Designing The Right Financing Model For Microbusinesses In South Africa

by

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DECLARATION

I, Bhekiwe T. Ngema, declare that the research work reported in this dissertation is my own, except where otherwise indicated and acknowledged. It is submitted for the degree of Master of Management in Finance & Investment in the University of the Witwatersrand, Johannesburg. This thesis has not, either in whole or in part, been submitted for a degree or diploma to any other universities.

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ABSTRACT

This paper investigates the prevailing financing models that are used to finance microbusinesses in developing economies with the objective of adapting one of these models for use within the South African context. Using India, Brazil, Ghana and Kenya as case studies the current successful microfinancing models and their advantages and disadvantages in these countries are assessed. The results indicate that microleasing is a possible effective financing model that can be used to finance microbusinesses in South Africa. Furthermore, possible ways of addressing microleasing shortfalls are explored in the paper, by drawing on the suitable features of financing innovations developed in the other developing economies. Most importantly, it was also found that the government, donors and the private sector have a significant role to play in order to encourage further development of the nascent microfinance industry in South Africa.

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CHAPTER 1: INTRODUCTION

1.1 Problem statement

There is high demand for capital to finance microbusinesses in South Africa (Berry and Von Blottnitz, 2002). This demand is widespread in South Africa and overwhelms even the financial institutions which provide the much needed financial services. Consequently, there is general interest, both in government and the private sector, in finding sustainable financing solutions. South African financial institutions have developed great interest in this undertaking because of its economic and social values. These institutions have realised, evidently, that South Africa will turn out to be more economically productive as more businesses thrive. Many may have recognised that entrepreneurship enhances economic productivity and increases South Africans' chances at a brighter future through reducing unemployment and alleviating poverty (Nigrini, 2002). Moreover, entrepreneurship is a growing trade that promises rewarding prospects, for both the capital providers and the entrepreneurs.

Among the many government programmes being implemented to better the lives of many South Africans, entrepreneurship seems to be the most economically viable and beneficial. In the urban areas of the country, especially in Gauteng, people engaging in some form of entrepreneurship abound. Despite a large number of alternative economic growth programmes, the value of entrepreneurship, which can be achieved through getting the right product, right market, right business skills and right funding, is so great in that many South Africans can provide their families better chances of getting reasonable earnings and affording better living conditions. For entrepreneurship to thrive, however, one of the most important requirements is getting reasonable access to capital (Kaniki, 2007). Capital is the engine of commerce essential to ensure that budding entrepreneurs are able to start their businesses. With sufficient capital, these businesses have a better chance to become successful, as long as the entrepreneurs acquire the necessary and relevant skills to make the businesses sustainable (Kesper, 2000). This is the conventional idea of many entrepreneurs and policymakers.

However, it has been mentioned several times in the literature that getting access to capital is not easy for entrepreneurs (Berry and Von Blottnitz, 2002). This is especially true in South

Africa. There are many government programmes that have been implemented to bridge this gap and assist entrepreneurs but have been met with limited success in the market (Baumann, 2001). Hence it needs to be investigated, in order to determine if there is another model from other developing economies that can be adopted to enhance the ability of entrepreneurs to access capital effectively better than the current models? To answer this question, the effectiveness of current models used by government and financial institutions has to be explored. One of the models employed by entrepreneurs is getting finance from a third party (mostly financial institutions, e.g., banks), which can be a difficult and lengthy procedure with a lot of "red tape" (Kanini, 2007).

External financing is one of the most important methods of obtaining capital for entrepreneurs anywhere in the world (Ojah, 2009). Studies have shown that in order to start a business the available options to getting capital are: cash from friends, cash from family, cash from financial institutions or own private savings if available (Berry and Von Blottnitz, 2002). The first three, which are a form of getting capital from a third party, are the most prevalent as already mentioned above. It comes most commonly as equity (where the investor takes partial ownership in the business) or debt (where the investor provides a loan to the owner and expects to be compensated in the form of interest payments and payback of the principal). Another form of financing is where an entrepreneur obtains funding from a philanthropist in the form of a gift. In this case the philanthropist does not expect any financial compensation for his gift. However, this method is not going to be explored in this research, as it is not that common and not sustainable from the donor's perspective. This study will only focus on sustainable models where the relevant investor expects a return on their investment.

From the perspective of this research, a fundamental assumption regarding the efficacy of these financing models is that such models must also provide the entrepreneur with basic skills for running a business especially during the early stages, for the business to have a better chance of success. The goal of such financing models should be to enable reasonable access to capital and to foster the rapid acquisition of basic business skills, to facilitate cashflow management and growing the business. The direct and indirect stakeholders in the business consist of the entrepreneurs and the financiers. By extension, communities as a whole and the relevant industry have an indirect but significant stake, in the outcome and success of the business and the financing models that are used to finance them.

This study is mainly concerned with the evaluation of current financing models (referred to as microfinance) for microbusinesses. Microfinance serves as an umbrella term that describes the provision of banking services by poverty-focused financial institutions (microfinance institutions – MFIs) to poor parts of the population that are not being served by mainstream financial services providers. The core service of microfinance is credit and typically these are small loans to the poor (Deutsche Bank Research, 2007). Ultimately, this research seeks to develop a more appropriate microfinance model for microbusinesses in South Africa.

1.2 Purpose of the study

The purpose of this study is to identify current financing models that are used to fund microbusinesses in developing countries, understand the benefits and constraints of these financing models and then propose a sustainable financing model that will lead to more microbusinesses succeeding in South Africa.

1.3 Research questions

The proposed research is suggesting that a detailed investigation of the current methods of financing microbusinesses will reveal gaps that can lead to a more refined and effective solution. Specifically, the research paper will address the following research questions:

a. What financing models currently exist in developing countries?
b. What are the features, benefits and constraints of these models?
c. What model is best for microbusinesses in South Africa?

1.4 Significance of the study

Entrepreneurship is viewed as an important development policy tool by many policy makers (Reinke, 1998). The development of techniques to improve the financing of these businesses is also a goal of the National Youth Development Agency. Qualitative research has become increasingly common in the field of developing financing solutions. The proliferation of qualitative studies on various aspects has been unprecedented. Despite its new prominence in

South Africa, however, concerns remain about the ability of the current financing models to resolve the practical problems that entrepreneurs face in accessing funds (Ojah and Mokoteli, 2010). A key factor accounting for the perceived lack of effectiveness of the financing models is the relative absence of efforts from commercial banks and the inability of these institutions to implement effectively some of the recommended solutions. The research carried out in this study should provide a relevant and practical financing model that can be used for microbusinesses in South Africa. This model can then be rolled out provincially and nationally within South Africa.

1.5 Research methodology

Using historical research, this study will be carried out by construing three specific areas in literature: (1) the type of models that are being used in developing countries to finance microbusinesses; (2) the advantages and disadvantages posed by these solutions from the perspective of the microbusinesses and the finance providers; and (3) developing a sustainable solution that will work best for the microbusinesses and close the gaps posed by the current models in South Africa. Each aspect is well documented in literature and thus represents a rich opportunity for detailed analysis of the research questions described above.

To analyse these areas, published papers and articles will be studied in detail to outline the current models. Furthermore, these models will be deconstructed to establish the current gaps in meeting their mandate of providing financing to microbusinesses in an affordable and sustainable way. In addition, these solutions will be compared to each other to determine their advantages and disadvantages. Data studied will include the examination of popular essays, books and other relevant materials. Finally, the above body of knowledge will be used to develop a sustainable financing model for South Africa which will attempt to close the gaps left open by the current models.

Interpretation and analysis of these materials will remain open to various scientific explanations. However, the focus will primarily investigate the usefulness and relevance of the current models to meet the expectations of the market they seek to serve. Current models may be limited in that they do not understand the practical needs and intricacies of the market they are trying to serve. In order to examine the validity of this hypothesis, the needs of this market as documented in literature will be contrasted with the solutions that are currently being provided by government and financial institutions. To determine the benefits of these models, each of the models will be examined in relation to the problems that they are able to solve. In this regard, the analysis will then be useful in developing a solution that will serve to effectively meet the needs of the market. In conducting the analysis, however, this research will carefully avoid the constraints of developing solutions that will only work for a sophisticated market that is already used to utilising financial services.

Furthermore, this research will demonstrate how the developed solution can close the current gaps in the market that are not met by the current financing models. The data that will be analysed will be publications, articles, books and other material between 1990 and 2010 in South Africa, and other developing countries. Data between this period is readily available and is relevant in that during this time the government of South Africa and private sector were very active in attempting to find a solution for financing microbusinesses in South Africa. Sources of data that have been identified include, but not limited to, Statistics South Africa, World Bank, International Monetary Fund, economic and financial journals, bank websites and other useful sources.

1.6 Background literature

According to Statistics South Africa's Labour Force Survey for 2010 (Quarter 1), unemployment remains high at 25.2%. With the rate of unemployment being very high, people without an income represent a significant portion of the South African population. Due to the social and economic pressures of modern life, the absence of a stable income often has a devastating effect on the lives of the affected persons. The unemployed and unskilled often find it difficult to find employment, even though the desire to work is often present (Du Toit, 2003).

The key to effectively reducing unemployment and poverty in South Africa appears to be entrepreneurship (Makina and Malobola, 2004). The benefits of entrepreneurship for both developed and developing countries are well known and documented (Wennekers and Thurik, 1999; Schramm, 2006; Acs and Szerb, 2007 and Klapper et al, 2007). However, the willingness of commercial banks to provide credit to microbusinesses, or even the low-income segment, has been limited despite supporting initiatives from the government.

According to Pillay and Naude (2005), a lack of knowledge on the borrowing behaviour, preferences and experiences of the low income segment in accessing finance from the commercial banking sector in South Africa is a major barrier for banks. Entrepreneurship may be even more crucial for a country such as South Africa because of the psychological benefits as well as the physiological benefits that can be derived therein. The incentives of owning a successful business include a stable income for the individual and constructive economic participation which is beneficial to the community. Furthermore, it has positive social integrative effects by enabling individuals to experience success and contribute positively to the economy.

Compared to Asian countries, the contribution of small and microbusinesses to South Africa's GDP is far lower, however, as South Africa is seen to be less entrepreneurial than other developing countries (Global Entrepreneurship Monitor, 2009). This could impact negatively on the country’s job creation opportunities and economic growth. Furthermore, the Global Entrepreneurship Monitor 2009 Report found that South Africa is below the average rate of entrepreneurial activity compared to the other countries taking part in the survey. South Africa is ranked lowest of all developing countries that are part of the survey, including Chile, Brazil, Tunisia, India, Argentina and Thailand. There are several reasons mentioned in the report for the low level of entrepreneurship in South Africa which include: 1) limited access to capital, 2) lack of business skills required to run a business successfully, and 3) misdirected government support and bureaucratic red tape.

