



***A Critical Review of Financial Inclusion, Household Financialisation
and Financial Development in South Africa.***

By

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Plagiarism Declaration.

I declare that this thesis, which I hereby submit for the degree of Masters of Commerce (Economics) at the University of the Witwatersrand, Johannesburg, is my own work and has not been submitted by me for any degree or examination at any other University.

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Signed ...*Bongani Mtsweni*..... Date**01 September 2020**.....

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I. ABSTRACT.

As the country of South Africa undergoes a process of financial development, financial inclusion has been prioritised in the Government's National Development Plan (NDP), aiming to increase financial inclusion to 90% by 2030. This paper interrogates the traditional understanding of 'financial inclusion' in South Africa, it investigates the state of financial inclusion, and its impact/consequences. It also examines the extent to which this can best be understood through the lenses of financialisation or that financial development. The study reaches its findings through using the descriptive data obtained from various prominent sources capturing the information on the household access to finance in light with financialisation and financial development, such as, NCR, STATS SA, SARB, National Treasury, Global Findex (World Bank) etc. There is no doubt that South Africa has experienced a tremendous improvement in the level of financial inclusion. However, the growth in financial inclusion in South Africa shows that it may be reaching its saturation point if regulation doesn't influence the business model of the conventional bank to participate and not duplicate any service intended for development (financial inclusion). Henceforth focus should turn to quality financial inclusion to address pressing issues such, a need for cheaper, faster, accessible, and convenient financial products and services transcends economic means (i.e, all income groups equally need them).

Keywords: Financial Inclusion, Financialisation, Financial Development.

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III. Acronyms and abbreviations.

BCG– Boston Consulting Group

BIS–Bank of International Settlements

CDO– Collateralised Debt Obligation

CDI–Consumer Default Index

GDP– Gross Domestic Product

IMF–International Monetary Fund

JSE– Johannesburg Stock Exchange

MFI–Microfinance institution

NCR– National Credit Regulator

NDP–National Development Plan

NFC–Non- Finance Corporation

NIDS–National Income Dynamics Study

NSASA–National Stockvel Association of South Africa

OECD–Organisation for Economic Co-operation and Development

R–Rand

SARB – South African Reserve Bank

SASSA–South African Social Security Agency

SME–Small-Medium Enterprises

STATSSA–Statistics South Africa

UK–United Kingdom

USA–United State of America

CHAPTER 1

1.1 INTRODUCTION

There has been substantial study of the phenomena of financialisation and financial development. The two bodies of literature have discussed the phenomena with the focus on various players in the economy i.e. non-financial enterprises, banks, and the households. Although there has been literature on this, there has only been partial analysis of how these phenomenon impact or contribute to growing household integration into the financial system. This has been studied under 'financial inclusion' but this literature has not have explored all aspects in every country or situation.

Concern over the growing involvement of household in the financial system has expanded post the global financial crisis (housing bubble) of 2007/08. This financial crisis obligated many countries to broaden the scope of their assessment concerning their financial regulatory systems which ensure financial stability (Lydie and Frederic, 2017).

In this context, this thesis seeks to contribute to the literature through a South African case study, which focuses on the traditional understanding of 'financial inclusion' as the household integration into the financial markets grows. The study intends to first document the extent of financial inclusion in South Africa, and then analyse its current state to determine the extent to which it can best be understood as part of the process of 'financialisation' or that of 'financial development'.

1.2 FINANCIALISATION.

The term 'financialisation' arose in the early 1990s (Bonizzi, 2013) and has since been interpreted in different ways in various studies. There is no agreed upon single definition of 'financialisation,' with heterodox economists using the term to focus attention on the increased weight of the financial sector and financial transactions in economic activity. There are several different, if complementary, definitions, a general one, in the words of Epstein (2005), defining financialisation as the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international level. In another popular definition, Kripper (2005:174) narrows the

definition of financialisation to a “pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production”.

1.3 FINANCIAL DEVELOPMENT.

Financial development refers to the situation where private sections of the economy participate more actively in financial activities of the economy and can be assessed by such metrics as size, accessibility of capital, efficiency and stability of the entire financial sector in the economy. The sector is made up of banks, financial markets, bond markets or in general different financial institutions (Almasifard and Saeedi, 2017). According to Levine (2005) financial development refers to the improvement of financial functions, which leads to the production of investment information, efficient allocation of capital, firm monitoring, risk management, savings mobilisation, and easy exchange of goods and services. In this way it falls within orthodox economic theory, and it can be measured by the size of the financial sector to the extent that activities transform the extent of access to finance (loan-deposit) and the quality of investments (Becsi and Wang, 1997), exploring this literature and that of financialisation is the subject of Chapter 2.

1.4 FINANCIAL INCLUSION.

According to Conroy (2005) financial inclusion is a process of ensuring access to appropriate financial products and services needed by vulnerable groups such as the previously disadvantaged and low-income groups at an affordable cost in a fair and transparent manner by mainstream institutional players. Mohan (2006) holds a similar view and further states that financial inclusion signifies the ease of access by certain segments of the society to appropriate, fair and safe financial products and services. The most basic form of formal financial inclusion is the opposite of financial exclusion, for instance, having an access to the bank facilities (cheque, savings and, or credit accounts) (FinMark Trust, 2010). The household who do not have minimal access to the financial system (basic bank accounts) are thus defined as financially excluded but may in fact make use of informal financial services.

1.5 OVERLAPS AND COMPETING INTERPRETATIONS.

The literature on both financialisation and financial development is generally focused on the expanding role of finance in the economy, how the private sector of the economy (households, financial and non-financial corporations) utilises financial services to better their daily lives and operations (development) or generate additional profit. They also study the intersection of finance and the state, particularly the financialisation literature. They therefore broadly share a unit analysis but often use different methods and reach different conclusions.

Thus, the competing interpretations are often over the impact of the growing integration of the private sector into the financial system. With particular reference to household integration into the financial markets, financialisation sees a deeper inclusion of households as potentially destabilising and exploitative as they become more exposed to more risky assets which are destructive or exploitative, such as credit advances. This may cause situations of over-indebtedness and severe financial distress, to the extent that it generates impairments and write-offs through defaults which reduces the financial strength of the financial institutions through the losses incurred (Wichterich, 2012). In turn this has negative spiral effect on employment and income inequality.

On the other hand, the financial development and financial inclusion literature sees the expanding role of finance as potentially beneficial. The literature exploring access to finance and financial development draws more on the experiences and theories of microfinance, endorsing its overall beneficial impact on development. With respect to households, the literature intertwines with the issue of microfinance, and finds microfinance to play a valuable role in the provision of financial services to the poor by specialised institutions. Thus, access to finance by the household refers to the distributional aspect of financial development with the extension of financial services that reaches the more previously disadvantaged parts of society and succeed in spurring the 'pro-poor' growth and lowering inequalities.

1.6 RESEARCH PROBLEM AND QUESTIONS.

The expanding role of household integration into the financial system is also observed in South Africa, this phenomenon emanates from the growing global concern of financial inclusion in recent years. The recent studies have shown that the South African financial system appears to be fairly inclusive, compared to other emerging economies. According to the study conducted by the Boston Consulting Group (BCG) in 2018, more than 80% of South African adults, for example, have a transaction account. The study further confirms that the vitality of financial inclusion platform in South Africa is mainly driven by the banking sector which has since shown an increase in the number of banked population leading to a 30% decrease in financial exclusion in the country.

Thus, the trend of financial inclusion of adults in South Africa shows a steady increase in the banked population, which shows that South Africa's financial services sector has previously excluded low-income consumers. This actually originates from the growing body of research which identifies financial exclusion as a global challenge with dire consequences for a country's economic growth, small and medium-sized enterprise (SME) development, transformation and the household ability to participate in the formal financial sector (Demirguc-Kunt & Klapper, 2012). It is in this context that financial inclusion has been prioritised in the South African Government's National Development Plan (NDP). South Africa has set a target of increasing financial inclusion to 90% by 2030 (Banking Association of South Africa, 2015).

In this context, this study is interested in questioning the traditional understanding of 'financial inclusion' as South Africa undergoes a process of financial development. The purpose is to characterise this phenomenon 'financial inclusion', identify its essence, and its impact on household, and interrogate how best we should understand this. Hence, the study explores the following questions:

1. What is the state of financial inclusion in South Africa, and its impact/consequences?
2. How should we understand this phenomenon in the case of South Africa?
 - To what extent does it reflect or portray the premise of financialisation or that financial development?

1.7 RESEARCH METHOD IN BRIEF.

This study will use qualitative methods and descriptive data to reach its conclusions. The focus is mainly on how financial inclusion should be understood in the case of South Africa with the focus on household access to finance. This study relies on prominent data sources which specialise in the provision of information that is critical in examining the changing dynamics of household finance and their participation rate in the financial markets. The indicators which will be useful for this study are those that reflects the degree of household integration into the financial system. This will include the data on household deposits/savings held with various financial institutions in South Africa, this information will be obtained from the South African Reserve Bank (SARB). How this information is going to impact the findings of the study, is mainly on understanding the size and growth of household deposits as the percentage of GDP. The market conduct side of the SARB will provide the study with the information on the insurance products, short- and long-term investments of the household.

The other prominent data source for the study will be those that capture the cash flow data of the conventional banks and retail shops providing credit facilities to the household, housed within the National Credit Regulator. This source is critical to the study as it will assist in providing the statistics on household exposures to the retail revolving credit facilities. The NCR captures various information on household finance which tells a lot about financial inclusion depending on the research need, the information captured by this source includes that of micro-lending, unsecured lending, clothing, household accounts, vehicle and assets finance which forms part of the credit market.

Households have also shown an increasing degree of participation in the informal financial channel of stokvels for raising capital for the future. The data capturing these cash flows will be obtained from the National Stokvels Association of South Africa (NSASA) which is critical in tracing the flow of funds and understanding how this evolving and innovative channel impacts or benefit households in South Africa.

The Johannesburg Stock Exchange (JSE) will provide the study with data on the trades and investment products acquired by individuals, tracking the types, complexity

and the performance of securities traded in line with the household participation rate. Another prominent local source to be used in the study on household spending (consumption) will be the Statistics South Africa (StatsSA). Lastly, the Global Findex (World Bank) which aggregates the performance of the financial sector (financial inclusion, financialisation, financial development etc.) will be utilised.

Through an in-depth analysis of the data from these sources the state and the role of financial inclusion in South Africa will be understood if it follows the premises of financial development – *if it helps household to leverage and utilise financial horizons which increases their welfare* or that of financialisation – *if it leads to household integration into the financial system which exposes them increases risks and/or could trigger another financial crisis through uncontrollable credit exposures*. The History and the current state (structure) of the South African financial sector will be assessed to track its developments in line with the key premises underpinning the success of financial inclusion. This will include the review of the developments pertaining innovation on products and services, access by target market (income group). The study will also zoom into the records on diversification and information asymmetries that exists within the financial sector of South African. All this will be carried out through the descriptive data analysis of the study.

1.8STRUCTURE OF THE THESIS.

This thesis has five chapters. Chapter 2 contains our theoretical grounding and literature reviews. Chapter 2 interrogates the notion of financial inclusion, focusing on the debates between the two bodies of literature (financialisation and financial development). Chapter 3 outlines the current land scape of the South African financial sector in general and certain features that are relevant to the topic. Chapter 4 is about financial inclusion in particular, henceforth it providing an in-depth analysis of the outcomes and evidence on the case of the South African. The analysis is carried out by assessing the fundamental features of financial inclusion in light of the literature (the debate) on financialisation and financial development. Chapter 5, then outlines the concluding remarks on the outcomes of the analysis and further provide the recommendations on the topic.

CHAPTER 2

LITERATURE REVIEW

2.1 INTRODUCTION.

We noted in the introductory chapter that this chapter will provide a foundation to our study, unpacking our understanding of the impact of the growing household integration into the financial system. We zoom in on what the literature reveals about the aforementioned two different ways of understanding the same phenomena – financialisation and financial development – and assess which, in general, best captures the role of finance in the household sector and the economy at the macro level. The literature review documented in this chapter sets the foundation for the South Africa specific focus of this thesis and it lays a critical path which will steer the current investigation to reach its concluding remarks based on the interest of the study.

We begin this chapter in Subsection 2.2, by briefly reviewing the background and structural links of the existing bodies of literature pertaining the topic on the role of finance in the household sector. Thereafter, each body of literature will be explored in-depth (financialization in Subsection 2.3 and financial development in Subsection 2.4) to try unpack the effect of finance on various factors concerning the impact of finance on: 1. household debt; 2. inequality; 3. employment; and 4. financial stability at large. The structure of the discussion below will table what other studies have found on similar investigation in line with the theory, and thereafter show what evidence indicates and the consequences thereof. The conclusion of this chapter in Subsection 2.5 will then reflect on the key premises underpinning the literature which will be crucial in the case study analysis in the forthcoming chapters.

2.2 BACKGROUND – STRUCTURAL TRANSFORMATION IN THE EXISTING LITERATURE.

Two important bodies of literature relevant to this study are those concerned with financialisation and financial development in the economy, with a focus on understanding the impact of household integration into the financial system. There is considerable debate in this regard. Each of these approaches are tackled in turn below. The empirical phenomena that both the bodies of literature try to understand is

on the intensive and extensive expansion of role of finance, and the manner in which the households integration into the financial system has occurred, and consequences thereof.

2.3 FINANCIALISATION.

Many scholars define financialisation in the words of Epstein (2005), as a global, multi-dimensional process which denotes the growing size, importance, and the presence of financial institutions, financial motives in the operation of the economy and its governing institutions. More specifically, financialisation encompasses several processes relating to the growing reliance of ‘non-financial firms and households’ on financial activities as a source of revenue, seeking to generate more income or sustain living standards. Hence this phenomenon is said to represent a change in the path of capitalist accumulation which is argued to be unsustainable and dysfunctional, both at the national and international level as it limits economic growth and opens the economy up to the various vulnerabilities (shocks) of the financial sector (Stockhammer, 2004). This section of the literature review discusses the critical channels through which households have become ‘financialised’ and the impacts to the economy at large.

2.3.1 Financialisation and Household Debt.

The debate on the impact of financialisation on household debt is characterised by a pattern of major economic crises since financialisation began that have been related to the financial sector, ranging from the Savings & Loans crisis in the United State of America (US) in the 1980s, the debt crisis in 1982, the European Monetary System (EMS) crisis 1992/92, the Peso crisis 1994, the Asian Financial Crisis of 1997/1998, the Dot.com bubble of the early 2000s, and finally the global financial crisis of 2008/09 which led to a steep decline in the valuation of assets listed on stock exchanges around the world. Power, Epstein and Abrena (2003) as well as Jayadev and Epstein (2007) provide evidence from the Organisation for Economic Co-operation and Development (OECD) countries, which indicates that in these countries fragility and instability was evident in the run up to the financial crises which struck the global economy in the late 1990s and early 2000s, and surfaced again in the recent US sub-prime mortgage crisis that spread across the world. This followed a significant process

of financialisation of their economies from around 1990, associated with increasing household debt-to-GDP ratios. Countries post the crisis have striven to re-stabilise their fiscal budgets which requires costly bailouts and stimulus packages.

Since the manifestation of financialisation various sectors of the economy have encountered dramatic increases in debt levels. This included, the debt of households, businesses and financial corporations (measured as a ratio to GDP). According to the study conducted by the Bank of International Settlement (BIS, 2012) in the United Kingdom (UK), whilst the business sector has increased its debt from 52% of GDP (in 1976) to 77% (2009), household debt has doubled from 45% (1976) to 96% (2009), with a clear acceleration in the early 2000s. Hence, the effects of financialisation on households have been as profound as those on businesses, increasing the household debt ratio to their disposable income or to GDP. What is even more remarkable is that financialisation in the UK economy has caused the level of debt across various sectors to rise substantially (Alexiou and Nellis, 2016).

