Micro-Finance in Rural Communities in Southern Africa

Country and Pilot Site Case Studies, Policy Issues and Recommendations

PREPARED FOR THE INTEGRATED RURAL DEVELOPMENT PROGRAM OF THE
W.K. KELLOGG FOUNDATION, SOUTHERN AFRICA BY
THE HUMAN SCIENCES RESEARCH COUNCIL, PRETORIA

Photo Credits

pp 1, 24 – Ellen Elmendorp

pp 20, 26 – Paul Weinberg (South Photographs)

pp 76, 142 – Motlhalefi Mahlabe (South Photographs)

Cover by Paul Weinberg

DTP and Design by Charlene Bate

Produced by Compress in 2002

Contents

Glossary

ACAT	African Co-operative Action Trust
ADAF	Agricultural Development Assistance Fund
AFC	Agricultural Finance Corporation of Zimbabwe
AFRACA	African Rural & Agricultural Credit Association
AGRITEX	Agricultural Technical & Extension Services
BAAC	Bank for Agriculture & Agricultural Co-operatives
CAP	Credit Against Poverty
CARE	Concerned Americans for Relief Everywhere
ITDG	Intermediate Technology Development Gap
CASS	Centre for Applied Social Studies, University of Zimbabwe
CBZ	Commercial Bank Of Zimbabwe
CCDR	Corperativa de Credito para o Desenvolvimento Rural
CCM	Conselho Cristao de Mocambique
CGAP	Consultative Group to Assist the Poorest
CSO	Central Statistical Office
DGRV	Deutscher Genossenschaft und Raiffeisen Verband
FCPL	Food Consumption Poverty Line
FPL	Food Poverty Line
FRELIMO	Frente de Libertaçao de Moçambique
GB	Grameen Bank
GMB	Grain Marketing Board
GTZ (ISTARN)	Gesellschaft fur Technisches Zusammenarbeit (German Development Corporation) (Informal Sector Training and Resource Network)
IDDP	Initiative for Integrated District Development Programme
IFAD	International Fund for Agricultural Development
ILRP	Inhambane Livelihood Recovery Programmes
IRDP	Integrated Rural Development Programme
LSM	Living Standards Measurement
MDC	Movement for Democratic Change

MFI	Micro-Finance Institution
MFRC	Micro-Finance Regulatory Council
MIS	Management Information System
MMF	Mozambican Micro-Finance Facility
MSE	Micro and Small Enterprise
NASASA	National Association of South Africa of Stokvel Associations
NGO	Non-Governmental Organization
NHFC	National Housing Finance Corporation
PARPA	Plan for the Reduction of Absolute Poverty
POSB	Post Office Savings Bank
PPPP	Public Policy Promotion Programme
RDC	Rural District Council
RENAMO	Resistençia Nacional Moçambique
RDDC	Rural District Development Council
ROSCA	Protecting Savings and Credit Associations
SACCO	Savings and Credit Co-Operative
SACI	Specialized Agricultural Credit Institution
SAFIRE	Southern Alliance for Indigenous Resources
SBP	Sustainable Banking with the Poor
SDI	Spatial Development Initiative
SME	Small and Micro Enterprise
SMME	Small, Medium & Micro Enterprise
SOCREMO	Sociedade de Credito de Mocambique
TCPL	Total Consumption Poverty Line
USAID	United States Aid Agency
WKKF	W.K. Kellogg Foundation
ZAMFI	Zimbabwe Association of Micro-Finance Institutions
ZANU (PF)	Zimbabwe African National Union
ZAPF	Zimbabwe Agricultural Policy Framework

Executive Summary

INTRODUCTION

The Integrated Rural Development Program (IRDP) is a core initiative in the W. K. Kellogg Foundation Africa portfolio of programmes, which aims to reduce poverty and improve the quality of life of rural communities. A component of this programme is to help capitalise locally based enterprise development initiatives by stimulating the provision of and access to micro-finance in rural areas. Three sites have been selected to pilot the introduction of this and other IRDP activities. These are: Chimanimani (Zimbabwe), Chimoio (Mozambique) and Nyandeni (South Africa). As part of this initiative, the Human Sciences Research Council (HSRC) based in Pretoria has conducted an evaluation in three key sites of the IRDP to evaluate the implications of implementing a micro-finance scheme in these areas.

While micro-finance in its various forms has helped to make loan capital more accessible to low-income rural communities, much remains to be done to increase its outreach, impact and sustainability. The essential objective of this study is to make well-researched recommendations for IRDP policy and strategy to enable the micro-finance agents that it will shortly be appointing to maximize improvements in these key indicators in the three pilot sites. Chapter 1 outlines the institutional context and terms of reference of the report and briefly discusses its timeframe, methodology, value and limitations.

Chapters 2 and 3 depict, on the one hand, the demand for financial services in the three pilot sites and, on the other, access to micro-finance in the respective communities.

In Chapter 4 an account is given of the essential nature and capabilities of micro-finance, of recent developments in this regard, of fundamental lessons from international experience and of best practices in a rural context.

Chapter 5 identifies the key sets of policy issues facing, in the first instance, public policy makers seeking to promote micro-finance development and, in the second, donors/investors/wholesalers seeking to support individual micro-finance retailers. It then applies the findings of Chapter 4 to the three on-the-ground pictures sketched out in Chapters 2 and 3 to arrive at some initial and very tentative recommendations for policy for the IRDP in the respective pilot sites.

STATUS QUO IN THE PILOT SITES

The demand for micro-finance in Chimanimani

Chimanimani has been affected by the prevailing political instability facing Zimbabwe recently resulting in a difficult economic environment. This instability involves farm resettlements or invasions, the rule of law increasingly under threat, violence and political intimidation.

This has contributed to less formal employment being available throughout Zimbabwe, which has further expanded the average size of households in areas such as Chimanimani, as less migrant work has become available. Over 70% of the population of Chimanimani (110 000 people) live in the communal areas, which have less potential for commercial agricultural production and an increasing pressure on natural resources.

Economic activities

Chimanimani has extremely varied ecological and climatic conditions. The five agro-ecological zones of Zimbabwe are present in the district, ranging from areas that receive over 2000mm per annum in the Chimanimani mountains to areas that have dry, harsh conditions, which receive less than 300mm per annum. This means that there is extensive variability in agricultural potential and in natural resource endowments. Essentially this means that the major diversity found in Chimanimani should be used by Kellogg and the IDRP to test and refine different options for the variety of agro-ecological zone present.

The district has a mixed economy with agriculture being the main economic activity. Agriculture in the communal areas is primarily for subsistence. The District has a dual agrarian system divided between commercial farms (48.5%) and small-scale farming (subsistence) community (51.5%).

The area is rich in natural resources with a locational advantage in terms of private sector partnerships and cross-border trade.

A recent study (June 2001) undertaken by TechnoServe, which was\designed to carry out an assessment of Potential Economic Drivers for the district, details the most attractive economic opportunities as:

- Fresh fruit production
- Fruit processing and
- Tourism
- Honey manufacturing

However, the government and non-governmental organisations' intervention, which includes income generating activities, has fallen short of exploiting such opportunities. The contributing factors cited include lack of institutional capacity, poor infrastructure, fragmented agricultural production with no value adding, the group focus that does not consider entrepreneurial and management skills, as well as capital and market access.

Implications for micro-finance

- Political and macroeconomic instability has reduced the availability of formal sector jobs and increased reliance on the informal sector. This will have increased the demand for micro-finance (credit and savings) but will also have increased the risk of default on loans. Political instability is a particular problem in Manicaland, in which the Opposition MDC party has strong support. Violence involving the military and police was reported in Chimanimani as recently as mid-October.

- Most rural households reside in the less fertile agricultural areas. They are nevertheless still heavily dependent on agriculture for income, given the near absence of social security payments, the declining contribution of remittances to household income and the virtual collapse of arts and crafts trade as tourism has evaporated with political instability. But the long period between cash outlays and cash inflow in most sorts of farming makes agriculture difficult to finance with micro-credit.

- All of the economic activities identified as having greatest potential – fruit growing and processing, tourism and honey production – offer opportunities, directly or indirectly, to small enterprises who will be looking primarily to micro-finance to help meet their capital needs.

- Though little information on local household expenditure patterns has yet been obtained, it can be expected that almost all spending will be for consumption. Income, whether from earnings or from loans, used for this purpose in effect constitutes a small entrepreneur's/household's working capital.
- The rapid increase in the incidence of HIV/AIDS will also have increased the need for access to micro-finance (again both credit and savings) in care-giving households to help them maintain income streams and reduce the pressure to sell assets. But, again, it will have raised the risk of default as well as raising the number of households beyond the ambit of sustainable micro-credit.
- Most households continue to use formal sector savings facilities. Given the distance and the cost of transport, there is an urgent need for improved informal sector savings alternatives. The location of about 81% of households in rural areas suggests that unit transactions costs will be high for micro-financiers
- The multiple constraints on economic activity – political/macroeconomic instability, poor infrastructure, low levels of business skills ... – indicate that, on its own, improved access to micro-finance will have only a limited impact on poverty reduction. An integrated range of interventions is needed for significant impact.

Access to Financial Services in Chimanimani

- Access to credit for micro-enterprises in Chimanimani is very limited. The few formal sector lending institutions that there are, either do not cater for clients without adequate traditional collateral security or do so only for specific needs, such as seasonal agricultural input requirements.
- Informal sector lenders are reported to be few and, in general, small and weak. In addition, such savings and credit associations as there are – whether co-operatives (SACCOs) or rotating – are confined to lending only to their own members.
- One registered micro-lender has now begun to operate in about half of the wards in the district, but is also still very small, has yet to prove its viability and lends only to women on a group basis.
- Especially recalling the substantial and increasing demand for micro-loans from the informal sector, there is an urgent need for a sustainable expansion of micro-lending in Chimanimani.
- There is also an urgent need for new, more widely distributed and more user-friendly savings facilities – formal or informal. While meeting this need could be articulated

with responding to the demand for more micro-loan facilities, linking the two would probably be the slower path and the less effective – particularly for advancing credit

- A more enabling public policy framework – engineered jointly by regulatory authorities, wholesalers/donors and retail micro-financiers – would be an important step in accelerating the growth of sustainable MFIs.

The Demand for Micro-Finance in Chimoio

The rainfall pattern along with annual precipitation, humidity and fertile soils endows the area with an important agricultural potential. Geographical and environmental conditions are favourable for a high level of agro-forestry, animal husbandry, and certain levels of tourism. During the raining season, however, the access to the production areas becomes difficult, as the roads deteriorate quickly under heavy rainfall. However, the mountainous areas along the Zimbabwean border are minimally suitable for agriculture.

Mozambique experienced a civil war for over fifteen years, gaining a democratic government in 1992. The fact that Mozambique has an elected government for the first time in its history and has conducted two general elections, should not obscure the threat posed by fault-lines in the political structures and power struggles between the two main political parties.

Most ordinary Mozambiquans equated democracy with an improvement in material conditions. Instead, the economic gains recorded thus far seem to benefit only a relatively small middle class concentrated in Maputo, while the rest of the population has had to adjust to increases in the cost of living and little change in the rudimentary public and social infrastructure. This is partly due to the liberalisation of the economy, fiscal discipline and the recent impact of flooding in the southern parts of the country. The widening gap between rich and poor and rural and urban potentially poses a serious threat to political stability. The prevailing state of poverty and rural-urban inequalities is an important context to consider when evaluating any economic development intervention.

This context was starkly emphasised during the recent devastation caused by flooding in 1999 and 2000. For a country recovering from the debilitating effects of the civil war coupled with devastating flooding, poverty has become the most pressing issue. Illiteracy stands at about 60.4 percent of the adult population; and there is a shortage of skilled labour and financial resources. According to the Ministry of Planning and Finance, the incidence of absolute poverty is 69.4 percent, indicating that more than two-thirds of the Mozambique population is living below the poverty line (2000). In rural areas, it is estimated to be as high as 71.2 percent, an alarming figure as 80 percent of the population is concentrated into these areas. The figures for urban area stand at 62 percent.

Economic activities

From the analysis around the financial needs of the average household in Manica and from the information presented under the historical and political context it is clear that most families utilise what can be termed a multiple livelihood strategy. This concept essentially posits that a multiple livelihood strategy is dependent on people's capacities to generate and maintain their means of living, enhance their well being and that of future generations. These capacities are contingent upon the availability and accessibility of options which are ecological, economic and political.

People survive by building on a range of "capitals" be they land, livestock, skills, knowledge, or natural resources. They include natural capital, such as the resource base, in particular land and water; human capital, such as education, skills and health; social capital, such as social networks, norms and organisations; physical capital, such as farm equipment and shelter; and financial capital, such as income, credit, claims, savings and cattle. These assets constitute the capital base of a livelihood and determine how vulnerable or robust it may be. Poverty is strongly associated with a lack of assets, or the inability to put assets to productive use.

It is clear that the informal sector is extremely important in Chimoio. The formal sector is practically non-existent in Sussundenga, Gondola and Manica. Agriculture and animal husbandry are extremely important components of the multiple livelihood strategy in Chimoio although it should be emphasised that this on its own is increasingly unable to provide a sufficient means of survival in rural areas of low-income countries. Employment or agriculture should be considered as a component of a livelihood, which draws upon a range of formal and informal activities and income sources. Agricultural production in Manica province is, as emphasised earlier, largely subsistence in nature. Agriculture does, however, have the potential to become a more significant component of livelihood strategies considering the high agricultural potential of the area considering the soils, climate and abundance of arable land.

Although some part of population in the district go to formal work in central business district (CBD) in downtown, such as offices of governmental and non-governmental organisations, banks, shops, hotel and rest-houses, and others institutions (private and public enterprises), a large proportion depend of agriculture activities and informal business.

The expenditure patterns evaluated indicate that the main financial needs per low-income household pertain largely to consumer needs. The largest expenditure was for groceries with annual expenditure at 12.76 percent overall. This was closely followed by annual expenditure on cooking oil at 12.34 percent. Clothing was the third highest at 9.89 percent followed by entertainment at 8.66 percent and by meat and fish, the dominant source of protein, at 8.41 percent. These indicate that the greatest expenditure was on the basic commodities of food, clothing and on food processing.

Implications for micro-finance

- While economic performance has improved substantially for the country as a whole over the past decade, the benefits have been confined largely to urban areas and even there to a relatively small part of the population. Widening income inequality increases the potential for political instability. Interventions, such as improving access to financial services, to broaden the spread of benefits to rural areas and to lower income people are extremely important.
- The location of about 85% of households in rural areas suggests that unit transactions costs will be high for micro-financiers.
- Farming is still by far the most important source of income for most households. While the district has great potential to export agricultural produce, reliance on local markets has increased with the damage to roads caused by the 1999-2000 floods.
- A number of key formal sector industries – in textile and clothing manufacture, tanning and food processing (jam, fruit juice, dairy products) – have closed in recent years in the face of external competition, increasing reliance on agriculture and informal sector activities.
- There is a thriving informal sector, but it is based rather narrowly on retail trade in consumption goods, agro-processing and services, such as repairs and hairdressing.
- Very few small enterprises – almost all in the informal sector – have access to micro-credit. Though the multiple constraints on the growth of economic activity – poor infrastructure, lack of business skills, lack of institutional support – indicate that micro-finance interventions on their own will only have a limited positive impact. They are no less important on this account. What is needed is an integrated programme of interventions, of which improved access to finance for 'unbankable' small entrepreneurs/households – through micro-credit – is a key component.

- The rapid increase in the incidence of HIV/AIDS will also have increased the need for access to micro-finance (again both credit and savings) in care-giving households to help them maintain income streams and reduce the pressure to sell assets. But, again, it will have raised the risk of default as well as raising the number of households beyond the ambit of sustainable micro-credit.

- Most households continue to use formal sector savings facilities. Given the distance and the cost of transport, there is an urgent need for improved informal sector savings alternatives. The location of about 81% of households in rural areas suggests that unit transactions costs will be high for micro-financiers.

Access to Financial Services in Chimoio

- Though data on a number of formal sector institutions that provide micro-finance in Chimoio has still to be obtained, it is evident that very few micro-enterprises in the district have been able to access micro-credit. Those formal sector MFIs that do operate there tend to have quite specific, limited target markets which exclude many categories of micro-enterprise. Especially given the growing reliance on informal sector employment, there is an urgent need to broaden access to micro-finance.

- Much more research is required to assess the extent of informal sector MFI activity. But however extensive, access to credit can be expected to be confined to members of relatively small savings groups.

- Access to formal sector savings facilities is also limited, with banks operating branches in only the largest urban centres. At this point, lack of adequate information about informal sector MFIs prevents firm conclusions about the need for additional micro-savings facilities.

- The growth strategies adopted by the larger, better established MFIs suggest that the industry as a whole is moving towards far greater outreach and sustainability. But this is from a very low base and a great deal remains to be done to realize the potential that is now being shown. In particular, institutional strength needs to be gathered as a first priority, with less emphasis being placed at this stage on client and product expansion.

- Public policy needs to be reformulated, inter alia, to provide for the evolution of MFIs into a wider, more flexible range of institutional forms than the present two options – commercial bank or savings co-operative – and to incentivize MFI-private sector partnerships.

The Demand for Micro-Finance in Nyandeni

The whole of the Nyandeni and Port St Johns region falls into the summer rainfall of the Eastern Cape and precipitation is characterised by sharp heavy showers and high variability. However, micro-climatic conditions in this region vary significantly, with Port St John receiving much higher summer rainfalls than Nyandeni. This, together with widely differing types of soils and vegetation and land can be placed under irrigation (rain-fed). The agricultural productivity in this is poor and below average although the natural fertility of the country forms part of the indigenous Wild Coast of the eastern Cape. The whole of the Nyandeni region is susceptible to drought. Irrigation farming offers the best opportunity for increasing productivity on the farms and for diversifying crop production to include high value crops such as vegetables. Irrigation farming offers an opportunity for increasing productivity on the farms and for diversifying crop production to include high value crops such as vegetables.

Economic activities

Economic activities in this region depend to a large extent land resources, and therefore major economic activities in Nyandeni and Port St' Johns are land based economic activities. There are no formal sector industries in this region and industries based on rural land resources are almost non-existent in this region. The region has no formal sector employment opportunities. The only employment opportunities are in various government departments mainly in the teaching, nursing, police and administrative services of various government department. Major sources of household income are old age pension grants and other welfare social benefits, remittances from family members working outside Nyandeni and Port St Johns areas; income from agricultural activities and from many different informal sector survival strategies.

Implications for micro-finance

- In common with Chimanimani and Chimoio, farming still predominates as an economic activity, despite the unreliable rainfall. But in contrast with the other two pilot sites, while taking up a large part of labour time, it accounts for a significant proportion of household income only in a minority of cases. A recent report concludes that 'full-time farming does not seem to be the objective of most households (who) aim at diversifying their sources of income. Today's diversity represents the background for tomorrow's diversity and development programmes ... should take this into account.' (Peret, S et al., p32).
- While social security payments make up an important part of many households' income, active steps towards diversification have traditionally involved temporary

migration by household members to find wage employment. With the steady decline in the number of formal sector jobs in recent years, the importance of employment/self-employment in the local informal economy, though still small, has begun to grow and, with it, the need for access to micro-finance by micro-enterprises, who are usually seen as 'unbankable' by the formal banking sector.

- The data available on the informal sector suggest the presence of a wide range of micro-level agricultural, agro-processing, manufacturing and service activities, almost all of which – including the most popular agricultural line, poultry production – have cash flow patterns compatible with most micro-credit schemes.
- Though the number and intensity of constraints on local economic development are not as great as in Chimanimani and Chimoio, poor physical and institutional infrastructure and lack of business skills will still limit the capacity of micro-finance on its own to reduce poverty. For maximum impact, micro-finance initiatives need to be complemented by programmes to deal with these other constraints.
- Though little information on local household expenditure patterns has yet been obtained, it can be expected that almost all spending will be for consumption. Income, whether from earnings or from loans, used for this purpose in effect constitutes a small entrepreneur's/household's working capital.
- The rapid increase in the incidence of HIV/AIDS will also have increased the need for access to micro-finance (again both credit and savings) in care-giving households to help them maintain income streams and reduce the pressure to sell assets. But, again, it will have raised the risk of default as well as raising the number of households beyond the ambit of sustainable micro-credit.
- Most households continue to use formal sector savings facilities. Given the distance and the cost of transport, there is an urgent need for improved informal sector savings alternatives. The location of about 81% of households in rural areas suggests that unit transactions costs will be high for micro-financiers.

Access to Financial Services in Nyandeni

- South Africa has a large, well established rapidly expanding micro-finance industry. However, the centre of gravity of the industry is firmly in urban areas, in consumer finance and in the salaried employee market.
- Though as much as 35% of micro-finance activity is estimated to take place in rural areas, the overwhelming bulk of it is through informal sector savings groups. Micro-

credit for rural households and micro-enterprises is much more difficult to access. Even in the nearest city or large town, these categories of borrower – especially micro-entrepreneurs – are not well catered for, as relatively few are regular salaried employees and most micro-loans are geared to consumer needs. Very few NGOs that offer financial services are located in rural areas. Coetzee concludes that unless rural communities expand their own initiatives, access to micro-finance – particularly micro-credit – can be expected in general to deteriorate rather than improve in the foreseeable future.

- Notable potential counterforces are the Land Bank, TEBA-Cash, in Kwazulu-Natal, Ithala Bank, all of which are institutionally and financially strong and are committed to operating in rural areas, and the village banking movement, which, though still small, appears to be expanding on a sound basis after an indifferent start.
- Only a very small percentage of micro-enterprises (urban or rural) use micro-credit – estimated at no more than 1% currently. The main source of loans for micro-enterprises is trade credit in some form and the purpose to which it is put is, as expected, to fund working (as opposed to fixed) capital requirements. Almost no start-up capital for micro-enterprises is borrowed from MFIs.
- Though unemployment levels are high, especially in rural areas, most rural households are able to draw on income from a range of sources. Locally earned wages are on average the most important source, but remittances from household members employed elsewhere and welfare payments (chiefly pensions and disability grants) also contribute a substantial component. From recent surveys conducted in KwaZulu-Natal and the Northern Province, it is evident that the average rural household will generate no more than about 5% of its income from agriculture. Significantly, domestic micro-enterprises bring in almost the same. (The Nyandeni district is likely to be reasonably comparable to the Northern Province.) This diversity of income sources adds greatly to rural households' ability to cope with income volatility and consequently to their creditworthiness.
- The popularity of informal savings groups is explained by the long average distances to formal sector savings facilities recorded in the same surveys – 30-80 km. While a proportion of these savings is on-lent, it is almost always only to members of these groups, either on demand or on a rotating basis. Much of the balance of the savings is channelled through formal sector deposits away from the rural economy. Very few formal sector bodies that offer rural savings facilities also engage in micro-lending in rural areas – TEBA-Cash and, in KwaZulu-Natal, Ithala Bank being the main exceptions.

- The picture in Nyandeni does not appear to differ significantly from this countrywide rural perspective. At present, no formal sector MFIs are recorded as having branches in the district, although one NGO and one parastatal have provided start-up and other grants for a range of informal sector employment projects and assisted the projects in obtaining finance from other sources, such as the Land Bank. One formal sector bank offering micro-credit is reported to be planning to open in Libode.
- However, just outside the district's western border is Umtata where a broad range of formal and informal micro-finance services is available. It can safely be assumed that many Nyandeni residents make use of these facilities, though, as already noted, not often for micro-enterprise finance.

POLICY ISSUES

The W.K. Kellogg Foundation's (WKKF) Integrated Rural Development Programme (IRDP) has a twofold interest in policy issues. The first arises directly from the implementation of the programme in the nine chosen pilot sites, and the second through the Public Policy Promotion Program (PPPP), soon to be launched as an integral part of the IRDP. One of its key objectives is the improvement of public policy as it impacts on rural development.

Chapter 5 focuses firstly on public policy on micro-finance promotion in Zimbabwe, Mozambique and South Africa, which are the countries in which the three pilot sites for the IRDP's planned micro-finance initiative are located. It then moves on to donor/investor/wholesaler policy for retailer support, in particular as it relates to the three pilot sites.

Public Policy on Micro-finance

Zimbabwe

The essential stance of Zimbabwean government towards the micro-finance industry has been positive. Various initiatives, such as an apex lending window for the industry, have been undertaken. However, the fact that the industry has not expanded or prospered as it should have over the last ten years can nevertheless be ascribed to a large degree to public policy, as borne out by the following list of problems:

- The Moneylender's Act, which governs a large part of the industry, is outdated and inadequate in a number of crucial respects, in particular in providing for effective supervision of micro-finance institutions' (MFIs') operations and interest rate ceilings that are compatible with current high inflation rates.

- The requirements for micro-lenders to qualify to borrow from government's apex window seem to be too restrictive. In addition, loans have been available solely for on-lending, whereas MFIs' needs are often for loans for other valid purposes, such as building their institutional capacity in preparation for expanded on-lending.
- There is a lack of co-ordination between the various government support programmes and, in particular, no single ministry responsible for MFI development. The White Paper containing proposals to rationalize government support does not seem to have been based on adequate consultation with the respective ministries and programmes.
- Different Acts, different forms of registration and different legal status apply to MFIs that are all providing similar services. There is a need to develop a clear, coherent policy framework, in consultation with all relevant stakeholders, within which all MFIs operate.
- Savings and credit co-operatives (SACCOs) can only lend to their own members, i.e. those who have already established an adequate savings track record with them. This way, accumulating capital to lend is slow and outreach is far too tightly circumscribed to meet overall demand for micro-credit.
- Most MFIs that are not registered SACCOs cannot make loans from savings deposited with them. Since most are also unlikely to be able to borrow on commercial money or capital markets, this large group of MFIs can therefore only operate as savings vehicles, or have to rely heavily on donors for on-lending capital. Since most savings made in rural areas through these MFIs are deposited in commercial banks to earn interest, savings are channelled away from the areas where they are most needed to capitalize micro-loans.
- The revision of legislation governing the state's agricultural banking arm, AgriBank, and the subsequent restructuring of the bank to create the Agricultural Development Assistance Fund (ADAF) to lend to small market-orientated farmers using modified traditional agricultural lending instruments, has not enabled the bank to reach the vast majority of small farming households, who produce mainly for their own consumption. To reach these farmers effectively, ADAF will need to enter the field of non-specific cash micro-lending, which may require further amendments to legislation.
- Fiscal and other incentives to the private sector to become more involved in micro-lending have been lacking.

Dominating and dwarfing all these deficiencies in recent years have been political policies that have brought turbulence and a deteriorating macro-economy. This has created a problematic environment for any business to operate in – especially fledgling industries such as micro-finance. The net result has been a dearth of financial intermediaries capable of channelling state or donor capital injections widely but sustainably to micro-enterprises, especially in rural areas.

This is a particularly difficult time in which to launch a new micro-finance initiative, but also a particularly valuable one if it is able to succeed.

Mozambique

Although it is still small and weak, the MFI industry in Mozambique has made important strides towards improving outreach and sustainability in the past few years. Beyond the determination of most larger operators to become more market responsive and to take on board the structures and systems needed to achieve this, developments in state policy to promote MFI growth, though relatively few, have also assisted. Most obvious areas for taking this process forward include:

- More effective implementation of the 1998 requirement for all institutions and individuals providing credit to register with the Bank of Mocambique (BoM).
- The standardization of reporting requirements needs to be taken further and has not been helped by slowness to register. Donors can play an important role to enforce compliance in both respects in their selection of and support for MFI retailers.
- Most MFIs are still informal savings or savings and credit associations or are donor-driven NGOs. The range of institutional forms into which such MFIs may evolve to facilitate growth and sustainability is still very limited. The only two options currently are: commercial bank – with minimum capital and reporting requirements that are beyond the reach of most aspirant MFIs; and credit co-operatives – which can only lend to members with adequate savings track records and are consequently not attractive to most donors/investors/wholesalers.
- Among the options missing are credit unions of the nature seen in most other countries. Appropriate legislation, based on international best practice and incorporating provisions to allow both corporate and mutual or co-operative share structures, needs to be drafted in consultation with MFIs and other stakeholders.
- Another important measure is to reinforce the BoM's supervisory capacity.

South Africa

A recent study identifies eight important categories of measures needed to improve SMMEs' access to financial services. These are:

i) removing price barriers to lending that will stimulate investment in SMME lending, e.g. allowing exemption from the Usury Act to apply to larger loans than at present;

ii) improving market information, e.g. the wider operation of credit bureaux, better collection of baseline statistics and more market research;

iii) developing more cost-effective debt recovery systems, inter alia, which require fewer steps necessitating slow, expensive court action;

iv) increasing the attractiveness of the industry to venture capital, e.g. by offering tax incentives;

v) expanding the use of "financial scorecards" to screen clients, especially start-ups, by MFIs;

vi) creating a homogeneous government policy framework applying to MFI promotion and regulation – several government departments and parastatals are currently involved, each with their own approach;

vii) stimulating access to capital for non-bank financial intermediaries, e.g. by facilitating the capitalization of savings and credit associations by donors/investors/wholesalers; and

viii) promoting capacity building in SMMEs and MFIs.

All will need careful scrutiny to make sure that the interests of clients/members are not compromised. Measures 1, 4 and 6 most clearly involve changes in public policy and legislation, but almost all of the others – with the possible exception of 5 – seem to offer scope for public intervention as well.

Donor/Investor/Wholesaler Policy for Retailer Support

Donor organizations around the world face very similar sets of unknowns and policy/strategy decisions in their efforts to select and support micro-finance retailers. In response, various sets of principles have been drawn up to crystallize and assist best practice. The report draws heavily on a widely used statement of guidelines compiled by the World Bank-related Consultative Group to Assist the Poorest (CGAP).

Though the need for diversity to address local circumstances is recognized, the guidelines are based on the premise that fundamental principles of finance apply widely and must be applied by all institutions if they are to succeed.

The framework for the guidelines is built around the two crucial, complementary objectives: outreach and sustainability. It first identifies characteristics that donors should seek in selecting institutions to support, then outlines appropriate forms of support and concludes with some suggestions for reporting requirements.

Characteristics to guide MFI selection

The following defining characteristics are listed, which should be applied with discretion where the micro-finance industry has not yet established itself on a firm footing, as is arguably the case in Zimbabwe and Mozambique and, in certain respects, also in rural South Africa.

- *Institutional strengths:* culture, structures, capacities and operating systems to a significant and growing number of low income clients; accurate and efficient management information systems; operating methods that manage a high volume of small transactions cost efficiently; and meaningful reporting standards to enable effective monitoring.
- *Quality of services and outreach:* evidence of focus on and commitment to servicing low-income clients, particularly those with least access to other financial services (rural people, especially women, youth and HIV/AIDS-support households); client-appropriate lending (quick access to small loans for short periods, escalating, if demanded, on track record and using non-traditional forms of collateral); savings services, if possible; demonstrated growth of outreach, especially once adequate institutional strength has been achieved.
- *Financial performance:* appropriate pricing policies (interest rates able to cover full costs of a mature MFI, including an acceptable return on equity, but no higher); sound portfolio quality (arrears and defaults low enough not to threaten ongoing viability); self-sufficiency (steadily reducing dependence on subsidies/donations, first to cover full operating costs and eventually full capital costs); movement towards complete financial independence (ability to raise full capital requirements on commercial equity/capital/money markets). If MFIs are also tasked with delivering training or business development services, the cost of the latter should be excluded from assessing the financial performance of lending activities.

Strategies for donor support

It is essential to move away from large, ongoing subsidies with a charity rationale – which perpetuate the myth that the poor are indeed unbankable – towards market based, high volume, low transaction cost self-sufficiency.

- *Appropriate uses for grants:* institutional development appropriate to and diminishing with the level of development of the MFI (either for building human capacity or the physical asset base); capitalization mainly to build the loan portfolio, but also, inter alia, to improve gearing, reduce the average cost of funds and meet minimum capital/reserve requirements; other than in a circumscribed start-up period, grants should not be used to cover operating losses.
- *Appropriate uses for loans:* where MFIs are mature enough to be able to service and repay debt, loans can be used for many of the same purposes as grants, though obviously not to reduce gearing; caveats are not to expose recipient MFIs to undue foreign exchange risk and not to undermine either the foundations of savings-led micro-lenders by making it cheaper to borrow than take savings deposits or the need for MFIs to aim for creditworthiness on commercial capital/money markets
- *Commercial sourcing of funds:* donors may validly improve MFIs' access to both commercial equity and commercial loan funds through using their own reputation or through appropriate forms of guarantee.
- *Coherence of donor policies:* co-ordination between donors is important to avoid undermining MFIs that do follow sound principles by assisting others that do not to out-compete them; where micro-enterprise training, business development or other important complements to micro-finance are essential to achieve sufficient development impact and/or sustainability for the MFI, policy coherence requires arrangements to provide these services; coherence also involves aligning the vision, objectives and operating/reporting requirements of donors and MFIs as closely as possible to minimize the costs and contradictions for both parties.

Basic reporting standards

Performance measures are needed to track:

- *Outreach:* e.g. number of clients, value of portfolio, percentage of female/youth clients
- *Portfolio quality:* e.g. credit in arrears, default rate

- *Efficiency:* e.g. administrative costs per unit value loaned out, number of clients per loan officer
- *Profitability:* e.g. portfolio yield, operational sustainability (income/operating costs)

A number of other basic policy recommendations applicable in most situations are summarized in the following box:

Some Other Important Pointers for Donor MFI Retailer-Support Policy

- Don't confine loans to particular groups, if at all possible – apart from being discriminatory, critical mass is essential for sustainability.
- Don't try to restrict the purpose for which cash loans are made – apart from being almost impossible to monitor, consumption and capital spending are often difficult to distinguish in households which operate micro-enterprises.
- Don't dictate retailer structure, systems and products – rather select retailers carefully and provide technical support.
- Don't emphasize outreach growth ahead of institutional capacity development for retailers without strong structures and systems – it will almost certainly result in poor recovery rates.
- Don't look to micro-loans to finance market-orientated farming or the purchase of what borrowers will regard as "large" assets.
- Do build in local capacity development requirements, where local MFIs are in partnership with international organizations.
- Do engage with government regarding legislative reforms needed to foster micro-finance.
- Do ensure that the scope and nature of the demand for and supply of micro-finance in the target areas is adequately documented and understood before making key strategic decisions about new micro-finance initiatives.
- Do use the services of organizations such as CGAP or of specialized professional consultants – on their own or as part of a broader team – in selecting and setting up relationships with MFIs.

Implicit in all of the above is the range of strategic choices that donors may make for engaging in micro-finance promotion in a chosen country, region or district. Among the most obvious are:

- to work solely with government and other apex bodies for public policy improvement;
- to develop a broad technical assistance programme to support all MFIs operating in the area with technical support;

- to act as a relatively passive funding agency for all MFIs in the area that meet as many of the basic guidelines set out above as the donor wishes to apply;
- to engage directly in retail micro-finance;
- to select one appropriate retailer for comprehensive support.

This is by no means an exhaustive list and the options are not necessarily mutually exclusive, making a variety of combinations possible. While all would be valid roles, from the IRDP's "Request for Proposals" for "licensed and/or registered micro-lending entities with experience and credibility in rural-based business or enterprise development" for "micro-finance provision in ... Chimanimani ... (an) activity (that) will form part of the IRDP in the district" (24 August 2001), it is assumed that the decision has already been made to pursue the last of these options, though the decision to launch the Public Policy Promotion Programme indicates that the first will also form part of the IRDP.

In this instance, perhaps the most important single policy/strategy issue for the IRDP is whether to draw in "external" bodies with an established track record of outreach and sustainability in micro-finance, such as the Land Bank's Step-Up programme or TEBA Cash, to drive the initiative or to aim to "upscale" a relatively small "indigenous" body, such as a local savings and loan group or a member of the budding village bank movement, to enable it to provide micro-finance services to a much wider spectrum of clients in the district.

Of course, this is oversimplifying the choice and describing only the polar options. In between lie a number of other possibilities. In addition, it assumes that organizations that roughly meet the description of both polar categories do actually exist within the respective countries. The country overviews suggest that while in Nyandeni this may be correct, in Chimanimani and Chimoio, it may well not.
The report concludes by briefly exploring the advantages and disadvantages of these two options.

Using established "external" MFIs as retailers

Size, experience and capital base indicate that this should be the quicker of the two routes. Whether it has the potential to meet the IRDP's objectives of "increasing community development towards sustainable economic development" and of "mobiliz(ing) rural communities to work together" needs more exploration once the identity of contenders is known. However, if they are sufficiently sought after, meaningful ways for community participation and capacity building can almost always be found. For example, one of the key ingredients of Step-Up's success to date has been its reliance on individual agents drawn from local communities for marketing and recovery promotion. This is a three-way "win" relationship for the individuals, the communities concerned and the bank.