According to the Global Competitiveness Report (GCR, 2008-2009), the high level of crime was ranked as the second most problematic factor for doing business in South Africa. The right kind of access to capital can lead to more successful microbusinesses being started as well as higher economic participation and possibly reduced risk of crime linked to unemployment.

Having discussed the objectives, the significance of this study and the research methodology employed therein, the rest of the paper is divided into four sections. The first section (chapter 2) discusses case studies from four developing economies (India, Brazil, Kenya and Ghana) which are facing similar economic and socio-political challenges to South Africa. There are many similarities that India and Brazil share with South Africa, economically and socio-politically (Global Entrepreneurship Monitor, 2009). One of them being that the income distribution gap between the rich and the poor is among the largest in the world for India, Brazil and South Africa. On the other hand, Kenya and Ghana were chosen because enterprise finance models for small and micro businesses are taken seriously in these African countries. To that end, these countries serve as an appropriate base to seek lessons that can be applied within the South African context as they face similar economic development challenges as South Africa. The second section (chapter 3) presents an analysis of the prevailing Small Medium and Micro Enterprises (SMME) financing models in South Africa. The third section (chapter 4) then develops an argument for a microfinance model that can be applied in South Africa by considering all the best-practices from the other developing economies. The paper ends with concluding remarks (chapter 5) regarding the proposed financing model and the suggested way forward for the South African microfinance industry in general.

1.7 Outline of the Study

1.7.1 Introduction

1.7.2 Literature Review

1.7.3 Prevailing SMME Financing Models In South Africa

1.7.4 Proposed Financing Model For Microbusinesses In South Africa

1.7.5 Concluding Remarks

CHAPTER 2: LITERATURE REVIEW

2.1 Microfinance models in developing countries

2.1.1 India

The history of rural credit, poverty alleviation and microfinance are inextricably interwoven in India. Since gaining independence from Britain, institutional credit was perceived as a significant instrument for enhancing production and productivity and for alleviating poverty in India. The institutional vehicles chosen to expand credit to the rural population in a timely and sufficient manner were cooperatives, commercial banks and Regional Rural Banks (RRBs). However there has been a gap between these objectives and the reality in India due to defects in policy design, infirmities in implementation and the inability of government to desist from resorting to measures such as loan waivers. Consequently, the banking sector was not able to understand lending to the poor as a viable and profitable activity but only as a social obligation (Thorat, 2006).

Hence, the financial sector had to wait several decades in order for the microfinance model to be considered credible. Policy planners began the search for products and services that would enable the financial system to provide products to the poor and rural population. The relentless search discovered that the poor tend to – and could be induced to – come together in a variety of informal ways for pooling their savings and dispensing small and unsecured loans at varying costs to group members on the basis of need (Thorat, 2006).

Microfinance in India started in the early 1980s, with a small effort to form informal self-help groups (SHG) that provide access to savings accounts and credit services. From this small beginning, the microfinance sector has grown significantly in the past decades. National bodies such as the Small Industries Development Bank of India (SIDBI) and the National Bank for Agriculture and Rural Development (NABARD) are devoting significant time and financial resources on microfinance. This signifies the growing importance of the sector. The strength of the Indian microfinance organisations (MFOs) lies is in the diversity of approaches and techniques that have evolved over time. In addition to the home-grown models of SHGs and mutually aided cooperative societies (MACS), the country has learnt from other microfinance initiatives from across the world, particularly Bangladesh, Indonesia, Thailand, and Bolivia, in terms of delivery of microfinance services. India, where more than 300 million people live on less than $1 a day, is viewed as an especially significant laboratory for microfinance (Sriram and Upadhyayula, 2002).

One of the most successful and fastest growing MFIs operating in the country is SKS Microfinance which was set up by Vikram Akula in 1998 to provide microfinance to the poorest sections of the Indian society that earns a per capita income less than $120 per year. The MFI targets only women and uses the group-lending model as collateral which was popularised by the Grameen Bank. In this model, the women must apply for loans in groups of four or five, and because none can ask for additional funds until each member of the group pays back her loan, peer pressure lowers default rates. Women are preferred in this case because research has shown that women are more likely than men to reinvest business earnings in their households and to support others in their borrowing group (Deutsche Bank Research, 2007 and Akula, 2008).

By negating the traditional assumption that microcredit is not a viable business in developing countries, SKS brought a new technologically-savvy microfinancing model in India, which is profitable and self-sustaining. By reducing costs through prevention of wastage at each step of the loan process, combined with innovative technologies and an efficient management system, SKS has transformed into one of the fastest growing microfinance institutions in the world. From the onset, the strategic goal of SKS's founder was to model the business on McDonald's and Starbucks by using technology and standardised systems to wring enough efficiency out of each tiny transaction to lower unit costs. By attracting capital from global financial institutions such as Citibank and through its automated Management Information System (MIS) and its SmartCards Pilot Project, SKS has been able to grow rapidly (Rupesh, 2006).

To craft and execute a competitive advantage, SKS focuses on operational efficiency and continuous improvement of its model at every part of the lending value chain. A key feature of the SKS business model is the computerised "Smart Card" introduced in 2000. Each borrower in the village is given a card, which is then inserted in the handheld computer (HHC) carried by the loan officer at which point the two gadgets synchronise with each other. The information from the HHC is then transferred to the branch office computer, where all the accounts are automatically updated. This considerably reduces the time consumed in processing loan transactions, enabling the staff to carry out additional meetings in limited time. Moreover, by creating simple loan management accounting software which can be used by loan officers with no computer experience, SKS reduced the time spent on accounting matters from several hours to minutes (Bhatnagar et al., 2002).

The MFI achieves efficiency by also using some simple but effective rules such as requiring borrowers to pay the same amount periodically in exact change, instead of allowing coins and letting borrowers pay whatever amount. The impact of this results in fast turnaround times for loan officers, which then allows them to visit more villages each day (3 instead of 1) and handle more borrowers at each meeting (50 instead of 20). At one point in time, the MFI was dangerously exposed to one business sector, SKS management was able to respond quickly and source borrowers from other business sectors such as tractor repair, brick making, tire re-treading and tea shops. In this instance, through built-in early warning mechanisms, the software enabled SKS to diversify its loan portfolio risk by including borrowers from other business sectors (Bellman, 2006).

SKS estimates that poor households in India have borrowed approximately $1.8 billion from microlenders in the period between 2001 and 2006. However, the MFI believes that they could borrow more than 20 times that amount if they had financial institutions that could bring simple and affordable lending to each village. Spread across rural India, this approach to tiny financial transactions plays well into the social development agenda of India's ruling coalition, which assumed power in 2004 with the promise of driving India's growth in the rural areas in a sustainable way. These small, income generating loans have had a tremendous impact on the lives of female borrowers and their families in India. Hence, India's central bank is very optimistic about the microfinance model such that it recently changed its regulations to allow small rural institutions to act as agents for banks (Bellman, 2006).

Moreover, adding to its success is the fact that SKS has also been able to raise money from the private sector including ICICI Bank, India’s largest private-sector bank by capital, and foreign institutions such as Citigroup and Sequoia Capital. The private-equity giant Sequoia Capital invested $11.5 million in SKS Microfinance, in March 2007. Due to Sequoia’s status as a commercial venture capital fund with prior investments in companies such as Yahoo! and Google, the deal was heralded as the first purely for-profit private equity undertaking in the microfinance industry. As a true sign of its commercial viability, SKS has since made plans to list its shares on the Indian stock exchange during 2010. Partnering with and raising money from the private sector has been one of the foremost strategies of the MFI in order to ensure its long-term sustainability and viability of its model (Sloand, 2010).

In 1998, SKS was able to drop its annual interest rates from 36% to around 24% due to its more-efficient systems. At that time, these rates were lower than what most people paid for credit-card debt in the cities. Most importantly, this rate was less than half that charged by many rural loan sharks, who have been blamed for the rise in suicides by farmers who faced ruin in the past year when their crops failed. SKS's next product development is to bring health and crop insurance to the poor in an affordable and sustainable manner. It also hopes to use Visa's card technology to make microloans as simple and inexpensive as getting cash from an ATM (Bellman, 2006). As of March 31, 2010, SKS had 6.78 million female borrowers and total disbursements worth more than $3 billion, and many of its clients are repeat borrowers (SKS Annual Report, 2010).

SKS provides many important lessons for MFIs in that it takes a very capitalistic approach to building its business model while at the same time meeting the needs of its clients in the rural areas. Akula (2008) and Bhatnagar et al. (2002) summarise effectively in a concise way the various lessons that the SKS business model offers in establishing and managing a next-generation MFI. The key lessons are summarised below:

- Scalability is very important - ensure that the business model can be scaled up quickly in order to grow the business rapidly and increase the number of customers especially since margins are low when dealing with the bottom end of the income pyramid.
- Adopt a profit-oriented approach in order to be able to access commercial capital from commercial banks, private equity players and other investors seeking high returns.
- Standardise products, training and other frontline and back-end processes in order to boost capacity by adopting business principles used by companies such as McDonald’s and Starbucks.
- Implement easy-to-use technology such as the SKS Smart Card system to reduce costs and limit errors and manipulation by eliminating arduous paper-based and manually driven processes.

- Entrench customer loyalty – engage clients in a culturally appropriate way, by using local knowledge, an MFI is then able to design a set of products and delivery mechanism tailor-made for that community.
- Seek other revenue streams by leveraging the company brand and partnering with other service providers and thus offering complementary products, this enhances the profitability and sustainability of the MFI.

2.1.2 Brazil

Brazil has a huge potential for the microfinance industry, considering the fact that it has a large population, with over 174 million people. Furthermore, Brazil has the largest economy in South America with an estimated GDP of US$ 503.9 billion in 2001. Despite the country's wealth, Brazil has the highest number of poor citizens in South America and this equates to an environment conducive to microfinance. The income inequality is among the highest in the world, with the richest 10% of citizens receiving 48.9% of total income. Hence due to this skew, a high proportion of the population has a need for microfinance services (Nichter et al., 2002).

Despite the seemingly conducive environment for microfinance, the industry has not flourished as one would expect but has experienced slow growth rates since its first introduction in 1973. The industry has only had a low penetration of about 2% of the country's estimated 8.2 million microbusinesses. Different factors have been given as the reasons for the low take-off of the industry including the harsh economic climate before 1994, a strong presence of government-subsidised credit initiatives and an inadequate regulatory framework, among others. These barriers limit the emergence of sizeable MFIs and create several challenges for the microfinance industry (Nichter et al., 2002).

