FINANCIAL INTERMEDIATION FOR THE POOR

SOUTH AFRICAN CASE STUDY

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CHAPTER 1

INTRODUCTION

1.1 Origin and purpose of the study

The popularity of 'micro-finance' as a subject has led to a flurry of activity and the development of a professional literature on financial services for the poor. Little of this research has, however, focused on the African case, or on transferring lessons from Asia or Latin America to the African setting. In the absence of region-specific information, bankers and policy makers in Africa base programs and policies on hope rather than knowledge. While handbooks such as the UNDP's 'Microstart' guides are becoming available, it is unclear how much their content and approach are supported by practice encountered in Africa, and how much are false generalisations based on misunderstanding of the *mechanisms* by which essential features of financial services for the poor are working. Moreover, the field is rapidly shifting from a focus on credit services to full financial intermediation, about which little is known for any region. This evolution requires new research into how to build cost-recovering full-service financial institutions that serve this market, how to design the appropriate regulatory regimes, and how to manage a much greater level of financial risk

This report forms part of a wider research project on 'Financial intermediation for the poor' undertaken as part of the EAGER/PSG (Equity and Growth through Economic Research in Africa: Public Strategies for Growth) initiative. The purpose of the project is to explore ways to develop self-sustaining and widespread financial service systems for the poor, and particularly the rural poor, in Africa. This directly addresses a priority research area in several countries participating in the EAGER project. The first step in the project was a comprehensive literature review to identify cases of full financial intermediation in Asia, Latin America, and Africa, and to synthesise lessons learned and hypotheses generated *which are applicable to Africa*, with recommendations how to apply them.

The report on the international experience will be supplemented by a report on fieldwork conducted in Senegal and South Africa, which seeks to provide insights into institutional options and requirements for building financial systems serving the poor, particularly in rural areas. Special focus will be given to policy and regulatory conditions that help or hinder development of a sustainable financial system. In addition, practical examples of financial products and risk management techniques which have been effective will be published separately as an aid to financial institutions interested in reaching a poor and rural client base.

The study will, therefore, eventually consist of three volumes: a State of the Art Paper concerning practices world-wide,[1] and two thematic volumes— one on institution-building, policy and regulation, and one on financial analyses of specific products and portfolio management techniques for reaching poor and dispersed populations in African settings. These will be firmly based on the country studies. Policy influence of the research depends on a strong dissemination of results. The papers will be presented for critical debate at a regional workshop for policy makers, practitioners, donors, and academics from countries participating in the EAGER project. The recommendations will include 'next steps' for design and implementation of such institutions and policies.

The South African case study, which will eventually be synthesised in the second volume together with that of Senegal, is presented here.

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[1]This volume was presented at the EAGER Workshop in ~~December~~ July 1996 and is not a formal part of this presentation.

1.2 The target population

The social cost of any intervention that aims to bring benefits to a section of a population consists of the costs of administration, the leakage of benefits to those not targeted by the programme, and the costs flowing from the changes in incentives facing both these groups. For example, a programme that aims to bring access to financial services to a well-defined target population will have higher costs of administration than a more loosely defined programme, and it will create incentive problems, especially for those groups who narrowly miss definition as part of the target population. On the other hand, there will be less leakage of benefits to the non-targeted population. Therefore, it is necessary to, at least conceptually, subject all such interventions to a benefit-cost analysis to find the appropriate balance. Simultaneously, it is necessary to subject all possible intervention agencies to a benefit-cost analysis to counter any bias in favour of intervention by the state.

The 'state of the art' paper that began this study identified the financial needs of the poor, based on international experience. These findings are corroborated by the South African experience, as will become evident in Chapter 2 below. Broadly stated, these needs are (Nelson, p. 5):

- ...regular access to adequate food. After food security, improved living standards, income generation and growth require the accumulation of productive assets, including 'human capital' in the form of health, education and training. Access ... to services is governed by income and by purchasing power, which includes the ability to shift income in time (from periods of income generation to periods of penury) and space (from migrants in urban areas or abroad to rural households) as part of a coping strategy. The ability of a household to cope ... depends upon, *in order of importance to the poor themselves*:

    - income generation, which for marginalised households and individuals depends in turn upon diversification of revenue sources;
    - savings and dissavings from that income, whether in cash or in kind;
    - transfers; and (as a last resort)
    - borrowing.

- The poorest of poor households ... may draw on diversified sources of revenue including transfers and dissaving (including selling off assets). Increasing household debt (the obverse side of the coin called 'credit') is a revenue option, but one not taken lightly by a household confronted by adversity, even when donor programs have attempted to lighten the repayment terms for that debt. Indeed, one of the major lessons of the past is that credit programmes have not addressed the needs of the poor, particularly the poorest of the poor. Improved financial intermediation involves providing instruments for stabilising the household's consumption with the least damage to its wealth and income. Constructive coping strategies including emigration, diversification of income sources, or pooling capital with others to start microenterprises. Destructive strategies include undertaking poorly paid off-farm labour out of desperation, charcoal production from gathered wood, skipping meals or less nutritious foods, cultivating marginal lands, emergency borrowing for non-productive purposes at high interest rates, prostitution, and sending children to beg rather than to school. Access to remittances may be key to raising the poorest households above the poverty line (World Bank, 1995). This financial framework is much broader than the concept of productive credit which led many donor activities in the past, which stressed income generation (and sometimes diversification) and borrowing, but which ignored savings and transfers.

This emphasis on liquidity is important. Access to liquidity prevents a setback from becoming a catastrophe either in terms of productive assets or in basic nutrition; the obverse of the coin is that it permits individuals and households to benefit from unforeseen opportunities to engage in profitable activities. The accumulation of such activities (or the avoidance of such catastrophes) leads to asset accumulation which permit productive investment and which provide the collateral for acquiring debt for productive purposes. As is well known from the literature on credit impact, finance is not a productive asset, it facilitates production and investment. Thus, the provision of financial services to the poor is not a growth strategy, it supports such a strategy and the efforts of the poor themselves.

This study concentrates on the institutions (in the economic and social sense, not the bricks and mortar type) which function already to resist the mechanism(s) that worsen poverty and to strengthen the mechanism(s) that support nutrition, consumption smoothing and accumulation of productive assets. While many of these institutions exist for all social and economic classes, higher-income individuals and households have greater access to formal financial services, and this study will not deal with these except as they have an effect on the provision of access to financial services to poorer members of society. In examining the specific African country experiences, the research explores the importance of particular types of constraints, whether macroeconomic, regulatory, or institutional. While based on specific cases, the exercise will yield a checklist of issues for researchers and policy makers in other countries to use in developing a strategy to provide full financial intermediation for the poor.

1.3 The case of South Africa

Studies in comparative history[2] of this nature have to take into account the vagaries of each of the countries under consideration. In this sense there are at least two issues that need to be examined in some detail in order to provide context to the South African case. These relate to the geographic and demographic identification of the target clientele of a study of this nature; and to the peculiar institutional arrangements that exist to serve the needs of this clientele, and upon which any proposals will have to build.

First, in section 1 of Chapter 2 an attempt is made to define those people who do not at present have continuous and affordable access to the full array of services provided by the financial markets in South Africa, other than through intermittent transactions that link 'informal' and formal markets. This analysis points to a number of anomalies that exist, especially related to the weakness of the data base. More specifically, a review of all relevant sources of data and an examination of classification systems in use to identify the urban and rural distribution of the South African population shows that each source relied on the definitions of Central Statistical Services (CSS) for their basic classification. Until recently, however, CSS only made a simple distinction between urban and non-urban people as the base classification of the population.

The difference between 'urban' and 'non-urban' is whether an enumerated household lives within a formally declared township or not. This means that large numbers of people living in 'urban' conditions are defined as non-urban, such as many of those in the greater Durban metropolitan area that are the subject of one of the case studies in Chapter 3. In formal terms many of these people occupy land that falls under the jurisdiction of a traditional authority, i.e. it is tribally owned land. On the other hand, if these case studies had been replicated among people who are living in similar circumstances in the Gauteng or Western Cape provinces, they would in all likelihood have been classified as 'urban' purely because much of the land that they occupy happens to have been proclaimed as formal townships.

This difficulty is compounded by the situation in the former homeland areas. Some 47% of the population live in these areas, which make up some 14% of the surface area of the country. Yet official data show that only 3 of 104 magisterial districts are classified as 'urban', while more informed estimates, such as that of Graaff (1987)[3] show that, by the mid-1980s, at least 50% of the population lived in areas that are functionally urbanised.

The result is that any study of this nature will tend towards a rural bias if these official definitions of population categories are used. The reader is, therefore, cautioned to allow some flexibility in attempting to understand the particular plight of South Africa's poor and marginalised population.

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[2] To use the phrase in the sense proposed by Johnston (e.g. 1995?)

Second, any scholar of South Africa's modern history will recognise that the provision of financial services to the poor is similar to most other developmental problems that confront the state. Here, as elsewhere, the main problem that has to be addressed is the possibility of delivery in the presence of unsustainable institutions. These institutions, whether formal or informal, and whether public, private or non-governmental, are a product of the apartheid past. Any recommendations for remedial action have to take this factor into account. This problem of unsustainable institutions is prevalent along at least three dimensions of the development problem:

- There is ample evidence that financial markets operate through informal institutions in bringing a wide range of financial services to especially poor people in South Africa. The numerous case studies of such informal arrangements presented in Chapter 3 below add to the available evidence in this regard. However, past policies have a major impact on who uses these markets, and under what circumstances. They also determine the nature of links between formal and informal financial institutions. Further, while such informal arrangements may meet the immediate needs of the poor, they do not of themselves constitute a development strategy. The poor need access to other support services, and in terms of access to financial markets, the poor need more choices.

- The evidence presented in Chapter 2 below will show that most formal financial institutions in South Africa that try and provide banking services to the poor are unsuitable vehicles for this purpose. In summary, state and parastatal institutions are perpetually subsidy-dependent, private sector institutions 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.

- One of the main reasons for the institutional weakness of state and parastatal institutions described above is the dual bias in existing institutions towards lending to agriculture. International experience has shown that this bias weakens financial institutions in two ways. Lending to the poor creates problems of moral hazard, and a single-sector strategy creates problems of covariant risk. The case study on the agricultural banks in the Eastern Cape shows up the weakness of this strategy, and the kind of remedial actions that are being taken. As was noted, the private sector has only recently tried to devise mechanisms to circumvent these problems (one such attempt is included as the case study of the NewFarmers Company in Chapter 3), while NGOs have yet to prove that they can deliver at scale without repeating the mistakes of their counterparts in the public and private sector (this issue is also raised in the case study on the Village Banks in Chapter 3).

Finally, this report has drawn strongly on the analysis and conclusions of the Strauss Commission[4], as stated in the Terms of Reference for the study. This has the advantage of drawing on the most recent comprehensive analysis available, yet the disadvantage of inheriting some of the biases in that investigation. For this purpose, the case studies presented in Chapter 3 have been chosen in an attempt to address the bias towards the rural and agricultural activities of parastatal institutions. While two of the case studies have an agricultural background, there is also an analysis of private sector involvement, of the problems of a largely urban and peri-urban population, of the provision of other services such as transmission and savings instruments, and of the use of alternative lending technologies such as group approaches.

1.4 Study outline

The purpose of this introductory chapter has been to explain the origins and goals of the study, and to provide a perspective on the research that was undertaken, as well as the context within which the report has been set. In Chapter 2, the analyses that were used in the Strauss Commission report are summarised to provide some guidelines as to who 'the poor' in South Africa are, and what they need from the financial services sector. This is followed by a description of the major policy initiatives that are being undertaken by the present

[4] The *Commission of Inquiry into the Provision of Rural Financial Services,* appointed in 1995, produced an Interim Report (March) and a Final Report (September), whose recommendations were substantially accepted by the

government, with a focus on the effect on financial markets and on the way in which poor people engage in these markets.

Four case studies of this kind of interaction between the poor and the financial markets are presented in Chapter 3. These include cases taken from the initiatives of the parastatal, private and NGO sectors, as well as from informal financial markets. An attempt has been made to balance these cases studies with respect to geography, sector focus, clientele and financial instruments. Thus, while two of the case studies are on institutions that have focused exclusively on agriculture in the past, they also raise issues of alternative collateral instruments, of the possibility of using savings mobilisation, and of the use of venture capital as an alternative source of funding for the capital requirements of a land reform programme. The other cases cover the needs of people who are no longer as strongly tied to the rural economy, as well as the ways in which linkages can be forged between formal and informal institutions.

In Chapter 4 the legal and regulatory environment is described, with a focus on the ways in which it debilitates access by the poor to financial markets, whether formal or informal. In the South African circumstances, it is clear that any recommendations that aim to create the preconditions for successful banking for the poor will be dependent on legal and regulatory reform. This conclusion was reached by the Strauss Commission, and these legal and institutional disabilities remain as the major cause of weakness in existing institutions.

CHAPTER 2

THE PROVISION OF FINANCIAL SERVICES TO THE POOR IN SOUTH AFRICA

The purpose of this chapter is to describe:

- The results of research on the need for financial services among the poor in South Africa;
- The institutions that are currently providing financial services to poor people;
- The policy environment for rural finance in South Africa.

The focus of the Chapter is on the needs of rural people, in keeping with the terms of reference of the study, and in terms of the analysis that was done for the Strauss Commission. However, the discussion in the first section highlights the dangers of watertight distinctions between urban and rural in South Africa. The urban and rural economies are closely interlinked through a wide variety of institutional, sectoral, factor market and personal links. Therefore, what is said about the needs of the poor is often as relevant to the needs of the urban as it is the rural poor. However, the bias in this chapter is most evident in the analysis of the formal institutions involved. While the Strauss Commission covered all rural institutions, and not only those who serve agriculture, a discussion of the many institutions that have been created to meet the needs of the urban and peri-urban poor, i.e. in the small business, housing finance and personal services markets is missing from this report.

2.1 The need for financial services

2.1.1 The distribution of South Africa's population

Estimate of size

The weakness of the existing data base in South Africa makes it impossible to identify where people live in South Africa, or much about who they are and what they do. However, the Strauss Commission attempted to find a measure that allows at least a slightly improved classification of the distribution of the population, based on magisterial district data[5]. The following stratification system was adopted:

- **Urban vs. non-urban.** The primary disaggregation is the distinction between urban and non-urban households as used by CSS. A district was considered non-urban if more than 20% of its population was so classified in the 1991 Census. This arbitrary criterion matched relatively well those districts with a significant rural character. Only three former homeland districts were identified as urban.

- **Former homelands and non-homeland areas.** The former homeland areas are economically and socially distinct for obvious historical reasons, and are, therefore, identified separately. Three further districts of the 104 in the former homelands were reclassified as urban because they are contiguous to a large metropolitan area.

- **Significance of agriculture.** Districts in which agriculture constituted an important part of the economy were also identified separately. The average of agricultural gross geographical product (GGP) as a percentage of district GGP and agricultural employment as a percentage of the economically active labour force was converted into a composite index to allow for the agricultural variability that characterises the different regions. A district was considered to have an important agricultural sector if the value of the indicator exceeded 20%. This second level of stratification was applied only to districts classified as non-urban, non-homeland. Of the 213 districts in that group, 169 were found to have significant agricultural sectors.

- **'Deep rural areas'.** A further breakdown was made in an attempt to define more closely those areas of the country that are not well served by physical and social infrastructure. The criterion used was proximity to either a metropolitan area, the capitals of the new Provinces, or the capitals of the former homelands.

Table 1 reproduces the familiar and unhelpful near-50% split between the 'rural' and 'urban' population in South Africa. The following observations can be made. **First,** the potential number of people currently involved in commercial agriculture and other rural business enterprises as entrepreneurs and workers can be no larger than the sum, adjusted for age, of:

- **'Urban agriculture'[6].** The (relatively small) number of people classified as 'non-urban' living in 'urban, non-homeland' areas (category 1 in Table 1). When districts contiguous to the metropoles and provincial capitals are included, the potential size of the group increases by more than threefold, as can be seen in columns 3 and 4 of category 1.

- **Commercial farming.** Those classified as 'non-urban, non-homeland' and living in districts where agriculture is important (category 2.1), largely commercial farmers and farm workers. Many of these people live contiguous to the metropoles and provincial capitals. The commercial farming category also includes an unknown (small) fraction of the 'non-urban' population in category 2.2.

Second, it is not possible to estimate the total population that could potentially be served by rural financial institutions which are accessible to all rural people. The detailed analysis by magisterial district shows however that 45% of South Africa's population lives in districts where more than half of the population is classified as 'non-urban'. This probably represents the upper limit of the potential clientele of rural financial services institutions, adjusted for age.

Third, it is even more difficult to estimate the divide between what could be termed 'deep rural areas' and the rest of the country. This classification would allow an estimation of the extent of the population that has no access to rural financial services principally because of a lack of access to physical infrastructure. This would include at least:

- A (small) part of category 2.1 and a likely smaller part of category 2.2, both excluding those districts that are contiguous to the metropoles and provincial capitals; and

- A large part of category 3.2. When this category is adjusted for districts contiguous to metropoles and provincial capitals that fall within the former homelands, as well as those districts that are contiguous to the former homeland capitals, the potential size of this population declines substantially (from 15,4 million to 10,5 million).

The potentially 'deep rural' population is, therefore, approximately 25% to 30% of the total population of South Africa.

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[6] ... [illegible] ...lities as defined prior to 1 November 1995

Table 1: Distribution of South Africa's urban and non-urban population, 1991[7]

	By Magisterial District (CSS Definition)		Adjusted for Areas Contiguous to Metropoles, Former Homeland Capitals and Provincial Capitals	
Category	Number[1]	%[1]	Number[2]	%[2]
I. Non-homeland population				
1. Urban				
Number of districts	56	15,01	89	23,86
Non-urban population	477383	2,39	1448993	7,19
Urban population	12167397	63,49	13251268	69,14
Total	12644780	32,17	14700261	37,39
2. Non-urban				
Number of districts	213	57,10	180	48,26
Non-urban population	4104204	20,37	3132594	15,55
Urban population	8291140	21,09	6235659	15,86
2.1 Districts in which agriculture is important				
Number of districts	169	45,31	146	39,14
Non-urban population	2712233	13,46	2038390	10,12
Urban population	1987069	10,37	1573312	8,21
Total	4699302	11,95	3611702	9,19
2.2 Districts in which agriculture is unimportant				
Number of districts	44	11,80	34	9,12
Non-urban population	1391971	6,91	1094204	5,43
Urban population	2199867	11,48	1529753	7,98
Total	3591838	9,14	2623957	6,67
II. Former homeland population				
3.1 Urban				
Number of districts	3	0,80	29	7,77
Non-urban population	148438	0,74	5004819	24,84
Urban population	1032117	5,39	2072551	10,81
Total	1180555	3,00	7077370	18,00
3.2 Non-urban				
Number of districts	101	27,08	75	20,11
Non-urban population	15416694	76,52	10560313	52,42
Urban population	1778195	9,28	737761	3,85
Total	17194889	43,74	11298074	28,74
4. Total				
Number of districts	373	100,00	373	100,00
Non-urban population	20146719	100,00	20146719	100,00
Urban population	19164645	100,00	19164645	100,00
Total	39311364	100,00	39311364	100,00

Notes: [1] For example, there are 56 magisterial districts (or 15,01%) in the 'non-homeland' urban areas of South Africa. Here 2,39% (or 477383 people) live in 'non-urban', non-homeland areas, as defined by CSS.
[2] The population in the various categories is adjusted for areas contiguous to metropoles, former homeland capitals and provincial capitals, i.e. the CSS definitions are redefined.
Source: DBSA data files

Migration trends

The research of the Commission showed up a number of 'new' demographic trends among the South African population whose implications are far-reaching. There is every expectation that these will become more dominant in the future, and that they could even counter the effects of circulatory migration. The most

[7] Readers should note that the initial estimate of the total population of South Africa, based on the 1996 census, is in the order of 39,7 million, leading to the conclusion that the 1991 total used here represents a significant over-count of approximately 10%.

important of these are a) the reverse flow of remittances, b) the higher relative economic and population growth in secondary and smaller towns in South Africa, and c) the tendency for settlement near to transport and service nodes.

On the first point, the international literature shows that most studies of remittances look at gross and not net remittances. Poor rural people often spend large amounts to finance job-seeking by the able-bodied, and the source of these funds is often remittances. It takes the form of providing a livelihood in the rural area until enough has been accumulated for the person to take the risk of going to look for a job. That person provides labour services in the rural area during this period, and is often confronted with the real possibility of having to stay there for an extended period. So urban/rural links are strong, but may imply the need for more investment in job creation in rural areas rather than in urban/peri-urban areas.

On the second point, it is important to identify the source of economic growth in non-metropolitan 'urban' areas. Empirically, this is often the result of government spending (essentially civil service wages and salaries in the former homelands). Whether this will continue, and in the same location, is of course determined by the new Constitution. While some places (e.g. Lebowakgomo) are no longer 'capitals', most will remain at least important subregional centres (Thohoyandou, Umtata), so these relatively prosperous economic bases could still fulfil that role in the future. In addition, there are many other settlements that have prospered for other, more sustainable reasons, such as tourism, farming, large investments in industry or infrastructure, etc. While some of these places are rapidly becoming part of the 'formal' urban landscape of South Africa, they also attract the rural poor, both as migrants and as potential job-seekers and entrepreneurs, and it is not clear that the financial service needs of, for example, prospective farmers supplying these markets will be attended to without focused support.

The third point is much the same as the second, although these areas are more often found in the more remote rural parts of the country, thereby creating an even larger need for focused support to rural dwellers.

Rural poverty

Rural people manage risk by diversifying their sources of income, and by minimising 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. Most rural people in South Africa will remain poor, at least relative to the rest of the country's population, for some time. However, most rural people save and invest, some borrow and all require access to services such as money transmission. Their biggest problem is access to appropriate savings and lending institutions and instruments that are tailored to their liquidity needs. Rural financial services need to expand flexibly, because the rural poor often pursue survival strategies to diversify sources of earnings from both rural and urban areas. This points to the importance of transmission instruments and therefore to sustainable, accessible and operationally flexible rural financial institutions.

The use of remittances by the rural poor is diverse. 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. A dynamic rural economy, where comprehensive support is given to a wide range of rural enterprises, will be more successful at adding value and creating jobs. Rural development is more successful when the efficient delivery of financial services (including savings instruments) to a broad range of rural people is pursued. Furthermore, given the high covariant risk associated with agriculture, non-agriculture activities could mitigate such risk. Rural finance intermediaries have often become more balanced and less risky enterprises in this way. Comprehensive rural support strategies are, therefore, required rather than single sector strategies.

2.1.2 The use of financial services

The Commission was able to analyse the use of loan financing by rural people in South Africa using data from the Living Standards Survey[8]. These data do not describe the use of other financial services, yet show the following summary characteristics of debt for the rural population in South Africa:

- **Rural households have disproportionately few loans.** 43% of all debt outstanding was owed by rural households, even though 50% of households were classified as such. 57% of rural households are without debt, compared to 45% of urban households.

- **Rural households have disproportionately small debts.** The average loan of a rural households was R4 249, compared to R32 299 for urban households. Although rural households controlled 25% of household expenditure in South Africa and represented 43% of the number of households, they owed only 9% of the outstanding debt.

- **Most of the loans to rural households are mortgage bonds (i.e. secured by property), but very few households incur this debt.** 61% of the amount of debt owed by rural households is for bonds. The average amount of debt (R87 156) exceeds that of urban households with bonds (R66 569). These loans, however, are outstanding from only 3% of the rural households with debt, compared to 45% for urban households. Because large debts carry large repayment schedules and thus require large, regular incomes, this suggests that most debt in rural areas is owed by relatively wealthy households, probably commercial farmers. Loans to affluent farming households may also explain the larger average amount of debt from government and NGOs in rural areas compared to urban areas.

- **Many rural households use hire purchase agreements and loans from shopkeepers.** Hire purchase agreements or debt with shopkeepers accounted for 73% of the number of loans incurred by rural households and for 22% of the amount of debt, compared to 39% and 4% respectively for urban households. The amount of debt owed by rural households to these sources is roughly half that owed by urban households to the same sources. Thus while large numbers of rural households have hire purchase agreements and loans from shopkeepers, the amount of such debt is disproportionately small.

- **Informal lenders are important sources of credit in rural areas.** About 22% of the rural households with debt have their largest obligations to informal lenders. Although these loans account for 6% of the amount of debt in rural areas, they account for less than 1% of debt in the country as a whole. In addition, these lenders account for only about 3% of the number of debts in the country as a whole.

The largest sources of debt for black households were as follows:

- **Relatively few black rural households had debt.** Black households hold 95% of all loans in rural areas. However, only 42% of black rural households had debt, compared to 56% for other rural households.

- **Black rural households had relatively small loans.** Black rural households owe 30% of the outstanding debt of all rural households, while controlling 87% of household expenditure in these areas. The average debt for those who borrowed was R1 320, compared to R63 301 for other rural households. The average debt outstanding for other rural households exceeds that of black rural households for all sources of loans except for informal loans. For example, even though shopkeeper debt has a similar incidence across race groups, the average amount owed for other groups (R3 748) is more than nine times the average amount owed by blacks. Likewise, debt for hire purchase is even more common among other rural households than among black rural households, and the average amount owed by them (R11 498) is much larger than the amount owed by black households (R1 776).

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[8] The Living Standards Survey was undertaken by the Project for Statistics on Living Standards and Development at the University of Cape Town between August and December 1993. The coverage of poor rural households in this survey was, unfortunately, rather limited.

- **Housing bonds are held unequally by black and other rural households.** 2% of indebted black rural households borrowed in this form, which account for 30% of the outstanding debt in this group. By contrast, 31% of other rural households owed money on bonds, which accounted for 72% of the total debt of this group. The average black rural housing bond is R25 208, roughly one sixth of the average for other households.

- **For black rural households, hire purchase is the most important source of credit.** Hire purchase agreements accounted for 31% of all loans to black rural households and 42% of their outstanding debt. Shopkeepers, the other important source of debt for this group, accounted for 43% of the number of loans and 14% of the outstanding debt.

The above analyses were repeated by location, race and gender.

- **Black rural households with a female head have somewhat smaller but not fewer loans.** Households with a woman head constituted 29% of black rural households. These households accounted for 28% of all households with debt, and they owed 20% of the outstanding debt. 39% of these households had debt, compared to 43% of households with a male head. Female-headed households control 26% of the expenditure of black rural households. This pattern may be not be due to different sources of loans between households with a male or female head. Although 90% of loans owed by black female-headed rural households are from shopkeepers, hire purchase agreements, or family or friends, the same is true for black male-headed rural households. The differences in rural areas are due to male-headed households having larger debts.

- **Bonds are not the most important source of credit for black rural households with a female head.** The amount owed on bonds by them (2% of these households with debt) averaged only R12 486. More had debt from informal sources, shopkeepers, family or friends and through hire purchase than under housing bonds. Hire purchase agreements represent a larger portion of the amount of debt (44%) than bonds (24%), and shopkeeper and family and friends combined (29%) also exceed bonds in amount.

- **Bonds are not the most important source of credit for black rural households with a male head.** The amount owed on bonds by these households averaged R31 952. All sources of debt, excluding loans from government or NGOs, are more common than bonds, and hire purchase agreements represent a larger proportion of their outstanding debt. While they have larger bonds than female-headed rural households, they do not use bonds more frequently. This suggests that bonds are uncommon among these households because of their race and location of residence, not because of the sex of the household head.

Household debt, expenditure, pensions, and remittances were also classified by race and location of residence. The data were also sub-classified into households with no debt, those whose largest debt is with a formal source, and those whose largest debt is with an informal source.

- **Rural households with debt have higher monthly expenditures than do rural households without debt.** The average rural household with debt spends R389 per month per scaled adult equivalent. The figure for households without debt is R298.

- **Debt is more unevenly distributed across rural and urban households than is expenditure.** Per capita monthly expenditure for rural households is 34% of per capita expenditure for urban households. The proportions are further skewed for debt. Average rural debt per capita in households with debt was 11% of that of urban households. This pattern is repeated in the ratio of debt to expenditure. For rural households, the ratios for formal debt and informal debt are 286% and 63%, and for urban households they are 1 230% and 113%.

- **Rural households with debt use about one-fifth of their monthly expenditure to service debt.** The ratio of monthly debt repayments to monthly expenditure for rural households is 19% for formal debts and 22%

for informal debts. This may imply that the use of formal or informal debt may depend less on the borrower's repayment capacity than on the lender's willingness to lend.

- **Transfers fund large portions of monthly expenditures for blacks, and are especially large in rural areas.** Pensions and net remittances combined cover 32% of monthly expenditure for rural households on average. For urban households, the corresponding figure is 23%.

- **Households with members receiving pensions are more likely to have no debt or to have debt with informal sources.** Both rural and urban households with no debt have pensions equal to about one-fifth of their monthly expenditure. For households with debt, the figure is 16% for rural households. In addition, households with informal debts have larger portions of their expenditure covered by pensions than do households with formal debt (9% vs. 20% for rural households and 7% vs. 13% for urban households). As in the analysis by race, it seems that pensions are associated more strongly with household poverty in general than with an increase in debt capacity.

- **Rural households have less debt and less debt from informal sources, as remittances contributed to a larger proportion of monthly expenditure.** The pattern found with pensions is repeated for remittances. Rural households without debt have net remittances that cover a higher portion of their monthly expenditure (15%) than households with informal debt (11%) and those with formal debt (7%).

- **The analysis shows that loans from the government and NGOs seldom reach poorer households.** The average per capita debt owed by households with loans from the government or from NGOs (R7 534) is exceeded only by households with bonds. The monthly burden of debt repayment (25%) was second only to bonds, and the ratio of debt to expenditure (582%) was second only to bonds. The final sign that these loans have not reached the masses in poverty is the fact that only 0,6% of the households that reported debt owed their largest debt to these sources.