Upscaling "indigenous" MFIs

This would perhaps meet the two IRDP objectives more fully, but would probably also be the slower route. There would probably also be some tough psychological, operational and perhaps legal obstacles to be overcome, though these could be reduced by opting to set up a village bank in the case of Nyandeni. This may be the tougher of two options, but other workshop reports will allude to a number of notable examples of success in upscaling in other parts of the world.

In the end, the decision hinges as much on *a priori* principles and preferences as it does on strategy in the particular situation. It would not be appropriate here to make a firm recommendation either way. If there are two firm recommendations that need to be made, they are to conduct a thorough field study of the demand for, access to and environment of micro-finance services in each of the pilot sites and to call in the advice of organizations such as CGAP or of other specialized professional consultants – on their own or as part of a broader team – before making fundamental decisions about strategy.

1

Introduction

1.1 CONTEXT OF REPORT

The Integrated Rural Development Programme (IRDP) is a core initiative in the W.K. Kellogg Foundation Africa (WKKF Africa) portfolio of programmes, which aims to reduce poverty and improve the quality of life of rural communities. The patterns of poverty in rural areas in Southern Africa can only be broken if communities create among themselves a new vision for the future and work together towards achieving that future. The IRDP therefore aims to build the capacities of rural communities to drive their own development in an integrated and sustained manner.

In April 2001, the IRDP was launched in nine sites in six Southern African countries. The programme strives to:

- mobilize rural communities to work together, maximizing their institutional capacities to support sustainable development;
- increase community capacity towards sustainable economic development, especially among economically marginalized groups;

- increase the capacities of individuals, families and communities to follow healthy and defensive lifestyles; and
- develop community capacity, especially among women and the youth, in life skills, family and community values, and sensitive and responsible leadership.

A pilot phase of the IRDP, called the IDDP (Initiative for Integrated District Development Programme), has been ongoing since 1998 at three selected sites: the Chimanimani district in Manicaland, Zimbabwe; the Nyandeni district in Western Pondoland in the Eastern Cape; and the Masalale area (programme named Mohlanatsi) in the Northern Province, South Africa. More recently, an additional site at Chimoio in Manica province, Mozambique, was selected as part of the ongoing IRDP second phase.

Programme processes at each site were facilitated by an intermediary contracted as a "District Facilitating Agency" (DFA), working in conjunction with the WKKF Africa programme director(s) responsible for the IDDP and other project grants at a particular site.

1.2 TERMS OF REFERENCE

The W.K. Kellogg Foundation's IRDP is committed to assisting economic and social development in Southern Africa. One component of its programme is to contain the spread and ameliorate the impact of HIV/AIDS in rural communities.

A further component is to help capitalize locally based enterprise development initiatives by stimulating the provision of – and access to – micro-finance in rural areas. Three sites have been selected to pilot the introduction of this and other IRDP activities. These are: Chimanimani (Zimbabwe), Chimoio (Mozambique) and Nyandeni (South Africa).

In addition, the Foundation plans shortly to launch a Public Policy Promotion Programme (PPPP) as part of the IRDP. The essential objectives of the PPPP will be:

- to capture the lessons from on-the-ground experience with the IRDP's projects and translate them into concrete recommendations that will improve rural development policy and practice in the region;
- to achieve the effective inclusion of rural communities in the formulation and implementation of policy by ensuring that policy makers are informed of and responsive to communities' needs and day-to-day experience of policy implementation;

- to build the capacity of communities, research institutions and delivery agencies to contribute to rural development;
- to produce and convey findings to related initiatives that assist the creation and sustainability of rural livelihoods, such as early childhood, health and local government programmes and partnerships.

The initial focus of the PPPP is on containing the spread of HIV/AIDS in rural communities, and ameliorating its impact, as well as the promotion of micro-finance.

1.1.1 Objectives

While micro-finance in its various forms has helped to make loan capital more accessible to low-income rural communities, much remains to be done to increase its outreach, impact and sustainability. The essential objective of this study is to make well-researched recommendations for IRDP policy and strategy to enable the micro-finance agents that it will shortly be appointing to maximize improvements in these key indicators in the three pilot sites.

In keeping with the overall goals of the IRDP and in order to co-ordinate most effectively with other existing or planned initiatives of the programme, the study should place special emphasis on:

- micro-lending to fulfil the respective communities' capital needs as opposed to their consumption needs;
- micro-finance rather than on alternative sources of capital, such as venture capital or conventional commercial bank loans;
- non-agricultural income earning activities;
- women and youth and, to the extent that data makes it possible, HIV/AIDS-affected households.

Specific objectives for each of the three sites are:

- to identify and profile the main drivers of economic activity, actual and potential facilitators and current constraints on these drivers;
- to assess the impact these drivers and current constraints have on key development indicators, such as income and employment, and the impact that improved access to micro-finance could be expected to have (a) on its own and (b) in conjunction with the reduction of other important constraints;

- to profile the current state of micro-finance and the context within which it operates in the respective countries and sites, noting especially factors facilitating or constraining the expansion of micro-finance services in rural areas;
- to assess the degree to which the need for access to adequate and appropriate financial services – in particular micro-lending – is being met in the three sites;
- to review international experience in respect of rural micro-credit, highlighting key policy and strategy issues and performance indicators, extracting the most important lessons for Southern Africa and drawing attention to models that appear to hold greatest promise for the region and the three sites; and
- to deduce the policy and strategy implications for maximizing the outreach, impact and sustainability of the micro-finance programmes to be mounted by the IRDP's agents and to make recommendations accordingly.

1.3 TIME FRAME, METHODOLOGY, VALUE AND LIMITATIONS OF THE REPORT

The time frame for compiling this report was short – about 14 weeks at initial conception in early July 2001. Discussion about the terms of reference continued for some weeks after this, and final agreement about the terms of reference was reached only on the conclusion of the IRDP micro-finance workshop held in Pretoria on 11–12 September, at which point the contract for the research was also signed. Although secondary research had commenced in July and a key sub-contract had been set up – though not activated – this left only about six weeks for completion of the project.

Initially, a limited programme of field research, involving interviews of households, micro-entrepreneurs, social groups and key figures in the three pilot sites had been planned. After discussion with the IRDP programme manager, it was decided that this would be premature, given the overall stage of implementation of the programme and the comparative "newness" of the district facilitators in the pilot sites. Consequently, only the most cursory field investigations, in no case lasting more than a few days, were undertaken by locally based agents – who responded positively and generally competently at very short notice – to try to fill the most important secondary information gaps.

While this in no way invalidates the findings and recommendations that follow, they can clearly be regarded only as preliminary. Regardless of whether the key decision about micro-finance delivery strategy – i.e. whether to go to the "external downscaling" route (see chapter 5) – is made primarily on the basis of predetermined policy or not, it will be essential for thorough field research to be undertaken in the respective pilot sites to maximize the likelihood of success. This is akin to the thorough market research that one would expect a competent commercial enterprise to conduct before deciding whether and how to enter any particular market.

A great deal was nevertheless learned about the three pilot sites from the preliminary and secondary research that it was possible to conduct. This was certainly sufficient to provide a good initial "feel" and consequently a reasonably well-founded set of preliminary conclusions and recommendations. The following two chapters document what was learned, in the first instance, about the demand – existing and expected – for micro-finance and, in the second, about the current nature and level of access to financial services – in particular micro-finance – in each of the sites.

2

Determinants of Demand for Financial Services in Three Pilot Sites

This chapter will profile of each of the three sites – in Zimbabwe, Mozambique and South Africa – in order to evaluate the implications for micro-finance.

2.1 CHIMANIMANI DISTRICT IN MANICALAND PROVINCE, ZIMBABWE

2.1.1 Geographic, Historical and Political Context

The following section outlines the location, size, topography, natural resources, physical infrastructure and political context of Chimanimani, Zimbabwe.

Geographic Context

Chimanimani district is one of the seven administrative districts of Manicaland Province in eastern Zimbabwe (alongside Mozambique). The district has a total land area of approximately 3 450km2. It shares a border with Mozambique, as well as a major transport route leading towards Chimoio and Beira on the Mozambique Channel.

As the border between the two countries comprises the largest mountain chain in Zimbabwe, the district is characterized by very diverse terrain. As a result, climatic conditions are extremely varied across the wards that comprise Chimanimani district, which includes all five of the agro-ecological zones found in Zimbabwe within 80 kilometres. The border mountains receive rainfall in excess of 2 000mm per annum in some areas, but portions of the lower inland areas record less than 300mm per annum and often experience prolonged periods of drought. This variety across the agro-ecological zones is indicated in figure 2.1.

FIGURE 2.1 Agro-Ecological Zones, Chimanimani District, Zimbabwe

Zones	Characteristics
(Zone One: 900 – 1000mm/annum)	Some wards have a high annual rainfall and the area is suitable for growing fruit trees, plantation crops such as coffees, macadamia nuts and teas. It is also good for intensive livestock production.
(Zone Two: 750 – 1000mm/annum)	This zone is suitable for intensive crop and livestock production (ITZ, 2000a: 5). Approximately 90% of Zimbabwe's crops are produced in this region (national), including maize, tobacco, soya beans, wheat and cotton.
(Zone Three: 650 – 800mm/annum)	Wards have lower rainfall that is subject to periodic drought and prolonged dry spells. These areas are suitable for semi-intensive farming.
(Zone Four: 450 – 650mm/annum)	Wards have low annual rainfall and are subject to droughts. This rainfall is too low and unrealiable for cropping except certain tolerant crops. The appropriate systems are livestock and game ranching.
(Zone Five: 0 – 450mm/annum)	Other wWards experience hot, dry conditions and less than 300mm per annum of rainfall.

The rainfall pattern creates extensive variability in agricultural potential. This is reinforced by the fact that the district is not homogeneous in terms of resource endowment and the type of economic activities undertaken within communal areas. Agriculture is the main economic activity in Chimanimani and its potential is dependent on the Zone. Intensive agriculture and high-value crops can only be undertaken in Zones One and Two.

The district is bordered by the Eastern Highlands range, which is associated with high rainfall on the eastern side and very low rainfall in the leeward side. The eastern side of the mountainous range falls within Zones One and Two, where the rainfall and soil type are good for intensive agricultural production. The leeward side falls within Zones Three, Four and Five, which are associated with very low, erratic rainfall and easily eroded soils. 61.8% of the district is in Zones One and Two, with the balance of 48.2% in Zones Three, Four and Five, where most of the communal farmers reside.

Zone One is suitable for both deciduous fruit production in areas of higher altitude and sub-tropical fruits such as mangoes, pineapples and granadillas in lower lying windward valleys. Hilly areas with high rainfall are highly suitable for large-scale timber production of both pine and eucalyptus. Zone One areas and parts of Zone Two areas are highly suitable for tea and coffee production. Zone Two also offers potential for reliable high-yielding crops such as maize, soya beans, sunflowers, groundnuts, paprika, as well as other major crops and horticultural products.

The areas incorporating Zone Three, although still suitable for cropping major food and oil seed, experience slightly more unreliable rainfall. Sandy soils in the region are highly suitable for the production of both barley and flue-cured tobacco, although the latter have higher managerial and infrastructural requirements.

The areas incorporating Zones Four and Five experience lower and more unreliable rainfall. Cropping should be limited to drought-tolerant small grains such as finger and bull rush millet and sorghum. However, changes in food preferences mean that subsistence farmers still attempt to grow maize, thus contributing further to food insecurity.

Generally speaking, the heavy and regular precipitation in the mountainous areas, together with the drainage pattern, which runs from north to south through the arid western portion of the district, means that the area is well endowed with both perennial water sources and a major river system, the Odzi/Save. This provides a number of opportunities for irrigation agriculture and a series of schemes already exists.

Historical and Political Context

The prevailing political instability affecting the country since 1999 has led to a difficult economic environment in Zimbabwe. This continues to deteriorate at a rapid rate, creating growing hardship for the majority of the population.

The rule of law has been under attack for some time in Zimbabwe. The year 2000 was characterized by widespread violence, threats, intimidation and lawlessness. Scores of people were killed and large numbers were injured or had their property destroyed. Many people affected by the violence were completely deprived of the protection of the law. In the aftermath of this violence, fear spread throughout the country (Feltoe, 2001).

Most of this violence resulted from the Zimbabwean government, formed by the Zimbabwe African National Union (ZANU [PF]), its orchestrated farm invasions and the campaign by supporters of the ruling party against the main opposition party, the Movement for Democratic Change (MDC). The violent intimidation of opposition party supporters prior to the election subverted the entire democratic process by preventing an electoral process which would allow people to exercise their vote freely.

Any development intervention, such as implementing micro-finance schemes, should take cognisance of this negative political, economic and social climate in the country, including such events as (ITDG, 2001a: 3):

- negative response to the draft constitution by the majority of Zimbabweans (52%);
- forceful occupation of commercial farms by some war veterans and communal area residents;
- the destruction of the livelihood base by Cyclone Eline, mainly in districts like Chimanimani;
- parliamentary elections preceded by violence and intimidation, as well as loss of lives;
- a post-election phase characterized by withdrawal of donor funding, a decline in tourism and investment, shortage of foreign currency, worsening of the fuel crisis, growing unemployment levels and implementation of fast-track resettlement programmes without adequate resources;
- ZANU PF Congress bringing in new people in the top leadership (politburo) structure, and a process to restructure the party at district and provincial levels; and
- conflict between the judiciary and executive arms of government.

2.1.2 Demographic Context: Population and Households

The following section outlines the population size, population structure, population characteristics, household income levels, household income distribution, sources, flows, expenditure categories and flows.

Demographic Context

It should be noted that various publications held by the Chimanimani Rural District Council and various other organizations in the province have different population statistics for the district. Discussions with the provincial heads from different government and non-governmental organizations yielded the same results. Given this state of affairs, the figures that can be relied upon for planning purposes are those from the Central Statistical Office (CSO), as represented by census figures. All figures quoted in this report will therefore be from the CSO unless otherwise indicated. The last census by the CSO in 1992 gives the following demographic data for Chimanimani.

FIGURE 2.2 Total Population, Area and Population Density by Province

Province	Total Population	Percentage of Total Population	Area	Density
Manicaland	1 537 224	14.76	36 459	42.16
Mashonaland Central	856 736	8.23	28 347	30.22
Mashonaland East	1 034 342	9.93	32 230	32.09
Mashonaland West	1 112 955	10.69	57 441	38.00
Matebeleland North	641 186	6.16	75 025	8.55
Matebeleland South	592 398	5.69	54 172	10.94
Midlands	1 307 769	12.56	49 166	26.60
Masvingo	1 222 581	11.74	56 566	21.61
Harare	1 485 615	14.27	872	1 703.69
Bulawayo	621 742	5.97	476	1 298.00
TOTAL	10 412 548	100.00	390 757	26.65

Source: CSO, 1992 Census Report

The Central Statistical Office undertakes a countrywide population census once every ten years, the last one being conducted in 1992. The next census will be held in 2002. In the meantime, current figures can be calculated through interpolation using the estimated inter-census growth rate of 3.2% per annum (3.1% according to the poverty assessment reports of 1998, CSO).

According to the population census of 1992, the population of Zimbabwe was 10 412 548 and 51.18% of the population was female. Manicaland Province had a population of 1 537 224, with 52.75% of the population being female. For administrative purposes, Zimbabwe is divided into ten provinces, namely Manicaland (where Chimanimani is situated), Mashonaland Central, Mashonaland East, Mashonaland West, Midlands, Matebeleland North, Matebeleland South, Masvingo, Harare and Bulawayo. Two of the provinces, Harare and Bulawayo, are made up of an urban population only.

FIGURE 2.3 Population Statistics of Chimanimani

Male population	52 905
Female population	57 199
Total population	110 104
Annual average inter-census growth rate 1982–1992 (%)	3.14
Number of households (HH)	22 763
Average size of household	4.8
Population density (persons per square kilometre)	42.95

Source: CSO, 1992 Census Report

At the time of the census, Manicaland Province had 14.76% of the country's population and a population density of 42.12 persons per square kilometre, 15 persons above the country's average of almost 27 persons per square kilometre. The province is divided into eight administrative districts, namely Nyanga, Rusape, Makoni, Mutasa, Mutare, Buhera, Chimanimani and Chipinge. Chimanimani has the smallest population in the province and is the second smallest district in size. It covers an area of 3 450.14 square kilometre and has a population density of 32 persons per square kilometre. (Manicaland provincial profile: CSO, 1992). Chimanimani is 100% rural, with a rural service centre that is termed the urban ward in this report.

FIGURE 2.4 Manicaland and Chimanimani: Comparative Statistics

	Manicaland	Chimanimani	**Chimanimani 2001
Total population	1 537 224	110 104	148 183
Male population	726 320	52 905	
Female population	810 904	57 199	
Area in sq. km	36 459	3 450,14	3 450.14
Population density	42.2	32	42.95
Sex ratio: females to population	52.75%	51.95	

Source: CSO, 1992 Census Report

** Projected figures from 1992 census at a natural increase of 3.2%, which is the inter-census growth rate. It would however be difficult to estimate the female/male population through this method of interpolation.

As indicated under the geographical context, Chimanimani has all the five agro-ecological regions and all the land use patterns, ranging from state farms, resettlement areas and communal areas to small-scale and large-scale commercial areas. State farms are large-scale commercial farms run and managed through parastatals like the Forestry Commission or ARDA. Of the 327 306ha of land in the district, 120 700ha is communal (Chimanimani district profile; RDC, 1999). The rest is divided into commercial farming areas and resettlement areas.

The population density in communal areas is estimated at about 70 persons per square kilometre and there are currently an estimated 27 072 households (Chimanimani: 2001). There were 22 763 households in the 1992 CSO report, with an average household size of 4.8 (between 3.3 and 5.6) in the 24 wards. Information from the wards visited by a field agent on 6 October 2001 provides estimates of household sizes above the 1992 census figures. Household sizes are now estimated to be between six and 12 members per family. This is compared to the population density of Manicaland, which is estimated at 42 persons per square kilometre (GTZ, 1998: 16).

Dispersal of Population in Chimanimani

Chimanimani is entirely rural and has no urban centre. 70% of the population resides in Zones Three, Four and Five. The people are stratified into wards. There are 27 wards according to the census of 1992 with following population statistics:

FIGURE 2.5 Total Population per Ward in Chimanimani District

Ward	Total Population	Average Household Size	**Estimated Pop. in 2001
1. Mhandarume	4 290	5.2	5 619
2. Chakohwa	3 687	5.0	4 829
3. Chiramba	2 616	4.7	3 426
4. Guhune	4 606	5.4	6 033
5. Rupise	4 483	5.2	5 872
6. Chayamiti	2 138	5.0	2 800
7. Chikukwa	2 673	5.6	3 501
8. Nyanyadzi	4 415	5.3	5 783
9. Shinja	2 338	5.0	3 062
10. Gudyanga	4 218	5.4	5 525
11. Chikwakwa	3 340	5.3	4 375
12. Mhakwe	2 733	5.1	3 580
13. Biriwiri	7 990	5.3	10 466
14. Changazi	4 580	5.1	5 999
15. Chabika	2 911	5.1	3 813
16. Ngorima A	5 074	5.3	6 646
17. Ngorima B	7 436	5.4	9 741
18. Manyuseni	8 823	5.1	11 558
19. Nyahode	6 840	4.8	8 960
20. Bumba	4 079	5.6	5 343
21. Ward twenty-one	2 855	3.9	3 740
22. Ward twenty-two	3 815	3.5	4 997
23. Ward twenty-three	5 455	4.0	7 146
24. Ward twenty-four	2 532	3.9	3 316
25. Ward twenty-five	3 833	3.3	5 021
26. Ward twenty-six	955	3.6	1 251
27. Ward twenty-seven	1 389	3.8	1 819
Total	110 104	4.8	144 152

Source: CSO, 1992 Census Report

** Estimated figures interpolated using the 3.2% inter-census growth rate

General Structure of Households

Five wards were visited briefly on an HSRC commissioned study. These were Ngorima A, Mhakwe, Gudyanga, Nyanyandzi and Chimanimani urban. Discussions were held with the headmen, councillors and kraal heads of the areas. The results in four of the five wards have been tabulated below.

FIGURE 2.6 Household Structures

Ward	Absentee Members	Female-Headed HH	Migrant Workers	Estimated HH Size
Ngorima A	Mainly school children in boarding schools	50% of households	At least 3 members per family	6 members per family
Mhakwe	Mainly school children	50% of households	1 per family	6 members
Gudyanga	Almost nil	40% of households	1 in 5 HH	10
Nyanyadzi	Some irrigation farmers' children	48% of households	nil	12

These figures were difficult to get in the urban ward. It would appear that female-headed households are increasing in number in each ward. The family size has also increased, especially in Zones Four and Five. The increase puts considerable pressure on the available resources. The fact that there are fewer migrant workers in the same areas means that very little income is received from outside the ward. According to the reports from the Ministry of Health through the district nursing officer, 50% of the current population is below 15 years (about 75 129 children) and 18% of the population comprises women of child-bearing age.

Poverty

According to the 1995 Poverty Assessment Study, 71% of the people of Chimanimani live in poverty (GTZ, 1998: 24). This figure is made up of those who are very poor because their incomes are less than the Food Poverty Line (FPL) and 12% who are poor because their incomes are below the Total Consumption Poverty Line (TCPL) for the district. The Food Consumption Poverty Line (FCPL) for the district in 1995 was estimated at Z$1 157.26 and the TCPL at Z$1 886.33. Poverty is more severe in communal areas than in the large-scale commercial farming and resettlement areas of the district. 81.42% of the male population is literate and 67.94% of females are literate.

Main Economic Activities of the Average Household

Agriculture (subsistence, sub-subsistence and commercial) is the major economic activity undertaken by households in the district. This consists of fruit and vegetable production in the Eastern highland areas, and irrigation and dry land farming in Zones Four and Five. The other non-economic activities include arts and crafts, tourism and honey production. These will be elaborated on in section 2.1.4 dealing with economic activities in Chimanimani.

FIGURE 2.7 Typical Assets Owned by Households

Asset	% of Pop. owning the Asset in Zones One and Two	% of Pop. owning the Asset in Irrigation Schemes	% of Pop. owning the Asset in Zones Three, Four and Five
Radio	75	90	< 50%
Television	80	10	Nil
Sofas	80	90	40%
Solar electricity panels	80	Nil	Nil
Direct (ZESA) electricity connected	10	10	Nil
Electric stoves	50	1	Nil
Kitchen units	80	50	Nil
Ploughs/harrows	75	90	40
Wardrobes	80	–	–
Irrigation pipes	20	–	–
Hand hoes	100	100	100
Plantation crops (fruit, tea, coffee)	100	75	10
Brick under asbestos houses	90	90	>10
Cattle	10	85	30
Goats	–	90	80

Source: Discussions with all village heads, councillors and kraal heads

Most of the household expenditure in Ngorima A is on consumer goods like furniture, clothing and hoes, which are bought every year. Investment into capital assets is limited in both wetland and dry land areas. All the assets tabled above can be pledged as collateral since they have resale value.

Main Capital Needs of the People in Chimanimani

The people in Ndima, Ngorima, Cashel Valley and Nyahode require capital for the purchase of irrigation pipes to tap the mountain underground streams that break out in certain areas of their fields. They would like to harness the water systems to irrigate their plantations during the dry season. Some households would like to buy individual trucks for ferrying fruit to the market; others would like to buy solar panels and electric equipment. Hoes are purchased every year as they form the basic farm equipment for land cultivation. In the rugged terrain, there is minimum use of ploughs and tractors. The coffee and tea growers would like to purchase tractors for ferrying their produce to the nearby processing plants. The Nyahode co-operatives also require tractors for ferrying wood to their sawmills.

Besides investment capital at the household level, the people in Ngorima, Ndima and Nyahode would also like to upgrade and equip their fruit warehouse to be a cold room. The fruit growers' association would like to increase its fleet of lorries from two to five and set up a fruit processing plant through grant support. If funds were available they would like to upgrade their road network to all-weather tarmac roads.

The dry land natural region Four and Five areas have a different capital needs structure, especially at the household level. Dry land agriculture production is very risky with very low output of less than a tonne of grain annually. Because of the flat terrain, the capital requirements consist of implements like ploughs, harrows, cattle and crop inputs. As a community, they need irrigation facilities. The old night storage dam in Nyanyadzi is leaking and needs to be repaired.

There is, therefore, definitely scope for micro-finance in Chimanimani. A huge demand for flexible and easily accessible savings facilities exists in the high potential areas of Ndima, Ngorima, Nyahode, Cashel Valley and Chikwakwa. Fruit and vegetable production in these areas takes place all year round. Truck owners come weekly to purchase the produce and farmers need a day's travel to deposit funds into a commercial bank. The minimum transport cost (return trip) to Chimanimani is Z$ 300, to Chipinga Z$600 and to Mutare Z$1 000. The general shortcoming of the Post Office Saving Bank (POSB) is the stringent withdrawal regulations. All the areas expressed the need for credit for reinvestment purposes.

2.1.3 Physical/Institutional Infrastructure

The following section will outline the physical and institutional infrastructure in Chimanimani, including towns, transport, education, medical services, power, water, authority structures, and social groups/associations.

Government in Chimanimani

Local government is characterized as follows: 23 ward communities make up Chimanimani, along with five traditional authority areas[1]. These form the District Council. The district local government structure is the Rural District Council (RDC). This comprises 23 councillors (of 23 wards), three chiefs representing all five chiefs of

[1] These chiefs are Chief Mutambara, Chief Muusha, Chief Chikukwa, Chief Ngorima and Chief Ndima.

area, and the CEO of the council. Heads of department advise councillors without voting rights, as do the district administrator and other heads of service ministries. NGOs are encouraged to attend meetings. The full council meets four times a year.

The RDC has six committees:

- Finance
- Natural Resources
- Social Services
- Roads, Planning and Works
- Administration
- Rural District Development Committee (RDDC)

Plans are underway to include business representatives, communities, women and youth in the RDDC. At present, there is usually a conflict of interest between civil servants (who are sometimes known as "think tanks") and other stakeholders interested in broader participation (ITZ, 2000: 10). ITZ has actively sought to include women and youth in participatory processes. This is a new concept in these communities. Both of these groups are now beginning to realise the importance of challenging the status quo (ITZ, 2000: 12).

Below the district level are formal local bodies: the Ward Development Committee (WADCO), which comprises chairpersons of Village Development Committees (VIDCOS) established in 1984. Both the Chimanimani WADCO and VIDCO are almost non-functional. The Ministry of Local Government co-ordinates a number of national service ministries via the district administrators' offices. These include:

- National Ministries: Education, Health, Home Affairs, Environment & Tourism, National Affairs, Local Government & National Housing, Labour & Social Welfare
- National Departments: Agricultural Technical & Extension Services (AGRITEX), Veterinary Services
- Traditional structures of which chiefs are the highest authority. The chieftainship is enhanced by the local government structure.

Community Associations

There are a number of institutions working with groups such as community associations in Chimanimani.

FIGURE 2.8 Major Institutions Working with Groups in Chimanimani

Institution	Wards Covered	Type of Groups Formed
SAFIRE	Ngorima A, Biriwiri, Chikwakwa, Guhune, Nyanyadzi, Changazi, Mhandarume	Natural resources groups
Credit Against Poverty (CAP)	Nyanyadzi, Ngorima A and B, Biriwiri, Changazi, Gudyanga, Mhakwe, Chimanimani urban	Credit groups
Kellogg Foundation	Bumba, Chayamiti, Ngorima A & B, Changazi, Nyanyadzi, Mhakwe	Ward development committees
Tsuro dzemadzimai (permaculture)	Chikukwa, Chimanimani urban, Chakohwa, Ngorima A & B, Biriwiri, Nyanyadzi, Chikwakwa	Permaculture groups Campfire associations
Campfire	All wards	
Jekesa Pfungwa	Ngorima A&B, Biriwiri, Mhakwe, Chakohwa, Nyanyadzi, Changazi,	Community gardens, poultry and rabbit groups, sewing clubs
Agritex department	All wards	Farming groups
Ministry of Health	All wards	Nutrition gardens

A number of community associations have been identified in Chimanimani by ITZ (1999):

- Chimanimani Arts Festival Trust
- Chimanimani Business Association (links with European Union, Africa University)
- Chimanimani Youth for Development (links with CASS for leadership training, JAZ for entrepreneurial training, SPW for life skills, GTZ (ISTARN) for training and help about micro-finance, *Tsuro dzeChimanimani* in sustainable agriculture; Community in Mhakwe Ward have a Youth Garden Project)
- Chimanimani Beekeepers Association
- Chimanimani Women Development Association
- Chimanimani Community-Based Orphanage Programme (links with Africa University, FACT)
- The Local Consultative Forum of Nyanyadzi Training Centre
- Three Community Development Boards in pilot communities: Mhakwe, Nyanyadzi and Ngorima
- TSURO responding to farmers' demands for improved management of natural resources

Physical Infrastructure

The government has provided a number of health and education centres throughout Chimanimani:

Education:

- Primary schools: Registered 68
- Secondary schools Registered 20

Health:

- Health facilities: 23
- Rural hospitals: 2
- Rural health clinics: 5
- Commercial clinics: 7
- Mission hospitals: 2
- Rural District Council hospitals: 7

2.1.4 Economic Activities

The following section will elaborate on economic activity in Chimanimani. This includes formal sector industries' turnover, employment, wages, growth patterns and constraints; and the informal sector's occupations, turnover, incomes, employment, growth patterns and constraints.

Main Economic Activities of Chimanimani

Recent analysis of Chimanimani's economic opportunities indicated that the area is rich in natural resources with a locational advantage in terms of private sector partnerships and cross-border trade. However, government and non-governmental organisations' intervention, which includes income generating activities, has fallen short of exploiting such opportunities. The contributing factors cited include lack of institutional capacity, poor infrastructure, fragmented agricultural production with no value adding, a group focus that does not consider entrepreneurial and management skills, as well as capital and market access. There is likely to be potential to enhance existing businesses in retail, manufacturing, agriculture, tourism and transport.

The district has a mixed economy, with agriculture being the main economic activity. Agriculture in the communal areas is primarily for subsistence. The district has a dual agrarian system divided between commercial farms (48.5%) and the small-scale farming (subsistence) community (51.5%). In most communal land, distribution is the responsibility of the chief, although in some areas this has been modernized to include councillors and agricultural extension staff. However, in other areas there have been political tensions over land allocation between traditional structures and local government and VIDCOs. The district lies within areas that offer opportunities for expansion and the opening up of new forms of employment in agro-processing and tourism development.

In addition to the major variation in agro-ecological zones, there is also a wide diversity of land tenure types. These include:

i) Large-scale plantations of timber, tea and coffee, often owned by large companies including trans-nationals and parastatals such as the Forestry Commission.

ii) Commercial farms carrying out a wide range of cropping options including tea, coffee, fruit (deciduous and sub-tropical), major food and oil seed crops, tobacco, dairy and livestock production. Some of these are owned and run by state corporations.

iii) Resettlement farms include those established under Zimbabwe's official resettlement programme over the last 20 years and the more recent "fast-track" land occupations. Resettlement models vary considerably:
   - Individual farm settlement with 5ha arable and communal grazing (Model A).
   - Co-operative and collective (Model B).
   - Specifically planned core estates with outgrowers or individual produces (Model D), like the Rusitu Valley dairy production project.
   - Small farms of 50 – 250 ha distributed to "persons of means" under the more recent resettlement initiatives.
   - The yet unplanned and more "random" or spontaneous resettlement areas.

iv) Communal areas with traditional communal land tenure, where the major portion of the district's population lives.

v) National Park and wildlife areas.

The massive and complex diversity of land tenure and agricultural potential in Chimanimani has a major impact on any programme implemented in the area. This wide diversity is reflected in the recent study (June 2001) undertaken for the Kellogg Foundation in the district and the Mozambique province of Manica. The study, designed to carry out "an assessment of potential economic drivers" for the district, details that the most attractive opportunities are in:

- Fresh fruit production
- Fruit processing
- Tourism
- Honey manufacturing

While this observation may hold true for the mountainous and high rainfall areas, it is somewhat misplaced when applied to the arid portions along the Odzi and Save Valley (unless it only refers to those areas with irrigation). The extreme variation in agro-ecological potential clearly means that any strategy to develop the district and its various land tenure options must be linked to a multi-faceted development initiative, which has a series of tailor-made options for different areas.

Chimanimani's diversity should be used by the Kellogg Foundation and the IDRP to test and refine different options for its variety of agro-ecological zones. Such diversity should be exploited to gain experience in different climatic zones. For example, the variation from mountainous to medium-rainfall plateau to semi-arid and arid low-altitude valley is reflected in the changes experienced in Mozambique's Manica province, where rainfall drops off significantly from the mountains in the west towards the Chimoio Plateau and the Pungwe lowland and from the central plateau north and south towards the hot dry valleys of the Zambezi and Busi rivers.

Technoserve (2001) evaluated the strengths and weaknesses of market segments in

Manicaland using the following criteria:

- number of producers
- concentration of traders
- growth potential
- access from main business centre
- conducive business/finance culture
- demand for products
- annual household income
- impact on employment

FIGURE 2.9 Strengths and Weaknesses of Market Segments in Manicaland, Zimbabwe

Segment	Very Attractive	Attractive	Unattractive	Very Unattractive
Fresh fruit	X			
Fruit processing	X			
Tourism		X		
Honey manufacturing		X		
Processing labour-intensive cash crops		X		
Dairy processing		X		
Fresh vegetables			X	

Thus fresh fruit, processed fruit, labour-intensive cash and food crops and tourism were assessed as the most promising economic opportunities for the Manicaland region. It was therefore recommended that the agricultural processing industries should be developed and cross-border trade with Mozambique facilitated to support these industries (tea and fruit in particular). In addition, it was recommended that the tourism industry be promoted and that business skills be provided for farmers and entrepreneurs.

Farming Based Economic Activities in High Production Potential Areas

Five communal areas fall within the high potential belt of ZONES One and Two, namely Ndima, Ngorima, Cashel valley, Nyahode and Chikwakwa. The major economic activities in these communal areas include fruit production (bananas, oranges, mangoes, pineapples, avocado pears, naartjies), plantation crops (tea, coffee and gum trees), crop production (sweet potatoes, yams, maize, sugar cane and dry beans) and horticulture (leaf vegetables, tomatoes, pulses, etc). All these crops are grown for the market, except maize, which is a staple. Discussions with Ngorima farmers indicated that on average each farmer in the area owns 1500 banana plants, 20 orange trees, 30 naartjie trees, 30 000 pineapple plants, 30 avocado trees, an acre of sweet potatoes and an acre of yams. There are 500 tea farmers and 200 coffee farmers. This represents potential annual income to a household of about Z$650 750 (over six hundred thousand Zimbabwean dollars) as seen below.

FIGURE 2.10 Potential Annual Household Income in Ndima

1500 banana trees, 3 bunches, 100 fruits per bunch, Z$1 per banana	Z$450 000
20 oranges trees, 250 oranges per tree, Z$1 per orange	Z$5 000
30 naartjie trees, 300 fruits per tree, $1 per fruit	Z$9 000
30 000 pineapple plants, 1 pineapple per plant, Z$5 per pineapple	Z$150 000
20 buckets of yams per acre, Z$250 per bucket	Z$5 000
100 buckets of sweet potatoes per acre, Z$250 per bucket	Z$25 000
30 avocado trees, 150 avocados per tree, Z$1.50 per avocado	Z$6 750
Total Income	Z$650 750

Source: Ngorima Fruit Growers' Association: 2001

Discussions indicate that these are conservative figures of each household's plantation crop ownership in terms of numbers. Very conservative yield estimates have also been used for oranges, avocados and naartjies. However, while the production indicated above is a true reflection of the output per household, average income per household rarely reaches the level calculated due to marketing problems.

The major marketing problem is lack of transport to the major marketing centres, Harare (>500km) and Bulawayo (>800km). The Fruit Growers' Association has two lorries that ferry produce to the major market centres but this is inadequate in the face of high production. Most of the fruit is sold through truck owners who dictate the price per unit. This leaves the producers at the mercy of intermediary truck owners. The major marketing problem is the inaccessibility of the area during the rainy season, which leads to rotting of most of the fruit that ripens during the rainy season. Mangoes are the most affected.

Farming Based Economic Activities in Low Production Areas

About 80 % of the rural population resides in the drier Zones Three to Five. The regions receive erratic/uZoneseliable rainfall below the 600mm per year suitable for extensive agricultural and livestock production. Dry land agriculture is a very risky business and yields, if any, cannot meet the family needs for the rest of the year. In such areas, arts and crafts are the major economic activities that complement the family income. Selling of goats is another source of household income.