On the side of household's liabilities, household debt levels have increased sharply since the mid-1970s, with the volumes of mortgage credit constituting majority of the credit advances to households in most countries. In credit markets, the real median level of household debt in the US increased by 179% between 1989 and 2007 (Wolff, 2010), the involvement of households in financial markets has increased significantly over the last two decades. The risk in the financial system has been that whilst the mortgage loans account for the major share of the household debt, unsecured loans have also increased rapidly creating hazardous channels of risk that warrant attentiveness. Furthermore, as the low-income group's credit consists mostly of the unsecured facilities, both conventional and micro-lenders have been exposed to non-repayment risk, hence most borrowers with default records are priced with higher interest rates (Bank of England, 2017). Lazonick, (2014) names the aforementioned situation a 'debt peonage', as households end up borrowing more money, mostly for the purpose of paying the interest, and once they default the indebtedness of the financial corporates increases, and no profits are retained to fund investments and this further undermines the ability of the financial institutions to meet the regulatory liquidity and solvency requirements, and also the shareholders dividend expectations. Therefore this implies that with defaults or repayment risk the likelihood of systemic

banking distress could increase, since banks hold both direct and indirect credit risk exposures to the household sector.

The positive impact of financialisation on household debt is also noted in this section that this has been necessary to sustain demand in the economy. A good example is shown in the case of Iceland which is true for many countries. Evidence in the case of Iceland shows that the effects of increased household exposure in the financial system appears to be similar to the effects observed in other countries, although the strong relationship between the change in disposable income and consumption has remained intact, (Ólafsson and Kristjánsson, 2013). Studies of the relationship between financialisation and household debt in Iceland have confirmed a strong indirect link between debt and consumption through the growing reliance of financial services available to the households. These outcomes connect well to the habit formation framework of Cynamon and Fazzari (2008), where they gather that growing consumer references adjust to a changing environment. The Icelandic experience during the years of economic boom (2003-2006), when both corporate and household spending reached unprecedented levels, and this may serve as one of the better evidence of how financialisation can change the consumer behaviour and motivate excessive risk-taking (Guðmundsson, 2015).

On the side of households' asset, Davis (2009), shows the positive impact that the housing bubble of the years 2000- 2007 had, proving a widespread promotion of housing investments as entrepreneurial activities. He characterizes the US at the beginning of the 21st century as a 'portfolio society', where investment becomes the dominant metaphor of a person's place in society. He claims that financialisation means changing the way people think about what they own, hence from that point of view, most US households began to adopt financial strategies actively as a way of managing their consumption, debt and savings, which may be called the financial culture. For instance the percentage of households with direct equity or investment funds increased from 20% to over 30% since the 1990s in the US, and the average amount of financial transactions had increased more than three times in that period (Kremp, 2010).

On the Household debt and the economy's growth path, the microeconomic effects of the growth in the dominance of financial markets on accumulation of capital, distribution and growth have been found to be harmful (Epstein, 2005). Epstein states that the real economy is no longer funded by the market-based finance but somehow attracting rent-seeking (self-serving strategy). The high net worth household with high propensity to save are more likely to hold more financial wealth in risky assets (such as shares, mutual funds, and bonds) held with 'fund or asset managers'. The fundamental problem of financial markets is that they are highly volatility and that alerts some participants of their high risks and uncertainty because some investors lacks essential information about future events and the information is not available or found in any publicly available data set (Epstein, 2005). Dodd (2005) in his study also mentioned other risks related to the 'derivatives' that they can also be used to violate the laws and regulations. Therefore, while these channels have their benefits, they also facilitate many, unproductive, distractive and inefficient activities. Hence Kaltenbrunner and Paineira, (2015) found that global stock market speculation, derivatives traded are the most risky financial assets which suffocate economic development in the process of financialisation through distorting the market price discovery; and sometime these platforms are used to manipulate accounting rules.

Household debt-driven growth has also had a profound impact from the late 1970s onwards, whereby most economies placed less reliance on the Fordist model of wage-led growth as wage growth didn't seem to correspond with productivity growth in the 1970s and 1980s, also because businesses wanted to drive down growth, (Crotty, 2005, Lavoie and Stockhammer, 2013). The US and the UK were countries characterised by 'debt-led' growth, with focus on households consumption increasingly financed through stagnant real wages and higher indebtedness (Stockhammer, 2015). "Other countries like Germany opted for a different growth model in line with their economic problems and relied on export-led growth, limiting wages and consumption to increase the level of competitiveness in export sector" (Baccaro and Pontusson, 2016, p.176). These developed economies, developed a new growth model which illustrated different solutions to the economic problems, which did not centre a 'wage driver' promoting aggregate demand (Baccaro and Pontusson, 2016). The financialisation literature argues that this occurred not because wages couldn't drive growth but because businesses wanted to pay lower wages.

Stockhammer and Wildauer (2015) argued that growth regimes which placed heavy reliance on debt-finance growth, i.e household debt accumulation and rising spending due to the financial market booms, turned out to be more vulnerable to financial crises as soon as the bubble bursts. They further stated that higher growth rates achieved through debt over the short to medium term might not pay or be sustainable over the longer run. Therefore for the economy to bridge that gap and restore a feasible growth path, it will be crucial to change the financial sector model and ensure that credit is directed to productive uses rather than reckless consumption. On an earlier study of the same interest, Cecchetti, Mohanty and Zampolli, (2011) found that high debt levels weakens the ability of the financial corporates to survive demand fluctuations and further to that it increases their vulnerability to funding shocks.

Further evidence is found in the US study done by Baccaro and Howell (2017), where they find that an increase in the household debt-to-income ratio in the US was largely facilitated by the deregulated credit markets, witnessing a high degree of 'financialisation' which has indicated that debt-led growth also has direct impact on the rising inequality. Hence they stated that for the debt-led economy to positively address the economic problems of poverty and inequality it needs to attract international financial capital to cover its widespread current account deficit as a result of excessive consumption spurred by credit.

2.3.2 Financialisation and Inequality.

In the literature, financialisation has been shown to increase inequality in a number of ways.

First, as shown by Epstein (2006), financialisation squeezes or leads to the shrinking profitability of non-financial corporations in which many find employment. This implies shrinking the net wages for many middle-class and blue-collar workers operating in the productive industries. This places more pressure on the wages of general workers, which have increased more slowly than those of the top management in these firms. Also the corporate governance structure has since put more stress on the alignment of shareholder and manager interests, which invariably led to a focus on short-term

profits. This focus gave firms incentive to cut labour costs, while rewarding top executives who made such decisions (Lazonick and O'sullivan, 2000).

Second, and related, this has furthered income inequality in the form of stagnant wages for workers and significantly higher pay for top corporate officers. According to Mishel *et al.* (2007), CEO pay has increased from 38 times average worker pay in 1979 to 262 times in 2005 in both developing and developed world, he further stated that the same case is found to be an era of a blunt real growth in emerging economies like South Africa, except India and China. Palley (2007), argues that the shift from the real economy to the financial sector as the dominant source of profit has possibly contributed to the weakening of certain policies and institutions that help keep income disparity in check, such as unions and minimum wage laws. Guðmundsson, (2015) found that in Iceland financialisation has led to high levels of income inequality, primarily due to the rise in financial earnings such as interest income, dividends from investments, rents, and also capital gains driven by the inflation on asset prices. However the findings shows that this benefits accrued to the high-income group, causing a severe income inequality as measured by the Gini coefficient.

Third, Yeldan's (2000) detailed study of Turkey (an OECD member) also found that financialisation increased inequality because growing income inequality was associated with the extensive tendency towards the marginalisation of labour due to new (advanced) technologies which favour skill-intensive production patterns, the informal industrial relations, and an unambiguous trend towards the disassociation of the financial sector from the productive area of the economy and the affiliated expansion of financial rents. Fourth, Stockhammer (2009) showed how global financialisation led to the declining wage share of income for 22 high-income countries from 1979-2007. He found in several different specifications that the global financialisation variable (defined as foreign assets and liabilities as a share of GDP) was statically significant and negatively correlated with the wage share (Stockhammer, 2009). In his preferred model, this global financial exposure variable was the single most significant one, explaining a 4.2% decline in the wage share. Charpe, (2011) also examined the impact of global financialisation on the labour share of 16 high-income countries from the period 1981-2005 and their regression analysis outcomes shows that the wage share is impacted negatively by financial globalisation when controlling

for such factors as trade openness. They also noted that the stock market boom of the period 1990-2000 has contributed to a rise in the income concentration of the top early investors (high-net worth) who acquired the financial assets at the beginning of the boom, and benefited from higher returns on their investments, compared to those who entered the market later with low income, and suffered losses (Kremp, 2012).

2.3.3 Financialisation and Employment.

Financialisation also appears to negatively impact the economy through increasing unemployment (Freeman, 2010 and Stockhammer, 2004), particularly because financial crises and slower accumulation of real capital suppress production of many industries, hence resulting in job losses, not only in the financial sector. Freeman (2010:164) documented that “the huge costs to the real economy of the finance-induced ‘Great Recession’, appears in terms of lost employment and likely reductions in public goods provision and economic growth”.

A study on OECD countries by Assa (2012), found that an increase in financialisation is related to a 0.2% slower growth of GDP, and between 0.12% and 0.74% higher rates unemployment. Assa demonstrated the opposite findings to the above, and showed that the more households integrate into the financial system the more business generated by the financial sector and that creates opportunities for employment to respond to the service demand. He observed a positive change in the employment opportunities in the financial sector with the increase in the degree of financialisation. He found that in the end of the 2008 financial crisis, the employment rate of the 23 OECD countries surpassed 10% of the overall employment, while in 1970 the rate was below 10%. In relative terms financialisation has advanced even further, with 10 OECD countries multiplying their financial sector employment rate, 5 countries tripling it, Luxembourg, Spain and Korea saw their proportions increment nine-fold, Japan five-fold, Italy six-fold, Finland and Poland four-fold. In the study done by Cecchetti and Kharroubi (2012) for the Bank of International Settlements, they found a parabolic (U-shaped) relationship between financial sector’s growth and total employment. Their study shows that once employment in the financial sector exceeds 3.5% of total employment there is a negative impact on employment.

2.3.4 Financialisation and Financial Stability.

The impact of financialisation on financial stability is interrogated in most studies on the basis of the consequences of the phenomenon on the various economic segments – non-financial corporation, public sector and household – that participate in the financial sector. For our purposes, the focus is only on households which have since shown a growing rate of participation in the financial sector, as noted above.

Ryszard and Justyna (2017) found that, household financialisation generally entails taking on more and more risky economic ventures with an intention of financing expenditures (e.g. excessive debt) and savings (investments in various assets classes, equities, bonds, forex etc.). Thus, the consequence of household's financialisation on financial stability is their excessive reliance on the financial markets, including the money and credit market. This has involved a relative change in their debt and savings ratio, also incorporating the changes in the proportion of savings towards riskier forms of financial assets.

Battiston *et al.* (2016) argued that, as the real sector gets more financialised, it becomes directly exposed to financial shocks. He also states that a strong interconnectedness amongst the financial institutions might have a strong impact on the recovery rate of contracts among financial firms which result to financial instabilities. As observed during the credit crisis of 2008 and the 2011 EU sovereign debt crisis, the value of the collateralised securities related to the household mortgages were subject to sudden variations. Financialisation, by granting 'excessive' funding in loans related to real-estate and mortgage related securities led to a systematic risk of mispricing of huge portions of collateralised debt obligations (CDO) contracts. Subsequently when the market participants got alarmed of the mispricing, recovery rate initially dropped, so with the value of their balance sheets (Battiston *et al.* 2016 and Stolbova *et al.* 2018).

Icelandic households also responded strongly to an excessive supply of financial products, such as unsecured credit and foreign-denominated loans. In this case, financialisation in Iceland has not only followed the traditional channels seen in many countries where household debt levels increased due to finance demand to maintain or fund ever increasing living standards of the household. But it is found that, in

Iceland, the effect of financialisation has also contributed immensely to foreign currency speculation and resulted to increased financial instability (fragility) Guðmundsson, (2015).

The trend shown in the literature discussing the key developments in household debt since the Great Financial Crisis (GFC), highlights some critical features of the mechanisms through which household debt may threaten 'macroeconomic' performance through financial instability formed by the increased debt levels in the economy. This could be the result manifested by the refined business model of the financial sector, which has since increased the sum of its assets and expanded its business largely by selling more and more financial products to households. The products offered include: consumer loans, mortgages, investment accounts, student loans, vehicle loans, and various forms of insurance and pension products (Aalbers, 2008; Greenwood & Scharfstein, 2012).

2.4 FINANCIAL DEVELOPMENT.

We turn now to a discussion of the literature on financial development and its impact, first and foremost it is worth noting that many of the trends that the financialisation literature describes above are not only acknowledged, but also celebrated by the financial development literature to be discussed below. The key examples are the expansion of finance and increasing household credit. Similarly, 'finance culture' and 'portfolio society' (shifting the mindset and class identity of 'consumers') have been core parts of the neoliberal agenda. Financial development is defined "as the situation when private segments of economy partake more actively in financial activities of the economy" (Almasifard and Saeedi 2017:510). It can be evaluated by various ways such as access to capital, size, stability and efficiency of the whole financial sectors. Furthermore, financial development can be assessed by inspecting the task of different actors of the economy driven to fulfill the objective of financial intermediary such as banks, financial markets, insurance and bond market. The tasks of these intermediaries incorporate enforcing financial contracts, making transactions and creating incentives for the emergence of particular types of financial contracts.

2.4.1 Financial Development and Household Debt.

The fundamental theoretical literature underlying these empirical investigations draws a clear distinction between the roles of household and enterprise credit. As most theoretical models with endogenous financial intermediation focus more on enterprises in need of external finance for investment or production purposes (Levine, 2005). While this body of literature has drawn substantial mechanisms through which financial development impacts the enterprise credit and vice versa, it provides unclear predictions about the effect on household credit. Hence, Ardic *et al.* (2011), as well as Mohieldin *et al.* (2011), note that there is also a strong relationship between household integration into the financial system and financial development. Hence, financial development is also viewed as a process which spurs the growth of the financial sector through increasing the ratio of household credit and savings to GDP, which has been recommended to promote economic development.

The earliest recognised proponents of the idea that finance could influence or be an engine for driving growth are Opie and Schumpeter (1934); their observation was later endorsed by Gurley and Shaw (1955), McKinnon (1973). These arguments were used to support the series of structural and policy reforms in the financial sector that many African countries embarked on during the period of 1980 and 1990s. These were part of overall economic reforms with the objective of restarting economic growth as well as improving overall economic and financial sector efficiency (Elbadawi et al., 1992). In the financial sector, the problem was argued to be financial repression, and its pervasiveness in developing countries was responsible for stifling economic growth (Mackinnon, 1973 & Shaw, 1973). The financial development, suggests that a well-functioning financial system has the potential to foster the accumulation of physical capital, improve economic performance. This is because an effective financial system ensures that scarce capital is channeled to its best alternative use.

In the first generation of financial sector reforms, the measures adopted included abolishing explicit controls on the pricing and allocation of credit, reducing direct government intervention in bank credit decisions, relaxing the controls on international capital movements and allowing the interest rates to be market determined. The second generation of financial sector reforms focused on structural and institutional constraints, such as improving the legal, regulatory, and supervisory and judiciary environment, restoring bank soundness, and rehabilitating financial infrastructure. "The impact of these reforms on the financial sector has generally been positive. Financial depth has improved, interest rates are largely market determined, and entry restrictions into financial sector have been relaxed. However, challenges remain, especially with respect to access to finance by the majority of the population and by SMEs remains, which remains poor" (Batuo et al, 2010).