2.2 The institutional supply of rural financial services[9]

In this section an overview is provided of the performance, as measured against international norms, of the different kinds of rural finance institutions in South Africa. The discussion on the performance of NGOs is included in Chapter 3 in order to provide a comparative context for the Village Banks case study.

2.2.1 Development finance institutions

Development finance institutions (DFIs) and Agricultural Banks are the main formal institutions serving rural clients in South Africa. The apartheid legacy has left the country with a particularly large number of such institutions, and with a particular concentration on lending to agriculture. Such specialised loan portfolios leave them with a high covariant risk, and they are, therefore, heavily dependent on direct government funding. Many of them also incorporate technical assistance and extension support to clients and were involved , with direct budget support in some cases, in the funding of large scale farming projects.

Tables 2, 3 and 4 offer a performance profile for seven DFIs in the country. The institutions include the Agricultural Credit Board, the Land Bank, Agriwane[10], the KwaZulu Finance Corporation, the Agricultural Banks of Ciskei and Transkei and Agribank of the Northwest Province. The data for the Land Bank is further disaggregated into the total portfolio (including cooperative and individual clients) and its portfolio for individual clients only.

Institutional outreach

In Table 2 the outreach of these institutions is reflected by the number of branches and the number and volume of deposits and loans. ACB and the Land Bank serve commercial farmers, while the remaining five institutions traditionally lent to emergent farmers. It is clear that the Land Bank and the KFC differ from the other institutions through the size of their branch networks. The Land Bank is national in scope, whereas all the other institutions are limited by their former homeland jurisdictions. Despite its geographical limits, however, the KFC has 44 branches. Many of these are associated with the Ithala savings mobilisation programme spread throughout the province.

The branches of KFC reflect a notable outreach effort. This is underscored by the higher number of deposits compared to any of the other institutions. The unusually small number of branches for the agricultural banks in the former Ciskei and Transkei clearly limit their outreach, even allowing for the smaller territory. The ACB has no branches, since its loans are handled by the central Department of Agriculture. The lack of deposit facilities in the Transkei bank clearly limits its outreach in the supply of financial services. The small number but large average sized deposits in the Land Bank and Agribank suggests these may be government or company accounts. The lack of deposits in the ACB and the limited number of deposits at the Land Bank indicate the limited reach of these institutions in the supply of financial services to a rural clientele.

The final set of outreach indicators refers to the number and average size of all loans and agricultural loans specifically. Again the Land Bank, ACB and KFC record a substantially larger number of loans than the other institutions. However, it is evident that KFC is serving a lower income clientele with substantially smaller average sized loans. The Land Bank serves more established commercial farmers, either through cooperatives or directly. The ACB also records a high average loan size. The relatively small number of loans in the other institutions reflects small areas served and a limited branch network. Combined with the lack of a deposit base there is concern about how cost effective these institutions can be, now or in the future.

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[9] A detailed discussion on NGOs that provide financial services in rural areas is included in Chapter 2.

[10] Due to the scheduling of the analysis Agriwane has been included with the DFIs, while it would fit more comfortably with the later section on Development Corporations.

Table 2: Outreach indicators for the main DFIs in South Africa

Indicators	ACB	Land Bank: individual	Land Bank: total	Agriwane	KFC	CAB	Transkei	Agribank
Branches	0	24	24	4	44	2	5	12
Non-financial services	No	No	No	Yes	Yes	Yes	Yes	No
Number of deposit accounts	0	1 349	2 917	0	214 297	10 882	0	225
Average deposit size		131 950	249 571		797	510		217 034
Number of loans outstanding	14 000	33 253	35 143	853	30 980	1 775	4 774	4 431
Average loan size	104 428	125 282	267 137	16 915	20 805	3 671	3 122	16 713
Agricultural loans outstanding	14 000	32 502	34 392	853	10 702	1 323	4 774	4 431
Average agricultural loan size	104 428	126 946	271 807	16 915	2 773	6 705	3 122	16 713

Productivity and profitability

Tables 3 and 4 contain indicators of productivity and profitability. Productivity is measured by the number of clients and the volume of loans managed by loan officers and their supporting staff. The Land Bank has a smaller case load and a larger volume per officer and per staff member than the remaining institutions.

Table 3: Productivity indicators for main DFIs in South Africa

Indicators	ACB	Land Bank: total	Land Bank: individual	Agriwane	KFC	Ciskei	Transkei	Agribank
Arrears (% by volume)	65[1]	2	3	28	12	14	39	35
Loans/staff	na	27	26	19	69	-	106	47
Volume lent/staff	na	7 210 445	3 199 693	327 927	1 432 300	465 426	331 215	787 819
Loans/loan officer	na	107	101	24	620[2]	254	238	148
Volume lent/loan officer	na	28621951	12 701 220	400 799	12 890 700	930 839	745 236	2 468 500

Notes: [1] By number of loans. Remaining arrears are measured as the amount of interest and principal overdue (i.e. missing one instalment) over loan outstanding in the portfolio.
[2] Refers only to officer originating loans, and excludes those involved in monitoring and collection.

A larger case load of smaller average sized loans suggests a more difficult and problematic clientele. Thus it is not surprising to note the higher arrears for the Ciskei and Transkei banks compared to the Land Bank. An arrears rate of 12% places KFC between the two extremes in the table for arrears, case load, and average volume per staff. This reinforces a fairly consistent pattern among the three indicators.

Table 4 is the most revealing on the relative performance of DFIs. The rate of return on assets for institutions receiving a large amount of direct subsidies or concessional funding, or benefiting temporarily from deposit accounts earning a high interest, may be misleading. The ACB illustrates this point. It records a relatively high rate of return on its assets, in large part because it benefits from direct transfers from the budget (i.e. it pays no interest). Much of its loan portfolio is non-performing (65%) yet it can record a positive rate of return on assets because about 30% of its interest earnings comes from fixed deposits in other institutions. It also registers a misleadingly low operational cost per loan, since the cost of the Department of Agriculture staff handling its loans is not included and it has a zero cost of funds. The implicit subsidy per client is consequently high.

The SDI is the most comprehensive measure of the cost to society of a financial institution benefiting from direct budgetary transfers and concessional funding. The ACB records an index of 308%. This means the

ACB would have to raise its current interest rate by 308% to break even or to eliminate its subsidy dependence on the government. This is, however, an understatement of the true subsidy, as the cost of operations is not included in the calculation.

All the institutions listed in the table record positive SDIs, some embarrassingly high. Only the Land Bank registers a modest subsidy, i.e. 7%, which it could easily eliminate by a small rate adjustment. The KFC is the next with a 54% SDI, implying that it would have to raise its current interest earnings on its portfolio (17%) to 25% to eliminate its subsidy dependence. Conversely it could reduce its dependence on concessional funding and depend more on locally mobilised deposits from the public at non-concessional rates.

The other banks all record high SDIs and high absolute levels of subsidy per client, indicating a high cost to society for these institutions. For some this grows out of unusually high grants or concessional funds (the ACB, Transkei and Agriwane) while for others it is due to unusually high operational costs; the cost is R1,36 for every rand lent for Ciskei and R1,22 per rand lent for the Transkei bank.

Table 4: Profitability indicators for main DFIs in South Africa

Indicators	ACB	Land Bank: total	Land Bank: individ.	Agriwane	KFC	Ciskei	Transkei	Agribank
Return on assets	4%	2%	2%	-71%	4%	-4%	-74%	4%
Implicit subsidy (Rm)	243,0	104,0	na	7,1	55,0	6,4	4,1	10,0
Subsidy per borrower (R)	17,357	2,952	na	8,335	1,775	3,634	858	2,369
SDI	308	7	na	370	54	808	307	63
Subsidy-free %	22	16	na	21	25	124	99	40
Interest earned on average portfolio	5	14	16	11	17	19	24	24
Interest paid on average portfolio	0	12	14	15	4	15	0	11
Gross margin	5	2	2	-4	13	4	24	13
Non-interest expenses/average portfolio	2	1	2	104	12	136	122	21
Return on average loan book	3	1	0	-108	0	-132	-98	-8
Typical deposit %	n/r	13	13	n/r	4	6	n/r	13
Typical loan %	8	15	15	8	16	16	14	14

There is also concern about the ability of a number of these institutions to achieve viability, given the small geographically delimited markets in which they operate and the specialised focus of their lending activities in agriculture.

2.2.2 Development finance corporations

In addition to DFIs or Agricultural Development Banks, Development Finance Corporations were set up in the former homelands. These institutions were intended to serve as independent implementation agencies of selected government departments. Their incorporation was also intended to allow them to follow private sector behaviour by quick response to emerging problems under their jurisdiction. The five development corporations referred to in the Strauss Commission report were involved in lending, technical assistance, advisory and project management services. The institutions are:

- The Gazankulu Development Corporation (GDC).
- The KwaNdebele National Development Corporation (KNDC).
- The KwaNdebele Agricultural Company (KAC), a subsidiary of the KNDC.
- The KwaNdebele Utility Company (KUC), a subsidiary of the KNDC.
- The Northwest Development Corporation (NWDC).

Institutional outreach

Table 5 sets out the outreach indicators for the lending activity of these corporations. GDC has the most extensive branch network. Two of the non-agricultural corporations, KNDC and KUC, have no or few branches, highlighting their limited geographical scope. It is not surprising to note that the corporation with the largest number of branches (Gazankulu) also has the largest number of loans (9,643).

Table 5: Outreach indicators for lending activity of selected development corporations

	GDC	NWDC	KNDC	KAC	KUC
Number of branches	25	16	3	12	1
Non financial services	Yes	Yes	Yes	Yes	Yes
Number of deposit accounts	0	0	0	57	0
Average deposit Size				1958	
Number of loans outstanding	9643	2045	565	298	1,900
Average loan size	10527	74924	69574	43786	22000
Number of agricultural loans outstanding	162	0	0	298	0
Average agricultural loan size	8867			43786	

All the institutions offer non-financial services, and KAC, with 57 accounts, negligible deposit services. These corporations are essentially credit institutions with a limited loan activity, given the relatively small number of loans recorded (with the exception of GDC). Agricultural loans are not part of the outreach effort for three of these institutions and only a small part for a fourth (GDC). Only KAC is exclusively involved with an agricultural clientele. Finally, the large average loan sizes, particularly for NWDC, KNDC and KAC, suggest that these institutions are not reaching small entrepreneurs or farmers. These are substantial enterprise loans, implying that the thrust of their effort is more towards medium sized operations.

Productivity

Table 6 presents productivity indicators for these corporations. The arrears rate is high for the KNDC, with the others recording more modest arrears. These figures would no doubt be higher if the arrears were expressed over the amount of the loan portfolio actually due for repayment, rather than over the entire outstanding loan book.

Table 6: Productivity indicators for lending of selected development corporations

	GDC	NWDC	KNDC	KAC	KUC
Arrears (% volume)	7	14	37	7	16
No. loans/staff	140	26	11	99	317
Volume lent/staff	1 471 205	1 915 250	741 689	4 349 431	6 966 667
Number of loans/loan officer	197	41	63	99	633
Volume lent/loan officer	2 071 697	3 064 400	4 367 723	4 349 431	13 933 333

Profitability

Table 7 deals with the profitability of these corporations. Four have either negative or nil return on their assets (ROA). The one positive ROA (KNDC) is misleading because it receives its funding as grants from the government. The gross financial margin is relatively thin for four of the corporations (GDC, KNDC, KAC and KUC) which makes it unlikely that they will be breaking even in their financial operations. This is substantiated by line f where the return on the average loan book is negative in all programmes, and substantially so for GDC, KNDC and KAC. Only the housing finance programmes of KUC and the non-farm enterprise finance programmes of NWDC came close to meeting their gross financial margins.

Table 7: Profitability indicators for lending for selected development corporations

	GDC	NWDC	KNDC	KAC	KUC
Return on assets	-3	-16	4	0	-1
Interest earned on average loan book	32	21	5	17	11
Interest paid on average loan book	29	9	0	11	6
Gross financial margin	3	12	5	6	5
Non-interest expenses on average loan book	29	15	32	56	8
Return on average loan book	-25	-3	-27	-50	-3
Typical deposit rate	n/r	n/r	n/r	8	n/r
Typical loan rate	18	18	20	8	12

The return on the average loan book is estimated by subtracting administrative costs per rand lent from the gross financial margin per rand lent. The high negative return of 50 for KAC is due primarily to its high administrative cost per rand lent. This is also true for GDC and KNDC. On the other hand NWDC and KUC register a lower ratio of administrative costs per rand lent (15 and 8 respectively) and therefore record lower negative returns on their average portfolio.

2.2.3 Commercial banks

Institutional outreach

It is estimated that the commercial banks in South Africa have more than 4000 branches throughout the country, an increase from 3300 in 1994. Most of these branches are, however, located in urban areas. However, submissions indicate that some banks have a visible presence in all but the remotest rural areas. In 1995, one bank had 17 branches in towns outside the metropolitan areas; a larger bank claimed to have 134 branches in small rural towns and 121 in medium sized rural towns; while another has 247 branches outside the major metropolitan centres and cities, in addition to 60 agencies. The commercial banks have an important physical presence in rural areas, which facilitates the supply of products and services to these areas.

Products and services

Bank services appear on both sides of the balance sheet (i.e. deposit and loan services). However the more rural the setting, the greater the role of transmission services, including the transmission of pensions, and the supply of a range of deposit and savings services. The poorer the population base, the more likely is the use of deposit services rather than loan services.

Deposit and related services are increasingly being rendered via automated teller machines (ATMs) and through the use of smart cards. These more efficient and rapid transaction methods are also safer as they reduce cash handling. However, they are more prevalent in peri-urban areas than in truly rural settings. In deep rural areas only the more conventional deposit and savings technologies prevail.

Loan Services

The provision of loan services is less widespread than savings services, but commercial banks do provide a range of farm and non-farm enterprise loans, personal loans and small business loans in peri-urban and near rural areas. Overdraft facilities, home loans, hire purchase credit, revolving credit plans and, in some cases, micro loans (R500 to R6000), round out these activities. As in the case of ATM and smart cart technologies, micro loans are more prevalent in denser urban and peri-urban areas than in truly rural areas, as some degree of population density is required for them to be cost effective for the lending institution. These micro loans are often made to clients employed by firms, enabling the banks to rely on stable wage earnings for loan repayment and instalment deduction by the employer. Micro loans are also made to artisans and traders.

Future considerations

Together with the Post Office, commercial banks have the best distribution of branches in terms of their accessibility to poor people. The ratio of commercial bank branches per population, at 15000 people per branch, is also higher in South Africa than elsewhere in Africa, where the ratio is estimated at 450 000:1 (Coetzee, 1997)[11].

A careful analysis of the financial behaviour of poor rural people in South Africa[12] indicates that a small proportion meet the lending criteria of the commercial banks. However, it is clear that the banks have insufficient on these clients, hence their unwillingness to provide more than transmission and savings services. There is possibly a role for the state, in its role as the creator of a conducive environment, to support the provision of this information. Alternatively, the banks could find other avenues to access the necessary information on client profiles. In the case studies presented in Chapter 3, three examples of such 'partnerships' between the commercial banks and prospective clients are illustrated. These include links between commercial banks and NGOs (the Village Banks case study); between commercial banks and the informal financial services market; and private sector cooperation to create a new institution that is intended to be closer to the clients, and, therefore, have better access to information regarding their risk profile (the NewFarmers Development Company).

The South African banking sector is widely considered to be relatively sophisticated for the level of development of the country, and the sector normally follows developments elsewhere in the world. A recent report (Deloitte and Touche, 1995)[13] argues that the profile of especially commercial banks will, therefore, change considerably in future.

The main reason that such change is expected revolves around the perceived inefficiency of these institutions. However, new technologies that are expected to revolutionise the movement and storage of money are expected to lower the cost of current bank practices and create alternative distribution channels for retail banking products and product distribution. The result is expected to be cheaper ways of reaching customers than by conventional retail branches. In the USA, for example, telephone banking is more than 50 per cent cheaper than branch banking, and these non-traditional channels are gaining market share.

The result is that commercial banks are expected to de-emphasise branch banking in future, to the detriment of service provision in areas that do not have access to electricity and telecommunications infrastructure. Many of the rural poor in South Africa will, therefore, have less access to commercial banks until such time as the required infrastructure is put in place and the new technologies have been made available. In the final section of this chapter, current government policies with respect to infrastructure provision are explained.

2.2.4 Farmer cooperatives

Institutional outreach

Most cooperatives claim to provide some service to small emergent black farmers, though few actually document the extent of outreach. All cooperatives claim that any farmer can become a member if they meet set qualifications. There is a strong belief among the cooperatives that they are financially sound and have a strong infrastructure capable of supplying a wide range of products and services to all their clients. The services include low cost access to agricultural inputs through volume discounts, product storage and marketing, business advisory services, etc. Therefore, they believe that the most cost effective way to expand

[11] Towards the implementation of policies on increasing access to rural financial services - strategies at the retail level. Unpublished report, Development Bank of Southern Africa, Midrand

[12] Simkins, C: University of the Witwatersrand. Personal communication.

[13] Details are to be found in Coetzee, 1997, *op cit.*

the outreach of services to disadvantaged black farmers is to create incentives for the existing commercial farmer cooperatives to carry out this function rather than create costly new cooperatives. One suggestion is for a cooperative to make input loans to small farmers and deduct the loan repayment during the marketing of the final product. For effective contract enforcement, however, it would have to assume the farmer had no other marketing outlet.

Several cooperatives pointed out that a number of smaller post office branches have been shut down in their area. They therefore suggest that farmer cooperatives be allowed to accept savings deposits from the public. This would change the cooperative from being a credit-only institution for seasonal input finance into a more complete financial institution offering services on both sides of the balance sheet. Such an action would require authorisation from the appropriate authorities. Most cooperatives agree that disadvantaged black farmers are not well serviced by their organisations. However, they feel they could play an important part in expanding the use of their services by these farmers if the government would share some of the risks and costs necessary to reach them.

2.2.5 Other institutions

Banks under the Mutual Banks Act, 1993

The Mutual Bank Act allows for a distinctive form of ownership of banking institutions. However, the capitalisation requirements are relatively high for a start-up financial institution, while there have been complaints to the effect that the reporting requirements are onerous. It is, however, too early to determine whether the Mutual Banks Act has closed a gap in the financial market. A general view from informal and semi-formal operators is that start-up requirements should be even more accommodating and flexible.

At the time of the Strauss Commission, two institutions were registered under the Mutual Banks Act, namely the Community Bank and Cash Bank, both of which operated in urban areas. The Community Bank was set up on the principle that it would work closely with the Community Trust (a co-owner of the Community Bank) to introduce potential clients, and thereby lower its transaction costs.

The Community Bank operated a guarantee scheme with the United States Agency for International Development for its business loans. Personal loans were characterised as follows:

- Loan amounts ranged from R500 to R5000;
- The interest rate was 28%;
- The repayment term was a maximum of 5 years (the actual period depended on affordability criteria);
- Repayments were made through a monthly debit order.

All loans were made to individuals, although household income was taken into account when determining affordability. However, while the Community Bank had no confirmed defaulters and a low arrears rate when investigated by the Strauss Commission, it has subsequently had to close branches, and has been bought out by another institution.

The Cash Bank was created out of an NGO, the Group Credit Company. It provides housing finance in what is considered a fast-growing market, on the same basis as the Rural Finance Facility, i.e. repayments are ensured through a payroll deduction against the pledge of the borrowers pension. The Cash Bank operates exclusively in urban areas, and the indications are that it is planning for rapid growth in what is considered to be an under-serviced component of the market.

TEBA Cash

The mining industry's objectives and need for financial services for mineworkers are served jointly by TEBA Cash and TEBA (The Employment Bureau of Africa Limited). The primary function of TEBA has been to recruit labour for the mining industry but has decreased in importance. The provision of a payments system for mineworkers now accounts for nearly 70% of TEBA activities. TEBA Cash provides financial services through 103 branches in hostels of major mines and through 69 TEBA offices in the rural areas of South Africa.

TEBA Cash provides savings and transmission services. It is tailored to the needs of mining employees and their (often rural and distant) dependants. TEBA Cash operates more than 700 000 savings accounts and processes in excess of 20 million transactions per annum with a turnover of R11bn (1994). The majority of mineworkers making use of TEBA Cash have close family connections in rural South Africa. TEBA Cash operates under a (renewable) exemption from the Banking Act. A number of options, including the Mutual Bank route, are under consideration.

PostBank

The Post Office Savings Bank was established in 1883. In 1974 the Post Office took full control of the Savings Bank, which up to then had been operated as an agency on behalf of the Treasury. Changes since 1974 have included the provision of ATMs and a change in focus from being solely a provider of funds for telecommunications projects. In 1993 the Post Office Savings Bank was renamed PostBank with the aim of becoming a player in the provision of banking services to the previously unbanked communities in South Africa.

On 31 March 1995 PostBank had 2,4 million savings accounts with a total value of R1,1bn. Of these accounts, 55% by value were book based savings accounts (2,2 million accounts with balances of R587m). More than 80% having balances of less than R500. Other products include a card based Telebank savings account (179 000 accounts with balances of R40,7 million) and savings certificates (49 000 accounts with balances of R440,6 million). The certificates are being redeemed at an increasing rate due to the removal of tax privileges.

According to PostBank most savings account holders are lower income black rural people. Minimum balance requirements are low and the accessibility of PostBank through Post Office branches, even in remote rural areas, is good. The Post Office has 2064 outlets and is of the opinion that they have better coverage than the commercial banks.

PostBank is not able to recover the full costs of providing services. The main cost items are interest paid, agency fees payable to the Post Office, staff costs, materials, communication costs and the upgrading of computer technology. There are no transmission facilities between PostBank and other banks. PostBank makes use of the Post Office treasury for funds management. Nearly half of the R1,3bn savings balances is on loan to Telkom (46%). PostBank's operational costs amount to R0,07 per R1,00 of deposit on average for the 1994/95 financial year.

Woman's Development Business

The Woman's Development Business, colloquially known as Women's Development Bank, provides micro-enterprise loans only to women, and operates in Mpumalanga Province. It was originally capitalised by the DBSA (with a 14% interest loan) and covers its administration costs by donor funding, mainly from the Open Society Foundation. It intends to become self-sufficient, and currently has a loan book of about R800 000.

Micro-enterprise loans are made available under the following conditions:

- loans are provided to groups of 5 women;
- the loans vary from R300 to R3000;
- the interest rate is 28%;
- the terms are dependent on the size of loan, for example: 6 months for R300 - R500, 12 months for R1000 - R2000, etc.

Where a customer has no security, the bank follows a savings first approach (for example, R20 must be saved before a R300 loan is granted). Repayments are directly to the bank or to development assistants at 'club meetings'. The default rate is considered reasonable, with 10% bad debts during the 1994 year. Though only group loans are offered initially, customers can later 'graduate' to individual transactions. The bank also offers basic business management training to customers. It employs 9 development assistants who operate 2 offices. It also holds savings accounts for individuals. No personal loans are offered at present but a broader range of products is under consideration.

Small loans industry

The quick growth of the small loans industry in this country has resulted from a gap in the market for small loans. The more than 5000 operators in this market are active in providing short to medium term loans to individual borrowers who fall outside the formal banking network due to their inability to provide conventional collateral. This industry consists of approximately 1200 formal operators with an annual turnover of R2.5bn and approximately 4000 informal operators with an estimated turnover of R3.5bn. Small loan firms provide credit services to clients who can provide them with proof of employment and a bank account. They provide the small loans firm with a bank card and a PIN number. The small loans firm withdraws the payments according to the loan contract after each wage or salary deposit made by the employer into the borrower's bank account. This is an urban based product which does not fit the income profile of rural people, who do not have access to regular income sources. It is not seen as a major growth industry in rural areas, except in larger rural towns.

Traders

A wide range of speciality furniture stores provide credit to a rural clientele. Their basic requirement is a fixed income and an address where the goods will be kept. These institutions are also quite flexible with respect to the rescheduling of loans and payment amounts. No aggregate statistics are available on the number of loans outstanding, payment records and defaults. A qualitative assessment of these sources of credit indicates that the lenders have evolved a workable system over time.

2.2.6 Informal finance

Informal financial activities are common in South Africa. While there is a perception that these only take place owing to the unavailability of formal financial services, informal financial arrangements even exist in formal institutions, for example between staff members. The existence of informal activities signals a need for services not supplied by formal intermediaries, usually because of two problems. In some instances formal intermediaries do not serve remote areas. In other instances access is impossible owing to high transaction costs, or to inadequate services or because many poor people perceive formal institutions as inaccessible, mainly because of a lack of information on how they operate.

Stokvels and derivative mechanisms

Information on the flow of cash through stokvels in urban areas indicates that they are used mainly by poor people in South Africa. Very sketchy survey information on stokvel activities in rural areas is available. It shows a presence of stokvels, but no information exists on the frequency or volume of money handled. Case study information indicates the presence of rural stokvels in the majority of settlements and rural villages.

The National Association for Stokvels in South Africa (NASASA) serves as an umbrella body for stokvels. They negotiate with commercial banks and other financiers to use the accumulated savings of individual stokvels as a basis for granting loans. In this way the informal financial sector is linked with the formal financial sector. Two reasons most frequently given for the formation of informal financial institutions are the absence or inaccessibility of formal financial services, even though these services may be physically present in a specific setting.

Individuals: family and friends

A variety of intermediaries are active in informal finance. The borrower of today may be the lender of tomorrow. Most transactions in rural areas are between family and friends, normally at low or zero interest rates. However, these transactions always involve reciprocal obligations. They contribute to the management of risk by rural households. In periods where households from the same area face covariant risk, a shortage of funds for borrowing exists. It is during these times that most rural people turn to moneylenders. The majority of rural households try to get by with self-financing. Surveys (also in South Africa) indicate that credit is not as important a source of finance as self-financing. Formal insurance and investment in assets to be liquidated are outside the reach of most poor people.

Borrowing is not always in the form of cash. In rural areas it can take the form of farm inputs, food, material and even farm implements and livestock. Repayment is also not always in cash. Borrowing for a specific purpose, e.g., farming, does not mean that farming will generate the funds for repayment. This underscores the fungibility of money and its impact on allocation decisions in households. Because informal intermediaries, and especially family and friends, have such intimate knowledge of each others' production results, alternative sources of income and pressing expenditures, adjustment of the terms of lending can easily be negotiated. Collateral arrangements in terms of reciprocal obligations and the social shame of wilful default contribute to the low transaction costs.

2.2.7 Summary and conclusions

Table 8 summarises the institutional outreach of formal financial institutions serving a rural clientele in South Africa. At first glance, the coverage of the rural population seems fairly comprehensive. However, a more careful analysis shows that, while rural people have access to savings and transmission facilities, most loan facilities are available in the larger towns only, and are, therefore, less accessible to the poorest segments of the population.

Table 8: Summary of the outreach of formal retail institutions in the rural areas of South Africa

Retail institutions	Number of branches and agencies	Rural coverage[1]		Loan contracts/clients
		% of branches	% of clients	
Land Bank [2]	25 to 180+	90+	90+	33 000 to 50 000+
Provincial parastatal banks	66	50+	50	50 000
Development Corporations	10	?	70	60 000
Post Office outlets[3]	2365	?	60+	2 400 000
NGOs	13 - 18	?	35	23 700
Cooperatives	250+	80+	60+	142 000 members
Commercial Banks	4055	33	?	?
Teba Cash	172	40	?	700 000
FAF	20	100	100	20 000
Small loans industry[4]	5200	?	?	377 clients per month per outlet

Notes:

[1] According to the institutions' own definition.

[2] The Land Bank has 25 branches, and retails through approximately 180 cooperatives.

[3] This is the total of all grades of branches of the Post Office. Of these, 333 are full service outlets, and less than a 1000 branches provide full PostBank services.

[4] It is difficult to estimate the number of clients reached due to repeat clients and short loan periods. The number of clients per month was estimated using the reported average loan size of R450 per client.

Source: Coetzee, G K (1997). Towards the implementation of policies on increasing access to rural financial services - strategies at the retail level. Unpublished report, Development Bank of Southern Africa, Midrand

2.3 The policy environment for rural finance in South Africa

2.3.1 The Reconstruction and Development Programme

The rural development policy of South Africa is not static. Formal statements of current policy and strategies are to be found in the Reconstruction and Development Programme (RDP) White Paper. The Departments of Housing, Land Affairs and of Water Affairs have also published White Papers that set out important elements of rural development policy and strategy, while the Department of Agriculture is preparing a White Paper. Together with the 'Rural Development Strategy of the Government of National Unity' and its urban counterpart, these constitute the most important elements of the government's rural policies.

Major policy changes are suggested in or implied by the RDP, including those that will affect rural financial services through their direct and indirect impact on rural households.

Education

The crucial role of education in socio-economic development is recognised in the RDP. It seeks to close the gap in access to education. Education is one of the major motives for household savings in developing countries. Implementation of policy changes as envisaged in the RDP will result in an increase in the proportion of children in school, and rural household saving patterns may be affected in at least two ways. **First**, parents will be required to enrol children of school-going age who are not presently in school. Additional funds will be required for school uniforms, fees, transport, books and other items. Parents will be required to withdraw from their savings or borrow money to pay for these items. Some parents will also find it necessary to save to provide for future expenses related to the further education of their children. **Second**, parents who have children not yet ready for school or expecting to have children in the future will be induced to save for the education of their children. Thus, there will be a demand for savings facilities to finance education.