The soils in these dry land areas are suitable for irrigation farming and four irrigation schemes have been established to date, as seen in figure 2.11.

FIGURE 2.11 Irrigation Schemes in Dry Land Areas of Chimanimani

Name of Scheme	Potential Area (ha)	Area Developed (Ha)	Plot Holders
Nyanyadzi South	180	73	460
Nyanyadzi Main	414	414	460
Chakohwa	86	86	115
Nenhowe	113	53	53
Total	793	626	1 088

Source: Chimanimani district profile, 1999

According to Agritex, most of the one-hectare plots have been subdivided to accommodate more households so the plot holder figures have increased considerably. The major crops grown are leaf vegetables, tomatoes, pulse, wheat and groundnuts. Although income figures could not be estimated, indications were that the plot holders produced enough of all crops and vegetables to sell. The irrigation schemes have had a positive impact on the standard of living of these farmers as shown by the comparative asset ownership statistics in figure 2.7.

The district has a lot of surface water in the eastern part and underground water in the western side. Most of this underground water is suitable for irrigation. The largest rivers in the west that are major sources of irrigation water are the Save and Odzi, whose major tributaries are the Nyanyadzi, Umvumvumvu and Wengesi. This presents irrigation potential for the dry land areas, which would increase income per household.

Non-Farming Economic Activities

The major non-farming economic activity at household level is bee keeping. Bee keeping in Chimanimani dates back to pre-colonial days when traditional hives were used. The traditional hives produced half of the colony's potential due poor harvesting methods and exposure of the hives to predators and ants (Mungwari, 1999). The new, improved Kenyan-style and top bar hives introduced through Agritex and the Intermediate Technology Development Group (ITDG) have greatly improved production levels in the area. The rudimentary methods of honey harvesting and extraction have been improved through the establishment of the ITDG marketing centre in Ndima. However, it is still very difficult to penetrate the market in Zimbabwe, which consists largely of pharmaceutical companies. The table honey market is also being monopolized by a few intermediaries, who have set up stringent entry requirements (Mungwari, 1999). Table honey is a new product that has to compete on supermarket shelves with jam, which is cheaper. Growth in off-shelf purchases would greatly depend on vigorous marketing strategies and combined efforts with existing monopolist players in the market.

Eco-tourism is another potential economic driver, although it is limited to mountain-climbing camps and towns. These mountains provide an important tourist destination, which could be further exploited. There is generally a lack of infrastructural investment or advertising to underpin this potential. Tourist attractions are the Haroni Botanical Reserve, the Chimanimani Ranges, Pera Falls and Hotsprings. Chimanimani Arts Festival is another potential tourism driver. This is a one-day event held every year, and is gradually growing in popularity in Zimbabwe. Chimanimani as a district has a great potential in tourism and crafts. The eco-tourism site at Vimba offers great potential for botanical tourists, presenting some of the unique stick insects and carnivorous plants in Southern Africa. The area, which borders with Mozambique, offers very good triangulation prospects in tourism. Bike rides and walking trails in the Chimanimani mountain range have been a big attraction over the years. The Bridal Veils Falls within the Chimanimani area have also been well marketed.

Main Economic Constraints

Road access: Chimanimani roads to the high potential areas are dry-weather roads only and are inaccessible during the rainy season. This means all production during the rainy season is lost, as truckers cannot reach the area. This will continue greatly to undermine the production potential unless measures are undertaken to resolve the situation. Some suggested measures include equipping the fruit storage facility with cold rooms to increase the shelf life of fruit so it can be sold at a higher price, ensuring that access roads are all-weather roads and establishing a processing plant.

Price takers: Most of the producers in irrigation schemes and the Eastern Highlands have problems transporting their produce to the market. Most of them rely on trucks that come in to buy and therefore dictate the price of the product. If the growers had their own trucks they would be able to take their crops to the fresh markets where higher prices are offered.

Shelf life: The high production areas produce fruit and vegetables with very short shelf lives. Value adding through processing would open new marketing horizons both locally and internationally. The fruit can be processed into jams, chutneys, canned fruit, dried fruit and fruit powder like yam powder. At present, the vegetable production co-operatives in Nyahode and Cashel Valley depend on Cairns Foods in Mutare, which buys their product in bulk. However, canning factories offer the lowest prices in the market, as they are willing to receive the lowest grades. Due to lack of transport to the fresh markets in Mutare and Harare, the co-operatives end up selling their entire crop to the canning factories, which greatly undermines their annual incomes.

Communication and access to information: Access to information and markets is poor (ITZ, 2000: 2). The state of roads and the transport network, particularly feeder roads, is also poor. Infrastructure (water, electricity, telecommunications) also requires expansion. Many parts of the district with good economic potential (e.g. Rusitu Valley) are not readily accessible. The lack of telephones in certain areas, such as the Ngorima Valley, Nyahode, Ndima and Chikwakwa, limits communication and access to information.

Access to credit and savings facilities: The district is inadequately serviced by financial institutions and farmers have difficulties accessing savings and credit facilities. A few women's savings clubs in the villages do not provide safe and reliable saving facilities for large amounts.

Political tensions: Negative international sentiments resulting from the political, economic and social climate of the country, affect tourism and investment (ITZ, 2001a: 3). Periodic clashes in the district have had negative impacts on tourism and crafts. The invasions of private farms by ex-combatants, even farms where lodges are situated, have reduced occupancy rates to the minimum. Visits made to all lodges and hotels in the area reveal that they have not received any international tourists in the last 20 months. Craft sales, which are a major economic activity in the dry areas of Chimanimani from Wengezi junction to Nyanyadzi, are directly related to tourism activities in the district.

With the reduction of tourists into the area there has been a general decline in craft sales. The closure of the craft centre in Chimanimani urban has been due to lack of activity.

Property rights: Except for Chimanimani town, most growth points have no title deeds to land, either for private or business development (GTZ, 1998: 26). The district also has a shortage of serviced stands for industrial and commercial purposes (although this is better in Chimanimani town). The RDC lacks civil engineers, surveyors and funds to service land.

2.1.5 Main Implications for Micro-Finance

- Political and macro-economic instability has reduced the availability of formal sector jobs and increased reliance on the informal sector. This has increased the demand for micro-finance (credit and savings) and increased the risk of default on loans. Political instability is a particular problem in Manicaland, where the opposition MDC party has strong support. Violence involving the military and police was reported in Chimanimani as recently as mid-October 2001.
- Most rural households reside in the less fertile agricultural areas. They are nevertheless still heavily dependent on agriculture for income, given the near absence of social security payments, the declining contribution of remittances to household income and the virtual collapse of arts and crafts trade as tourism has evaporated because of political instability. However, the long period between cash outlays and cash inflow in most types of farming makes agriculture difficult to finance with micro-credit.
- All of the economic activities identified as having greatest potential – fruit growing and processing, tourism and honey production – offer opportunities, directly or indirectly, to small enterprises which will be looking primarily to micro-finance to help meet their capital needs.
- Although little information on local household expenditure patterns has yet been obtained, it can be expected that almost all spending will be for consumption. Income used for this purpose, whether from earnings or from loans, in effect constitutes a small entrepreneur's/household's working capital.
- The rapid increase in the incidence of HIV/AIDS has increased the need for access to micro-finance (again both credit and savings) in care-giving households in order to help them maintain income streams and reduce the pressure to sell assets. But, again, it has raised the risk of default, as well as the number of households beyond the ambit of sustainable micro-credit.

- Most households continue to use formal sector savings facilities. Given the distance and the cost of transport, there is an urgent need for improved informal sector savings alternatives.

The multiple constraints on economic activity – e.g. political/macro-economic instability, poor infrastructure, low levels of business skills – indicate that improved access to micro-finance alone will have only a limited impact on poverty reduction. An integrated range of interventions is needed for significant impact.

2.2 CHIMOIO DISTRICT IN MANICA PROVINCE, MOZAMBIQUE

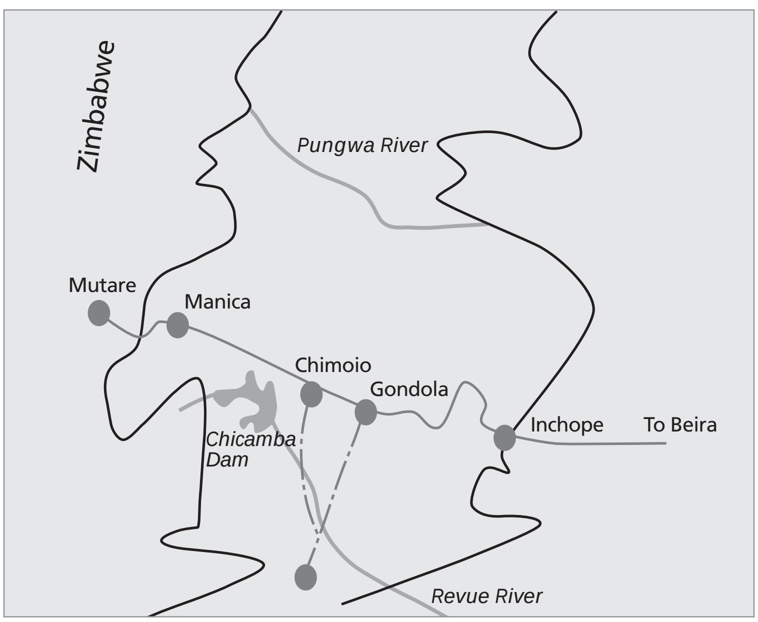
2.2.1 Geographic, Historical and Political Context

The following section outlines the location, size, topography, natural resources, physical infrastructure, and historical and political context of Chimoio.

Geographic Context

Chimoio is the capital town of the province of Manica, which is situated in the west of central Mozambique near the Zimbabwean border. The town is strategically placed between land-locked Zimbabwe and the harbour of Beira, and serves as an economic corridor between the two countries.

FIGURE 2.12 Location of Chimoio in Manica Province, Mozambique



Source: Technoserve, ICC and Rutec, 2001: 7

Manica province has a north-south expansion of about 500km and an average west-east expansion of about 100-120 km. In the north it is marked by the Zambezi river and in the south by the Save river. Only a few small areas in the north and south are located below 500m. The landscape rises strongly towards the border of Zimbabwe along the Chimanimani mountain range and at its highest it reaches an altitude of more than 2 000m above sea level.

As a result of its altitude and relief, Manica province enjoys a relatively high rainfall. The areas around Chimoio, in particular, have a normal annual precipitation of more than 1 000mm, which falls exclusively in the rainy period from the end of October to March. Only in the far northern and southern areas is the amount of rainfall lower, usually between 600mm and 800mm per year. For the province as a whole, rainfall is between 980 and 1 730mm per annum.

The mean annual temperature is 21°C to 22.5°C with an absolute maximum of 37°C, an absolute minimum of 8°C and relative humidity of 71% to 73%. The soils are mainly deep and fertile throughout the province, although the mountainous areas along the Zimbabwean border are minimally suitable for agriculture. This mountainous area provides a variety of natural and mineral resources, such as bauxite, iron ore, asbestos, copper and tin.

The rainfall pattern, combined with the annual precipitation, humidity and fertile soils, endows the area with significant agricultural potential. Geographical and environmental conditions are favourable for a high level of agro-forestry, animal husbandry, and certain levels of tourism. During the rainy season, however, access to the production areas becomes difficult, as the roads deteriorate quickly under heavy rainfall.

Physical Infrastructure

As indicated above, the transport infrastructure requires development. The main transport route between Beira and Mutare, the EN6, is in good condition and facilitates the movement of large amounts of cargo, but secondary roads generally require additional maintenance or rehabilitation, while the majority of tertiary roads require urgent intervention. Other roads in the province are in an extremely bad state.

The existing infrastructure is suitable for services needed for the life of an urban centre such as Chimoio, although some services of economic interest are only found in Beira. Other services (e.g. supplies) are procured in Mutare, Zimbabwe. Infrastructure in general has been severely damaged by a long period of war and instability. After 1992, significant progress was made in infrastructural development, which was unfortunately severely affected by flooding in 1999 and 2000 (see below).

Historical and Political Context

Chimoio is situated in Gondola district, which was the most economically and socially dynamic district of the province before the Mozambique civil war (1975-1992). Building on this basis, it has great potential to regain its place as a dynamic area within Mozambique.

The Civil War

The Mozambique civil war between the *Resistencia Nacional Moçambique* (RENAMO) and the *Frente de Libertacao de Moçambique* (FRELIMO) severely disrupted economic and social stability before 1992 in a conflict that was noted for its destruction of rural production systems. Transport links, health clinics, schools and all other infrastructure that represented social security and government provision was destroyed by RENAMO. After almost two decades of violent conflict, this infrastructure remains depleted.

The signing of a peace process in 1992, followed by democratic elections in 1994, ushered in a new era with considerable potential for economic growth and prosperity. The democratic process seems to be relatively stable in Mozambique despite challenges from RENAMO of vote rigging and allegations of corruption and mismanagement against the FRELIMO government. The fact that Mozambique has an elected government for the first time in its history and has conducted two general elections should not obscure the threat posed by fault-lines in the political structures and power struggles between the two main political parties.

Most ordinary Mozambicans thought democracy would bring an improvement in material conditions. Instead, the economic gains recorded thus far seem to benefit only a relatively small middle class concentrated in Maputo, while the rest of the population has had to adjust to increases in the cost of living and little change in the rudimentary public and social infrastructure. This is partly due to the liberalization of the economy, fiscal discipline and the recent impact of flooding in the southern parts of the country. The widening gap between rich and poor and rural and urban populations potentially poses a serious threat to political stability. The prevailing state of poverty and rural-urban inequalities are important considerations when evaluating any economic development intervention.

The 1999 and 2000 Floods

Flooding in 1999 and 2000 caused widespread devastation. The Mozambican government's confidence that economic growth rates of 10% or more could be sustained for the foreseeable future suffered a blow when floods swept through much of the south and centre of the country. Every major valley south of Beira was affected as rivers burst their banks. When a cyclone hit central Mozambique shortly afterwards, it worsened an already massive natural disaster. Faced with the devastation, the government was forced to cut back its target for economic growth in 2000 from 10% to below 4%. The United Nations' World Food Programme was still feeding over 150.000 people per month in May 2001.

According to the World Food Programme, almost two million people (some 12% of the total population) were seriously affected, with half requiring food aid from international agencies[2]. Almost 250 000 people lost their homes, more than 113 000 small farm households lost their livelihoods and 140 000 hectares of cultivated and grazing land were lost to the floods. This involved about 11% of the total cultivated area in the five provinces affected, including the southern parts of Manica province. Furthermore, some 20 000 head of cattle were missing and feared drowned, and many more were vulnerable to disease.

The worst agricultural losses were to irrigation-based production, with the government estimating that some 90% of the country's functioning irrigation infrastructure was damaged. Industry also suffered as torrential rains caused severe damage in Matola, the industrial city on the outskirts of Maputo, leading to shutdowns or sharply reduced production in some of Mozambique's most successful factories. Over a thousand shops and wholesalers in the river basins were damaged.

Many secondary and tertiary roads were washed away, as were many bridges. All the railways in southern Mozambique were badly affected, particularly the Limpopo line from Maputo to Zimbabwe. The floods also closed 630 schools, attended by 214 000 pupils, while 42 health units were destroyed or damaged, including the country's second largest hospital, Beira Central Hospital.

These figures portray the immense damage caused by the flooding and the massive hurdles faced by economic development. Much of the development created after 1992 was effectively destroyed during the floods. Although Chimoio was not as badly affected as a town, the indirect damage was considerable, especially given its agrarian economy largely based on subsistence.

Poverty

For a country recovering from the debilitating effects of a civil war and devastating flooding, poverty has become the most pressing issue. Illiteracy stands at about

2 See http://www.afrol.com/News/moz003_flood_economy.htm

60.4% of the adult population; and there is a shortage of skilled labour and financial resources (SAIIA, 2001). According to the Ministry of Planning & Finance, the incidence of absolute poverty is 69.4%, indicating that more than two-thirds of the Mozambican population is living below the poverty line (2000: 13). In rural areas, it is estimated to be as high as 71.2%, an alarming figure given the fact that 80% of the population is concentrated in these areas. The figure for urban areas is 62%.

The endemic poverty has been concretized by the threat of HIV/AIDS. According to the 1999 UNDP report, 14.5% of the adult population in Mozambique is HIV positive. An estimated 700 Mozambicans are infected with HIV every day while approximately 2.3 million have AIDS. By early 2001, a quarter of a million people had already died from the disease.

2.2.2 Demographic Context: Population and Households

The following section portrays population size, population structure, population characteristics, household income levels, household income distribution, sources, flows, expenditure categories and flows.

Population of Manica Province Compared to other Provinces

The population in the province of Manica is 974 208, corresponding to 6.38% of the country's total population. The following table shows the percentage distribution of population according to province.

FIGURE 2.13 Percentage Distribution of Population according to Province

Provinces	Population	Percentage
Manica	974 208	6.38
Niassa	756 287	4.95
Cabo Delgado	1 287 814	8.43
Nampula	2 975 747	19.48
Zambézia	2 891 809	18.93
Tete	1 144 604	7.49
Sofala	1 289 390	8.44
Inhambane	1 123 079	7.35
Gaza	1 062 380	6.95
Maputo-Province	806 179	5.28
Maputo-City	966 837	6.33
Total	15 278 334	100

Source: INE, 1997

FIGURE 2.14 Population Dispersal in Chimoio

Area	Population	Percentage
Sussendenga District	92 622	9.5
Gondola District	184 629	18.95
Manica District	155 731	15.98
Chimoio District (city)	171 056	17.55
TOTAL Manica Province	974 208	100

Source: Technoserve, ICC and Rutec study: 3

According to the second general census of population and housing (1997), the population of Chimoio district was 171 056 inhabitants, corresponding to 17.56% of the total population of Manica province.

The majority of the population of Manica is located in the districts of Gondola (18.95%), Chimoio (17.56%) and Manica (15.98%) (see figure 2.15). This can be attributed to the geographic features of these areas. The district of Chimoio is the capital of the province and the place in which the main social end economic infrastructures are located. The district of Gondola surrounds the city of Chimoio, and there is a strong relationship between these areas. Manica is located on the border with Zimbabwe, and is forms the end of the Beira Corridor, which crosses the district of Gondola. By contrast, Macossa and Tambara in the north are located very far from the city of Chimoio and have the lowest populations, 1.43% and 3.23%, respectively.

FIGURE 2.15 Percentage Distribution of Population according to District in Manica

District	Population	Percentage
Chimoio	171 056	17.56
Barue	81 002	8.31
Gondola	184 629	18.95
Guro	45 680	4.69
Machaze	75 804	7.78
Macossa	13 969	1.43
Manica	155 731	15.98
Mossurize	122 244	12.55
Sussundenga	92 622	9.51
Tambara	31 471	3.23
Total	974 208	100

Source: INE, 1999.

FIGURE 2.16 Number of Households in Manica Province

Area	Households	People per Household
Sussendenga District	20 000	4.8
Gondola District	40 000	4.6
Manica District	32 000	4.9
Chimoio City	34 000	5.0
Other Districts	77 000	4.8
TOTAL Manica Province	203 000	4.8

Source: National Institute of Statistics (INE) quoted in Technoserve, ICC and Rutec, 2001: 10

In relation to households, the nearby districts present the following scenarios:

- Gondola has a total of 39 398 households, with an average number of 4.6 members each: Of these, 3 636 are married by civil register; 26 679 are married by marital union; 2 328 are separated or divorced; 4 175 are widowed; and 2 361 are single (unmarried). Among all households, 5 487 are mono-parental (of which 725 are headed by males and 4 762 are headed by females), 16 972 are constituted by couples, and 12 960 households live with other parents (INE, 1999).
- Manica has a total of 31 982 households, with an average number of 4.7 members each. Of these, 4 287 are married by civil register; 20 004 are married by marital union; 1 902 are separated or divorced; 3 542 are widowed; and 2 088 are single (unmarried). Among all households, 3 785 are mono-parental (of which 659 are headed by males and 3 126 by females), 14 045 are constituted by couples, and 11 091 households live with other parents (INE, 1999).
- Sussundenga has a total of 19 182 households, with an average number of 4.7 members each. Of these, 4 287 are married by civil register; 20 004 are married by marital union; 1 902 are separated or divorced; 3 542 are widowed; and 2 088 are single (unmarried). Among all households, 3 325 are mono-parental (of which 402 are headed by males and 2 923 by females), 7 822 are constituted by couples, and 6 502 households live with other parents (INE, 1999).

This implies that the majority of the population (almost 150 000 people) are resident outside Chimoio and rurally based.

The Average Household Size and Structure

On average, there are 4.8 people per household. Only one person in every 2.1 households is formally employed, according to Technoserve, ICC and Rutec (2001: 10), which leaves approximately 105 945 households without a member deriving a formal income. Figure 2.17 indicates income levels of economically active people in Manica province.

FIGURE 2.17 Income Levels of Economically Active People in Manica Province

	Monthly Income	Total Formally Employed	Percentage Formally Employed	Total Monthly Income
High	$500 to $1 500	1 049	1.1%	$1 049 000
Middle	$100 to $200	12 094	12.6%	$1 814 100
Low	$20 to $30	82 822	86.3%	$2 070 550
		95 965	100%	$4 933 650

Source: Technoserve, ICC and Rutec study, 2001: 14

Within the district of Chimoio there are 33 022 households. Of these, 5 329 are married by civil register; 20 392 are married by marital union; 1 728 are separated or divorced; 2 523 are widowed; and 2 864 are single (unmarried). Among all households, 3 070 are mono-parental (of which 598 are headed by males and 2 472 by females), 12 999 are constituted by couples, and 14 123 households live with other parents (INE, 1999).

In the mono-parental households, one of the pair is out working as a migrant in Zimbabwe or in other towns of the country. In general, many households are constituted by a couple, sons and, in some cases, other parents such as father, mother, young brothers- or sisters-in-law.

Main Sources of Income per Average Household

Agriculture is the main source of income as Mozambique is largely an agrarian economy: about one-third of GDP is derived from agriculture. This sector employs about four-fifths of the population and generates a large proportion of export earnings. The 105 945 households without a formal source of income rely largely on subsistence farming and retail sales, with an average income of US$25 per month. The average income for subsistence farmers is indicated to be US$13 per month. With inflation, this is currently about US$16 per month.

Other sources of income are the sale of extracts from the natural resource base (e.g. bush meats, indigenous medicines and thatching grass) and a wide range of other commodities available within the informal economy.

Although some people from the district go to formal work in the central business district (CBD) downtown, such as offices of governmental and non-governmental organisations, banks, shops, hotels and rest-houses, and other institutions (private and public enterprises), a large proportion of the population depends of agriculture activities and informal business.

Many households have farms in peri-urban and rural areas, where they cultivate maize, vegetables, citrus and bananas. Part of production is destined for home consumption, and the rest is sold in the city's bazaar. The people involved in these activities are mainly female.

The informal business is carried on outside bazaars and in the crossroads. Products sold in this way include clothes, food products, school materials, detergents and hygienic products, which are bought in Zimbabwe. The people involved in these activities are mainly young males, although there are some females as well. In rural areas most households rear livestock, chickens and goats for subsistence but few sell them for income.

The summary of distribution of population is given in the table below, which compares the economically active population (EAP) in agriculture to the total EAP.

FIGURE 2.18 Distribution of Economically Active Population in Manica Province

Province and Districts	Total EAP in 1997	Agriculture EAP in 1997	Agriculture EAP as a Percentage of Total EAP, 1997
MANICA	405 106	257 729	63.62
Chimoio	48 537	11 147	22.97
Barue	39 844	28 063	70.43
Gondola	70 783	44 510	62.88
Guro	20 199	17 398	86.13
Machaze	39 015	30 734	78.78
Macossa	5 888	4 870	82.71
Manica	62 352	33 701	54.05
Mossurize	57 365	38 274	66.72
Sussundenga	43 936	33 660	76.61
Tambara	17 187	15 372	89.44

Source: National Early Warning System for Food Security, Crop and Monitoring Unity, FAO – GCPS/MOZ/060/EC, 2000

Figure 2.19, which describes total households compared to peasant households, confirms that most people depend on agriculture-based livelihood strategies outside the formal economy.

FIGURE 2.19 Percentage Distribution of Peasant Household in Manica Province

Province and Districts	Total Households 31/12/99	Peasant Households Total	Peasant Households Percentage
MANICA	239 439	141 538	59.11
Chimoio	46 346	10 644	22.97
Barue	16 813	11 842	70.43
Gondola	46 198	29 050	62.68
Guro	11 280	9 716	86.13
Machaze	15 062	11 865	78.77
Macossa	2 273	1 880	82.71
Manica	41 630	22 501	54.04
Mossurize	29 148	19 447	66.72
Sussundenga	22 259	17 053	76.61
Tambara	8 429	7 539	89.44

Some households depend only on wages, others depend only on informal business; but many households gain their income by distributing parallel tasks for each member. Many people derive their income from frequent trips to the Zimbabwean border to sell their produce, as well as to buy what they need. Other sources of income include the making and selling of alcoholic beverages in homes and at drink-stands.

Main Expenditure Patterns in Manica Province

The expenditure patterns of low-income earners, who account for 86.3% of the residents of Manica province, can be seen in figure 2.20 below. The breakdown is important in helping to determine prominent sectors that could be targeted for economic development, possibly through a micro-finance scheme. Low-income households do not purchase a diverse range of products, limiting local business development. However, since the end of the war more people are generating incomes in the middle and high-income groups.

The low-income household's main food base is cereal, such as maize and sorghum – now being produced locally in greater quantities – and rice, which is produced outside the district. Most products sold in the city of Chimoio come from Zimbabwe in packages or sacks, although a few, such as vegetables, come from other Mozambican districts. Some crops are grown in the district's peri-urban and rural areas, such as cereals (maize, sorghum), cassava, sweet potatoes and vegetables. Fruit is produced and distributed in the district by Citrinos de Manica, a specialist enterprise. Some householders produce enough to satisfy their food needs, but not enough to earn an income to pay for school fees, toiletries, medical bills, etc.

A baseline survey by Chivizhe (1995) determined income levels and expenditure patterns of people residing in Manica province. A summary of the expenditure patterns of 37 respondents is shown in the following table:

FIGURE 2.20 Expenditure Patterns of Low-Income Households in Manica Province

Expenditure Item	Average Annual Expenditure: Meticais	Average Annual Expenditure: US$	Average Monthly Expenditure: US$	No. of Low-Income Households	Annual Expenditure per item: US$	% Annual Expenditure per item
Maize Milling	155 270	9.70	0.81	172 869	139 799	5.91
Maize Meal	189 243	11.83	0.99	172 869	170 387	7.21
Fares	196 703	12.29	1.02	172 869	177 103	7.49
Hospital	69 162	4.32	0.36	172 869	62 271	2.63
School Fees	171 595	10.72	0.89	172 869	155 035	6.56
Social Contribution	62 459	3.90	0.33	172 869	56 236	2.38
Entertainment	227 324	14.21	1.18	172 869	204 673	8.66
Meat/Fish	220 892	13.81	1.15	172 869	198 882	8.41
Cooking Oil	324 000	20.25	1.69	172 869	291 716	12.34
Salt	32 270	2.02	0.17	172 869	29 055	1.23
Clothing	259 649	16.23	1.35	172 869	233 777	9.89
Soap	91 568	5.72	0.48	172 869	82 444	3.49
Contract Ploughing	36 811	2.30	0.19	172 869	33 143	1.40
Sugar	76 865	4.80	0.40	172 869	69 206	2.93
Weeding	12 703	0.79	0.07	172 869	11 437	0.48
Toiletries	151 568	9.47	0.79	172 869	136 465	5.77
Dipping	1 270	0.08	0.01	172 869	1 14	0.001
Groceries	335 108	20.94	1.75	172 869	301 717	12.76
Transport	6 389	0.40	0.03	172 869	5 752	0.24
Fuel	5 676	0.35	0.03	172 869	5 110	0.22
Seed	402	0.03	0.00	172 869	365	0.02
Total Annual Expenditure	2 626 927	164.16	13.69	172 869	2 364 574	100.00

Source: Chivizhe (1995), quoted in Technoserve, ICC and Rutec study, 2001: 14

Implications of these figures for micro-finance are that if people were to borrow money they would likely use it for consumer expenditure, as there is no spending on capital goods per household.

Main Financial Needs of the Average Household

The expenditure patterns tabled above indicate that the main financial needs per low-income household pertain largely to consumer needs. The largest annual expenditure was for groceries (12.76% overall), closely followed by cooking oil (12.34%). Expenditure on clothing was the third highest (9.89%), followed by entertainment

(8.66%), and meat and fish, which are the dominant source of protein, at 8.41%. Thus it is evident that the greatest expenditure was on the basic commodities of food and clothing. Second-hand clothing is readily available in Manica province – a trade that according to Technoserve, ICC and Rutec (2001: 21), has contributed to the bankruptcy of the local textile industry, although competition from the South African textile market, which has challenged Zimbabwe domination of the sector, has also played a role.

An additional 7.21% was spent on maize meal, which is the staple of the average household, while 5.91% was spent on maize milling. Transport fares and school fees constituted 7.49% and 6.58%, respectively.

Overall, a very small percentage was used on obvious income-generating activities. These included contracts ploughing (1.40%), weeding (0.48%), dipping at 0.001% and seed at 0.02%. Overall, these agricultural activities constituted just under 2% of annual expenditure.

Products such as household chemicals, canned and other processed foods, are usually smuggled in from Zimbabwe, and are therefore unlikely to appear in a household's expenditure pattern.

Main Economic Activities of the Average Household

From an analysis of the financial needs of the average household in Manica and from the historical and political context, it is clear that most families utilize what can be termed a multiple livelihood strategy.

People survive by building on a range of "capitals": natural capital, such as the resource base, in particular land and water; human capital, such as education, skills and health; social capital, such as social networks and organizations; physical capital, such as farm equipment and shelter; and financial capital, such as income, credit, claims, savings and cattle. These assets constitute the capital base of a livelihood and determine its robustness or vulnerability. Poverty is strongly associated with a lack of assets or the inability to put assets to productive use.

It is clear that the informal sector is extremely important in Chimoio. The formal sector is practically non-existent in Sussundenga, Gondola and Manica. Agriculture and animal husbandry are vital components of the multiple livelihood strategy in Chimoio, although it should be emphasized that this alone is increasingly unable to provide sufficient means of survival in rural areas of low-income countries. Employment or agriculture should be considered as components of a livelihood, which draws upon a range of formal and informal activities and income sources. Agricultural production in Manica province is, as already emphasized, largely subsistence in nature. Agriculture does, however, have the potential to become a more significant component of livelihood strategies, given the soils, climate and abundance of arable land in the area.

It is interesting to note that, broadly speaking, the issue of land as an asset for the improvement of a rural livelihood does not occupy a prominent position in poverty alleviation planning and processes. The general view is that rich areas of arable land are available in abundance and that farm sizes and productivity have remained low as a result of other constraining factors. In fact, the latest draft of the Plan for the Reduction of Absolute Poverty for Mozambique 2001–2005 (PARPA) expresses this very well: "Land is not, therefore, a limiting factor for poor peasants, but rather their capacity (and therefore means of production) to work the land they have in order to achieve acceptable levels of productivity." (Norfolk & Liversage, 2001)

The various components of the multiple livelihood strategy will be discussed in more detail in the section dealing with economic activities in Chimoio.

2.2.3 Physical/Institutional Infrastructure

This section will outline the physical and institutional infrastructure of Chimoio, including towns, transport, education, medical services, power, water, authority structures, and social groups/associations.

Major Institutions: Formal

Apart from national, provincial and local government, another vital realm of governance exists in rural Mozambique: traditional authorities. These have a very important role in the decision-making process and considerable influence in the area.

Many non-governmental organizations (NGOs) and development agencies work directly with either local communities or entrepreneurs in the different districts of Manica province. There are currently five NGOs offering micro-finance opportunities for people in Chimoio:

- Small Industry Foment Fund
- Concern Manica
- UCAMA
- Kwaedza Simukai Association
- CRESCE

Major Institutions: Informal

Traditional financial systems exist in Chimoio. This entails a number of people deciding to form a group and collect cash periodically. Each time money is collected, it goes to one of the members. No interest rate is included in this system and the only condition is to make sure that each member's contribution is available at the end of each period.

Traditional forms of community control exist in the rural areas surrounding Chimoio, exemplified by traditional tenure arrangements. These traditional institutions have particular implications for the social status of women and for land ownership in Chimoio.

Within traditional communities around Chimoio, the majority of producers are men, assisted by women. Women have limited social status in the community. Only a few households are headed by women because the cultural system does not provide for it. Even if women produce and sell products, the man takes responsibility for deciding how the income is spent.

No one owns land in Mozambique as all land belongs to the government.

- Commercial farmers lease land from the government.
- Subsistence farming is practised in the villages.
- There is a shortage of agricultural land in and around the towns owing to the migration of people to towns as a result of the war.

Infrastructure

The civil war had a significant influence on the settlement patterns of Chimoio:

- The town has three sections, the Central Business District (CBD), a residential area consisting mostly of old colonial houses surrounding the CBD, and a dense village-type settlement on the outskirts of town.
- Some people reside in small villages next to the major roads along the Beira Corridor.
- 25% of the people reside in rural areas, predominantly small villages. These villages are isolated from the economic mainstream.
- Poverty increases in relation to distance from the CBD. The most prosperous people reside in the residential areas surrounding the CBD, followed by poor households in the villages neighbouring the residential areas. The poorest people live in the rural areas.

- Economic activities in the form of informal market places developed in the dense village-type settlements.

The local infrastructure is suitable for the services required for the life of a town, although some economic services are only found in Beira. Other services, such as supplies, are procured in Mutare, Zimbabwe.

Roads are largely urban based although the transport industry may provide growth opportunities for lodging and restaurants along the main corridor. The road network is good and construction activities for housing are a growing trend.

Transport

There are three types of transport: road transport (for passengers and cargo), railways and air transport. The road network links the north and south of the country. Chimoio is the transit centre for transport coming from the north and south and from/to Zimbabwe and Beira. The railways carry cargo from Zimbabwe to the port at Beira and vice-versa. Air transportation is based on charter system.

Education Network

The education network is generally regarded as good. Besides the general education, there are facilities for technical and professional education.

2.2.4 Economic Activities

The following section will elaborate on economic activity in Manica province and Chimoio in particular. This includes turnover, employment, wages, growth patterns and constraints in the formal sector, as well as occupations, turnover, incomes, employment, growth patterns and constraints in the informal sector.

The Main Economic Activities of Chimoio

The main economic activities are agriculture, industry and trade. The Beira corridor connects Zimbabwe and the Indian Ocean through Chimoio. Economic activity comprises largely the movement of goods and people, and holds great potential for future growth.

Agriculture

The most frequently cultivated crops are vegetables and fruits such as banana, citrus, litchis, mangoes and papayas. Animal production is predominantly poultry and cattle. Forestry also offers potential as an agriculturally based opportunity.

Agriculture is largely rural based with some peri-urban activity. This implies that the major economic activity in the rural areas is agriculture, largely subsistence for the majority of the population, with some employment on commercial farms.

Tourism

This sector is underdeveloped and local resources are scarce. The conditions for the development of tourism are very good, especially for nature lovers, the appreciation of traditional cultures, etc. Accommodation facilities are very poor in Chimoio.

Trade

There is substantial competition between the formal and informal sectors. The informal sector is considered to be avoiding paying taxes on its trading activities, while smuggling products in from neighbouring countries such as Zimbabwe, without paying import duties.

Industry

Industry, which revolves mainly around agro-processing, is stagnant. Existing processing plants for fruit, juices, canned goods and others are not currently operational. The only plants operating are those of the dairy industry and alcoholic beverages, based on local fruits. Maize mills and oil processing units operate on a very small scale. There is a timber industry with some sawmills and carpentry plants for furniture production. The textile industry is not operational, partly owing to the availability of imported second-hand clothes. Other industrial sectors include brewing, steel works and tobacco.