In the recent literature, Arcand et al. (2012), Easterly et al. (2000), Deidda and Fattouh (2002) focusing on high- and low-income countries they find a non-monotonic relationship between financial development and economic growth, they conclude that the relationship is non-linear. These literatures shows that when an economy has too much debt its influences the economic growth negatively and households are a large part of what is contributing to debt at intermediate levels of financial depth, there is a

positive relationship between the size of the financial system and economic growth, but it also shows that, at high levels of financial depth, more finance is associated with less growth. Earlier than this, Jappelli and Pagano (1994) had argue that easing households' credit constraints reduces the savings rate, with negative consequences for economic growth. Specifically, they show a sample size of 25 middle - and high-income countries with lower liquidity constraints on households. These parameters are proxied by the loan to value (LTV) ratio for mortgages associated with a lower rate of savings and GDP per-capita growth. There exist an opposite element in the literature whereby the economic growth drives the motive and demand for more financial services by the household (Robinson, 1952).

According to Levine (2003), there are two general ambiguities between economic growth and the emergence of financial development, which improves resource allocation and reduce risk. This mainly relates to how higher returns ambiguously affects saving rates, due to well-known income and substitutions effects. Similarly, lower risk also ambiguously affects savings rates (Levhari and Srinivasan, 1969). Therefore, financial arrangements that improve resource allocation and lower risk may lower saving rates. In a growth model with physical capital externalities, financial development could delay economic growth and lower welfare if the drop in savings and the externality combine to produce a sufficiently large effect.

A critical aspect is the microfinance industry, driven by the desire to ensure financial development, and silently redefining a new objective in terms of facilitating financial services for households. Microfinance is seen as an effective channel for the objective of improving social welfare and alleviating poverty through creating employment opportunities, increasing income and consumption (Khandker, 1998; Khandker & Koolwal, 2015; Li, Gan, & Hu, 2011; Mahjabeen, 2008; Yunus, 2003). Some studies, argue against this findings and state that microfinance has no direct effect on the standards of living of the poor household and also it has no immediate poverty-reduction impact in a short run (Hulme & Mosley, 1996, Coleman, 1999, and Takahashi *et al.*, 2010).

The empirical studies conducted in Vietnam also confirm diverse results. On the one hand, some studies find a critical role played by microfinance in improving the

household income or self-employment profits, and consumption, contributing to poverty reduction (Cuong, 2008;). On the other hand, some studies conclude no positive impact of microfinance on income, rather repayment risk and defaults (Phan *et al.*, 2014).

In the Philippines, evidence shows that access to microfinance led to a 7.9% decrease in holding of health insurance, suggesting microfinance was used to cushion variations in income or expenses (Karlan *et al.*, 2011). In India, borrowers of microfinance reported utilisation of loans to smooth consumption or buy goods (15% in India and 8.5% in Bosnia and Herzegovina) (Augsburg *et al.*, 2015). The study by Banerjee *et al.*, (2015) found that others used the funds to service other loans (30% in India) or pay for general consumption, paying school fees, and ceremonies (9% in Ethiopia) which is good. An evaluation done in South Africa found that microfinance loans for average creditworthy households helped them to secure their jobs and maintain living standards by absorbing short-term cash flow shocks that would have made them not afford transport to work and consume food (Karlan *et al.*, 2010). These outcomes suggest that borrowers in South Africa have high personal returns to using microcredit for non-business or risk-mitigation purposes, although acquiring finance for these purposes attracts a premium in the form of high interest rates unlike utilising the funds for business productivity.

Takahashi *et al.*, (2010), found that at the micro level, microfinance borrowers benefit significantly from self-employment rather than other sources of income like property resources and wage. Therefore, it indicates the role of microfinance in income diversification. At the macro level, the indirect effect is on the short-run output increase, which in turn influences macroeconomic growth through aggregate consumption and financial sector growth in the economy. Bateman (2012) contests the aforementioned benefits of microfinance, he argues that in reality this new objective recognised by microfinance of improving social welfare through new channels of financial solution appears to have even less substance to the failed poverty-reduction objective it is designed to replace. Furthermore, as the idea of microfinance is that it will inspire 'bottom-up' enterprise development, and therefore creating employment opportunities in the poorest communities, and that it will enable some microenterprises to grow into Small-Medium Enterprise (SMEs). This has not seemed to be the case in

most countries including South Africa (following from James 2012, 2014, Bateman 2014, 2015).

Isaacs (2018) argues that where microfinance has been utilised for the purpose of enterprise development it has been so stimulating that the high levels of competition outcomes have curbed profits and wages in the informal sector with neutral net job creation. This has led to social tensions, mainly between foreign and local township shop owners, and to business failures with unreliable demand of households due to highly precarious incomes (James 2014). Mader (2014) in his study done for India, argues that microfinance does not drive or reduce poverty and inequality, in fact it successfully established a creditor-debtor relationship amongst the poor household, creating markets, and financialising the civil society actors who are frequently at the forefront of microfinance.

2.4.2 Financial Development and Inequality.

The development of financial markets has an impact on the distribution of income, and the direction of that impact is far from settled in the literature. Some argue that the development of financial markets has a positive impact on income distribution because more developed and freer markets widen the availability of credit, thus allowing the poor to invest in building their human and physical capital. They are presented with an opportunity to invest in their skills and those of their children and also set up new small businesses (Banerjee and Newman, 1993). Thus, by widening the financial opportunities available to the poorer, financial markets have the effect of equalising the distribution of income. Kapingura (2013) uses ATM access as a measure of financial development in South Africa and finds that even though the variable is negative, it is still significant thereby implying a positive relationship between financial development and income inequality. Using panel estimation technique of econometric model (GMM), Batuo *et al.* (2010) finds that income inequality decreases as economies develop their financial sector. The result also confirms that educational advancement plays a significant role in narrowing income inequality.

In a study done by Kinkyo (2016), it is shown that financial development tends to reduce inequality in the long-run, while it can increase inequality in the short-run. Furthermore, the study finds that good governance seems to be important for achieving inclusive growth through financial development. In a study done by Odhiambo (2009) it is shown that both financial development and economic growth cause poverty reduction in South Africa. The study finds that this applies irrespective of whether the causality test is conducted in the short-run or in the long-run.

This would confirm the theories which presume financial development to help the poor by both accelerating aggregate growth and reducing income inequality. The theory points to different channels through which this relationship can work. On the one hand, there might be a direct impact by enabling the poor to invest in their human capital and in microenterprises by gaining access to credit, an effect that is more likely to be captured by household credit (Galor and Zeira, 1993; Banerjee and Newman, 1993). On the other hand, financial development might result in a more efficient capital allocation across incumbent and new enterprises, fostering structural change, higher growth, and lower income inequality, an effect that is more likely to be captured by enterprise credit (Gine and Townsend, 2004; Beck, Levine and Levkov, 2007).

There is evidence that financial development contributes to poverty reduction and inequality. Banerjee and Newman (1993), postulate that financial development eases credit constraints, which benefits the low-income groups or household through increasing capital accumulation and human capital. However, it is stated that the success of this relationship strongly depends on the phase of the economic development in the country. Hence at early stages of development, only the high-income groups are eligible to access financial services due to their affordability of the fixed cost incurred in order to join the financial coalition, causing a broader income inequality. Therefore, as the economy grows and financial markets develop, the financial system opens up and becomes accessible and affordable to the poor household were previously excluded from getting loans. Such financial system development tends to improve efficiency of capital allocation and lessen funding

constraints, thereby resulting in a positive relationship between financial development and income inequality.

Although there is an existing relationship between finance and inequality, it has been argued that there also exist information asymmetries or financial imperfections, such as information on transactions costs, which affect mainly the poor who lack credit histories and collateral. This increases constraints for the poor and benefits the privileged who can afford to acquire lower-interest mortgages, and also use these for income generating purposes. This benefit leads to inefficient allocation of capital; income inequality could therefore be reduced through increased credit availability to the poor whom need funding for productive investments (Galor and Zeira, 1993; Aghion and Bolton, 1997; Galor and Moav, 2004). Therefore, this implies that financial development should foster the efficient allocation of capital through alleviating constraints which makes access credit more difficult and disproportionately exclude the poorer parts of society. Burgess and Pande (2005) found that financial development improves the income of the poor, especially in developing countries like India. Clarke *et al.* (2006) and Beck *et al.* (2007) used an expanded dataset with more developing countries to test the different theories, and find supporting results which predicts a linear inequality-reducing influence of financial development in developing countries.

Bulir (1998), Honohan, (2004) and Demirguc-Kunt, et al. (2004), each using different empirical strategies for a cross section of countries, find that financial development lessens either inequality or poverty. Also, Bittencourt (2006) examined the impact of financial development on earning inequality in Brazil in 1980s and 1990s and found that financial development improved access of credit to the poor, alleviated extreme inequality and consequently improved welfare without distorting economic efficiency. According to Batuo *et al.* (2010), the relationship between financial development and reduction in income inequality is both a correlation and is causal, and this causality may run both ways. For example, as the share of the income held by the poor grows, they may increase their demands for financial services, which may drive the positive association between finance and growth. On the other hand, by increasing growth, finance may contribute to increasing the incomes of the poor.

However, others point out that since the poor do not have equal access to credit due

to lack of collateral and connections, financial markets development may actually exacerbate income inequality. As such the financial reforms undertaken by many African countries to deepen and develop their financial markets may be correlated with a persistent increase in inequality. This is because those who are relatively well-off are better equipped to exploit the new financial opportunities that the liberalisation of financial market entails.

In this thinking the assumption is that financial market imperfections such as financial asymmetries, transaction cost, and contract enforcement costs, may be especially binding on the poor, who lack collaterals, credit histories and network relationships. As such, even when the poor may have projects with high returns, they may still be credit rationed. This reduces the efficiency of capital allocation and limits the social mobility of the poor. Under such circumstances, income inequality rises with the development of financial markets.

Recent empirical studies, such as the study by Jaumotte *et al.* (2013), Jauch and Watzka (2015) and de Haan and Sturm (2017), find similar result to those of Demirgüç-Kunt and Levine (2009) but in developed countries – namely that more access to finance increases income inequality. Their findings show that over a certain level or threshold, financial development could benefit the high-income earners more extensively. According to (Kay, 2016), income inequalities could rise due to the growing compensation of senior employees-management Rajan (2010) demonstrates before the financial crisis of 2008, wage stagnation and rising income inequality in the US has encouraged the lower-middle income households to extend their debt exposure in order to maintain their consumption level. Higher debt obligation, in turn, increased the level of income transfers from the deficit households to the wealthier (investors) further worsening inequality.

Other theories predict that financial development is not primarily benefiting only the wealthier parts of society because poor households rely more on informal (local area) means of raising funds, and so this may be why the results may show that the larger, formal financial sector is more beneficial to privileged households. Evidence for this is found in the study by Greenwood and Jovanovic (1990), whereby they developed a theoretical prediction model on the finance-inequality nexus. Their model predicted a

nonlinear relationship between financial development and income inequality that depends on the standard of living or the state of economic advancement. What their model showed as evidence is that, financial development plays a critical role in improving allocation of capital, which contributes to economic growth, and thus helps the poor, regardless of the state of economic advancement. The critical similarities were that indeed the wealthier parts of society does afford access to finance, hence they deemed to be the first beneficiaries of financial development.

Contrary to the above findings, Coskun (2016) finds neither support for a linear nor non-linear relationship between financial development and income inequality. They assess the finance-inequality-poverty nexus by taking the separate and simultaneous impacts of banks and stock market into account. Their findings demonstrated that while financial development does promote economic growth, it does not necessarily benefit those in low income brackets within emerging economies. Like the finance-growth nexus, it is possible that poverty and income inequality reduction exerts a positive effect on financial development through an increase in savings and demand for funds. An examination of this relationship not only helps to understand the role of financial deepening in sustainable development but also sets a framework for discussion of financial and distribution policies for the lower income group.

Although the above section indicates that there some of the literature indicates that that financial development can have adverse outcomes, there is also literature which argues that financial development can be beneficial. This is through its positive impact on households, through poverty reduction and fostering equality. This phenomenon has long been regarded as an important factor for economic growth and development.

Johnson and Nino-Zarazua (2011) caution that even though financial development could be a leading contributor to economic growth, there is no substantial evidence to suggest that it correlates to poverty reduction. In this context, Mirakhor and Iqbal (2012) argue that the best form of financial development for the economy is the one that is inclusive. Hence countries should place greater emphasis on the expansion of access to finance in order to eradicate poverty. Numerous definitions of financial inclusion exist in the literature, in this case financial inclusion means having a minimal

level of access to the financial system (basic bank facilities) i.e. cheque, savings and/or credit accounts (FinScope, 2010). Therefore, households who do not have this are thus defined as financially excluded. Along these lines, Demirguc-Kunt and Klapper (2012) mentioned that a well-functioning, inclusive financial system benefits the poor as it promotes entrepreneurship and creates greater opportunities for advancement. Mishi *et al.* (2012:2) further assert that “a well-functioning financial system is the one that is not exclusive but inclusive. At the household level, access to financial services enables the family to invest, save, insure their property or borrow, while at small business level it yields neutral net job creation”.

A study by the World Bank (Global Findex Database, 2013) suggests that, although an inclusive financial system is deemed to be good for the economy it is not always pro-poor as it obscures the massive socio-economic inequalities that continue to persist across the country and masks important nuances about financial exclusion in particular social contexts. Until today, the literature on financial inclusion generally observed an absence of formal financial services, as an evident deficiency. About 2.7 billion adults worldwide do not have credit, savings, or insurance with a conventional bank or other formal institution. Yet, the more investigation unfolds on the financial lives of poor household, it becomes clearer that in low-income families there is still a serious need for wide array of financial services (Ehrbeck *et al.* 2012). Collins *et al* (2009), goes further and argues that poor people’s problem of having low income is exceeded by their lack of access to reliable, flexible, convenient, and appropriately structured financial solutions to manage low incomes. With even greater sadness, a report presented by the G20 (ATISG 2010), shows that for poor households, money management is completely a central part of their daily life and remains a necessity. Therefore as the stats from the above report on G20 shows than 2 billion adults do not have access to formal or semi-formal financial services which further validates a need for a study on investigating the state of financial inclusion in the group (G20).

2.4.3 Financial Development and Employment.

Finance-driven growth may be pro-poor by increasing employment opportunities as it may favour entrepreneurs and yield profit which can be invested in expanding the production capacity which in turn requires more human capital-labour (Pagano *et al*,

2012). Karlan *et al*, (2011) found the aforementioned claim by Pagano *et al*. is not always the case. They state that an increase in private credit to GDP ratio across countries lowers employment growth in the smallest firms significantly, but increases the large firm's employment growth. This evidence coincides with the recent empirical evidence, which reveals a small number of micro-enterprises employees with access to credit-finance compared to those without (Karlan *et al*, 2011). The interpretation provided here reveals that that small businesses utilises their loans proceeds on managing their households' risks rather than investing them in their businesses.

Benmelech, Bergman & Seru (2011) argue that there is an employment-to-business cash flow sensitivity, similar to the cash flow sensitivity relative to investment which is also found in the study by Fazzari *et al*, (1988). Based on their results the authors claim that credit availability or access to credit has a direct impact on the firm employment, and subsequently, on the overall employment rate of the economy. Campello, Graham & Harvey (2009) based on the data used their study reveal that the US, Asian and European firms, which were constrained by the financial crises of 2008, published higher job cuts than non-constrained firms. Caggese & Cuñat (2008) show theoretically and experimentally in their study, evidence for Italy that financially restrained firms are more prone to use extremely flexible employment contracts than the unconstrained firms. The serious usage of such employment contracts helps the firms to regain their capacity to absorb product demand volatility. Hence this outcomes implies that firms that lacks financial flexibility are forced to use flexible employment contracts instead, provided that labour relation act permits sufficient flexibility.