School feeding scheme

Anecdotal evidence indicates that in most rural areas children have already shown a positive response to school feeding programmes in terms of improved school attendance and performance, despite considerable initial problems with the implementation of the programme. This confirms that there is a real underfeeding problem in these areas. It is not expected that existing household food consumption will be reduced by the feeding programmes, and the net effect on household cash flow is therefore assumed to be negligible in the short term. Insofar as it leads to higher pass rates, it may lead to increased out-migration in those cases where local opportunities for skilled jobs are absent.

Health care scheme

As with the school feeding scheme, there have been initial problems in extending the outreach of this programme to the more remote rural areas. To the extent that the problem has been overcome, the evidence suggests that it will bring real benefits to rural communities. **First,** implementation in rural areas will counter the urban bias inherent in such schemes, and therefore remove a potential incentive to migrate. **Second,** there is a positive effect on the cash flow of those households who have been making use of health care services. **Third,** the programme will benefit young children as they will be better prepared for school. **Fourth,** it is expected to benefit the rural population over the longer term through the beneficial impact it will have on the health of women. **Fifth,** preventative health care is expected to lower the potential burden of conventional health care among rural people in the medium to longer term.

Public works programmes

The public works programmes aim to reach the poorest of the poor, with a special focus on rural people. It is likely that incomes will be used to eradicate previous dissaving, and to meet pent-up consumption demand. However, even with a scaled-up public works programme, it is unlikely that sustained programmes will develop in many rural localities. Exceptions could occur if Government was to return to major labour intensive road and other bulk infrastructure building programmes, which, by their nature would be longer term. Although the net effect of the public works programmes would therefore be to increase household incomes sporadically, this is not expected to lead to a sustained increase in people's need for and use of financial services.

The community water programme and other programmes designed to improve access to social services will have little effect on household cash flow where only basic needs are met, which is likely in remote rural areas. Where improved services are provided, the demand on household cash flow will increase. The biggest short term impact of all these programmes will be on the time saved by women in fetching water and wood, etc. and in improving opportunities for existing businesses.

Improved physical infrastructure will reduce the transaction costs of financial services. The willingness of rural people to save and the availability of physical infrastructure are positively correlated. Thus, it may be expected that rural people in areas with better physical infrastructure, such as roads and electricity, will have a greater willingness to save. The demand for credit is also expected to increase due to lower transaction costs and a greater need for appliances.

The land reform programme

The land reform programme aims to address the inequitable distribution of access to land. The programme has three components: land restitution for those whose land was taken away during the apartheid era; land redistribution to those who wish to own land, develop it or provide in their housing needs, but lack the means to do so; and the provision of tenure security. Land redistribution grants are proposed in the RDP to facilitate the transfer of land ownership to those who were disadvantaged. To the extent that the land reform programme is successfully implemented, access to land for the disadvantaged for both farming and non-farming purposes will be improved.

The proposed grants include the settlement planning grant, the district planning grant and the settlement/land acquisition grant, with the latter implemented in parallel with the housing grant as administered by the national Department of Housing. This means that only those earning less than R1 500 per month will be eligible for the grant. Farm workers have been specifically targeted to allow them to use the land acquisition/settlement grant as a lever to acquire a part of the farm business under farm worker equity schemes.

While a monthly income of under R1 500 includes most rural households, it does not accommodate many entrepreneurs who have the potential of launching or expanding successful rural businesses. Therefore, a further grant (discount subsidy) has been proposed to facilitate access to land for emergent entrepreneurs. The subsidy is intended to provide some leverage to supplement own contributions and any possible borrowing. The target group of participants is the strata of potential entrepreneurs who earn more than R1500 per month.

Access to land through using land reform grants may affect rural financial services in at least five ways. **First**, there will be a short term and direct positive effect on the cash flow of households who qualify for the grants, as well as from increased household food production. Potentially favourable indirect effects will flow from the better planning of community life, and better physical and social community infrastructure. There will be increased demand for building materials and skills, which could affect local economic activity. The sustainability of this impact is difficult to gauge, but could lead to higher levels of economic activity and increased demand for financial services, including savings. Where recipients of grants are able to relocate closer to services and infrastructure, the long term effect on productivity will be even better. The demand for deposit facilities is expected to increase as the recipients of grants open savings accounts.

Second, since land acquisition grants will not cover the full price of land, additional loans will be required for those households who are able to gear up in order to exploit farming or other rural production opportunities. This will create additional demand for financial services, both directly and indirectly through linkage effects, as was shown above in the case of the small growers in the sugar industry. That example also points to the pitfalls of an uncoordinated entrepreneur support strategy.

Third, a larger land base requires investment in inputs such as equipment, labour, physical infrastructure, etc. Additional funds will be required to finance the purchase of these, thus, the demand for credit is also expected to increase. The demand for inputs will also increase as farm and non-farm enterprises become more profitable. **Fourth,** the provision of security of tenure is expected to remedy, at least partially, collateral problems, and to increase the incentive to invest. **Fifth,** the state will require secure and efficient transmission facilities to get the grants to households participating in the land reform programme.

Capacity building programmes

Capacity building programmes to expand the planning horizon of individuals, households and communities are essential for them to recognise the possibilities for capital formation and increased use of financial services. This needs to be linked to training in long term budgeting and financial management, and to effective and relevant information provision, not only about financial but also about a range of technical options.

The planning process envisaged for the land reform and rural housing programme will commit the community in a very real degree to transfer planning skills. The training envisaged for new local authorities at the rural local government level is a start to this process of skills transfer. It is disappointing that first tier local structures in rural areas are not planned for in this round of local government elections. However, insofar as effective training is provided to the local development forums or local RDP committees, this will start the filling of a void. Capacity building programmes for financial management and long term planning could also be more effective if linked to indigenous savings programmes like credit unions, stokvels, etc.

2.3.2 DFI system transformation.

The development finance system in South Africa is in the process of being transformed. This process is evolving piecemeal in reaction to the introduction of new socio-economic policies. Part of this process is the current transformation of the DBSA, the creation of Khula Enterprise Financing Facility, a National Housing Finance Corporation, and this Commission's focus on the provision of rural financial services. DBSA's transformation was preceded by a study, focusing on the organisation *per se*, initiated by the Department of Finance. Khula and the National Housing Finance Corporation were preceded by political decisions following economic policy changes embodied in White Papers for entrepreneurial development and housing, led by the Departments of Trade and Industry and of Housing, respectively. The bias is toward creating national level wholesale institutions that are sector-focused.

The Ministry of Finance has initiated a formal process to investigate ways of coordinating the development finance system on the national, provincial and southern African level. The aim of this process is to investigate ways of coordinating the activities of the various development finance institutions, decreasing reliance on the budget, and rationalising overlaps between institutions, especially at the provincial level. The process covers aspects such as the link between development finance and the macro-economy, the relationship between institutions at national level and their areas of operation, the relationship between national and provincial entities, the relationship at provincial level and issues like the efficiency and effectiveness of national and provincial level institutions. The potential involvement of these institutions in southern Africa will also be raised.

2.4 Implications

The analysis of the need for financial services among the (rural) poor in South Africa leads to the following broad implications for the future:

- Most rural people will remain poor, and the broad demographic profile of the rural areas is unlikely to change radically in the medium term. However, the demography of many settlements will continue to change rapidly. Generally, settlements closer to economic opportunities, physical infrastructure and amenities will grow faster, and their populations will be younger. The volume and type of migration will also continue to change, differently and not predictably, in different areas of South Africa. Financial institutions therefore need to provide services that permit **rapid two-way rural-urban transfers,** because migration and remittance strategies are often selected to diversify sources of earnings from both rural and urban areas.

- There are many instances where rural communities have experienced increasing total income. In some cases this has resulted from the successful exploitation of economic opportunities. In many cases, however, it seems to be more the result of government spending, especially on wages and salaries. Whatever the source, this presents a situation where rural financial services could profitably be introduced to help people **capitalise on these gains**, to obtain a greater degree of control over their economic circumstances, and to improve their options and their quality of life. This, of course, implies more than the provision of credit only.

- All the evidence from South Africa supports the conclusion that rural financial markets are best understood as **markets for liquidity**, rather than markets for credit or savings. Poor people do save, and they borrow and repay their loans. Their biggest problem is access to appropriate savings and borrowing institutions and instruments, tailored to their liquidity needs. This points to the importance of transmission instruments and of sustainable and accessible rural financial institutions.

- The providers of rural financial services should consider a household's urban-rural network as a **single financial venture**. Credit could be provided for education, or for improvement of housing in urban areas, as long as a balance is maintained between urban and rural investment in the household portfolio. The provision of rural financial services should therefore be more than merely a geographical extension of existing services.

The following conclusions can be drawn from the analysis of existing rural financial institutions in South Africa:

- Building viable structures for rural financial services in other countries began slowly and took many years. 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 and are reluctant to lend to the poor because of high transactions costs. Large formal lenders face lower covariance, but lack local knowledge. While such information problems have been addressed by many NGOs, they 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.

- The institutions described, with the exception of the commercial banks, are small, or have a narrow focus in terms of their target clientele, geographic spread and service portfolio. There is much interest among them to expand the provision of financial services to rural people. Such expansion requires state assistance. However, while subsidies will have to be designed to provide incentives to expand outreach, they must also provide incentives to rural financial institutions to search for, and adopt, cost saving technologies.

- The institutional review indicates the need for radical transformation to support the new rural development initiatives. The institutions which exist emerged and defined their role and clientele in specific historical circumstances. A strategic redefinition is now called for, and whilst this may be difficult, it also presents exciting challenges and potential rewards.

Finally, South Africa is still in the midst of a major social, political and economic transition. It is in this sense too early to know what effect changed rural 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. While the informal financial markets provide services that the poor need, these services are not always competitively priced. The challenge is to forge stronger links between formal and informal financial markets, and to create greater opportunities for private sector involvement in these markets. The major development finance institutions have a role to play in creating such opportunities. Here again, however, it is too early to judge whether they will be able to do so successfully.

CHAPTER 3

CASE STUDIES OF FINANCIAL INTERMEDIATION

3.1 Introduction

The purpose of this chapter is to describe recent instances of financial intermediation in the rural areas of South Africa that have met with some degree of success. The four case studies include:

- Specific interventions that have been implemented within the agricultural banks of the former Ciskei and Transkei homelands as examples of successful innovations within imperfect parastatal institutions;
- The NewFarmers Development Company as an example of a successful institutional innovation by the private sector to serve a specific niche market;
- The Village Banks as an example of a successful NGO intervention;
- A wide range of case studies of how rural people interact with informal financial markets

3.2 The Agricultural Bank of Transkei and the Ciskei Agricultural Bank

N Vink

3.2.1 Establishment of the institutions

Agricultural Bank of Transkei (ABT)

ABT was established under Decree No. 3 of 1990 of the former Transkei homeland. When it started operations in April 1990, it ABT inherited all the assets and liabilities of the loans division of the Transkei Agricultural Corporation (Tracor). However, the liabilities were not properly vetted and far exceeded the assets. To compound matters, a serious conflict erupted between the Board, the Managing Director and Management of ABT during the period January 1991 to July 1992. This lead to the suspension of the Managing Director by the Board, and in July 1992 the suspension of the Board by the responsible Minister, and simultaneously the removal from office of the entire Management. A curator from the office of the Auditor General and a seconded official from the Department of Agriculture and Forestry were responsible for the management of the bank as an interim measure.

Between 1990 and August 1992 ABT had only one employee, namely the Managing Director, as all other employees were seconded in terms of employment contracts from Tracor.

In view of what was happening within top Management, and out of concern about their employment status, which had never been properly clarified, the staff started to challenge Tracor on who their employer was. Whilst it was said that they were employed by ABT from 1990 onwards, in reality they were still holding Tracor employment contracts, and were still not placed within the ABT structures. This was one of the issues that did not receive sufficient attention at the time of excision from Tracor. This issue remained serious until, in 1992, the outcome of a compulsory arbitration procedure, which ruled that these workers were employed by ABT, and should pursue their employment status there, and not with Tracor.

The Curator and the new Management completed the process of staff placement in October 1992. In March 1993, the implementation of ABT policies was completed, and it became a fully fledged and autonomous entity which no longer had to comply with Tracor policies. In November 1993, the services of the Curator were terminated by the Minister, and ABT fell under the control of an Interim Board. In April 1994 the Managing Director won his court case and was reinstated by order of the Supreme Court. From June 1994 the interim Board appointed senior managers to head the Operations and Treasury and Administration divisions. In March 1995 a Loans Manager was promoted from within the ranks of the institution. In March 1996 the Internal Audit Manager was appointed to start an Internal Audit Department, and in April 1996 a Credit Controller was appointed to activate the Credit Control department, which had come to a virtual standstill. The Management appointments from June 1994 constitute the current management of the Bank.

The mandate of ABT was to provide agricultural loans to small scale and emerging farmers within the borders of the former Transkei. These farmers were, in terms of legislation of the time, excluded from accessing loans from either the Land and Agricultural Bank of South Africa or the Agricultural Credit Board. At the same time farmers were unable to source agricultural loans from local commercial banks. Today, ABT is a development financing institution (DFI) responsible for financing agricultural development in the Eastern Cape province.

ABT makes only agricultural loans, generally in small amounts, to underprivileged farming groups and individuals in the former Transkei area. It operates from four branches and a network of approximately 34 district offices spread over the entire area. The institution had 46 employees and total assets of R5,856,677 in March 1996. At this date there were 6,415 borrowers with an outstanding loan balance of R15,894,757 and the average size of the loans granted in that year was R816. Fifty percent of the of the loans were in arrears, up from 44% in March 1995. ~~The institution~~ is facing serious funding constraints and the audit reports since 1995 have included going concern qualifications.

The Ciskeian Agricultural Bank (CAB)

The CAB was founded in 1984, with the aim of financing emerging and commercial farmers in the Ciskei. According to the Ciskeian Agricultural Bank Act, the CAB had to be in a position to generate its own funds and to operate independently from Government funds. There was also a need for a financial institution of this kind to act as intermediary between developers in the Ciskei and financial institutions such as the Development Bank of Southern Africa.

The CAB was formed on an almost non-existent financial base that consisted of the transfer of non-viable projects of the Ciskei Development Corporation in the form of share capital. During the period 1984 to 1987 no money was allocated to the CAB by the Ciskei Government. The lack of funds during this time was one of the reasons why a **rural savings bank** was opened. Two branches and 6 mobile points were used to provide deposit facilities to people in rural areas.

In 1987 the Department of Agriculture decided to restructure the bank by strengthening its management and capital base. The Land Bank Act was amended in 1989 to allow financial institutions like the CAB to borrow funds from the Land Bank, and the CAB was the first organisation to apply for funding. The ruling from the Land Bank, however, was that the CAB's capital base was too small to qualify for funds. During this period the bank experienced political as well as managerial interference from the Department of Agriculture in its staff and loan policies. In the period 1990 till 1993 the bank operated without a Managing Director. The bank was able to increase its activity in loans and savings during this period by more than 300% and to reduce its staff component by nearly 25%.

The bank was also able to increase its loan portfolio drastically through rural development loans and loans to commercial farmers. However, the poor loan recovery rate became a threat during this period. The savings bank was able to maintain balances of R6,5 million and 10000 savings accounts during this period. As the bank does not qualify for registration under the Banks Act, management is restricted in its efforts to make the savings bank viable by on-lending the savings.

The current objective of CAB is to provide a broad base of banking services to communities, individual farmers and rural entrepreneurs. This is done through offering loan and deposit facilities to these communities to ensure economic growth and stability.

3.2.2 Financial performance

Table 9 shows the financial performance of the two banks as measured by a range of criteria.

Table 9: The financial performance of ABT and CAB[1]

	ABT			CAB		
	1994	**1995**	**1996**	**1994**	**1995**	**1996**
Interest, fees as % of average loan book	9.8	10.0	15.5	9.2	10.1	16.2
Bad debts as % of average loan book	(16.4)	(16.0)	(13.5)	(14.3)	(13.1)	(19.8)
Margin (%)	(6.8)	(6.8)	0.5	(5.9)	(3.7)	(4.5)
Staff cost as % of average loans	20.7	21.8	19.8	55.2	37.9	20.7
Other operating cost as % of average loans	9.2	8.7	10.4	30.5	21.1	13.0
Staff cost as % of total operating cost	68.8	70.2	64.2	64.2	64.2	61.2
Operational self-sufficiency (%)	32.5	32.1	50.3	26.3	34.8	67.8
Financial self-sufficiency (%)	(14.5)	(12.7)	4.1	8.2	9.8	6.0
Subsidy dependence index	590	560	320	1639	1095	428

Note: These results differ from those in Table 4 due to different accounting conventions used by the respective analysts.

For ABT and CAB, respectively, the operating loss before subsidies was R5,4m and R1,2m for the year ended 31 March 1996, and the operational self-sufficiency index was 50.3% and 67,8%, implying that the banks were only able to cover that proportion of their operating expenses (including salaries but excluding the cost of finance) from loan interest and fee income. The level of bad debts and provisions is such that it wipes out the total interest earned on the loan book, leaving no margin to cover the cost of finance or operating expenses. The subsidy dependency index for both institutions was high, but has decreased considerably in the past year. This improvement can be seen in all of the indicators shown above.

3.2.3 Some innovations

It does not take much knowledge of rural financial markets to predict that neither of these institutions has any chance of survival unless they change the ways in which they operate. While neither of them have been successful at managing the process of change to date, there are three examples of innovations that have been implemented, and that may help in determining the best way forward for these two banks. Table 10 below provides summary statistics on the loan portfolio of the two banks, as background to the discussion of these innovations.

Table 10: The loan portfolio of the banks

	1994	1995	1996
Transkei Agricultural Bank			
Number of approvals	10,978	18,034	15,028
Average loan approved	R1,106	R951	R816
Ciskei Agricultural Bank			
Number of approvals	1,039	3,101	2,265
Average loan approved	R13,174	R8,105	R7,008

Group lending

It is evident from Table 10 above that the loans which CAB advances tend to be significantly larger than those advanced by ABT, the reason being that a big part of ABT's loans are disbursed as group loans. At 55% of the total portfolio value, ABT's group loans are the biggest portion of their lending. The total value of CAB's rural development and group loans, by comparison, form less than 20% of its total loan portfolio. In October 1996 ABT had 24 loans in excess of R100,000 as compared to 41 in CAB's case. In October 1996 55% of CAB's loan portfolio were lent to 104 borrowers. ABT's finance, therefore, appears be directed at a lower income segment of the rural market.

ABT lends only into the agricultural sector, and the bank advances loans to individuals and to groups, where the maximum group size is 10. The group members are jointly and severally liable for the repayment of the loan. The distribution between individual loans and group loans is shown in Table 11.

Table 11: Individual and group loans

	1994	1995	1996
Individual loans	178	105	88
Group loans	10,800	17,929	14,940
Total	10,978	18,034	15,028
Average loan amount	1,107	952	816

The interest rates charged on the loans vary, and are currently issued at rates of 19.5% for groups and 21.5% for individuals. Borrowers are charged at prime rate at the date the loan was granted. This rate remains fixed over the period of the loan. The interest rates do, therefore, not reflect the level of risk of the loans. Further, the loan repayment terms are too long. This is specially relevant for input loans, where the one year term with a single repayment required at the end of the term complicates cash flow management for the client and the follow-up for the bank.

Table 12 shows the criteria that are used to approve loans. It is evident that the credit assessment process is not appropriate for the nature of the market in which the bank operates, and does not reflect the international best practice of rural lending. The assessment of group loans gives limited attention to group coherence and to the previous performance of projects undertaken by the applicants. The repayment capacity of the applicants is largely disregarded with little consideration given to the impact on disposable income of critical factors such as family size, other household debts and other sources of income.

Table 12: Credit assessment criteria

Group loans	Individual loans
The potential of the agricultural project which is proposed No security, but an initial deposit required	The potential of the project Quality of security, with the following as order of preference 1. Investments 2. Urban property 3. Session of life insurance policy 4. Surety over proceeds of project

The ratio between group and individual loans extended by ABT was 55:45 at the end of March 1996. Theoretically, group loans should be less risky for the bank than individual loans, if one assumes that the groups are small, are well managed, and the average loan much smaller than individual loans. The latter is applicable to ABT, but the other factors are debatable, as the groups, at up to 10 members, are fairly large, and the management of these groups does not appear to be efficient. This is reflected in the large overall arrears position of the loans portfolio.

Despite these negative comments, however, it is clear that ABT has gained some experience in group lending, a technology that could stand it in good stead in the future.

Non-agricultural lending

CAB grants both agricultural and rural development loans. The former is for specifically agricultural purposes, while the latter is mainly for hawkers. The amounts lent vary from R2000 to R1 million across the various categories. Most of the loans are repayable in monthly instalments, although some loans are also structured for the needs of the agricultural users. The loan terms vary from a number of months to a maximum loan term of 20 years

The interest rates charged on the loans vary from 17% to 19%, after an incentive for good repayment. A rural development loan is, for instance, granted at a rate of 27% but the borrower receives a discount of 10% for punctual repayment. These discounts are paid by cheque at the end of the loan term.

CAB has, therefore, made some attempts, especially with the rural development loans, to adapt its loan products to the needs of the market in which it operates. As in the case of the group loans of ABT, the implementation of this product is faulty, although it is a step in the right direction, and the experience gained in its design and implementation could prove useful in the future.

Savings mobilisation

CAB offers savings facilities at its two branches. At 31 March 1996 the total amount deposited with CAB was R6,512,129, from 15,008 clients, with an average deposit balance of R559 when calculated on number of accounts. Eight accounts, which made up 33% of the total savings, had balances over R100 000, leaving the average size of the remaining accounts at less than R300. Eighty percent of the deposits consist of savings accounts. The net cost to the bank of maintaining the savings accounts varies between 19% and 20% (this is before the interest earned from the investments are taken into account). CAB does not on-lend the savings, and is therefore not performing an intermediation function. It is not registered as a bank and the fact that it takes deposits therefore constitutes a contravention in terms of the Banks Act.

The total balance on deposit has fluctuated over the period, with an increase of 13% from 1993 to 1994, a decline of 2% from 1994 to 1995 and an increase of 12 % from 1995 to 1996. The total amount saved with the bank has, therefore, declined in real terms. Savings have grown from 65% to 78% of the total deposits. The reason for this change is the change in the maturity profile of the savings, as reflected in Table 13 below. The funds have been placed on deposit, and the interest earned is used to cover the operating costs of the institution.

Table 13: The maturity profile of savings at CAB

Total deposits analysed in maturity bands	1994	1995	1996
- maturing within 6 months	92,7%	79.6%	79.5%
- maturing from 6 to 12 months	7.3%	20.4%	20.6%

3.2.4 Conclusion

Both CAB and ABT have taken some steps to customise their services to market demand, as evidenced by the range of their products and innovations such as ABT's group lending and CAB's Rural Development Loans. The process of institutional adaptation and product development informed by a systematic market analysis and clear orientation towards specific market niches has, however, still a long way to go. CAB has also developed savings facilities, but these are only available at two branches. The security situation has played a major role in preventing them from expanding this service. CAB does not on-lend the savings which it mobilises and does therefore not engage in intermediation between savers and borrowers, principally because of legal constraints.

ABT provides finance for agricultural purposes only, while CAB has made some progress in this area with the development of their Rural Development Loans. However, both institutions provide their finance as direct payments to suppliers. This limits the flexibility for borrowers and does not give them discretion to respond to changing circumstances. Due to the collateral requirements a substantial portion of the rural population in the areas which CAB and ABT is serving are denied access to finance. ABT, through their group loan product, has made some progress in this direction. ABTs application of the group lending methodology appears to be the most significant application of alternative lending methods. However, the lack of rigour in their application, and in enforcing the penalties for non-performance by borrowers, undermines the effectiveness of these alternative lending methods.

Three main conclusions can be drawn from this case study:

- The Strauss Commission envisaged an institutional structure that would consist of the Land Bank as the apex institution that would provide financial services on a wholesale basis to a broad range of clientele, including its existing clients in commercial agriculture as well as a new clientele of poor farmers. Therefore, in accordance with the formal decision by government in accepting the Final Report of the Commission, the Land Bank will retain its focus on agriculture. This means that no steps are envisaged to manage the covariant risk of the institution. In addition, it is not yet clear whether the Land Bank intends to expand the range of financial services that it offers to more than loan financing. If this is not done, then by implication little will be done to manage the moral hazard problem of the institution. It would, therefore, be unwise for retail level such as the two described in this case study to remain so strongly focused on one sector and one service instrument. Both the institutions discussed here have initiated steps to widen the scope of their clients and to introduce new services, and they should be encouraged in this endeavour.

- However, these institutions are struggling to find a new (sustainable) role while still burdened with the legacy of the past and all that this implies. At the same time they are also subject to a legal and regulatory environment that impedes their ability to operate effectively, as will be seen in the following chapter. They are, by implication, a high risk for a wholesaler such as the Land Bank unless they are transformed into more efficient institutions. Such a transformation calls for difficult political decisions as well as a measure of interim subsidisation until such time as they can operate in a financially sustainable manner.

- The innovations that have been attempted by these institutions have drawn on the international experience. However, this experience shows other important lessons that have yet to be adopted. These include the futility of trying to impose groups for savings or lending purposes; recognition that direct payments to suppliers ignore the needs of poor people; and that there is no easy way out: such innovations cannot survive if the institution itself is at risk. These innovations should become the core business of such institutions, rather than experiments that are carried out in a manner that puts the assets of the poor at risk.

3.3 NewFarmers Development Company

A S M Karaan

3.3.1 Background: The land reform and empowerment context

The dawn of a new dispensation in South Africa has brought many challenges related to correcting the wrongs of the past and crafting a better social and economic future. The legacy of dispossession and deprivation of black people has limited their participation in agriculture to subsistence farming in the former homeland areas and labouring on white commercial farms. Land reform is, therefore, considered to be key to achieving greater equity and social justice through the mechanisms of restitution, redistribution and tenure reform. However, in a dualistic agriculture, the mere transfer of land to the disadvantaged will not be sufficient to bring them into the mainstream of agriculture. A business development and empowerment mechanism is thus required.

Organised agribusiness in especially the high value agricultural sectors has been keen to find innovative ways to facilitate the establishment of previously disadvantaged people in various ways in these parts of the agricultural sector. Their reasoning has apparently been, *inter alia* a desire to: (i) improve productivity in the sector; (ii) be proactive in promoting commercial as opposed to subsistence farming; (iii) gain greater favour with government; (iv) improve their international stance; and (v) establish a positive relationship with new entrants in commercial agriculture. The involvement of the private sector in facilitating farmer settlement through the creation of a mechanism such as NewFarmers, whose primarily function is to provide capital to new entrants, is one of the more unusual innovations in financial intermediation for the poor in South Africa.

3.3.2 A brief history of NewFarmers Development Company (NFDC)

The NFDC started as an initiative of leading South African enterprises that were directly or indirectly involved in agricultural. The lead was particularly taken by Unifruco, the most prominent deciduous fruit exporter in the country. They were joined in the endeavour by the KWV (wine), and Outspan (citrus). The financial sector was represented by ABSA, Sanlam, and Old Mutual, who were sufficiently convinced to invest in the initiative. The initial capital originated as follows: Old Mutual (R5m), ABSA (R4m), Sanlam (R4m), Outspan (R2,5m), Unifruco (R2m), and the KWV (R0,6m), to give a total initial capital of R18,1m.

This start-up capital enabled the creation of the NFDC, which became operational in March 1995 with a professional staff compliment of 4 i.e. a Managing Director, a Financial Manager, and two Project Managers.

The NFDC saw the their initial capitalisation as a first phase, which had to be followed by a second capitalisation phase to ensure continued sustainability. Two farming projects had been implemented by the time it became necessary to commence with phase two. In this phase (1996) the capital base was expanded to R58,2m, of which R20,56 was generated by South African institutions (Old Mutual, Sanlam, Unifruco Ltd., First National Bank Ltd., ABSA Bank Ltd., Outspan International Ltd., Southern Life Ltd., and KWV Ltd.) and R21 million by international development finance institutions (Commonwealth Development Corporation, Proparco , and FMO). South African shareholders control 59% of the issued share capital and international development finance institutions 41%. The detailed shareholding is provided in the table at the end of this section

3.3.3 Farm workers

A brief overview of farm workers is considered useful in providing the context for the NFDC model. As the activities of the NFDC are thus far predominantly centred in the Western Cape, this overview is limited to this province.

The size of the permanent labour force in agriculture in the Western Cape was estimated at 125 000 in 1992, and growing at about 2,7% per annum. The size of the seasonal labour force is estimated at about 110 000, and growing at 4,2% per annum. The horticultural sector is the most labour intensive. Vines and deciduous fruit together absorb around 46% of the farm labour force in the province. The number of households per farm could be up to 40. Despite the considerable size of the seasonal labour force, 31 % of the permanent labourers have lived on the same farm for more than 10 years. This confirms the notion that a firm proportion of farm workers, evidently those in the higher ranks who are better skilled, choose to remain in the agricultural sector. It is mostly this group who in the new South Africa are searching for empowerment opportunities to be settled as commercial farmers. Their main constraints remain access to capital, management and administrative expertise, institutional networks in the sector, marketing skills, and confidence. Their strengths are operational experience, entrepreneurial skills, and a strong determination to find their place in commercial agriculture. The NFDC is intended as a mechanism to capitalise on their strengths and complement their weaknesses.

3.3.4 Mission and objectives of the NFDC

The mission of the NFDC is to create opportunities for viable farming enterprises, focusing on developing communities, through project development, loan finance, and equity participation. This mission is underpinned by two objectives:

- Broadening the ownership base in agriculture; and
- Integration of clients from developing communities into the mainstream of commercial agriculture.

These objectives can broadly be summarised as promoting equity and economic empowerment in order to contribute towards job creation and access to income streams in the rural economy.