Market segments

The various market segments in Manica include:

- fresh fruit and fruit processing
- juice and jam production
- alcohol
- fresh horticultural commodities
- canned or dried horticultural foods
- processing labour-intensive cash crops, e.g. tobacco, cotton
- processing labour-intensive food crops, e.g. maize, wheat; sunflower oil
- dairy product processing
- beef production

- carpentry and timber construction products
- fisheries
- tourism
- manufacturing
- commercialization and retail development

Formal market

FIGURE 2.21 Economic Activities in Formal Business

	Chimoio	Gondola	Manica	Sussendenga	Total
Retail sales	105	16	32	8	161
Wholesale	21	0	0	0	21
Textiles	2	0	1	0	3
Shoe sales	1	0	1	0	2
Brewing	3	0	1	0	4
Steel works	1	0	0	0	1
Tobacco industry	1	0	0	0	1
Wood processing	3	3	0	0	6
Restaurants	21	2	1	1	25
Bars/coffee shops	72	3	19	0	94
Guest houses	8	0	5	0	13
Total					331

Source: Technoserve, ICC and Rutec study: 17

Informal market

The informal markets are important economic centres throughout Manica province. Almost anything required by local residents is available at informal markets. Entrepreneurs at these venues focus on consumables needed by individuals and households. The following businesses are common in the markets.

FIGURE 2.22 Economic Activities in Informal Business

Clothing supply	Tailoring	Shoe repair	Shoe sales	Cosmetic sales	Hardware sales	Bicycle repairs
Seed/feed supply	Furniture manufacture	Furniture sales	Fruit sales	Vegetable sales	Maize sales	Rice sales
Broiler sales	Household chemicals	Fish drying	Fish sales	Bread baking	Basic farming equipment	Hairdressing
Hair cutting	Cooking oil sales	Plastic wares	Soap	Bean sales	Egg supply	Groceries

Source: Technoserve, ICC and Rutec study, 2001: 18

Other Information Regarding the Economic Profile in the Manica Province

- According to a study conducted by Technoserve (2000), local business people do not understand economic development principles. During a meeting in Chimoio, it was clear that they want the freedom to import more products. By participating in value-added production activities for raw materials available locally, one would create an "inflow" of capital to the region through the sale of these commodities. Importing or smuggling products creates a cash "outflow", does not create jobs and is generally destructive to the economy (Technoserve, ICC and Rutec study, 2001: 18).

- The import duty on raw materials is 2.5% and on processed products 7.5%. This small difference does not necessary encourage local processing. One cannot say with certainty that if raw materials were imported local producers would be able to produce and still compete with the mass producers elsewhere regardless of the reduced duties. It would depend on the nature of the product. Further research is required regarding raw material import for production purposes (Technoserve, ICC and Rutec study, 2001: 18).

2.2.5 Main Implications for Micro-Finance

- While economic performance has improved substantially for the country as a whole over the past decade, the benefits have been confined largely to urban areas and even there to a relatively small part of the population. Widening income inequality increases the potential for political instability. Interventions, such as improving access to financial services are extremely important to broaden the spread of benefits to rural areas and to lower income people.

- Farming is still by far the most important source of income for most households. While the district has great potential to export agricultural produce, reliance on local markets has increased with the damage to roads caused by the 1999/2000 floods.

- A number of key formal sector industries – in textile and clothing manufacture, tanning and food processing (jam, fruit juice, dairy products) – have closed in recent years as a result of external competition, increasing reliance on agriculture and informal sector activities.

- There is a thriving informal sector, but it is based rather narrowly on retail trade in consumption goods, agro-processing and services, such as repairs and hairdressing.

- Very few small enterprises – almost none in the informal sector – have access to micro-credit. Though the multiple constraints on the growth of economic activity –

poor infrastructure, lack of business skills, lack of institutional support – indicate that micro-finance interventions alone will only have a limited positive impact, they are nevertheless important. What is needed is an integrated programme of interventions, in which improved access to finance through micro-credit for “unbankable” small entrepreneurs/households is a key component.

- The rapid increase in the incidence of HIV/AIDS will also increase the need for access to micro-finance (both credit and savings) to help care-giving households maintain income streams and reduce the pressure to sell assets. However, it will also raise the risk of default, as well as the number of households beyond the ambit of sustainable micro-credit.
- Most households continue to use formal sector savings facilities. Given the distance and the cost of transport, there is an urgent need for improved informal sector savings alternatives.

2.3 NYANDENI AND PORT ST JOHNS MUNICIPALITIES IN THE EASTERN CAPE, SOUTH AFRICA

2.3.1 Geographic, Historical and Political Context

Geographic Context

The Nyandeni Municipality is made up of two magisterial districts, namely, Libode and Ngqeleni, which form part of the Oliver Tambo District Council. Nyandeni Municipality has 97 administrative wards, made up of about 295 rural villages as follows:

Libode:	142 villages
Ngqeleni:	222 villages

Port St Johns, unlike the Libode and Ngqeleni magisterial districts, has municipality status and forms part of the Oliver Tambo District Council. Port St Johns has 95 villages. The villages are grouped into traditional authorities and administration areas under the administration of chiefs or headmen. Port St Johns forms part of the Wild Coast Spatial Development Initiative (SDI), which has a 280km-long coast lying parallel to and 80-100km from the N2 highway that provides the north-south linkages (CIET international, 1998).

The entire Nyandeni and Port St Johns region falls into the summer rainfall area of the Eastern Cape. Precipitation is characterized by sharp, heavy showers. However, micro-climatic conditions vary significantly, with Port St Johns receiving much higher summer rainfalls than Nyandeni. As Port St Johns is on the north-eastern coast of the

Eastern Cape, it has warm to hot summers whereas winters remain mild with warm temperatures. Frost does not occur. Nyandeni, which is inland, has a much drier micro-climate, with lower summer rainfalls. Winter temperatures can drop to freezing point and frost occurs regularly in the winter months.

Agricultural productivity in this area is below average although the land is naturally fertile. The Nyandeni region is susceptible to drought. Irrigation farming offers the best opportunity for increasing productivity on the farms and for diversifying crop production to include high-value crops such as vegetables. Farming activities offer great economic potential in Libode, where the land is fertile and there is much arable land that can still be developed.

Historical context

The Nyandeni and Port St Johns municipalities form a core part of the former homeland of the Transkei, which was one of the ten homelands created by the previous South African government. It was the first to accept independence. The area's economic history is one of underdevelopment within the context of homeland development under apartheid ideology. Nyandeni is one of the most underdeveloped poverty-stricken districts in the former homeland of the Transkei.

The socio-economic background of the Nyandeni district cannot be understood without insight into the way in which it was developed and into the community's relationship to the wider South African society. During the period 1850-1950, the last African chiefdoms were brought under European control, while the discovery of gold in the 1880s started a process of rapid South African industrialization. For black people, this meant the breakdown of traditional, social, economic and political structures, as well as the introduction of migrant labour system. The appointment of a governor general in the Cape also undermined traditional chieftainship.

Political Context

The relative economic, infrastructural and administrative poverty of Nyandeni's rural communities reflects its position of political and economic dependence in the Eastern Cape. Its people were unable to influence the political machinery of either their tribal authorities or that of the magisterial districts, and unable to establish independence. They had little control over the conditions of their everyday life and subsistence. The tribal authorities to whom they looked for services and assistance were themselves dependent upon the Transkei government for part of their budget, as well as for much of their administrative capacity.

2.3.2 Demographic Context: Population and Households

The number of households headed by females is almost equal to the number of male-headed households. On average, the age of the head is 51 years. The majority (88%) of the heads of households were born in the area and have both primary and secondary (38%) schooling. The majority of female heads of households are widows.

The total population of the Nyandeni region is 284 081. Ngqeleni is the most densely populated area with 152 303 people, while Libode has 131 778. The total population in Port St. Johns is 142 753.

FIGURE 2.23 Population Distribution

Race Group	Libode and Ngqeleni	Port St. Johns
African	282 080	141 333
Coloured	515	525
Indian	67	42
White	41	137
Other	1378	716

FIGURE 2.24 Total Population of the Oliver Tambo District Municipality

King Sabata Dalindyebo	379 928
Nyandeni	284 081
Port St. Johns	142 753
Mhlontlo	190 275
Ntabankulu	109 018
Ingquza	243 026
Mbizana	228 375
Total	1 150 622

Source: Map by AFRICON 2001

FIGURE 2.25 Total Population by Race and Gender: Nyandeni and Port St Johns

Racial Groups	Nyandeni Libode	Nyandeni Ngqeleni	Totals: Nyandeni	% Total Population: Nyandeni	Totals: Port St Johns	% Total Population: Port St Johns
African						
Male	59 762	69 324	129 086	43.88	64 384	45.20
Female	71 145	81 922	163 067	55.43	76 975	54.04
Coloured						
Male	71	184	255	0.09	295	0.21
Female	90	186	276	0.09	393	0.28

Figure 3.6 *continued*

Racial Groups	Nyandeni Libode	Ngqeleni	Totals: Nyandeni	% Total Population: Nyandeni	Totals: Port St Johns	% Total Population: Port St Johns
Indian/Asian						
Male	7	7	14	0.00	15	0.01
Female	20	12	32	0.01	10	0.01
White						
Male	7	8	15	0.01	74	0.05
Female	7	5	12	0.00	41	0.03
Unspecified						
Male	320	329	649	0.22	130	0.09
Female	346	329	775	0.26	124	0.09
Total						
Male	60 167	69 852	130 019	46.00	64 898	45.56
Female	71 608	82 454	154 062	54.23	77 543	54.43

Source: ACAT (Eastern Cape)

FIGURE 2.26 Total Population by Age Group: Nyandeni and Port St Johns

Age Group	Nyandeni Libode	Ngqeleni	Totals by Age Group: Nyandeni	% Total Population: Nyandeni	Totals by Age Group: Port St Johns	% of Total Population: Port St Johns
00–4 yrs	21 045	25 120	46 165	16	11 494	17
05–9 yrs	21 105	25 447	46 552	16	11 637	17
10–14 yrs	19 624	23 322	42 946	15	10 419	15
15–19 yrs	15 941	18 232	34 173	12	7 570	11
20–24 yrs	10 860	12 311	23 171	8	4 854	7
25–29 yrs	7 107	7 752	14 856	5	3 428	5
30–34 yrs	6 419	6 567	12 986	5	3 176	5
35–39 yrs	5 441	6 074	11 515	4	3 012	4
40–44 yrs	4 179	4 521	8 700	3	2 102	3
45–49 yrs	3 462	3 581	7 043	2	1 855	3
50–54 yrs	2 862	2 929	5 791	2	1 338	2
55–59 yrs	3 169	3 837	7 006	2	1 848	3
60–64 yrs	3 200	4 237	7 437	3	1 605	2
65–69 yrs	2 802	3 650	6 452	2	1 618	2
70–74 yrs	1 545	1 806	3 351	1	735	1
75–79 yrs	1 240	1 361	2 601	1	696	1
80–84 yrs	540	501	1041	0	226	0
85 or more	404	405	809	0	156	0
Unspecified	830	653	1483	1	336	0

Source: ACAT (Eastern Cape)

Labour Force Size and Structure

The major characteristics of the labour force in Nyandeni and Port St Johns are that it very large in the age groups of 20-50 years, but much smaller in the age group of more than 50 years. Illiteracy levels are very high in this age group – an estimated 65%. Labour-intensive programmes would be recommended for this type of labour force.

FIGURE 2.27 Structure and Size of Labour Force in Nyandeni and Port St Johns

Age-Groups	Nyandeni Libode	Nyandeni Ngqeleni	Total Labour by Age Group	% Labour to Total Population	Port St Johns	% Labour to Total Population
20–24 yrs	1 0860	12 311	23 171	8	4 854	7
25–29 yrs	7 107	7 752	14 856	5	3 428	5
30–34 yrs	6 419	6 567	12 986	5	3 176	5
35–39 yrs	5 441	6 074	11 515	4	3 012	4
40–44 yrs	4 179	4 521	8 700	3	2 102	3
45–49 yrs	3462	3 581	7 043	2	1 855	3
50–54 yrs	2 862	2 929	5 791	2	1 338	2
55–59 yrs	3169	3 837	7 006	2	1 848	3

Employment and Wages

Unemployment is very high in Ngqeleni and Libode areas and there are no formal sector industries. Lack of agro-industries in the region is a major limitation to job opportunities. The informal sector provides an alternative source of income for some, usually as hawkers. Hawking is carried out in both open spaces and from shelters like old caravans and other small purpose-built shelters.

FIGURE 2.28 Employment Status

Category	Libode and Ngqeleni	Port St Johns
Not Applicable	796	–
Under 15 yrs	126 832	–
Unspecified	148	–
Unemployed	28 596	16 992
Employed	12 791	5 019

Source: Personal interviews with municipalities (based on the 1996 census)

Characteristics of Household Income

Major sources of household income are old-age pensions and other social benefits, such as disability or child maintenance grants, as well as remittances from family members working outside Nyandeni and Port St Johns areas, although many of these people have been laid off and the situation has been deteriorating steadily since early 1980s. Income is also derived from agricultural activities and many different informal sector survival strategies.

FIGURE 2.29 Annual Household Income

Income Range	Libode and Ngqeleni	Port St Johns
None	14 902	10 132
Under R18 000	28 978	13 375
R18 000–R72000	3 720	1 771
R7 200–R132 000	555	274
Over R132 000	293	121
Not Applicable	10	5
Unspecified	2 051	1 054

Source: Personal interviews with municipalities (based on the 1996 census)

2.3.3 Physical/Institutional Infrastructure

Power and Waters Services

Villages that are closer to towns at Ngqeleni and Libode have electricity, whereas those far from town still do not have electricity. Villages purchase electricity directly from Eskom through local agencies, while those closer to town purchase electricity from the municipal offices.

FIGURE 2.30 Sources of Power/Electricity

Source	Libode and Ngqeleni	Port St Johns
Electricity = Municipality	2 112	1 060
Electricity = Eskom	242	137
Gas	239	139
Paraffin and Firewood	17 770	8 384
Candles and Firewood	29 484	16 680
Other	1	332
Firewood	661	–

Source: Personal interview with municipalities (based on the 1996 census)

FIGURE 2.31 Sources of Water

Source	Libode and Ngqeleni	Port St Johns
Unspecified	587	225
Other	131	75
Natural Sources	40 163	23 668
Borehole	1 218	652
Tanker	640	288
Public Tap	6 917	1048
Onsite	404	455
Dwelling	449	301

Source: Personal interview with municipalities (based on the 1996 census)

Less than 30% of rural villages in Nyandeni and Port St Johns have been reached by the government water delivery programmes. A large number of villages still depend on traditional sources of water supply.

FIGURE 2.32 Sanitation

Type of Facility	Libode and Ngqeleni	Port St Johns
Unspecified	568	210
None	27 926	19 489
Bucket Latrine	458	118
Pit Latrine	21 313	6 207
Flush Toilet	244	708

Source: Personal interview with municipalities (based on the 1996 census)

Access to Telephones

FIGURE 2.33 Number of People with Access to Telephones

Access	Libode and Ngqeleni	Port St Johns
None	41 229	21 457
Other	3 079	2 567
Public phone	6 017	2 387
Dwelling	184	141

Source: Personal interview with municipalities (based on the 1996 census)

Education and Medical Services

There are two schools in the town of Ngqeleni: a secondary school (from Grade 1 to Grade 9) and a high school (Grade 10 to 12). Ngqeleni does not have a hospital of and only mobile clinic at certain days of week is available to the communities.

Transport

The only railway line ends at Umtata and does not pass through the area. The whole region depends on road transport. The road linking Ngqeleni, Libode, Port St Johns and Umtata is tarred. Transport from Umtata to Ngqeleni, Libode and Port St Johns towns, and to villages along the main road, is mainly by taxis (Kombis) and buses. The buses also serve the rural communities of the three towns. However, taxis are more frequent. The buses mostly travel in the early morning, at lunchtime and in the evening. Transport from the town to the villages is mainly by pick-up vehicles (bakkies) with canopies, which can handle the rough roads typical of the rural areas. Transport infrastructure is in poor state, with rural roads not maintained at all.

2.3.4 Economic Activities

Economic Activities in Nyandeni and Port St Johns

Economic activities in this region depend to a large extent on land resources. As a result, major economic activities in Nyandeni and Port St Johns are land-based economic activities. There are no formal sector industries in this region and industries based on rural land resources are almost non-existent. The only employment opportunities are in teaching, nursing, the police and the administrative services of various government departments.

Major economic activities are based on rural peasant, subsistence, small-scale farming. Small-scale farmers or farming households consist of heterogeneous groups, many of them “non-farming” types who do not look beyond the borders of their family farms to sell their produce, probably due to a lack of farming capacity. In essence, they are involved in subsistence farming on a micro-scale.

These households practice crop farming in the homestead (household gardening), producing for subsistence purposes. Constraints on crop production are mainly diseases, as well as other factors such as the need for irrigation water, lack of fencing, unavailability of productive land, lack of capital, etc. Livestock ownership per household is low – on average, fewer than three sheep, cows or goats. Animals and animal products are not marketed. The households do not have any formal reliable source of income. Reliable sources of income are various types of state welfare grant. However, they spend on average R250 per year on agriculture and R2 253 per year on foodstuffs. Their expenditure on food ranges from R240 to R5 700 per year. As expected, they have no savings. Moreover, food is in short supply in these households all year round.

The majority of households in both Nyandeni and Port St Johns are headed by women – over 90% of them widows, as single women are rarely accorded such status. Female heads of households are in the majority especially within the age group of 55 to 81 years. This is attributed to the high death rate of male heads of households in this age group.

There are distinct socio-economic advantages (and in some instance political advantages) in male-headed households compared to those headed by females. Male-headed households have a wider range of options for income generation, while female-headed households tend to rely on a limited number of livelihood strategies. While more than 55% of female-headed households have access to arable land, evidence indicates that they have limited capital to invest in agriculture and, in some instances, limited capacity to mobilize female labour for agriculture. They grow crops in their home gardens or on an arable piece of land, with low yield and insignificant market activities. They keep fewer livestock, plough small amounts of land and generate very little income from agricultural activities.

On average, female-headed households own fewer than three cattle and fewer than five each of small stock, i.e. goats and sheep. Almost all of these are kept for household consumption and only on very rare occasions are sold for cash to pay for school fees, school uniforms and other family cash needs.

While it is extremely difficult to be precise regarding the total income from peasant agricultural farming because some of the produce is consumed immediately before it is even quantified, most female heads of households estimated the total annual income from agriculture to be less than 2% of total annual household income. Taking into account all other sources of income – including contributions from state welfare grants, pension funds, remittances and other external activities – the average yearly income for female-headed households is R7 488. Almost 85% of total income is spent on basic household consumption needs and they experience money/food supply shortages almost throughout the year.

The majority of male-headed households have external sources of income. In most of them, the husband or children work outside the community (usually in mines) and send remittances every month to the household. The average age of male heads of households is 48 years and the number of male-headed households steadily decreases in the age group over 55 years, where female-headed households dominate.

On average, male-headed households own five heads of cattle and more than five each of the small stock. However, cattle and small stock are sold only in times of crisis, when it is usually difficult to negotiate a favourable price and the seller accepts whatever is offered.

Agricultural income for male-headed households in Nyandeni and Port St Johns contributes 5% of the total annual household income. This is party because male-headed households are able to invest more in agriculture and raise more family labour, and they have a wider range of options in cases of crisis, such as drought or livestock diseases.

While these socio-economic differences between female and male-headed households may appear insignificant, in real financial terms they indicate the depth of poverty in this region. The average total annual income from all activities for male-headed households in Nyandeni and Port St Johns is R18 000.00. The difference is largely because most male-headed households have a wage earner whereas female-headed households do not have access to any wage income. However, very little of this income for male-headed households is translated into investment in agriculture or other income generating activities.

Although male-headed households are able to invest more in agriculture than female-headed households, evidence suggests that agriculture is not a priority activity in Nyandeni and Port St Johns. The majority of the households do not market their livestock and there are major constraints limiting livestock production, especially diseases (e.g. tick-borne diseases).

2.3.5 Main Implications for Micro-Finance

- In common with Chimanimani and Chimoio, farming still predominates as an economic activity, despite the uZoneseliable rainfall. But, in contrast with the other two pilot sites, while farming takes up a large percentage of labour time, it accounts for a significant proportion of household income in only a minority of cases. A recent report concludes that “full-time farming does not seem to be the objective of most households (who) aim at diversifying their sources of income. Today’s diversity represents the background for tomorrow’s diversity and development programmes … should take this into account.” (Peret, S *et al.* , p32).
- While social security payments make up an important part of many households’ income, active steps towards diversification have traditionally involved temporary migration by household members to find wage employment. With the steady decline

in the number of formal sector jobs in recent years, the importance of employment/self-employment in the local informal economy, though still small, has begun to grow and, with it, the need for access to micro-finance by micro-enterprises, who are usually seen as "unbankable" by the formal banking sector.

- The data available on the informal sector suggests the presence of a wide range of micro-level agricultural, agro-processing, manufacturing and service activities, almost all of which – including the most popular agricultural line, poultry production – have cash flow patterns compatible with most micro-credit schemes.
- Though the number and intensity of constraints on local economic development are not as great as in Chimanimani and Chimoio, poor physical and institutional infrastructure and lack of business skills will still limit the capacity of micro-finance alone to reduce poverty. For maximum impact, micro-finance initiatives need to be complemented by programmes to deal with these other constraints.
- Though little information on local household expenditure patterns has yet been obtained, it can be expected that almost all spending will be for consumption. Income, whether from earnings or loans, used for this purpose in effect constitutes a small entrepreneur's/household's working capital.
- The rapid increase in the incidence of HIV/AIDS will increase the need for access to micro-finance (again both credit and savings) to help care-giving households maintain income streams and reduce the pressure to sell assets. However, this will also raise the risk of default, as well as the number of households beyond the ambit of sustainable micro-credit.
- Most households continue to use formal sector savings facilities. Given the distance and the cost of transport, there is an urgent need for improved informal sector savings alternatives. In most parts of Southern Africa on average 81% of households are in rural areas which suggests that transaction costs would be high for micro-financers.

3

Access to Financial Services

3.1 ZIMBABWE

In this chapter, the section on Zimbabwe is drawn almost entirely from a recent report by Vulindlela Micro and Development Finance Consultants for ZAMFI that was executed in 2000. Ebony Consulting has adjusted some of the findings marginally and added information from other surveys. Ebony Consulting assessed the work and found it to be of good quality and appropriate to base planning for support of the sector.

The purpose of the survey was to review the micro-finance sector in Zimbabwe in order to streamline initiatives, understand the constraints and assess the financial gap. It is envisaged that this survey would provide the baseline information for a series of annual surveys to follow.

3.1.1 Country Overview: Zimbabwe

The demand for micro-finance services continues to grow as more and more people enter the informal sector to supplement their incomes. At the same time, profit margins are becoming smaller owing to cut-throat competition in the sector, shrinking of consumers' disposable incomes and general increase in input costs.

It is generally agreed that the micro-finance industry is as yet in its infancy in Zimbabwe and therefore delicate. The sector still needs technical and financial support as the numerous micro-finance institutions (MFIs) are young and treading uncharted waters. Although there has been a general increase in the number of suppliers of micro-finance, the real growth in portfolio sizes has been very slow. Against that background, it is sad to note that the level of external financial support has gone down as a result of a shift in policy and priority by national governments represented in Zimbabwe. Rough estimates indicate a financial gap of over Z$3 billion in loan capital to meet the demand of the MSE operators. In order to manage that level of funding, another Z$700 million is required to sustain the operations of the MFIs. It is foolhardy for any investor to push through loan capital and not invest in the human and technical elements of the MFI as this eventually determines the success of the venture.

One major aspect noted during this study was that the government has been positive about the growth of the micro-finance sector, as evidenced by the existence of facilities such as the Social Development Fund on-lending window. At the time of this report, the government has been applauded for making specific mention of micro-finance in the budget, with a provision of Z$200 million. However, it is regrettable that it is not putting maximum priority on co-ordinating the creation of an enabling environment and formulation of a policy framework for the sector.

There is a definite need for concerted efforts among key stakeholders in making micro-finance a success in Zimbabwe. Solid, financially sustainable institutions need to be built to deliver loans in an efficient manner and in large volumes. The challenge for stakeholders in the micro-finance sector, therefore, is to ensure that funds are channelled to MFIs with potential for growth. Such funding should not be restricted to loan capital but extended to institutional building as well. Secondly, by investing in governance development and general human resource development, stakeholders may be able to build a recognized industry. Thirdly, private sector participation should be encouraged to ensure that the sector becomes more market oriented, competitive and professional. Fourthly, the fragmented policy framework needs to be addressed. Stakeholders need to begin reviewing the regulatory environment, investigate options and engage government in a consistent dialogue to resolve the various impediments constraining the industry.

Rural finance in Zimbabwe suffers greatly from the current political situation and the recent restructuring of the AFC into Agribank and the Agricultural Development Fund has not shown any promise in improving the plight of rural entrepreneurs and small farmers.

Constraints to Micro-Finance Development in Zimbabwe

Development of the micro-finance sector in Zimbabwe is constrained in two major ways, i.e. organizationally and environmentally.

- Lack of sufficient funds for training and capacity building: In the MicroStart Project Document[1], areas of support listed for Zimbabwe include capacity building, institutional strengthening and capacity development for micro-finance. There is a realization that before money can be invested in the sector the capacity of the institutions needs to be developed to enable them to manage resources properly. While investors are expecting professional delivery of service, most MFIs can neither attract nor afford professionals. The major constraint to the growth and development of the micro-finance sector is the lack of institutional capacity within existing MFIs. Most are still battling with pertinent issues of human resource management, governance, systems development and financial management (including delinquency management). These are the key issues that make or break MFIs anywhere in the world. Institutional capacity building should be a national programme. The UNDP MicroStart programme was a good initiative, but was withdrawn, being applied for only one year instead of three.
- *Donor demands not consistent with MFI vision:* The ZAMFI sector survey showed that 40% of MFIs considered donor requirements difficult to comply with, noting that their visions were not necessarily the same. Among the constraints are issues of reporting requirements, reporting schedules and strategic focus. With regard to strategic focus, issues to consider include male/female emphasis, as well as urban/rural focus. It is believed that this leads to programmes being donor driven.
- *Lack of private sector investment:* Privately owned MFIs get funded through the sale of shares or by holding companies. There has been little participation by the private sector in funding MFIs with a focus on business loans. Many privately owned MFIs are involved in consumer lending rather than enterprise lending. Once enterprise lending proves successful, many private investments may be channelled in that direction. Some success stories are needed to enable the private sector to appreciate the economic benefits in the sector. These can be championed in a number of ways,

1 Pearson, R. Peters, M. MicroStart Zimbabwe project document, December 1997

such as building an MFI in collaboration with leading technical service providers. Through such collaboration, the technical service providers would mentor the MFI and impact on its management skills. In some cases, resident advisors are co-opted by the MFIs and it is hoped that during this association a lot of capacity building could be done. The MicroStart project in Zimbabwe is but one example of such collaboration.

- *Savings not a legal source of funding:* The majority of MFIs who are not members of SACCOs cannot utilize savings of their clients to on-lend. The "savings" can arise, for example, in the form of collateral deposit. What tends to happen is that the MFI collects these "collateral deposits" and places them with a financial institution until they are returned to the client when he or she repays the loan. Perhaps some linkages with financial institutions could provide a win-win situation between the MFIs, the banks, as well as entrepreneurs.

- *Regulatory framework:* While there is a clearly streamlined policy framework for the formal financial institutions, with different acts governing specific activities, there is no such instrument for the micro-finance sector. However, one wonders what form and nature the micro-finance regulatory framework should take. Given that the industry/sector is still young, there is still a lot of experimentation and shaping up, so enough time should be allowed to ensure that the sector develops with minimum regulatory constraints. Thereafter, the framework may be instituted through a dialogue process. In South Africa the various stakeholders, including the government, agreed to the formation of a self-regulatory body, the Micro Finance Regulatory Council (MFRC)[2]. Countries such as Ghana, Bolivia and Peru are quite advanced as they already have passed laws that promote formation of Private Financial Funds, as well as their regulation. One caution should be added, however. The process is lengthy and highly participatory – anything short of that may result in the creation of a monster that will further constrain the industry. The major regulatory issues that need to be addressed urgently are registration and the interest rate cap.

- *Client mobility:* institutions prefer dealing with clients of fixed abode as security for their investment. The clientele for the micro-finance sector either changes residence within a city or relocates to other places in search of better markets. This causes the

---

2 MFRC comprises the Department of Trade & Industry, Banking Supervision Department of the Reserve Bank, National Housing Finance Company, the Land Bank, the Alliance of Micro Enterprise Development Practitioners and the Micro Lenders Association. The MFRC accredits and ensures protection of consumer rights, as well as discrediting practitioners who may not be complying with the stipulated requirements.

lending institutions to incur huge operational costs as costs for follow-ups and tracing are high.

- *Credit bureau:* With the MFIs increasing in number, a clearing facility to screen defaulters has become imperative. Already a number of MFIs have been funding the same defaulters, thereby affecting their loan books. It is therefore apparent that the lack of such a facility is a constraint to the development of the micro-finance sector. Furthermore, such a facility would provide those clients with a good credit history with the opportunity to build a record that becomes an asset even for accessing larger loans from formal financial institutions.

- *Harsh environment:* The macro-economic environment is very harsh, demanding highly competent managers who are innovative and can respond quickly to market demands and changes. With inflation of above 60%, if MFIs have to operate within the provisions of the Moneylenders Act, they would actually be charging negative real interest rates!

- *HIV/AIDS pandemic:* The Ministry of Health & Child Welfare estimates that 1 200 people die every week due to the AIDS pandemic in Zimbabwe. The disease affects the sector in that some clients or their relatives are its victims. In addition, some staff members of micro-finance institutions are either suffering from the disease or have died as a result of it. The sector thus incurs the cost of funerals, recruiting and training new staff and loss of productivity.

- *Political stability:* Volatile political situations negate the growth and development of the micro-finance industry anywhere in the world. The period since the beginning of 2000 in Zimbabwe bears testimony to that. After the referendum in February and parliamentary elections in June, there was much uncertainty about the political future of the nation. MFIs operating in areas where the situation is politically hostile are forced to reduce their operations, thereby reducing business output. Monitoring and business procurement by loan officers can be suspended, stopped or slowed down in areas that become political hot beds. Clients' businesses are equally affected. Markets are lost and debts are not collected.

- *Political interference within MFIs:* Political interference that influences who should receive credit and how the MFI should be managed has affected the growth of the sector as operations tend to be managed at the expense of the laid out procedures, with damaging results. Through political interference, loan beneficiaries often ignore repayments. In some instances, there is political interference with the appointment of board members of NGO-based MFIs.

- *Lack of incentives:* Currently, there are no incentives to attract serious players into the market. If the government perceives this sector as a high development priority with potential to create jobs and increase household incomes then there should be incentives for participants. Examples would be tax breaks for the first five years, as is the case with enterprises at growth points.

It is clear that the micro-finance sector in Zimbabwe is riddled with many problems that need to be addressed. At the moment, it is very difficult for any institution to operate efficiently in the Zimbabwean context, let alone institutions with as many internal constraints and weaknesses as those in the micro-finance sector.

3.2 CHIMANIMANI

3.2.1 Formal Sector Financial Services

Formal financial institutions in Chimanimani are:

- Four Post Office Savings Banks (POSBs), which provide savings facilities only. These are in Ngorima, Ndima, Nyanyadzi and Cashel Valley.
- Two commercial banks, viz. the Commercial Bank Of Zimbabwe (CBZ) and Beverley Building Society, are situated in Chimanimani urban. CBZ has up to now managed to provide loans through the guarantee of SAFIRE to 12 members who are moulding bricks using river sand. The building society is concentrating on mobilizing savings deposits rather than providing loans for any other purpose, except the construction of low-income housing projects.
- Credit Against Poverty (CAP), although registered, is considered an informal MFI. It is a non-deposit taking institution operating in Chimanimani, with offices in Chipinge. Its outreach to date is about 450 clients in Chimanimani. The typical loan size is Z$5 000. Loans are given to women clients only for agriculture and non-agricultural enterprises.
- The Grain Marketing Board (GMB) also provides loans to dry land and irrigation maize growers in the district. So far, it has given loans to 80% of the Nyanyadzi irrigation farmers and 20% of the dry land farmers. GMB's average loan size is Z$10 000. The loan is given in kind, i.e. in the form of maize inputs.

The Agricultural Finance Corporation, which used to be the major source of credit, and SEDCO are no longer operating in the area. This means the bulk of the savings are exported and used outside the district. Savings and credit co-operatives are non-existent in the area and the few women-based rotating savings and credit programmes have minimum coverage, usually confined to villages.

The banks that provide better financial services like the commercial banks and building societies are in Mutare (Z$1 000 return bus fare) and Chipinge (Z$600 return bus fare). With savings clubs and burial societies providing insignificant services to the community, the POSB perceived as unfriendly, and other banks several bus fare dollars away; there is definitely a gap in the area for savings facilities. The community leadership expressed the need for easily accessible, friendly savings facilities.

Over the years, Chimanimani has been unable to access institutional credit services from MFIs until the introduction of Credit Against Poverty in 2001. CAP was founded in 1995 from seed capital supplied by Grameen Bank of Bangladesh. It is a relatively small organization, with one officer in the neighbouring Chipinge district providing credit facilities to clients in Copa, Mutsvangwa, Paidamoyo, Tonhorai (irrigation scheme), Ndima, Hotsprings, Mawamba, Nhowe and Chakohwa irrigation scheme. To date, 200 clients have received loans from CAP in Nyanyadzi and Mhakwe wards, although the loan officer claims to have managed to recruit and establish some 140 groups with 560 members. The loans are given to women clients for both agricultural and non-agricultural activities – gardening, vegetable and fruit vending, general dealers, sewing, jam and fruit canning, buying and selling. The gender discriminatory policy, however, disadvantages male clients, who are the majority plot holders in Nyanyadzi. The absence of a resident loans officer who is easily accessible to the clients has greatly disadvantaged CAP in the area. Clients' questions on CAP are only attended to during repayment sessions. Discussions with some clients indicate very little knowledge of CAP despite the five-day training undertaken. The repayment for the first round of loans is 100% and demand outstrips supply.

The Grain Marketing Board (GMB) provides credit facilities to the farmers in Nyanyadzi Irrigation scheme in form of crop inputs. The average loan size is Z$10 000 and is paid back soon after harvesting and marketing. Some 80% of the irrigation farmers and 20% of the dry land farmers have received such loans. ADAF, which used to be resident at Nyanyadzi, providing loans to Ndima, Ngorima tea and coffee growers and Nyanyadzi irrigation scheme farmers, has since closed its offices.

The Post Office Savings Bank (POSB) is another state-initiated parastatal that provides savings facilities to small savers through a network of almost 200 post offices around the country. It offers demand and fixed deposit facilities to small, medium and micro-enterprises in rural areas. The bulk of the money is invested in government securities and placements within commercial banks. This means that money deposited through POSB is a net withdrawal from the rural areas to investments elsewhere. It has to be noted, however, that since the financial liberalization, deposits into the POSB have been steadily declining but steadily increasing in commercial banks (ICC, 1999). This has been attributed to the fact that POSB does not provide lending facilities and imposes stringent withdrawal arrangements.

3.2.2 Chimanimani: Informal Financial Services

The high potential areas receive a lot of income from fruit and vegetable production annually. However, the money is received as and when the marketing intermediaries come to buy. Although some regular buyers have established a routine for their purchases every week, by and large the income comes irregularly. This has created a need for easily accessible savings and credit facilities.

There is at least one rotating savings club initiated by women in each area. Small "stokvel" amounts are saved and passed to one member of the group each month, which is normally used for purchasing kitchen utensils. At least one burial society exists in each ward, normally initiated through churches like the United Baptist Church. Small amounts ranging from Z$5 to Z$50 per month are saved. There is a common understanding in the villages that everyone contributes Z$5 and 2kg mealie meal once a member of the village dies. These social obligations honoured through the generations negate the usefulness of burial societies in the area.

3.2.3 Main Implications for Micro-Finance (Chimanimani)

- Access to credit for micro-enterprises in Chimanimani is very limited. The few formal sector lending institutions that exist either do not cater for clients without adequate traditional collateral security or do so only for specific needs, such as seasonal agricultural input requirements.
- Informal sector lenders are reported to be few and, in general, small and weak. In addition, such savings and credit associations as there are – whether co-operatives (SACCOs) or rotating – are confined to lending only to their own members.
- One registered micro-lender has now begun to operate in about half of the wards in the district, but is still very small, lends only to women on a group basis, and has yet to prove its viability.
- Given the substantial and increasing demand for micro-loans from the informal sector (see 2.1.5), there is an urgent need for sustainable expansion of micro-lending in Chimanimani.
- There is also an urgent need for new, more widely distributed and more user-friendly savings facilities – formal or informal. While meeting this need could be combined with responding to the demand for more micro-loan facilities, linking the two would probably be the slower, less effective path, particularly for advancing credit.