2.4.4 Financial Development and Financial Stability.

Financial markets perform the essential function of channelling funds to those individuals or firms that have productive investment opportunities. If the financial system does not perform this role well, then the economy cannot operate efficiently and economic growth will be hampered (Mishkin, 1999). Honohan (2004) find evidence that financial development cannot achieve financial stability without pre-existing good quality financial system infrastructure, including the regulatory and legal environment. Hence he found that countries with 'superior' financial systems, good accounting practices and regulatory framework do in fact experience a high level of

financial stability and economic growth. As financial regulation develops policies which ensures that the development fosters access to finance for all the previously excluded (disadvantaged) parts of society and small businesses. Thus, for microfinance to improve the access to finance of the poor, its effectiveness as a pro-poor growth engine of financial development needs the right legal and regulatory infrastructure.

The consequences of financial development have been shown by recent cross-country comparisons. Johnson and Nino-Zarazua (2011) caution that although financial development may be presumed to be a leading contributor to economic growth through financial stability. In this context, Mirakhor and Iqbal (2012) argue that the best form of financial development to positively impact the household and the economy at macro level is the one that is inclusive. Hence most recent studies which borrow from this literature conclude countries should place greater emphasis on the expansion of access to finance in order to eradicate poverty. Also the idea if microfinance is deemed to be far more fragile and impact the financial sector negatively in terms of defaults and impairments (Bateman, 2012). Bateman further argues against the findings of Jappelli and Pagano, he postulated that, in reality this new objective for microfinance appears to more precarious and de-stabilizes the economy through defaults and impaired books of unsecured lending to household.

The last five years, the global economy has experienced severe bouts of financial instability that have had devastating impacts on many countries. In Mexico, GDP growth fell from above 4% percent in 1994 before the crisis to -6% percent in 1995. In Thailand, Malaysia, South Korea and Indonesia, GDP growth fell from above 5% in 1996 before the crisis to below -5% in 1998. These swings of over 10% in rates of GDP growth are of the same order of magnitude as what occurred in the United States during the Great Depression (Mishkin,1999). According to Schularick and Taylor (2012), high levels of debt are not the only key indicator or predictor of financial crisis but also a critical element of the intensity of the subsequent recession. Their findings were further complemented by the recent early warnings signals literature, which alluded to the critical role of household debt servicing in forecasting the forthcoming vulnerability of the banking system stresses and recession (Drehmann and Juselius, 2014).

To a large extent most financial instability occurs mainly due to the information asymmetries which still exists in the financial system. According to Mushkin, (1999) the function of channelling funds to market participants implies a capability of making judgements about which investment opportunities are more or less creditworthy. As a result, a financial system would struggle with problems of asymmetric information, in which one party to a financial contract has much less accurate information than the other party. For example, borrowers who take out loans usually have better information about the potential returns and risk associated with the investment projects they plan to undertake than lenders do.

Asymmetric information leads to two basic problems in the financial system (and elsewhere) which affects financial stability: adverse selection and moral hazard. Adverse selection occurs before the financial transaction takes place, when potentially risky borrowers are those who most actively seek out a loan, i.e., those who want to take on big risks are likely to be the most eager to take out a loan, even at a high rate of interest, because they are less concerned with the possibility of default. Thus, the lender must be concerned that the parties who are the most likely to produce an undesirable or adverse outcome are most likely to be selected as borrowers. This outcome is a feature of the classic lemons problem analysis first described by Akerlof (1970). In the case of capital markets, partially informed lenders may steer away from making loans at high interest rates, because they know that they are not fully informed about the quality of borrowers, and they fear that someone willing to borrow at a high interest rate is more likely to be a low-quality borrower who is less likely to repay the loan. Lenders will try to tackle the problem of asymmetric information by screening out good from bad credit risks. But this process is inevitably imperfect, and fear of adverse selection will lead lenders to reduce the quantity of loans they might otherwise make.

Moral hazard occurs after the transaction takes place. It occurs because a borrower has incentives to invest in projects with high risk in which the borrower does well if the project succeeds, but the lender bears most of the loss if the project fails. A borrower also has incentives to misallocate funds for personal use, to shirk and not work very hard, and to undertake investment in unprofitable projects that serve only to increase personal power or stature. Thus, a lender is subject to the hazard that the borrower has incentives to engage in activities that are undesirable from the lender's point of

view, that is, activities that make it less likely that the loan will be paid back. Lenders often impose restrictions (restrictive covenants) on borrowers so that borrowers are less likely to engage in behaviour that increases the risk of default. However, such restrictions are costly to enforce and monitor, and inevitably somewhat limited in their reach. The potential conflict of interest between the borrower and lender stemming from moral hazard again implies that many lenders will lend less than they otherwise would, so that lending and investment will be at suboptimal levels. Banks also have advantages over other financial services providers who can't afford big investment in information technology and data sources which is vital in reducing moral hazard because, as demonstrated by Diamond (1984), they can engage in lower cost monitoring of accounts conducts and credit history. Also because, as pointed out by Stiglitz and Weiss (1983), they have further advantages in preventing risk-taking by borrowers since they can use the threat of cutting off lending in the future to improve a borrower's behaviour.

As the growing literature places more emphasis on explaining the institutional structure of financial markets by recognising that this structure has evolved to reduce the asymmetric information problems of adverse selection and moral hazard (Gertler, 1988). The commercial banks, thrift institutions, finance companies, insurance companies, mutual funds and pension funds, of which banks are the most important, have both the ability and the economic incentive to address problems of asymmetric information. The natural advantages banks have is the ability to collect information at the time they consider making a loan, and this ability is only increased when banks engage in long-term customer relationships and credit line arrangements which can help in addressing or reducing moral hazard.

2.5 CONCLUSION.

What we see from the discussion above is two bodies of literature that recognise the role finance and its consequences for the economy at the household and macro level. However, these literatures illustrate that there are contesting ways to understand the expanding nature of finance. It is worth noting that the two bodies of literature draw on the same trends witnessed in the growing role of finance and its impact in the household debt, employment and what could be the results of financial instabilities. The financialisation literature portrays the role of finance to be dysfunctional to the

real economy as its openness includes households in a precarious way that exposes them to numerous vulnerabilities i.e. growth of debt exposure to disposable income, and defaults which impact the bottom line earning of the firms. In turn this affects employment in the financial sector and to a certain extent this leads to a spiral effect on the employment rate of other industries (small and large firms).

The financial development literature, by contrast, celebrates the expanded role of finance, speaking to the evolving finance culture, innovations and portfolio society. The literature argues for the critical role played by financial development in improving income distribution and employment, through three channels. Firstly, the greater access to finance which allows the poor to borrow to smooth their consumption, invest in their human capital, especially education and health, or start up new ventures, hence reducing the income gap between the rich and poor. Secondly, financial development promotes economic growth, which may trickle down to the poor in the form of increased job opportunities or high demand for low-skilled workers, which raises wages of the poor and eventually leads to lower income inequality, the channels through which finance can benefit those in lower socioeconomic strata have been extensively discussed by Demirgüç-Kunt & Levine. Lastly, following from the asymmetric information which still exists and give rise to financial instabilities in many occasions, Mishkin, 1999 has noted that banks have an ability to address nor reduce the moral hazards.

A contested understanding of the expanding nature of finance, documented in the literature above is found to be centered around the relationship between finance and inequality which relates to a central part of this thesis. Here we seek to interrogate the state of financial inclusion, the phenomenon which emanates from the growing global concern on the role of finance and inequality. On the one hand, the financialisation literature argues that the expanding role of finance is negatively impacting inequality through increasing the incomes of those with most access to finance, credit history and collateral in place. On the other hand, notwithstanding the existing inequalities, the financial development literature argues for the benefits of the increased role of finance in the economy which is said to be functional to the economy; in the end it further notes that this phenomenon is good for households if it is inclusive.

As this research project is interested in exploring the ways in which households have become more deeply included in the financial sector in South Africa the forthcoming chapters will base their analysis on the above discussed literature and assess which body of literature is best equipped to help us understand that. The next chapters explore a case study of the South African financial sector and analyse the state of financial inclusion in South Africa through looking at the households exposure into the financial markets (assets and liabilities) held with the financial institutions at an aggregate engagement and the impact they have.

CHAPTER 3

THE CURRENT LAND SCAPE OF THE SOUTH AFRICAN FINANCIAL SECTOR.

3.1 INTRODUCTION

In Chapter 2 we reviewed the literature on the expansion of finance and the manner in which the relationship between the financial sector and the households sector have been altered over the last two decades. In order to set to the scene for our later exploration of the intersection between finance and households in South Africa, this provides a description of the South African financial sector, and it highlights how important households have become for the financial sector. This is depicted mainly through the households and financial (banking) sector's balance sheet. In the subsection 3.2 we provide a background of the South African financial sector, 3.3 focuses on the household integration into the financial sector and lastly 3.4 provides the \ current landscape of the financial sector regarding household participation. Hence, this chapter probes transformations in the South African financial sector with an objective to assess financial inclusion and the current state (the landscape) of the South African financial sector. It highlights how financialised the sector is, and also notes developments emerging from the increasing household integration in to the financial system.

3.2 BACKGROUND OF THE SOUTH AFRICAN FINANCIAL SECTOR.

South Africa is considered to have a highly sophisticated and sound financial services sector that plays a critical role in the economy at large. According to the World Economic Forum Global Competitiveness Report of 2018, the South African financial sector was ranked 67th globally with a score of 60.8/100 and attains the second spot in Sub-Saharan Africa. Among its strengths, this financial sector is home to a large market size (68.4/100), good infrastructure (68.6/100) and a well-developed financial system (82.1/100). This sector consists of all entities or intermediaries that manage money on behalf of the household, private and public sectors, and generally comprises of institutions such as banks, insurers, asset managers, stock brokerages, credit unions, micro-financiers and other private or public entities capable of extending financing activities.

Despite this, the sector is dominated by large and complex financial institutions with a historical bias towards extending access to financial products to high-and middle-income earners and major corporations. Figure 1 below depicts the composition of the financial sector of South Africa.

Table 3.1: Overview of authorised financial service providers in South Africa.

Financial Service Providers	2018
Banks	18
Mutual Banks	3
Credit providers	7572
Short term insurance providers	91
Long term Insurance providers	75
Co-operative Banks	2
Registered Co-operative Financial Institutions	36

Source: SARB (2018)

The banking industry of South Africa is currently made up of 18 registered banks dominated by the ‘big four’ banks which is Absa, Standard Bank, First Rand and Nedbank accounting for 89% of the total assets and deposits of overall banking sector (SARB, 2018). The country has 15 local branches of foreign banks, dominated by 5 banks competing with the aforementioned ‘big fours’ in corporate and investment banking – HSBC, Deutsche Bank, Citi Bank, JP Morgan, and Standard Chartered. There are three mutual banks including the Venda Building Society (VBS) which was since placed under curatorship on the 11th of March 2018, following its liquidity problems (South African Banking Sector Overview, 2018). The major players within the insurance business are: Old Mutual, Sanlam, Momentum Metropolitan Holdings (MMI), Liberty Group and Discovery. The aforementioned are formal financial intermediaries in South Africa and geared towards short and long-term financial market intermediation, serving the household sector, corporates and the public sector.

The financial services sector is at the heart of the South African economy as it allows the segments it serves to make daily economic transactions, save and preserve wealth to meet future aspirations and needs, and insure their fortunes against any unforeseen

economic crisis. At the level of the macroeconomy, the financial sector enables economic growth, job creation, the building of vital infrastructure and sustainable development for South Africa. Table 3.2 below, shows how important the financial sector of South Africa is, or has been, in contributing to the overall Gross Domestic Product of the country based on the average growth rates, in different sectors, of value added in constant prices. It is first worth noting that this sector amongst other sectors of the economy has never recorded a negative growth in real value added. The table below confirms that, the financial sector of South Africa has been contributing positively towards GDP growth since the year 1985. In fact, the financial sector has outperformed other sectors (industries) and maintained its consistent positive impact to the GDP growth of South Africa.

Table 3.2: Sectoral distribution of production (% of GDP 1985-2018)

Percentage change	1985-1994	1995-2004	2005-2014	2015-2018
Agriculture, forestry and fishing	3,9	0,3	6,8	-3,2
Mining and quarrying	-0,6	0,4	-1,7	-1,4
Manufacturing	-0,1	2,6	0,3	0,9
Electricity, gas and water	3,6	1,1	-1,0	0,9
Construction	-2,3	2,9	3,5	-1,2
Trade, catering and accommodation	-0,1	4,4	1,4	0,4
Transport, storage and communication	1,6	6,9	3,5	0,9
Finance, real estate and business services	1,8	4,8	2,7	2,2
General government services	2,0	1,2	3,2	0,8
Personal Service	2,0	0,3	1,8	1,0
GDP	1,2	2,5	1,8	0,8

Source: Statistics South Africa: (2018)

Historically, the role played by the sector in influencing the economy started in the beginning of capitalism in South Africa, with English financial capital supporting the growth of the economy and mining in particular. Later, financial institutions served to channel Afrikaner savings and agricultural surpluses into the development of an

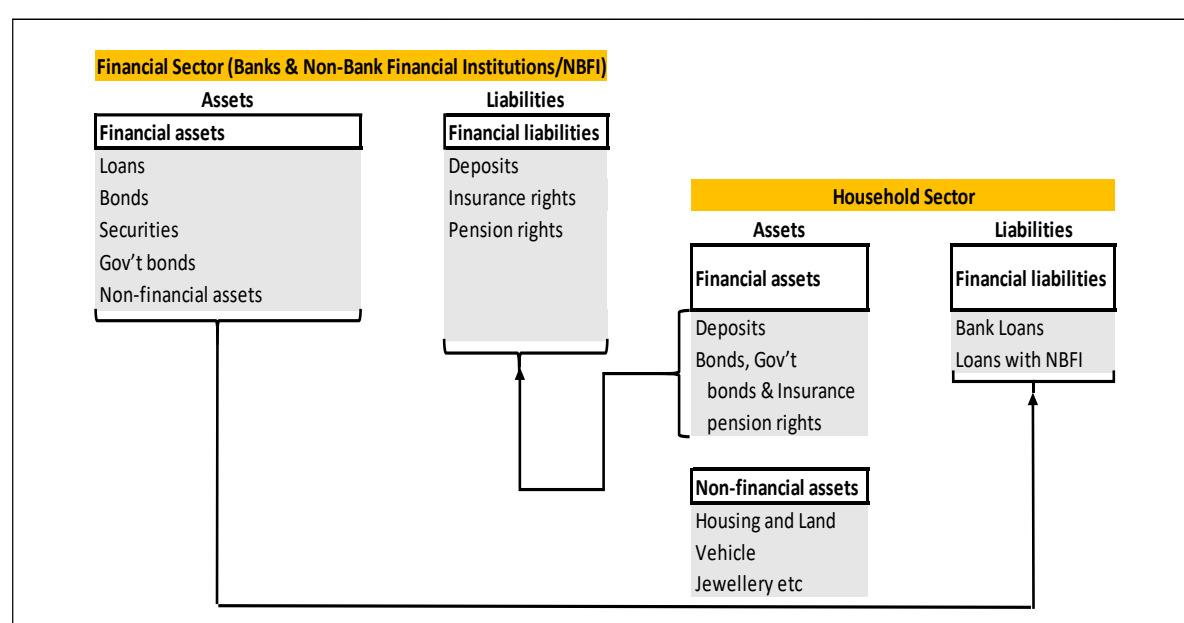
'Afrikaner' industrial base (O'Meara, 1983). Standard Bank and Barclays from the UK were the earliest players in the sector. The focus was mainly on driving corporate finance and trade to grow the (diamond and agricultural) businesses through foreign (private) sources of funding governed by the British monetary system. With the establishment of the National Finance Corporation (NFC), the role of finance expanded, moving funds from private sources to institutional funding with interest in mining, supporting the role of the large mining groups to form mining-finance houses to coordinate mining operations in South Africa. Fine and Rustomjee (1996) point out that this change ultimately helped to erode differences between English and Afrikaner capital which was used as part of empowering Afrikaners and drawing them in to the economy. They further stipulated that, towards the end of apartheid and the later integration of the country into international trade and financial markets, foreign investment bankers played a larger role. According to Lipton (1986) and Nattrass (1988), the top-tier corporate advisory work used to be dominated by the local banks until the prominent international banks landed in South Africa with their strong balance sheets, research capabilities, reputable brands and global distribution which pushed the local banks out of this segment.