However, in recent years the microfinance industry has grown substantially and the majority of this growth stems from just one MFI, Banco do Nordeste , a public regional bank, which grew from 35,322 clients in December 1999 to 85,309 clients in December 2001 (Nichter et al., 2002). Its most successful product, CrediAmigo, which is aimed at microbusinesses, serves almost one-half of the total number of microcredit customers in the country. What added to the success of the Crediamigo product is that the bank spent considerable money and resources to understand the needs of the microbusiness sector before developing it (Young and Fiori, 2005).

The bank carried out extensive research before launching the programme. The research found that most microbusinesses do not borrow from conventional commercial banks, and those that do use credit depend more on suppliers, family, and moneylenders. This is despite the fact that the monthly interest paid, to the suppliers and moneylenders, is higher particularly when compared to the credit products offered by the public banks. The main reason given by microbusinesses for not obtaining bank credit is the difficulty they face in meeting documentation and credit guarantee requirements. Moreover, suppliers and moneylenders tend to provide a more flexible lending environment and greater convenience compared to conventional banks (Schonberger, 2001). Taking these needs into account the bank then innovated to develop the CrediAmigo programme. Table 1 below shows an overview of the CrediAmigo microfinance programme developed by Banco do Nordeste.

Table 1: Overview of CrediAmigo programme offered by Banco do Nordeste in Brazil

Name	CrediAmigo
Institutional type	Bank division
Operation began	November 1997
Source of funds	Transfers from parent Banco do Nordeste
Geographic region	Northeast region
Estimated market	2.5 million
Number of branches*	51
Guarantees	Solidarity group
Average term (months)	3
Nominal interest rate (monthly)	5%
Frequency of repayment	Every 15 days
Total disbursed	US$39.1 million
Number of loans disbursed	121,444
Outstanding portfolio	US$8.2 million
Number of loans outstanding	34,085
Average outstanding balance	US$241
Number of loan officers	213
Clients per loan officer	153
Loan officer education level	Secondary graduates and college graduates
Loan officer base salary	US$211
Incentive (% of base salary)	Average 40%
Other services	Training

Note: Figures are as of July 31, 1999. *"Branches" refers to any permanent physical location used as an operational base by the microfinance institution.

Source: Schonberger (2001)

CrediAmigo defines its market as regional and has pursued a high-growth strategy since its inception. The programme is not leveraged from deposit accounts or loans from private banks but receives commercial funds through its parent company. Even though the programme falls within a regulated financial institution, it has its own customised disbursement and repayment windows. Other programmes in Brazil are offered by NGOs and disburse money through cheques which are cashed at banks, and these banks also accept loan repayments. Most of these programmes are funded through grants while others through low-interest, long-term loans. These programmes have also largely benefited from international institutions for grants and technical assistance for designing the programmes and for institution building activities. Furthermore, these programmes focus on specific geographic areas based on the municipalities where they operate. However, CrediAmigo follows the strategy of its parent, Banco do Nordeste, and takes a wider regional approach. In this case it benefits through economies of scale provided by its parent company (Schonberger, 2001).

Consequently, the impact of the CrediAmigo programme has made a difference in that CrediAmigo accounts for 58 percent of active loans in the Northeast region and for 63 percent of all customers, further indicating that the programme's strategies are working successfully. In the absence of credit guarantees the programme uses the solidarity group-lending model to address this issue. The programme also offers the flexibility in repayment frequency to better match the cashflow patterns of its clients. This has allowed clients to take up larger loans as they establish a reliable record with the MFI of repaying their loans (Young and Fiori, 2005).

Due to low productivity, the salaries of loan officers are generally low. CrediAmigo loan officer salaries are typically US$300 per month whereas other similar programmes pay about US$500 per month on average. In the case of the other programmes the larger salaries are due in part to high productivity of the loan officers. However this has not negatively impacted on the success of CrediAmigo. Most of the programmes also offer their clients additional services such as training as they believe that this will enable the microbusinesses to flourish and thus improve their ability to repay the loans. But this is not a requirement for getting approval for a loan. Future services being considered by CrediAmigo include offering a savings product, as an additional source of funding for loan funds. Since it is part of a regulated financial institution, Banco do Nordeste, it is legally able to offer such a product (Schonberger, 2001).

However the microfinance industry in Brazil still faces major challenges which prevent it from reaching its full potential. Even though the macroeconomic environment has improved, the MFI sector has grown slower than other credit products. These challenges include a confusing regulatory environment which changes frequently. As a result, clear information is not widely available regarding the laws and permitted activities under which MFIs should operate. The lack of transparency and standardisation has prevented other MFIs from learning from each other in terms of which strategies work and which ones should be avoided. For example, Banco do Nordeste which offers the CrediAmigo programme is not open about its best practices, hence other MFIs cannot learn from it. Moreover, cheap public sector credit lines which focus on agriculture have had the negative impact of creating the impression to rural clients that credit is cheap. In addition, rural clients assume that loans need not be paid back. As a result, this has made it difficult for MFIs to penetrate rural areas and build sustainable business models (Nichter et al., 2002).

Even though Banco do Nordeste is not open about its best practices, the CrediAmigo programme offers several lessons in terms of the endless possibilities within the MFI industry, as already discussed above. The key lesson is that this model shows that commercial banks or state-owned banks, with a substantial capital base, can play a significant role within the microfinance sector, especially if they form an autonomous division within the bank that primarily focuses on providing tailor-made microfinance products to the poor and SMMEs.

2.2 Microfinance models in Africa

2.2.1 Kenya

In Kenya, as in many African countries, providing financial services to poorer populations in rural areas remains a challenging goal. The rural environment of Kenya is characterised by poor communications infrastructure, low population density, low levels of literacy, undiversified economies, low profitability and high risk economic activities. Consequently, it has thus far proved unattractive to NGO microfinance institutions (MFIs) and commercial financial institutions (Johnson et al., 2005).

The microfinance industry is relatively new in Kenya with the sector gaining industry status in the last 10 years or so, according to Hospes et al. (2002). In the past 20 years the sector has seen a lot of MFIs being set up to take advantage of providing financial services to the under-served poor in the country. In addition, the Kenyan government and international donor agencies have also played a major role in boosting the sector. The government of Kenya regarded the lack of access to credit as the major bottleneck to economic growth and enterprise development. As a result the international donor agencies donated about $80million to the development of microbusinesses in Kenya between 1995 and 2001.

The major beneficiaries of these funds were the Kenya Rural Enterprise Development Programme (K-Rep) and Kenya Women Finance Trust (KWFT). K-Rep is widely considered as the forerunner of NGO Microfinance in Kenya. Its philosophy during inception was the provision of minimalist financial services (loans and deposits) to existing entrepreneurs and not necessarily people who required to be trained to become entrepreneurs. In order to increase its chances of survival as a financing solution, K-Rep reduced the number of NGOs it supported from twelve to five, and also decided to establish KWFT. K- Rep, inspired by the Grameen Bank of Bangladesh, adopted the group-lending model in its microfinance initiatives and also encouraged other MFIs to follow suit. As a result of this adaptation, Kenya evolved mainly as the "Bangladesh of Africa" (Hospes et al., 2002).

The Kenyan financial services environment is not different to other developing economies in the sense that traditional commercial banks are reluctant to lend to the microbusiness sector, because MFI borrowers seldom have any credit history or assets that they can use as security. The reasons cited are that financial institutions are not located in rural Kenya because of the perceived high transaction costs and risks. Hence, the majority of people living in rural areas do not have the time and money for a trip to the bank that exists in the major towns. Consequently, a small number of banks have ventured into developing credit products targeted specifically for microbusinesses. As a result of these barriers, MFIs such as K-Rep are widely regarded as the best hope for Kenyans in the rural areas to receive access to credit due to their innovative and flexible approaches. Some of these approaches include: minimalist versus integrated approaches and group-lending models versus individual-lending models. The minimalist approach focuses specifically on providing microloans to microbusinesses and the integrated approach bundles other value-added services.

In addition, the group-lending schemes organise clients into groups to attain economies of scale from the small sized transactions and establishing group-guarantee mechanisms. K-Rep has also established Financial Services Associations (FSAs) which are aimed at increasing outreach to the rural areas. FSAs are based on internal member resources where members buy equity in the credit fund. By using FSAs, K-Rep is hoping to invent a low-cost model of establishing new MFI-type programmes and also diversify its clientele in the process (Hospes et al., 2002).

Although these programmes have been largely successful, it has been found that clients cite several reservations with regard to the lending practices used by institutions such as K-Rep. Clients mention that they do not like the group-lending model as it is unnerving to take into account the behaviour of other people in the group. Other clients also state that they dislike the mandatory weekly meetings due to the lengthy time that these sessions take. Others would like to have more control over the deal terms of the loans regarding size, time and interest rates that are charged.

Table 2: Geographical outreach of banking institutions involved in microfinance in Kenya (as per December 31st of 2000)

Basis for Comparison	KCB	Post Bank	EBS	Cooperative Bank	K-Rep Bank
No. of branches in cities and major towns	25	57	2	11	1
No. of branches in smaller towns, market centers and district headquarters	70 full time 32 satellites	437	10	19	21
Total branches	95 full time 32 satellites	494	12	30	22
Total number of staff	3,600	1,300	145	930	122
Total customers' deposits (volume) at year-end December 2000 (Kshs)	42 billion	6.9 billion	1.2 billion	15.4 billion	267.4 million
Volume of loans and advances year-end December 2000 (Kshs)	33 billion	N/A	607 million	11.6 billion	380 million
Total share capital and shareholder's equity fund (Kshs)	6.4 billion	270 million	194.5 million	1.4 billion	506 million

Source: Hospes et al. (2002)

By the end of May 2001 the total loan portfolio of the five banking institutions involved in microfinance was Kshs 1 billion. More than 60% of the loan customers were K-Rep bank customers. Furthermore, the deposits mobilised from 33, 689 customers were over Kshs. 467.3 million, of which 70% of the customers belonged to K-Rep Bank. Clearly, K-Rep specialises in providing microfinance to the poor and thus provides the largest number of microloans compared to the other financial institutions. It has also been widely reported to have the highest geographical coverage among MFIs that target small-scale microbusinesses. Moreover, studies have shown that other banks that play in this market are only focused on providing savings accounts as opposed to loans.