3.3.5 Modus operandi

The following approaches epitomise the *modus operandi* of the NFDC:

Project design is underpinned by a philosophy of partnerships between the NFDC, developing communities (mainly ex-farm labourers), commercial farmers (or agri-entrepreneurs), and external investors. A range of ownership structures can be introduced to satisfy the preferences of new entrants and the other investors. These include equity schemes, sale of farms or portions thereof to new entrants, develop-and-transfer schemes, lease and buy schemes, contract farming, syndicated joint ventures, etc. In the short term the NFDC will focus on equity schemes with elements of satellite farming. It is highly preferred that all projects involve an experienced entrepreneur as co-investor who should accept managerial responsibility. Often, the previous owner and/or farm manager fulfils this responsibility.

Only highly profitable ventures contend for **project selection**. Hence there is an emphasis on the most profitable agricultural sectors, including deciduous fruit, wine, sub-tropical fruit, citrus, vegetables and flowers. These are usually labour-intensive and technically sophisticated with opportunities for value-adding and exporting, thus enabling vertical integration and improved profitability.

Beneficiaries are usually existing organised disadvantaged groups searching for opportunities in commercial agriculture, or labourers on a commercial farm who express an interest in equity-sharing in the business. The approach is to involve them in the project in a way that capitalises on their developed skills (technical) and experience, building entrepreneurial skills, and supplementing other necessary expertise through partnerships with the commercial sector, e.g. management, finance, strategy, marketing, and so forth.

The NFDC hopes to build a **balanced portfolio** of projects in terms of: geographic location, agricultural sectors, size of investment, term of loan maturity, and cash flow.

Projects are appraised on the basis of the following **financial considerations**:

- The project must be profitably and effectively managed, with returns on investment and equity around

20%;

- The present value of the capital outlay and future long-term cash flow must be acceptable if measured by standard discounted cash flow techniques such as IRR and NPV;
- The degree of indebtedness of a project must be of such a nature that it will have a positive financial leverage effect on the ROE and still be able to service its debts;
- The project must be able to meet its short term debts as shown by liquidity ratios;
- Projects must contribute to a balanced investment portfolio;
- NFDC's total exposure to a project will not exceed 70% of the total capital requirements of the project, whilst the equity stake will normally not be less than 26%.

Projects are appraised on the basis of the following **technical considerations**:

- Projects must have sufficient scope to expand by way of new developments by at least 25%;
- A project must be primarily focused on one highly profitable sector, to which supplementary crops offering good returns could be added;
- Vertical integration and value-adding opportunities must prevail;
- Strong support services in terms of management, marketing, technical advice, training, access to credit, and production inputs must be in place;
- There must be a commitment to sound environmental practices.

There is considerable reliance on the R15000 capital grant subsidy of the land reform programme as part of the equity contribution of beneficiaries. Where possible, savings are also mobilised. Upon this capital base financial gearing is applied to enhance the contribution of disadvantaged beneficiaries through loan finance and warehousing of shares in their interest.

3.3.6 Services

The main services provided by NFDC include the following:

- **Facilitate access to loans.** The NFDC does not consider itself primarily a lending institution. In the cases that it has extended loans, this was mainly done to purchase or develop a farm for settlement at a later stage. The capital invested is then taken as part equity investment by the NFDC, and the rest can be acquired by beneficiaries and other investors. The NFDC would approach lending institutions to finance equity acquisition and development costs on behalf of the project.

- **Equity investments.** This is considered their main business. The NFDC will invest in a settlement project with a view to generating dividends for its shareholders. Their equity can, however, be acquired by the project beneficiaries as soon as they are financially capable of doing so.

- **Structuring of project finance.** A considerable proportion of the time of the staff of NFDC is devoted to packaging loans, investments, grants, warehousing of shares and related aspects. This involves dealing with commercial banks, donors and other potential investors, accessing settlement grants from government, and frequent meetings with project stakeholders.

- **Participation in strategic management.** NFDC staff do not participate in the day-to-day operational management of the farms, as this responsibility is relinquished to the more experienced managers and ex-workers. They reserve their management participation to strategic levels e.g. the Board of each project.

3.3.7 Current Projects

Table 14 below summarises the current projects of NFDC.

Table 14: The current projects of NFDC

	Projects	Region	Investment (Rm.)	
			to date	total
A	**Committed projects**			
	Verlorenvlei	Western Cape	6	12
	Warmwater	Western Cape	2.1	4
	Erfdeel	Western Cape	6	25
B	**Advanced preparation**			
	Cape Olives	Western Cape		23
	Chennels	Mpumalanga		28
C	**Preparation**			
	Vegetables	Free State		unknown
	Dewlands Juices	Western Cape		unknown
D	**Total**		14.1	max. 40

3.3.8 Overview of selected projects

Partnership with NuweBegin

NuweBegin ('New Beginning') is an association of about 40 disadvantaged farm workers (households) who formed the organisation as a vehicle to achieve their aim of becoming commercial farmers upon the dawn of a new political dispensation in South Africa. All the members have extensive experience as labourers on commercial farms in the Western Cape. Their leadership consists of those who occupied management and supervisory positions on the farms where they were employed. They are assisted by a (white) farm manager who shares their development ambitions, and under whom most of them have worked on more than one commercial farm over more than 20 years. They have thus developed a unique value system which manifests well in their motivation and productivity. Their commitment is further evident from the monthly contribution each makes to the capital base of their company (NuweBegin) out of their wage incomes. These funds were mainly used to finance their search for economic opportunities in commercial agriculture.

NuweBegin approached the NFDC to facilitate their settlement in the agricultural sector. Settlement grant assistance of R15000 per household was sourced from the Department of Land Affairs as their equity contribution. NewFarmers saw fit to involve NuweBegin in two of their very first projects. A grant was also received from the Independent Development Trust to enable them to contract professional expertise regarding legal and technical matters.

Verlorenvlei

The farm Verlorenvlei was a first purchase by the NFDC for the settlement of new entrants in the export deciduous fruit sector. It is situated between Ceres and Touwsriver in the Western Cape, approximately 200 kilometres from Cape Town. The farm comprised 34ha of orchards, but has sufficient additional land and water resources to allow for the development of up to 169 ha of fruit and 73 ha of cash crops, for a total of 242 ha under irrigation. The crop mix consists of nectarines (7,5 ha), peaches (27,3 ha), apples (100 ha), and pears (34,5 ha).

Feasibility studies have revealed that the development of the farm will ultimately yield an IRR of 21%, returns on investment which turn positive in year 6 and stabilise at around 25%, and returns on equity stabilising at around 30%. To achieve this would require a capital outlay of close to R12m, to be financed with loans from NFDC, loans from banks, equity investments, and settlement grant subsidies.

About 10 households of the NuweBegin group have already been settled on Verlorenvlei, and up to 30 households could eventually be settled on the farm once fully developed. The farm manager who has been involved with NuweBegin has been appointed in an advisory capacity for Verlorenvlei and has also agreed to a 5% share by way of a capital investment in the project. A farm manager has been appointed from the NuweBegin ranks, and it is foreseen that various other specialist managers will be appointed. NuweBegin's shareholding in the project has not yet determined, but would be based on the extent of their settlement grant subsidy, leveraged by additional loan finance.

Warmwater

The Warmwater project is situated between Barrydale and Montagu in the Western Cape, an area which is established and recognised for deciduous fruit growing. The farm comprises 40ha of orchards, which can be expanded to 55ha. In total the farm extends over 542 ha, which offers further opportunities. Value-adding to existing crops such as drying and processing is another possibility.

The feasibility studies indicated a NPV of R3m, an IRR of 28%, returns on investment approaching 26%, and returns on equity reaching 29%. Debt will be around 45% of assets, and capital growth of 14% on net asset value is expected.

NuweBegin holds a 40% interest in the farming trust, which could gradually be increased by reducing the NFDC interest of 60%. A farm manager has been appointed from among their members, and an experienced farm manager, who holds a 5% share, has also been appointed. Currently, 20 members of NuweBegin are settled on Warmwater.

Erfdeel

Erfdeel farm is situated near Piketberg on the west coast of the Western Cape. The NFDC was approached by the existing farmer, who is interested in getting the workers settled as farmers and participating in the equity of the business, whilst he retains a substantial interest in the project.

The farm currently has an irrigation capacity of 93 ha of table grapes, vines, citrus, peaches, and nectarines, with expansion possibilities in table grapes and citrus. A further 500 ha is suitable for the cultivation of dryland grain and pastures.

It is envisaged that, while the workers would be incorporated in equity sharing in the short term and compensated for labour, in the longer term satellite farming units could be established for smallholders. The main farm will thus continue to be managed and controlled by the appointed managing director, the workers, the NFDC, and other equity investors. The establishment of the satellites will gradually evolve as will it's relationship with the main farm. The nature of this arrangement remains a key challenge in settlement projects. Initial indications are that the main farm and the satellite farms will have a return on investment of between 25% and 30%. The total funding requirement is R25m, to be invested over the first four years.

Agribusiness

The NFDC is considering investing in agribusiness ventures pertaining to value-adding, as these activities are considered more viable than farming alone. These investments would also commence as worker equity sharing initiatives. Cape Olives is one such venture, involving the production and large scale processing of olives. Another project involves the processing of fruit juices for the export market. These projects are currently at an advanced stage of preparation and the NFDC foresees increased involvement in such ventures, mainly as a result of the higher returns on offer.

3.3.9 Key indicators for the NewFarmers Development Company

General

Table 15: Base information on NFDC

Year established	1994
Type of institution Ownership Aid Staff composition: (6)	Limited Company with empowerment objectives focusing on investments in the agricultural sector Shareholders (see Table 19 for list of shareholders) No donor or other development aid funds are used by the NFDC 40% of the shares are held by foreign parastatals • Managing Director • General Manager: Finance • 2x Project Managers • 2x Administrative

Profitability

Table 16: Profitability indicators for NFDC

Total Assets	R58 217 161
Profits before tax (year 1 to present)	• 1995 = R33 487 • 1996 = -R1 036 666 • 1997 = R566 858 More than 90% of profits to date are derived from interest income
Returns on equity	• 1995 = 0.34% • 1996 = -11.45% • 1997 = 1.12%
Debt-equity ratios	Ratio is projected to vary between 0.01:1 to 0.8:1

The short term profitability (to date) is mainly achieved from interest income. The negative results in 1996 is a result of the investment in one project i.e. Verlorenvlei and is rather a special non-conventional investment. Although the interest income constitutes more than 90% of present income, the ratios is set to change considerably over the longer term as capital is invested and profits are realised from project investments. Current moneys on deposit should reduce to about R8 million by 2003 in which period returns on investments and equity (ROI and ROE) is increased to about 7% and 12% respectively.

Outreach

Table 17: Outreach indicators for NFDC

No of beneficiaries	Between 10 - 30 per project
Geographic spread	Western Cape, Mpumalanga
Branches: - current - envisaged	Only one branch which is Head Office based in Durbanville. No other branches are foreseen.
Volume of investments outstanding to date	R10 611 971
Maximum investment size	Maximum 10% of share capital i.e. about R5 million per project. Can only be exceeded with Board's permission.
Average investment size	R2,6 million
Average investments per Project Manager	R5 million
Real growth in annual assets	• year 1= R12 746 477 • year 2 =R10 314 747 • year 3 =R58 217 161

Terms and conditions

Table 18: Investment terms and conditions for NFDC

Eligibility requirements	• Workers in the agricultural sector; • Organised disadvantaged groups; • Involvement of experienced agri-entrepreneur
Types of activities financed	High value, high returns commodities/activities in the agricultural sector
Involvement of groups	A disadvantaged group is usually organised into a legal entity e.g. a trust.
Average number of project beneficiaries	Range between 20 and 200 per project
Investment approval adjudicators	Board of Directors of the NFDC
Community/ beneficiary involvement in decisions	Operational decisions on farm are devolved as far as possible.
Repayment frequency of loans and dividends	Per annum with grace periods where required
Supervision of investments	NFDC staff and Board
Proposed length of involvement in projects by NFDC	NFDC is prepared to reduce its interest in projects as soon as it is able to carry the total capital burden and development objectives are realised.
Performance incentives to staff	Currently under consideration
Foreclosure or repossessions	Not applicable
Loan interest rate	Below prime

Financial performance

Table 19: Financial performance of NFDC

Administrative expenses / annual average total assets	R477539/R50m, i.e. maximum 1%
Administrative expenses / annual average investment portfolio	R477539/R32 million = 1.5%
Personnel expenses / annual average total assets	R1 324 728 / R50million = 2.65%
Personnel expenses / annual average investment portfolio	R1 324 728 / R32million = 4.1%
Salaries / administrative expenses	R1 192 718/R1 670 257 = 71.4%
Staff training provided	Yes. Attendance at relevant seminars.
Training provided to borrowers	Facilitate access to grant funds for operational and management training in agriculture.
Interest expenses/annual average total assets	R252 504 / R50million = 0.51%
Interest expenses/annual average investment portfolio	R252 504 / R32million = 0.8%
Salary costs as % of average annual investment portfolio	R1 192 718 / R32million = 3.73%
Operating cost as % of average annual investment portfolio	R205 477 / R32 million = 0.64%
Total income/annual average earning assets	Approx. 15%

3.3.10 Conclusion

The Western Cape Province is responsible for more than 60% of the farm exports from South Africa, and these exports have been growing rapidly over the past decade. It is little wonder, therefore, that there is currently substantial private sector investment in agriculture in the province. The 1993 agricultural census shows that the province is responsible for approximately 10% of total farm output in the country, 32% of the capital investment, and 15% of the total farm debt.

This performance has been achieved despite the relatively poor resource base for agriculture in the province. It is known that some 90% of the high value arable land in the country is to be found in KwaZulu-Natal and the eastern Transvaal area (i.e. Mpumalanga and parts of Gauteng province), and that most of the arable resources in the Western Cape are of medium quality at best. The export orientation of the Western Cape can probably be ascribed to the relative ease with which the industry has been able to re-enter markets from which it was excluded during the sanctions era, its traditional export orientation, and the long distances to South Africa's main domestic market in Gauteng.

In addition, there is a close relationship between agriculture and the booming tourism industry in the province. The result is a growing and relatively prosperous sector that is well served by private financial institutions. Under these circumstances, farmers have approached land reform opportunities from a profit motive, rather than from a socio-political perspective. A recent study[14] has shown the large efficiency gains that are made on farms where workers are drawn in to the business on a partnership basis. In a sense, therefore, the creation of NFDC seems an inevitable, and logical, outcome of the ruling circumstances in the province. In the event that other parts of the sector in South Africa turn towards the international market, the expansion of NFDC, and possibly its replication by other similar institutions, could also be expected. This raises the obvious question, in the context of this study, of the replicability of the concept in other countries in Africa which, if they have any access to venture capital at all, have to source it largely from donor institutions.

Even in the South African case, donor country institutions have provided some 40% of the capital base of NFDC, as is evident from Table 19 below. In addition, it is not clear whether the new entrepreneurs have access to other sources of funding beyond their claim on grants and their own capital. In this sense, the case study confirms the finding of the Strauss Commission, namely that private funding sources, including the commercial banks, are reluctant to take up the perceived risk of providing services to such clients, and limit their services to deposit taking and transmission instruments. The result is that better-off farmers and farm workers have preferential access to such opportunities, and that such programmes, while useful instruments for land reform, do little to alleviate poverty.

[14] Eckert, J B, J N Hamman and J P Lombard, 1996. Perceiving a new future: empowering farm workers through equity sharing. *Development Southern Africa*, Vol 13 No 5. October: 693-712

Table 20: NFDC shareholding after private placing

	NUMBER OF SHARES	NAME OF SHAREHOLDER	%
1	10,000,000	Commonwealth Development Corporation	19,52
2	8,000,000	Societe De Promotion Et De Participation Pour La Cooperation Economique	15,62
3	5,000,000	ABSA Bank Beperk	9,76
4	5,000,000	SANLAM (CMB Nominees (Edms) Bpk)	9,76
5	5,000,000	South African Mutual Life Assurance Society	9,76
6	4,056,197	Unifruco Bpk	7,92
7	3,000,000	Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden NV	5,86
8	3,000,000	Outspan International Ltd.	5,86
9	1,000,000	Kynoch Kunsmis Bpk	1,95
10	1,000,000	The Southern Life Association Ltd	1,95
11	1,000,000	Rembrandt S.A. Beperk	1,95
12	1,000,000	Koöperatiewe Wynbouersvereniging van Suid Afrika Bpk	1,95
13	1,000,000	First National Bank of Southern Africa Ltd	1,95
14	500,000	Metropolitan Life Limited	0,98
15	300,000	Anton Rupert	0,59
16	250,000	South African Fruit & Vegetable Canners' Association (Pry) Ltd	0,49
17	250,000	Caltex Oil (Pty) Ltd	0,49
18	250,000	Appelkoos-, Peer- en Perskekwekersvereniging	0,49
19	200,000	Cape Dried Fruit (Pty) Ltd	0,39
20	200,000	PEPKOR Bpk	0,39
21	150,000	NAMPAK Limited	0,29
22	100,000	Sentrachem Bpk	0,20
23	100,000	Pick 'n Pay Stores Limited	0,20
24	100,000	SAPPI Limited	0,20
25	100,000	Towerkop Suiwelkooperasie Bpk	0,20
26	100,000	Irvin & Johnson Limited	0,20
27	100,000	Standard Bank of South Africa Limited	0,20
28	50,000	Tabakraad	0,10
29	50,000	South African Marine Corporation Limited	0,10
30	50,000	Bonnita (Edms) Bpk	0,10
31	50,000	Boland Bank Beperk	0,10
32	36,160	WPK Landbou Beperk	0,07
33	30,000	Westelike Provinsie Kooperatiewe Tabakkwekers Bpk	0,06
34	25,000	Investec Bank Limited	0,05
35	22,816	Kleinsake-Ontwikkelingskorporasie Beperk	0,04
36	20,000	Simonsberg Vrugteverspreiders (Edms) Bpk	0,04
37	20,000	Woolworths (Pty) Ltd	0,04
38	15,000	Boskop Opleidingsgroep	0,03
39	10,000	LANOK (Edms) Bpk	0,02
40	10,000	Nitrophoska (Edms) Bpk	0,02
41	10,000	Consol Limited	0,02
42	10,000	Suid-Westelike Landboukooperasie Bpk	0,02
43	10,000	Sentrasure Bpk	0,02
44	10,000	Porterville Landboukooperasie Beperk	0,02
45	10,000	Boeresake (Koop) Beperk	0,02
46	10,000	Caledon-Riviersonderend Kooperasie Beperk	0,02
47	10,000	Oranje Kooperasie Beperk	0,02
48	5,000	Moorreesburgse Koringboere Kooperatief Beperk	0,01
	51,220,173		100,00

3.4 The Village Banks

N Vink and G K Coetzee

3.4.1 Establishment of the Village Banks

The Village Banks are simple community-level banking institutions that were designed to create access to basic financial services in three villages in the Northwest Province. A project, developed under the Agricultural Committee of the RSA-US Bi-National Commission and approved for funding by the South Africa office of USAID, has been launched to assess the existing Village Banks and the replicability of the model in other areas.

The Village Banks are designed to enable a community to organise into an association in which every member has a share. Individuals can accumulate shares, and in so doing can increase their voting power up to a ceiling of five per cent of all votes. At the same time members can make regular contributions to a savings account. Both the shares and savings are deposited in nearby commercial bank branches. These deposits can serve as collateral for a loan from the bank to the village association, which will in turn retail the loan to individual members through a loan committee, following established credit criteria. Other services, such as pension payments and insurance products, can also be channelled to association members via the commercial bank. The Village Bank thus serves as a vehicle to link member-clients to the formal financial markets through the security of their fixed deposits. Professional security firms transport the cash from the association to the bank, and loan and pension moneys from the bank to the village association. The transport cost is absorbed as a part of the fees charged to members.

Ownership of shares enables citizens to become owners of the bank, to use its services and to elect the Board of Directors. The essence of the Village Bank concept is that it is funded, operated and controlled by a community, who make the decisions and bear the risk associated with those decisions.

The main descriptive features of the three Village Banks that have been established in the Northwest province are given in Table 21 below.

Table 21: The characteristics of the Village Banks

	Kraaipan	Lotlhakane	Motswedi
Population	24 000	20 000	7 000
Date established	December 1994	July 1995	February 1996
Number of shareholders	370	150	206
Total deposits	R134 600	R57 000	241 000

3.4.2 Performance

The Village Banks are a rare example of finance NGOs that operate purely in the rural areas of South Africa. There are, furthermore, few NGOs that specialise in the provision of financial services among the poor, whether rural or urban, as will become evident from the case study on informal finance below. Nevertheless, the Strauss Commission analysed these finance NGOs as part of its survey of potential retail level finance institutions. Theoretically, it is expected that these institutions will have an advantage over, for example the commercial banks or parastatal institutions, in that they should have access to better information about their clients. Five NGO financial institutions were analysed by the Commission to test this proposition. It will become evident from the discussion below that these institutions vary widely in the way in which they conduct their business. Comparisons between them are, therefore, less relevant than the profile that is provided about how each of them attempts to serve their clients. The institutions included in this discussion are:

- The Financial Service Associations (Village Banks);
- The Small Enterprise Foundation (SEF);
- The Get Ahead Foundation (GAF);
- The Rural Finance Facility (RFF);
- The Financial Aid Fund of the Sugar Association (FAF) for sugar outgrowers.

The SEF is exclusively rural in its outreach, and operates in the Northern Province, while the RFF has a strong rural base in its micro loan facilities in Mpumalanga and the former Transkei. Its small housing loans also reach low income workers in unionised firms. The GAF has one large rural branch in Acornhoek in Mpumalanga, while its remaining branches serve a low income urban clientele. Finally, the FAF exclusively serves a rural clientele, i.e. small sugar outgrowers along the coast of KwaZulu Natal.

The Village Banks have followed a savings first strategy, as opposed to the credit-first approach of the four other NGOs, although the portfolio of FAF is evenly balanced between savings and credit operations. While the Village Banks, FAF and the RFF through its housing loans lend to individuals, the Get Ahead Foundation, the micro finance section of the RFF and the SEF follow group lending practices. While the GAF and RFF issue a small number of individual loans on an experimental basis in their micro finance facilities, their micro finance activity is predominantly made up of group lending, largely to poor women.

Outreach

Table 22 shows the extent of outreach for these NGOs, using standard measures. FAF has a healthy savings outreach compared to the Village Banks, as FAF has been operating for 22 years, while the Village Bank movement only began in 1994. However, some two thirds of the savings accounts held in FAF are compensatory guarantees linked to loan contracts, while the other third are voluntary savings accounts from non-borrowers in the cane growing areas. The average savings balances of FAF and the Village Banks are roughly the same.

Table 22: Outreach of financial service NGOs in South Africa

	Village Banks	SEF	GAF[1]	RFF	FAF
Number of branches	2	4	10	9	20
Number of satellite branches	-	-	13	-	-
First year of lending	1995	1992	1988	1993	1973
Non-financial services	No	Yes	No	No	No
Number of deposits accounts	129	0	0	0	26 000
Average size of deposits (Rand)	317	-	-	-	269
Number of loans outstanding	Limited	1 994	Micro: 6678 Business: 111 Partner loans: 77	Housing: 757 Micro: 623	38 000
Average loan size (Rand)	-	390	Micro: 462 Business: 4345 Partner loans: 2637	Housing: 3830 Micro: 474	1 711
Agricultural loans outstanding	0	20	0	0	38 000
Average agricultural loan size	N/R	417	N/R	N/R	1 711

Note: GAF also has branches elsewhere in Southern Africa. These data refer to South Africa only.

The number of branches of these NGOs is a function of the age of the programme, with the older FAF programme having the largest branch network, followed by GAF and the RFF. FAF also has a greater outreach with its loans programme, with considerably more loans on its books than the other NGOs combined.

The wide variation in average loan size reflects the variety of loan products offered. First, SEF, a 'Grameen replicator' offers a group loan service only (to groups of five people, typically low income women hawkers and artisans) in its micro finance facility. This is the smallest loan size among the NGOs, indicating that SEF is possibly reaching further down into the poverty class than do the micro group loan facilities of GAF and RFF, who also largely service women hawkers and artisans in their facilities.

GAF and RFF also offer individual loans. In RFF, home and home improvement loans are granted to workers in unionised firms. Employers deduct repayments from the payroll, and the workers' provident fund is used to guarantee the loans. These practices serve as a collateral substitute, as property, even if secured by a title deed, can in practice not be reclaimed. The average size of these loans is about R3 800, as compared to loans from its micro group loan facility (R474). Some 87% of the housing loan clientele are male, compared to the group loan programmes, where roughly 87 per cent of the clients are women.

GAF has a small number of individual business borrowers. However, given their poor repayment record, new loans have been suspended except for a pilot project in the Acornhoek office. The average loan size for these loans at R4 345 is the largest loan size recorded amongst the NGOs. GAF also services a small number (77) of business clients through its commercial partners programme. These clients draw on a line of credit, available at a large wholesaler, and guaranteed by GAF. The loans are typically for two weeks' duration and allow borrowers to purchase goods to resell in village spaza shops. This programme has a high recovery rate.

Only FAF lends to farmers, as the other NGOs focus largely on non-farm rural enterprises, and for RFF on housing in urban and peri-urban areas. SEF operates in deep rural areas, as does GAF and RFF, and most of their loans are to women engaged in non-farm trading and artisan activities. This outreach is in sharp contrast to the performance of parastatal rural financing institutions in South Africa, many of which concentrate on farm loans, and whose clientele is largely male and farmers.

Productivity

Table 23 shows indicators of the productivity of these NGOs. By these criteria, FAF stands out from the other NGOs in terms of the case load of loans per staff and loans per loan officer, mainly because FAF has only nine loan officers and 20 full time staff in the programme. However, the programme also depends upon the equivalent of roughly 100 staff at the sugar mills, who enforce loan contracts through automatic deductions at delivery of the cane. RFF benefits in a similar manner through its home loan programme.

Table 23: Productivity of financial service NGOs in South Africa

	Village Banks	SEF	GAF	RFF	FAF
% Arrears (by number of loans)		0	9	Housing: 1,6 Micro: 8,3	25
Number of loans/staff member	-	69	130	58	317
Volume lent/staff member	-	26 807	26 138	96 145	541 667
Loans/loan officer	-	166	198	100	4 222
Volume lent/loan officer	-	64 784	39 976	166 667	7 222 222

GAF and RFF have a similar loan arrears rate, unlike SEF, which has no loans in arrears despite having a high drop-out rate. The reason for the latter is that clients often regard the SFF as being too rigid, as they often require loans that are smaller than the (small) minimum size of SFF loans (R300); that many borrowers ill borrow only once as their real need is for a 'kick-start' loan; and that id a borrower has problems in repaying a loan, the group makes up the deficit, but does not allow that person further access.

The arrears performance recorded in the Table is reasonable for relatively new micro loan programmes such as that of RFF. However, the nine per cent arrears rate for GAF is more serious, as this programme has been operating for close to ten years. FAF, however, has a significantly higher arrears rate, partly because of the arrears definition used here. Arrears definitions for the other NGOs are measured as overdue (i.e. missing one instalment) interest and principal. FAF, however, estimates bad debt on the basis of expected cane yields early in the season. Hence the 25 per cent estimate for 1995 is an expected arrears based on the expected delivery of cane to the mills. Nonetheless, the table shows that NGO programmes servicing farmers will be exposed to a higher default risk than programmes that target a non-farm clientele.

Profitability

Table 24 shows profitability indicators for these NGOs, and offers insights into the characteristic problems of NGOs attempting to serve the low income clientele that banks and parastatal development finance institutions typically ignore. For example, SEF and RFF have a negative net rate of return on their assets, despite earning 46 and 34 per cent interest respectively on their loan portfolios. The reason lies in the high non-interest operational expenses per loan, which reaches 134 per cent in SEF and 120 per cent in RFF. Hence, such institutions require continuing subsidies until they can learn to lower their lending costs or expand the scale of operations with a given administrative base.

Table 24: Profitability (self sufficiency) of NGOs in South Africa

	Village Banks	SEF	GAF	RFF	FAF
Return on assets	0	-2	-28	-47	3,2
Interest earned on average portfolio	-	46	42	34	16,5
Interest paid on average portfolio	-	14	47	15	10,7
Gross financial margin	-	32	-5	19	5,8
Non-interest expenses on average portfolio	-	134	153	120	7,4
Return on average portfolio	-	-101	-158	-101	-1,7
Typical deposit rate	11	NR	NR	NR	11
Typical annualised loan rate	-	46	45	Micro: 67 Housing: 24,5	15,5

3.4.3 Conclusions

NGOs are often seen as a viable alternative to state and parastatal providers of financial services to those poor people who do not have access to commercial services. This belief in their efficacy was based on their supposed ability to reach their target clients and their ability to capitalise on the vacuum left by the closure of many specialised credit institutions in developing countries. In this process, the NGO lobby has gained considerable strength, drawing strongly on their elevated status as 'saviours of the poor'.

Unfortunately, there are few examples from anywhere in the world of financial service NGOs that have remained independent of subsidisation, raising questions about the opportunity cost of the funds they use. A low gross financial margin (the difference between interest earned and paid on their average portfolio) and high non-interest expenses are among the main reasons for the lack of sustainability of these institutions, as is shown in Table 25 below. While the data are limited, the Table also shows that South African NGOs compare well with their Latin American counterparts. While they seem to record higher non-interest costs of conducting their businesses, their interest spread tends to be higher.

The Village Banks can obviously not be included in this comparison, due to their entirely different approach to the provision of financial services. This difference can be found in terms of the services offered (savings rather than credit), the scale at which activities are conducted (community level) , and the overt attempt to manage the potentially crippling overhead costs through the links that are being forged with the commercial banking sector.