This above history illustrates the bias within the sector towards growing large corporates businesses owned by the minority, and increasing the wealth of the elite income groups, particularly white people's access to personal finance. Hence little is said about the participation rate of the majority of the South African population comprised of previously disadvantaged groups. Therefore, in assessing the structure of the financial sector of South Africa this thesis looks at the critical part of serving the household sector specifically not corporate business. The focus is on the financial services providers intended to serve the household market, later this is used to explain the state of financial inclusion in South Africa, hence a greater focus is on retail banking than any other segment. Therefore, from the conventional banking perspective we look into the market share of the financial services providers' and underline the importance of the household integration as they have shown to dominate the assets of financial services providers since the financial crisis of 2008, the information is shown in Figures 4 and 5 below.

3.3 HOUSEHOLD INTERGRATION INTO THE FINANCIAL SECTOR:

The household sector, like the corporate sector, is part of the real sector in the economy, in which it plays an important role for many reasons. The household sector acts, not only as a creditor sector, but also as a debtor sector. As a creditor sector, households may allocate their funds generated from incomes, wages and other sources to financial assets such as bank deposits, shares and other securities, or to non-financial assets such as houses, land and other fixed assets. As a debtor sector, households receive funds from financial and non-financial institutions to finance consumption and investment or saving. Therefore households are affected by and, in turn, affect the financial sector through different transmission channels, as shown in Figure 3.1. The figure shows the circular flow of funds between the financial sector and the household sector, going through the different contra-accounts held between the two segments. For example, the assets (deposit, bond etc) shown in the balance sheet of the household sector are held with the financial institution and are due upon demand by the owners (households), hence kept as liabilities in the balance sheet of the financial sector. The same explanation holds in the balance sheet of the financial sector versus that of the household sector. The loans granted by the financial sector are recorded as assets in the bank's balance sheet and as liabilities to the household sector's balance sheet since they are due to be repaid or serviced as per the loan agreement between the two segments.

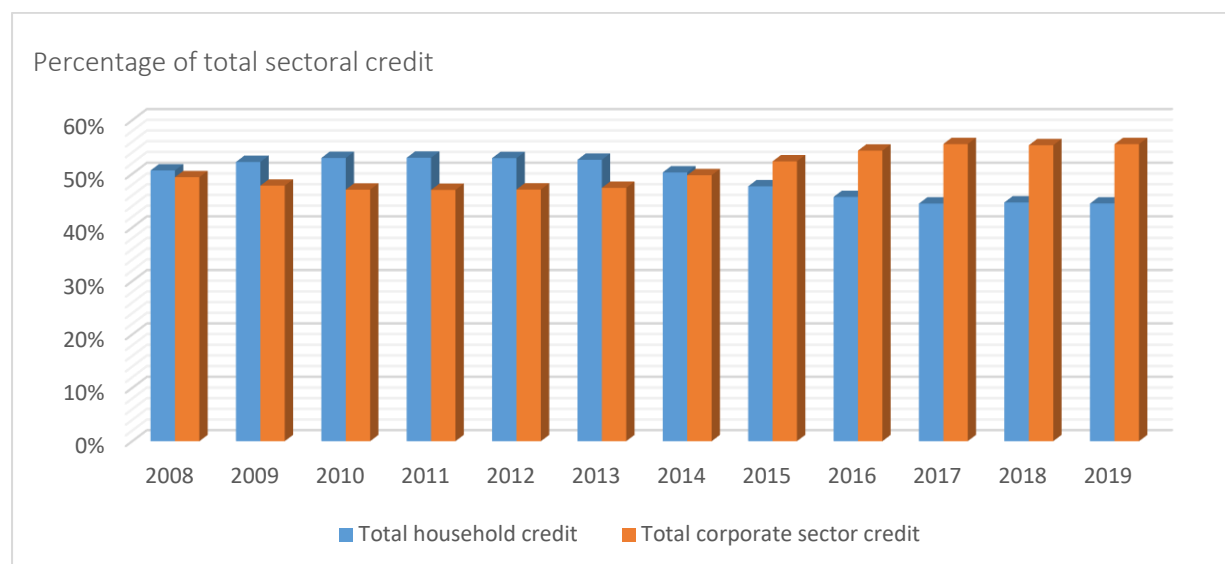
Figure 3.1: Household and Sectoral Balance Sheets.



Own workings

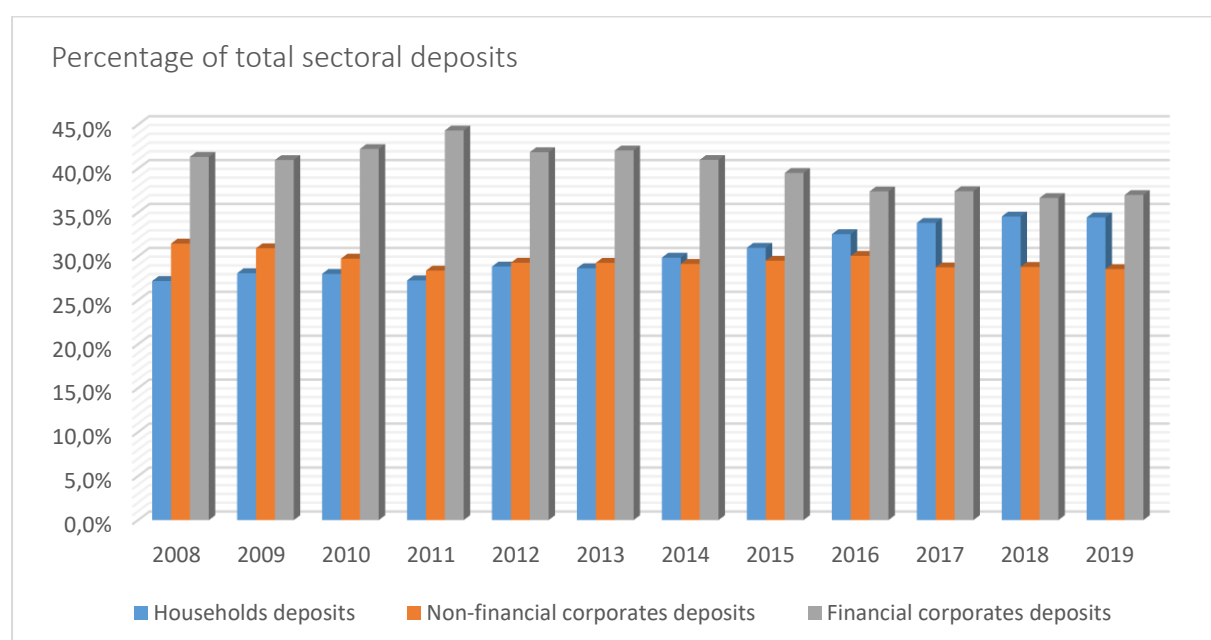
As the financial sector grows, financial services offered to households have increased as proven by the assets book and deposit held by the Banks and non-banking financial institution, as shown in Figure 3.2 and 3.3 below. The figures shows real values as a percentage of the total financial sector's assets and liabilities.

Figure 3.2: Financial Sector's Assets–Household Credit as % of Total Credit.



Source: SARB (2019)

Figure 3.3: Financial Sector's Liability–Household Deposit as % of Total Deposits.



Source: SARB (2019)

The above figures are for the financial sector, and show that a different pattern is evident in financial sector assets (slight decline in importance of households) and financial sector liabilities (showing increasing importance). The above information reveals the growing importance of the household involvement in the financial sector's balance sheet (assets and liabilities), which have lately outperformed the contribution of the non-financial corporation in deposits held with the banks (deposit takers). Hence the outcome justifies the interest of this thesis on interrogating the growing integration of household in the financial system, it also shows how households have become more important for banks. In section 3.4 below we further zoom into the current landscape of the financial sector of South Africa by looking at critical spheres of the sector which serves the household through various channels i.e. retail credit, transactional banking and, micro lending, informal financial solutions and insurance.

3.4 THE CURRENT LANDSCAPE OF THE FINANCIAL SECTOR WITH HOUSEHOLD PARTICIPATION.

3.4.1 Primary Banking (Credit and Borrowing) in South Africa.

On the banking front, we have recently seen an increase in the number of the market participants with an insurance provider 'Discovery Holdings limited' extending its product range and acquiring a banking licence to take advantage of the prosperous digital banking platform, following the CBA 'Tyme Bank' which has also joined the sector and formed a strategic partnership with retail food outlets like Pick 'n Pay and Boxer, allowing its customers use their debit card when shopping to earn Smart Shopper bonus points. These new financial service providers are also geared towards short-term lending to the households. Hence, the big four banks mentioned above, which according to the World Bank (2015) had previously accounted for 84% banking sector assets, have since represented a stagnant growth in their retail market share since the arrival of these competitors.

A more robust rival and aggressive competitor of note, has been, and continues to be, the Capitec Bank (Bloomberg, 2019), which is a small but specialised retail institution in comparison to the big four banks which operate in retail, wholesale and investment banking. Capitec Bank offers a unique and functional banking solution to all its clients,

called Global One which offers each client with a transaction account, four savings accounts, access to credit, mobile phone banking and internet banking for a monthly fee of R5 down from R5.80 which is less compared to other bank's monthly service fees (Capitec, 2019).

The World Bank (2013) notes that Capitec Bank has taken an increasing market share from the bigger banks in SA. According to the Capitec Bank Annual Integrated Report of 2019, approximately 127 000 new clients join Capitec Bank per month and by the end of February 2019, the bank had a customer base of 11.4million (2018: R9.9 million), approximately 31% of the South African banking market. The number of Capitec Bank branches in South Africa, has increased by 120 since 2016 to 840, while the number of ATMs increased by 1306 since 2016 to 5 011 in 2018 (Capitec, 2019). Capitec itself says that: "The Capitec Bank business model aims to promote the economic welfare of the communities in which it operates through client engagement, financial literacy programs, interventions at schools and corporate social investment" (Capitec, 2019:30). According to the World Bank (2016) the entry of new players into the banking sector has had a positive impact on financial inclusion as the increase in competition can lead to product innovation and reduced customer costs.

The South African banks have branches across the country, mainly in urban and peri-urban areas. The level of concentration in the provision of financial services by the commercial banks is identified by the National Treasury as it can be a matter of concern from a market conduct perspective and financial inclusion. The dominance of the said four banks may have a negative effect on innovation, competition, and costs of financial services.

3.4.1.1 Extending Transactional Banking.

Mzansi Account.

One of South Africa's critical initiatives to enhance financial inclusion amongst the impoverished or previously disadvantaged group (LSM 1-5) was the establishment of the Mzansi account in 2004, with functionalities that make it possible to electronically transfer and receive payments at minimal or no cost (GPFI, 2014). The Mzansi account was designed by the Incumbent banks as part of a government initiative for

promoting inclusive financial products and services for the unbanked sector of the economy. This phenomenal success was achieved through a collaboration of the aforementioned four largest commercial banks together with the state-owned Postbank in October 2004. It involved launching a niche banking product intended for lower-income consumers and previously unbanked households; it resulted in increased financial inclusion in South Africa (Kostov et al, 2015). According to the World Bank (2013), the total number of mzansi accounts issued at inception in 2004 was 6 million. In 2013, they represented 6% of the market and 4% in 2014, more than 50% accounts were opened with Postbank, and 72% being previously unserved end customers.

While the Mzansi account is considered a historical success when it comes to providing a transaction account to previously unserved customers, the model has faced challenges as regards sustainability. Hence the big four banks have further prioritised their own basic bank account offerings and some new products and services (e.g. mobile services, remittances in cooperation with retailers). However, evidence has shown that post the Financial Sector Charter of 2009 the local banks continued using the Mzansi account as an entry-level solution amongst other new entry-level products and services which have developed from the Mzansi account concept. From this concept the banks further created new account offerings still aimed at the lower-income market from which the clients could be ultimately migrated to nearest equivalent transaction accounts (NEA) which each bank offered independently. The new products were renamed, rebranded and exclusive to the banks (as opposed to being standardised as the Mzansi accounts were). Such products include FNB's Easy Plan initiative, Absa's Transact account, Standard Bank's Access account and Nedbank's Ke Yona account. Hence the Mzansi account is currently no longer marketed by the banks, while the number of existing account holders has declined. Unlike the Mzansi account offering, these services are largely exclusive and are not offered at the cheaper cost (National Treasury, 2015).

3.4.1.2 South African Social Security Agency (SASSA).

In March 2012, SASSA in conjunction with MasterCard, introduced a biometric grant-payment-disbursement system. This new system was introduced to reduce fraudulent grant applications and collections, as well as to reduce grant administration costs by distributing all grant payments electronically (South African Government, 2013).

Grant recipients encounter no management process and no cost in opening the new bank account, with no monthly transactional fees attached, i.e. on savings and money transfers. Hence, the SASSA MasterCard enables the grant recipients to use the card to: make purchases, check account balances and withdraw cash at till points of any retail outlet that accepts MasterCard cards at no costs (SASSA, 2013).

This innovation of moving to the MasterCard system from cash payment, is deemed to have yielded benefits to most South Africans, approximately one fifth of the South African population now enjoy the benefits of a formal banking product (South African Government, 2013). As noted by the FinMark Trust (2014) survey, 34% of the banked population in South Africa owned a SASSA MasterCard card which allows them to transact at the retail shops. Hence, this platform of introducing previously disadvantaged group into the financial system is critical and relevant to financial inclusion South Africa. The South African Social Security Agency's grant program's purpose is to alleviate poverty, social exclusion and inequality through a comprehensive social protection system, which consists of seven types of grants (Department of Social Development, 2016).

3.4.2 Micro-lending in South Africa

In South Africa the first major growth in the market of unsecured lending took place in mid-1990s (Leriba Consulting, 2013). During this period small short-term loans, which were mostly microloans, were exempted from the Usury Act, the act which was replaced by the passing of the National Credit Act (NCA) in 2005. There are many NCA registered micro-lenders, the South African microfinance sector today can be divided into microenterprise lenders, financial cooperatives, salary-based lenders, micro lenders, alternative banks, primary banks, and retail development finance institutions (BASA, 2013) with more than 20 000 active loans each. Neither

Microfinance has been particularly important and has grown enormously (Bateman 2010, Bateman and Chang 2012).

According to a research report by the South African Human Right Commission (SAHRC, 2017), which focuses on human rights impact of unsecured lending and debt collection, commercial banks command more than 80% of the South African unsecured credit market. While ABSA made an explicit decision to reduce its involvement in this sector, the other five, and most notably African Bank and Capitec, have deliberately targeted the unsecured credit market because of its profitability. The greater number and diversification of the lender profile, as the report notes, has led to increased competition for clients, however, such competition has not led to significant price competition but rather to a race to the bottom in credit vetting criteria. In order to grow their book, many lenders will accept lower-quality clients than their competitors.