Most notably K-Rep, has been largely successful in reaching its mission of "empowering low income people, serving as a catalyst for them to increase their participation in the development process and enhance their quality of life" due to its unrelenting focus on its mandate. The development of microbusinesses was at its core from its inception in 1984. Not only did K-Rep focus on supplying much needed financial services to microbusinesses, but it also expanded its programmes and included providing management and financial services to NGOs involved in the development of microbusinesses.

To this end, the MFI has been successful in making financial services available to microbusinesses that have not accessed credit through conventional banking institutions. Having clear and altruistic objectives, allowed K-Rep to receive generous funds and support from international donors. These funds and professional support enabled the organisation to establish three distinct agencies under the umbrella name K-Rep Holding: K-Rep Development Agency (non-profit organisation); K-Rep Advisory Services (consultancy firm) and K-Rep Bank Limited (for-profit organisation). The overall objective of K-Rep Holding is to generate employment and increase incomes by expanding financial services to the poor (Hospes et al., 2002).

In essence, the strategy used by K-Rep Holding is two-fold: (1) Identify, test and develop new microfinance products that increase access to financial services for the poor and (2) create institutions that can deliver these services in a sustainable way. This effective strategy has allowed the MFI to deliver results to 21 different districts in Kenya which are home to some of the poorest communities in the country. In various pilot projects, the client composition by gender has been 52% male, 44% female and 4% groups. This is further evidence to its goal of providing financial services to a diverse group of people in the most remote areas in Kenya. The over-arching key to the success of such programmes is that they are run professionally from inception and are staffed by professional people with the appropriate skills to execute on the mandate from the private sector, donors and government. The K-Rep Development Agency's positive experience in turning around MFIs that are performing poorly, serves as a good lesson of the prospects that world-class professional management can offer to nascent MFIs operating in other developing economies (Johnson et al., 2005).

2.2.2 Ghana

In Ghana, it has also been discovered that microbusinesses and poor individuals have very limited access to deposit and credit facilities and other financial services provided by formal financial institutions. For example, only about 5 percent of the population has access to the conventional banking industry. In many African countries the poor represent a "lion's share" of the population hence the informal sector is an important part of the economy. To meet this demand for financial services, various types of MFIs have surfaced over time. Some MFIs focus on providing credit products, some focus on providing savings products and others provide both savings and credit facilities. In Ghana, the MFI sector has a strong orientation towards savings. Moreover, licensed institutions such as the Rural and Community Banks (RCBs), nonbank institutions, and the Savings and Loans Companies (S&Ls), play a more prominent role than NGOs and account for most of the microfinance activities in the country (Basu et al., 2004).

It is no surprise that these MFIs would be able to set up a sustainable business model, since the commercial banking system, which is dominated by a few major banks (among the 17 in total), only reaches approximately 5% of households. Moreover, most of these households are excluded by the large minimum deposit requirements imposed by the banks. It has been reported that 60% of the money supply falls outside the commercial banking system, hence the rural banks, savings and loans companies, and the semi-formal and informal financial sectors play a significantly important role in Ghana's private sector development and poverty reduction strategies (Steel and Andah, 2003).

There were 115 RCBs operating in Ghana at the end of 2001, however these are very small in terms of loan size. But at the same time they have a large number of depositors (1.2 million) compared to borrowers (150 000). And there were eight S&Ls in the non-bank sector, with 160 000 depositors and 10 000 borrowers by 2002, according to Basu et al. (2004). The RCBs are owned by members of the community through the purchase of shares and comprise of a major share of the microfinance services. Second to the RCBs, in terms of supplying MFI services, are the Savings and Loans companies. Recently modern cooperative societies have sought to expand their services to non-members as well, to overcome resource constraints to their growth and sustainability.

Furthermore, the MFIs in Ghana are constantly seeking new innovative approaches to progress towards sustainability. These new approaches include using group savings with credit schemes. These schemes involve group members depositing their pooled funds with the MFI and then using these pooled funds as security to access loans, which they would not otherwise qualify for individually. The group savings accounts coexist with the loan accounts, however the loan repayments are made individually but settled through the group account. Such a scheme creates a dual advantage for the MFI by minimising risk and basing the loan on a high security and using group solidarity to prevent defaults. Nsoatreman, Bosomtwe, and Lower Pra RCBs are some of the examples using this strategy in Ghana. Once individuals have established a sound credit history they may then apply for loans individually to the MFIs (Chord, 2000).

The informal money-lending sector in Ghana has been a rich source of innovation for the formal MFIs. Some of the innovations have been adopted by the formal MFIs and have thus assisted in the development and growth of the industry as a whole. A good example of innovation has been the Ghana Susu system which has since been widely adopted. This system covers a wide range of activities such as individual savings collectors, rotating savings and credit associations (ROSCAs), and savings and credit "clubs" run by an operator (Steel and Andah, 2003). Table 3 below shows the different types of Susu role players.

Table 3: Building on Informal Sector Savings and Credit Mechanisms: The Example of the Ghana Susu System

Type of Susu Institution	Description
***Susu* collectors**	Offer a saving vehicle by collecting daily amounts voluntarily saved by their clients, which they return at the end of the month, minus one day's amount as a commission. The susu collector function was expanded by licensed MFIs with "Mobile Banking" services working as a collector going locally to mobilise savings and offering additional services, such as promised loans (proposed for example by Nsoetreman Rural Bank and First Allied S&L), and life insurance benefits (introduced briefly by the State Insurance Corporation in the 1980s).
***Susu* associations**	Are either (i) rotating (ROSCAs), that is, they collect savings from their members and allocate them to each member in turn, or (ii) accumulating, which allow regular contributions to be accumulated, to cover the lump sum costs of such special future events as funerals.
***Susu* clubs**	Combined the above two systems, operated by a single agent. Members commit to save a pre-defined amount over the medium-term (50- to 100-week cycles) and pay commissions on each payment and fees when they are advanced the targeted amount before the end of the cycle.
***Susu* companies**	Are more recent (late 1980s) and registered. In addition to savings collected using traditional susu collectors, they provide loans after a minimum saving period.

Source: Basu et al. (2004)

According to Basu et al. (2004) the MFIs have used Susu associations, clubs, and companies to expand their services. In these schemes, Susu club operators are clients of licensed financial institutions. The club operators are attracted by the safe instruments where they can place the mobilised savings. In addition, they are interested in the lending facilities that they can use to provide more advances to their own clients. The licensed MFIs, on the other hand, may leverage on local informal agents' in-depth knowledge of their clients. The RCBs and S&Ls have initiated a pilot project which provides funds to Susu collectors who then on-lend to their own-clients. These combined initiatives have resulted in cost synergies which effectively allow the MFIs to increase their outreach to lower income segments and women in general.

In addition, some commercial banks, insurance companies, RCBs, S&Ls, and credit unions have developed a savings product named "Susu," including hiring people to gather the savings in the same way as a Susu collector. The State Insurance Corporation was the first financial institution to introduce such a "Money Back" savings plan in the 1980s, comprising a life insurance benefit for clients as an additional incentive to get savings, however due to a low uptake, the scheme was discontinued in 1999 (Steel and Andah, 2003).

There are several challenges which the industry still faces including finding, selecting and training good staff and monitoring their progress in the field. Creating sustainable methodologies, financial products and services that resonate with the targeted vulnerable and marginalised market is an on-going battle that requires continuous research and development and support from donors. Funding for this sector comes from three sources: the institutions themselves, government and development partners. However, it has been discovered that the funds do not seem to be adequate to meet demand and the varying sources come with onerous conditions, distorting the market in some cases. There is also currently no microfinance fund to which MFIs can apply for on-lending and capacity building support. Moreover, there is no national governing body which is given the responsibility for coordinating all activities associated with the microfinance industry. Consequently, the sector lacks a coherent approach, which results in fragmentation, duplication and inadequate collaboration between and among MFIs, development partners, service providers, practitioners and end users (Opare-Djan and Apania, 2008).

Although there are many challenges that still face the microfinance industry in Ghana, the country provides key lessons in that formal MFIs and commercial banks, in other developing economies, can learn a great deal from the informal sector which will allow them to tailor-make solutions to expand their services in this sector. The key here would be for the managers that operate in these formal institutions to open their minds and be willing to study the current business best-practices that are being used to provide credit by the informal players in this market.

CHAPTER 3: PREVAILING SMME FINANCING MODELS IN SOUTH AFRICA

3.1 Historical development of the microfinance sector

The modern South African microfinance industry began in the 1980s and its growth was spearheaded by a number of role players with different objectives. These role players included NGOs, for-profit organisations and government agencies. Porteus (2003) suggests that the growth of the microfinance market can be categorised into four distinct phases, namely: Pioneer, Break-out, Consolidation and Maturity. It should be noted that these phases do not take into account the informal lenders who have been around even before the 1980s and operate mainly in the townships in South Africa.

The Pioneer phase (from 1980 to 1994) comprised of NGOs and commercial lenders who developed microfinance products and gained initial success. These lenders operated illegally and charged excessive interest rates. The Breakout phase (from 1995 to 1999) comprised of rapid growth of the industry spurred by the exemption in 1992 to the Usury Act of 1968 that removed interest rate caps on short-term loans. This move effectively legalised the microfinance sector and as a result large capital flows were attracted from the legal financial sector. The Consolidation phase (from 2000 onwards) consisted of stiff competition among MFIs due to the rapid growth of the sector and this led to lower profit margins and increased risk to the MFIs. In addition, the government established the Micro Finance Regulatory Council (MFRC) and outlawed payroll lending which was used by MFIs as a collection mechanism.

As a result, the lower profit margins, increased compliance and loss of a stable collection method led to many MFIs going bankrupt. According to an analysis conducted by Porteus (2003), there were 3500 formal MFIs in 1997, an increase of 192% over 1995. But this number was drastically reduced to 1334 formal MFIs in 2000 due to the stiff competition and the other factors mentioned above.

The Maturity phase is characterised by the National Credit Act of 2007 which removed the cap on loan size (previously R10 000) and the establishment of the National Credit Regulator (NCR) which replaced the MFRC. The NCR is focusing on increasing access to microfinance for the low end of the market. Since then, the rate of microloans issued has increased at a lower rate, but it continues to increase nonetheless. This phase will be codified once the microfinance industry reaches a long-term sustainable growth rate and a consistent regulatory framework is implemented and adopted by all market participants. The microlending book in South Africa grew from about R17 billion in May 2004 to aboutR30 billion in May 2007 (Skowronski, 2009).