- A more enabling public policy framework – engineered jointly by regulatory authorities, wholesalers/donors and retail micro-financiers – would be an important step in accelerating the growth of sustainable MFIs.
- In addition to capitalization, donors can contribute most effectively to helping build the industry by:
  – assisting only MFIs that demonstrate real potential for sustainable growth;
  – funding and providing technical assistance for human resource development – probably best achieved by supporting training initiatives independent of but geared to the needs of MFIs;
  – ensuring the closest possible alignment of their own and indigenous partners' objectives and needs; and
  – maintaining their support for the industry during the current political turbulence.
- It is an exceptionally difficult time at which to attempt to launch new business initiatives, but also an exceptionally valuable one if it can be done successfully.

3.3 MOZAMBIQUE

The section on Mozambique is largely drawn from a recent study by ICC (Mozambique) on "Micro-Finance in Mozambique". The report was executed for MICRONET, the Mozambique Micro-Enterprise Network. With support from CARE Mozambique, and in collaboration with the Ministry of Agriculture & Rural Development (MADER) and UNDP/UNCDF, the Mozambican Micro-Finance Facility (MMF) commissioned the present study to document developments in micro-finance since the 1998 study. Micro-finance institutions (MFIs) are defined as NGOs, associations, co-operatives, individuals or other institutions that provide financial services of credit and/or savings in monetary form and of values less than US$1 000. Therefore, credit in kind is not analyzed in this study.

The objectives of the study were to:

- assess the level of development of the sector in Mozambique;
- analyze and document how the micro-finance sector has evolved since 1998;
- compare current practices with recognized good micro-finance business practices;
- identify challenges and constraints for the sustainable development of the sector.

Ebony Consulting felt that this was a comprehensive study and would serve as a good basis on which to do any planning for interventions in the micro-finance sector in Mozambique. Additional sources were added where necessary.

3.3.1 Country Overview: Mozambique

This overview is a summary of the main points, which shows that a professional business approach is needed. Micro-finance is a high-volume/low-margin business; MFIs must therefore develop products and systems that maximize outreach to achieve economies of scale and scope.

Positive returns on assets are achievable but require vision, commitment and financial innovation by management. Achieving commercial viability requires that providers and donors change the way they do business: from a poverty alleviation project perspective to one that builds viable financial services at the micro retail level; from a project document to a strategic business plan; from arbitrary pricing of products defined by donors to financial pricing of products that meet changing demand; from projects managed and staffed by development specialists to institutions managed and staffed by professionals who understand finance and business; and from project reports to monitor impact to financial statements and reports used to monitor profitability, etc.

This drive for commercial viability has important implications in a number of areas, namely: governance structures, ownership, management and financial transactions with the funding partners. The thrust of the business needs to be clarified to establish what are the trade-offs between poverty alleviation and the drive for financial sustainability. Funding strategies need to be defined to leverage donor equity to achieve scale and financial viability.

Performance measures need to be put in place to track the performance of the institution towards commercialization. Outreach (which measures business volume and market penetration), portfolio quality (which measures the health of the MFIs main asset, its portfolio), efficiency (which measures staff productivity and efficiency of operations) and profitability (which measures its ability to cover costs and operate without subsidies) need to be monitored constantly by the MFIs and their partners.

These guiding principles were used in analyzing the evolution of the micro-finance sector in Mozambique over the last three years.

The preliminary results of the study highlighted major changes in the micro-finance sector in Mozambique and indicated that the sector is still in a growth stage. The number of individual initiatives/operations providing financial services to the poor in Mozambique is virtually unchanged since 1998. However, the turnover rate has been enormous: many operators stopped their micro-finance activities (e.g Help Age, Helvetas, ISCOS, Oxfam and Papir) and many new ones have also been started (e.g. CCDR, CCM, ILRP/CARE, Karibu, Kulima, Kwaendza, Novo Banco). This "sector restructuring" is partly due to increased awareness of good micro-finance practices among donors and operators alike. This has pushed some operators to evaluate their involvement and comparative advantage in micro-finance, and to decide either to start a micro-finance operation or cease operations.

In 1998, most operations were projects of the government or international NGOs. Today, there is a larger presence of local legal entities, with some becoming independent institutions. Most programmes are still very dependent on expatriated management or on foreign technical assistance but, in some cases, they are taking measures to create local capacities.

In June 2000, there were 16 000 active clients, about three times as many clients as in 1998. Given that these clients are being served by virtually the same number of institutions as in 1998, the average outreach has also increased. Most institutions are serving the poor (with average outstanding loan balances of less than 20% of GNP per capita) and providing mainly credit services, although 22% are providing savings, but few provide related services such as insurance or training.

The geographic dispersion is much wider than in 1998. Most provinces have at least one initiative in operation, while some operators are now serving the rural areas ("distritos"). Clearly, the rural areas are still not adequately covered but expansion is underway and, at least in the case studies, seems to respond to identified market opportunities rather than from external pressures. This is encouraging as it provides the path to serve rural areas in a sustainable way. Furthermore, according to the operators' plans, the number of active clients will surpass 60 000 by 2002.[3] With most of the operators planning to expand to new districts (more than 70%) or new target groups (more than 50%) the geographic coverage should increase significantly.

Unlike in 1998, the operators are targeting most market segments using a variety of methodologies, terms and conditions. On average, women represent 57% of the customers and are mainly involved in informal trade (40%), agriculture (25%), small industries (25%) or services (10%).

In general, most products seem to be adapted to the needs of the market and apply good micro-finance business practices. It is interesting to note that the products offered are

[3] ECI considers this estimate over ambitious as many aspects militate against reaching these figures. These aspects include a lack of access to funding, a lack of capacity in institutions to make the leap to commercialization and an underdeveloped overall financial infrastructure in the country to assist the outreach of institutions, while improving the sustainability. The situation is even worse in rural areas.

mainly in credit, with few savings or insurance offerings. The most widespread methodology is the solidarity group with self-selected members.[4] The terms, conditions and procedures vary. Initial loan sizes are US$20-30 (300-500 000 meticais), which can increase in subsequent cycles to $300-600 (5-10 million meticais), with repayment periods from three to six months. Some operators offer larger loans to small groups of farmers or small enterprises.

Interest rates are from 3% to 6% monthly, usually charged on a flat basis. In most cases, these are set based on the prevailing market rate, which indicates that they are not subsidized. Non-traditional guarantees are widely used, with most operators using solidarity groups as a pressure mechanism in place of real warranties. This is good as it allows significant outreach while reducing costs. Some operators demand savings or other types of compulsory contributions or goods as a warranty, particularly in the case of individual lending.

In relation to 1998, the number of operators offering savings seems to have increased. In total, these institutions have 4 213 customers with savings and a total of US $112 500 (1,8 billion meticais) in deposits, which represents an average saving of $27 (400 000 meticais) per person.

The good business practices in micro-finance seem to be better known than before. In 1998, most operations were projects of international NGOs or the government; today, there are a significant number of local institutions with an independent legal entity. Furthermore, there is a trend, particularly clear in the case studies, towards becoming truly independent local financial institutions. Also, over half the operators have a board of directors and have developed a business plan in the last year.

Procedures, policies and systems have also improved. Most operators provide regular training to their staff and some, particularly those of the cases studies, have an incentive scheme for credit officers. In terms of their Management Information Systems (MIS), the results of the study are mixed. Few operators could provide information about their portfolio quality, their income or their operating costs, which is an indication of an inadequate MIS. However, the case study MFIs have invested or are in the process of investing significant efforts and resources in designing or adapting an MIS suitable to their needs. They were able to provide standard financial information.

4 Note that we could not obtain figures on dropouts from these programmes. Our experience in Africa indicates high dropout rates, especially in solidarity programmes. Dropout rates as high as 50-70% have been recorded in similar programmes in East and Southern Africa. The experience is that these dropout rates are caused mostly by inappropriate product design and delivery, so we question the statement on the well-adapted products offered by these institutions.

All these are important steps towards becoming an independent, commercially minded, self-sufficient institution. However, the study also shows that the majority of intermediaries are at the start-up phase, with only a few at the consolidation phase. Most of the operators in Mozambique are very young: only two have been in the market for more than six years and only ten for more than three years. They are still subsidy dependent, have a small outreach, weak financial management skills, weak ownership and governance structures, and weak operational systems and business planning.

Although the number of active clients has grown substantially, it is still small for a country of Mozambique's size and population. Only one operator, FCC, has more than 4 000 active clients and another four each have more than 1 000 active clients. Only one, SOCREMO, has an active portfolio of about US$500 000 (eight billion meticais). Another four have an active portfolio around $100-200 000 (1,5 to three billion meticais), while the remaining operators' portfolios are below $50 000 (0.8 billion meticais). Although these numbers represent a significant improvement since 1998, they are clearly small and below those needed to become self-sustainable.

The performance of the six institutions of the case studies is still below that of other small African MFIs (as reported in the September 2000 issue of the MicroBanking Bulletin). Their portfolio quality is, in general, adequate as indicated by portfolio at risk below 5% of the total outstanding portfolio, but they generally have a lower portfolio yield and are further away from operational sustainability. Only SOCREMO has a similar coverage of its operating costs and portfolio related income to its African colleagues. At the time of the study, only one institution, TCHUMA, financed part of its operations with commercial sources. However, according to the plans presented, most have the objective of reaching operational sustainability and accessing commercial sources of funds in the next five years.

Since 1998, the Bank of Mozambique (BM) has issued a decree to regulate micro-credit activities. While this is an important first step, it is not clear why only some operations have been registered and why those that are registered do not submit the required financial performance information to BM. In any case, it is obvious that additional efforts on behalf of BM are needed to enforce compliance and establish explicit performance indicators and thresholds for obtaining a formal licence, specifically designed for micro-finance operations.

In summary, it could be concluded that micro-finance institutions in Mozambique are typically not yet viable but still dependent on donors. In understanding the challenges that MFIs face it is important to distinguish between local MFIs and MFIs with strong support from international partners. The latter, in general, tend to be bigger, are usually registered with the Bank of Mozambique, have some sort of MIS system with which they can produce frequent reports to monitor their portfolio and costs, and use a selection of ratios to monitor their performance. They usually have some business projections and plan to reach sustainability sometime in the future (five to ten years). Their challenge is to increase their size significantly to reach sustainability by building local human and management capabilities, improving their current systems, policies and procedures and accessing additional funds. This trend suggests the importance of continued technical support being provided by the international partner.

The local MFIs, particularly those with no "permanent" technical partner, tend to be smaller, are not usually registered with the Bank of Mozambique, have weak or no MIS and do not use financial information to monitor their performance. They usually do not know or do not apply micro-finance professional standards. Their challenge is to develop systems, policies and procedures and to build their capacities before trying to increase their outreach. Acquiring the technical input to address these institutional weaknesses will depend on the commitment, as well as entrepreneurial spirit and ability of the operators.

As in 1998, it is important for all stakeholders to commit to this process of becoming professional. Donor support, whether under the new programmes – MicroStart[5] and the Mozambican Micro-Finance Facility (MMF) – or directly, should be conditional on the MFIs complying with BM registration and minimum reporting requirements.

It is clear that we are looking at a young, fledgling industry, that has a long way to go in terms of capacity, maturity and outreach. The industry has a low market penetration and limited outreach, and these institutions are not generally self-sustainable.

3.4 CHIMOIO

3.4.1 Formal Sector Financial Services

Banks located in the district of Chimoio are Banco Internacional de Moçambique (BIM), Banco Comercial de Moçambique (BCM), Banco Austral and Banco Standard e Totta de Moçambique (BSTM). Except for Banco Austral, which has more than one branch and is strongly represented outside Chimoio city, and BCM, which has small centre presence, they are present only in the provincial capital.

[5] The MicroStart programme in Mozambique is managed by ECI.

Five NGOs are known to operate some form of micro-finance service in Chimoio:

- Small Industry Foment Fund
- Concern Manica
- UCAMA
- Kwaedza Simukai Association
- CRESCE

Of the five, information has so far been traced only on CRESCE, a licensed MFI started in 1996 by CARE Mozambique. The information is drawn from a report on five MFIs selected for a detailed study because:

- their level of outreach and portfolio size are significantly greater than average for Mozambique;
- they are run along business principles;
- they have relatively sound operating systems, policies and procedures;
- they are striving to become independent self-sustaining financial institutions; and
- they show signs of accessing commercial sources of funding.

These characteristics provide a useful thumbnail description of the organization and suggest that, although its operational sustainability is only at about 41% (still the second highest in the group), it has the potential to fulfil a considerable part of the district's needs for micro-credit.

In addition to in Chimoio city itself, CRESCE operates in the neighbouring small urban centres of Gondola and Manica, as well as in Zambezia and Sofala provinces and in the large urban areas of Beira and Quleimane. An emphasis on developing the business more on market opportunities than on the availability of donor funds is evident.

The total client base is currently about 2 000, a little over 40% of whom are women. No figures are available for Chimoio specifically. Most clients reside in or near urban centres or markets and could be classified as middle-income earners. Average loan size is about one million meticais (just over R500 or US$50), while the average time period varies between from two and a half to five months. To increase the size of its target market, CRECSE may need to write more small loans, as does its largest and most self-sustaining rival, SOCREMO. The most common use of loans is to provide working capital.

To overcome the general lack of traditional asset-based collateral security and to reduce information and transaction costs, CRESCE – in common with the other four institutions in the study – lends mainly to individuals who are part of solidarity groups, demanding only a 10% upfront savings deposit. Recovery rates are reported to be exceptionally high, with less than 2% of the portfolio being more than 30 days in arrears and less than 1% more than 90 days behind. At 1% per week, the effective interest rate is about 87% per annum – more or less in the middle of the group.

3.4.2 Chimoio: Informal Sector Financial Services

Local rotating savings and loan groups are known to operate in the district, though no information is available about numbers. Best known are those called *Xitique*, whose members are mostly women. The rotating payout is sometimes used for start-up capital for micro-enterprises. Further information about other sorts of informal financial groups, such as burial societies, is awaited.

3.4.3 Main Implications for Micro-Finance

- Data collected in Chimoio indicates that very few micro-enterprises in the district have been able to access micro-credit. Those formal sector MFIs that do operate there tend to have quite specific, limited target markets, which exclude many categories of micro-enterprise. Given the growing reliance on informal sector employment, there is an urgent need to broaden access to micro-finance.
- Much more research is required to assess the extent of informal sector MFI activity. But however extensive it is, access to credit can be expected to be confined to members of relatively small savings groups.
- Access to formal sector savings facilities is also limited, with banks operating branches in only the largest urban centres. At this point, lack of adequate information about informal sector MFIs prevents firm conclusions about the need for additional micro-savings facilities.
- The growth strategies adopted by the larger, better established MFIs suggest that the industry as a whole is moving towards far greater outreach and sustainability. It should be remembered, however, that this is from a very low base. A great deal remains to be done to realize the potential now becoming apparent. In particular, institutional strength needs to be gathered as a first priority, with less emphasis being placed at this stage on client and product expansion.
- Public policy needs to be reformulated to provide for the evolution of MFIs into a wider, more flexible range of institutional forms than the present two options – commercial bank or savings co-operative – and to incentivize MFI-private sector partnerships.

- Donors can play an important catalytic role, for instance, by:
  - selecting only MFIs with real potential for sustainable growth for partnership/support;
  - helping capitalize micro-lenders, who, by law, may not take deposits to raise capital and who, for the most part, are not yet able to borrow in the commercial market;
  - providing technical assistance and training to enable local MFIs to develop their institutional capacity;
  - aligning their own objectives, criteria and operating requirements as closely as possible with those of their local partners, whose agenda should be driven by the market rather than donors; and
  - assisting with the enforcement of public MFI regulations.

3.5 SOUTH AFRICA

In this section, a comprehensive overview of the rural finance situation in South Africa has been provided, drawing on several data sources.[6] Firstly, an overview of the micro-finance market in general is provided. The services supplied to rural people and specifically to small farmers are then highlighted. However, it is clearly impossible to ascertain the exact use of loans disbursed in terms of location and target group. This will represent a general view and an overview of the supply side of the market. Secondly, the situation is presented from the demand side. This will be based on the results of recent small farmer and rural surveys, specifically a survey executed in 1997 and a 2000 survey on informal credit.

3.5.1 Country Overview: South Africa

The demand for banking services by the lower income strata of the population in South Africa is growing rapidly, due to a variety of factors. These include the current low frequency of use of formal banking services by the poor and MSE[7] market; increased income of the lower income strata; income redistribution in favour of lower income people; urbanization; rising consumer aspirations; the rapid growth of the informal

[6] Ebony Consulting based large parts of this section on work executed for the Department of Trade & Industry while doing an interest rate study in 2000 and subsequent work for the DGRV on rural finance in South Africa. Both studies contributed substantially to the knowledge on these issues in South Africa.

[7] Micro and Small Enterprise (including small farmers).

business sector; and, perhaps most importantly, the relaxation of the Usury Act on loans below R6 000 in 1992 and more recently to loans below R10 000. As a result, there has been considerable growth in the micro-finance sector. The biggest source of growth is from the micro-lending sector. The conventional, formal banking sector seems inappropriately structured to satisfy this rapid growth in demand and chooses not to engage in it directly. The "new" commercial banks (those that were formed recently through acquiring shells of banks with licences or by other methods) are emphasizing the micro-finance market, and are posting quite remarkable results.

The micro-finance sector is still quite small compared to the formal banking sector, but growing much more rapidly. Its contribution to the national economy is probably not accurately reflected in the national data as a result of the informal sector nature of many of the industry members, which leads to an underestimate of its size and contribution to GDP. The finance, insurance, real estate and business services sector is a significant contributor to the South African economy, providing approximately 15% of total GDP in real terms in 1998. The total assets of the banking sector at the end of 2000 were R800 billion, with advances totalling nearly R650 billion. In 1999, the size of the micro-finance industry was estimated at R10 to R15 billion, with advances at R10 billion (Econometrix, 1999). Recently, a comprehensive analysis of the sector estimated its size on the basis of current portfolios to be R14 billion and the value of loans written per year to be R25.8 billion. This analysis divided the sector correctly according to loan term and other characteristics, and then compiled an exposure on the basis of annualized figures. From the figures it appears that the micro-finance sector now contributes approximately 2% of the overall financial sector in rand terms, although it is clear that this sector touches the lives of most South Africans in terms of numbers.

However, any estimate of the size of the micro-finance market should also consider the definition of the market. For the purposes of this study the micro-finance market is defined as the market reflecting transactions by poorer South Africans on loans below R10 000. Poorer people are considered to be those described in marketing studies as in and below Living Standard Measurement (LSM) 6.

FIGURE 3.1 Classification of Living Standard Measurement Categories

LSM	Number (16+)	%	Female (%)	Unemployed (%)	Monthly Income (R)	Savings (%)	Biggest Problem	People in Household
1	3 738 000	15	59	80	659	4	Unemployment	3.2
2	3 560 000	15	52	74	776	7	Unemployment	3.0
3	4 294 000	18	54	72	929	7	Unemployment	2.9
4	3 314 000	14	51	65	1 244	8	Unemployment	2.9
5	2 041 000	8	52	62	1 664	8	Crime	2.9
6	1 888 000	8	58	61	2,264	6	Crime	3.2
7	2 534 000	10	50	49	5 675	5	Crime	2.5
8	3 246 000	13	49	37	9 752	5	Crime	2.4

Source: Eskom Consumer Surveys, 1998

Micro-finance also refers to the savings transactions of the poorer portion of the population. It is important to consider both savings and credit as this provide a far more comprehensive picture of the financial market within which poor people operate. Of course, there are other financial products pertinent to this stratum of the financial market. Most important after savings and loans are the transmission facilities that are an integral part of the lives of poor people, where support systems and sources often do not reside within the household. In addition, insurance products in many guises are also considered important financial products that will be demanded by the poor.

The present usage of banking and financial services by MSEs (including small farmers) is very small, with a minute section of the market – estimated at less than 1% – currently being reached. This is the most unbanked area of micro-finance, and an area that is still in the introductory phase in the micro-lending industry. No study exists which provides a comprehensive overview and analysis of overall supply to the lower income and MSE market. Existing studies provide an overview of the institutions active in this market, but do not quantify supply in terms of clients reached. This study necessitates an overview of outreach, and therefore an indicative (rather than exhaustive) summary is provided in the table below. In the next section, the institutional forms notes in the table are discussed in more detail, focusing on their future role in the lower income and MSE market. The purpose of this overview is to gauge future formal support to this stratum of the financial sector. After this, an attempt is made to estimate the rural portion of clients served by each institutional format.

Aggregate Supply

The present supply of micro-finance services in South Africa is presented in Figure 3.2 on the next page.

FIGURE 3.2 Summary of Retail Outreach in the Micro-Finance Market in South Africa (1999/2000)

Retail Institutions	Loans Rm	Savings Rm	Outlets	Estimated % Rural	Loan Accounts	Savings Accounts
Public Sector	330	1 646	2 440	36	78 000	2 840 000
Land Bank	30		25	80	43 000	
Provincial Parastatals	300	600	50	80	35 000	840 000
Post Office Outlets		1 046	2 365	35		2 000 000
Private Sector	12 599	4 661	17 132	38	7 951 580	4 740 100
NGOs	108	5	30	35	66 000	
Village Banks		1	10	100		1 100
Credit Unions	9	10				6 000
Co-operatives			1 200	80		
Commercial Banks	12	4 000	4 000	33		4 000 000
Retail Stores	5 000		1 000	35	2 173 913	
TEBA Cash	130	600	172	40	86 667	700 000
Private Sector	40	45	20	100	25 000	33 000
Registered Small						
Loans Industry	7 000		5,700	35	5 600 000	
Pawnbrokers	300		5 000	35		
Informal Sector	400	1 760	1 150 000	35	0	14 750 000
Mashonisas	150		25 000	35		
Burial Societies		1 560	325 000	35		6 500 000
Stokvels	250	200	800 000	35		8 250 000
Total	13 329	8 067	1 169 572	35	8 029 580	22 330 100

Public Sector

Land Bank

The Land Bank has largely reformed itself in terms of its political positioning. However, its systems and products, as well as clarity on mandate, have not materialized as clearly. In the micro-finance arena, the Land Bank managed to launch its Step-Up product successfully in April 1998. It is currently approaching 43 000 clients and the repayment level is around 80%. The product is handled by the Start-Up group in Cape Town and the payments and accounts system by First National Bank and the Post Office Savings Bank (Post Bank). The intention is to expand this product. It starts at loans of R200 and the ceiling of the last repeat level has recently been increased to R20 000. The mere fact that the Land Bank is entrusting this product to an agent indicates its approach to co-operation and its use of third parties. It lacks a service structure since it has only 25 branches. These branches service its biggest income sources, namely individual farmers and co-operatives. The Land Bank does extend loans (maximum R50 000) to emerging commercial farmers in its bronze range of products.

Provincial Parastatals

A wide array of failures and limited success is a good summary of the state of the provincial parastatal financial institutions (previously homeland institutions). We concentrate only on those providing financial services. The majority of the retail development finance institutions at provincial level are experiencing severe financial problems, based on a combination of inefficiency, bad policy and strategy, and a severe decrease in government transfers.

One successful institution is the Ithala Development Finance Corporation in KwaZulu-Natal. This institution is the second biggest public sector mobilizer of savings (after the Post Bank). Most of the rest of the parastatals are in decline. This will leave a tremendous vacuum, and there is already a large number of clients with no access to services. In the Eastern Cape a small rural bank has been formed from the ashes of two conventional homeland agricultural banks that were closed recently. The problem with most of these institutions is a lack of physical premises and outreach (i.e. they have no branch network).

The reformed parastatal banks are increasingly similar in their approaches to the enterprise lenders, except that they have a far greater existing investment and base from which to build. Some have savings as a resource (like Ithala, with approximately 800 000 clients) and others have institutional investors, which provides them with cheaper access to capital. Some of the largest lenders include Land Bank (which now has a micro-lending portfolio of 43 000 clients, but an outstanding book of only about R30 million) and Ithala.

Post Office Savings Bank

The Post Bank has the second largest reach to commercial banks on a national scale, but not all branches of the post office provide saving services.

FIGURE 3.3 Summary of Type, Number and Volume of Accounts at the Post Bank (Aug 98)

Products	Number of Accounts	Share (%)	Balance (Rm)	Share (%)	Distribution (Mostly)
Savings Bank	1 755 880	85.9	699.6	73.5	Rural
Telebank	224 173	11.0	43.6	4.6	Urban
Savings Certificates	63 507	3.1	208.7	21.9	Urban
Total	2 043 560	100.00	951.9	100.0	

The Post Bank has recently completed an investigation into the feasibility of providing loans to existing savings customers. This report has not yet been implemented.

Private Sector

NGOs

NGOs form an important part of the financial market fabric in rural areas around the world. The problems of conventional development finance policy appear to make NGOs a promising option in the field of financing small and micro-enterprises. This view is based on a belief in the ability of NGOs to reach the target clients and capitalize on the vacuum left by the closure of many specialized credit institutions in developing countries. The NGO lobby became quite strong and NGOs have been elevated to the status of saviours of the poor.

However, experience shows that NGOs providing financial services generally need continued subsidization, which reflects their inability to provide answers to the retail financial services problem. This does not necessarily imply that NGOs are bad institutions. They simply are not the right instruments to be applied in expanding retail financial services on a substantial scale. This view is echoed in the Strauss Commission's Final Report (Strauss Commission, 1996)

FIGURE 3.4 Profitability of NGOs in South Africa compared with a Latin American Survey

	Small Enterprise Foundation	Get Ahead Foundation**	Rural Finance Facility**	Latin American Comparison*
Loan volume per staff member (R)	26 807	26 138	96 145	54 000
Interest earned/average portfolio	46	42	34	45
Interest paid/average portfolio	14	47	15	29
Gross financial margin	32	–5	19	16
Non-interest exp./average portfolio	134	153	120	72

* Adapted from Schmidt and Zeitinger (1995) and Strauss Commission (1996). An exchange rate of R3.00 = US$1 was used for the 1992 figures. The interest earned/average portfolio percentage is based on an assessment of interest in real terms. The use of the Latin American comparison is indicative; these are averages based on a study of 15 NGOs in the region.

** Closed recently

Although the coverage of NGOs by the Strauss Commission was not exhaustive, it was concluded that NGOs have very limited coverage in rural areas. The Commission also calculated that these institutions have high operational costs, which impacts negatively on their sustainability. When comparing local financial services NGOs with international surveys, indications of higher efficiency in the international institutions are visible.

Micro-enterprise lenders are a special group in the micro-credit industry. Around the world, micro-finance is associated with enterprise development finance, though in South Africa micro-enterprise finance accounts for a very small portion of the micro-credit market. Though some "consumption" lending may go towards financing productive activities, micro-enterprise finance comes largely from NGOs and trusts. There is very little overt micro-enterprise finance from the commercial banking sector in South Africa, which has put a floor of R50 000 on enterprise lending. Khula is the major financier of enterprise finance and reports that there was R108 million outstanding among about 26 lenders, accounting for loans to 66 000 micro-enterprises. This is a tiny portion of the entire industry. Average loan sizes among the micro-enterprise lenders are in the range R3 000 to R6 000.

Village Banks

In 1994, the first Village Bank in South Africa was established in the North West Province. This was the initiative of the International Fund for Agricultural Development (IFAD) and the African Rural & Agricultural Credit Association (AFRACA). A village bank is in essence a savings and credit co-operative. Two more Village Banks were formed by 1996, after which growth in numbers was dormant until 1999/2000, when two institutions, Finasol and the Financial Services Association (FSA), started a concerted effort to increase the numbers of village banks. Registrations now stand at 60 covering five provinces.

These two institutions work independently with various sponsors and support groups to increase the number of Village Banks. FSA is the original institution that was involved in the formation of the North West Province village banks (albeit in a much less formalized format). FSA is being financed by the Department of Welfare to establish the infrastructure to support Village Banks and to ensure more Village Banks are formed. The United States Aid Agency (USAID) is financing Finasol with much the same objective. Finasol had its origin in an endeavour of the South African Sugar Association to reform or restructure its Financial Aid Fund.

It appears that there is considerable demand for collective action formats at grass-roots level in South Africa. This is indeed the premise on which most of the activities of FSA and Finasol are based. Its recent success with the formation of more groups is evidence of this local demand for financial services.

Credit Unions

Credit unions have a long history in South Africa. After restructuring, the Savings and Credit Co-operative League of South Africa (SACCOL) has now been active in financial co-operative development in SA for the past three years. Currently, 21 savings and credit co-operatives (SACCOs) are registered with SACCOL. South Africa's SACCOs have a combined membership of over 6 000, with member's savings of just over R10 million. The loan book has a balance of R9 million. All loans are issued to members who are also saving. The development of the movement has happened with minimal donor or government support. For the past three years SACCOL has received no donor support, which, while admirable, has constrained its ability and capacity to serve the "poorest of the poor", owing to the high start-up and servicing costs involved in rural development.

Co-operatives

The dominant form of co-operatives in South Africa is agricultural producer co-operatives. Most of these provide financial services to members, mostly commercial farmers, who are not entirely the focus clientele of this study. However, some 40 of these producer co-operatives have initiated project-based endeavours to assist small farmer development. Some of these services encompass financial services in the form of production loans to small farmers.

The extensive infrastructure and existing member base of these co-operatives provide opportunities in the provision of financial services to members. One opportunity exists where commercial banks do not acknowledge the asset value of milk producers' quotas provided by a sizeable local dairy co-operative. It makes sense for the dairy co-operative to attach a value to milk quotas and this presents an opportunity for linking this asset value with other financial services. The interest in financial co-operatives goes wider as farmers in the Eastern Cape/Karoo area have already expressed interest in the joining together of nearly 1 000 farmers in a financial co-operative with the objective to negotiate more favourably priced funds for production than is possible by individual farmers.

Owing to the overemphasis of producer co-operatives and the retail financial services offered by commercial banks in the past, very little attention has been given to financial co-operatives and their potential in commercial agriculture, or to extending these services to developing agriculture. The declining importance of agriculture in the portfolios of commercial banks and the costs associated with the provision of retail financial services in rural areas may provide opportunities for collective action in the form of financial co-operatives in rural areas. In effect, the withdrawal of commercial banks in Canada from some farming areas gave rise to the formation of the strong Canadian Credit Union movement. This is something that may hold true for South Africa in the near future.

Commercial Banks

In the drive towards growth and high profits, many commercial banks have merged with or acquired other institutions in order to grow market share. The five largest banks in South Africa (Standard Bank, ABSA, First National Bank, Nedbank, and BOE) presently hold over 80% of the market share. Although the mergers and acquisition approach is in line with international banking trends, closer analysis shows that for South Africa the bigger banks do not exhibit economies of scale. The banking environment itself has changed significantly during the last few years, with a clear move towards ATM and Internet banking, away from the bricks and mortar approach of the past. Old delivery channels of service are on the decline. In the market for deposits, the banks are losing ground to smaller niche banks, which are more flexible and which can target specific segments more efficiently than the larger banks.

Commercial banks only provide a limited range of services in rural areas, although they have the highest incidence of branches in the rural areas, together with the Post Office (Strauss Commission, 1996). South Africa also has a higher ratio of branches per population than elsewhere in Africa. However, this higher incidence of branches is skewed, with approximately double the number of people per branch in rural areas than in urban areas. A sharp decline in rural branches is also evident. It is estimated that whereas in 1995 approximately 50% of the South African population had easy access to commercial bank facilities, this number has declined recently to approximately 30%.

South African commercial banks are comparable in terms of development and technology to the commercial banks of Europe and the United States. Although there may be efficiency differences, South African banks are quite advanced in most aspects. It would therefore be possible to assess international trends in retail banking and expect similar trends from South African banks. Studies show that retail banking will change considerably in the future. Several issues have an impact on commercial banks. Little evidence exists to substantiate scale economies at a “macro” level for consumer banks and financial institutions. This explains the fragmented condition of the sector at present. The shape of retail banking at present seems to confirm that those forces pulling banks into smaller, more fragmented units appear to be relatively balanced with those that would naturally lead to consolidation. Consolidation is therefore slow, owing to the fact that limited exploitation of scale economies is taking place. The number of products offered by banks is increasing, which drives up the total management cost. It seems that retail banking is inefficient in its current form.

Technology is providing a counter to this trend of inefficiency. Technology revolutionizes the movement and storage of money and the distribution of bank products. In addition to decreasing the costs of current bank practices, new technologies are also creating alternative distribution channels for retail banking products. These result in far cheaper ways to reach customers than by retail branches (for instance, in the United States telephone banking is more than 50% cheaper than branch banking), and these non-traditional channels are gaining market share. It is especially younger customers who are abandoning conventional branches for the alternative technology driven outlets.

The question of the impact of these trends on rural finance also arises. The process and speed of adjustment and transformation of commercial banks will differ among countries. With increased globalization, the main constraints on change will be country-specific regulations and the ability to take up and apply technology. The banks that change the fastest will be recognizable in that they will sharply diminish their branch network, keeping only those branches with upscale or high net worth demographics. They will segment their client base and cross-sell only to those that clearly offer profit potential. They will increasingly interact with clients through electronic devices (the personal computer, telephone, Internet), and will clearly diminish the focus on rural areas, especially remote rural areas. Areas without high net worth demographics, electricity and communication channels will not be part of the new way of banking. To all intents and purposes no major expansion of commercial bank activities should be expected in rural areas. One would only expect banks to show more interest in rural communities once technology has been made accessible to rural people.

Small farmers and rural people in general will still save with commercial banks, but it will become increasingly costly to do this as bank branches decrease in number in rural areas. Commercial banks do invest in the micro-finance market, but they do so indirectly through purchasing shares in banks with micro-finance portfolios (the case of ABSA and Unibank) or by striking strategic alliances with commercial banks with micro-finance portfolios (as in the case of Standard Bank and African Bank).

To summarize:

- conventional commercial bank presence in rural areas will decline at an increasing rate;
- the farming portion of the commercial bank portfolio will further decline over time;
- emphasis will be on the agribusiness sector and larger producers; and
- financial services to farmers will be provided by the broad retail sections of banks and farm-specific portfolios will decline. This will be based on the diverse income sources of future commercial farmers.

Retail Stores

Furniture and retail store lenders are the latest entrants to the micro-finance market, primarily arriving since the creation of the Micro Finance Regulatory Council (MFRC). The furniture industry is already a R15 billion industry per year in South Africa, with about R10 billion of that being sold on credit. Historically, furniture sales have been made under the Credit Agreements Act, which restricted interest rates to the ceiling of the Usury Act, while allowing the seller to retain ownership of the goods sold as collateral. However, with the advent of the MFRC and a clearer, more transparent regulatory environment for micro-lending, many of the furniture lenders, as well as other retail stores such as Woolworths, have also entered the market. They have registered branches as micro-lenders and are actively promoting micro-loans to their regular, well-known clients. These lenders have a solid credit history on their clients and rely on a credit scoring methodology to assess risk without requiring debit orders or other deductions at the source. Most of their clients, however, are salaried employees.

TEBA Cash

Teba Cash is the institution responsible for handling the payments system of mineworkers in South Africa. It has 172 offices over Southern Africa. As they have a large compliment of savings accounts and an immediate market (the mineworkers), a banking licence has been granted recently to TEBA. It provides over-the-counter loan products (very similar to those envisaged for the Post Bank) and has a current loan book of around R130 million.

Private Sector Agricultural Firms

Started by the Financial Aid Fund (now called Umthombo Agricultural Finance) of the South African Sugar Association 20 years ago, the trend towards the establishment of private sector processors has been boosted recently by cotton ginners, vegetable processors and agents. Farmers are provided with crop establishment capital and, in some instances, production credit. Some institutions also provide extension services. This method of finance is quite common in non-farm MSEs and in contract farming. It has potential for development on a vast scale in the agricultural sector, especially if commercial farmers can be convinced to contract small farmers to ensure throughput and turnover.

Registered Small Loans Industry

The rapid growth of the micro-loans industry is the result of a gap in the market for small loans. Micro-lenders are active in making short to medium term loans available to individual borrowers who normally fall outside the formal banking network because of their inability to provide conventional collateral. This gap has been filled by institutions that combine easy access arrangements with home-grown collateral models. These operators provide credit services to clients who can supply them with proof of employment and a bank account. 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 that does not fit the profile of rural people, who often have inconsistent income patterns. It is not seen as a major growth industry in rural areas, except in larger rural towns.

There are major drives to organize this industry. Several associations have been formed and registration with the newly established Micro Finance Regulatory Council is compulsory if operators decide to conduct business within the exemption to the Usury Act[8]. It is expected that some of the larger more formalized operators (some of which are already listed on the stock exchange) will investigate the formation of banks soon.