3.4.3 Informal sources of financial service.

Despite the growth and gains in the formal banking sector which offers financial services to the population with bank accounts, there are millions of South Africans who are still unbanked or underbanked and variously financially excluded, the majority being those from previously disadvantaged population groups (FinMark Trust, 2017). The underbanked are a distinct group from the unbanked people that have no access to mainstream financial services normally offered by retail banks. The underbanked can be characterised by a strong reliance on non-traditional forms of finance and microfinance, often associated with either poorly regulated or unregulated channels, such as cheque cashers, loan sharks and, in South Africa, stokvels (Seidman, Hababou and Kramer, 2005). There are many NCA registered micro-lenders, as well as '*mashonisas*' (neighbourhood credit provider) who remain largely unregistered and there are also many other credit providers, such as insurers, retailers and specialist lenders (SAHRC, 2017).

These informal and unregulated channels, such as loan sharks (*mashonisas*), grassroots credit unions (*stokvels*), make up a larger share of the credit market than formal channels for those unbanked and underbanked (Boston Consulting Group, 2018). The dealings with informal lenders like the '*mashonisas*' are very complex, some lender charge interest rates in excess of the National Credit Act caps, and upon default they also confiscate ATM cards as they have no formal system of collateral

held against the debt (James 2012). In some cases they confiscate assets like furniture (Television, HiFi, Computer, Fridge etc), some retain the ID documents of the borrower until the borrower make means to repay the debt.

According to the National Stokvel Association of South Africa (NSASA, 2017), approximately 11.4 million South Africans are members of stokvels. Together they would form the second most populated province in the country. The pooled money in stokvels is truly mind-blowing, a sum of R44 billion is collectively saved in 820,000 stokvels in South Africa. That means that together, the members of these savings vehicles could buy a number of South Africa's biggest companies in cash — including Pick n Pay, which has a market value of R33 billion; Truworths, valued at R43 billion; or Netcare, valued at R38 billion. Hence the motivation by the banks to accommodate these pool of funds from various informal schemes.

In a situation where formal banks are reluctant to meet the credit needs of the poor due to the legislation (compliance) and or affordability, these informal channels like stokvels normally represent a better alternative to access credit. In particular, borrowing or raising funds through stokvels could overcome the “intimidating and impersonal experience of applying for bank credit” (Verhoef, 2001:276). These informal financial services in South Africa see people with surplus cash mobilising their savings together through various types of informal groups, and lend to those in need at lower interest (FinMark Trust, 2017). Stockvels have no come to be seen as an opportunity to the banks like Capitec, Nedbank and Absa which have since responded to the market shift by tailoring or customising their product to accommodate these stockvels to save the cash collected with them at an attractive savings rate offered (Capitec leading with a 10% guaranteed on short-term savings) for future cash use (i.e. purchase of assets, travel, re-investment/savings etc).

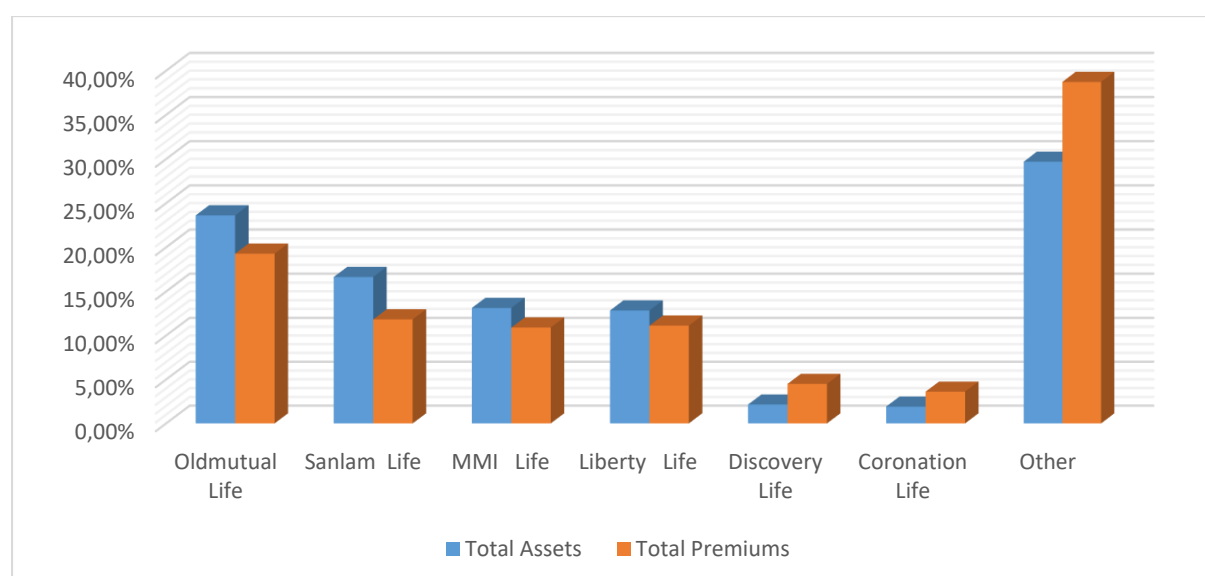
3.4.4 Insurance in South Africa

The history shaping the structure of the banking industry analysed in the section 3.2.1 above can be read as applying to the insurance sector, as there was a close relationship between the banking and insurance industry, which both had close relationships with mining-finance groups and white customers. The long-term insurers – Sanlam, SA Mutual, and Liberty Life – played a large role in market ownership, both

of financial institutions and of industrial enterprises. It was in this context that in 1939 Afrikaner nationalists held the Eerste Ekonomiese Volkskongres (First Economic Congress of the People) to develop a reddingsdaad (a rescue act) to uplift the Afrikaner poor whites, and accelerate Afrikaner nationalism (Innes 2007). In the opening address L. J. du Plessis defined the goal as mobilising “the volk [the people] to conquer the capitalist system and to transform it so that it fits our ethnic nature” and to create volkskapitalisme (capitalism of the people) (New History 2013). Driving forces behind the initiative were the Afrikaner Broederbond and senior executives at the Cape Town-based insurance company Sanlam (Isaacs, 2010).

The current top insurance and financial services groups are depicted in the figure below, which also shows that the products offered to household (life insurance) constitute majority of the long-term insurance and from the noted insurance companies other than those not reflected (under other). The majority of the market is captured by Old Mutual in terms of both assets and premiums. The information below further confirms the important role of the household in the financial sector and they still constitute majority of long-term insurance products. This information is captured to highlight the household impact in the financial sector, as South African adults are covered by full-life policies that provide long-term benefits for survivors, and many South Africans devote a large and unsustainable share of their disposable income to the life, funeral, and burial policies. However, the focus of thesis places more emphasis on basic access to banking services, thus the highlighted insurance sector analysis comes in handy in closing the picture on the state of financial inclusion in the country.

Figure 3.4: Insurance industry Market Share in terms of Assets and Premiums



Source: SARb (2019)

The topic of insurance has only more recently become an integral part of national financial inclusion strategies or financial sector strategies. Well-designed insurance products provide households with the means to protect themselves against the consequences of different kinds of shocks. Thereby they make households more resilient and less vulnerable which indirectly benefits socio-economic growth. However, in many countries the offer of insurance is not yet adapted to the needs of low-income people and small businesses. In line with this, financial services such as inclusive saving, lending or payment services receive significant attention in national strategies while ‘inclusive insurance’ products and related topics do not always seem to be prioritised. To address this situation, many studies on various countries have started integrating the topic of insurance into their NFIS or FSS. A NFIS is an integral multi-stakeholder initiative to support financial policymakers, regulators, and other public and private stakeholders to increase access to quality financial services, including insurance for unserved and underserved populations and regions. This under incorporations is the same in the case of South Africa, hence the current study focuses more on access to finance from an angle of basic banking products, transactional services, credit and savings accounts.

3.5 CONCLUSION

The discussion on this chapter has brought to light the direction and central features of this thesis, starting with demonstrating the current landscape of the financial sector of South Africa, and the financial inclusion, with the exception on insurance service. Hence, it is now clear that when one seeks to assess or investigate the consequences of the growing household integration into the financial system. The investigation has to take into account the fact that there are various channels through which households are served, via formal and or informal financial solutions.

The above information depicted in the sectorial balance sheet shows us that the majority of South Africans still save and take credit through non-bank formal institutions and informal institutions. This shows that behind the high level of financial inclusion in South Africa, the formal sector is far away from meeting the needs of the majority of the population, especially those living on low incomes. Despite the gains with regard to the proportion of the population with bank accounts, there are millions of South Africans who are unbanked or underbanked and variously financially excluded, the majority being those from previously disadvantaged population groups (National Treasury, 2011). The underbanked are a distinct group from the unbanked people that have poor access to mainstream financial services normally offered by retail banks. The next chapter looks into the current trends which provides in-depth analysis on the household involvement in the financial system and the consequences thereof. At the same time the chapter will indicate or point out how financialised the sector is and further assess which of the literatures best explains the trends seen.

CHAPTER 4.

CASE STUDY ANALYSIS – SOUTH AFRICA

4.1 INTRODUCTION.

We now turn to assess the manner in which households have been drawn into financial markets, building on from our discussion of Chapters 2 and 3. We explore this across two dimensions. First, we note the way in which the households have become deeply and directly enmeshed in financial markets, their exposure in the financial system. Secondly, we analyse the state of financial inclusion in South Africa and link the findings back to the previous discussions of Chapters 2 and 3 of the thesis in order to determine how best to characterise the nature of financial inclusion in South Africa (with relation to financialisation and financial development).

To quantify the growing integration of the households into the financial system and assess the impact thereof, this chapter uses an indicator of financial depth that is measured in a similar fashion in all EU and OECD countries. An indicator which is also found to be useful in the study by Beck and Levine (2004), of using total credit to the household sector from deposit banks to measure the state of financial inclusion in the economy. This measure has been relevant since the 1990s, and it is now more accurate as it has expanded to include not only the total credit by banks but also by other financial institutions - formal and informal.

When we discussed financialisation and financial development in Chapter 2, we noted four critical dimensions of household integration into financial markets: 1. Household debt; 2. Inequality; 3. Employment; and 4. Financial stability at large. Thus in the analysis conducted we can relate the features and the outcomes of household exposure to the financial sector to these four dimensions and the literature reviewed. In Section 4.2 we provide an overview on the current state of financial inclusion in South Africa, thereafter in section 4.3 we interrogate, in depth, the extent, nature, and unevenness of household engagement in formal and informal financial markets in South Africa and their alteration over time. We do so by zooming into the various financial product types offered or available to the household, exposure per income group and affordability, their conduct and performance over time. Under each discussion we will reflect back on the claims, evidence and consequences presented

in the literature review of Chapter 2. Thereafter the thesis will be able to enlighten us with the basic understanding of the growing financial integration into the financial system.

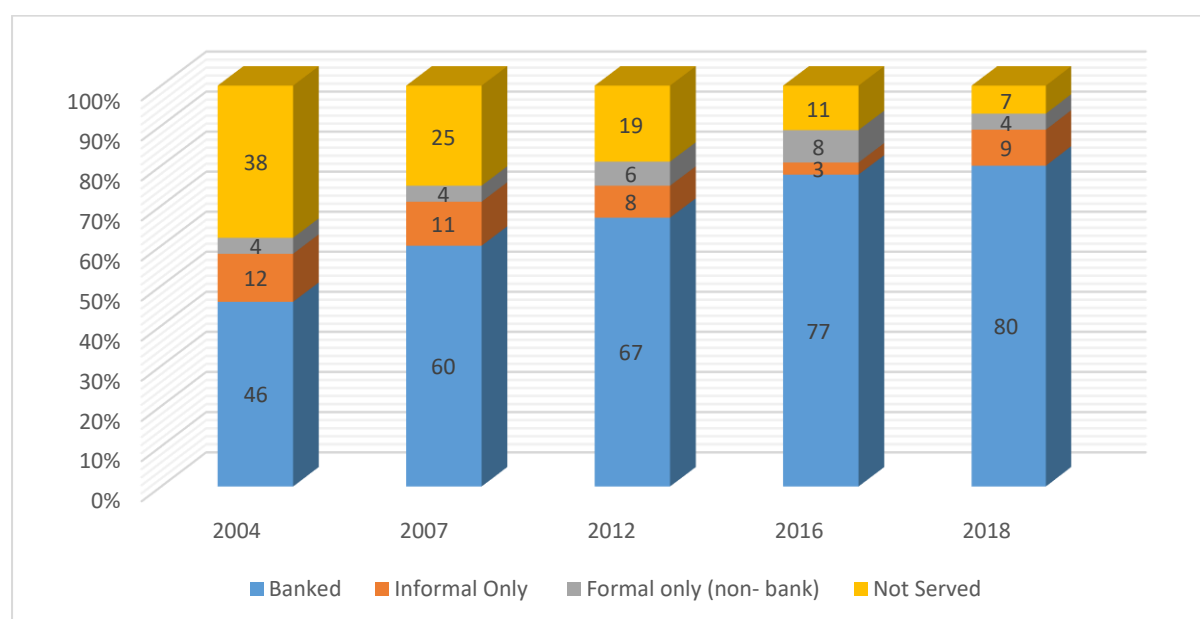
4.2 AN OVERVIEW OF FINANCIAL INCLUSION IN SOUTH AFRICA.

As discussed in the introductory chapter, and further within the literature review of this thesis, financial inclusion means having a minimal level of access to the financial system (basic bank facilities) i.e. the transactional cheque, savings and/or credit accounts (FinMark Trust, 2010). Hence, it is stated in the literature that the households who lacks access to the aforementioned basic bank accounts is considered to be financially excluded and this has recently become a global concern as it poses concerns for a country's economic growth, transformation and the poor's ability to partake in the formal financial sector (Demirguc-Kunt & Klapper, 2012).

The banking sector has been in the forefront of driving financial inclusion in many economies and as competition increases in this sector, this drives product innovation, reduces customer costs which makes transactional banking products attractive to the perilously disadvantage group (World Bank, 2013:23).

In general, access to banking transactional service, has been used as a critical tool to measure financial inclusion in South Africa which is mainly driven by the banking sector, with minimal focus on the insurance side, as today the banks are also cross-selling insurance products in competition with the conventional insurance providers. In South Africa the data has shown that as the number of banked population has increased, the scope of financial exclusion falls in the country. Since 2004, the trend in financial inclusion of adults in South Africa has been showing a steady increase in the banked population, see Figure 4.1 below. In 2019, FinMark Trust, conducted a survey and documented that financial inclusion, as measured by the percentage of consumers using one or more formal financial service, grew from 46% in 2004 to 80% in 2018 as depicted in Figure 4.1 below, which indicate that more adults have got bank accounts, this include the grant recipients using the SASSA cards. To account for adults population In South Africa, FinMark Trust survey covers adults aged 16 years and above.