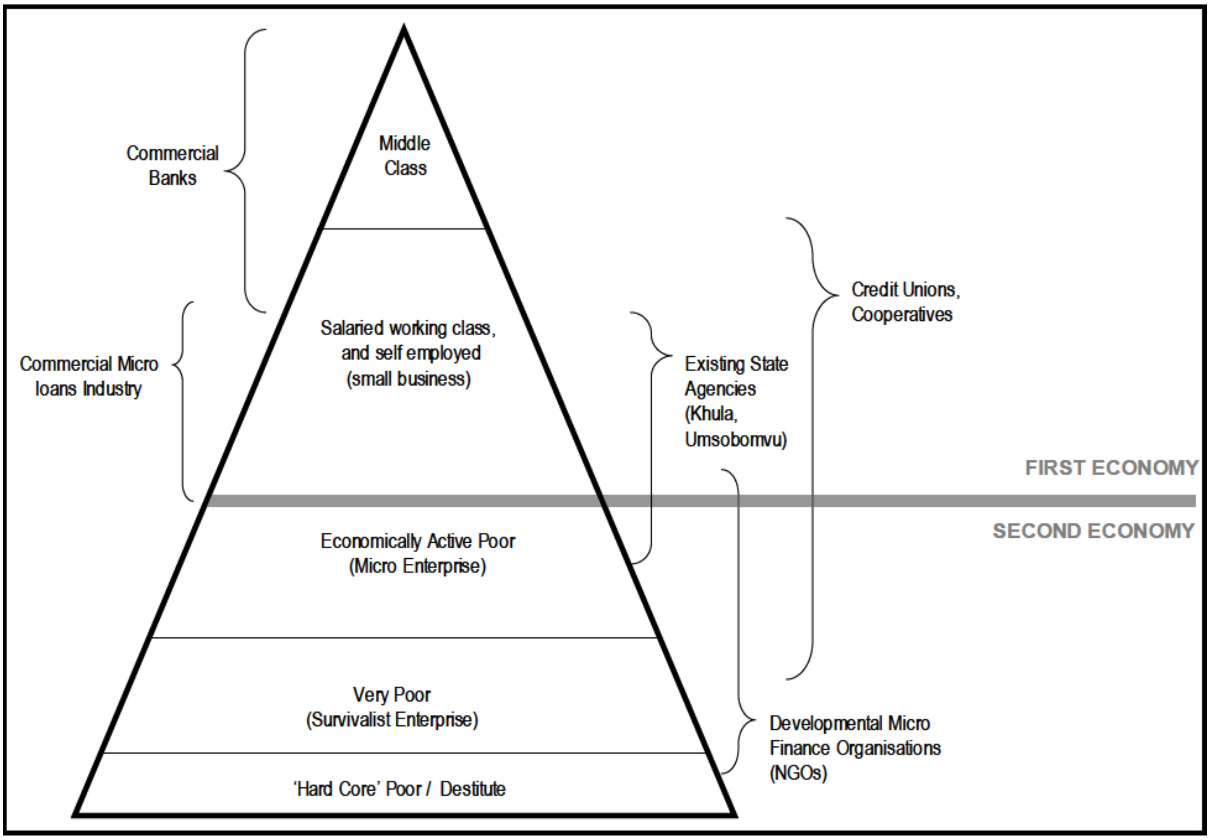
3.2 Supply of financial services to low-income households in South Africa

The South African industry consists of both formal and informal financial service providers. The major distinction between the two is that the formal providers are industry players who mainly abide by the law and regulatory requirements. On the other hand, the informal industry players are those that do not adhere to any regulatory requirements but only abide by the ”laws of the jungle”. That is to say, they provide whatever the market wants and if the product does not gain traction in the market they abandon it. Examples of formal financial products include bank accounts, credit cards, savings accounts and insurance products. And examples of informal financial products include stokvels (savings clubs), burial societies and loans from mashonisas (loan-sharks).

According to a report published by the Southern Africa Regional Poverty Network (2005), 13 million out of 27 million South African adults (48%) did not have formal banking accounts. Moreover, of the unemployed, 83% did not have a bank account and 60% of those that worked in the informal sector did not have a bank account (unbanked). Research shows that low income households spend a lot of time and resources in maintaining their finances across several informal and formal systems. South African low income households use 11 different credit instruments, 4 different savings products and 2 insurance instruments, and of these products, 70% come from informal providers and 30% from formal providers (Collins and Morduch, 2008).

Evidently, low-income households in South Africa demand and use a combination of financial products across the financial spectrum of services comprising of credit, savings, insurance and transactional offerings. However, accessing these products from the formal sector is still a major challenge for low-income households. The demand and supply of financial services can be thought of as a pyramid structure as shown by the figure below (Southern Africa Regional Poverty Network, 2005).

Figure 1: Market segmentation of financial services in South Africa



Source: Southern Africa Regional Poverty Network (2005)

The pyramid market segmentation above consists of two levels: the first economy and the second economy. The first economy which is at the top of the pyramid comprises of the financial needs of the middle class which are serviced by the big four banks (ABSA, FNB, Nedbank and Standard Bank). These providers supply a wide range of sophisticated financial products such as insurance, investments, savings, transactional accounts and other facilities. The salaried working class and those that are able to earn a regular income from self-employment are also able to access the big four banks although to a lesser extent. Moreover, they are able to source products from commercial microlenders, government agencies and credit unions. At the bottom of the pyramid exists the second economy which consists of microenterprises (economically active poor), survivalist enterprises (very poor) and the destitute (hard core poor). A huge gap exists in terms of financial services in the bottom half of the pyramid. There are few financial institutions that play in this market; these are primarily NGOs (developmental microfinance organisations) who provide limited access to loans for enterprise development, but few offer insurance and savings products.

3.3 Challenges facing the microfinance industry

There are many challenges that the microfinance industry faces in South Africa. The obstacles and some of the external variables that have been cited in several studies as an impediment to the growth of the industry are: (1) economic dualism; (2) formal competition; (3) informal competition; (4) higher loan sizes; (5) banking fees; (6) cost of regulation; (7) limited entrepreneurial training; and (8) urbanisation and immigration. These barriers are briefly discussed below (Skowronski, 2009):

- Economic dualism: South African MFIs pay first economy type salaries but earn revenues from the second economy. As a result of the cost-to-loan size mismatch MFIs in South Africa incur a high salary burden.
- Formal competition: South African MFIs face stiff competition from well funded and widely distributed commercial banks for borrowers with a good credit record.
- Informal competition: some borrowers are still skeptical of MFIs and thus rely on mashonisas and stokvels to access credit facilities even though the MFIs might have advantageous loan terms.
- Higher loan sizes: on average MFIs in South Africa have to offer higher loan sizes than in other emerging markets due to higher demands of borrowers. As a result MFIs are unable to diversify risk from their loan portfolio by borrowing to more clients compared to their counterparts in other emerging markets.
- Banking fees: South African commercial banks charge high fixed banking fees rather a fixed percentage to accept deposits and this has a negative impact on profitability for MFIs that deposit large volumes of small loan repayments.
- Cost of regulation: South Africa has a first-world regulatory environment which imposes onerous compliance costs on MFIs that are higher than their counterparts in other emerging markets that have less formal government agencies.
- Limited entrepreneurial training: during the apartheid era small black enterprises were prohibited to ensure that there was cheap labour for large enterprises. As a result, emerging entrepreneurs lack role models from whom they can learn the relevant and necessary business skills.

- Urbanisation and immigration: large cities have a transient population which lacks long-term relationships as a result of urbanisation, consequently it is difficult for MFIs to offer solidarity based loans. However, to a certain extent, this is mitigated in the townships and probably in the rural areas.

3.4 Programmes targeted at providing finance for Small Medium and Micro Enterprises (SMMEs)

There are many different programmes that are aimed at providing finance to the SMME sector in South Africa. These programmes can be broadly grouped into three categories: (1) State initiated institutions involved in SMME financing; (2) Private sector programmes for SMME finance; and (3) Non-commercial or community-based financiers of SMMEs. State initiated institutions were set up by government with the aim of providing and increasing access to financial services for SMMEs. Private sector programmes include the banking sector, commercial microlenders, insurance products and venture capital and equity funds. The non-commercial financiers comprise of the non-profit microfinance sector and village banking model which target SMMEs.

3.4.1 State initiated institutions involved in SMME financing

There are numerous state initiated programmes that exist and each one of these is covered briefly below, highlighting their focus of providing SMME funding. However, Khula is the most prominent of these programmes in terms of its focus on the lower end of the SMME sector, thus a detailed analysis of the products and services it offers is outlined.

(a) Khula Enterprise Finance Limited (Khula)

Khula was set up as a wholesaler with the objective of creating and developing SMMEs by providing loans particularly to previously disadvantaged individuals. It was established by the Department of National Treasury in 1996 with a grant of R162 million and operates as a private company with government as the only shareholder. Khula's main strategy is to fulfill its mandate by leveraging Retail Funding Intermediaries (RFIs) and providing guarantees to commercial banks. The products and services that are offered by Khula to SMMEs are briefly outlined below (Khula, 2003 and Motsa, 2004).

(i) Khula Loans

Debt financing, seed loans and capacity building to RFIs are some of the offerings provided by Khula Loans. The sizes of loans to RFIs range from R10 000 to R2million. In 2001, the average loan size for all RFIs was R 29 323. Business loans to RFIs are usually made at an interest rate lower than the prime lending rate of banks and these are meant to be on-lended to SMMEs. In addition, seed loans which are non-interest bearing are supplied for covering the operational shortfall of start-up RFIs. Furthermore, capacity building to assist with training and management systems is also provided for start-up RFIs.

(ii) Khula Start

Khula Start is an entry-level product aimed at the microbusiness sector. The product utilises the group-lending model to groups of rural women who own micro enterprises. The loans which range from R300 to R3500 are made available through intermediary organisations called Micro Credit Organisations (MCOs). Khula Start loans are largely made to first-time borrowers who need micro loans to provide for their families through micro economic activities.

(iii) Private Equity Funds

In addition, Khula provides financing for private equity funds that cover transaction values ranging between R250 000 and R5 million. As a result of this product, in 2003 the Anglo-Khula Mining Fund, a joint venture between Anglo American and Khula, was launched to assist emerging miners (Khula, 2003).

(iv) Credit Guarantee Scheme

The scheme was set up to provide access to finance to SMMEs who want to start or expand their businesses but lack sufficient security to act as collateral as required by the major banks. The participating banks through which SMMEs can access the scheme are ABSA, First National Bank, Nedbank and Standard Bank. The scheme covers loans between R10 000 and R3 million.

(V) Thuso Mentorship Programme

The mentorship programme provides pre-loan and post-loan support to SMMEs who apply for commercial bank loans. The pre-loan support covers business plan development and advisory services whereas post-loan assistance includes rescue services and mentoring support. The scheme was established to encourage commercial banks to use the Khula Credit Guarantee Scheme. Subsequently, in 2001, the programme was extended to include other RFIs.