Table 25: Profitability of NGOs in South Africa compared with a Latin American Survey

	Small Enterprise Foundation	Get Ahead Foundation	Rural Finance Facility	Latin American Comparison*
Loans per staff member (R)	26807	26138	96145	54000
Int. earned/average portfolio	46	42	34	45
Int. paid/average portfolio	14	47	15	29
Gross financial margin	32	-5	19	16
Non-interest expenses on average portfolio	134	153	120	72

Source: Coetzee, 1997

This survey of some of the financial service NGOs in South Africa shows that, while they suffer from the same weaknesses as similar institutions world-wide, they have also tried to experiment with new and innovative approaches. These include measures such as seeking alternative collateral instruments, ways of cutting down on the high cost of information, and means of managing covariant risk. The wide range of permutations in these experiments, and the short life span of most of these institutions, however, makes it difficult to generalise about the optimal path to reaching the dual goals that most such institutions set themselves, namely to alleviate poverty and to become financially self-sustaining.

What is clear from the analysis is that none of the 'credit-first' institutions have entirely succeeded in reaching the poor, nor are any of them financially independent of donor subsidisation. The question that remains to be answered is whether a 'savings-first' strategy such as that followed by the Village Banks has a greater chance of success. The experiment to date has depended on donor funding, and there is little evidence that the presence of a Village Bank has contributed anything to the alleviation of poverty in those villages in which the institutions have been created. However, the lessons of international experience, as well as the assessment of the financial service needs of the poor in South Africa, do show that a focus on savings mobilisation and the provision of transmission services (which is accomplished through the linkage with commercial banks) at least focuses on the needs of poor people. In this sense, the case study presented here points the way to innovations that may bear closer monitoring by other institutions that have similar goals.

3.5 Distant echoes of the big bang? Local informal credit in a mobilised rural community[15]

C. R. Cross[16]

In the last five to ten years an important revolution has taken place in many of South Africa's rural credit markets. Formal credit has become widely accessible and acceptable to people in communities close to towns and cities, and often even to people living in outlying parts of the former homelands.

Higher levels of education and higher pay in the civil service and the private sector have combined with the push to make full-standard housing available to all, and have brought introductions to banks and building societies. At the same time, scope for employer lending has also expanded. Rural residents who previously feared becoming entangled with private formal credit institutions are now confidently running bank accounts and exchanging check payments. Rising wages for employed people have increased financial confidence and the perceived margin for experimentation, and have probably raised loan amounts and cut transaction costs for previously hesitant institutional lenders.

It seems that many parts of rural South Africa are quietly undergoing a 'big bang' financial transition of their own, with increasing access to credit. An important factor here is the relation between formal and informal credit markets.

This greater integration with the financial institutions of the developed sector has had major knock-on effects for how people in many rural communities handle financial exchanges on the ground: this is particularly true for the economically mobilised rural fringe clustered near towns and cities. The role of informal, local credit within such communities seems to be shifting as it adapts to the sudden appearance of the formal credit market.

3.5.1 Formal and informal credit in collision

Up to ten years ago, informal credit from within the local community was probably the main form of credit open to rural families. Consumer goods were sometimes covered by a narrow sector of private-sector hire-purchase transactions around furniture, appliances and basic consumer goods, but consumption needs and most fixed investments - including housing and cars - were usually capitalised by wage and pension throughput, by savings or by informal credit, including both person to person loans and local civil credit from savings clubs.

Under current conditions, formal-sector finance in the form of personal bank loans and employer loans is often available to employed people who are in contact with the developed outside economy. For them, formal credit with its lower charges is often the preferred alternative for larger items. However, formal finance is still not accessible to many categories of rural residents. Where it is available, distribution is often lumpy or inappropriate for the needs of many earners outside of town.

In these conditions, local informal lending takes on a new role in backstopping shortfalls in credit availability from formal sources. At the same time, for the large sector of the community effectively unable to access formal credit, informal borrowing and lending remain the only options for offsetting the unforeseen, and reducing the impact of consumption shortfalls and sudden emergencies to a manageable level. Case material suggests that the informal local credit market has expanded and changed shape as it has met formal credit at the margin.

[15] Acknowledgment and thanks are due to M T Nzama and O S Dlamini, as well as to T W Mbhele, whose experience and capabilities have shaped the present analysis. We also need to thank Phil Raikes, and Nick Amin's recent workshop group, for very useful discussions around some of the case material.
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3.5.2 Case studies: credit in the inner rural zone

Material on which this chapter is based is drawn mainly from fifteen case studies of individual borrowers, collected in a semi-rural community in the former KwaZulu homeland where a considerable body of research data on credit transactions has been built up since the 1980s (cf. Cross 1988). These cases highlight the expansion of moneylending in this area, and eight of them are presented in this chapter. Additional material on the stokvel sector is taken from workshops, from a report dealing with a second peri-urban area adjacent to a formal township, and from previous research for the DBSA on the small scale farming sector in a Tribal Authority district on the KwaZulu Natal south coast (Cross, Mlambo, Mngadi, Kleinbooi, Mbhele, Saayman, Pretorius & Bekker, 1997 forthcoming).

Because of the limited source material, generalisations must be evaluated with care. Developments in the mobilised inner rural zone are not uniform, and need not indicate that similar changes will follow in outlying deep-rural communities: in the outer rural districts credit markets are limited by lack of cash flow and poor access to the urban sector. However, changes in credit practice closer to the cities do show possibilities for change in credit throughout the rural sector.

The community where the main case studies were collected lies in the northern peri-urban zone of the Valley of a Thousand Hills, and forms part of the economically mobilised region of African settlement surrounding the port of Durban. A dense population has built up against the boundary of the former KwaZulu 'homeland' as families have migrated in looking for access to the regional metropole. Local incomes are relatively high and unemployment has not bitten as deep as it has in the outlying parts of former homelands, but a poverty sector persists alongside the new elites. In this mobile population, both formal and informal lending are thriving.

The area is within what were once Natal Province's African reserves, and is under formal Tribal Authority administration, with a chief, tribal councillors, and appointed ward headmen or *izinduna*. These officials handle resolution of disputes, including informal credit cases. A movement during the early 1990s for committee structures based on local ANC-aligned youth groups to take over local government collapsed into disorder, returning the area to the pre-existing chiefship system. The Tribal Authority structure is loosely linked to the IFP, the majority party in the provincial government. Most of the local people are now ANC supporters, but there is little political tension.

Additional data come from an informal settlement on formerly rural land near the very large Umlazi formal township, and from an ANC-aligned Tribal Authority district much further from the metropole, where agricultural activity is strong and expanding.

The main study community follows a communal land tenure system that has evolved to provide a thriving informal land market. Families continue to see themselves as entitled not only to a residential site, but also to household land for cultivation and use of communal grazing. However, land resources are now very short, and some families cannot find cultivation land.

Although this community is well outside the fringes of the city, in economic terms the areas where population is building up are merging slowly into the urban economy. As this happens, the poverty sector is left behind as part of the rural economy.

Interviewers working on the study were local residents with extensive experience in community-level studies of rural finance. Their brief was to select and write up short case studies illustrating changes in informal lending during the past ten years, and to help workshop the interpretation. Additional material has been contributed by intensive fieldwork in the other two communities.

The discussion that follows is based mainly on this series of fifteen recent case studies written by local researchers. Four of the cases presented involve the recent credit experiences of women in this economically mobilised community, and four record credit dealings by men. The terms of the loans are summarised in Table 26.

Table 26: Informal credit conditions

Case/Sex	Amount R)	Term (Months)	Interest Rate /Month	Provider	Remark
1 M	na	na	na	Bank	Refused
	500	4	15	Stokvel	Rebuild collapsed home Agent forced to pay first month
	100	3	20	Money-lender	Pay 'damages' for pregnancy
2 F	100	5	25	Money-lender	Transport to pick up pension
	200	1	25	Money-lender	Transport to visit son in hospital
	500	na	na	Money-lender	Combi hire for engagement—refused
	700	2+	25	Money-lender	Combi hire for engagement
3 F	500	na	na	Stokvel	Refused
	300	4	35	Stokvel	Loan for cement blocks and television instalment payment; only part used for intended purpose. Daughter helped pay off
	200	2+	25	Money-lender	Still being repaid; interest paid on schedule
	100	2+	20	Money-lender	Interest 1 month in arrears
	?	1+	0	Employer	Being paid through wage deduction
4 M	20,000	180	0	Employer	Housing loan, first tranche, paid through salary deduction
	20,000	na	0	Employer	Housing loan, second tranche—refused
	1,000	4	10	Stokvel	For housing materials; half repaid after 2nd month with assistance from uncle
	500	open	0	Relative	Repayment may not be expected
5 F	1,500	4	0	Supplier	Building blocks for house construction, revolving account, maximum open position R400; two payments delayed. Repair of faulty construction damaged some blocks creating financial strain.
6 F	50	3	140	Moneylender	Moneylender retroactively stated rate was 35%/week, not month; implicit oral agreement protested but accepted by borrower who boycotted further relations.
	200	open	0	To agent	<u>As moneylender</u>, free loan to recruiter
	?	divers	20		<u>As moneylender</u>, 5 good clients through agent
	200	2+	20		<u>As moneylender</u>, 1 client in arrears; agent responsible for recovery
7 Stokvel	1,000?	± 4	30	Rate to non-members	<u>As stokvel</u>, earns high interest on returns to non-members *but* may write off problem loans when interest payment reach 150% of principal.
8 M	Unknown by borrower			To employer	Hire-purchase of taxi, no records kept and borrower unaware of amount of owner's bank loan or repayment terms; employer claimed R110,000 outstanding and reclaimed taxi.
	9,000	open	0	Relative	Contribution by brother; insufficient; returned
	na	na	na	Taxi assoc.	Refused
	10,000	?	0	Businessman	Insufficient to needs
	na	na	na	Bank	Loan restructuring—refused
	66,000	open	0	Relative	Brother's guarantee to purchase a Combi which may not be appropriate for the roads driven
	1000	1+	10	Stokvel	For vehicle repair; principal outstanding. Vehicle is currently inoperable and market value is not R66,000.

Note:
"+": loan still outstanding so final term is unknown
"?": terms unknown

James Z and Mrs Nonhlanhla N show how male and female heads of household use local informal credit in dealing with social and domestic emergencies, while the cases of Jonas P and Thokozani N illustrate how local credit works with and without an employer loan to support owner-builder house construction. Sanele X's account deals with loan terms for an elite savings and loan club. Jabu M's story highlights the risks of dealing with moneylenders, and Mrs Busisiwe S relates how she, a widowed grandmother with slender resources, has got in deep with the siren attractions of the local credit market. Finally, Philip D tells how he tried desperately to retrieve a repossessed taxi with the help of informal credit as venture capital.

The material presented below suggests different options and contexts for the well-off and the relatively poor. However, it also appears that different sets of options exist for men and for women: these options are strongly determined by how far they can activate both social and institutional lending links outside their domestic and neighbourhood sphere, and how much they can expect to raise at need through different connections. As wages have risen and standards of consumption have increased for the families of the employed, financial demands have also increased, and not only for those who have a secure link to the developed economy. Risk factors related to credit may be approaching a new high, and according to the inexorable laws of credit the heaviest burden falls on those who can least afford it.

Informal credit in social and domestic emergencies

Informal credit delivers cash at point of need, and world-wide one of the main uses of informal credit is in covering unexpected situations that demand cash. This relatively affluent peri-urban community makes extensive use of local informal credit for emergencies. Families that might once have had either to liquidate assets or beg help from relatives and neighbours now routinely borrow money to cover sudden demands. In doing this, they frequently avoid having to liquidate their assets, but explicitly or implicitly pledge them as collateral for loans.

It seems clear from the case material that repayment is substantially more difficult for women in this situation than men. Women may be borrowing proportionately larger amounts as a share of their total household income than men borrow, and it looks as if women may routinely pay significantly more in interest before they succeed in repaying the principle.

CASE 1. JAMES Z: A MAN COPES WITH DOMESTIC EMERGENCIES ON INFORMAL CREDIT

'These people lending money do help us a lot in this place. I can say they're 100 percent better than the banks!'

The family of James Z has been faced with two emergencies which put them into the informal credit market: in 1996 their earth-built house collapsed, and later that year his son was involved in having to pay damages in relation to a failed love affair which resulted in pregnancy. Helped by his son's earnings, James Z was able to access and manage informal credit successfully - a stokvel loan and a loan from a private lending syndicate - after being turned down for formal credit.

Finding his family homeless, James Z held a family meeting to take the decision to look for credit to rebuild their house. They first tried Standard Bank, where his employed son had an account, but the son's approach was turned down. He then decided to try the local credit market, and asked for an introduction by a friend to a stokvel savings club to which the friend belonged. With his friend to vouch for him, he obtained a loan of R500, at a R75 (15 percent) monthly interest charge. The agreed interest rate (*abantwana*, the children) was expected to be paid in full every month till the principal (*onina*, the mothers) was repaid.

The loan was used to cover R150 for the builder's fee, plus poles, cement and nails. The house was successfully rebuilt, but James Z was unable to pay the first month's interest when his son did not return home at the end of the month. As the introducer or agent, his friend then covered the interest payment for James Z.

James Z then had to pay R150 at the end of the second month. After four months of interest payments, his son become impatient and managed to repay the principal, winding up the loan. The total amount repaid included 60 percent interest of R300 on top of the principal of R500.

In the pregnancy case, the family of the son's former girlfriend demanded damages of R1000, plus a goat. James Z's son had no savings at the time and was unable to pay. Such cases are considered a semi-public matter, and often go to the community's tribal officials for a settlement. The ward councillor heard the story from both sides and wrote out a statement in which the Z family accepted the plaintiffs' demands and agreed to pay after three months. This statement was signed by both families.

After three months the Z family had only R400 for a goat and R700 for damages. This amount was refused by the other family, who demanded a larger goat for R500 and the full R1000 fine. The councillor refused to accept requests for more time, and gave James Z one week to come up with the outstanding payment, on pain of having the tribal policemen come to his house and seize goods to cover the remaining amount.

After another family meeting, James Z was sent by his wife and daughter to a local moneylender, who represented a private lending syndicate, to obtain a loan of R100 to cover the last amount left after further efforts had apparently raised pledges of more money. After checking with another syndicate member who served as witness and shared the decision, the lender agreed to R100, at R20 interest payable monthly. The loan was recorded in a notebook, with the condition that loans were not allowed to run more than three months.

James Z then returned to the councillor and paid the full fine, promising to deliver the goat in two weeks' time. The goat was delivered on time, with a receipt for payment of R500 as agreed. The loan ran over two months with only the interest paid, until in the third month James Z reminded his son of the loan. The son provided the R120, which James Z duly paid over. The total cost of this small loan was R160, including 60 percent in interest payments.

James Z and his family were highly satisfied that they had been able to raise the cash when they needed it badly, and had no real problems in repaying the small amount borrowed. He has twice been successful with informal credit, after initially failing to get a formal loan when he needed one.

CASE 2. MRS NONHLANHLA N: A WOMAN COPES WITH DOMESTIC EMERGENCIES ON INFORMAL CREDIT

'At the first place where I started borrowing I have now introduced my other daughter. She ran out of money when she was expected to provide the *umbondo* (wedding gifts) to her prospective in-laws, and she wanted to borrow R500. The lender told me she was not very concerned with my daughter's situation, because I myself would be the one involved if my daughter fails to keep the wheel turning. I agreed to that, as I know how I will deal with it. My daughter has just now taken this money, so I need to see how she's going to do by month end...'

Mrs Nonhlanhla N is a pensioner still fairly new in the area who has begun to make extensive use of local market credit. She has borrowed for emergency transport and for social spending connected to her daughter's wedding, and expects to borrow more shortly for her late son's memorial dinner and to make routine house repairs.

She seems to have had little or no success in raising contributions or credit from relatives, and does not report having tried to get formal credit for any of these needs. However, she hopes to retrieve the wedding expenditure from her son-in-law, who still owes her outstanding lobola payments. She has used moneylenders for all her borrowing and expects to continue.

Mrs Nonhlanhla N moved into the community from Howick, and has not transferred her pension because of the risk that any tampering would stop it altogether. Finding herself without transport money to get to Howick for her pension after trying her daughter and her cousin, she was introduced to a woman lender in her cousin's neighbourhood by her cousin's wife. Vouched for and witnessed by the cousin's wife, Mrs N obtained a loan of R100 to get to Howick the next day, at a monthly interest rate of R25.

After obtaining her pension, she decided to pay the interest for that month forward, and immediately gave the lender R25, without repaying the principal. Full repayment took five months. By this time she had paid R200 in all, with 100 percent in interest.

She repeated the process when she found herself needing emergency transport to visit her son in hospital, this time paying the same lender the full amount within a month. The total cost was R250, with 25 percent in total interest and R200 as the principal.

When she later had to hire a Combi to take a party to her daughter's engagement in Greytown she approached the same lender for R500, but was turned down. She was then introduced by a relative to a male local lender, who was well-established but whom she did not know herself. The lender asked her for details of where she was from and what she needed, and took her by car to have a look at her house and family. Mrs N assured him that she was a pensioner but had sons working. He then agreed to lend her R700 at 25 percent monthly interest, noting down her particulars from her ID book as well as from her daughter's ID.

Mrs N has now paid an initial instalment of R200 plus R170 in interest, which will reduce the August interest payment to R120. She is not sure if she will pay another R200 in August, or wait and let the interest payments continue. If she pays in straight instalments of R200 and R300 along with the interest due, the least she will pay is R1060, or about 50 percent interest on the principal. The actual figure is likely to be higher.

As she notes in the quote above, Mrs N has now put another daughter in touch with the first woman lender in order to help this daughter cope with her own wedding expenditure. She herself expects to continue borrowing, and seems to have enough resources in the form of claims on employed male relatives so that she may be able to manage her indebtedness successfully. Mrs N appears relatively satisfied with her credit experience so far, though concerned about possibly taking on too much debt.

CASE 3. MRS BUSISIWE S: GETTING IN TOO DEEP

'These credits are going to drive me mad now. Look, I haven't paid Savell's Furnishers for three months. During June I took another R100 credit at my lenders' place, I paid them the R20 for monthly interest but I still owe them another R20 for the end of July and I can't pay the principal. I don't know what's wrong with the money...'

Mrs Busisiwe S has been trying to find money for several expected and unexpected expenditures since February, including payment for cement blocks bought on credit, a door for the house, her community garden levies, three or four television hire purchase instalments and new school shoes for her grandchild. All together, her reported obligations totalled about R700. She has one working son who is unreliable at paying debt obligations, and two employed daughters whose earning level is very low.

During the period from February to June Mrs S reports she borrowed a total of R600 from stokvels and lenders within the community. Only about R450 appears to have been spent on the obligations listed: the rest of the money borrowed may have gone on daily consumption.

At the time her story was recorded, Mrs S had paid her community garden levies of just under R100 for fencing materials and seed, which was higher than anticipated and put her out of budget. She had received an informal letter of demand from the blocks supplier and had then also paid half the amount owed for the blocks, as well as one payment on the television account and the whole price of R130 for the school shoes. She still owed R100 on the blocks when the borrowed money ran out, and three more months of television payments have gone unpaid. She has not been able to buy the door as of August, and is still using a sheet of corrugated iron as a stopgap substitute.

Mrs Busisiwe S began in February by inquiring about a loan of R500 from Sanele X's elite stokvel, which gives relatively good terms for larger loans (see below, case 7) but was turned down as a marginal borrower. She then borrowed R300 from another stokvel, at a relatively high interest rate of 35 percent. This loan took four months to repay, at a total cost of R700, including 130 percent interest at R100 per month. One of Mrs S's daughters contributed R75 to help with the interest.

After paying the shoes, one television payment and half the amount for the blocks, no money was left. Mrs S decided to take out another loan, from a woman lender several kilometres away. This loan was for R200, at 25 percent interest per month. As of August, this loan had not been repaid, but interest payments had been made on schedule. It was followed in June by a third loan of R100, from a married couple who are in business as lenders, at 20 percent interest monthly (see case 6). One interest payment was made on time, but the July payment is now behind schedule. She has also taken an informal private loan from her employer, where she does domestic work: this loan is being deducted from her wages.

Mrs Busisiwe S's total income seems to amount to about R550 per month, made up of her own R300 domestic salary and her late husband's R250 pension from work. She will not be old enough to qualify for state old age pension for about seven years. Mrs S does not know when she will be able to buy the door, get her television account up to date, or get out from under her debt burden.

If Mrs S needs four months in each case to repay her last two local informal loans, the total repayment on the money reported borrowed in the local informal credit market would come to about R1300, with interest payments approaching R700, or about 115 percent of the principle.

The underlying problem seems to be that Mrs Busisiwe S's total obligations can run higher than her family's effective income whenever expenditure demands arrive in clusters. Unlike Nonhlanhla N, she does not have the cushion of effective claims on workers with good salaries. The easy availability of both hire purchase and local informal credit from a number of unconnected sources tempts borrowers in similar situations to fall back on more debt than they can manage, leading to a risk of progressive default on several of the credit lines, in a domino reaction.

Informal credit in home building

While domestic emergencies are perhaps usually dealt with in the informal local credit market, the preferred source for home building and larger home repairs is formal credit, which lends much larger amounts and spreads repayments over a much longer period at cheaper rates. However, with the national housing subsidy still not available in communal tenure areas and banks reluctant to lend, the experiences of Jonas P suggest that formal credit can be hard to get and not always reliable. In spite of the favourable position of this peri-urban community in relation to developed credit markets, formal credit is also unavailable to a large sector of the community. People such as Thokozani N are pushed into local civil and social credit if they want to improve their housing conditions.

CASE 4. JONAS P: BUILDING A HOUSE WITH INFORMAL CREDIT

'I spoke to a friend about how I can get the money for my roof, as everyone in my neighbourhood was laughing at me. This friend took me to a sort of stokvel club in the Mondini area. There I was asked how much I need, as they don't give out more than R1000 to people who are not their members...After they had checked my papers, their treasurer gave me the money and made me sign. I thanked them and we left...I went back to Bonus Suppliers again... When I paid the last of this stokvel money, they thanked me a lot, and told me to call again!'

During his efforts to build a house, Jonas P has taken credit from (1) his employers, (2) a stokvel lending association and (3) a relative. He has paid off the informal lenders, and continues to pay his employer loan and his relative.

Jonas P himself has little education, and comes from a deep-rural background. He is employed at a medium-sized firm at about R2400 per month, and in May 1995 he approached his employers for credit to build a four-roomed block and tile house on a site in his community. Such sites are considered to be privately owned on the informal market, which is fully accepted in the community, with rights that can be defended in the local tribal court. Jonas P's firm routinely gives such loans, and reacted favourably. After consultations through his foreman, his supervisor and the director, the firm agreed to a loan of R40 000, which they did not consider to be a large amount.

This loan was to be paid off by deductions from salary of R50 per week. Jonas P reports that this loan did not carry interest. If so, paying off the principal alone would take him roughly 15 years at the rate noted. The time format of repayment would be roughly parallel to that for a mortgage loan from a bank or building society. The loan was to be paid over to Jonas P in cash, rather than via vouchers or other arrangements for buying the materials.

Jonas P was given an initial payment of R20 000. Around R4000 of this money appears to have been used to pay off his remaining *lobola* (bridewealth) to his parents-in-law, and it is not clear whether some of the rest went to other pressing needs. Jonas P then went to a local building materials supplier and opened an account for R33 000, handing over perhaps R10-15 000 immediately, and, according to his own account, also promising monthly payments of R200. Since he presumably would not need to make immediate payments on a pre-paid account, it is possible that the payments only kicked in once the initial payment was used up.
Jonas P then arranged a builder at a fee of R8 000. The builder was given R4 000, and began the job. The work went well for some time, and Jonas P had no trouble in covering his costs.

When the house had reached the stage of needing to be roofed, Jonas P ran into problems. He was R2000 in debt to the builder at this point, and had run through the R20 000 paid to him on his employer loan. He therefore went back to his employers for the second loan instalment.

At this point, Jonas P was told by his employers that no money was available for him since his work-mates had already borrowed all the available cash. Eventually, the employers gave him a further R2000. From here his employers disappear from Jonas P's story, and the work on his house ground to a halt. Caught with a half-finished house, turned down by his employers and with no immediate prospects of completion, he became a local laughingstock. Seen as having failed in an ambitious project, he reports that he was looked down on by his neighbours and associates.

Jonas P turned to the local informal credit market. In March 1996, by which time he was finding the change in his neighbours' regard intolerable, he approached a local friend for advice on how to get the roof built. His friend took him to a money-lending stokvel in an adjoining ward. With his wife's advice, Jonas P asked this association for R1000, the top amount they make available to non-members.

The stokvel agreed to the loan, at a monthly interest rate of R100. The association wanted to know where he worked, and inspected his ID book. After this, the association paid over the R1000, requiring Jonas P to sign a written agreement covering repayment.

This amount was considerably less than what he needed in total for the roof, but it enabled Jonas P to get the process moving again, in the eyes of the neighbourhood if not in objective terms. His apparent intention at this point was to continue his building using savings or household cash throughput wherever possible, and informal loans to fill in where necessary. This time, he made a systematic effort to get lowest-cost materials.

Jonas P approached his usual building suppliers and asked the price of a ready-made roof. When he learned it was R8000 for the wood, bolts, nuts and nails only, he decided to look further. He approached another friend in the nearest town, who directed him to a white informal dealer who sold planks cheaply. This man supplied him with 18 rafters for R600, steel fastenings for R300, and nuts, screws and bolts for R210, for a total cost of R1110.

Jonas P was very satisfied with this transaction, and remarked that he had saved significantly relative to the ready-made roof. However, he still had no money for the builder or for the actual roofing material, and the work has not moved forward significantly up to the time of writing. However, Jonas P has paid most of his informal debt, and may be getting to the point of borrowing again.

At the end of the first month Jonas P paid the stokvel the R100 interest, but felt he was losing a lot of money on the interest payments. He then went to an uncle in Clermont, an African freehold township next to the local urban sub-centre of Pinetown. He told his uncle about his interest costs. The uncle told him he was wrong from the start to take such credit, and told him to return at the end of the month to get R500 to pay back the lenders.

It appears that his uncle did expect him to repay this money, but thought of it as reciprocity between relatives and was willing to accept sporadic repayments of the principal over a considerable time period. It is not clear whether the uncle expects interest, but often this type of loan between relatives is not interest-bearing. Jonas P is believed to own two adult cows, which he did not pay over as lobola and which he has not sold to fund his building. The total value of two good cows is perhaps R4000-5000. If Jonas P reneges on the debt, his uncle could in principle claim one of the cows.

With the R500 from his uncle, Jonas P paid the stokvel R550 at the end of the second month. He would now be paying R50 in monthly interest till he had repaid the principal. At the end of the third month, he felt forced to tell the stokvel he was short of cash. They agreed to defer his interest payment.

By the fourth month, Jonas P managed to save the remaining R600, including what was left of the principal plus two months interest. He repaid the stokvel, and was free to continue his building work on current income and savings.

With his uncle's help his informal loan cost him R1250 in total, including 25 percent in total interest payments, a low rate for informal credit. He still owes R500 to his uncle, but is under no great pressure to pay. However, after having had an employer loan, he appears to have found his experience with informal credit useful at point of need but expensive. He seems to have no immediate plans to borrow more, but may be forced to do this if he cannot save enough in advance to pay his next building costs.

CASE 5. THOKOZANI N: BUYING BLOCKS ON INFORMAL DEALER CREDIT

'I was still short of 100 blocks, the kitchen and bathroom had to be rebuilt again. We went again to buy from Matthew... Matthew was at home, sitting at the table, smoking as usual [but] it seemed like something was wrong. He said, "Didn't you finish the credit?" I said, "Of course," and I asked him what was his problem. He said his books show me still owing R100. I sat next to him, explaining... Three of us were reading the notebooks, it took twenty minutes, but the books were not against me. He asked how many blocks were used. I told him without hesitating. He checked and it was right. Joking, his wife said, "Shame, once he looks at your house he just sees R100." He wasn't sure, and he finally called his son. The son's account was the same as mine... On the way home I faced the sky, praising almighty God, because I almost got into trouble. If we had not come there today he would have told everyone I ran away with his R100. Everyone would have believed him. To avoid the uproar I would even have paid that money for nothing...'

Having bought a site, Thokozani N and her fiancee Silas D decided to start their house in 1996. Neither had a regular full-time job, and they planned their expenditure very carefully, dividing payment responsibility between them by task and according to who had money at point of need. They decided to start with a two-roomed house with a bathroom, and expand it later.

When they had paid for the installation of services on their site they began to run short of money. Both looked for more part-time work and also stepped up their various informal enterprises to earn more. They used savings and household cash throughput for most of their costs, but relied on informal credit from the block dealer as well as from several builders, and for various other building and consumption expenses. Although they are both veteran credit users, during this period both were involved in more informal credit accounts than usual.

Their main initial expense was for cement blocks. Their supplier was Matthew M. Matthew M is a local builder and block maker who sold good quality blocks at R200 for 100 blocks, with a R20 charge for his sons to deliver by wheelbarrow.

He supplies neighbours such as Thokozani N and Silas D on credit by arrangement, but sells to strangers only on cash. His product is popular, and he sometimes ran short of stock. It appears that Matthew M charges no interest on his client credit, but orders made on credit seem to slide down the delivery queue by one to three weeks or more, and he delivers to cash customers first.

In May Thokozani N bought 200 blocks from Matthew M for R400 cash. Most of these blocks went into the foundation, and she decided to order another 100 blocks for R200 on credit, with R100 to be paid each month end. From this point to April of 1997 she maintained a credit account for blocks that hovered at or below R200, with new credit orders following after the outstanding amounts were paid off. Matthew M, himself a builder, gave her an offhand estimate that 500 blocks would complete the planned two-room house with a bathroom. This estimate proved to be optimistic: the final total without having to correct mistakes would have been about 700.