Figure 4.1: Access strands in South Africa (% of adult population) (2004-2018)¹



Source: FinMark Trust (2019),

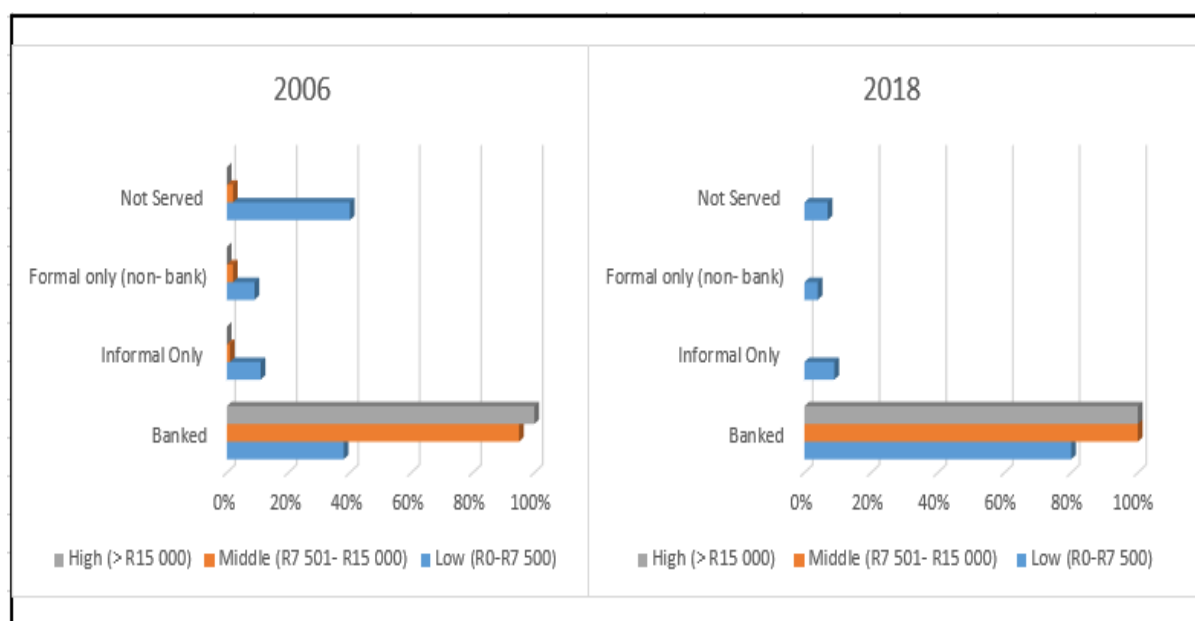
A study conducted by the Boston Consulting Group (BCG) in 2018, further noted that the increased levels of financial inclusion meant that about 31.2 million (84%) of adults were formally served, meaning they have a bank to access credit and other formal non-bank product/services, compared to 46% in 2004.

Figure 4.2, using data from the FinScope consumer survey (FinMark Trust 2019), shows the extent to which different income groups are 'financially included'. We see that the lower income groups, unsurprisingly, make less use of banking services, more use of informal financial products, and are more likely to be 'financially excluded'; whereas in 2006 only 38% of those in the low-income group had bank access, this was 95% and 100% for the middle and high-income groups, respectively. The extent to which those in the low-income group have bank access doubled (from 38% to 80%) between 2006 and 2018. Some of this has to do with the expansion of banking – and advances due to digitisation in particular – but a large degree is due to the payment of

¹ **Banked** – refers to those individuals who have or use products or services from licensed commercial banks that are regulated by the central/reserve bank – the 'banked' population. **Formal** – refers to those individuals who have or use products or services from financial institutions that are regulated through Acts of law but which are not commercial banks – the 'formally served' segment of the population; **Informal** – refers to those individuals who have or use products or services from financial institutions that are not regulated (informal financial institutions and mechanisms) and/or use community based organisations/mechanisms to save or borrow money – the 'informally served' segment; **Not Served** – refers to the 'financially excluded' segment, individuals who manage their financial lives without the use of any financial products or mechanisms external to their personal relationships.

social grants with debit cards and their inclusion in the definition of 'bank access'.

Figure 4.2: Financial access by income group (2006 and 2018)



Source: FinMark Trust (2019),

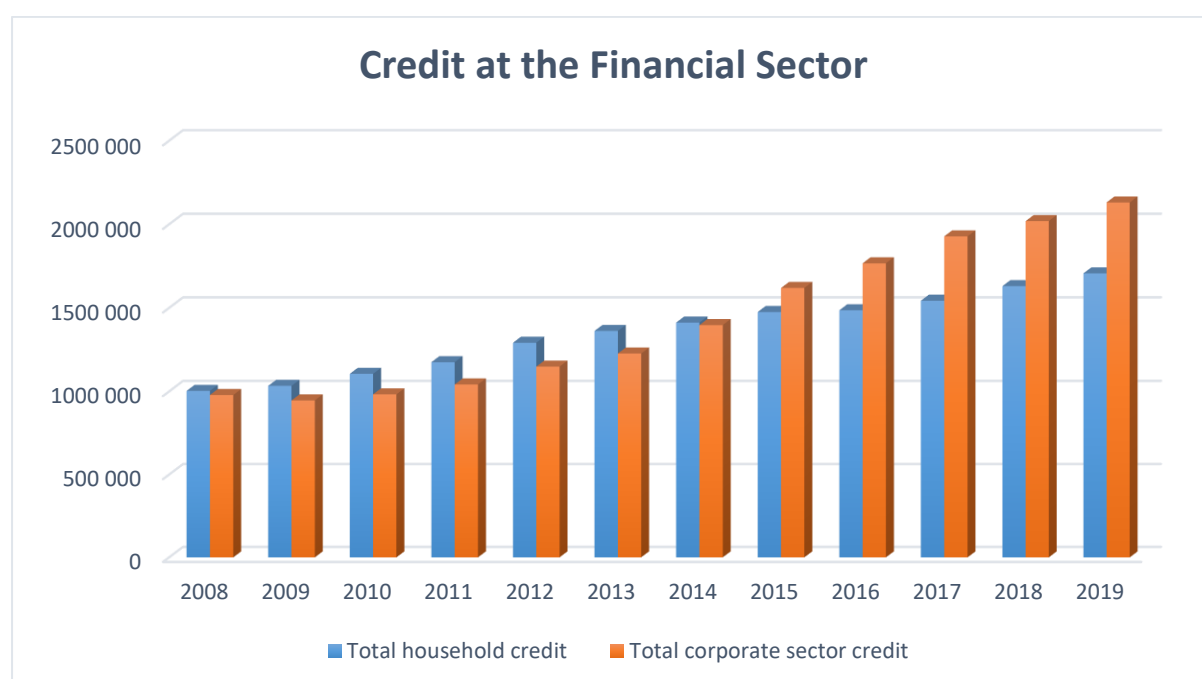
This improved figures show a positive trend which confirms that the South African financial system appears to be fairly inclusive compared to other emerging economies as now 80% of South African adults, have a transaction account. The study by BCG further notes that the share of adults who have borrowed from a financial institution in the past year (2017) or with a credit card is 13% and confirms that unsecured personal credit is growing faster than GDP in South Africa, this findings are analysed in the section below when looking at household access to credit with formal financial sector.

4.3 HOUSEHOLD FINANCIAL INTEGRATION: FINANCIAL ASSETS AND LIABILITIES: AGGREGATE ENGAGEMENT.

4.3.1 THE ANALYSIS HOUSEHOLD LIABILITIES (CREDIT EXPOSURE) HELD WITH FORMAL FINANCIAL INSTITUTIONS.

Figure 4.3 is borrowed from Chapter 3, to lay a foundation in this chapter on understanding the importance of the growing households' integration in the financial sector. The figure shows that the 'extent' of credit acquired by the households of South Africa has been increasing at a steady state, this is shown from the period of 2008 to 2018, henceforth the analysis from Figure 4.4 will be unpacking for us the types (nature) of the credit facilities acquired by the households, performance per income group's exposure and unevenness thereof.

Figure 4.3: Financial Sector's Assets–Household Credit vs Corporate Credit.

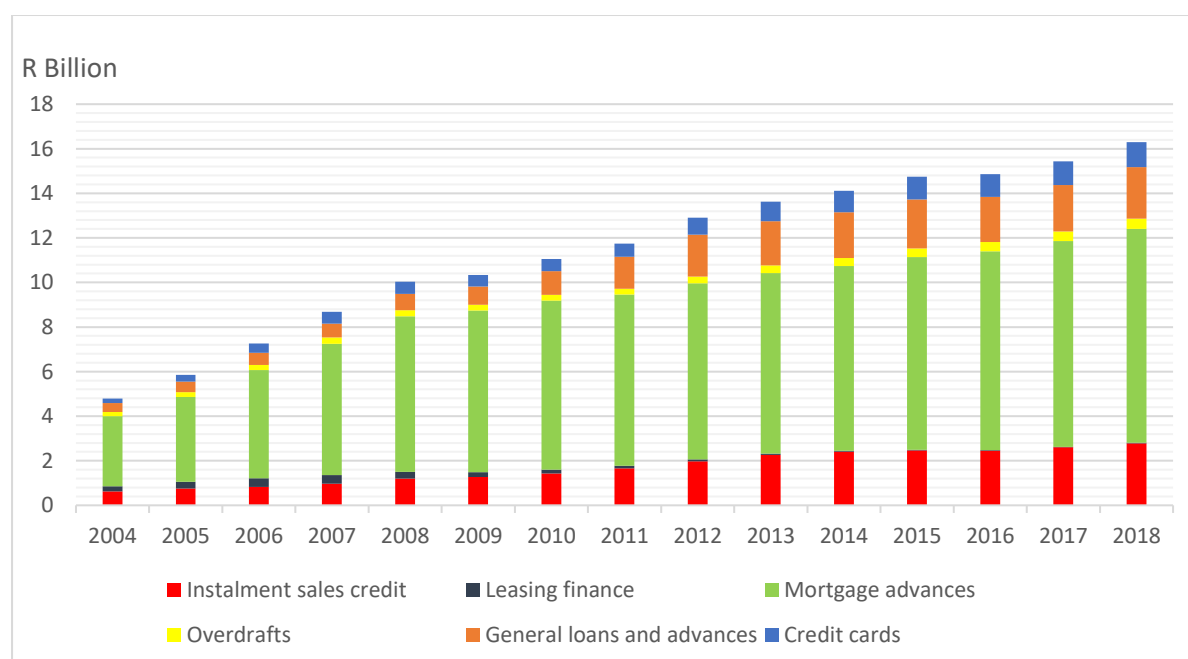


Source: SARb (2019)

Figure 4.4 below show the acquisition of financial liabilities as a share of disposable household income for the household sector. The composition of household liability acquisition shows an upward trend since the housing bubble of 2007/8. The graph below shows a persistent growth in credit advanced to household which has been

accelerating pre and post the financial crises of 2008. The increase in credit extended to households has been mainly due to a rapid rise in the credit cards and general loans debt category. Furthermore, recently growth in total household debt rose to 6.9% in the fourth quarter of 2018, from 5.1% in the third quarter of 2018. While these forms of credit play an important role in boosting financial inclusion in South Africa, the higher interest rates they carry may exacerbate the financial vulnerability of low-income households.

Figure 4.4: Composition of household debt (Constant Prices) (2004-2018)



Source: NCR & SARB (Financial Stability Report) 2018:27

4.3.1.1 The composition of credit products available to the households.

In South Africa the provision of mortgage debt began to slow from 2007/8, with the restrictions imposed by the National Credit Act (NCA), over-indebtedness, and the nature of global integration (see below) helping to explain this. Hence other forms of debt (unsecured) rose from 10% of GDP in 2008 to 25% in 2018. The increasing unsecured debt measures, amid slowing economic growth prospects and deteriorating household financial positions, implies that households have become more vulnerable (discussion in next section where we show product per incomes group).

Figure 4.4 above, breaks down gross outstanding debt by types and confirms the predominance of unsecured loans (general loans and advances) and mortgages, albeit with slightly different percentages. Notable, is that the growth of unsecured lending has been rising, as a percentage of total loans advance the increase is from 16% (2004) to 24% (2018). Mortgages still account for a large share in terms of quantum (advanced amount) indicating their large size, with credit facilities such as (credit cards, store cards, and bank overdrafts) accounting for the majority of outstanding loans and the number of lease finance remaining below 5% over time (from 2% in 2004 to 4.9% in 2018). This shows that the short-term loans doubled in both value and number of the period since 2007.

What is depicted in the above graph, fits well with the literature on financial development. These outcomes confirms the trend of the household debt increases since the Great Financial Crisis, mid 1970s, with the volumes of mortgage credit constituting majority of the credit advances to households in most countries. In credit markets, the real median level of household debt increased by 179% between 1989 and 2007 (Wolff, 2010), i.e in the US, the involvement of households in financial markets has increased significantly over the last two decades. Hence the risk in the financial system has been that whilst the mortgage loans account for the major share of the household debt, unsecured loans have also increased rapidly creating hazardous channels of risk that warrant attentiveness, this is further confirmed in Figure 4.8 and Table 4.3, which assess the impact on credit defaults due to repayment risks. Also, the illustrated outcomes can further be judged based on the argument that, the financial sectors of this country still reveals the existence of information asymmetries or financial imperfections, such as information on transactions costs, which affect mainly the poor who lacks credit histories and collateral. Below is detailed analysis of the distribution of credit advanced to households (exposure) per income group.

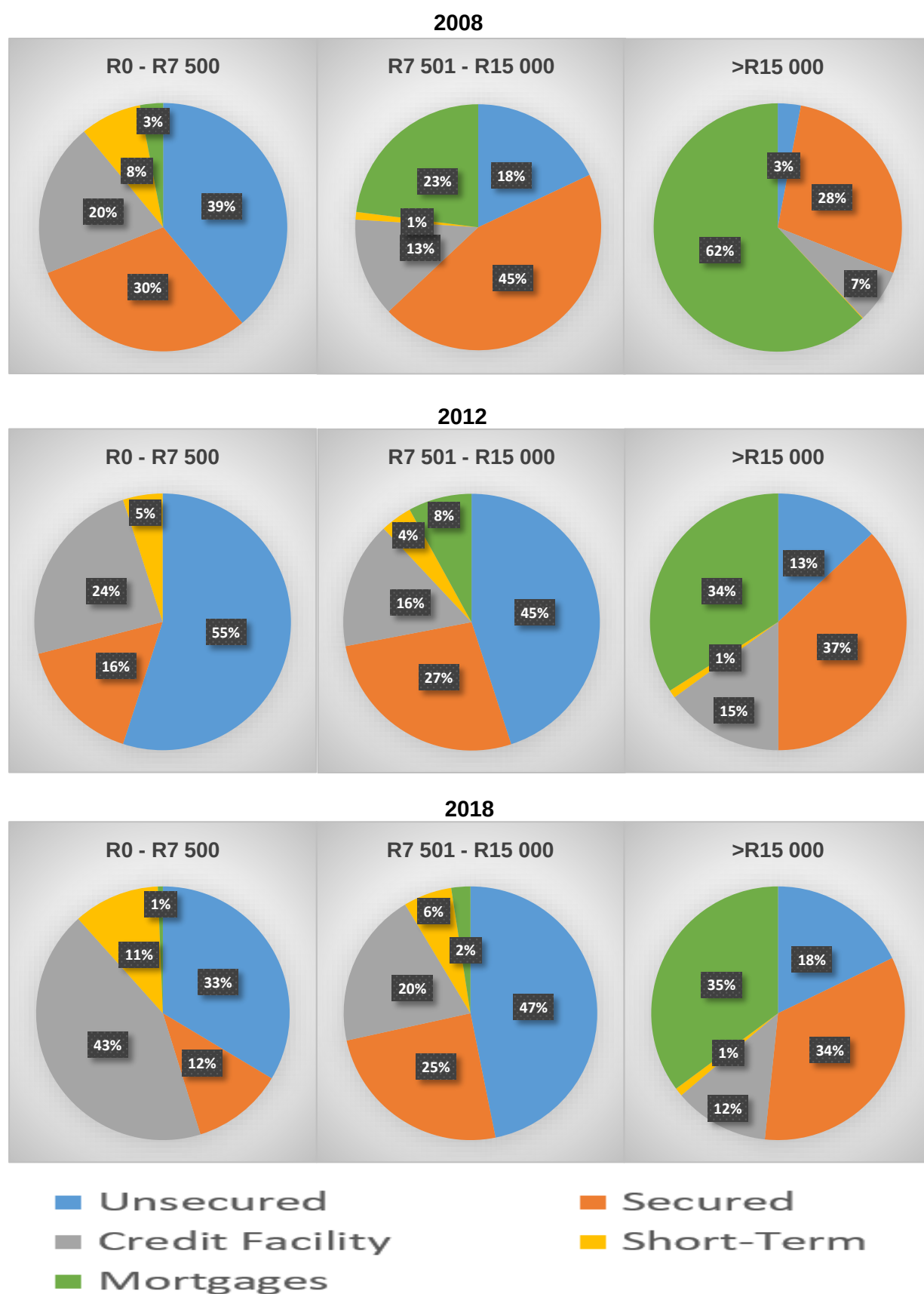
4.3.1.2 Access to finance by income groups.

