to the needs and circumstances of the poor. Numerous informal financial systems have been sustainable because operators have more control over them; there are no rigidities in operations; people involved are familiar with each others conditions so that they make facilities available at the right time and within the shortest time possible. Being able to respond expressly to the pressing needs of the poor is key to the success of informal finance. The informal financial sector can be supported and made more efficient by the formal sector only if the above factors are taken into consideration.