Throughout its existence Khula has faced many challenges and criticism one of them being a disappointing uptake of the guarantee scheme by banks. Foxtrott et al. (2002), in their 2002 Global Entrepreneurship Monitor report found that the scheme was a good idea in principle, however it was poorly implemented and marketed. Moreover, it has been discovered that Khula's portfolio guarantees have not been able to provide additional credit supplied on less demanding terms. Furthermore, the funds have failed to generate large enough volumes to achieve economies of scale and thus reduce unit costs to profitable levels (Schoombee, 2000).

The wholesale model used by Khula has also been raised as an issue in that the retailing banking institutions which Khula uses have been designed to serve only the high end of the overall market. Furthermore, because the banking sector and its practices were not comprehensively focused on SMME financing, the number of banks was still far from being able to adequately service SMMEs. Khula management has continued to consider the possibility of employing a retail model in order to be able to directly service its primary target market (SMMEs). However the debate continues and the decision has not been finalised, and this further adds to the detriment of SMMEs (Motsa, 2004).

Another challenge is that a lot of RFIs faced problems with institutional capacity. Due to poor governance, inefficient management systems, fraud and mismanagement, many RFIs collapsed in 2000. However, steps were taken to ensure that RFIs remain sustainable and these changes included improving governance, the appointment of specialist risk managers, regular audits of RFIs and employing stricter financial management control systems. Due to these improvements, further collapses were prevented. As a result, Marang Financial Services one of Khula's best performing and largest RFIs with over 20,000 clients continues to thrive (Motsa, 2004).

Marang Financial Services emerged from the collapse of the Get Ahead Foundation (GAF) and Rural Finance Facility (RFF) in 2000 and was built upon the experience and institutional memory of the two organisations. The organisation currently operates in five provinces (Mpumalanga, Limpopo, KwaZulu-Natal, Gauteng and Eastern Cape) with 23 branches and 19 satellite offices, and its clients are mainly women. Marang provides group enterprise loans by employing the solidarity lending model to groups of women between five and eight, and between ages 18 and 70 years. These are women who are not able to get loans from the formal sector due to not having collateral. Marang is also considering individual loans and microinsurance products to men and women (over 21 years of age) who have been operating their businesses for at least two years (Skowronski, 2009).

(b) Other state initiated programmes

There are several other state initiated programmes aimed at supplying financial services to SMMEs and these are briefly outlined below.

(i) National Empowerment Fund (NEF)

Established in 1998, the NEF's major objective is to promote economic participation of historically disadvantaged persons and to facilitate black economic empowerment through finance and investment activities. The NEF has three main offerings: private equity (for transactions between R25 –R200 million); venture capital (for seed and acquisition capital) and investment services (for designing and packaging of mass empowerment share-buying schemes). NEF plays a role in financing the upper end of the market for SMME and it has been widely criticised as slow to take off and as another "white elephant setup to benefit a few chosen blacks" (Wadula, 2003).

(ii) Industrial Development Corporation (IDC)

The IDC offers a wide range of products which are aimed at the high-end of the market requiring a minimum of R1million in funding. Recently the IDC has facilitated black empowerment transactions for emerging black businessmen wanting to acquire a stake in established formal South African businesses.

(iii) Land Bank

The Land Bank has a focus on providing finance to agricultural entrepreneurs from start-ups to established commercial farmers. The Land Bank also promotes black economic empowerment initiatives within the agricultural sector. Microfinance loans are also provided to poor individuals and farmers which range from R250 to R18 000. No security is required for these loans but borrowers need to have a bank account and a fixed interest rate of about 2% is levied. This microfinance initiative called Step-Up was established in 1998 by the Land Bank. However the impact of the Step-Up scheme in the market has not been widely studied and documented as yet (Sukazi, 2003).

(iv) Post Bank

Post Bank offers savings facilities to the low end of the market through its widespread post office network distributed throughout the country. It has also been reported that the Post Bank and government are considering expanding the range of products that the institution offers to include other financial services such as insurance (Motsa, 2004).

(v) Business Partners

Business Partners is a specialist investment organisation and was established as the Small Business Development Corporation in 1981 and re-launched as Business Partners in 1998, after a change in strategic direction. It focuses on investments between R250 000 and R7 million. These investments are structured using equity, shareholders' loan accounts, royalties and term loans or any combination of these. Its focus is mainly on the upper end of the SMME finance market.

(vi) Umsobomvu Youth Fund (UYF)

The UYF was established in 2001 to facilitate job creation and skills development of the South African youth, the UYF provides business advisory services and finance through its voucher scheme and various business partnerships. Funding varies from microfinance to equity finance of up to R5 million. However, according to Motsa (2004), the potential impact and relevance of the fund in the microfinance market and on youth development has not been widely documented. In 2009, the National Youth Development Agency (NYDA) was formed as a result of a merger between the UYF and the National Youth Commission (NYC). The move created a single, consolidated structure that is responsible for all aspects of youth development in South Africa.

3.4.2 Private sector programmes for SMME finance

As previously noted, private sector programmes consist of the banking sector, commercial microlenders, insurance products and venture capital and equity funds. According to the 2001 GEM report (Driver et al., 2001) commercial banks are not optimally configured to financing SMMEs and this is largely due to that they developed in an economy dominated by large enterprises. Consequently commercial banks lack the set of skills necessary for assessing and mentoring start-ups and small enterprises. As a result their assessment and decision making, and consequently their products are not tailored to the specific needs of entrepreneurs. Alternatively, commercial microlenders, distinct from microfinance for enterprise development, have long been considered in a negative light - as it is seen to be a consumer credit driven sector - by those seeking to provide microfinance for SMME development. Commercial microlenders have only been interested in providing consumer loans to salaried workers with no real interest in social development (Motsa, 2004).

On the other hand, the insurance industry has not been under as much pressure as the banking industry to provide services to the SMME sector. With the spread of HIV/AIDS and the risks posed to SMMEs, this is going to become a major priority. Moreover, due to the informal nature of most of the insurance organisations that operate in this sector, products often overlap, crossing the distinction between insurance, savings and credit (Bester etc al 2003). These institutions are mostly burial societies and have an estimated 8 million members which contribute in excess of R10 billion each year. Research has found that most of these organisations operate with a connection to an insurance company. Hence, the formal insurance industry also has a potential role to play in the provision of credit and other financial services to the SMME sector (Bester et al, 2003).

Research conducted on the South African venture capital industry found that South Africa has a developed venture capital market, however very few organisations focus on small and microbusinesses (ECI, 2001). The study also highlighted the fact that the lack of management skills is likely to limit small and microbusinesses and entrepreneurs from accessing the potentially beneficial resources provided by the venture capital industry.

3.4.3 Non-commercial or community-based financiers of SMMEs

As indicated before, non-commercial financiers comprise of the non-profit microfinance sector and village banking model which target SMMEs. Among the MFIs which play a significant role in South Africa, the Small Enterprise Foundation (SEF) is one of the oldest MFIs and has been active since 1992. Its target market is largely residents based in the rural areas of South Africa, mainly Limpopo and Mpumalanga, where poverty is widespread. SEF has about 58,000 clients and an outstanding loan portfolio of R89 million with an average loan of about R2000 per client (2009 figures).

The MFI provides two products: the Microcredit Programme (MCP) which specifically targets poor women and the Tshomisano Credit Programme (TCP). Both programmes employ the Grameen model of providing loans to solidarity groups of five members. Members are required to save (R10 minimum) at every biweekly meeting and savings are held at Post Bank branches. The model uses loan officers who are active in collecting information about each member's savings records and food consumption. Quarterly reports are documented which allow the loan officer and client to build an in-depth relationship regarding financial services (Skowronski, 2009).

The village banking model exists as a potential vehicle to supplement existing microfinance initiatives for microenterprise and local economic development. However, it has had a somewhat difficult existence in South Africa, due largely to two factors: (1) the issue of an unclear regulation and (2) a lack of financial support for the establishment of "umbrella" bodies. Nonetheless, the potential role that village banks can play with respect to the use and up-take of loan products tailored specifically for SMMEs needs to be investigated, as it has not yet been well researched and documented (Motsa, 2004).

Evidently, there are several business best-practices that can be adopted from other developing economies and then adapted and applied within the South African context. Having taken into account the prevailing models that are used in South Africa, the next section of this paper explores the designing of a possible financing model that would be suitable for use in South Africa targeted specifically at microbusinesses.

CHAPTER 4: PROPOSED FINANCING MODEL FOR MICROBUSINESSES IN SOUTH AFRICA

4.1 Introduction

A recent paper by Ojah and Mokoteli (2010) briefly assessed the relevance and potential of using leasing as a financing tool for microbusinesses in South Africa. The paper suggested that improved use of leasing could be a possible beneficial financing model, because this model would overcome some of the existing constraints in providing credit to the poor. In a leasing contract, the asset which is leased remains the property of the lessor (seller) for the period of the lease and thus serves as a contract enforcement mechanism. In developing economies where microbusinesses lack the necessary collateral to access credit this form of contract addresses the collateral requirements of most financial institutions (Ojah and Mokoteli, 2010). Hence this arrangement would improve the chances of microbusinesses accessing credit.

This section of the paper explores in further detail the case for using leasing as a financing model for microbusinesses in South Africa – microleasing. Therefore, the features, advantages and challenges of microleasing are presented in detail to make the case for microleasing.

4.2 Microleasing as a suitable financing model

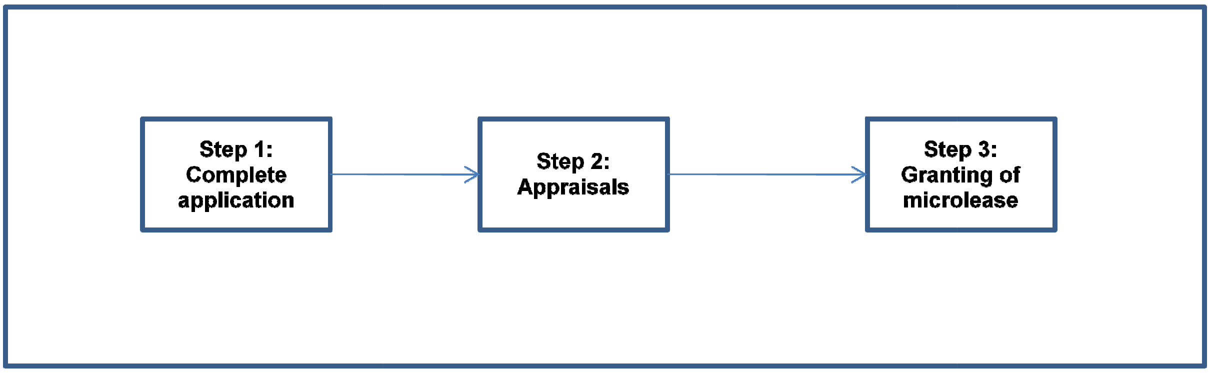
Leases are long-term rental-type contractual arrangements: in this case a provider (lessor) allows a user (lessee) to use an asset for an agreed-upon time in exchange for predefined payments. There are two main types that differ significantly: financial leases and operating leases. In a financial lease agreement, the lease amortises most of the cost of the asset and at the end of the lease period the lessee has the option to purchase the asset for a nominal price. In general, a lease agreement cannot be cancelled, and the associated maintenance and insurance costs are the responsibility of the lessee. Almost all the risks associated with owning the asset are transferred to the lessee without actually transferring the ownership title. However, in an operating lease agreement: the lease amortises only part of the asset cost; there is no option to buy the asset; operating leases can be cancelled for a fee; and maintenance and insurance costs lie with the lessor (Nair and Kloeppinger-Todd, 2006).