The available information in South Africa fails to differentiate accurately between rural and urban micro-finance. There are several different segments in the industry:

- formal registered firms, which include commercial banks, financial institutions, Section 21 (not for profit) enterprise lenders, developmental lenders, and the larger short-term moneylenders;
- semi-formal moneylenders, which include small unregistered moneylenders who are doing it as their main livelihood, and pawnbrokers, who are not yet formally included in the money lending statistics; and
- purely informal moneylenders, such as township moneylenders (mashonisas) and stokvels, burial societies, and rotating savings and credit associations (ROSCAs).

These different lenders can be regrouped into different categories based on the type of lending in which they are involved. The first four are focused on "consumption" lending and lend only to customers with bank accounts and regular salaries (thus, they are urban orientated). The other lenders, either developmental or enterprise lenders, generally base their repayments on cash flow from productive activity. The source of repayment is the main differentiating factor between the two groups of lenders.

Short-Term Cash Lender

The short-term cash lender focuses on loans up to 32 days, or the next pay period. On average, these lenders charge an interest rate of 30% per month, all fees included. They comprise the largest number of individual institutions, but each branch tends to be relatively small in size, with loan books of between R50 000 and R500 000. Their target

[8] Government Gazette of Pretoria, 1 June 1999 (Vol. 408), Department of Trade & Industry, Notice in terms of Section 15A of the Usury Act, 1968 (Act No. 73 of 1968), No. 713.

market is clients with a net income of up to R2 000 per month. The average loan for these firms is about R500, taking into very strict consideration the capacity of the borrower to repay at the end of the month. Capital resources come mainly from their own sources, and occasionally from illegal loans from friends (illegal because this is not allowed under South African law).

It is important to note that the rate charged by 30-day cash lenders applies to all loans less than that period or which are repaid on a weekly basis. This raises the effective interest rate of the loan. Very important to note is that even with bankcards and pin numbers as security measures, the default rate on loans was in the neighbourhood of 2.5% to 5%. Now that the use of bankcards and pin numbers has been eliminated, this rate has tended to double among the lenders.

Medium-Term Cash Lenders

There is often some overlap between term lenders and firms lending for period of one to six months. They have a mix of products that are mostly 30-day loans, but also a range of slightly longer-term loans reserved for better clients. Average loans in the one-to-six-month category can increase to a multiple of the person's actual net take-home pay, as they have more time to pay it off. Historically, these lenders have also used bankcards with pin numbers as the repayment mechanism. With the restriction of the use of bankcards, many lenders are experimenting with other forms of collection.

Interest rates vary according to the term of the loan, but are usually discussed as a flat rate on a declining balance, which increases the effective rate. The nominal interest rate may be between 30% (for 30 days) and 12.5% (per month for the period), but the effective interest rate is always greater than 20% per month. Because these loans are made to better-known clients, the default rate is generally lower, about 2.5%, without the bankcard.

Short-term and medium-term cash lenders are often lumped together in the same category since branches often do both, so it is difficult to differentiate between them. Overall, the estimates from credit bureaux specializing in cash borrowers are that there are now roughly 3 500 to 4 000 storefronts in the country. This figure is down from an estimated 6 000 two years ago, and is expected to continue declining this year to a ceiling of 2 500 storefronts by the end of the year.[9]

9 Conversations with Compuscan and Micro-Lenders Credit Bureau (MLCB).

Term Lenders

Term lenders make loans for periods between six and 36 months. The industry started through the use of Persal, the government's central payroll system, which used debit orders to extract repayment at the source before the borrower actually had a chance to see the money. Now that these lenders are saturating the market, they are branching out to establish credit service relationships with the larger private companies. This is the most rapidly growing segment of the industry, but one that has often been restricted by cash to lend. The commercial banks are becoming increasingly involved in this segment of the market, buying up the large term micro-lenders to develop their access to the market, while reducing the financial constraints on their lending partners.

Housing Lenders

Housing lenders are closely associated with term lenders. Most long-term mortgage loans are greater than the ceiling set for micro-loans and fall outside the exemption. Nonetheless, many micro-loans are made in the name of housing, as it is the basis of access to a Persal code that greatly facilitates repayment. Housing loans can also be secured by provident funds, effectively bringing the risk to almost zero. Large banks are involved in housing finance, as well as small, specialized lending boutiques. The National Housing Finance Corporation has a number of programmes to assist retail lenders to access finance to on-lend to borrowers for housing improvement.

The NHFC promotes both urban housing and rural housing. Lenders in the housing industry include micro-lenders, small banks, social housing programmes and non-bank financial institutions such as NGOs. Methods of security include: none (unsecured), provident fund, payroll and mortgages. The Rural Housing Loan Fund programme works with micro-lenders financing housing in the rural areas with unsecured loans. For this, interest rates of 40% (on a declining balance) are common. For provident-backed loans, margins above the cost of money are typically between 4% and 5%.

Pawnbrokers

Pawnbrokers comprise one of the oldest industries in South Africa. They use durable and semi-durable goods as collateral against money which they advance to individuals in need of short-term funds (generally less than 30 days). These are often used to finance emergencies or short-term cash flow deficiencies in their daily lives and businesses. The advances are made against the pledged item(s) at a rate of 25–30% per month, and the borrower has up to three months to reclaim his items by paying off the advance, otherwise he forfeits them. Between the time the pawnbroker makes the advance and the time the client comes to reclaim the item, the pawnbroker must store and maintain the item in original condition. If the client forfeits the item, it then belongs to the pawnbroker and he is free to sell it second-hand. Roughly 35% of all pawned items are not paid off and collected.

While there are many debates about the value applied to items that are pawned compared to their real value, the pawnbroker must incur many costs. The pawnbroker must appraise the item, transport it to his shop, store it for up to three months (with the opportunity cost of capital), and, if the item is not collected, proceed with the sale, which could take several months, depending on the demand.

There are some 5 000 pawnbrokers in South Africa, according to the Association of Pawnbrokers, which officially represents 1 500 of them. Pawnbrokers are registered under the Second-Hand Goods Act, so are already regulated and pay VAT on all transactions. The cost structure for pawnbrokers differs radically from that for micro-lenders, owing to their primary operation of storing and selling the second-hand goods. Most loans are for one month or less. Estimating that the average portfolio outstanding is about R60 000 per pawnbroker, there is an outstanding monthly balance of about R300 million. Taking an average term of one month (which may be too long), this translates to an annual turnover of R3.6 billion.

Informal Sector

Mashonisas

Mashonisas are informal sector lenders who operate completely outside the formal sector. When there was no other alternative for borrowers, the mashonisas provided the solution. Mashonisas specialize in short-term loans, generally for 30 days. Interest rates run in the range of 50% per month, though no additional interest is charged if the borrower is late, effectively reducing the cost of borrowing. Mashonisas are often women with no other means of support. Clients borrow an average of R150 to R250 at a time. Individually, the mashonisas are extremely small players, but there are an estimated 25 000 to 30 000 around the country. Monthly earnings are often quite small in absolute terms – in the range of R2 000 to R3 000 per month. Interestingly enough, it appears that most mashonisas are close to their clients, who are loyal to them.

The best estimate of the number of township moneylenders is approximately 30 000. This is the figure that has been developed by Du Plessis and is most commonly referred to by researchers. The research by Jimmy Roth on township moneylenders in the Grahamstown area can be taken as a proxy for the average lender. This was confirmed by a recent survey in the North Province, which found similar statistics. The typical lender has about 15 to 20 clients, with a total outstanding book of about R5 000. Using this as a proxy, township lenders account for about 600 000 clients on a monthly basis, equal to the number from formal moneylenders, although at some R150 million, their outstanding book is significantly smaller. On an annual basis this translates to R1.8 billion.

Stokvels and Burial Societies

Here, the term "stokvel" refers to the various informal financial institutions that capture member savings and then either save them or on-lend them to some of the members of the group on a rotating basis. These include the Stokvels, properly stated, burial societies, and rotating savings and credit associations (ROSCAs). According to the National Association of South Africa of Stokvel Associations (NASASA) there are an estimated 800 000 such institutions, comprising about 8.25 million adults and accounting for some R200 million a month in savings. They are governed under the Banks Act under the Stokvel exemption. This allows for stokvels as member based organizations providing services only to their members, and who are members of NASASA, to be regulated by NASASA. Only 15 000 groups are officially registered with NASASA, but in reality all stokvels are providing services only to their own members so are considered to be safe.

There are very few costs. Management of the associations is voluntary, and most of the funds are normally distributed to members at the time of the group meeting and deposit of funds. Since all repayments, with any interest, go back into the group fund for redistribution to the members, the interest rates serve more as mechanisms for forced savings for the members. Interest rates may or may not be charged, depending on the group and its operating procedures.

The Eskom consumer survey of 1998 confirms the existence of numerous burial societies. It estimates 6.5 million South Africans are members of burial societies. We estimate on a conservative basis that if each member contributes R20 per month for a year the accumulated total will be R1.56 billion. This is a severe under-estimate as many of these societies have monthly contributions per member far in excess of R20. However, we also consider the reality that much of these savings would be deposited with commercial banks, the Post Bank or other formal savings facilities. Thus, double counting may be possible and the total savings figure should be treated with caution.

Access to Financial Services for Rural Households and Small Farmers

Figure 3.5 provides adequate information on which to assess the scope of rural and small farmer finance. As stated, it would be virtually impossible to do a clear delineation between rural and urban micro-finance. It is estimated, however, that approximately

37% of 19 500 formal retail outlets where a client could enter into either a loan or a savings transaction are in rural areas. It is also estimated that approximately 35% of the 1 150 000 informal “outlets” in South Africa can be found in rural areas.

If we turn to financial services for small farmer agriculture it is even more difficult as it is expected that many diversions of loan funds occur as a result of the general unavailability of sources of small farmer agricultural credit. Much of small farmer agricultural activity is also cyclical in nature and many “small farmers” will leave farming if economic conditions improve and wage income opportunities are more available. On the other hand, one can also assume that a sizeable proportion of small farmer credit also gets diverted because of the simple fact that many “small farmers” are forced to obtain the credit for small farmer purposes, albeit that they have other needs than for agricultural production. Without entering the minefield of definitions of exactly who is a small farmer, this table serves as an indication of the confusion surrounding the concept of small farmers.

FIGURE 3.5 Selected Results from Farm Household and Small Business Surveys in Two Provinces (1997)

Item (%)	Small Farmers Surveys		Small Business Surveys	
	Northern Province (n=150)	KwaZulu-Natal (n=152)	Northern Province (n=270)	KwaZulu-Natal (n=225)
Agricultural income as % of gross income:	3.4	2.8	1.0	8.5
Percentage who used loan finance to finance:				
Durables/assets	4.0	9.9	14.0	16.0
Farm inputs/other inputs	7.3	9.0	7.0	11.0
Savings at (in % of respondents):				
Formal institution (average distance km) [a]	(60.7)	(45)	92.0	77.0
Informal institution (average distance km) [b]	80.7 (0.0)	29.6 (19)	64.0	76.0
Sources of finance for establishment of business:				
Personal savings			93	73
Retrenchment package			30	12
Pension			17	1
Loan from family or friends			10	5
Loan from development corporation			6	6
Income from other business			4	13

a. The institutions with highest use

b. Information not available for small business surveys

The table confirms the fact that rural people have diverse income streams that may include farming as a source. This is not entirely surprising as it represents one of the numerous ways in which poor people manage risk, i.e. by diversification of income sources. When interviews are conducted on the basis of stereotyped notions of small farmers, it may be found that a "small businessman" has a higher income from farming activities than a "small farmer" or that the majority of small farmers may be female.

However, it is assumed that, since agriculture plays such a small part in the household income streams of most small farmers, loans for agriculture are quite scarce and targeted towards those that are full-time farmers (ironically the higher risk farmers). To refer to small farmer finance may therefore be somewhat incorrect, whereas the concept of rural finance is non-sector specific and emphasises rural areas as the locality of financial transactions.

It is estimated that less than 1% of the portfolio of the Land Bank is for small farmer financing (loans below R10 000 in accordance with our definition of micro-finance). Approximately 30% of the outstanding small business finance book of provincial parastatals is for small farmer finance. This will decline and should not rise above 25% as most of these banks capped their exposure to agriculture after the restructuring of these institutions.

It is expected that a leakage to farming activities exists in the portfolios of some institutions without specific farming loan products. These institutions include NGOs, Village Banks, agricultural co-operatives, TEBA Cash, stokvels and even the micro-lending sector. It is, however, very difficult to assess the magnitude of this leakage.

What is the demand by rural people for financial services? Note that demand equates to expressed demand since no comprehensive demand study with respect to rural finance has yet been executed in South Africa, barring the analysis of the Strauss Commission that qualitatively derived demand from a description of economic activities in rural areas. Figures 3.6 and 3.7 reflect the results of a survey executed in 1997 to serve as an indication of the characteristics of rural households and their use of financial services.

It is clear from the tables that farming plays a small role in terms of income, although many small farming and small business households (thus rural households) cultivate the land and produce crops. Very little of the crops or livestock are sold and the majority of the households are deficit producers (Van Zyl & Coetzee, 1990). The majority of households in all the surveys do not (or are unable to) access credit services, while most households are engaged in savings activities.

A rich fabric of informal financial arrangements was identified, although not at a comparable frequency to that of urban areas. Under the conventional approach clients would have been bombarded with credit, while in the circumstances outlined in the surveys they do not demand a high level of credit. The clients in these surveys accessed loans from development corporations (or provincial parastatal financial institutions) and the informal markets. This may indicate an inadequate supply of formal credit, either in the form of lack of access or as a result of inappropriate financial products on offer. Most people who save money have commercial bank accounts. This indicates an effort to deposit savings since the majority of rural branches of commercial banks are in medium to larger towns, which are normally far away from these clients. The Post Bank and NGOs did not feature in the survey results. In the case of the Post Bank, this may be due to the fact that not all rural Post Office branches offer savings facilities. It may also indicate the provision of inefficient services based on outdated savings product technology (something which has recently been addressed by computerizing the manual centralized processing system of the Post Bank). Very few financial NGOs are active in rural areas in South Africa and the penetration of the rural finance market by NGOs is therefore negligible.

FIGURE 3.6 Illustrative Profile of Farming Households based on Surveys in Two Provinces

	Northern Province (N=150)	KwaZulu-Natal (N=152)
Household characteristics:		
Male household head (%)	68.0	72.4
De facto female household head (%)	99.3	66.4
Household size	–	8.8
Land tenure:		
Cultivate all land (%)	79.3	58.6
Leased land out (%)	8.0	9.9
Borrowed farm land (%)	9.3	13.8
Services and energy use (% of households):		
Use grid electricity	7.3	61.8
Use flush toilet	1.3	1.3
Cook with fire wood	95.0	78.9
Water source unprotected	83.3	66.4
Public standpipe	44.0	19.1
Gross annual income (R):		
From farming	394	637
From wages	9 308	14 157
From micro enterprises	149	1 294
From remittances	974	4 251
From pensions	1 489	2 667

☞

Figure 3.6 *continued*

		Northern Province (N=150)		KwaZulu-Natal (N=152)	
Farm assets – % of households with:					
Car/Bakkie		5.3		22.0	
Tractor		5.3		2.0	
Trailer		2.0		1.3	
Plough		4.8		6.0	
Credit used to purchase durables (% of households):	Main source of credit:				
Car/Bakkie	Commercial bank – CB	3.3	CB	9.9	PS
Generator	Private supplier – PS	1.3	–	2.6	–
Refrigerator		4.0	CB	32.9	PS
Television		2.0	–	19.7	–
Savings facilities used (% of households):	Distance to institution (km):				
Banks		30.0	60.07.0	48.7	45.0
Money keeper		0.0	0.0	3.9	21.0
Informal		80.7		29.6	19.0
Farm inputs financed on credit (% of households):					
Fertilisers		7.3		9.0	
Seed		6.0		5.0	
Farm equipment hired		2.7		0.0	
Chemicals		0.7		6.0	
Veterinary medicines		0.7		0.0	
Livestock feed		0.0		0.0	
Ploughing services		0.0		9.0	
Transportation services		8.0		10.0	
Credit source used to finance farm inputs and implements (% of households):					
Local moneylender		0.7		0.7	
Friend or relative		4.7		3.3	
Development corporation		10.0		0.0	
Miller		0.0		0.0	
Stokvel		0.0		0.0	
Savings club		0.0		0.0	
Input supplier		0.0		2.6	
Commercial bank		0.0		0.0	

Source: Adapted from Ouattara and Graham, 1997

FIGURE 3.7 Illustrative Profile of Small Business Households based on Surveys in Two Provinces

	Northern Province (N=270)	KwaZulu-Natal Province (N=225)
Average age	26	46
Female (%)	21.6	22.9
Women who can sign contract without husband's permission (%)	33.0	70.7
Number of years in operation	8.3	10.0
Number of workers at start	3.2	4.5
Average value of business at start (R)	5 612	4 509
Number of current employees	3.5	4.6
Sector of operation (%)		
Construction	37.8	35.5
Manufacturing	26.3	26.7
Services	35.6	37.8
Multiple sources of financing business at start (%)		
Personal savings	93.3	73.3
Retrenchment package	29.6	12.0
Pension	17.4	0.9
Loan from family or friends	10.0	4.9
Loan from development corporation	5.9	6.2
Income from other business	4.1	13.3
Sole ownership (%)		
Registered business (%)	87.4	93.8
	33.0	22.7
Place of work (%)		
Home	37.0	34.7
Adjacent to home	7.4	5.3
Market	50.4	33.3
Place of delivery of service	5.2	26.7
Selected income, input and output indicators (R)		
Average wages received per month	1 326	1 102
Average remittances received per month	739	1 360
Average pensions per month	414	438
Average business income for business 1 per month	3 601	2 057
Average business income for business 2 per month	3 796	1 979
Average business income for business 3 per month	7 721	2 800
Average annual agricultural income	1 250	10 886
Average value of physical assets on hand	17 913	12 995
Average value of inputs per annum	1 067	12 703
Average value of output per annum	92 031	58 044
Average labour expenditure per annum	25 360	41 380

☞

Figure 3.7 *continued*

	Northern Province (N=150)	KwaZulu-Natal (N=152)
Use of loans (%)		
Asset finance: Cash loans	10.0	10.0
Asset finance: Hire purchase	14.0	16.0
Supplier credit	7.0	11.0
Customer advance	16.0	29.0
Customer loans	18.0	16.0
Shopkeeper loans	56.0	–
Savings (%)		
Formal: Mostly commercial banks	92.0	77.0
Informal: Stokvel	26.0	76.0
Informal: Burial society	64.0	22.0
Electronic banking	35.0	18.0
Handling of shocks or misfortunes (%)	21.0	52.0
Main principle cause: Stolen equipment (% of shocks)	52.0	31.0
Main fallback mechanism: Personal savings (% of shocks)	67.0	24.0

3.6 NYANDENI

3.6.1 Formal Sector Financial Services

Lying just outside the western border of the greater Nyandeni district is Umtata, capital of the former apartheid "state" of Transkei. Most of the bus services in the district originate or end in Umtata, which is the regional hub. Even the farthest parts of the district, such as Port St Johns on its eastern extreme, lie within two hours' bus ride of Umtata.

Although there are few branch offices within Nyandeni's borders, almost all of the formal sector institutions operating in the micro-finance market outlined in section 3.5 are within reach of micro-entrepreneurs in the district. Indeed, those that use local agents to extend their outreach, such Land Bank's Step-Up micro-loan programme, operate actively in parts of the district.

No data regarding the activities of these institutions in the Umtata region has been gathered, but it can reasonably be assumed that many households in the Nyandeni district have accounts with them, especially those providing consumer credit.

The Land Bank has been largely restructured based on the proposals of the Strauss Commission (1996). It has struggled to reposition itself and still occupies a somewhat ambiguous position within the broader financial market and specifically in terms of competition with commercial banks. The bank offers four groups of products:

1 The Step-Up loan scheme, with approximately 60 000 clients across all the provinces, is a scheme where borrowers are promoted to bigger loans based on their repayment of loans. The scheme offers loans from R200 to 20 000

2 Bronze products are aimed at small farmers and people graduating from the Step-Up scheme. It provides loans up to R50 000.

3 Silver products are for commercial small farmers.

4 Gold products are for large commercial farmers.

The Land Bank has acted as an apex institution in the past (i.e. wholesaler of funds) by granting loans to traditional agricultural input and marketing co-operatives (and later co-operatives/companies) who, in turn, have on-lent seasonal input loans to their members. However, with the recent shift in its mandate to expand the financial frontier to include more disadvantaged clientele, this apex role is being expanded into alternative channels of agents and intermediaries, thereby facing some of the same challenges as an apex like Khula or the NHFC.

The outreach potential of the Step-Up programme is high. This programme is likely to generate the largest numbers and possibly reach the poorest clients. In July 2001, after a little more than three years of operation, it has incorporated over 43 000 borrowers with a net loan book of roughly R12 million and an on-time loan recovery over 80%. The average loan size is around R500. In time, these borrowers will be able to "step-up" into larger loan sizes each time they repay their six-month loans on time (or earlier). Interest and fees are 3% a month. Borrowers can continue for nine loan cycles, currently to a maximum loan size of R20 000 at the end of which time they can continue at this level (or at some smaller amount) or else graduate into a Land Bank agricultural loan product.

There are several distinct features of this programme. First, it is largely rural in focus in contrast to the urban-based Start-Up programme in Cape Town (which follows a similar format). Second, it is not necessarily targeted to agricultural loans, but is more inclusive in its mandate, accepting rural non-farm activities as well as farming. Trading, shop keeping and similar village-based activities are facilitated, many of which are related to handling agricultural products.

The programme creates interesting potential for graduates to shift into small-scale agricultural loans as they undertake agricultural activities. It is important for the Land Bank to avoid becoming too rigid in applying the "agricultural" criterion in deciding whether to grant loans to clients at this level. Frequently, low-income households are engaged in multiple activities to diversify their risks, with non-farm and off-farm activities complementing their agricultural activity. The bank, in effect, makes a loan to a household rather than for a specific activity within the household.

Initially, loan officers from the Land Bank branches disseminated the particulars of the programme, which requires very little from the lender or the borrower. Interested borrowers must have a valid ID document and open a bank account at the nearest First National Bank branch with a R50 deposit to secure their first Step-Up loan of R200 It is possible to open an account in a different bank in their locale, but it must have electronic transfer linkages with the First National Bank branch to which their monthly repayments plus interest will be transferred for each six-month loan. Prospective borrowers are also expected to attend a short Step-Up presentation at their local Land Bank branch. Finally, they must have a contactable postal address for communication purposes.

The lender engages in no loan evaluation or creditworthiness exercise, so costs are low. Nonetheless, the bank believes that carrying out initial promotion efforts and follow-up monitoring for delinquent borrowers drains too much loan officer time from other duties, so branches in district areas select independent agents. The key incentive feature in the agents contract is that he only receives his commission on each loan (currently designed at R40) after it has been completely repaid at the end of its six-month term (or earlier if the borrower repays early). Only R10 per loan is made upfront to the agent for all loans successfully registered in the programme. Another advantage is that no money passes through the agent's hands, thereby reducing the scope for possible abuse (i.e. opportunistic behaviour) by agents.

Another feature stimulating reasonable loan recovery is the personal incentive for borrowers to stay in the programme so they can automatically benefit form future "step-up" or larger loan sizes. This is a strong inducement for borrowers to repay to protect their access to future loans. This built-in voluntary contract enforcement is in effect a collateral substitute. Nevertheless, the programme is still young and the effectiveness of the agent network has yet to be tested.

The programme represents a savings on capacity building expenses (since none are needed here) and administrative overheads typical of other lending programmes that engage in client evaluation tasks. Finally, there is no need to worry about ownership and governance structures since the Land Bank is working through individual agents rather than intermediaries. In the end, this micro-finance initiated by the Land Bank could prove to be an innovative vehicle to reach hitherto excluded poor rural constituencies. Risks to the Land Bank, low at present, will increase over time as more borrowers graduate into the higher "steps" of borrowing.

Formal Sector Services at Nyandeni and Libode

The two magisterial districts of Nyandeni Municipality, Libode and Ngqeleni, have no formal banking facilities and none of the major banks is operating in these towns. A newly formed community bank is called Financial Services Co-op but apparently it has not yet started operating. Since there is no bank in Ngqeleni, people use banks in Umtata, which is about 30km away. Some people in the area bank with the Post Office.

There are a number of service provider organizations in Libode town. These include an NGO called *African Co-operative Action Trust (ACAT)*, which has its head offices in Umtata and services a number of projects in Libode (see the table below).

FIGURE 3.8 ACAT Community Projects in Libode District

Nature of Project	Number of Projects	Project Membership	Range
Vegetable gardens	13	173	4–30
Baking	4	31	6–10
Leather	1	10	–
Candle making	2	9	3–6
Sewing clubs	15	73	2–12
Piggery	3	28	8–12
Handcrafts (disabled)	1	16	–
Brick making	1	10	–
Poultry	10	79	5–14
Poultry & candle making	1	10	–
Traditional wear	1	18	–
Netting wire	1	3	–

LIBEC (Libode Business Enhancement Centre) is an organization that helps people or communities in the area with training and micro-finance. It was started in 1998. The branch of LIBEC responsible for training of communities is funded by the Ntsika Enterprise Promotion Agency. It also assists individuals to apply for funds from the Land Bank in East London on a step-up programme (step up loan ladder), whereby individuals are given loans ranging from R200 to R18 000 to start their own projects or businesses. Most people who borrow from this fund are apparently hawkers who would like to set up businesses, such as selling apples, chickens, etc.

The micro-finance branch of LIBEC promotes borrowing by groups rather than individuals. An interested group of people (3–10) can apply for a loan, following which the facilitating officers visit the group to verify everything stated in the application. Those borrowing for the first time get loans ranging from R300 to R600 per person in the group. They are allowed a period of four months in which to pay back the loan at an interest of 2.5%. After paying back the loan, they qualify for another ranging from

R600 to R1 500 per member in the group for a period of six months, also at an interest rate of 2.5%. If the same group would like to borrow for a third time, it would qualify for a bigger loan of R3 500 per member of the group, for a period of 12 months, at an interest rate of 2.5%.

LIBEC only operates in two of the three districts, i.e. Ngqeleni and Libode. It obtains its funds from KHULA, which is an agency of the Department of Trade & Industry.

When a group qualifies for a loan, it opens a bank account into which the money is deposited. All members of the group are asked to be present when the cheque is handed to the project's leader – to avoid some members claiming not to have received the money. The group repays the money to LIBEC through the Standard Bank branch in Umtata.

So far, some 55 groups have been funded by LIBEC. There are few new projects because the organization is now more cautious about screening applicants in an effort to minimise problems regarding repayment.

NUBIAN has been advertising for agents to represent the bank and will soon start to operate in Libode.

Libode Farmer Support Centre was started in 1997 as part of the Presidential Project Team (PPT). Funding was obtained to open a farm-input outlet, which requires those interested to pay a joining fee and an annual subscription fee. Paid-up members receive a discount of 5% on every purchase. Individuals pay a once-off joining fee of R50 and an annual subscription fee of R20. Groups wanting to benefit from the services of the centre pay a joining fee of R250 and annual subscription of R150. “Non members” may purchase from the centre, but do not receive any discount. The centre provides services like input supply and advice to farmers from Tsolo, Qumbu, Ngqeleni, and Port St Johns. The current membership is about 50.

There is *one post office* that provides both postal and banking facilities. This is especially useful for old people who find it difficult to travel to Umtata, 30km away.

Libode Community Advice Centre was started in 1998 with funding from a Swedish organization, International Commission of Jurists. It provides communities with information of various kinds, and collaborates with an organization called Legal Resources, based in Grahamstown, to deal with problems such as: delayed receipt of pensions and other grants like unemployment benefits; suspension of disability grants; etc. As with most NGOs, funding to keep the centre afloat is becoming a major problem.

Tombo Enterprise Development Centre in Tombo, 20km from Port St Johns, was started in 1996, but became operational in 1997 with funds from the Presidential Project

Team. The centre provides services such as support to entrepreneurs in terms of business advice, training and information dissemination. It also facilitates funding for potential entrepreneurs by referring them to the Eastern Cape Development Corporation and the Land Bank. The activities of the centre are subdivided into: SMMEs, youth activities, women's projects, and farmers' groups. Overall, the centre services about 90 project groups, which range from sewing, baking, farming, piggery, poultry, arts and crafts. The National Development Agency has also assisted by funding some of the projects.

The size of loans are small at R250 per person in a group of at least five people, though some individual business people have borrowed large amounts up to R50 000.

Burial Societies

Burial societies in Libode town include Chithibunga, Mantolo, AVBOB and Khululani. All are formal businesses that send out agents to canvas and recruit members both in towns and villages. They operate on a provincial or national level. However, there are also informal clubs in the villages, which are called burial or burial and social clubs. The majority of membership of both burial societies and clubs are old people. The club members organize themselves in a group to pool money to assist members with funerals or weddings.

Chitibunga Burial Society. A member pays a joining fee of R60, and a monthly fee of R55. These amounts cover both spouses and dependants below the age of 21 years. Dependants over 21 pay R45 a month. New members pay the monthly fee for six months before qualifying for benefits.

Benefits: When a "member family" is bereaved of an adult (anyone over 14 years of age), the administrators of the society collect the body and prepare it for burial. They provide a coffin and pay the family R2000 to buy sheep, and another R800 for groceries. They also provide the family with tents used as shelter at the family home together with public address system coupled with preparation of the grave. After a year, the society "donates" a tombstone to the family. In the case of a child under 14 years, the family receives R500 sheep, R300 for a coffin, R200 for groceries but no tombstone.

Mfolozi Burial Society. There appears to be no joining fee, just a monthly fee of R20. Members must pay their monthly dues for six months before they can claim benefits.

Benefits: in the case of bereavement, the family is given four sheep, R1 500 for groceries and a coffin worth R2 000. If members use the society's tent, the fee is R600. If not, the family receives R600. No tombstone is provided.

Quma Burial Society. The joining fee is R55 and the monthly fee R25. As with Mfolozi, age determines how much a member pays.

Benefits: three sheep, R1500 for groceries and a coffin worth R2 000.

In the Nyandeni region, Quma has teamed up with a local businessman, who owns a grocery shop, known as Codesa, by which Codesa supplies and transports the groceries and the sheep to the bereaved family's home. This alleviates the trouble the family would have gone through shopping and transporting the goods. In turn, Codesa receives payment by cheque from the society administrators. This has apparently attracted more people to the society.

Other Associations and Institutions

According to a study conducted by Jordan (1999) in the Wild Coast Spatial Development Initiative (SDI), there are many institutions/organizations involved in development in the area. Among these were the TRC, TLC, SANCO, traditional authorities, a hawkers' association, farmers' association and SDI committee. Membership of these institutions ranged from 11 to more than 200, with those that are community-based having less than 50 members. Half of the institutions relied on self-funding while the rest relied on government and funds from the ratepayers.

Most were involved in collaborative work such as cleaning campaigns, crime fighting, road construction in the villages, running workshops on conflict resolution and financial management, etc. Members of the institutions claimed to have been trained in agriculture, housing/road construction, electrification, resource management, conflict resolution, financial management, candle making and arts and crafts. There were a number of projects in the area, especially along the coast.

Formal Sector Services: Port St. Johns

Standard Bank Group Scheme. They charge a joining fee of R50, and a monthly fee of R35. There are a number of benefits: On the death of the head of family or his spouse, the scheme pays R10 000. On the death of children, the scheme pays an amount of R5000 to R6 000.

Many informal village based burial clubs have collapsed due to competition from the formal societies. The formal societies organize impressive funerals, which serve as advertisements for them. As a result, some members of the locally based clubs opt to join the formal societies.

3.6.2 Informal Sector and Occupations

Moneylenders

About three moneylenders in the area closed early in 2001. The majority of people are said to depend on uZonesegistered loan sharks, who demand interest rates ranging from 30% to 50% per year.

Burial Clubs

Many informal village based burial clubs have collapsed due to competition from the formal societies. The formal societies organise impressive funerals, which serve as advertisements for them; as a result, some of the members of the locally based clubs opt to join the formal societies.

3.6.3 Main Conclusions and Implications for Micro-Finance

- South Africa has a large, well established, rapidly expanding micro-finance industry. However, the centre of gravity of the industry is firmly in urban areas, in consumer finance and in the salaried employee market.
- Although as much as 35% of micro-finance activity is estimated to take place in rural areas, the overwhelming bulk of it is through informal sector savings groups. Micro-credit for rural households and micro-enterprises is much more difficult to access. Even in the nearest city or large town, these categories of borrowers – especially micro-entrepreneurs – are not well catered for, as relatively few are regular salaried employees and most micro-loans are geared to consumer needs. Very few NGOs offering financial services are located in rural areas. Unless rural communities expand their own initiatives, access to micro-finance – particularly micro-credit – can be expected to deteriorate rather than improve in the foreseeable future.
- Notable potential counterforces are the Land Bank, TEBA-Cash, Ithala Bank (all of which are institutionally and financially strong and committed to operating in rural areas), and the village banking movement, which, though still small, appears to be expanding on a sound basis after an indifferent start.
- Only a small percentage of micro-enterprises (urban or rural) use micro-credit – estimated at no more than 1% currently. The main source of loans for micro-enterprises is trade credit in some form and the purpose to which it is put is to fund working (as opposed to fixed) capital requirements. Almost no start-up capital for micro-enterprises is borrowed from MFIs.

- Though unemployment levels are high, especially in rural areas, most rural households are able to draw on income from a range of sources. Locally earned wages are on average the most important source, but remittances from household members employed elsewhere and welfare payments (chiefly pensions and disability grants) also contribute substantially. From recent surveys, it is evident that the average rural household generates no more than about 5% of its income from agriculture. Significantly, domestic micro-enterprises bring in almost the same. This diversity of income sources adds greatly to rural households' ability to cope with income volatility and, consequently, to their creditworthiness.
- The popularity of informal savings groups is explained by the long distances to formal sector savings facilities recorded in the same surveys (30–80km on average). While a proportion of these savings is on-lent, it is almost always only to members of these groups, either on demand or on a rotating basis. Much of the balance of the savings is channelled through formal sector deposits away from the rural economy. Very few formal sector bodies offering rural savings facilities also engage in micro-lending in rural areas – TEBA-Cash and Ithala Bank (in KwaZulu-Natal) being the main exceptions.
- The picture in Nyandeni does not appear to differ significantly from this countrywide rural perspective. At present, no formal sector MFIs are recorded as having branches in the district, although one NGO and one parastatal have provided start-up and other grants for a range of informal sector employment projects and assisted the projects in obtaining finance from other sources, such as the Land Bank. One formal sector bank offering micro-credit is reported to be planning to open in Libode.
- However, just outside the district's western border is Umtata where a broad range of formal and informal micro-finance services is available. It can safely be assumed that many Nyandeni residents make use of these facilities, though, as already noted, not often for micro-enterprise finance.
- For donors whose objective is to increase access to micro-finance – particularly microcredit – in rural areas, the key strategic choice in Nyandeni seems to be:
  - whether to try to assist existing indigenous savings-based groups to "upscale" their activities and, in particular, to expand their lending to borrowers who are not necessarily also savers (with the group) – a major psychological, operational and legal challenge;

  - or to work with an established micro-lender – such as the Land Bank, TEBA-Cash or the village banking movement – to expand their operations into the district in a way that meets both parties' objectives.

- In both instances, all of the considerations regarding selection, capitalization, technical support and monitoring and evaluating that were raised in respect of Chimanimani and Chimoio (see 3.2.3 and 3.4.3) also apply here.

4

Micro-finance in Rural Communities

4.1 OVERVIEW

Rural finance can be considered the stepchild of the broad micro-finance sector. Most efforts in the world to support micro-finance endeavours are in the urban or peri-urban context. Rural finance is often equated with agricultural finance, and associated with the general high risk of providing financial services to the agricultural sector. Rural finance basically refers to micro-finance in rural areas and it incorporates agricultural finance. This section gives an overview of rural finance issues, lessons learned and best practices.

Financial intermediation between banks and clients is more difficult and costly in rural areas than in urban areas because of three inescapable rural characteristics (Coetzee *et al*, 1996):

- spatial dispersion and the associated high information and transaction costs;

- specialization of rural areas in a few economic activities linked directly or indirectly to agriculture, which exposes rural clients to the vagaries of nature and leads to covariance of their incomes; and
- seasonality of production with its accompanying sharp and opposite fluctuations in the demand for credit and deposit services.

If a rural bank operated in a single small area such as a group of villages, it would be able to sharply reduce the information and transaction cost problems associated with spatial dispersion. However, covariance and seasonality would force it to operate with a large reserve ratio. A high reserve ratio requires large intermediation margins to make such rural banking profitable. Rural financial institutions conventionally use three ways to reduce the impact of covariance and seasonality on reserve requirements. Firstly, they diversify their client base and loan portfolio out of agriculture into agro-processing and other rural non-farm enterprises. Secondly, they link their operations to the urban economy through financial markets or by integrating the rural operations into a branch network that includes urban locations. Thirdly, they set up inter-regional risk pooling mechanisms via networks or federations of individual rural financial institutions.