Thokozani N paid over R100 at the end of June, but needed more blocks immediately. She felt unable to ask for more credit since R100 was still owing. Building work stopped for a while. Luckily her fiancee Silas D had a temporary job with the local election process at the time. He was able to pay the other R100 at the end of July, plus another R200 cash for another 100 blocks. This cash payment avoided the delay they had noticed on credit orders.

Not long after a problem occurred with the builder. One of Thokozani N's neighbours was also a builder, who sometimes worked together with Matthew M; she had initially spoken to them about doing the work on the house, but rejected their bid in favour of a cheaper quote. This neighbour pointed out to her, as well as to the builder she had hired, that the back wall of the house was not straight, and the fault would need correction. The builder paid no attention, telling Thokozani N that the neighbour and Matthew M were jealous because they had not gotten the contract. The neighbour and Matthew M came by again and insisted that if the problem was not corrected it would be impossible to put the roof on later.

It became clear that the rear wall would have to be stripped down and rebuilt. Twenty or more blocks were broken in this process, which also required another four bags of cement to repair. The builder took no responsibility, and Thokozani N fired and replaced him. At this point she still owed Matthew M R100 on account, and was too annoyed to pay immediately. She paid this amount at the end of August, and ordered another 100 blocks, for a total of 600 so far.

Around this time, after paying about R1000 together with Silas D, Thokozani N began to find the financial strain too heavy. She told Matthew M that she would not be able to pay any more for a month or two.

However, her new builder wanted another 50 blocks. Thokozani Ndid not know how to approach Matthew M for more credit since she owed him R200 already, the accepted maximum for her informal account. Deciding it was unwise to be a coward, she gripped her courage and went to speak very humbly to Matthew M.

However, Matthew M told her that the blocks in his yard at the time belonged to another customer, who had supplied the cement and commissioned the blocks, paying the labour charge with extra cement. Matthew M suggested she tell the builder who had made the error that he should cover the costs of more blocks. Winking at her, he remarked, 'Look, we black people are suffering because of hiring cheap labour', a reference to her apparent mistake in giving the building contract for her house to someone else.

Thokozani N kept her temper although she was angry and disappointed, and resolved not to let Matthew M off the hook. Feeling humiliated but without alternatives, she politely said the builder had been helping her and offered to work cheap, obliquely excusing herself for not having hired Matthew M and the neighbour. The conversation rambled for another two hours, with Thokozani N quietly persisting until Matthew M finally promised her more blocks after one and a half weeks.

In fact, she did not receive the 50 blocks till the end of September, when she paid down her informal account to R200 again. She hinted that she would rather be dealing with another supplier, and relations appear to have been cool at this point. After a month or two without further payment Matthew M came by to check the building of the house, in effect pressuring Thokozani N to pay something. She took him aside and gave him R100, not allowing the builder and his assistant to see the transaction since she also owed them money.

The builder then wanted another 50 blocks, and Thokozani N paid this amount just before Christmas 1996. She intended to pay off her blocks supplier's account finally by February 1997, but did not succeed until March. Faced with getting a bad reputation at her stokvel where she also owed money, she elected to pay the stokvel first.
However, at this point Thokozani N found herself needing another 100 blocks, to tear down and rebuild the kitchen and bathroom as she describes in the quote above. She was now using her third builder. She and Silas D considered using a cheaper supplier, who charged only R150 for 100 blocks, including delivery. However, this supplier gave excuses when they went to confirm their order, and asked for an extra deposit. Silas D convinced her that the cheaper supplier, an Mpondo outsider, was too bad-mannered to deal with, and that they should go back to Matthew M.

When Silas D had paid for the new blocks, Matthew M accused Thokozani N of not having fully paid her last credit line, and was only convinced with difficulty. Thokozani N's deep fear of losing her informal credit rating is evident in her remarks.

At this point they had paid roughly R1500 for 750 blocks, plus delivery charges of about R120, and a great many linked costs. They had not paid interest, but they had used four different builders and had gone through a great deal of financial and personal stress, including a partial breakdown of relations with a key supplier, and the risk of a break with Thokozani N's stokvel.

They had also found themselves in a typical owner-builder dilemma: paying unnecessarily an additional R300 for the 150 blocks needed to re place blocks broken during rebuilding, plus additional cement and labour costs, due to having tried to cut corners. These extra costs were not due to credit charges, but put serious extra strain on the supplier relationship, which revolved around on-time payment of charges made on credit.

Silas D is to pay the last R50 for the final batch of blocks at the end of this month. Thokozani N, an experienced informal borrower and lender, is undeterred by the stress of building on informal credit. None of her experiences were unexpected, and she is now considering whether to borrow more local credit immediately to extend the house to a more comfortable size.

Sources of informal credit: lenders, stokvels and personal loans

Stokvel rotating credit associations are a well-established mechanism for savings mobilisation in rural and urban communities. Lending from their pool of assets to both members and non-members, they help families to cover both consumption and capital needs, and seem to represent the most widespread kind of community-level voluntary association in both peri-urban and rural communities.

By comparison, money lenders are also an old established institution, but seem to have gained greater respectability in the last few years. Cases presented here suggest that as a source of local informal credit, moneylenders are becoming more widespread and popular. They now seem to be functioning as an accepted form of informal business in much the same niche as stokvel-type groups.

CASE 6. JABU M: DEALING WITH MONEYLENDERS

'Listen Mr X, if I am in trouble again with no food for my children, I'll never come back to you. We would rather eat sand. Last year when you yourself were short of R50 I gave it to you without charging you even a black cent, and now when I come to you for R50, you charge me a rate no one ever heard of, and not even a month has gone by.'

'Look Mrs D, myself I repaid your money the very same date I told you I would. If you had repaid this loan in one week's time I would not have charged you any interest either.'

Jabu M is also an experienced user of local informal credit, and as a member of an old family she has extensive social connections in her neighbourhood. In 1997 a married couple whom she and her partner had helped with credit in the past went into business as moneylenders. Based on their past relationship, these people have sought Jabu M's advice and asked her to serve as an agent or steerer, inviting clients to do business with them. She has also used their lending services directly to borrow money for her own house repairs.

Dealing with an old-style moneylender

Jabu M's partner and intended husband is remotely related to Maxwell D, husband of Thenjiwe D. This relationship is at the level of clan surname, a form of relationship which dates to pre-colonial days but is still socially recognised as a kind of extended brotherhood or sisterhood. Made more secure in their friendship by this connection, Jabu M had been lending Thenjiwe D small amounts of money for minor domestic emergencies during 1996, without charging interest. Non-interest-bearing credit between individuals is normally an effective sign of a close, active social connection. Though anyone may give anyone else an interest-free loan, for at least fifteen years small loans in this community have often carried interest even within families.

Early this year Thenjiwe D ran short of money for groceries, and asked Jabu M for a small loan. Jabu was short herself at the time, so Jabu M's partner Elliott D took Thenjiwe to Vusi X, a man in the neighbourhood who lent money. Since Thenjiwe D and Vusi X already knew each other, Elliott D's role was to act as witness rather than as introducer.

This man agreed to lend Thenjiwe D R50, at an interest rate of R35, or 70 percent. The lender apparently said nothing about the period for which interest was payable, and everyone on the borrowing side assumed that it would be monthly, as usual. Thenjiwe D saw no reason to pay before the end of the month.

During the third week after taking the R50 loan, Thenjiwe D was visiting Jabu M. A child came to the door with a letter for Thenjiwe D from his father, the lender. Suspecting something wrong, Thenjiwe D asked Jabu M to read the letter out loud. It read, 'Mrs D, as you have now failed to pay the money you borrowed for the last two weeks, the point is this: by tomorrow I need R155. My interest rate is weekly and is now R35 x 3.'

Both Jabu M and Thenjiwe D were stunned and angry, asking themselves what was happening in the world. Jabu M knew that the same man regularly lent money to pensioners at R35 monthly interest on R100. The following day the lender came to Jabu M's house. Jabu M asked him why he was charging so much.

The lender replied that his rate to pensioners was low because of their circumstances, while Thenjiwe D had a well-paid husband supporting her. Acting slightly shy or hesitant, he still insisted that he wanted his money.

Charging interest weekly was the original practice for urban moneylenders operating in men's hostels. However, weekly interest has apparently lapsed for lenders living and dealing in these semi-rural communities, where for many years potential clients have had the option of borrowing stokvel credit on monthly interest.

It does not appear as if anyone involved with the loan ever considered refusing to pay the interest demanded on the grounds that it had not been disclosed in advance, or thought of challenging the lender's demand in any other way. As in Thokozani N's case, the risk involved - of being publicly identified as having reneged on an agreed loan, losing a good informal credit rating and becoming unable to borrow at need - is seen as very serious even for people who are well off. The burden of ascertaining the conditions of the loan seems to rest on the borrower. Thenjiwe D warned Jabu M that the story must not reach her husband's ears, and they went together the following day to repay the money.

They found a large number of people inside the lender's house, drinking. Reluctant to talk under these conditions, they asked the lender to meet them outside. He took his time and smoked a dagga cigarette before joining them. Jabu M acted as intermediary, asking the lender how much money he needed. Grinning, he told them the amount was R155. Jabu M tried to persuade him to moderate his demand on grounds of good human relations. Finally the lender reduced his demand to R120, made up of the R50 principal and two weeks' interest at R35 per week.

Jabu M thanked him unwillingly, but Thenjiwe D was angry. As she says in the quote above, she had herself made Vusi X a loan of the same size the previous year without charging interest. The lender was undeterred, and replied that he had repaid her money exactly on schedule, while she had let three weeks go by and paid nothing: if she had repaid him before a week was up, he would likewise have charged her nothing. He did not explain why he wanted to charge her weekly interest when the local practice is monthly interest. Thenjiwe D told him that she would never borrow from him again, breaking off the reciprocal connection that sustains lender-client relations over time.

They then paid the money. On their way home, they told each other resentfully that the lender was a crook, and rude, and an Mpondo outsider who would never get anywhere in life. They took no other action, and saw the transaction as closed.

Becoming new moneylenders

A few months later Maxwell and Thenjiwe D themselves became moneylenders. Maxwell was pensioned off by his firm on grounds of ill health, and with this source of cash he and his wife decided it was now their turn to lend money to the neighbourhood.

Thenjiwe D consulted Jabu M on how much interest they should charge. As they discussed the problem Jabu M told her that she, Jabu, knew several local moneylenders, both old ones and new ones. Two of the four she knew charged R25 interest monthly on R100, one charged R30, and one charged R35. Jabu M recommended that Thenjiwe D and her husband should undercut the market by charging R20 on R100, and try to take over market share from the competition.

Thenjiwe D liked this proposal, and suggested that Jabu M act as their agent or introducer, and steer customers to them. For doing this, it seems that Jabu M gets an interest-free line of credit at a level of about R200 per loan, but no salary. It is not fully clear if she can also claim any kind of fee or kickback for individual introductions, but it appears that getting credit free probably excludes getting kickbacks as well. In addition, Jabu M as an introducer is actively and positively involved in networking, and is also in a small-scale position of power relative to people who need credit.

Jabu M and her partner promptly took a loan from Thenjiwe and Maxwell D for R200 for plastering sand and other supplies to help repair their house. This loan appears to be interest-free for an indefinite period, and according to Jabu is not put in question by problems with repayment from one or two of the loan customers whom Jabu has introduced. When the R200 is repaid, they can borrow again when they need to, without interest as long as Jabu continues to send clients.

During their initial discussions Thenjiwe D and Jabu M also decided it would be in everyone's interest if clients were encouraged to pay interest forward if they could afford to. For the client, as in Nonhlanhla N's case, paying the first month's interest at the time of taking out the loan makes the eventual repayment of the principal easier: it does not seem to reduce the interest rate or make any other difference to the terms of the loan. If interest is not paid forward, it has to be paid at the end of each month, and in the last month will be paid together with the principal.

Thenjiwe D then provided herself with a notebook to keep records, and considered herself and Maxwell to be in business. Having arranged with someone they trusted to act as an initial introducer of clients, they had access to a fair-sized pool of customers right away, without being in the embarrassing position of having to sell their own services directly. As with most lenders today, Thenjiwe and Maxwell D decided to ask for ID documents from customers they do not fully trust. They do not seem to have put any restrictions on the time loans were to run, and they do not ask for other formal security.

Jabu M reports that she began looking for customers for them 'without wasting a minute. In June I caught six, and they are giving her interest.' However, she is afraid she may be running into trouble with one of her introductions, a relative of hers who may default.

This relative took out a loan for R200 from Thenjiwe and Maxwell D on 26 June, and should have paid her first interest payment on the same day of the month following. Jabu M reminded her on 30 July. The relative told Jabu M that she was not used to this kind of money, and would pay at the end of the following month, August.

Loan interest is normally due each month on the date of the original loan: Jabu's relative, an experienced and wily borrower, was duplicitously manoeuvring to drop her interest payment back to the end of the month instead. Jabu M is now afraid that she will not pay on time, and the responsibility will be partly her own since she referred this woman, who is also a close relative.

It appears that Jabu M as the introducer is not directly liable for her relative's bad faith. Even if the relative defaults entirely, Jabu M interprets her own liability as limited to making strenuous efforts to get her relative to pay, fulfilling the second part of the introducer's role. In the worst case scenario, where her relative reneges altogether, Jabu M explains that she would contact her cousin, one of the woman's adult daughters, a school principal, or, alternatively, this cousin's oldest brother, a valued white-collar employee of an urban firm. Either cousin would probably be willing to pay the whole amount to avoid exposing the family to loss of reputation.

What will happen to her relations with Thenjiwe and Maxwell D if her relative does default, and no one covers the loan, is likewise not clear. Jabu M ends her account by remarking that she does not intend to pay any interest on the R200 she and her partner borrowed for home repairs, but will rather pay back the principal only, and only after all repairs have been completed. Her insistence here may suggest concern that Thenjiwe and Maxwell D might ask for either interest or immediate repayment if Jabu M's relative does default on her own R200 loan. If so, then this kind of interest-free loan may act as a kind of bonded security for the effective performance of the agent or introducer.

CASE 7. SANELE X: OPERATING RULES FOR AN ELITE STOKVEL

'Right, Sanele says if the borrower pays the interest only on R500 for five months, failing to repay the principal, then he himself visits the person and tells them to forget about paying any more, it's all right. This is very unusual for anyone who is lending in this place, and I can't understand why he does this.'

Sanele X is a teacher, and a well-respected man in his local community. He is also involved in loan business for an elite stokvel which serves the general area, including two semi-rural Tribal Authority districts. He is a leading organiser of the group as well. This group has more than 25 members, making it a large one. The people who belong are nurses, teachers, and others who are locally seen as very important persons. They have a vested interest in wanting their stokvel and loan group to run in a smooth and respectable manner.

Several kinds of stokvel continue to operate in rural and semi-rural communities, as well as in urban areas. The classical rotating savings and credit association - in which members contribute monthly or weekly and take turns to receive the entire amount of the contributions as a payout - has come to be seen as ineffective, in that it delivers mainly the savings principal and relatively little interest. Since bank savings have become accessible and accepted in the community, people no longer need to save in the intangible form of obligations to each other, and are now looking toward making capital gains on their deposits. In the informal settlement, the classical rotating credit group is found mainly among women street traders, who run them on a daily basis and use the payouts to buy their stock. In the main study community, these groups are sometimes found among older and poorer women, and those in outlying parts of the area.

Access to banking means stokvels are no longer tied to the need to disperse their deposits every month: the newer stokvels can concentrate and hold large amounts on behalf of individuals. For at least fifteen years, the most popular form of stokvel in the main study community have been the ones which take in payments every month from all members, and bank the deposits and any loan proceeds for a general payout divided among all members at the end of the year.

Variations on this kind of savings and credit group include bank-linked stokvels dedicated to bulk buying of food, education stokvels, agricultural stokvels, and stokvels run by church groups for mutual solidarity and emergency resources. All these types of group normally record their officers with their bank, and require several signatures for withdrawals.

Stokvels that save through banks make rural savings available to the developed financial sector in the first instance, rather than to the community. However, the addition of bank interest increases the potential payout to members on the money which is saved rather than lent. Likewise, money in the bank lowers total risk: it is nearly safe from default, if not from malfeasance by officers of the association.

To maximise returns, most of these stokvels also lend out money. There may be reason to suspect that competition among stokvels for deposits and from moneylending for profits has put increasing pressure on the stokvels - which were originally mainly savings concentration schemes - to bring on line high-profit levels of interest. It seems to be increasingly common for stokvels inside and outside the study community to pursue the maximum feasible amount of informal on-lending. Many or most now follow the same practice as Sanele X's group, in making borrowing back of fixed monthly amounts for on-lending compulsory, as a condition of membership.

Sanele X's group has a number of rules, which are fairly typical except for the relatively high amounts involved, and which appear to be followed fairly strictly. Each member pays in a monthly contribution of R1000, and receives a lump sum payout at the end of the year. Members of the group are also expected to serve as on-lending agents. Each member is provided with R1000 to lend out during the month, and either lends this money to clients of his/her own choice, or takes the loan personally, at the going rate of interest for member borrowers. Members can access the group's credit facilities, but all clients must repay their loans by November, so that loans can be checked out internally and interest allocated.

It appears normal for lending stokvels in this and other peri-urban communities to close down operations from November to early January, over the holiday period. At the height of this season firms shut down, and normal community economic activity either shoots up or comes to a halt as people return home and commit themselves to socialising and entertaining. Loan repayment lapses or becomes unreliable as demands for entertainment spending rise sharply, and local moneylenders also tend to close down their operations. The end of year holidays are then quickly followed by the new school term and demands for money to pay school needs and equip children with supplies and uniforms. Credit activity seems to rise sharply again as education-related demand kicks in.

Entertainment spending is not seen by either borrowers or lenders as a legitimate reason for a loan, and lenders usually inquire into the purpose of any loan requested when checking the borrower's ability to repay. Any loans taken during the holiday season are thought to be likely to be diverted into frivolous uses and therefore would be less likely to be repaid. Legitimate

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From the side of the group, stokvels want to provide their members with as much money as possible at the start of the holiday season, when their need for cash is often urgent. However, stokvels normally have problems allocating interest if they run a yearly payout rather than a rotating payout. This problem is compounded if they also accept payments of varying size, so that dividing the total year's interest into equal shares becomes doubtful if not totally unacceptable. Many groups, including Sanele's, insist on equal payments to avoid extra transaction costs and the risk of quarrels. If differing payments are accepted, time is needed to calculate the shareout if the group does not simply use the interest money to hold a party for all its members, as was once often done.

Sanele X's group is a large one, with capacity to handle significant amounts of money. Without the income from loans, the group should receive about 250 individual contributions per year. Yearly savings turnover should be at least R250 000, which would normally go through a local bank. Each individual member would receive R10 000 at the end of the year from their own savings contributions alone, assuming that they had not charged any personal loan interest against their yearly payout. Unfortunately, there is no solid data available on the total loan turnover, or on total earnings from loans.

If each month R1000 is loaned out by 25 people at up to 30 percent, the stokvel should earn something like R7500 in interest in the first month of the loan, for a minimum of R75 000 at the end of the year if each loan brings in only one month's interest. Each member would then receive at least an additional R3000 if this amount of interest is divided equally. If the loans actually run two to three months, then the total interest payout per member would double or triple. In practice, it may not be the case that each member succeeds in lending out or otherwise borrowing personally the whole amount of R1000 every month, and some loans default. As Sanele's unusual approach suggests, an elite lending association is not in a good position to adopt tough tactics to ensure repayment.

Consequently, the group's loan policy is selective about potential borrowers who are not members of the group. As a category, widows on pension seem to be red-lined as bad credit risks unless they have well-paid working children who have good credit ratings. It appears that other weak borrowers are also rejected. Interest rates are relatively high, at R150 on R500, or 30 percent, payable monthly until the principal is repaid. In this bracket of the local informal credit market, loans are usually repaid in full by the fourth month.

However, Sanele X's innovation is to convert partial bad loans - where the principal has not been repaid for five months although the interest has been paid in regularly - to a retroactive instalment plan, and declare them paid off. For a loan of R500, five months of interest payments come to R750. At this level a cut-off will allow a profit of 50 percent on the capital invested, while at the same time avoiding the embarrassment and loss of social capital involved in an elite group pressuring weak borrowers for full payment.

In effect, this fallback system allows loans to be shifted from the usual system of allowing total interest to climb until it forces an effort to repay the principal, and puts weaker borrowers onto time payments instead.

This is not the usual practice for loans in the informal market of less than R1000. But for a group whose members value their respected social standing it may offer considerable advantages, allowing them to drop unsuccessful borrowers with a minimum of disruption. The group's overall returns appear to be strong enough to tolerate a fairly high percentage of loan failures.

However, it is doubtful if such a process could serve as anything other than an exit option. Instalment payments without the usual escalation factor would remove incentive to repay from the system. It could mean many informal borrowers would likely to take their payment obligations much less seriously, resulting in a rise in defaults.

CASE 8. PAUL D: TAXI REPOSSESSION AND INFORMAL VENTURE CAPITAL

'In the ninth month, he gave me the papers claiming R110 000 needing to be paid, or if not then they take the vehicle. I asked him why this was still owing, and he said he doesn't understand it, but I must pay this sum of money. I tried by all means to get this money, I put in my savings, now I was looking for some more money to cover the rest. So, I went to my brothers in Dassenhoek to borrow money...'

Paul D is a taxi driver who has been employed by a local taxi owner and businessman for many years. He is a steady man who is locally respected as a citizen, but he has never been a businessman himself, and met credit problems when he finally found himself with an opportunity to fulfil his aspirations and become an owner-driver.

The returns Paul D's employer received from Paul's work as a driver enabled him to put down a deposit on a second taxi in 1993. However, this new taxi was given to a new driver, to Paul D's disappointment. This situation continued for a year. Though no details have ever surfaced, it appears that during this time Paul D's employer ran into repayment problems on his bank loan for the new taxi.

In 1994, the employer told Paul D that he would give him the new taxi as his own property if he would try to earn enough with it to cover the bank instalments. Paul D's account does not say how much the bank payments were, the total amount of the loan for the taxi, or specify any other credit conditions, and he does not seem to have gone into these details in any depth either at this time or later. Instead, he trusted his employer to take care of this end of the transaction. The taxi remained under the owner's name at the bank, and Paul D did not sign any paperwork dealing with it.

Driving for himself now, Paul D tried hard to cover the instalments, but did not succeed. He says he regularly paid over the money he was able to save to his employer, but he is not sure whether the employer paid this money to the bank - 'I gave him the money, but I'm not sure whether he was paying, for I didn't notice or check on him'. He seems to have had no written record of the payments he made to his employer. He continued with this arrangement for eight months, and during this period he paid the cost of minor repairs to the vehicle.

As he describes in the quote above, and to his surprise, after nine months Paul D's employer presented him with bank papers claiming R110 000 outstanding payments for the taxi, under threat of repossession. The employer claimed that he did not know how so much could still be owing, but pointed out that the money would have to be paid, and that it was Paul D's responsibility to pay it.

Paul D was taken aback, but did not see this amount as entirely outside his resources. He decided to try to use his informal credit resources to deal with the demands of the formal bank loan. However, he did not try the informal credit market, which would not lend in the bracket he needed, and would be prohibitively expensive if it did: instead, he expected to use his personal credit network for a series of direct interpersonal loans, for what would amount to venture capital.

From his years as a taxi driver, Paul D himself had savings of R8 000, and he had contacts with others in the local taxi and business establishment who had access to significant funds. In addition, his family of origin had formerly run a successful local bus line which had been taken over by the KwaZulu Government in the 1980s, and his relatives still had extensive local business interests. However, Paul D himself had moved away from his family and seems not to have been directly involved in their business activities. His first step was to go back to his community of origin to ask his brothers to help him by lending the outstanding money.

Paul D's elder brother promised him R9 000, well short of what he needed. His second brother did not offer any money, but promised Paul D that he would consult his lawyer to determine the best course of action. However, this brother did not follow through on his offer of legal help.

Paul D then tried the informal grouping of the taxi owners of his present community for financial help, but got nothing but 'long stories'. Temporarily baffled, Paul D then went to the bank to ask them for more time, explaining that he had just taken over the vehicle from the original buyer, and offering to pay in small instalments over time.

However, the bank officer told Paul D that by then the vehicle loan should have been paid down to one quarter of the original amount. With so much still left unpaid, the bank was forced to take back the vehicle and sell it.

Paul D then tried another local businessman for financial help. This man gave him R10 000 immediately. Paul D then went to collect his elder brother's promised R9 000. At this point, he had managed to mobilise R27 000 in cash, leaving him with R83 000 still not covered. Seeing that he was not likely to raise more quickly, he decided to go back to the bank with what he had. However, he did not go immediately.

At the end of the month, as he was about to leave the taxi rank on his way to the bank, he saw the bank officer he had spoken to drive past him and meet Paul D's own employer. Shortly after, they returned to the taxi rank with a driver. To Paul D's deep humiliation, these people took the taxi away from him in front of all his colleagues at the rank.

Since he was being laughed at by all his co-drivers, a friend took him to the bank so he could see what he could do with the money he had raised. He spoke to the bank manager, who sent them to a garage in Pinetown. There a salesman told them the taxi was sold, and he would have to forget about it.

Finding that at least he did not owe any interest on the deal, Paul D was able to go back to his brother and return the R9 000. He also went to his businessman friend to give back his R10 000. However, this man saw his distress and told him to keep the money and try to find a second-hand vehicle, saying that he did not like to see Paul D in such a mood.

Paul D took this money and his own R8 000 to his elder brother for safekeeping, and began looking for a good second-hand combi. However, two months later his former employer came to ask him to drive a Venture for him. The employer also told him that he had spoken to the bank and it was possible that Paul D would get the repossessed vehicle back. According to the employer, the bank had appeared to repossess the vehicle 'so as to make us pull up our socks with the instalments', and the vehicle was there for them.

By now suspicious, but aware that he was unemployed and had a family to support, Paul D decided he could not refuse his former employer's latest offer of a new driving job. However, when he drove the Venture to the taxi rank to collect passengers, he was amazed to see the same combi he had been struggling for there at the rank, with the same registry numbers but with a different name on the door.

The combi had been bought by a shopkeeper and taxi owner living in the neighbouring TA district, one of the men Paul D had approached for a loan but who had turned him away. Taxi owners are known to watch each other to see which taxi loans are in trouble, and are sometimes said to move in behind the back of the nominal owner to make offers to the garage and take over the loan contract without notice. It appears that Paul D's former employer's story about getting back the combi had been a complete fabrication.

Paul D was angry and hurt, but could do nothing effective, and finally seems to have concluded that he was being lied to and used. To make his feelings clear, he drove the Venture back to his employer's home and dumped it in the yard, then left without saying a word. He was now unemployed again.

Now in a crisis situation that exposed his entire family to ridicule, Paul D went back to his older brother and told him the story. His brother became angry, and went with him to a Mariannhill garage which sold used vehicles. With his well-known and financially solid brother present to support the transaction, Paul D was able to get a VW 15-seater for R66 000. The brother told Paul D to take the vehicle, as he would advance the money and Paul D could pay it back little by little over time. Paul D agreed to this.

It is not clear whether the entire R66 000 was paid immediately to the garage, or whether the brother's contribution amounted to topping up a substantial deposit and guaranteeing future payments. The brother took over the transaction and made the arrangements with the garage, which delivered the vehicle to Paul D at home two days later.

Paul D went to work driving his used taxi. After three months he had a breakdown, which cost him R1 600 at the garage. At this point, since he had no savings left and had used up his personal connections, he went to the informal credit market. He took a loan from his own stokvel for R1000 at ten percent monthly interest, to help him with the cost of the repairs. At the time of writing Paul D has paid his first month's interest and still owes his stokvel the principal.

Paul D's total credit obligations, and his prospects of paying them, are not clear from his account, and may not be fully clear to him. He owes his brother and his businessman friend at least R58 000 of the R66 000 price of the used combi, assuming there are no formal or informal finance charges involved. He owes nothing to his former employer, but will not be able to retrieve the eight months of payments he had made to his former employer toward the vehicle that was later repossessed. He has no written record for these payments, and his former employer has refused to pay any of it back on the grounds that his shop is losing money. If he continues with this combi, Paul D will have to cover the cost of present and future repairs for an older used vehicle out of his earnings and with the help of informal market borrowing.

In addition, it is generally understood that VW combis are not suitable to the rough road conditions in Paul D's community, and are much more likely to break down than other minivan brands. At the time of writing Paul D's vehicle is not in running condition. It is thought to be seriously damaged, and he may have to sell it. The interviewers believe that if Paul D had been able to keep the first combi, he would have succeeded as an owner-driver. As it turns out, he is not likely to be able to base a business on the VW combi bought by his brother, and he has now gone back to work as a driver for another owner.

Paul D's potential earnings as a taxi owner-driver should be substantial, but were evidently not enough as assessed by his various colleagues to persuade them to lend him money as a business venture: if he had been a more convincing and experienced borrower, his network connections certainly commanded the resources needed to lend as much as R110 000. It seems clear that his lack of financial experience and street-smarts kept him from raising a loan from his extensive contacts as venture capital. Paul D also seems to have overestimated his claim on network solidarity from competing operators in a business characterised by cut-throat competition: he was never told by any of his co-workers that his combi had been bought by a local colleague, whose interests did not include helping Paul D to retrieve the vehicle.

Instead, he only managed to resolve his credit problem partially, through putting social pressure on his kinship network by endangering their own collective reputation. The loan he finally got from his brother was in the nature of emergency family help, not business capital in the expectation of profits. In addition, it was arranged hastily, and was not really directed to Paul D's best interests.