In the context of this paper, microleasing takes the form of a financial lease agreement and serves as an alternative to loans as an effective means of financing for microbusinesses. Furthermore, microleasing is a means to acquire assets to start or expand a business as opposed to renting the assets. The benefits of this approach to microleasing are discussed henceforth in the sections that follow (see 4.3).

4.2.1 Processes

The microleasing process from application to equipment transfer can be completed quickly possibly within approximately two weeks. The steps involved are depicted in figure 2 below.

Figure 2: High-level microleasing process



The process starts with a loan officer assisting the applicant to complete a simple application form. The loan officer then verifies the application form with supporting documents such as proof of residence and national identity document (Step 1). Step 2 involves a preliminary appraisal by the loan officer and a secondary appraisal by the branch manager. Additional documents from the lessee include copies of incorporation of the entity and basic financial statements (if available), this depends on the nature of the microbusiness whether it is a new or established business. The client is also expected to supply at least three quotes of the equipment to be purchased. This step can also include the loan officer assessing the borrower's prior income, assessing the risk involved in the venture, method of payment and visit the borrower's house or potential business premise. In addition, the cashflow of the business will be assessed to calculate the appropriate payment terms and period (Dowla, 1998 and Gallardo, 1997).

The final step includes various activities such as signing of the microleasing contract and the purchasing of the equipment. In this case the MFI (lessor) pays the equipment supplier directly. To obtain competitive prices the MFI can build a relationship with several major suppliers of popular equipment used by microbusinesses depending on the particular market. Furthermore, clients that establish a good credit record with the MFI can be able to get multiple microleasing contracts, as long as they are viable (Nair and Kloeppinger-Todd, 2006).

The process outlined above shows a situation where the MFI is approached by a client. Conversely, the loan officers of the MFI can scout the community for potential microleasing candidates. In this instance, the loan officer identifies a potential client and then follows the same procedure as depicted in figure 2.

4.2.2 Key features

There are several characteristics of microleasing that are imperative to make the model work especially in the context of developing economies. To make this model practical, the following features listed below are required (Havers, 1999; Dowla, 1998 and Nair and Kloeppinger-Todd, 2006).

(a) *Collateral:* The asset is used as primary security. Depending on the risk of the client an additional 10-20% of the cost of asset is requested as a deposit in order to issue the microlease. This deposit is then deducted from the residual cost of the asset at the end of the microlease.

(b) *Insurance:* The microlease is covered by insurance on the life of the client and another insurance to cover all risks (fire, theft etc) on each asset. Additionally, residual value insurance is taken to cover the instance were a repossessed asset is worth less than the balance due on the microlease. All the insurance costs are included in the microlease weekly or monthly payment (rental).

(c) *Period of microlease:* The microlease period can range from anywhere between 6 to 24 months depending on the nature of the microbusiness and affordability of the client.

(d) *Cost of microlease:* The microlease rental is loaded with costs such as the cost of the equipment, operating costs, loss provision, insurance costs and profit margin.

(e) *Payment schedule:* The microlease payment can be made weekly or monthly depending on *the* length of the microlease. For shorter and riskier clients, weekly payments would be more appropriate to monitor the client more closely.

(f) *Option to buy equipment:* The client has the option to buy the equipment at the end of the microlease. If there was a deposit made the residual costs would be offset against the deposit.

(g) *Used equipment:* Microbusinesses tend to use secondhand machines hence it would be unduly restrictive for MFIs to only fund new equipment. However this practice requires a robust secondhand market and reputable independent valuators to determine accurate resale values.

(h) *Appraisals:* The MFI is required to have a robust method of determining the ability of the leased asset to generate the required cashflow that will cover the microlease periodic payments.

(i) *Buying of the asset:* The MFI pays the equipment supplier directly and the money never actually passes through the microbusiness.

4.3 Advantages of microleasing

Microleasing is a close substitute for loans as a financing tool for business assets. For MFIs that provide microleasing, microleasing offers several advantages compared to loans. These advantages are derived from the difference of the two methods as well as the legal requirements that govern the two types of financing tools. According to Nair and Kloeppinger-Todd (2006) transaction costs of microleasing are typically lower than those of loans, because the cost associated with securing collateral and the cost of foreclosure, in the instance of default, are avoided. Furthermore, taking possession of loan collateral is more difficult than repossessing leased assets. The latter situation does not normally require the use of the court system, whereas the former does. Moreover, MFIs that offer leasing are not subject to the same arduous regulatory framework as banks. Consequently they bear less costly regulatory requirements.

Gallardo (1997) identifies several advantages that accrue to the microbusiness (lessee) and those that accrue to the MFI (lessor). Advantages to microbusinesses (lessees) are:

- Microleasing can fill the gap left by banks in terms of financing microbusinesses in many developing economies.

- Less stringent and simpler collateral arrangements means more microbusinesses can access credit more easily than bank loans.
- Microleasing contracts can be easily configured to match the cashflow requirements of the microbusiness.
- Microbusinesses can gain tax benefits by offsetting their full microlease payment against profit before tax, compared to the depreciation allowance or interest charges on bank loans. Although this might be more applicable and relevant in more developed economies with advanced tax regimes (Havers, 1999).
- No requirement to attend mandatory group-lending meetings required by MFIs which are time-consuming and onerous (Havers, 1999).

The advantages that microleasing offers to MFIs (lessors) includes the following:

- Since the MFI buys the asset directly it reduces the chance of the borrowed funds being used for other means rather than for the starting or growing the business.
- Simpler documentation and quicker processes associated with microleasing means better cost control and MFIs can grow their organisations quickly.
- Less stringent regulatory requirements in the case where the MFI does not take any deposits from the clients.
- The MFI has a stronger collateral position since the asset belongs to the MFI until the obligations of the microleasing agreement have been fully met by the client.
- As the owner of the asset the MFI can get the tax benefit offered by the depreciation expense, as a shield against taxes on income gained from the microleasing agreement.

4.4 Challenges facing the microleasing model

Despite the numerous advantages that the microleasing model guarantees, there are several constraints that the model faces. Dowla (1998) mentions that the Grameen bank experience has largely been positive regarding its microleasing programme, however it faces certain problems. These problems originate from the failure of bank staff to enforce the rules mandated by the bank. These problems include transportation equipment being involved in accidents where the insurance claims cannot be processed due to vehicles lacking the necessary documentation. In some instances, prior to the lease expiring, the leased asset was sold fraudulently by the client to raise more funds without the MFI’s permission. Moreover, there are situations where the MFI was unable to repossess the leased asset. However, all these challenges are manageable and can be addressed with the proper training of staff and appropriate legal framework in place to facilitate repossessions for lease-type agreements.

Another challenge is due to the fact that microleasing is primarily used to finance the purchasing of an asset and not for financing working capital. Not all businesses require finance to buy equipment, some may require finance to buy stock. In this scenario, the MFI may use the "sale and leaseback" technique, where the microbusiness sells an asset (that they already own) to the MFI. The MFI then leases the asset back to the microbusiness, thus releasing the required funds for working capital. Nonetheless, in practice, research has shown the "sale and leaseback" method requires strict control measures and the client must have a sound business or proposal for it to work effectively (Havers, 1999).

4.5 Suggested strategies for success

A study conducted by Nichter et al. (2002) found that there are a number of key factors that are required for an MFI to succeed, some of which are relevant to MFIs offering microleasing. These factors are based on the premise that MFIs that adopt appropriate strategies can overcome obstacles facing microfinance, in general, thereby improving the performance and growth of the MFI. These strategies are as follows:

- *Focus on lower-income SMMEs*: In many developing economies this segment forms a large share of the microfinance market. By focusing on this market, it reduces competition from substitute credit products. Guarantee requirements force many institutions not to play in this market segment.
- *Develop specific products relevant to the needs of the client*: MFIs should understand the specific needs of the customers and then innovate to provide credit products that will solve the client's problems. Currently, MFIs offer vanilla credit products that may at times not fit the cashflow or income patterns of the client.
- *Promote an understanding of the products to the target market through effective marketing*: MFIs should use messages and media channels that will increase awareness of the credit products that they offer. In marketing campaigns, MFIs should emphasise how a product specifically meets the needs of the client. Moreover, the Media channels used should be relevant and resonate with their target market (microbusinesses).

- *Explore alternative effective distribution channels*: Using alternative distributions that do not rely on loan officers could allow MFIs to offer new products and increase their outreach. Possible solutions would include partnering with the retail industry or the widespread postal office network and other government institutions.

On the other hand, Havers (1999) and Johnson et al., (2005) indicate that for an MFI to be successful it has to have the right balance and synergy in terms of professional skills. The management team has to complement each other with both financial management skills and social sciences' skills. The notion of having the right skills set is the same reason given to the success of SKS Microfinance as mentioned by Akula (2008). In addition, Havers (1999) and Akula (2008) suggest that being a for-profit business also helps with the running of the microfinance in that clients and staff act professionally and take the business seriously. In this case, clients do not get the wrong impression that there is an unlimited source of funds from "some generous benefactor" who will allow them to avoid loan repayments.

As stated previously, Akula (2008) found that for a business focusing on the bottom end of the pyramid it is imperative that its business model be scalable since profit margins are very low in this market. Scalability allows the business to grow very quickly and hence achieve the necessary volumes required to make the business sustainable. Microleasing as a business model is highly scalable. Havers (1999), notes that two characteristics make the model scalable, these are: (1) the clear rules and procedures inherent in microleasing make it easy to increase operations and hence distribution and (2) operational staff are not required to possess sophisticated technical skills and business decision-making. For these reasons, microleasing can borrow some of the entrepreneurial principles used by fast-scaling consumer businesses (McDonald's and Starbucks) such as standardising products, systems, training and other processes to boost capacity and reduce unit costs.