But interregional links, whether through branch banking, federations or other risk pooling devices, still face special difficulties in supervising and monitoring operations of an individual rural branch or office. These difficulties are associated with the distance and fluctuations in branch performance that are induced by seasonality and covariance. Rescheduling of the debt of rural clients within a particular zone is occasionally required in order to tide them over years of bad crops or bad prices. This leads to opportunities for clients to collude against a single local institution, a branch, or an entire system, which further increases the supervision problem.

Specialized farm credit institutions, the mechanisms of the conventional supply-led approach to rural credit, are poorly adapted to address the difficulties associated with rural finance. They typically do not diversify their client base and portfolio inside the rural areas. They are usually not integrated into larger institutions with urban operations and have limited urban diversification and risk pooling opportunities. Even with inter-regional risk pooling they remain vulnerable to major droughts affecting an entire country and to international commodity price slumps.

Recently, a more diverse approach to financial intermediation in rural areas became apparent. This approach acknowledges the context and a range of institutional options in different contexts. In some settings co-operative or member-based institutions seem to be more appropriate; in other settings credit programmes combining individual and group technology seem appropriate. Some reformed state banks have also been successful in improving access to financial services in rural areas. There is no single model that is applicable in all settings but there are some basic rules that are applicable in most settings. This will be explored further in this section.

The history of rural finance and the differentiation between a conventional supply-led approach and a new market based approach is aptly summarised in the table below.

FIGURE 4.1 Comparison of the Directed Debt Approach with the New Market Based Approach

Features	Directed Debt – conventional approach	Financial Market Based – new approach
Problem definition	Market imperfections	Transaction costs
Role of financial markets	Help the poor, technology, stimulate production	Allocation of resources
View of users	Beneficiaries	Clients
Subsidies and taxes	Dependent	Independent
Sources of funds	Vertical	Horizontal
Information	Not an issue	Central issue
Sustainability	Ignored	Emphasised
Evaluations	Bean counting	Performance of institution

Source: Adapted from Adams, 1999

Although the conventional approach is part of our history of rural and micro-finance, many challenges still remain. The following table summarizes recent development and continued shortcomings in rural finance and micro-finance.

FIGURE 4.2 Recent Developments and Continued Shortcomings in Rural Finance and Micro-Finance

Topic	Recent Developments in Some Countries	Continued Shortcomings in the Majority of Countries
Policy environment	Macroeconomic stability; interest rate deregulation; ease of setting up banks or branches; low minimum capital requirements for MFIs	Inadequate policy and legal environment; slow implementation of deregulation; inadequate property rights and judicial procedures
Micro-finance institutions	New legal forms for commercially operating MFIs; privately financed start-up; increasing numbers of self-sustaining MFIs	Lack of appropriate legal forms; excessive capital requirements
Non-formal and formal non-bank financial institutions	New legal framework provides opportunities for upgrading to formal levels and for financial market integration	The potential for upgrading millions of informal financial institutions remains largely untapped

☞

Figure 4.2 *continued*

Topic	Recent Developments in Some Countries	Continued Shortcomings in the Majority of Countries
NGOs	Innovative approaches to poverty lending in repressive environments; some successful conversions to formal intermediaries	NGOs are slow in mobilizing domestic resources and in striving for self-reliance; donors support unviable NGOs
Agricultural development banks	Incipient reforms towards autonomy, viability and self-reliance, with or without privatisation	Political interference; lack of viability; failure to meet demand for credit and deposit services
MFI regulation and supervision	Controversial discussion on the need for effective regulation and supervision of MFIs	Financial authorities unable to supervise MFIs; agricultural development banks (AgDBs) escape supervision; lack of MFI self-regulation
Agricultural finance	Self-financing from profits and savings plus non-targeted commercial credit replaces preferential sources	Self-financing and commercial credit insufficient to meet the demand for short- and long-term finance; inadequate savings mobilization
Access of the poor to financial services	Outreach of viable MFIs (including rural and other banks) to the poor as users and owners drastically increased	Vast numbers of poor people, particularly in marginal areas, lack access to savings and credit services

Source: IFAD, 2000

It is clear that major challenges still remain. In the next two sections the lessons of experience that can help to form a strategy on the best approaches in rural finance will be summarized, and the best practices in rural finance will also be highlighted

Figure 4.3 Some Frequently Asked Questions about Micro-Finance

What is meant by 'micro-finance'?	There is probably no universally accepted definition. But in the context of lending, a reasonable working definition is that it refers to loans to clients who are unable to gain access to conventional commercial bank loans. Such borrowers are often called "unbankable" – a complete misrepresentation when one recalls how many millions (at least eight million in South Africa alone) now borrow from the micro-finance industry. While reluctant to lend, commercial banks are quite willing to accept savings from "unbankable" clients. A reasonable working definition of micro-finance in a savings context might refer to the savings of all such "unbankable" clients, whether deposited with commercial banks or with any other financial institution (as well as any savings that "bankable" clients happen to lodge with informal, or unregistered, savings bodies). Micro-finance could also include any other financial services, such as transmission facilities or insurance, provided to "unbankable" clients.
What are micro-loans used for?	Almost anything that involves spending – consumption expenditure, from school fees to television sets, or capital outlays, from financing the purchase of goods to be sold to fund the acquisition of productive assets such as hairclippers or wheelbarrows. Some loans are made for specific purposes – e.g. credit advanced by the sellers of assets – and others are non-specific cash loans.

☞

Figure 4.2 *continued*

What are micro-loans well adapted for?	Most micro-loans are for short periods, typically a few days to several months, and require frequent small repayments. Clients need to have a frequent and fairly regular flow of income to meet this requirement. Stable wage employment generates just such a cash flow and so do many micro-enterprises that manufacture goods or provide services. Micro-loans are well adapted to almost any purchase that is not too large to be repaid within a relatively short period, given the client's earnings level and pattern.
What are micro-loans generally not able to do?	Finance the purchase of capital items whose payback period is longer than a few months or that does not generate an adequate stream of earnings for some while after the date of purchase. Most "large" capital outlays fall into this category for micro-entrepreneurs, as (unfortunately) do even relatively small short-term outlays for most types of farming (dairy and poultry being two exceptions), unless the farmer is able to draw on income from other sources.
Why do micro-lenders normally insist on short repayment periods and on frequent payments?	Micro-lenders rely on traditional forms of security for loans, such as a mortgage bond on a house or on land, to a far smaller extent than commercial banks, if at all. This is because borrowers often do not have such assets to pledge – which is why commercial banks regard them as "unbankable" – and because, even if they do, the cost of legally securing such assets and then of actually taking possession of them in case of default is far too high to be covered by the interest that the lender earns on a small loan. Instead, most micro-lenders have to rely on clients' future flow of income for security. The shorter the term of the loan and the more frequent the repayments, the smaller the risk that current known income sources will evaporate before the loan is settled in full. As clients demonstrate the ability to pay, so most micro-lenders are prepared to lend more, regarding the risk as smaller even though the amount lent is larger. Track record serves as an excellent, low-cost substitute for the typical careful investigation into clients' background that commercial banks conduct before lending.

4.2 LESSONS FROM EXPERIENCE

The experience gained in many developing countries in operating rural finance and agricultural credit systems is extremely important in considering the redesign of the rural finance system in the specific countries Southern African countries covered in this report. Generally, the performance of many rural finance systems in developing countries has failed with respect to both efficiency and equity considerations. However, over the last two decades, several successful institutions and programmes have emerged, scoring high when assessed with respect to the two overriding criteria:

i) outreach to the targeted population; and

ii) achieving full self-sustainability or significantly reducing subsidy dependence.

The experience gained in other developing countries can be instrumental in adopting policies, modes of operation and procedures that have been introduced in the few successful rural finance institutions and in refraining from repeating widely spread errors. Such errors have often drained scarce budget resources and have frequently benefited well-to-do, influential farmers rather than the more needy, low-income farmers and rural entrepreneurs.

The Performance of Specialized Agricultural Credit Institutions (SACIs)

In general, specialized institutions established to implement targeted and often subsidized loans were frequently planned and operated in a non-viable manner, or within economic, political, social and institutional environments, that hampered their effectiveness. Among the most important deficiencies of the state-sponsored SACIs has been the conspicuous absence of balance between voluntary savings mobilization and the institutions' sizeable loan portfolios. Inadequate, depressed deposit interest rates, which have resulted from and co-existed with easy access to cheap funds of state or international donors, have discouraged savings mobilization. As a result, these SACIs have often emerged as mere credit disbursement windows rather than as balanced, full-service financial institutions. Often the aggregate cost to society of maintaining continued operations of the institutions involved, including the value of the subsidies in the form of access to cheap and subsidised sources of finance, has not been properly disclosed.

Since their operations have not been motivated by commercial financial performance objectives, these institutions, by and large, have suffered from inadequate credit evaluation, management and follow-up procedures. This, in turn, resulted in very poor loan collection performance. Instead of gradual growth and prudent expansion, whereby collection performance and other financial viability criteria serve as prime indicators in assessing the soundness of the institutions involved, these institutions have practised lax screening of investment plans, rapid disbursements and imbalanced steep growth in lending volume and loan portfolio. Deficient financial reporting practices have often made it almost impossible to determine when and which payments are overdue, as well as what part of the loan portfolio is non-performing or beyond recovery. Arrears have often been measured against the total value of the loan portfolio, thus grossly underestimating the severity of the arrears problem when the portfolio has grown rapidly in nominal terms (which regularly happens in highly inflationary economies), when the loan portfolio has consisted of a substantial share of long-term loans, and when grace periods have been granted. Generally, adequate provision for bad debts has not been made and a proper assessment of the institution's sustainability has often been impossible. The financial results disclosed by these institutions have often been too rosy, as loan losses have not been accounted for properly. The actual dismal financial position would only be discovered when the institution lost its liquidity.

By attempting to ensure that eligibility criteria have been met and to avoid the diversion of funds, these SACIs have not only incurred high costs but also have imposed high transaction costs on borrowers by, *inter alia*, forcing them to wait long periods for loan disbursement. Control of on-lending interest rates, a widespread practice in developing countries, has not allowed compensation for the high level of risk involved in lending to agricultural operations, given their exposure to the vagaries of nature. In addition, medium and long-term loans have been granted without adequate analysis of the investments or adequate collateral. To maximize the return on these institutions' loan portfolios, when constrained by legally imposed ceiling interest rates, large borrowers have often been favoured in an attempt to minimize risk and administrative costs per dollar lent, thereby crowding out small-scale entrepreneurs.

The main lessons learnt over recent years can be summarized as follows:

Rural finance entrepreneurs, including small farmers, wish to have access to efficient formal financial services. The access, not the subsidization of the lending interest rates, is extremely important to their livelihood. Access to efficient formal finance systems, even without subsidized interest rates, would likely improve their situation as they would be paying less than the interest rates charged by informal moneylenders or less than interest rates that reflect the sum of financial and transaction costs associated with borrowing from less efficient supply-led programmes. Almost invariably, the design of such a system faces a dilemma: whether, subject to budget constraints, priority should be given to servicing more people with less subsidy per unit lent, or fewer people with higher subsidy per unit lent.

The rural poor have often greatly benefited from and appreciated the design of sound saving schemes that ensure convenient access to their secured and liquid deposits and pay adequate return on their savings.

"Urban Biased" Policies

Many developing countries have implemented "urban biased" policies that have adversely affected the performance and profitability of the agriculture sector over the recent decades. These policies have been: (i) over-valued rate of exchange; (ii) price control on agricultural produce; (iii) over-protection of outputs of domestic industry that are used as agricultural inputs; (iv) inadequate investments in rural infrastructure (roads, health, education, water supply, etc); and (v) direct, over-taxation of agricultural export.

In an attempt to compensate the sector for the results of these deficient policies, directed, concessional credit programmes have often been introduced. This "second best" compensation mechanism, however, cannot efficiently offset the adverse impact of these discriminatory policies. This "second best" approach is neither capable of ensuring the realization of the potential growth of the agriculture sector nor is it capable of mitigating equity issues. Furthermore, the subsidized interest rates of directed credit schemes are likely to benefit only a part, frequently a small part, of the farming sector because these schemes are invariably budget constrained, while the "urban biased" policies would continue to affect adversely the agriculture sector as a whole. In addition, it is often well-to-do farmers who are the likely beneficiaries of the directed, concessional credit scheme. Therefore, this compensation mechanism of subsidized interest rates is likely to worsen the income distribution.

Thus, these deficient policies ought to be tackled directly and removed to allow the agriculture sector to maximize its growth potential. The "second best" policy of partial compensation through subsidized credit is often a futile exercise that only augments distortions by adding financial intermediation distortions to the already existing deficient policies and distortions prevalent in the agriculture sector.

Interest Rate Policy

There is no *a priori* economic justification for general subsidization of on-lending interest rates to ultimate beneficiaries in the agriculture sector. Scarce resources will be required, however, to finance the start-up activities and institutional strengthening of emerging rural finance institutions. These institutions could benefit from gradually decreasing subsidies/grants provided in a time-bound manner. When income redistribution is pursued on equity grounds, a grant is a preferred mode over subsidized interest rates.

The use of grants, which should be budget funded, generates transparency and fiscal discipline. It also improves the likelihood of the adequate delivery of the intended grant. In contrast, a subsidized loan of the type extended by, for example, the typical SACI in South Africa (Agricultural Credit Board, now closed) – namely, a loan for the purchase of land for up to 25 years, with nominal interest rate of 8% per annum and a grace period of five years – results in a financial contract, the actual grant element of which is determined only ex-post by the difference between the rate of inflation and the 8% lending interest rate over the loan duration. The full extent of such subsidy is often hidden from both decision makers and the public, thereby making it impossible to assess the merits and costs of the subsidized terms of the loan compared with other public investments options.

Interest Rate Subsidies

Subsidized interest rates have been found to create a number of undesirable outcomes. Subsidizing interest rates creates a bias toward acceptance of investment projects with low returns. These projects do not enhance sectoral productivity and growth as much as projects with higher returns. If subsidies are to be given, they must be carefully designed not to distort the market, but rather to promote its development. Subsidies for technical assistance and location subsidies for reducing transaction costs are preferable to interest rate subsidies. However, directed lines of credit frequently involve below-market interest rates.

Interest rate subsidies have been found to encourage the substitution of credit for the borrower's own funds (or the funds of other lenders), promote excessive indebtedness, skew incentives in favour of capital-intensive techniques of production, encourage corruption and the rationing of credit, and weaken borrowers' incentives to repay and lenders' incentives for debt recovery. Interest rate subsidies also result in lower return to savers and higher costs for non-subsidized borrowers, unless the subsidy is fully paid by the budget instead of the banks. Finally, interest rate subsidies have added significantly to fiscal deficits and inflation in many countries.

Savings Mobilization

Poor people, especially the rural poor – who are subject to the vagaries of nature, face a high covariance risk and highly fluctuating incomes – need savings facilities. Often, access to savings is their only recourse in case of emergency. Therefore, the design of rural finance schemes should incorporate the provision of savings services. The latter includes, among others, the safeguarding of deposits and savings through adequate institution building in the rural finance institutions' concern, regulation and supervision. All the successful rural finance schemes have recently increased the financial ratio of voluntary savings over outstanding loan portfolio, thereby progressing towards subsidy independence and reduced reliance on donor or state funds. Furthermore, rural finance institutions have demonstrated a more efficient financial intermediation performance when they have operated on both sides of the balance sheet and have reduced the transaction cost compared with rural finance institutions that have extended only loans.

Rural Finance vs Agricultural Credit

When rural development is pursued, ensuring the availability of efficient rural finance services (including savings) is preferable to extending credit to finance exclusively agricultural production. There is nothing "sacred" about income generated from agriculture compared to income generated from any other rural activity. Furthermore, given the high covariant risk associated with agriculture, other non-agriculture activities would often mitigate such risk. Rural finance intermediaries have often obtained a more balanced and less risky arrears "contaminated" loan portfolio when launching credit in an indiscriminate manner to all segments of the rural economy, thereby considering the creditworthiness of the borrower and the merits of the investments financed.

Rural Finance, Rural Infrastructure and Complimentary Services

When rural finance schemes accompany investments in rural infrastructure, their performance is often more efficient and less subsidy dependent. They also achieve increased outreach and contribute more to the welfare of the rural population. Appropriate investments in rural roads, water supply, electricity, health and education are likely to increase the economic and financial return on private investments that, in turn, would facilitate improved loan collection and financial viability of the rural finance institutions involved.

Where land reform is implemented and new entrants lacking adequate skills are the beneficiaries, it is essential that they should benefit simultaneously from access to other complimentary services. This enhances the likelihood of successful settlement and prompt debt repayments (extension, etc.). Defaulters should be foreclosed as soon as it is realized that they cannot become viable farmers. This ensures financial discipline and adequate resource allocation within a framework of a well-defined exit strategy. Concerted efforts are essential to ensure the optimal mix of support granted to institutions that provide financial services, investment in rural infrastructure and provision of supplementary services.

Financial infrastructure is another extremely important consideration. South Africa's success emanates from its large existing infrastructure. Micro-credit is an easy add-on if people already have bank accounts. This refers not so much to the "unbanked" as to those who do not have access to credit. Countries with better overall financial infrastructure (including successful agri-credit banks) can adapt much more rapidly to successful rural finance.

Across Africa, the carrying potential of the market is a critical determining factor in the successful establishment of viable MFIs. Top-down, credit-driven institutions are often too expensive to operate successfully unless they have extremely high interest rates (well over 120% effective), which implies that the economic activities must be that profitable. The best financial intermediaries in poor rural areas reduce the "leakage" and financial transactions costs to a minimum, reinvesting the hard cash (which is the scarce resource) back into the programme. These tend to be savings based with transparent, simple systems for management. As noted above, areas with efficient rural infrastructure and intermediaries can help to reduce these costs by simplifying transactions and reducing their costs.

4.3 BEST PRACTICES

The International Experience

A growing literature on rural finance has recently based its assessment of programmes' performance on two criteria – the level of outreach and the degree of self-sustainability achieved. The main performance indicators of outreach are:

- the value of total savings;
- the average value and number of savings accounts;
- the value of the outstanding loan portfolio;
- the average value and number of loans extended;
- the real annual growth of assets in recent years;
- the number of branches or units established;
- the percentage of the targeted rural population actually served;
- the level of participation of women, small-holder farmers, the poor or any other underserved segment of the population that is intended to be serviced; and
- the outcome of the administrative intervention in the financial markets.

In addition, outreach has also recently been measured in softer terms, incorporating measures of the poverty levels of clients.

Financial self-sustainability of a development finance institution is achieved when the return on equity, net of any subsidy received, equals or exceeds the opportunity cost of funds. To eliminate or significantly reduce subsidy dependence, a development finance institution needs to have:

- a positive lending rate, which is high enough to cover its costs;
- a high rate of loan collection; and
- relatively low administrative costs.

It is also highly desirable that the development finance institutions develop an active policy towards promoting voluntary savings mobilization in pursuit of substituting funds sourced from the state or donors.

There are by now several well-documented cases of financial intermediaries, which have succeeded in reaching the rural poor in an efficient, innovative and sustainable manner. Perhaps the best known are the BRI – Unit Desa (BUD) in Indonesia, the Grameen Bank[1] in Bangladesh (GB) and the Bank for Agriculture & Agricultural Co-operatives in Thailand (BAAC). These three programmes differ in many respects. Nonetheless, an examination of both their differences and similarities has highlighted what may well explain their success in reaching a wide segment of their targeted clientele, achieving significant presence in their countries' formal finance sector and either fully reaching self-sustainability or making significant progress toward subsidy independence.

All these programmes have charged positive real interest rates on their loans. BUD has provided financial services exclusively and obtained a real interest rate exceeding 20% on its loan portfolio. It started by successfully restructuring its loan products and system. Following this and based on demonstrated demand by its clients, it included savings products in its product range. Lacking any subsidy over recent years, it has relied on a plethora of savings facilities to tap rural savings.

BUD's success in mobilizing savings is unprecedented. Its outstanding value far exceeds (2.1 times) its outstanding loan portfolio, which has grown at a rapid rate over recent years. BUD used high interest rates for both its lending and savings mobilization, thereby refuting two myths:

a) that the poor cannot pay sufficiently "high" interest rates to fully cover financial, administrative and credit risk costs; and

b) that the poor cannot save.

While administrative costs were high because of the small average loan size, loan recovery was excellent. The flexible mode of operations and the sophisticated set of incentives to staff, managers and clients, supported by an extremely efficient managerial information system, contributed to BUD's outstanding financial results, including the achievement of full subsidy independence. Currently, BUD has two million borrowers, and 12 million depositors.

[1] Although there are varied opinions on whether the Grameen Bank is a successful micro-finance institution and its current status in terms of sustainability is in question we still feel that it was one of the pioneers in the micro-finance world and that many strategies it followed can serve as an example for new programmes. Two other institutions in Bangladesh, BRAC and ASHA, are good examples of successful and focused micro-finance institutions, which warrant more attention than they get in the international arena.

GB in Bangladesh is probably the best-known programme aimed at poverty alleviation through credit granted to borrowers who comprise small groups while using joint guarantees. GB has succeeded in achieving prominence in rural Bangladesh and in providing a wide range of financial and non-financial services to its clientele, the lion's share of whom are poor women. It has also made significant achievements in empowering women while improving their income and socio-economic status. GB targeted lower income strata than BUD, with an average loan size below US$100 equivalent, and succeeded in achieving exceptionally high loan recovery. GB has consistently expanded its clientele to about two million and has eZonesiched and diversified the variety of services it offers.

BAAC in Thailand has reached unprecedented outreach in rural banking. About two thirds of agricultural households in Thailand benefit from having accounts with the BAAC, which directs its lending to agricultural production, unlike BUD and GB, which do not confine their lending to agricultural production. BAAC uses small group joint liability as a mechanism to generate cost savings, and harnesses peer group pressure to ensure adequate screening and prompt loan repayment by borrowers. In recent years GB has made major progress towards self-sustainability, while BAAC and BUD have already achieved full subsidy independence.

Despite variations in their modes of operation, these institutions score well in terms of significant outreach and sustainability. Their successful performance is based on the application of positive lending interest rates, increasing reliance on savings mobilization to finance lending, emphasis on very high loan recovery and efficient, innovative modes of operation to guarantee reduced administrative costs.

An increasing number of younger institutions, particularly in Latin America, have successfully adopted similar principles. Some models, such as village banking, train community groups to mange their own savings and loan operations to meet low-income households' productive and consumption needs. Others, such as ACCION's affiliates throughout Latin America provide working capital to solidarity groups and individual micro-enterprises with job creation potential. Financial performance has been outstanding, confirming the lessons demonstrated by the Asian success stories.

Banking with the Poor

Two recent World Bank initiatives have been aimed at extending improved rural financial services to the poor.

For example, the World Bank has launched a programme of research into Sustainable Banking with the Poor (SBP), designed with the objectives of improving the ability of policymakers, managers of financial institutions, NGOs and other organizations to design and implement policies and programmes aimed at providing financial services to the poor, women and other under-served groups in a manner that strengthens rather than undermines the financial sector and builds sustainable institutions. One of the goal is to identify ways in which to provide effective subsidies for institution building in participating financial institutions in order to build institutional capacity and enhance the efficiency of their operations. The SBP:

- examines bank and non-bank experience focusing on financial service systems that have successfully reached the poor;
- assesses the financial performance and degree of self-sustainability achieved by these systems, the policy environment in which they function and the mechanisms they have used to achieve outreach in order to draw conclusions concerning best practice; and
- distils these findings into a number of accessible dissemination formats including seminars, short publications and a source book on Sustainable Banking with the Poor.

At the International Conference on Actions to Reduce Global Hunger hosted by the World Bank in 1993, the Bank expressed a willingness to join with other donors in an effort to explore ways of systematically increasing the resources available to the very poor. Over the past decade, provision of micro-credit and savings services has proved to be an effective means of job creation and income generation among the very poor. Participation of the poor in credit and savings systems has been correlated positively with betterment of family welfare, including improved nutritional and educational status among children and lower birth rates. To broaden and deepen this success, the Consultative Group to Assist the Poorest (CGAP) was established to address the provision of assistance to the poorest, initially through a micro-finance programme.

The CGAP is not a social safety net. It focuses on enabling very poor men and women to become progressively more productive, with the expectation that some participants will eventually move on to use formal banking services. The CGAP aspires to:

- expand the level of resources reaching the poorest of the economically active poor, initially by channelling funds through sound micro-finance institutions that meet the eligibility criteria approved by the CGAP;
- improve donor co-ordination for systematic financing of such programmes; and

- provide governments, donors and practitioners with a vehicle for structured learning and dissemination of best practices for delivering financial services to the very poor.

Adequate Policies and their Impact on Promoting Viable Rural Finance Markets

It is useful to summarize the major lessons learnt regarding the development of viable rural financial markets and institutions. These lessons fall into three primary policy categories: macro-economy, financial sector policies and institutions, and agricultural and rural development. These policy prescriptions are essential elements of a framework for the successful implementation of agricultural credit projects.[2]

Macro-economy

- Stabilize price level
- Avoid overprotection of industrial products used as agricultural inputs
- Maintain a sound exchange rate policy

Financial Policies and Institutions

- Apply positive real interest rates on loans and savings
- Rely on domestic saving mobilization to enhance self-sustainability of participating institutions
- Provide an adequate regulatory and supervisory framework, but ensure the full autonomy of rural finance institutions
- Apply outreach (to a well-defined target clientele) and self-sustainability as the two key criteria to assess the desirability of intervention
- Avoid ceilings on lending interest rates (unless for a short period in economies that go through radical transition)
- If justified, apply subsidies to institution-building to cover transaction costs related to higher risk and larger administrative costs, rather than to interest rates
- Insist on achieving a high loan repayment rate – the common denominator of all successful rural finance institutions

[2] An elaboration of these policies can be found in Chapter 4 of Yaron, Benjamin and Piprek, 1997.

- Identify and remove unwarranted institutional constraints that inhibit the smooth flow of financial resources (e.g. excessive collateral requirements, enforcement problems and poorly-defined property rights)
- Invest in institution-building and MIS development in infant rural financial institutions to ensure sustainability and shortening the transition to viability

Agricultural and Rural Development Policy

- Align relative domestic input-output prices with international prices
- Remove price controls and other distortions from agricultural product prices
- Avoid over-taxation of agricultural exports
- Improve market access and information services to farmers
- Avoid using subsidized interest rates as a “second best” measure in order to compensate for distorted “urban-biased” policies that suppress product prices or tax agriculture indirectly (e.g. overvalued exchange rates)
- Invest adequately in rural infrastructure and human resources


Fresh Hot
POPCORN

5

Policy Issues and Recommendations

In determining how best to deliver micro-finance services to rural communities in the three IRDP pilot sites, three clear levels of policy formulation can be distinguished:

- public policy on micro-finance promotion;
- donor/investor/wholesaler policy on retailer support; and
- operational policy for retailers.

Of the three, the first two are of most immediate relevance here.

As principal, the W.K. Kellogg Foundation (WKKF) has commissioned this research to assist in achieving its objective of catalysing growth and development initially in the pilot sites and ultimately in the Southern African community at large. The most appropriate role for such a body is unquestionably that of donor/investor/wholesaler. While it would technically be possible for WKKF to set up and operate its own retail micro-finance outlets, it is most unlikely either that it would want to involve itself in the details of on-the-ground operations or that its constitution would allow it to do so. Donor/investor/wholesaler policy on retailer support is therefore of prime relevance.

The Foundation's intention to launch a Public Policy Promotion Programme (PPPP) as part of its Integrated Rural Development Program (IRDP), with the objective, *inter alia*, of improving public rural development policy (see Terms of Reference, chapter 1) also makes public policy on micro-finance promotion an area of direct concern.

Only the third – operational policy for retailers – is, in this context, of less immediate relevance, though far from irrelevant for the achievement of donor/investor/retailer goals.

This chapter deals briefly with public policy issues and recommendations for the three countries and then in more depth with policy issues and recommendations for donors/investors/wholesalers.

5.1 PUBLIC POLICY ON MICRO-FINANCE PROMOTION

5.1.1 Zimbabwe

The discussion in this section is heavily indebted to Madzima, 2000.

The Zimbabwean government has always perceived the development of the MSE and SME sectors to be part of the economic liberalization strategy. "The issues of SME support and promotion are closely intertwined with the question of indigenous promotion and development."[1] The government attitude towards the SME sector may thus be deemed positive. The efforts made in creating various windows through government departments or parastatals are a clear indication of government goodwill. The fact that the initiative has not been successful does not nullify the motive. Through various instruments and liaison with local governments, the government has provided space for SME and MSE operators termed home industries. Almost all-major towns and growth points have such areas that are serviced by the local authorities for the informal sector. Tax holidays have been granted to manufacturing businesses located at growth points in a bid to attract private sector and SME/MSEs investments into rural areas.

[1] Paper presented by O.M. Tshabangu, then Deputy Secretary in the Ministry of Industry & Commerce. Paper entitled, "Current and Planned SME Promotion Programmes in Zimbabwe – a Government Perspective" It should be noted that the term SME is all embracing and encompasses MSEs.

The somewhat "easy" registration requirements with the Ministry of Finance are further evidence of the fact that the government has a soft spot for the sector. Furthermore, while the Moneylenders & Rates of Interest Act is outdated and its provisions ridiculous, the Ministry of Finance & Economic Development has – in recognition of these anomalies – not enforced the outdated provisions. Apparently, it is willing to consider revisions to some of the provisions that are no longer applicable.

The Ministry of Finance & Economic Development plays a pivotal role in the licensing of the financial institutions, including NGOs and private companies, which operate under the Moneylender's Act. Besides being the ministry responsible for company registration, it is also the ministry's responsibility to deregister or de-license institutions when their licenses expire or if they are found flouting the laws. The ministry has helped the micro-finance sector grow by giving licenses to several NGOs and private companies that are operating as MFIs nation-wide.

The Moneylenders Act does not provide for consistent external supervision of moneylenders' operations. What is required of the moneylenders is that they maintain books of accounts that should be produced to the Secretary of Finance or his nominee on demand. The Minister of Finance & Economic Development is empowered under the Act to set maximum lending rates. The current interest rates are as follows:[2]

FIGURE 5.1 Interest Rate Ceiling as Controlled by the Moneylenders Act

Interest Rate Ceiling	Loan Amount
50% per annum	not more than Z$100
35% per annum	not more than Z$10 000
25% per annum	not more than Z$100 000

The regulations further state that a lender cannot charge a rate that is equivalent to the Reserve Bank's re-discount rate or commercial or merchant banks' banker's acceptance rate, whichever is higher. An administrative fee of 3% can be charged for loans that exceed Z$100 000. The majority of MFIs lend sums below Z$10 000. However, the regulations do not refer to an Effective Interest Rate (EIR) calculation neither do they indicate the method of calculation.

Most MFIs that are operating are registered NGOs. It is the Ministry of Public Service, Labour & Social Welfare's responsibility to register an NGO before it can apply for

2 Moneylenders & Rates of Interest (Amendment) Regulations, 1993 (No.3)

moneylender's license from the Ministry of Finance & Economic Development. The ministry does not supervise or monitor the operations of an NGO as a moneylender. Under the PAAP[3] the ministry, through the department of SDF, has a MED programme, which seeks to promote the development of micro-enterprises by on-lending funds to MFIs. The funds are available to approved institutions at a concessional rate of 15% pa over a repayment period of three to ten years. Six institutions have so far benefited from the scheme. These are Zambuko Trust, NISSI Micro-Finance, Pundutso and WDCS, Self-Help Development Foundation and Phakama. It is remarkable that a total of Z$45 million has been disbursed to these institutions. While SDF insists that there are no credible MFIs to on-lend to, the conditions and requirements that they have set up may also be constraining access. Furthermore, the financing instruments are limited to one product – loans for on lending. Experiences from other such apex loan windows indicate that there is need for product diversification to suit the different needs of the MFIs.

The Ministry of Youth Development, Gender & Employment Creation is responsible for the registration of Co-operatives and Credit unions. As part of its mandate the ministry also facilitates the creation of new co-operatives and savings clubs. Under the Co-operatives & Savings Union Act, the registered co-operatives and savings unions are allowed to give loans only to members. The co-operative union has the right to determine the rate of interest on loans to members and can use the mobilized savings for on-lending. Lobbying for changes in the law and the creation of a conducive environment for co-operatives and credit unions is done through the ministry.

The ministry also created a department of Micro-Enterprise Development (MEDP) similar to the one created by the Ministry of Labour & Social Welfare through the department of SDF. The target group includes women, youths and unemployed people who are involved in income generating projects including agriculture. The ministry is also involved in research into co-operative development programmes and training in various skills. In 1994 the Department of Employment Creation in the ministry established a loan facility at 12% interest/annum for the informal sector and by 1998 had disbursed Z$2 million with a repayment rate of 50 to 80%.

In the Zimbabwe Agricultural Policy Framework (ZAPF), the Ministry of Lands & Agriculture has outlined clear development objectives for the agricultural sector, with emphasis on smallholder farmers. With regards to provision of financial services the major objectives are:

- ensuring that adequate credit facilities are available for input supply;

3 Poverty Alleviation Action Plan

- provide financial support to smallholders, which is a necessary requirement for the transformation of the smallholder sector; and
- increasing investment in the rural areas by the private sector in order to complement government efforts.

The creation of the Agricultural Development Assistance Fund (ADAF) within AgriBank was a sure sign of commitment to the smallholder farmer. However, the history and precedence set within the former AFC smallholder lending is that of high defaults. Thus, until AgriBank modifies and fine-tunes its lending methods it will be difficult to expand that programme successfully. ADAF is capitalized by donors and the government of Zimbabwe, and managed by AgriBank.

It is challenging that in a country that is pre-dominantly agricultural, with 70% of the population living in rural areas and relying on agriculture, only 5% to 10% of the smallholder farmers have had access to credit. A number of integrated development projects[4] that have launched credit programmes in rural areas have had limited success as rural financial intermediaries are scarce.

The following weaknesses are apparent in the government's support for micro-finance:

- *Lack of co-ordination:* As noted from the different programmes under different ministries there is no key ministry responsible for the overall co-ordination of sectoral activities. While MSE development and micro-finance institutions should be overseen by the Ministry of Industry & Trade, the fact that the institutions provide financial services to the poor automatically makes them responsible to the Ministry of Finance. The recently launched SME White Paper that purports to encompass both SME and MSE activities was formulated without consulting all relevant ministries. During the study, key persons in the other ministries were ignorant of its existence, yet it is ready for presentation to Parliament.
- *Lack of registration cohesion:* The different forms of registration and legal status obtained by institutions providing similar services are not conducive to the sector's development. Although all MFI are "selling/trading money", the SACCOs do it under the Co-operative Act, while others operate under the Moneylenders & Rates of Interest Act. Currently, the SACCOs are working on a concerted effort to revise their act but the revisions will not cover other MFIs registered under the Ministry of

4 Programmes such as the IFAD /Australian funded project Smallholder Dry Areas Resource Management Program (SDARMP) have for the past 3–4 years failed to disburse loans to the rural communities, partly due to the lack of credible financial intermediaries.

Finance. Furthermore, NGOs by legal form and nature cannot be MFIs as they are supposed to be registered as "welfare" organizations. Thus, many MFIs that are NGOs have been forced to register subsidiaries, which are not-for-profit companies, public companies, or even private companies. This dual registration is unnecessary and time consuming. There is a need to develop in consultation with the key stakeholders a clear policy framework within which MFIs operate. Furthermore, the SME White Paper is purported to be an all-encompassing document, i.e. it covers both SMEs and MSEs and yet there has been very little consultation with the MSE sector. ZAMFI has indicated its reservations on behalf of micro-finance institutions and stakeholders, but their concerns have not been addressed to date. It is regrettable that the concerns and critical issues that affect MSE development are not adequately covered in the policy paper.

- *Savings not a legal source of funding:* The majority of MFIs who are not members of SACCOs cannot utilise savings of their clients to on-lend. The "savings" can arise for example in the form of collateral deposit. Perhaps some linkages with the financial institutions could provide a win-win situation between the MFIs and the banks, as well as the entrepreneurs.

- *Regulatory framework:* While there is a clearly streamlined policy framework for the formal financial institutions, there is no such instrument for the micro-finance sector. Given that the industry/sector is still young, time should be allowed to ensure that the sector develops with minimum regulatory constraints. Thereafter, through a dialogue process, the framework may be instituted. The major regulatory issues that need to be urgently addressed are registration and the interest rate cap.