He has now taken on substantial informal credit obligations, and perhaps formal credit obligations, and may not be in a position to cope. He is not likely to realise anything like the original R66 000 if he sells the second-hand combi now. Paul D is known to be a steady worker if not a clever operator, but it is difficult to see how he will pay off the taxi loan from his brother if repayment is actually required. It seems likely that a large part of the loan may be forgiven on the grounds that he has not been left with a viable business and the purchase was ill-advised in the first place.

3.5.3 Discussion: dynamics in a developing credit market

Perhaps the most striking aspect of change in the local informal credit market in this semi-rural community is the sudden expansion and gentrification of moneylending. Up to five or ten years ago, moneylending operated in the idiom of the urban men's hostels. These massive and severely overcrowded dormitories were and are used to house mostly poor and uneducated male migrant workers of rural origin, along with their urban dependants who include women and children. Physical and social conditions for residents were often appalling. Moneylending which emerged in this context has sometimes been described as 'loan sharking', with very high rates charged on weekly interest, and with violence routinely used to enforce repayment. Lenders were originally hostel residents who had managed to save up enough to be able to lend, and who were suspicious and sometimes contemptuous of educated people. This lending sector still exists in the surviving hostels.

Until recently, moneylending in the peri-urban community investigated here was still seen in this light, as tough, dangerous and very expensive. Lenders were often uneducated men willing to take harsh action against defaulters. Most local informal credit in the 1980s was stokvel lending and interpersonal credit, and recourse to moneylenders was usually a last resort not often taken by educated people. Thenjiwe D's experience as a borrower is a case in point.

However, as incomes have risen and more cash has flowed into the community from the urban sector, individual lending has emerged from obloquy. Bulking up savings through groups to support lending is less necessary now than in the 1980s, and market forces are pulling individuals with resources into lending as a micro-enterprise.

The individual moneylending sector appears to be expanding rapidly, drawing lenders from the upper middle income group as offering loans becomes accepted and respectable. As it takes hold, individual lending seems to have taken over market share from stokvel lending, and may now dominate the institutionalised side of local informal credit in this community.

This change and expansion has depended on the emergence of referrals and agents - third party interventions - as perhaps the central pivot of local informal credit. Where credit transactions until relatively recently required people to use their own social connections and for lenders and borrowers to know each other personally, the new domain of credit is based on introductions. Total strangers now routinely lend and borrow, requiring only that they belong to the same community and/or have a mutual acquaintance.

The implication is that the sphere of accessible credit has expanded radically, by shifting the bulk of transactions from face-to-face relations to quasi-impersonal transactions arranged through third parties. Social networks remain critical, but are now being bought in through outsourcing.

Defining the local credit market

In this mobilised semi-rural community, informal credit is available from a number of sources, and across a wide range of loan values. Within roughly four square kilometres where most of the case material was collected, there are a number of savings clubs or stokvels that lend money, at least five individual moneylending enterprises operating separately, a credit syndicate made up of moneylenders, and a thick webbing of interpersonal credit connections among ordinary citizens.

The total market for informal local credit has opened up significantly in the last five years. There are enough credit outlets today so that - at least in the credit band where most loan traffic takes place - a general reputation for creditworthiness has become more important than privileged access to individual loan sources. The different profit-making local loan sources now compete hard for clients, and clients now often go outside their own local neighbourhood to arrange credit. Taking multiple informal loans to bulk up credit in order to cover a capital expenditure or a package of consumption needs is now a common practice.

However, as the market delivers more credit, it also becomes more dispersed and less tied to savings mobilisation as such. More and more credit is becoming available through two-party contract arrangements rather than through membership of a group. One or two of the cases raise the question of whether access to credit is becoming a function of accessing income flows rather than accumulating savings.

Structure, scale and demand

This thriving overall market can be divided analytically in terms of the scale of loans offered by different categories of provider. Different providers and loan sizes seem to serve somewhat different sectors of credit demand.

The local informal institutional credit market - stokvels, individual lenders and the syndicate - operate in a band below the level of loan available from outside formal credit. That is, the profit-making commercial informal credit market is concentrated at the low to middle levels of effective demand, with formal commercial credit from banks and lending agencies higher up. The gap in between is largely a product of transaction costs and default risk. It is partly filled by interpersonal credit and sporadic access to employer loans, but leaves an important level of credit demand partly unfilled.

Local informal civil and private credit - from stokvels and moneylenders - make up the commercial sector of interest-bearing credit. These profit-directed loans range from roughly R50 to R1000. They are readily available to borrowers with good local credit standing, and even reach people whose local standing is equivocal. By adding on additional loans, amounts of several thousand rand can be built up. But this kind of approach to credit access comes at the cost of interest commitments that can easily double the total amount repayable over a few months.

In contrast, **formal credit** either from banks or employer firms is probably difficult to get below R5000[17]. Formal credit is not directly available to everyone, and normally requires a well-paid job in the developed urban sector to support it. Probably most of the formal credit reaching the local market is tied to housing provision, but a substantial proportion goes to vehicles, appliances and large and small consumer items packaged as hire purchase contracts. No exact figures are available for this area, but some of the consumer credit is deflected outwards from the formal borrowers to others in the community.

The informal loan sector which competes in the same range as formal credit is interpersonal loans, which are not institutionalised and do not always bear interest. They occupy a much wider, less defined band: credit from relatives and connections runs from R1 - R50 000 or more in known cases. An important part of this sector of the local credit market is venture credit for small to medium business start-ups. Much of the rest covers education needs and conventional social expenditures at the mid-level, and consumption shortfalls and household emergencies at the mid to low level.

Some individual families, white, Indian or African, also make loans to their domestic workers, from R500 to R20 000 or more. These are in most ways interpersonal loans, but can also be deducted at source, which is usual for employer credit. Some of this credit goes for consumption and for education, but a great deal seems to be aimed at housing development.

Access to credit and delivery mechanisms

Local informal credit in the study community represents a very dispersed market, adapted to a densifying area with rapid in-migration of strangers, and with little sign of communication among lenders. The market responds very flexibly and fast to client needs - in one recorded case a man who is not a community resident was able to raise R750 from a lender to take his wife-to-be to hospital, in about one hour from the time she suddenly went into labour late at night.

Access to credit in this context is still personal and not impersonal. However, for the institutionalised high-turnover band of credit, access now extends far outside the limit of the individual's own social circle.

Institutionalised lenders - stokvels and moneylenders - both make use of third party agents to identify clients, and clients use third party introducers to refer them to lenders. Both sides expect the third parties as facilitators to substantiate the clients' creditworthiness. Third party facilitators also serve as witnesses and help to guarantee the terms of the loan.

Most third party agents who assist lenders appear to work without wages, for free credit or other relatively marginal benefits: in Jabu M's case, her regular compensation amounted to saving R40 per month in loan interest. However, the study community's moneylender syndicate employs their third party agent formally, on salary, and therefore actually hires in network connections: at this tenuous level, institutionalised local informal credit has begun to generate employment. More usually, third party agents who help lenders on a regular basis seem to be lower income people who are active credit users and want to be involved in lending, but lack the capital.

In this context the direct role of relatives and neighbours as credit providers may be declining. Instead of relatives and neighbours providing individuals directly with credit when they need it, the individual's own network connections are increasingly likely to hand off the actual loan to the institutionalised local credit sector, and scale back their own role to that of third party facilitators. That is, instead of giving financial help, they put the credit seeker in line for it. As market credit has grown, reciprocity among relatives seems to have

[17] Employer loans are not formal in the sense of being sourced from registered financial institutions. However, employers follow standard banking practices, hence its inclusion here.

become more strictly balanced, and less deep and obligatory, reflecting the wide trend to greater household autarky.

However, above and below the band occupied by institutionalised local credit, access to loans depends heavily on interpersonal credit. This sector of credit provision is not clearly market-determined, and terms of repayment seem to be more indefinite and personalised than for the regular lenders. Access is relatively haphazard, but favours credit seekers with connections and assets, who can manage to put themselves in the right place at the right time. It seems to be much more dependent on kinship connections and particularly on male-solidarity connections which develop around workplace, school and neighbourhood links.

In the case data for the study community there is no sign of women being able to access the substantial loans that men can sometimes get through interpersonal credit, and particularly no sign of their obtaining venture credit in the way that men are sometimes able to do. Women as individuals routinely use their networks to provide each other with small consumption loans aimed at household reproduction, but even women running enterprises do not often seem to exchange significant amounts of business credit.

Interest rates

Interest rates on institutionalised borrowing increase for smaller loans, and there is some evidence that they may be differentiated for different categories of borrower. It is not clear at this stage if women borrowers have to pay some premium over men's rates across the board, but in practice women are more likely to be the takers of small loans. Women often seem to be paying 25-35%, while men most frequently reported 10-25% per month.

Evidence of differential interest rates in relation to poverty and ability to repay is conflicting. There may be some evidence that interest may vary for different borrowers in terms of what the traffic will bear. But although borrowers are able to shop around for better rates, in practice marginal borrowers are sometimes excluded from the best rates, and may find themselves unable to avoid paying more.

There is also a genuine pity factor in the local informal credit market, where hardship cases may be able to claim on the community at large for some preferential support in terms of access to credit and rates of interest. In some cases not presented above, a few impoverished borrowers seem to be able to manipulate the market in small ways: by appealing to pity, defaulting on small amounts and approaching different lenders; some very poor credit users may even be able to drain off more in credit than they repay over a period of months or years. The price they pay is one of burning out their ability to borrow, and risking violence or other reprisals if their manipulations become obvious.

Interest rates for the larger interpersonal loans are not known at this stage.

Client selection and characteristics

With third parties referring clients on a large scale, the local institutionalised credit market is able to select for clients in the low to upper middle income brackets, who have some access to outside income. The process of client selection itself is carried out through pre-loan negotiations and credit checks. Borrowers' reputations for reliable or unreliable repayment are widely known in their own neighbourhoods, but so far there is no indication that lenders communicate among themselves about client credentials. Some relatively unfortunate or unreliable credit seekers need their introducer or sponsor to provide a complete guarantee that repayment will be covered if the client fails to meet the loan terms.

Preferred clients seem to be people who run short of cash irregularly but generally have incomes that equal or exceed their spending, so that they are able to repay their loans fairly easily. Normal loans for a modal client seem to be in the vicinity of R200 over two or three months.

Some individuals who count as members of the elite, with incomes of more than R5000-7000 per month, also borrow fairly regularly. Very poor clients, with unreliable incomes or very little income, seem to manage to borrow up to R4-500 at a time in some cases, but usually restrict themselves to R50-100 or less. Marginal women borrowers may be directed to women lenders who give only smaller loans: men usually deal with men, and may or may not borrow at all from women lenders. There is also still a large sector of the community that does not use credit at all.

Loan approval and collateral

For institutionalised local credit, loan approval is normally a brief one-stop process based on an interview with the prospective borrower. Terms are discussed in the presence of a witness, identification is usually verified with standard documents, and the borrower has to establish ability to repay. Any limitations on the length of the loan or other unusual conditions should be made clear as part of the agreement. The borrower's reputation is an unseen but critical factor. Loans are normally recorded in notebooks, and clients may need to sign a written agreement covering repayment.

Stokvels and lending syndicates may allow the treasurer or another member to approve new loans, or may prefer to have at least two members present to decide. Some groups expect new loan clients to appear at a meeting, which raises transaction costs for the borrower and lenders both, but disperses responsibility for bad loans. Moneylenders usually make individual decisions, using the recommendations of third party agents.

For interpersonal credit, agreeing to make loans remains a way of investing in social connections, and still allows people who make loans to save their money in the form of credit obligations which can be called in or borrowed against at need. It is an individual decision, based on the state of the relationship, and evaluated against social status as well as social and financial returns.

Credit in the local informal market is normally secured against ability to repay and not directly against assets as collateral. This seems to mean control of income flows rather than savings collateral (for the actual role of assets in repayment, see below). A standard based on income flows favours men borrowers over women.

Women were active borrowers, but they had limited access to outside income flows in the form of wages and larger private pensions. Women negotiated for credit primarily through claims on the income flows of others. The great majority of women, who are not in well paid jobs, present themselves as loan clients in terms of their claims on the salaries or pensions of sons or other male relatives. Lenders routinely give credit on the basis of these claims, but seem to treat them at a discount, as not fully reliable and worth much less than direct ownership of income. Much the same applies to older men no longer working, and to the unemployed.

Women's own salaries - usually for part-time domestic work - are in the same bracket as state pensions, and seem to be seen by prospective lenders as wholly committed to household reproduction. It seems indicative that Sanele X says he redlines widows routinely: in the study community, state old age pensions are clearly no longer high enough to hold otherwise unsupported pensioners out of the poverty bracket, or to make them reliable borrowers.

A high percentage of local credit defaults and delays seem to relate to loans made against claims instead of directly against flows, but it is probably this sector of loan clients who are most likely to need credit, and who account for most local credit transactions.

Sanctions and repayment rates

No direct figures are available for loan repayment rates in the local informal market. However, repayment for informal credit competes against an array of domestic, personal and other demands, and one of the lessons of small-scale agricultural credit in South Africa has been that rural loans need strong incentives if repayment is to receive any priority.

The main sanctions behind repayment of local informal credit are loss of public reputation, loss of ability to borrow, and the financial losses incurred when local informal credit is allowed to run up interest charges. There may be reason to doubt that informal interest rates in this kind of market - where interest escalates rapidly up to where the principal finally has to be repaid as a lump sum - are entirely a response to the actual cost of the loan to the lender. High interest rates in this context provide a direct sanction against disregarding the obligation to repay: non-payment quickly becomes ruinous.

Beyond this point, institutional sanctions provide that lenders can send demand letters, or visit the houses of clients several times a day to demand payment and enforce loss of reputation. More drastically, they can report defaulters to officials of the Tribal Authority, and request authorisation to go to the debtors' houses accompanied by a tribal policeman and seize goods.

These goods - usually large consumer items and appliances - appear to be in effect impounded against payment, rather than sold immediately to liquidate as much as possible of the debt. However, repossession by either formal sector firms or the informal credit market is seen as very distressing and humiliating, and clients try to resolve the situation at this point if they can. Cases and workshops suggest that although credit is normally taken out against future income flows, in the last analysis loans are implicitly secured institutionally by personal physical assets.

Violence is the last sanction employed by informal creditors, and one case is on record of a male lender reverting to older style enforcement and threatening a non-performing client with a gun. In another case, an impoverished woman borrower who was delaying payment and was seen as acting in bad faith was threatened with attack by two women who were owed money. However, actual violence is reported to be very rare in the main study community, and most threats seem to stop at that level. In other rural communities violence as a sanction may be much more immediate and real.

Case material shows how persuasive these considerations can be for clients. For most borrowers in the respectable lower to upper income groupings, consequences of non-payment are taken as very serious, and repayment rates appear to be relatively high.

Because of the consequences to the family of the defaulting client, the threat of default sometimes seems to be used by women who borrow against claims as a mechanism to extract assistance from family members who control income flows. Sons who have not been willing to assist mothers or sisters with household debts may be shocked into paying by the threat that a default will become public.

However, very poor borrowers and people who have put together pyramided loans are sometimes unable to pay, and may be past the social point where they fear either notoriety or the build-up of more debt which could never realistically be called in. More solvent credit users also seem to hit household bottlenecks when their repayments stop temporarily. Short term pauses can usually be negotiated with lenders for borrowers in good standing, but any delay increases the chances of the loan defaulting. Lenders are relatively helpless against really insolvent borrowers who attract general pity, and women especially may be allowed to pay off symbolically through household or garden work, in order to restore some equivalence and allow both parties an exit.

In this and other senses, social class is also a factor in the application of sanctions for repayment. Old-fashioned, tough male lenders are generally thought to be willing to apply any means available to ensure that reluctant clients pay, but the new credit sector has less resources. Upper-class lenders or stokvels are not easily able to be seen putting pressure on defaulters, as Sanele X makes clear. The same applies to women lenders in general. However, lenders in these categories are more likely to deal with other women and other elite clients, who are strongly impressed by the social consequences of default. Given a less recalcitrant client base, it seems as if social pressure is enough to keep these credit enterprises viable in the face of default risk.

Transaction costs

Informal institutional lending is a form of enterprise that calls for very little investment in plant, overheads and running costs, and transaction costs are usually low. Lending is run from home with local or nearby clients, and basic records keeping is the main business activity. Loan approval is a relatively simple process. Most transaction costs to lenders come in relation to collection from defaulting or delaying clients.

However, the situation is less simple for groups. In the case of stokvels or lending syndicates, banking and computation of interest and payouts have now become important factors. Likewise, monitoring the due diligence of group officers and preventing group members from breaking away have always added to the cost of any transaction.

Difficulties here can have knock-on effects in causing strain within the group, and may contribute to groups breaking up. It is likely that the additional transaction costs involved in running a savings and lending group have been a major factor in the break-up of groups and the rise of individual moneylending enterprises.

For the lending operations, many of the transaction costs which normally attach to obtaining clients, running credit checks and ensuring repayment have been drastically reduced or even eliminated by the concomitant rise of third party agents or facilitators. By hiring in local network connections and outsourcing most of the task of credit checks and loan collection, the transaction costs for the actual lender drop to a minimal level. Lowered transaction costs probably accompany reduced default risk, and have probably contributed to the recent spread of individual lending against other kinds of microenterprise.

Prevailing high rates of unemployment may be linked to agents' willingness to exert themselves for little gain. For what seems to be very slight compensation, third party agents seem to do most of the locating, introducing, witnessing, securing, monitoring and follow-up of individual transactions. In the case of the moneylender syndicate, one lender was not even advised of a possible default till the third party agent had spent four months on the case and had tried every other avenue: once informed, the lender went directly to a goods seizure, and was able to collect the loan within days.

Savings mobilisation

The role of savings mobilisation in local informal credit in the main study community may have declined as stokvel lending has lost market share to individual lending. As noted earlier, larger cash flows are coming into the area, and it is now much less necessary than it was earlier to accumulate stocks of cash before starting to lend. More than one new lender reports using flows in the form of private pension money to run a lending operation. Others use taxi income, or normal household income flows based on wages when these are high enough.

For the most part, both borrowers and lenders seem to be reluctant to treat savings as working capital, or to involve these assets in credit transactions. Savings tend to be seen as long-term accumulation and/or funds for severe emergencies only, which should be kept separate from consumption, social expenditure and small business costs. These routine costs are seen as a risk to accumulation, and should then be covered from normal household throughput - that is, from income flows, which also cover credit payments.

If sources and sinks of money in the main study community are looked at broadly, money flows in mainly from the developed economy through wages, and secondarily through private pensions. State pensions and disability grants are perhaps less important than in the 1980s, but still very significant to the poverty sector. There is little locally based production, and agriculture is a small sector. Microenterprise helps to circulate outside income, and informal credit probably plays a pivotal role in helping to generate multiplier effects. Money then goes back out to the developed sector through the costs of household reproduction, including food, clothing, education and other basic needs and services paid directly or through hire purchase. Savings are transferred either directly or indirectly into formal sector financial institutions, and go to serve the needs of the developed financial sector.

In this light, informal credit coming through individual lending probably does not serve to mobilise savings in the usual sense, although where credit is directed to capital items, business or investment this is likely to be the final result. Because of the way local informal credit works, borrowers are compelled to save vigorously after the fact, concentrating funds in order to accumulate and pay over the principal to the lender.

Most of this money, especially for women, goes into consumption and expected social expenditure, which goes back to the developed sector and leaves nothing behind. Some credit does go into smaller informal business, and a great deal into housing, where it is filling a critical role. However, loans in the band needed for enterprise venture credit seem to be scarce from any sector of the market, and mainly or entirely accessible to men when they do occur.

However, where it uses flows rather than savings, local informal credit through both individual lending and stokvel associations does serve as a conduit for mobilising capital from the developed formal economy, and dispersing it into multipliers in the semi-rural fringe.

Especially if informal lending turns out to make extensive use of private sector pensions, local credit transfers would release money accumulated in the formal sector into the community: the alternative would be channelling it back into the formal financial institutions as individual bank accounts or stokvel savings deposits. In this sense, local informal lending improves local cash flow and liquidity without necessarily promoting savings as such. At the same time, it contributes very powerfully to fixed capital investment in housing stock, and provides vital support to a thriving local construction industry. Whether this is enough to meet the needs of women on their own, who are caught inside the local economy and have little direct access to outside income or credit, is still an open question.

3.5.4 Conclusions: filling needs

The general requirements for loan credit include providing enough credit near enough to point of need so that it resolves the client's need, while also bringing back reliable repayments at interest rates which cover costs, deliver acceptable profit if the loan is private, and enable the scheme to run sustainably without subsidy. Ideally, loans should serve the widest possible range of clients. Both delivery and repayment should also be flexible enough to take account of clients' circumstances and retain as many clients as possible, while avoiding costs for unnecessary legal procedures. Formal and informal credit have traditionally had different advantages and disadvantages relative to these principles. Interesting things seem to happen when the local credit market contains both systems.

Formal private credit from banks and other lending institutions is reliable and relatively cheap to those who can get it, but usually follows relatively rigid procedures for eligibility and collateral. Access is slow. Credit checks to establish borrower reliability are notoriously difficult if the client cannot produce paperwork or appear at the lending institution, and clients whose assets do not meet standards wind up red-lined. Small loans are usually uneconomic, and the system prefers large and well-known borrowers. Business credit and home loans are relatively easy to get, but consumption credit and related demand may be unobtainable. These hurdles usually exclude the majority of rural people, the less educated, most women and nearly all the poor.

Informal local credit has the opposite set of limits. Face to face relations and social networks provide relatively effective credit checks and allow relatively poor people to access and manage credit. Access is flexible and fast. Transaction costs are minimal by comparison, allowing relatively small loans to be economic. But loans cannot be monitored over any length of time, and are often limited to a few weeks or months. In this context they are often expensive.

In addition, in impoverished village contexts institutionalised informal credit may supply only relatively small loans. Larger requests may be uneconomic. In these areas most lending is on reputation and ability to repay, not many valuable assets are able to serve as collateral, and procedures for foreclosure are relatively uncertain. In the study community, repayment incentive through escalating interest commitments works very effectively, but is only viable for relatively small loans.

It follows that consumption needs and consumer credit - and incremental credit for housing - may be easy to get, but larger block needs, for moderate to medium business or agricultural use, may be difficult to meet without doubling up repeatedly on expensive credit from different lenders. The only local route to this kind of credit may be through the interpersonal loan sector, which is relatively undefined and requires connections, luck and good timing to get access. This kind of lending does not exclude the rural, the uneducated, the poor or women automatically, but it may tend to exclude them from economic loans - commercial and production credit - as opposed to low-level home building or consumption credit.

The formal and informal credit sectors do not appear to compete directly in the main study community. They address different loan levels, and seem to address the same demand mainly in relation to the housing sector, where formal credit is much preferred but informal credit is the usual option.

The upper limit for informal loans does not appear in reaction to cheaper formal sector loans coming in at that level: the formal sector probably comes in two or three thousand rand higher above the informal ceiling. Instead, it seems to result from the income structure of the lending market. Most lenders appear to be families with incomes that are high only by local standards. They may be unwilling to provide loans over R1000 because of the risk of tying up too much of their limited total capital in a few relatively large and risky transactions.

Informal lending then serves as a mechanism to circulate capital from the lending classes - the middle and upper middle income brackets - to the borrowing population, which extends from the elites almost all the way down, but perhaps concentrates on the lower middle income groupings. Upper elites, it appears, may not involve themselves in institutional lending because the returns are too small to be worthwhile. Lenders deploying capital of R2000 on a monthly basis might take in R400 - 700 depending on rate of interest, and assuming full repayment.

Credit at the low to medium end of this rapidly evolving peri-urban market is highly institutionalised, relatively expensive but freely available. It reaches most of the way down the poverty profile in the area. Though case material suggests that they are often unable to manage their debt burden, even relatively marginal women borrowers have been able to find local civil credit on the market.

However, above a ceiling of about R1000, local informal credit comes from a different market and is much more problematic. Loans between R1000 and about R5000 suffer from the mirror image of the formal-lending problem with transaction costs: that is, instead of being so small they are not worth what they cost the lender, they are large enough so they become too risky for small local lenders to undertake.

Above R1000, too much of a small lender's capital goes into one basket, and risk is concentrated instead of being spread and diversified among an adequate range of borrowers. It follows that the small lending market may not fully supply the growing market for home building, or for small business venture credit above the level of the smallest micro-enterprises. Nor does the formal sector reach these demands on a regularly accessible basis.

Credit in the medium range that covers investment and commercial uses seems to come mostly from employer credit and from interpersonal loans. This medium-range credit market is not institutionalised. Its distribution is sporadic, and usually limited to men with steady employment and good connections, who also manage to be in the right place at the right time: that is, even for individuals who seem to qualify, getting this kind of credit is partly chance. It is difficult to determine how much of the potential investment and commercial demand is covered by non-institutionalised individual loans, but this kind of lending seems to serve women much less, if at all.

None of the credit studies in this community, current or past, has uncovered a case of a woman obtaining an interpersonal loan for a substantial amount. Employer credit for women doing domestic work likewise seems to be scarce above the R1000 level. Though there may be such cases, no instance came up where women employed by firms had managed to get significant employer credit for house building. For men, such loans were fairly common.

Below and above the institutionalised band of informal lending where turnover is high and access is very wide, local credit becomes personal and based on dyadic relationships. It passes through connections and not through a market process.

In this situation, the result of putting both systems into the same context seems to be to put employed men borrowers with assets and urban connections into a relatively comfortable position. They have the option of borrowing from either formal or informal sources, in a range of loan sizes, and for a range of purposes. Their credit standing, if not ideal, is often within the acceptable range for both systems.

For women and men without urban connections, formal credit is usually excluded unless the candidate has unusually good qualifications and a well paid local job. Depending on what claims they have on employed men, women may find themselves either redlined, or restricted to very small loans and to uneconomic and unproductive forms of credit - unless they are prepared to manage the risks and costs of doubling up and rolling over their credit extensively. These kinds of credit are adapted to repair temporary breaks in the household's system of support options: they may help to avoid a sudden descent into poverty from loss of assets, but they do not open up new options.

CHAPTER 4

THE LEGAL AND REGULATORY ENVIRONMENT

Apart from 'mainstream' legislation, to which reference is made below, the constitutional situation in South Africa is complicated by the extent to which the former homelands enacted their own laws on a range of matters or, once having inherited applicable legislation, failed to update it; the extent to which legislation adopted by Parliament subsequent to those authorities' having obtained the powers, applied to such areas; and the extent to which such laws remain in force, have been taken over by the central government, or have been devolved to the provincial governments. This situation obviously calls for a serious rationalisation of the legal regime. In this chapter the most important laws concerning agriculture, land and housing, and the legal position of women are analysed in addition to legislation covering banking and finance. The discussion follows that presented by the Strauss Commission.

Agriculture

The principal statutes governing financial services for commercial agriculture are the Land Bank Act, the Agricultural Credit Act, the Marketing Act and the Cooperatives Act. The acts and the benefits that accrued through them did not apply to black farmers. Although it existed in an economy and polity until recently predicated on racial legislation, the complex legal infrastructure that supported and governed the agricultural economy was an anomaly. It has for long been neither directly discriminatory nor expressly racist. The spatial division of rural areas into 'white' and 'black' was so manifestly successful that the major rural legislative instruments did not need to mention race. Their racial character was contained in their area of physical jurisdiction.

The most important laws and provisions that influence the provision of financial services to commercial farmers include:

- **The Land Bank Act,** that established the Land and Agricultural Bank of South Africa. The business of the Bank is to advance money to farmers, companies and cooperative societies; to advance money to certain land owners for certain purposes (e.g. the construction of dipping tanks); to guarantee the performance of certain contracts by companies and cooperative societies; and to arrange appropriate insurance. These services are to be provided for purposes connected with agriculture or farming. The security requirements are, however, quite onerous, and most often require a first mortgage bond over the property. Advances and other services may also be made on the strength of a promissory note. The Act makes fairly drastic provisions for recovery of the debt, circumventing normal legal procedure.

- **The Agricultural Credit Act,** that established the Agricultural Credit Board and seems to have been intended to provide a mechanism for assistance to 'category III' farmers who were unable to raise funds elsewhere, as opposed to financial services on a systematic basis. This assistance can take various forms, including a loan for any purpose tending to safeguard or stimulate the farming industry; selling or letting to such person movable or immovable property of the State which is suitable for farming purposes; or in connection with a compromise.

- **The Marketing Act,** that provides for the creation of structures in terms of which the production and sale of certain agricultural products are controlled. Since the mid 1980s the various structures created by the Act have been modified to allow for market determined production and sales decisions on the part of farmers. Associated legislation governing specific commodities is found in the Sugar Act and the Wine and Spirit Control Act. A Bill intended to replace the Marketing Act is currently being prepared.

- **The Cooperatives Act,** that provides for the establishment of three different kinds of cooperatives, namely an agricultural cooperative; a special farmers' cooperative; and a trading cooperative. The powers of all three are extensive. An agricultural cooperative may acquire, process, manufacture or market any agricultural product. It may acquire, make and sell farming requisites and render any services necessary for or useful in connection with farming operations. It may carry on farming operations. Special farmers' cooperatives have the additional power of being able to deal in agricultural products and derivatives. Finally, trading cooperatives may 'be formed to carry out any object'. The 286 agricultural and 283 trading cooperatives can act as agents for the Land Bank and Control Boards, and as suppliers of inputs to farmers. They constitute a form of legal entity which, because of the particular relationship with its members, requires regulation often very different from that of a company. Various provisions in the Act suggest that the cooperative may be a useful vehicle for non traditional lending institutions. Thus, for example, the provisions of the Insurance Act do not apply to an agricultural or special farmers' cooperative carrying on certain 'insurance business' out of a fund maintained for that purpose. Furthermore, a cooperative may make advances to members and may take deposits from them as well[18]. However in respect of the rural poor, the formation of a cooperative is a difficult option as it has complex statutory reporting requirements similar to those of a limited liability company. Cooperatives continue to enjoy various tax advantages.