Furthermore, research conducted in Ghana found that the informal money-lending sector has been a rich source of innovation for formal MFIs, as earlier noted (Steel and Andah, 2003). In applying the microleasing model, this strategy used in Ghana suggests that the model when applied in South Africa should be adapted to the needs of the South African clients, by learning from the informal sector as well. That is to say, the current informal models in South Africa could have positive lessons for microleasing, and thus be a source of further innovation. For example, the group-lending models currently used in most of the developing economies including South Africa, as seen above in some of the schemes, could be adopted for use in microleasing. Even though the model uses the leased-asset as security, group-lending could reduce default and thus enhance the position of the MFI.

Another effective strategy is the one that was used by Banco do Nordeste to start the CrediAmigo programme. The key feature of this strategy is that CrediAmigo was formed as an autonomous division within an established bank, and primarily focused on developing solutions tailored to the poor and SMMEs. In this case, as earlier stated, the programme benefited through economies of scale provided by its parent company (Schonberger, 2001). However the danger in this strategy is that the parent company management might interfere needlessly with the division, so it would be crucial that the division remain autonomous. Alternatively, in this instance, commercial banks may offer microleasing as a product through a wholly-owned subsidiary or a joint-venture (with other partners) that operates independently of the bank (Kotei, 2010).

By using some of the strategies indicated above, such as focusing on innovative technology, effective marketing and simple and fast application processes, Capitec Bank has managed to serve profitably the low end of the market and provide a suite of financial services. Capitec Bank was established in South Africa in 2001 and has grown rapidly to 2.5 million clients as at 31 August 2010. The total value of loans advanced grew from R1, 477 millions in 2003 to R8, 645 millions in 2010 and the number of loans grew from 2, 454, 000 (2003) to 3, 861, 000 (2010). In addition, headline earnings increased from R30 million to R437 million during the same period. The bank attributes its success to its unique technology driven, low cost, flexible and scalable business model (Capitec Audited Financial Results, 2010).
Even though the bank focuses on salaried individuals it still serves as an example to refute the notion by the big four banks (Absa, FNB, Standard Bank and Nedbank) in South Africa that the low end of the mainstream market cannot be served profitably and sustainably (Motsa, 2004 and Driver et al., 2001).

4.6 The role of government, donors and the private sector

Microleasing plays an important role in bringing microbusinesses into the formal financial system. Once microbusinesses have access to microleasing they start building a financial transactional history which can later be accessed by formal institutions such as banks. Hence microbusinesses are then able to join the formal sector as they would already have an accessible credit history. Consequently, developing the microleasing sector provides a route for accessing finance for microbusinesses that are currently marginalised by the formal financial system, thus enhancing production, economic growth and job creation in developing economies (Kotei, 2010).

Moreover, microleasing can be a profitable financing model, however jump-starting it will require support from the government, donor organisations and the private sector. Studies conducted on companies offering microleasing in Uganda, Pakistan and Mexico found that even though these companies were all profitable, they benefitted substantially from access to government and donor funds (Nair and Kloeppinger-Todd, 2006).

In order to realise the economic advantages that microleasing may present to microbusinesses, a sound legal framework which provides clarity on leasing and ownership of assets is a pre-requisite. Furthermore, a favourable regulatory environment on MFIs that offer microleasing is also important, in that these institutions should not be subject to onerous regulation which is usually required of deposit taking institutions. The government and donor agencies can also provide wholesale funds in generous terms and conditions, especially in the early stages of this nascent financing model, in order to boost its development and sustainability. The private sector also has an important role to play. Leasing companies may provide technical expertise and capacity building skills to the MFIs that intend to offer microleasing. In addition, current MFIs may expand their services and offer microleasing, especially to clients who have graduated from a group-lending scheme (Havers, 1999).

Gallardo (1997) emphasises that the countries that have been successful in developing microleasing (e.g. Pakistan, Bangladesh, Indonesia and the Phillipines) had relatively stable macroeconomic conditions such as income growth, interest rates and foreign exchange rates. In addition, regulations regarding supervision and tax structures governing microleasing were clearly defined and formalised. Without a clear regulatory framework and support from government and the private sector, it would be difficult for microleasing to succeed and be sustainable, and thus help the poor access the much-needed capital for their microbusinesses.

4.7 Microleasing examples in other developing economies

Even though microleasing may face a number of challenges that serve as obstacles for its development, there are some success stories of organisations that have adopted the financing model and experienced positive results. Nair and Kloeppinger-Todd (2006), studied three commercial providers in Uganda, Pakistan and Mexico that have found success with microleasing as a viable financing model. These companies primarily serve clients in major rural segments in these countries. The companies in Uganda (Development Finance Company Uganda) and Pakistan (Network Leasing Corporation Limited) focus on SMMEs, whilst the company in Mexico (Arrendadora John Deere) serves medium and large farming enterprises. All three companies were found to be profitable, with Development Finance Company Uganda (DFCU) and Network Leasing Corporation Limited (NLCL) being listed in their national stock exchanges.

Nair and Kloeppinger-Todd (2006) discovered that the advantages of microleasing suggested in theory do actually work in practice. The companies reported that for their respective firms, they found transactional costs to be lower in microleasing than in lending, levels of defaults and write-offs were stated to be even lower. Furthermore, these companies were subject to fewer regulations compared to commercial banks as they were not registered as depository institutions. Consequently, they had lower costs related to regulatory compliance. In addition, the study found that the three companies reinforce the viability of microleasing as a feasible and sustainable financing tool for rural and urban environments. All three companies reported that their loans from rural clients performed as well as the loans from their urban clients. Furthermore, several clients had more than one microlease indicating that microleasing does have repeat borrowers which are critical for the success of any business.

Another success story of microleasing comes from Uzbekistan (Kotei, 2010). Uzbek Leasing International (ULI) which focuses on SMMEs is one of the leading and most successful leasing companies in the country. In August 2008, the International Finance Corporation committed US$3 million as a loan to ULI targeted at addressing the scarcity of term foreign currency financing in Uzbekistan, which would subsequently help ULI expand its outreach in Uzbekistan. The IFC has helped the company by providing advisory services to further strengthen its operational capacity.

Furthermore, the IFC has played a significant role in developing the leasing in Uzbekistan by facilitating the amendment of relevant legislation. As a result of these interventions by the IFC the leasing sector grew by US$220 million between 2001 and 2007. In addition, several SMMEs have been able to implement their investment plans and modernise their businesses through microleasing. Previously, SMMEs could only access finance from the informal sector, infamous for having high interest rates and unfavourable loan terms. Overall, the microleasing sector in Uzbekistan has had a positive impact on employment in the country (Kotei, 2010).

CHAPTER 5: CONCLUDING REMARKS

This paper has managed to establish convincingly that microleasing is a viable, sustainable and profitable model for financing microbusinesses in developing economies and particularly South Africa. The fact that it has not been explored sufficiently in South Africa remains a mystery and not enough studies have been conducted to determine why it has not been pursued by the commercial banks and other Developmental Financial Institutions (DFIs) and MFIs in South Africa. It can only be hypothesised that commercial banks have always taken a "tick the box" approach when it comes to offering financial services to the poor as they believe that this segment cannot be served profitably. Hence in their offerings banks have only focused on supplying vanilla credit products which require stringent unattainable assets as collateral and have not paid much attention to innovating for this segment. However, this study has presented the argument that in order to serve this segment profitably financial institutions require forward-thinking abilities and commercial astuteness.

Nonetheless, it has been shown that SMMEs can gain substantially from microleasing as they do not have assets that could serve as collateral for loans or other types of secured credit. Developing microleasing enables these SMMEs to access funding to set up their microbusinesses, and consequently allow them to access income-generating assets. The impact of this on the economy of developing countries cannot be undermined. With this opportunity, SMMEs are incentivised to access finance for their businesses and thus promote domestic production, economic growth and the creation of employment for the unemployed.

In addition, this paper has presented the numerous advantages that are offered by microleasing for both the MFIs (lessors) and the borrowers (lessees) over other types of lending including the fact that microleasing offers an enhanced form of collateral. This is a result of that the asset ownership of the leased-asset remains with the MFI until full payments have been made by the borrower, at which point the ownership of the asset passes to the borrower. In this case, repossessions are easy to execute by the MFI when the borrower is in default.

It has also been shown that there are many key success factors that can be adopted from other developing economies. These can then be applied within the context of South Africa. The different cases studied therein offer several key beneficial features such as the group-lending model, the importance of running an MFI professionally from inception, the use of simple technology to create simple and scalable processes, the significant role of the informal sector and the many lessons it entails and the emphasis on ensuring that the MFI is profit-oriented at all levels of the organisation. In addition, it is clear to see that within the MFI, standards of accountability, corporate governance and transparency need be world-class and of a high level. This has the added benefit of the MFI being able to easily attract much-needed capital from the private sector and international community.

Furthermore, it was found that creating a sustainable microleasing industry in developing economies requires considerable investment and technical knowledge and skills provided to policy makers, regulators, donors and private-sector participants. Concerted efforts must also be made by the South African government to put in place requisite infrastructural requirements necessary for building well-functioning microfinance systems. These systems are important to ensure that there are clearly defined and predictable laws and regulations governing microleasing transactions, clear accounting standards, an appropriate and conducive tax regime, and the presence of a suitable regulatory and supervisory framework.

In addition the commercial banking sector has an opportunity to offer microleasing as another product. However, it is imperative that these banks offer such a product through an independent entity to bolster independent thinking and an entrepreneurial philosophy for the staff of such an entity. In this way, the staff can be able to fully understand the needs of microbusinesses and be able to respond with appropriate services.

Lastly, there are many unresolved strategic issues that are facing the financial services sector, particularly microfinance, it will require a radically different mindset if it is to succeed in expanding services to the poor and unbanked population in South Africa. Most importantly, the industry needs to adapt and employ promising models such as microleasing, if it is to avoid an onerous solution imposed on it by government, in its altruistic efforts to bolster access to credit for all South Africans, including the poor in remote rural environments. On the other hand, community leaders must stress the need for self-reliance, a determination to be less dependent on “hand-outs” and for every South African to address the culture of dependency inherent in waiting for others to fix the problems that many people encounter. In this way, local solutions developed by South Africans and adapted from global best-practices to solve local problems will have a better chance of succeeding, since they will be able to resonate with the targeted communities.

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