- *Political Stability:* The volatile political situation negates the growth and development of the micro-finance industry. MFIs operating in areas where the situation is politically hostile are forced to reduce their operations and thus their business output.

- *Political Interference within MFIs:* Political interference that influences who should receive credit and how the MFI should be managed has affected the growth of the sector. In some instances, there is political interference with the appointment of board members of NGO based MFIs.

- *Lack of incentives:* Currently, there are no incentives to attract serious players into the market. If the government perceives this sector as a high development priority with potential to create jobs and increase household incomes, there should be incentives for participants. Examples would be tax breaks for the first five years, as is the case with enterprises at growth points.

5.1.2 Mozambique

In 1998, an analysis was made as to whether the existing policy, legal and regulatory framework in Mozambique provided a favourable environment for the development of micro-finance according to the "best practices and standards". The following summarizes the changes that have taken place since then and the degree to which they have contributed to the healthy development of the sector.

In 1998, the Bank of Mozambique (BoM) issued a decree (47/98) to regulate micro-credit activities, requiring all institutions and individuals providing credit, but were not registered under another form, to register with BoM. Institutions and individuals registered under this decree were allowed to provide credit but not to capture savings. This was a significant step towards providing a framework for the development of a solid, professional and reliable micro-finance sector. However, implementation of this decree is still very weak, partly owing to weak dissemination of information about the decree and lack of knowledge about the advantages of registration.

Although some steps were taken to standardize the reporting requirements to BoM[5], little effort has been made to raise awareness or push implementation of the decree. As a result, there still are very few registered micro-finance operations and, as a result, little information on the financial performance of micro-finance providers. Clearly, additional efforts such as monitoring, publication of consolidated information or elaboration of guidelines by BoM are needed to enforce compliance. Donors can also play a role in enforcing compliance by requiring that all MFIs receiving their financial and technical support register with BoM and comply with the minimum reporting requirements.

As mentioned before, the decree represents an important step for the development of the industry as it provides a mechanism to legalize the provision of micro-credit by associations and projects of local or international NGOs. Despite the progress represented by the decree, the regulatory framework facing micro-finance institutions still poses problems for the long-term development of the micro-finance sector. Given the emphasis in micro-finance on providing savings services and on accessing funding from non-donor sources, most micro-finance programmes will seek to move from the association or international NGO form to a more permanent form as some type of financial institution. The options currently available have several shortcomings as can be seen in the summary on the next page:

5 A form for micro-credit programmes to use in reporting to BoM was designed early in 2001 by ICC in collaboration with the Informal Working Group on Micro-Finance and BoM, and is now available for reporting.

Commercial Banks	Minimum capital requirement of US$1.2 million make this alternative unaffordable for most operators, particularly those focusing on the poor. Reporting and reserves requirements are too high for most of MFIs.
Credit Co-Operatives	Can only provide services to its members. Are not as attractive for investors. The decision making process is bureaucratic and cumbersome. The regulation is now being drafted and some constraints to membership are under consideration, which could make this alternative inadequate for MFIs.

As before, efforts should be made to find suitable alternatives that, while satisfying the legitimate concerns of BoM, also allow MFIs to become commercially and financially viable. The creation of a legal framework specifically suited for MFIs such as a "microbank", with reduced capital and reporting requirements, or for credit unions that would reduce the existing restrictions for credit co-operatives, are alternatives that should be explored by BoM and other stakeholders to foster the development of the sector.

One important issue is the distinction between shareholder-owned institutions with a corporate structure and co-operatives (credit unions). Most of the larger programmes operating in Mozambique today are moving towards becoming corporate-type institutions, a form most suited for attracting private investors and accessing commercial sources of finance. The only option available to these institutions currently is to become a bank, but the required threshold capital size for a bank is too large. The only alternative, becoming a credit union, is unsuitable for these institutions. On the other hand, there is a gap to foster genuine credit unions, as Mozambique is the only country in the region that lacks such local financial institutions. Appropriate legislation governing credit unions in most countries has minimum capital requirements suitable for grassroots-level organizations and allows small credit unions to operate without the need for central bank involvement. There are a number of international models that could be used as the basis of new regulation for micro-finance. It is most important that any new legislation should accommodate the dual structure (corporate and co-operative) that is emerging in Mozambique's micro-finance field. The best way to ensure that this happens is for the regulatory authorities and the micro-finance industry to engage in an open, ongoing dialogue, informed as needed by international experience.

Another important aspect is the need to reinforce the supervisory capacity to back up the regulatory framework. Supervising micro-finance institutions is not currently one of the BoM's priorities. One alternative should be the creation of a specific unit within the Supervision Department.

5.1.3 South Africa

The Commission of Inquiry into Rural Financial Services, better known as the Strauss Commission, active in 1995 and 1996, made a range of recommendations to rural Micro-finance Institutions provision, of which the most essential are highlighted here.

The Commission considered the major policy objectives of government and its brief to contribute towards increasing access to financial services for rural people. These services were identified as transmission services, savings products and loan products for consumption smoothing and productive loans (for farm and off-farm activities). The Commission also identified that state grants would be necessary under certain circumstances, and called for a detailed set of guidelines on the management of subsidies and grants, including their phasing out.

A role was identified for the state to facilitate, as well as co-ordinate, the provision of financial services, with special attention to the needs of women. The Commission proposed that the Land Bank be tasked to fulfil this role. It noted that the Land Bank, the state and other institutions should act in support of the market. At the same time, it acknowledged inherent weaknesses in the existing institutional fabric, noting that these institutions would not be able to contribute to the aims of rural reconstruction on a national basis without appropriate and active support.

A review of the policies and activities of different state institutions, such as government departments and parastatals, pointed to the dangers of lost development potential unless co-ordination takes place. The Commission therefore argued that the state should ensure that improved availability of rural financial services is provided as part of an integrated rural development strategy. This programme should include the land reform and housing programmes, the upgrading of infrastructure, such as the provision of water, electricity and roads, and capacity building, especially at the level of rural local government.

The Commission also argued that the state should acknowledge the current gap in rural finance delivery, and an overlap in the prospective policy briefs of the state-funded development finance institutions. International experience points to the success of multi-sector financial institutions at a retail level and a rich discussion exists on apex institutions internationally. However, there is very little experience, and little mention is made, of the advantages and disadvantages of multi-sector versus single sector wholesale institutions. The Commission accepted that all national development finance institutions have mandates to either continue or commence the extension of wholesale lending in rural areas: The National Housing Finance Corporation (NHFC) has earmarked dedicated funds; the Development Bank of Southern Africa (DBSA) will fund rural infrastructure projects; and Khula Enterprise Finance (KHULA) intends to finance Small, Medium & Micro Enterprises (SMMEs) in rural areas. The Industrial Development Corporation's portfolio already includes large-scale agro-industrial investments. The Commission supported the need for a financial institution at national level, such as the Land Bank, with both wholesale and retail activities and the responsibility to dedicate special attention to the needs of land reform programme beneficiaries. The Final Report (Strauss Commission, 1996) of the Commission emphasized that the Land Bank should focus only on agriculture, while the Interim Report (Strauss Commission, 1996) looked at agriculture as the primary focus, but did not exclude a multi-sectoral approach. A focus on a single sector can contribute to increased risk exposure for the institution. Especially in the South African agricultural setting it may imply increased covariant risk.

The Commission recommended that the future role of each of the provincial development corporations should be the result of specific consideration and consultation. This should be a joint approach of the national Ministry of Finance, national development finance institutions, provincial departments and provincial development corporations. The proposed development council should provide guidelines for this purpose, without attempting to design detailed blueprints for implementation at the provincial and retail level. This approach ensures that within a flexible framework, specific implementation strategies that reflect the reality of a specific setting or province could be worked out at provincial level, rather than being prescribed from the national level. Overall, the same rules should apply, but implementation should be realistic and pragmatic.

At the retail interface with rural clientele, the Commission recognized the important role of the Post Office in satisfying the most basic financial service needs, especially of the poorest, least mobile segments of the rural population. Commercial banks have, however, increased their outreach, and are well placed to offer savings facilities in the larger rural towns and respond to loan requests from small business entrepreneurs. The NGOs have shown themselves able to reach a micro-enterprise level that the formal banking institutions do not yet serve. The Commission proposed a multi-pronged strategy at retail level rather than a single institutional strategy. The purpose was to accommodate flexible approaches and reflects the reality that diverse circumstances in the country require diverse institutional approaches. Furthermore, the Commission's analysis showed that none of the current institutional structures proved to be highly successful in reaching rural clients, especially deep rural clients, and therefore it would be short-sighted to choose a single institutional strategy in this regard.

In order to foster an integrated approach to both urban and rural development, the Commission considered it essential to create an entity to co-ordinate and guide the activities of development finance institutions. This entity, referred to as the Development Council by the Commission, would be supported by a secretariat that could also play a part in structuring the reporting requirements for entities that make use of state support. All development finance institutions and other recipients of state financing would be obliged to conform to appropriate reporting and accounting standards, as the introduction of minimum disclosure requirements would enhance transparency and accountability. This function should be monitored and implemented by the Development Council's Secretariat.

The Commission also recommended that legislation governing agriculture, banking and land, presently in force in different areas of South Africa, should be harmonized as soon as possible. The Commission gave attention to legislation of the hitherto un-legislated sections of the financial market (for example, NGO financial service organizations, village banks, savings and credit co-operatives) and proposed that these complex issues should be attended to by specialists in the field.

The Commission argued that a process actively guided by the state, should be launched as soon as possible to transform the rural financial services sector. This process should build on the strength of existing local level institutions in the private, public and voluntary sectors. The need for a wide range of service providers delivering different products and catering for the diverse rural financial needs was accepted. The Commission favoured fostering a much wider retail financial services network. However, the Commission was concerned about longer-term sustainability and outreach.

The Land Bank's wholesale function will be geared to fostering, nurturing, supporting and co-ordinating local and provincial level rural financial institutions, be they NGOs, development finance institutions, co-operatives, commercial bank branches, local authorities, or any other kind of institution seeking to render agricultural and agriculturally-related financial services. Essentially, the Land Bank's "wholesale" function should reach those "retailers" who seek to serve the individual and small group agrarian needs of people in the "deep rural" areas, e.g. small-scale individual farmers, groups of female vegetable gardeners and small-scale poultry producers who are far away from the relatively limited retail branch network.

The responsibility of the Department of Agriculture to promote agricultural development is acknowledged. The Commission, however, recommended that the Department terminate the Agricultural Credit Board and suspend current policy initiatives, which would lead it to the role of a direct (central) wholesaler.

The Commission identified female farm workers; male farm workers; landless, unemployed rural poor; pensioners; small-holders; contract farmers; rural business-women; rural businessmen and small- and large-scale rural employers, including commercial farmers as requiring special support measures to gain access to financial services. The Commission also drafted guidelines on the application of subsidies and institutional transformation.

These recommendations of the Commission were put forward against the background of a set of guidelines, based largely on comparative international experience. The set of guidelines is important for this study and includes:

- views on the access to financial services;
- the application of commercial principles;
- diversification in terms of different financial services and sectors;
- ensuring that existing capacity is not eroded and refraining from the formation of new structures (rural areas in South Africa are characterized by a plethora of institutions with overlapping competencies and a lack of co-ordination -existing structures should be adapted, rationalized and co-ordinated to serve the needs of reconstruction);
- flexibility where locational differences are acknowledged and incorporated in policy and strategy;
- incentive-based approaches;
- improving information flows to ensure better decisions;
- management of risk and the structuring of the rural finance system in order to minimize the impact of covariant risk; and
- the detrimental effect of direct intervention by the state in retail financial markets.

Problems faced in South Africa to further the financing of entrepreneurs

There are important differences in the characteristics and needs of more formal and structured small and medium enterprises (SME) and the more informal micro and small enterprises (MSE). These differences are most apparent for business development support programmes and in the way that banks evaluate the borrower's loan applications. However, even with these differences, it is difficult to provide categorical breakdowns between types of firms, so policy and programmes must allow for a smooth transition between categories of firms and markets.

A recent study identified eight key categories of steps needed to reach the goal of improving widespread SMME access to finance in South Africa. An underlying condition for all the activities is that they achieve massive scale, or else they will not have significant impact. They are listed below.

- Removing price barriers to lending to SMMEs that will stimulate investment in SMME lending (i.e. lifting the ceiling on the exemption to the Usury Act).
- Improving market information (i.e. baselines, demand surveys).
- Developing cost-effective debt recovery mechanisms (i.e. legislative changes).
- Increased involvement of venture capital (i.e. tax incentives to entice more stakeholders).
- Use of application scoring by financial institutions (especially towards start-ups).
- Creating a homogenous government policy framework.
- Stimulating access to capital for non-banks (introduction of non-traditional role players).
- Promoting capacity building (SMMEs and financial institutions).

Of these, steps 1, 3, 4 and 6 most clearly involve changes in public policy and legislative strategy, though with the possible exception of 5, all the others reveal scope for more effective public intervention too.

5.2 DONOR/INVESTOR/WHOLESALER POLICY FOR RETAILER SUPPORT

5.2.1 Issues and Recommendations Common to All Three Sites

Donor organizations around the world face very similar sets of unknowns and policy/ strategy decisions in their efforts to select and assist micro-finance retailers.

The following document set of guidelines, drawn mainly from the Consultative Group to Assist the Poorest (CGAP) 1995, is included to give an indication of what donors have learned and of what to expect in terms of performance.

It is a joint product of the Donor's Working Group on Financial Sector Development and the Committee of Donor Agencies for Small Enterprise Development. It was inspired by and is largely consistent with the recommended standards for support set out by a UN expert group of leading small and micro-enterprise practitioners convened by Women's World Banking in January 1994. The donor committees adopted the principles in their current form in June 1995, following consultations with key donor agencies involved in small and micro-finance. The document is intended to be used by project officers in donor and implementing organizations, managers and policy makers.

The purpose of these principles is to establish common standards for donor agencies to apply in supporting broader access to financial services for micro and small enterprises. Such enterprises have historically lacked access to the formal financial system, but the growing success of many institutions provides confidence that access can be provided sustainably in many settings. It has now become possible to identify and agree upon the basic principles that support successful micro-level finance, so that donors can work in concert to ensure that lessons of success are translated to the institutions they support.

The framework for donor support to micro and small enterprise finance centres on two equally important and complementary objectives. First, outreach embodies the aim of expanding access to increasing numbers of low-income clients. Second, sustainability provides the means to expand and maintain outreach. These concepts underpin the guiding principles described here.

Different types of micro and small enterprise clients have different characteristics and demand different services. It is therefore desirable to encourage a range of institutions that use specialized methods to serve their particular market niches. These can include commercial and development banks, credit unions, mutual or community banks, non-governmental organizations (NGOs), finance companies, co-operatives, savings and credit associations, and other specialized intermediaries. At the same time, however, this document is based on the premise that fundamental principles of finance apply widely and must be observed by all institutions if they are to succeed. Moreover, donors must design their support mechanisms in ways that are consistent with best international practices and sound financial systems.

This statement of guiding principles first identifies characteristics donors should seek in selecting institutions to support. It then describes appropriate forms of donor support. Finally, some basic reporting standards on outreach and financial performance are discussed.

Characteristics to Guide MFI Selection

Intermediaries seeking support should be able to demonstrate the following characteristics, either in current operations or through credible plans underpinned by concrete measures. Since institutions are at different stages of development, it may be appropriate in some cases to adopt modified standards for limited support to new or transforming institutions. This will almost certainly apply in selecting MFI retailers for Chimanimani and Chimoio, and may also apply in Nyandeni, depending on other policy/strategy decisions (see 5.2.2).

A Institutional Strengths

1. Institutional culture, structures, capacities, and operating systems that can support sustained service delivery to a significant and growing number of low-income clients. Requirements include a sound governing structure, freedom from political interference, good fit to local context, competent and stable staff, a strong business plan for expansion and sustainability, and a mission and vision that create a sense of purpose, ownership, and accountability.
2. Accurate management information systems that are actively used to make decisions, motivate performance and provide accountability for funds. Such systems are essential for effective and efficient management.
3. Operations that manage small transactions efficiently, with high productivity, as measured by variables such as loans per staff and operating costs as a percentage of average annual portfolio (while maintaining portfolio soundness).
4. Meaningful reporting standards. Transparent financial reporting that conforms to international standards and allows prospective funders to evaluate performance adequately. At a minimum, the raw data should be provided, and institutions should regularly monitor financial condition using appropriate financial ratios derived from such data.

B Quality of Services and Outreach

1. Focus on the poor. Evidence of service to low-income clients, women and men, especially clients lacking access to other financial institutions. The focus need not be exclusive, as mainstream institutions such as banks are encouraged to become providers, but it must entail a distinct commitment to reaching the poor.
2. Client-appropriate lending. For example, for micro-level clients, institutions should feature quick, simple and convenient access to small, short-term loans, that are renewed or increased based on excellent repayments. Use of collateral substitutes

(e.g. peer guarantees or repayment incentives) or alternative forms of collateral to motivate repayment. Emphasis on character-based lending for smaller loans, with simple cashflow and project appraisal for larger and longer-term loans.

3 Savings services. Offering savings mobilization services, where legally possible and economically feasible, that facilitate small deposits, convenient collections, safety, and ready access to funds – either independently or with another institution (see section 5.2.2).

4 Growth of outreach. Making significant progress in expanding client reach and market penetration, demonstrating both strong client response to services offered and competence in service delivery management.

C Financial Performance

1 Appropriate pricing policies. Offering loans at rates sufficient eventually to cover the full costs of efficient lending on a sustainable basis (after a reasonable start-up period), recognizing that poor entrepreneurs are able and willing to pay what it costs an efficient lender to provide sustainable financial services. Interest charges by the retail unit should be set to cover the costs of capital (at the opportunity cost, including inflation), administration, loan losses and a minimum return on equity.

2 Portfolio quality. Maintaining a portfolio with arrears low enough that late payments and defaults do not threaten the ongoing viability of the institution. For example, organizations with loans in arrears over 30 days, below 10% of loans outstanding and annual loan losses under 4 %of loans outstanding satisfy this condition.

3 Self-sufficiency. Steadily reducing dependence on subsidies in order to move toward financial self-sufficiency. Achieving operational efficiency, i.e. covering all administrative costs and loan losses with client revenues within a reasonable time period, given local conditions. International experience shows that successful intermediaries have achieved operational efficiency in three to seven years, and full self-sufficiency, i.e. covering all financing costs at non-subsidized rates within five to ten years.

4 Movement toward financial independence. Building a solid and growing funding base with clear business plans, backed by operational capacities that lead to mobilization of commercial funds from depositors and the financial system, and eventually to full independence from donor support.

Financial performance standards apply only to activities that are an integral part of providing financial services. If programmes also provide non-financial services, such as business advisory services, health or education, they must account for such services separately from financial services. Standards for financial self-sufficiency do not apply to such services, and defining appropriate standards for non-financial services is beyond the scope of this document.

It is extremely important not to task MFIs with providing training and/or other business development services to their clients. Not only does this impose an impossibly heavy cost burden on financial institutions that are mostly struggling to reach sustainability, but it also compromises their role as professional lenders: the two functions are quite distinct and require different sets of skills. Moreover, locating them within one institution often leads to conflicts of interest between the two.

MFIs ought to be self-sustainable or at least be aiming for self-sustainability, whereas it is an open question whether institutions whose role is to help build a community's human capital base should be required to become financially self-sufficient, especially in a developing economy. As a result, they should also be capitalized separately.

There is every reason to try to articulate the operation of MFIs and training/business development organizations, because they both create a demand for the other's services. If donors have the resources and their mandate allows, it is a good principle to include them both in the same country programme, or otherwise to arrange with local service providers to fill the gap.

Strategies for Donor Support

Funding based on large, ongoing subsidies with a charity rationale has failed. Such programmes have drained resources without becoming sustainable, and have contributed to the mistaken notion that the poor are "unbankable". Funders should provide financial and other support in forms that foster the movement to scale, financial self-sufficiency and independence from donor support, taking into account the particular characteristics of different types of institutions.

A Appropriate Uses for Grants

1 Institutional development. Support for institutional development is appropriate at all stages of an institution's life, and for a wide range of institutions, although the nature and extent of such support should evolve with the institution. Such support should become more selective as institutions become able to meet more of their organizational development needs from within. It should also become more specialized as institutions tackle more difficult problems.

2 **Capitalization.** Capitalization or grants for equity are of strategic importance in enabling organizations to build a capital base. Capitalization can be used to generate investment income, build the loan portfolio, and leverage funds from local banks. One of the key purposes of providing capital funding is to enable institutions to mix costs of grant funds with commercial sources during the period it takes to build efficient operations and scale. Externally financed capitalization should be used as a catalyst and complement to domestic mobilization of funds by local institutions. Grant equity contributions can also help institutions seeking to become formal financial intermediaries to meet minimum capital requirements.

3 **Operating losses.** Donors should avoid covering operating losses except during a clear, time-limited start-up or expansion phase. By the nature of the small loan business every programme will take some time to reach a break-even point. Donors should be willing to provide support during that time. Afterwards, however, such support becomes counterproductive.

4 **Fixed assets.** Donors may wish to support purchase of fixed assets, such as computers, vehicles or premises. Such funding may be seen as contributions to the equity base of the institution.

B *Appropriate Uses of Loans*

Donor support through loans is appropriate for lending-based institutions that meet performance standards. However, loan capital from local and commercial sources should be sought as early as possible, even at start-up. Care should be taken to avoid burdening young institutions with foreign exchange risk in loans denominated in foreign currency, unless adequate precautions are taken. Donors are also advised to be careful not to undermine the savings mobilization efforts of savings-based institutions, such as savings and credit associations, by making loans available to them below the cost of mobilizing funds locally.

C *Commercial Sourcing of Funds*

The transition to fully commercial sources of funding requires special forms of support that help introduce institutions to the financial system. Donors can act as catalysts to effect this transition through means such as:

1 **Investor equity,** from both official and private sources. Donor support can help leverage private investment.

2 **Second-tier operations**, which raise funds from commercial sources and on-lend to micro-enterprise finance institutions.

3 **Partial guarantees of loans** made by commercial banks to NGOs.

D Coherence of Donor Policies

Institutions following sound principles for sustainability must not be undermined by others providing competing services below cost or in ways that cannot be sustained. When providing subsidies (grants or loans) to small and micro-enterprise institutions, donors should ensure that they co-ordinate that support with other funders, such that institutions are given clear incentives to become financially viable. In particular, donors need to consult each other regarding appropriate interest rates and other terms on which assistance to any given institution is supplied. Donors should also co-ordinate institutional support with sectoral policies such that financial institutions, including informal and semi-formal sectors, find enabling conditions for institutional development and growth.

1 Included in the term micro and small enterprises are a variety of enterprises (industry, transport, commerce, services, agriculture, etc) ranging in size from part time, seasonal activities of a single person to small, formal enterprises employing several non-family members.

2 It should be understood that costs of non-financial assistance provided to entrepreneurs may continue to receive subsidies. However, it is crucial that these costs be separated from the costs of lending operations, so that the financial viability of lending operations can be assessed.

Policy coherence extends also to aligning donor and MFI vision, objectives and operating/reporting requirements as closely as possible, so as neither to hamstring the MFI and burden it unduly with meeting donors' conditions nor to dilute the achievement of donors' goals.

Basic Reporting Standards

Performance measures need to be put in place to track the performance of the institution towards commercialization. Outreach (which measures business volume and market penetration), portfolio quality (which measures the health of the MFIs main asset, its portfolio), efficiency (which measures staff productivity and efficiency of operations) and profitability (which measures its ability to cover costs and operate without subsidies) need to be monitored constantly by the MFIs and their partners.

For outreach, some commonly used measures that would probably be appropriate in the context of the IRDP are:

- total number of clients
- value of portfolio, i.e. outstanding loans at month/quarter/year-end
- monthly/quarterly/annual advances
- number of female clients
- number of "youth" clients, e.g. below the age of 25 or 30
- estimated share of micro-lending in district

For portfolio quality:

- credit in arrears at month-end – value and period in arrears
- portfolio at risk at month end.

For efficiency:

- administrative cost per unit of money loaned out (operational costs/average value of portfolio)
- administrative costs per client
- number of clients per loan officer

And for profitability:

- portfolio yield
- operational sustainability
- and, though perhaps more a measure of comparative efficiency, effective annual interest rate charged (including or excluding any fees charged)

A number of other basic policy recommendations applicable in most situations are summarized in the following box:

FIGURE 5.2 Other Important "Dos and Don'ts" for Donor MFI Retailer Support Policy

- Don't confine loans to particular groups, if at all possible – apart from being discriminatory, critical mass is essential for sustainability.
- Don't try to restrict the purpose for which cash loans are made – apart from being almost impossible to monitor, consumption and capital spending are often difficult to distinguish in households which operate micro-enterprises.
- Don't dictate retailer structure, systems and products – rather select retailers carefully and provide technical support.
- Don't emphasize outreach growth ahead of institutional capacity development for retailers without strong structures and systems – it will almost certainly result in poor recovery rates.
- Don't look to micro-loans to finance market-orientated farming or the purchase of what borrowers will regard as "large" assets.
- Do build in local capacity development requirements, where local MFIs are in partnership with international organizations.
- Do engage with government regarding legislative reforms needed to foster micro-finance.
- Do ensure that the scope and nature of the demand for and supply of micro-finance in the target areas is adequately documented and understood before making key strategic decisions about new micro-finance initiatives.
- Do use the services of organizations such as CGAP or of specialized professional consultants – on their own or as part of a broader team – in selecting and setting up relationships with MFIs.

5.2.2 Some Site-Specific Issues and Recommendations

The distinction between donor, investor and wholesaler needs to be drawn because one important policy/strategy choice that bodies such as WKKF face in their role as funders is:

- whether to act as donor, where there would be no obligation on the retailer either to repay the capital provided by the Foundation or to pay dividends on it, whatever other conditions may be attached; or
- as investor, where there would be no obligation to repay capital as long as the Foundation wished to continue funding the retailer, but a flow of dividend income would be expected after a time; or
- as wholesaler, where the capital is loaned to the retailer, possibly on a zero-interest, indefinite-period basis, but nevertheless remains a loan.

While this may be decided as a matter of principle (i.e. as an across-the-board policy applying in all cases), where it is not predetermined, the best strategy probably depends primarily on the nature of the retailer.

Where the retailer is a relatively small, indigenous organization that will need to "upscale" to provide micro-finance services to a wider spectrum of borrowers and/or whose capital has until that point been generated mainly from members' savings, the natural role for a funder would seem to be as donor. This might well be the case for WKKF in Chimanimani and Chimoio, where there are few, if any, large, well established MFIs operating locally or elsewhere in the country.

Where the chosen retailer is already well established in other areas and is being incentivized or contracted to extend its services to the locality concerned, a funder's natural role would seem to be as investor or wholesaler. This might well be the case in Nyandeni, if WKKF decides to partner an organization such as the Land Bank, TEBA-Cash or even Uvimba Bank – an innovative reconstruction of the old apartheid Transkei and Ciskei agricultural banks.

This brings us to what is perhaps the most important single policy/strategy question for funders: whether to draw in "external" bodies with an established track record of outreach and sustainability in micro-finance to drive micro-lending initiatives, or to aim to "upscale" a relatively small, "indigenous" body to provide micro-finance services to a wider spectrum of borrowers.

Of course, this is too narrow a categorization of alternatives. In reality, there will be other possible retailers that do not fit neatly into either category, while there may not be organizations in existence to put into both of the two categories. In both Chimanimani and Chimoio, the respective overviews (see sections 3.1 and 3.3) indicate that there probably is no MFI operating in either country that has an established record of outreach and sustainability in micro-finance. Even in South Africa, large as they are, the Land Bank and TEBA-Cash may only partly meet that description. A proper due diligence investigation is needed to reveal the degree to which their micro-lending operations have reached maturity. Still, with some 100 000 micro-loan clients each (current figures), with their very large capital bases and with the long experience that both organizations have in their respective fields, they are clearly in a league of their own in the sub-continent as rural micro-lenders. So the point stands.

Both routes have advantages and disadvantages that are worth brief consideration.

Using Established 'External' MFIs as Retailers

Clearly, size, experience and capital base – and all of the structures and systems that go with them – count for a great deal. To use all of these will undoubtedly accelerate the increase of access to micro-finance substantially. But while this should help boost economic activity in the area, even without removing some of the other constraints identified, it should not automatically be equated with meeting the IRDP's objectives of "increas(ing) community capacity towards sustainable economic development, especially among economically marginalized groups" and, more pointedly, of "mobiliz(ing) rural communities to work together, maximizing their institutional capacities to support sustainable and integrated development." (University of Pretoria, 2001, p3)

Two questions arise: first, are there meaningful ways in which the community can participate in the initiative other than simply as clients? Second, and more fundamentally, should people in rural or urban communities be aiming to play roles in a banking business initiative in their community other than those normally taken on by any client and local community stakeholder group? In other words, is it necessary for sustainable economic development that local people be involved in ways beyond these traditional stakeholder roles?

An answer to the second falls outside the scope of this brief discussion, but it is important for policy makers – WKKF in this instance – to ask and answer the question to their own satisfaction. In response to the first, the answer is in general that if they are sufficiently sought after, meaningful ways can almost always be found for community participation, whether on a group or on an individual basis. For example, the Land Bank's Step-Up micro-finance programme owes part of its success – in terms of both outreach and sustainability – to its appointment of local people rather than professional organizations as agents to market the loans and assist in their recovery. There is a three-way "win" in this relationship: for the agents as individuals, for the community as a whole (communities that continually display high default rates eventually fall out of the Bank's sphere of operations) and for the Bank.

The key point is that taking this route in no way precludes the possibility of meeting the IRDP's objectives regarding community participation and capacity building. These objectives should in no way be diluted on this account. It simply requires mutual determination, flexibility and innovation to find appropriate means and put them into effect.

Upscaling "Indigenous" MFIs

"Indigenous" MFIs are typically savings groups, e.g. burial societies, or savings and loan groups, which may operate on a rotating basis, such as stokvels, or on a demand basis. Invariably, only members who have been active and regular savers with the groups qualify for a loan or capital payout.

Clearly, assisting such a group or groups to grow would fulfil the IRDP's objectives of community participation and capacity building to a high degree. However, there are some tough psychological, operational and perhaps legal obstacles to be overcome in upscaling such groups to serve wider and more general micro-finance needs in rural communities.

First would be to secure the wholehearted support of existing members, especially for activities that might involve lending without borrowers first having developed a sound record of saving with the group. This is a quantum leap that may not often be easy to make. Reluctance to make this leap may be based on awareness of the need for quite different operating technologies and management skills, a challenge that donor organizations, with the aid of appropriate specialists, ought to be well equipped to help meet – but not without changing the fundamental ethos of the institution – a challenge that outside assistance is ill-equipped to meet.

The legality of expanding operations in this way would also need to be checked. In Mozambique, it would almost certainly not be legal at present without a commercial banking licence and all that entails. In Zimbabwe, it is not clear. And in South Africa, the exemptions to various aspects of the Banks Act that informal institutions such as stokvels currently enjoy, might need to be revisited.

The process would be difficult and would almost certainly take a good deal longer to improve the broader community's access to micro-loans than the "external" approach, but there are several important examples of upscaling success internationally (see section 4.3) from which encouragement can be taken.

In the end, the decision about which route to take hinges as much on *a priori* principles and preferences, incorporated into a donor organization's pre-existing policy – and often its constitutions – as it does on strategy in the particular situation. If policy is indifferent on the matter, the faster and easier strategy route would probably be to go the "external" route, paying close attention to requirements regarding community participation and capacity building. But, if the latter are a higher priority than time and energy, the decision should go the other way.

It would not be appropriate here to make a firm recommendation either way. If there are two firm interlocking recommendations that bear repeating, they are:

- To conduct a proper field study of the demand for, access to and environment of micro-finance services in each of the pilot sites, and
- To call in the assistance of specialist micro-finance consulting such as CGAP before making fundamental decisions about strategy.

References

Bond, P (1998) Uneven Zimbabwe: A Study of Finance, Development and Underdevelopment, Trenton N J Africa World Press.

Deutsche Gesellschaft fur Technische Zusammenarbeit (GTZ) (1998) Situation Analysis of Rural Development Initiatives in Zimbabwe, Final Report for W.K. Kellogg Foundation, 17 February.

Deutsche Gesellschaft fur Technische Zusammenarbeit (GTZ) (2001) Proposal for Provision of Micro-Finance Services – Chimanimani Pilot Site.

Feltoe, G (2001) The onslaught against Democracy and Rule of Law in Zimbabwe, unpublished report.

Intermediate Technology Development Group – Zimbabwe (1998) The Economic Status of the Chimanimani District.

Intermediate Technology Development Group – Zimbabwe (1999) Chimanimani District Strategic Plan, Zimbabwe.

Intermediate Technology Development Group – Zimbabwe (2000) First Annual Report for DFA Chimanimani District, Zimbabwe.

Intermediate Technology Development Group – Zimbabwe (2000a) Three Year Strategic Plan & Annual Facilitation Workplan (March 1999 – 2002 February).

Intermediate Technology Development Group – Southern Africa (2001) Chimanimani DFA Transitional Plan, 14 March 2001.

Intermediate Technology Development Group – Zimbabwe (2001a) Final Report by ITDG Southern Africa of the IRDP Activities in Chimanimani District, Zimbabwe.

International Capital Formation and Giassemi, F (2000) Review of Zimbabwe's Financial System: Identifying Gaps and Opportunities for Micro-Finance, Harare.

Mbetu, R (1999) Report on District and Community Institutions in Chimanimani District, Manicaland Province.

Moyo T (2001) Financial Sector Liberalisation and the Poor: A Critical Evaluation. SAPRIN, Zimbabwe.

Raftopoulos, B and Lacoste, J-P (2001) From Savings Mobilization to Micro-Finance: A Historic Perspective on the Zimbabwe Savings Development Movement. Paper presented at the International Conference on Livelihoods, Savings and Debt in a Changing World, 14 –16 May.

Southern Africa Foundation for Economic Research (SAFER), (1998) The Credit Union Movement in Zimbabwe: A Diagnostic Study, Harare.

Saunders R (1996) Associational Life and Civil Society in Zimbabwe, Unpub. Mimeo, Harare.

Technoserve (2001) Potential Economic Drivers for Manica, Mozambique and Manicaland, Zimbabwe, IRDP Workshop, 16–17 May 2001.

National Economic Planning Commission (1999). Chimanimani District Profile

CSO 1992: Zimbabwe National Census Report.

CSO 1992: Manicaland Provincial Profile CSO 1998: Poverty in Zimbabwe.

ITDG 1999: Chimanimani Strategic Development Plan.

ITDG 2001: Ngorima Integrated Development Plan.

International Capital Corporation and Giassemi, F 2000: Review of Zimbabwe's Financial System: Identifying Gaps and Opportunities for Micro-Finance.

Mungwari, D. 1997: Initiative for Rural Economic Empowerment (Access to Capital): Situation Analysis Prepared for Kellogg Foundation.

Mungwari, D. 1998: The Marketing and Marketing Strategies of Honey in Manicaland Province.

Mungwari, D. 1995: Savings Clubs as Social Security Nets.

W. K. Kellogg Foundation 2001: Strengthening the Capacity of Communities – An Integrated Rural Development Programme Proposal for Southern Africa.

ITDG 2001: Chimanimani Women's Development Association Report.

Christian, R. P. 1989: Formal Credit for Informal Borrowers: Lessons from Informal Lenders.

RDC 2001: Chimanimani Five-Year Development Plans.

Chaves, R.A. and Gonzalez-Vega, C. 1999: The Design of Successful Rural Financial Intermediaries: Evidence from Indonesia.

Simba, D. (1998) The Policy Environment for Micro-Finance in Zimbabwe. Report prepared for SEEP/Zimbabwe, Sustainable Projects for the Poor.

Reinke, J. 1994 Alternative Models for Micro-Finance in South Africa: Theoretical Foundation and Two Case Studies in SA.

Magwada, D. 1998: Government Attitudes on Micro-Enterprise Sector. Report prepared for DAI.

Churchill, C.F. 1999: Client Focused Lending (the Art of Individual Lending). Calmeadow.

Kimeyi, M.S., Wieland, R.C. and Von Pischke, J.D. 1997: Strategic Issues in Micro-Finance: Contemporary Perspectives on Development Societies.

Mutua, K., Oketch, H., Banda, M., Maru, T., and Obuya, M. 1996: It Did Not Happen Overnight: The History of Group Based Credit Programmes in Kenya. K-REP.