- **The Subdivision of Agricultural Land Act,** which provides that land that is defined as agricultural may not be divided into smaller holdings without the consent of the Minister of Agriculture. It prohibits (further) joint ownership of agricultural land; the lease of a portion of agricultural land for more than 10 years; and the establishment on or encroachment of 'urban' jurisdictions on agricultural land without consent from the Minister. The Act defines its applicability negatively. 'Agricultural land' is defined as land outside of areas of 'municipal jurisdiction'[19] and land belonging to the state or a statutory body. Different kinds of consent to subdivide land are allowed, including the first consent, which allows agricultural land to be put to urban or other use, and the second consent, which allows for the subdivision of agricultural land in order to establish additional agricultural units.

  The implementation of the Subdivision of Agricultural Land Act cuts across agriculture and land issues. In a market economy there is little rationale for the Government to regulate minimum farm size. The administrative basis on which decisions around farm size are made are arbitrary at best, and the utility of the Act on policy grounds is questionable. In addition to the restrictions identified above, the Act prevents long term lease arrangements being entered into on portions of agricultural land, by regulating leases that subdivide land and are of longer then 10 years duration. There are no restrictions on shorter leases or on longer term leases that do not subdivide land.

  There are no economic grounds for regulating land leases in this way. Moreover the Act encourages short-term leasing arrangements that can lead to land degradation and the exploitation of tenants. Thus without long term security, tenants are more likely to degrade land and less likely to make investments that conserve or improve land. Landlords under short-term leases are less likely to invest in

[18] According to S 1 of the Banks Act, the 'business of a bank' excludes the borrowing of money by a cooperative from its members, subject to certain conditions. This effectively allows a cooperative to have members make deposits with it, and it is therefore effectively exempt from the provisions of the Banks Act. The relevant conditions prescribe that a loan from a member to a cooperative must be for not less than R1000, that the repayment period should be not less than 12 months, and that the cooperative shall issue an acknowledgment of debt in respect of each such loan. The loan shall be repayable either at a fixed date or upon 30 days notice by the cooperative to the member.

[19] The Act does not effectively apply in the former homelands. In terms of Section 239 of the Constitution all land formerly registered in the names of the governments of the TBVC administrations and the self-governing-territories vests in the President (but excluding former KwaZulu). In terms of Proclamation R95 of 1995, the application of the State Land Disposal Act with respect to those territories has been transferred to the Minister of Land Affairs. The trusteeship in respect of tribally occupied land areas vests in the President (however, in the case of tribal land in former Bophuthatswana this competency has been transferred to the Minister of Land Affairs, while in the case of KwaZulu trusteeship has been transferred to the Ingonyama in terms of the KwaZulu Ingonyama Act 1994)

infrastructure and to compensate for improvements. The Act is however the only land use zoning instrument in place in many rural areas. Zoning regulation is of crucial importance in the protection of environmentally sensitive areas, watersheds, riverine areas and high potential agricultural land.

- **Existing legislation** that contains various provisions which are inimical to the development of open rural financial markets. This includes Section 34, 54, 55 of the Land Bank Act; Sections 171, 175 of the Co-operatives Act; and Parts 3 and 4 of the Agricultural Credit Act. These provisions enable the respective institutions to enjoy preferential creditor status against other commercial entities. These provisions confer extraordinary benefits on the state, commercial farmers and agricultural entities.

- The **Conservation of Agricultural Resources Act,** which allows for state money to be advanced for conservation works on agricultural land. **The Agricultural Research Act** provides for the establishment of an Agricultural Research Council (ARC). The objects of the ARC are to promote agriculture through research, development and technology transfer. The research mandate of the ARC has been used for research directed principally at the needs of commercial agriculture. The way in which the ARC's administrative discretion is interpreted has a direct impact on the need for financial services by rural communities.

The success of the land segregation policy has been described above. Millions of black farmers eke out a subsistence with little or no state aid, safety nets or assistance. The former homeland governments all enacted statutes that had an impact on the provision of rural finance. The principal vehicle for financial services were the development corporations, established to provide support services to homeland agriculture, and specialised agricultural development corporations.

Banking and finance

The nature of provision of rural financial services is largely determined by legislation; the common law is only of indirect application. The most important laws include:

- **The Banks Act.** The Banks Act is based on first world criteria and principles, focusing on risk management. 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 approach of the Banks Act is functional and not institutional. It addresses the function of deposit-taking rather than the institutions accepting deposits. The advantages of this approach are that various groups of banks are regulated by a single act, and that a more level playing field is created, thereby eliminating past inequalities and discrepancies in the regulation of these groups. The Act introduced a general prohibition on the taking of deposits from the public unless registered as a bank. This provision has a dramatic impact on the ability of non traditional lenders to obtain wholesale funding. Certain practices and institutions have been exempted from the provisions of the Banks Act. These include stokvels and credit unions, on the condition that they be members of an umbrella body such as the Savings and Credit League of SA or NASASA, and have assets of less than R10 million.

  The Banks Act is based on the Basle Concordat, and focuses on the risk management of banks. It does so by relying on the risk management capacity of directors and senior management of banking institutions, capital adequacy and liquidity requirements. The focus is on protection of the banking system and the deposits made by the general public. The provision of credit to high risk borrowers with low incomes and no security therefore is not central in the focus of current banking legislation.

  Regulations No. R2509 and Regulations No. R2508, issued in terms of the Banks Act and the Mutual Banks Act respectively, provide that only loans fully secured by mortgages on urban residential dwellings will qualify for a 50% risk weighting for capital adequacy purposes. All other assets qualify for a 100% risk weighting, which has the effect of increasing the cost of loan finance for rural dwellings and or land.

- **The Mutual Banks Act** is the result of an attempt to provide for financial services for low income people. A need was identified for an Act to accommodate non-traditional lenders that could not take deposits from the general public, would have less stringent capital adequacy requirements but similar risk management requirements. There was also a need to involve communities in banking by making provision for local boards for branches of mutual banks. The main object of the Act is then to create a statutory framework for the regulation of the activities of juristic persons, established on the basis of mutual membership, doing business as mutual banks. A mutual bank, as far as structure and administration is concerned, conforms largely with the former permanent mutual building societies. The Act provides that a mutual bank may accept deposits and grant loans, advances or other credit.

  The majority of 'non-traditional institutions' have not registered under the Mutual Banks Act for a number of reasons. **First,** registration is believed to compromise their 'independence'. As soon as such an entity registers, it falls under the supervision of the Registrar of Banks, which, given the political environment out of which these entities have grown, could have been inhibitive. **Second,** banks are not necessarily perceived to be client-friendly institutions by low income persons, and registration may diminish the perceived legitimacy of non traditional lending institutions. **Third,** there are staffing, reporting and other cost implications in becoming registered. The Registrar needs to be satisfied with the directors and senior management, which in most cases requires the employment of high earning staff, and this could endanger the viability of this institution. **Fourth,** the capital adequacy requirement of R10 million is perceived to be too high. **Fifth,** liquidity requirements sterilise funds. **Sixth,** the people who are the driving force behind the success of non-traditional lending institutions generally come from an NGO background, and would not easily feel comfortable in a formal banking culture.

  To the extent that certain requirements of the Mutual Banks Act relating to capital adequacy or prudential requirements should be relaxed to accommodate the needs of the rural poor, it may be necessary to introduce deposit insurance to deal with bank failures which could then be expected to increase.

- **Legislation on the supervision of financial institutions**, including the Reserve Bank Act, which requires all banks and mutual banks to maintain a minimum reserve balance in an account with the Bank; the Financial Services Board Act, which established the Financial Services Board to function as a watchdog over the financial services industry (insurance and investment services); the Policy Board for Financial Services and Regulation Act, which established the Policy Board for Financial Services and Regulation to advise the Minister of Finance on policy matters relating to financial services and financial regulation, either of its own accord or on the request of the Minister.

- The **interim Constitution** of the Republic of South Africa deals in three sections with the constitutional role of the South African Reserve Bank. It provides that the Reserve Bank is the central bank of the Republic, with its primary objectives the protection of the internal and external value of the currency in the interest of balanced and sustainable economic growth. The Reserve Bank is entitled, in the pursuit of its primary objectives, 'to exercise its powers and perform its functions *independently*, subject only to an Act of Parliament...' There must, however, be consultation between the Reserve Bank and the Minister of Finance. The powers and functions of the Reserve Bank are those customarily exercised and performed by central banks, and are determined by Act of Parliament. The Constitution guarantees the independence of the Reserve Bank from government intervention and interference; only consultation with government is called for. However, the independence relates to the exercise of the *powers* and *performance* of the *functions* of the Reserve Bank in the *pursuit of its primary objectives* only. Arguably, the supervision of banks is not a primary objective, and the decision to institute or abolish exchange control, administered by the Reserve Bank, rests with the Treasury. The Registrar of Banks is an official of the Reserve Bank, and heads the Department of Banking Supervision in the Reserve Bank, although he or she reports to the Minister of Finance. Extensive powers of supervision and inspection vest in the Registrar, and he may call upon the auditors of a bank to furnish him with notices and other information. Moreover, the auditors must inform the Registrar of any matter relating to the affairs of a bank which, in their opinion, may 'endanger the bank's ability to continue as a going concern or may impair the protection of the funds of the bank's deposits or may be contrary to the principles of sound management ... or amounts to inadequate maintenance of internal controls'.

- **Other legislation.** A non traditional lending institution not taking deposits from the general public may choose to register as a company, in which case the Companies Act applies. In practice, several non traditional lending institutions have registered under section 21 as associations not for gain. The Income Tax Act has obvious influence on the normal operations of financial institutions. Apart from these considerations, the major potential impact of the Income Tax Act may be in the form of tax incentives to induce companies and banks to operate in this area, or in the form of tax exemptions enabling institutions to operate more successfully at this level[20]. The Post Office Act establishes the PostBank which shall 'undertake such activities as are customary for a financial institution carrying on the business of accepting deposits.'

- **The Usury Act,** that requires disclosure of information on certain transactions, particularly lending transactions, and also for the limitation of finance charges that may be recovered. The disclosure provisions relate to matters such as the amount of the loan, the interest rate and the total sum of finance charges involved, and the requirements for reporting to the borrower. The limits on recovery of finance charges are imposed in two ways. The type of amounts that may be recovered are specified, and a limit on the maximum annual finance charge rate that may be recovered is set. At present the maximum rates are 26% for loans of over R6 000 and 29% for certain loans of under R6 000. 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 of under R6000, provided that certain other conditions are fulfilled. The Minister of Trade and Industry published his intention to withdraw the exemption in 1994.

- **The Credit Agreements Act** is intended to regulate credit agreements otherwise known as 'hire purchase agreements'. This is done through prescription of what may or may not be contained in such a contract, such as the details of the goods and reference to what is to happen to the rights of ownership, the granting of certain rights to the credit receiver, such as a 'cooling-off' period, and the imposition of duties on the credit grantor, such as requiring 30 days notice in a letter of demand before goods can be reclaimed.

- **The Lay-by Regulations.** In 1980 lay-by regulations were issued in terms of the Price Control Act. These regulations are aimed at regulating a specific type of contract which is not subject to the Credit Agreements Act. A lay-by agreement is a contract of sale of no longer than six months where a deposit is payable, delivery of the goods takes place after payment of the deposit and ownership is transferred at delivery.

- The South African Law Commission has undertaken research into and has proposed a new **Credit Act,** rationalising the provisions of the Usury Act, the Credit Agreements Act and lay-by regulations[21].

- **Laws relating to collateral.** The law pertaining to the provision of security for money lending transactions is largely contained in the common law, specifically to the law pertaining to suretyship, cession and pledge, the 'cession *in securitatim debiti*' (in respect of which there has been significant confusion in the law). The Security by Means of Movable Property Act allows movable property to be used as security in the form of a pledge if a notarial bond is passed over it. The Pension Funds Act

[20] A provision of direct application is section 10(1)(cJ) of the Act, providing exemption for bodies which make advances for *housing* purposes to persons in a community where at least 75% of the adult members of that community earn less than R1500 per month. The restrictive nature of the preconditions for this exemption mean that it has not been taken up on any significant scale by non-traditional lenders since its introduction.

[21] South African Law Commission Working Paper 46, Project 67 'The Usury Act and Related Matters'

allows the withdrawal benefit of a member to be used as security for the advance of a loan for housing purposes, but effectively for no other purposes, such as the acquisition of land for farming purposes.

- **Laws relating to insurance.** The Insurance Act is relevant as it could be used to create a framework for certain vehicles which could help in providing financial services in rural areas, and as a law relating to the financial instruments that could be provided to rural persons. The Act also deals with the assets to be maintained by insurers and requirements for registration and for the possibility of exemption from the Act, albeit under limited circumstances, which discretion is conservatively exercised.

- **The former homelands.** In terms of section 32 and Schedule 1 of the Self-governing Territories Constitution Act of 1971, these territories were granted the power to make laws in relation to items listed in Schedule 1, as amended from time to time. This schedule included a number of powers relating to rural finance. The effect of these amendments was that one or more of the territories received powers to legislate, from which date subsequent laws of Parliament did not apply. In order to determine from which date laws of Parliament (including amendments) did not apply, it is necessary to know the dates when certain amendments were effected to Schedule 1. The former homelands exercised their power to enact laws relating to rural finance to a greater or lesser extent in each case. The result is that older laws may, due to the provisions of section 229 of the Constitution, still apply in different stages in particular parts of provinces.

  The Transkei Constitution Act, 1963 conferred self-government on Transkei on 30 May 1963. Transkei became 'independent' under the Status of Transkei Act in 1976. The Banks Act, 1990 and amendments never became applicable in Transkei and the Banks Act, 1965 still applies. Building societies legislation was enacted in the former Transkei in 1980. Bophuthatswana gained 'independence' under the Status of Bophuthatswana Act in 1977. The legislation which still applies in certain areas of the North West Province includes the Banks Act, 1965 and the Building Societies Act, 1965. Venda 'independence' followed in 1979. The Banks Act, 1965, and the Building Societies Act, 1965, still apply in that part of the Northern Province, where the Venda Building Society is still operative. Finally, Ciskei became 'independent' under the Status of Ciskei Act. The Building Societies Act, 1965, is still in force there. Banks are governed by the Deposit-taking Institutions Decree, 1993.

  Similar differences are likely to exist in respect of other South African legislation, in relation to the former TBVC states and the self-governing territories. An important example of this would be the exemption of loans of under R6000 from the provisions of the Usury Act.

Land and housing

Tenure is one of the critical legal factors influencing the provision of rural financial services. Commercial lending usually requires that the underlying property be mortgaged or otherwise encumbered to provide security. This necessitates a tenure system with the following characteristics:

- Certainty as to the boundaries of the property;
- An identifiable entity that holds the liability for the repayment of the loan;
- The ability, if necessary, to repossess the property free of any encumbrances;
- The ability to sell the property in order to recoup the loan (i.e. some sort of market in the land should exist).

The reality is that few poor people in rural areas are able to provide such security. While in commercial agriculture individual ownership is the dominant form of ownership, black farmers and communities live on land almost entirely owned by the State. Communities in these areas gain limited access to land through communal tenure, trust tenure, quitrent, freehold, statutory rights of occupation, leasehold or informal land tenure. The reality of rural tenure arrangements is a far cry from the tidy arrangements of the Deed's Registry and from text book examples of customary law arrangements. Instead complex informal tenure arrangements operate in rural areas. They often operate in relation to land where 'formal' tenure is registered, but ignore the formal land rights.

While these informal tenure systems may provide a basis for structuring communal ownership and different forms of individual rights in land, they do not provide a formal system of tenure which can act as a basis for commercial financing. The possible conflict between the need to protect rural communities' rights to land and the need to finance development on a sustainable basis, which may require formalisation and individualisation of informal rights, is one of the critical policy questions to be addressed.

There are a number of problems with informal rural tenure. **First,** there is often no certainty as to the boundaries of the property on the basis of which finance is sought. Portions of properties allocated to different families may shift as different pieces of land are required for different purposes. The Land Survey Act requires and ensures a high degree of certainty regarding the boundaries of property for the framing of registrable diagrams, which are essential for the registration of title deeds and therefore bonds.

Second, similar problems exist in identifying who will be liable in terms of the loan. Although a bond can be passed by any number of persons, they must each own immovable property which can be secured. If the land in question is occupied by a number of different families whose composition shifts from time to time, it is unclear who could assume the liability under a bond. Even a chief or other entity with control over the land is unlikely to be able to fulfil this criterion. If an entire community seeks to share liability, it is unclear whether one family's default will jeopardise the security of tenure of the other families.

Third, subdivision may allow individual owners to pass individual mortgages, but subdivision is often inimical to the optimal use of the property, and may jeopardise the complex and fragile tenure systems that exist currently. The Communal Property Associations Bill goes some way in addressing this problem by creating a juristic person that can hold property on behalf of a community.

Fourth, the land ethic which shapes informal tenure in rural areas consists of interlocking principles, some of which are contrary to the notion of a bank or other finance institution repossessing land. Although a form of land market exists in rural areas governed by informal tenure, access to land is tightly controlled by those in power in a particular area, and takes place according to informal principles. Thus a bank may have buyers who cannot gain access to the land if they do not meet the controlling authority's criteria. Without a land market, occupants will not benefit from increases in land values and will also tend to hold onto land in different areas to provide security for themselves and their families.

Tenure reforms will need to be designed to facilitate the provision of finance for housing and land in rural areas. If reform is unable (as is likely) to address all the problems mentioned above, it is clear that ordinary commercial financing is not likely to play a significant role and that a greater responsibility will have to be assumed by the state.

A complex web of legislation governs access to land in rural areas, depending on where the land is situated. This complexity is replicated in varying degrees across the country, and acts as a serious obstacle to the provision of finance in respect of housing and land in rural areas. In addition, financing will be complicated by the poor state of the records of rights to land. In order to trace the legislation applicable in a particular area and who has administrative responsibility for land, a series of investigations would need to be undertaken in relation to that particular area.

- The **Subdivision of Agricultural Land Act**, as described earlier, restricts access to land. It is, for example, more difficult for emergent farmers to acquire smaller farms, and labour tenants are unable to acquire subdivided portions of farms.

- The **Provision of Certain Land for Settlement Act** provides for the designation and development of state land or land made available to the state for settlement, free from the restrictions on subdivision imposed by the Subdivision Act. The Act is of restricted application, as it applies only to new developments and requires subdivision as an aspect of development. The Act does however provide for financial assistance for the development of designated land, and a proposed amendment contained in the Development Facilitation Act broadens the scope of this assistance.

- **The Restitution of Land Rights Act** sets out a procedure whereby certain communities and individuals may claim restitution of a right in land. The Act provides that the Land Claims Court may make an order recommending that the claimant be given priority access to state resources in the allocation and development of housing and land. Despite this provision, it is unlikely that claimants will have access to commercial finance. In addition the court may order that claimants pay certain amounts prior to receiving restitution of the rights in question.

- Debate continues as to whether the **constitutional protection of property rights** as set out in section 28 of the Constitution hinders the restitution process and the land reform process. In respect of access to housing and land in rural areas, it does have the implication that financial resources will have to be applied in order for poor people to gain access to land and housing, as the constitution envisages compensation for any land that is expropriated.

- **Large tracts of rural land are held in trust by traditional leaders**. This poses certain problems in allocating finance for housing and land in these areas. Some of these problems include lack of clarity regarding administrative responsibility, which can undermine the security of the occupants; the hierarchical and patriarchal nature of traditional authorities; confusion about the nature of the rights of occupants versus the nature of the rights of the Trust; and perpetuation of a multiplicity of authorities and laws.

The **Land Bank Act** specifies the purposes for whom money may be advanced, to whom it may be advanced and the nature of security required. Subject to certain exceptions, an advance must be secured by a first mortgage bond or against security of government stock. The nature of these provisions means that the Land Bank is unlikely to be able to provide assistance to the rural poor under the current provisions of the Act.

The **Agricultural Credit Act** allows for the provision of *inter alia* loans to the owners of land for the erection of dwellings for 'non-white' farm labourers. Similarly to the Land Bank Act, the Act does not provide specifically for the needs for the rural poor. Certain of its provisions do provide a vehicle for the provision of finance in this regard, however, subject to certain limitations:

- Only persons carrying on or undertaking to carry on farming operations qualify for assistance, which will not be the case in respect of all rural communities or families;

- In respect of farm worker dwellings, financial assistance is provided to the employer and not to farm workers themselves.

- Risk weightings in terms of regulations under the Banks Act and the Mutual Banks Act hinder access of rural people to commercial financing by providing that only loans fully secured by mortgages on urban residential dwellings will qualify for a 50% risk weighting for capital adequacy purposes.

Legal mechanisms for appropriate institutions are needed for rural communities in two respects:

- Institutions are needed which will both reflect the complex tenure arrangements which exist in rural communities and provide an institutional framework which will allow security for finance to be provided.

- Institutions can also provide a basis for collective leverage of finance where individuals would not have access to equivalent levels of finance.

Existing legal institutions such as companies, non-profit or otherwise, trusts, closed corporations, partnerships and cooperatives could all possibly be used to hold land and or to develop housing. However, they all have their advantages and disadvantages. The legislative and common law requirements for the establishment of such institutions are for good reason fairly complex, and all of these structures would require outside assistance for a community to establish and operate them. It is unlikely that an easy match would be found between one of these institutions and the requirements of a community which needs to formalise tenure arrangements.

Agricultural cooperatives have mainly been used by white farmers in order to increase their buying power and to pool certain resources. Certain cooperatives have evolved into powerful and wealthy institutions, many of which are seeking ways to contribute to small farmer development. Joint ventures between cooperatives, other private sector organisations and communities could provide a method of acquiring land and finance.

There is little in the Income Tax Act that directly assists in the provision of housing and land in rural areas, although capital expenditure for the provision of housing for employees is deductible up to R6000 per employee, in determining the taxable income of a farmer.

The Income Tax Act exempts a number of organisations directly or indirectly involved in the provision of housing or land from the payment of income tax. Although these exemptions could be used to facilitate the provision of housing and the acquisition of land in the rural areas, care would have to be taken to ensure that the institution was structured appropriately to qualify. This requires that the necessary submissions are made to the Commissioner of Inland Revenue to obtain the exemption. In most cases this implies the assistance of professionals and again it is unlikely that rural organisations, individuals and communities have easy access to this kind of assistance.

South Africa's land registration system is an accurate and relatively speedy system of registration offering virtually unassailable title. However, the cost of registration together with fairly onerous transfer duties make it inaccessible to the poor, who often resort to informal methods of transferring property, which provide only limited security. Land development procedures are also complex and lengthy, adding to the costs of the process.

While reforms in land registration systems are still to be investigated, the Development Facilitation Act offers a degree of interim relief. This Act provides for the fast-tracking of existing land development procedures, which will hopefully reduce the costs associated with development and allow land and housing to be provided more speedily and cheaper. In a rural context the Act allows communal tenure arrangements to be recognised and formalised through the imposition of conditions of establishment when a particular development is approved.

4.3 The law relating to the contractual capacity of certain women

Many women in the rural areas are the managers of the property in the family estate and the maintainers of their households. Yet women subject to customary law do not have legal capacity to receive a loan or other subsidy and to deal with her property nor to offer such family property as collateral. For women, such restrictions will depend upon the regime under which their marriage took place as well as whether the marriage is subject to South African or ex-homeland legislation.

Civil marriages governed by South African law

Civil marriages in South Africa are in terms of national law presently governed by the Matrimonial Property Act 1984 as amended by the Matrimonial Property Law Amendment Act, 1988 and the General Law Fourth Amendment Act, 1993, which abolished the husband's marital power for all marriages. The effect on black rural women depends on the date of marriage. Black women married by civil law prior to 1 October 1988 were automatically married out of community of property unless married with an antenuptial contract. The abolition of the marital power thus means that these women may now contract and deal with their property independently of their spouse. These marriages were, however, not common as most people signed a declaration in front of a Magistrate or Marriage Officer resulting in such marriages being made in community of property.

Black women married by civil law after 1 October 1988 are automatically married in community of property, unless married with an antenuptial contract. Women, and men for that matter, married in community of property are still, however, required to gain their spouse's written consent to bind the joint estate when entering into certain contracts set out in section 15(2) of the Matrimonial Property Act, 1984. These include:

- alienating, mortgaging or burdening immovable property of the joint estate and entering contracts thereto;
- alienating, ceding or pledging any shares, stock, debenture, insurance policies, mortgage bonds, fixed deposits or any similar assets, or any investment by or on behalf of the other spouse in a financial institution forming part of the joint estate;
- withdrawing money held in the name of the other spouse in any banking institution, a building society or post office savings bank of the Republic of South Africa;
- as a credit receiver, entering into a credit agreement as defined in the Credit Agreements Act, and to which the provisions of that Act apply in terms of section 2 thereof;
- as a purchaser, entering into a contract as defined in the Alienation of Land Act, and to which the provisions of that Act apply;
- binding him or herself as surety.

Thus while women married in community of property may, if they so choose, enter into certain contracts unfettered by their spouse's intervention, there are restrictions, most notably in terms of acquiring immovable property and entering into credit agreements. The effects of these limitations need to be studied when determining the nature and means of providing finance to the rural community. So too must the fact that most rural women do not marry by civil law.

Civil marriages governed by laws of the former homelands

Although the General Law Fourth Amendment Act was clearly aimed at eliminating marital power, most rural women are subject to legislation enacted in the former homelands or to customary law. Thus the marital power may still apply as both categories of territories had jurisdiction to legislate with regard to marriage. It appears that some of the TBVC states enacted their own legislation in relation to marriages. Both the Transkeian Marriage Act, 1978 and the Bophuthatswana Marriage Act, 1980 place the wife under the guardianship of her husband for the duration of the marriage. Women married by civil law in these areas thus require their husband's assistance when concluding valid contracts. A similar situation exists in the former self-governing territories.

Customary law

Generally in terms of customary law, women are either subjected to the control of their guardian or, after marriage, their husband The male household head represents the family and women generally have been deprived 'of proprietary and contractual capacity and *locus standi in judicio*' These principles have been codified in section 11(3)(b) of the Black Administration Act, 1927.

Section 11A of the Black Administration Act was inserted in 1985 in order to enable women to perform 'any juristic act' with regard to acquiring leasehold rights under the repealed Black Urban Areas Consolidation Act or the Black Communities Development Act. As with the 1989 amendment to the KwaZulu Code, Section 11A is limited in scope and impact. As the Gender Research Project has pointed out, it is not clear whether it applies to unmarried women as well. As it confers rights only with respect to property, women still have no independent contractual capacity with regard to non-property agreements. The reference to 'ownership' is unclear and certainly in terms of customary law and practice, section 11A does not change the fact that women are unable to use and enjoy such property which, on acquisition, comes under the control of their husbands. The above restrictions affect not only the ability of rural women to contract for the provision of financial services, but they have no *locus standi* in relation to any possible consequences flowing therefrom.

Legislation referred to in the Chapter

Abolition of Racially Based Land Measures Act, No 108 of 1991
Agricultural Credit Act, No 28 of 1966
Agricultural Research Act, No 86 of 1990
Banks Act, No 94 of 1990
Black Administration Act, No 38 of 1927
Black Communities Development Act, No 4 of 1984
Black Urban Areas Consolidation Act, No 25 of 1945
Bophuthatswana Marriage Act, No 15 of 1980 (Bophuthatswana)
Building Societies Act, No 82 of 1986
Companies Act, No 61 of 1973
Conservation of Agricultural Resources Act, No 43 of 1983
Cooperatives Act, No 91 of 1981
Credit Agreements Act, No 75 of 1980
Development Facilitation Act, No 67 of 1995
Financial Services Board, No 97 of 1990
General Law Fourth Amendment Act, No 132 of 1993
Income Tax Act, No 58 of 1973
Ingoyama Trust Act, No 3 of 1994 (KwaZulu)
Insurance Act, No 27 of 1943
KwaZulu Code of Zulu Law, No 16 of 1985 (KwaZulu)
KwaZulu Cooperatives Act, No 13 of 1985 (KwaZulu)
KwaZulu Land Affairs Act, No 11 of 1992 (KwaZulu)
Land Bank Act, No 13 of 1944
Land Survey Act, No 9 of 1927
Marketing Act, No. 59 of 1968
Marriage and Matrimonial Property Act, No 3 of 1988
Matrimonial Property Act, No 88 of 1984
Mutual Banks Act, No 124 of 1993
Mutual Building Societies Act, No 24 of 1965
Pensions Funds Act, No 24 of 1956
Policy Board for Financial Services and Regulation Act, No 141 of 1993
Post Office Act, No 44 of 1958
Price Control Act, No 25 of 1964
Provision of Certain Land for Settlement Act, No 126 of 1993
Republic of South Africa Constitution Act, No. 200 of 1993
Restitution of Land Rights Act, No 22 of 1994
Savings Bank Societies Borrowing Powers Act, No 6 of 1932
Security by Means of Movable Property Act, No 57 of 1993
South African Reserve Bank Act, No 90 of 1989
Stamp Duties Act, No 77 of 1968
Subdivision of Agricultural Land Act, No 70 of 1970
Sugar Act, No 9 of 1978
Transkei Land Survey Act, No 19 of 1978 (Transkei)
Transkei Marriage Act, No 21 of 1978 (Transkei)
Upgrading of Land Rights Tenure Act, No 112 of 1991
Usury Act, No 73 of 1968
Wine and Spirit Control Act, No 47 of 1970