Figure 4.5 below demonstrate that the structure of the household's debt by different income groups has change overtime, the presentation shows the analysis for the period between (2008-2018) based on the information obtained for NCR data (2018).

It is worth noting that the trends presented below are biased somewhat because the NCR income bands do not change over time in line with inflation.

What we see from the analysis is the increasing share of the short-term credit and credit facilities, i.e. store credit acquired by the lower-income groups, whilst unsecured lending remains the highest in both low and middle incomes groups. Credit facilities (revolving store credit card) granted to low-income individuals has increased by more than 100% since 2008 to 2018 (20% to 43%), for the middle income group the increase was from 2008 (13%) to 2018 (20%). Short-term credit takes the second largest share in all four years, with an increase from 8 to 11%, household's unsecured lending increased from 39% in 2008 to 55% in 2012 and then 33% in 2018. It is worth noting the middle-income group, has doubled the level of unsecured credit in their borrowings from the year 2008 to 2018, which has increased from 18% to 47%, respectively. This drastic growth seem to have been traded off the proposition of secured credit acquired by the middle income group since 2008, which has decreased drastically from (45%), 2012 (27%) and 2018 (25%). The low income group mortgage acquired has since declined from 3% recorded during the housing bubble of 2008 to 1% in 2018. The same holds for the middle-income group whereby the mortgage debt decreased since 2008 (23%), 2012 (8%), to 2018 (2%).

Figure 4.5: Income groups' credit by type (2008, 2012, 2018).



Source: NCR (2018a)

As expected, from the analysis depicted in figure 4.5, we come across the discussion found under the literature review on financialisation and inequality, whereby the asset-backed facilities like mortgages takes a largest share of credit extended to high-income group and while this type of debt makes consumers more vulnerable to interest rate hikes, it carries a lower interest rate and thus places less pressure on household finances, especially during periods of low economic growth. In contrast, low-income earners usually have high-interest bearing debt such as credit facilities and short-term credit.

The cost of credit differs per loan type and therefore income group; this is reflected in the NCR-imposed interest rate caps and fees. Most caps use the repo rate in their calculations, for instance mortgage loans are capped at repo plus 12% and unsecured microloans at repo plus 21%; a 2016 amendment to the NCR regulation has lowered the caps. In addition to caps, a 'service fee' can be levied per loan – R50 prior to the 2016 amendment and R60 thereafter – as can 'initiation fees' when the loan is made; these vary by loan type.

Table 4.1 shows that fees (potentially charged) can make small loans extremely expensive. Presuming the maximum fee and maximum interest rate is levied, a credit facility of R2000 repayable over 6 months can amount to an effective rate of 8% per month or 101% per annum. As the loan size rises the maximum effective rate per annum falls as fees have a smaller impact on the overall repayment sum. However, such loans are still very expensive, for example, an unsecured loan of R3,500 due over 36 months will cost the customer R8 373, equivalent to an effective annual rate of 46% whereas one for R30 000, over 48 months, incurs a total cost of R53 901 or an effective annual rate of 20%. It is clear therefore that the fee structure – if the maximum fees are levied and they may not be due to competitive market pressure – disadvantages lower-income earners taking out smaller loans. This excludes informal lending which are charged at up to 50% per month (James 2014).

Table 4.1: Maximum costs of loans by type, size and maturity (2019)

		</		

Source: NCR (2019a) – Repo rate 6.75%

Own calculation based on schedules in RSA (2019)

As we have showed the expense associated with unsecured loans facilities; here, in Table 4.2 below, this is complemented by the maximum cost of mortgage loans. Assuming a repo rate of 6.7%, the current interest rate cap for mortgages is 18.75 or 19% rounded off – although most middle- and upper-market mortgages hover around 11% (prime plus 1%) 2019 – whereas the cap for developmental housing loans is 33.74 or 34%. Our calculations show that the effective annual interest rate on a mid-size mortgage of R2 million is 14% (if the cap of 19% is levied whereas usually a rate of 11% applies). Recall from Table 4.1 that small loans using unsecured credit and other credit facilities are also often used for housing supplies/material – can attract even higher interest rates (although are also sometimes more cost effective). Lower-income households once again pay more to borrow.

Table 4.2: Maximum costs of Mortgage loans by type, size and maturity (2019)

Secured Credit Facility				
Loan Size	Term - Months	Total Repayment	Monthly Interest Rate	Annual interest Rate
R100 000,00	160	R272 832,00	1,1%	13%
R500 000,00	240	R1 921 519,00	1,2%	14%
R2 000 000,00	240	R7 686 077,00	1,2%	14%

Source: NCR (2019a) – Repo rate 6.75%

Own calculation based on schedules in RSA (2019)

An analysis of South African household integration into financial markets must be viewed against a history of ‘credit apartheid’ or the ‘dual economy of credit’ whereby the black majority’s engagement with the formal financial system was limited and structured by racial oppression. In the main, access to credit was usually confined to the acquisition of furniture and appliances from retailers via hire-purchase (James 2014), one reason for this being the lack of property collateral. Financial asset accumulation was also extremely limited due in large part to low wages and jobs without retirement benefits, with low formal savings.

These outcomes support the claim documented by the literature on the relationship between financial developments on inequality in Chapter 2. That the mortgage facility is the type of an asset finance which is itself a collateral to the loan advanced and again it is an assets that appreciates in value. Furthermore, some mortgage clients (holders) acquire this type of a loan for business purposes to lease or rent it out to other individuals or businesses. Hence it becomes an income-generating loan facility, whilst surplus profits are enjoyed by the owner (high-income earner). This then shows that some of the high-income groups in South Africa acquire credit facilities that will in turn raise their benefitting from the affordability test, credit history on record and their substantial personal position statement, whilst the low-incomes earners are tugged down by the cash draining unsecured credit facilities with insolvent positions.

The forms of debt accumulation depicted in the analysis above also indicate the global financial integration mandated for financial services associated with portfolio and financial inflows into the banking sector, which are extended to households as shown

in Chapter 3 of this thesis – the growing importance of the household in the financial sector. Furthermore the outcomes changes markedly, with some shifts since the financial crisis of 2007/8. We explore this further from Section 4.3.2 onwards which analysis the household assets and capital formation held with formal financial institutions. Section 4.3.3 investigates the differential integration (or exclusion) of different social classes mostly unequal relationships between households and various providers of financial services.

4.3.1.3 Household debt cost and affordability.

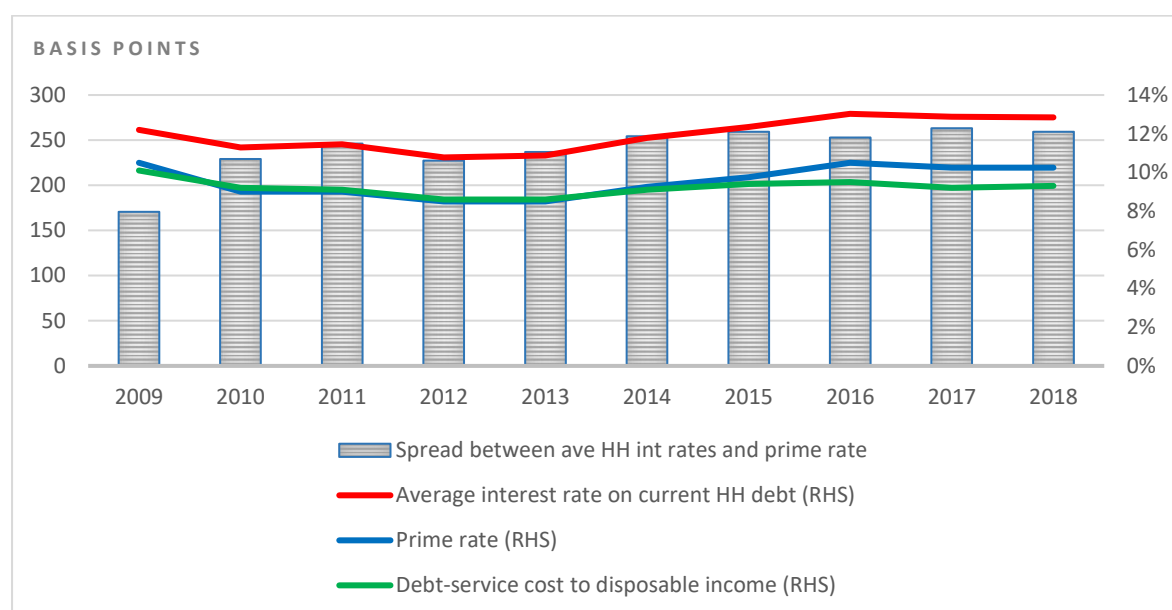
Figure 4.6 below shows that despite the acceleration in debt, household debt affordability measures (debt service as a proportion of household disposable income) only deteriorated in the period before 2007/08; however deterioration has been recorded again from the year 2013, see figure 4.6 below. The first deterioration noted (before 2008) could confirm the relaxed credit regulation which was tightened post the crisis, resulting to the thresholds set to limit or prohibit household over-indebtedness and a pulling back of the banking sector from certain mortgage classes i.e. amendment of the National Credit Act (NCA), hence post the crisis we note an improving position of household exposure into debt. Also due to default discussed further below in Figure 4.8 and Table 4.3.

The domestic regulation changes have been accompanied by the international regulatory change in order to conform to international standards, such as those laid in the IMF's Financial Sector Assessment Programme, Basel II and Basel III, the former being the regulatory accord which sought the revised capital framework which served as an update of the original accord Basil 1 of 1988). The latter (Basel III of 2010) further strengthen the regulation of leverage within the banking industry, with a focus on capital and liquidity reforms driven by the lesson of the Lehman Brothers collapse of 2008 and the ensuing financial crisis. These regulations have been put in place to be implemented and monitored through the monetary policy to manage new market segments often encouraging growth in the financial sector. For instance, microlending to the poor was rigorously pushed under the rhetoric of 'banking the unbanked', with a wide range of actors investing in microfinance institutions (MFIs) (Bateman 2014, 2015, James 2014);

Also the price stability has been the central stated objective of monetary policy through interest rate manipulation. A range of other indicators including the exchange rate, balance of payments, output gap, asset prices, wage settlements, credit growth, and the fiscal stance, complemented this target (Stals 1997). Inflation targeting in South Africa was specified as a commitment to a 3 to 6% target range; this was set by Treasury in consultation with the SARB, with the latter having 'operational independence' in achieving this end.

The information depicted in Figure 4.6 below further confirms the aforementioned statement on the trend and the regulatory adjustment. This is demonstrated by the decreasing cost of debt service from the year 2009, post financial crisis with household affordability regaining strength. This was achieved due to the reduced cost of debt through the stimulative packages implemented by monetary policy to infuse credit by reducing the interest rate (repo) which reduced prime. Hence we see a decrease in the prime rate and cost of debt from 2009 (11%) to 2013 (9%). However since then household affordability has been placed under pressure by the rising debt-service costs as a percentage of disposable income which has picked since the year 2013 (9%) to 2016 (11%). Figure 4.6 below also depicts that Debt financing costs have remained relatively subdued since mid-2016, supported by the introduction of the Affordability Assessment Regulations (under the National Credit Act 34 of 2005) and the relatively stable policy interest rate set by the South African Reserve Bank. However, recently the cost of debt as a percentage of disposable income increase was from 9.1 to 9.3% (2017 to 2018).

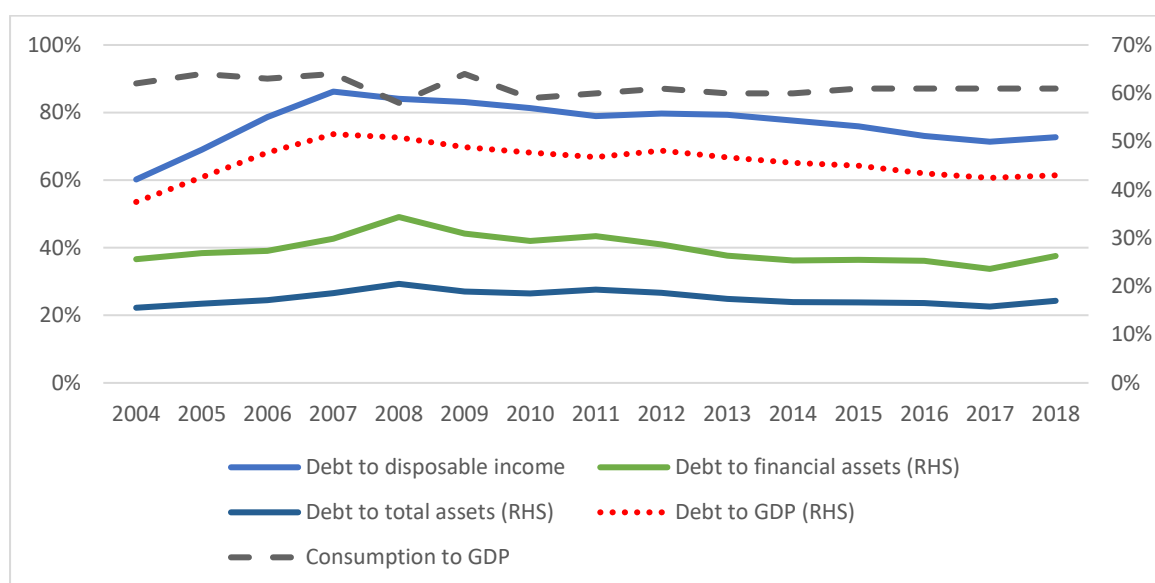
Figure 4.6: Household debt cost and affordability (2009-2018)



Source: SARB (Financial Stability Report) 2018:27

According to Isaacs (2018) as debt-service costs rise, high debt levels may also impact economic growth negatively, he mentioned that this occurs in a situation where the increased debt-service costs as seen in Figure 4.6 above spikes up whilst consumption and GDP growth rates moving swiftly as noted in Figure 4.7 below (2013 to 2018). Apart for the cost of debt impacting on consumption Figure 4.6 also shows that the concerns about the vulnerabilities in the households financial position emanates from the movement in consumption expenditure which seem to be strongly influenced by the debt acquired, hence this could further be linked to the literature of Chapter 2 on micro lending under financial development. That as households take on additional and more expensive debt their consumption expenditure rises which shows a support given by faster growth in household debt which continues on its upwards trajectory.

Figure 4.7: Household debt and Consumption to GDP (2004-2018)



Source: SARB (Financial Stability Report) 2018:27

The outcomes explored here are closely related to the literature review of Chapter 2 under both phenomena, whereby the role of finance has resulted to the increasing debt-to-GDP ratio and impacted financial stability in the end. The literature found the relationship between finance, household debt and financial stability to be impacted since the financial sector has increased the sum of its assets and has expanded its business largely by selling more and more unsecured financial products to households. Such that the effects of finance on households have been as profound as those on businesses, increasing the household debt ratio to their disposable income or to GDP.

Figure 4.7 above further confirms that the household debt in South Africa has also played a critical economic role. This is shown in the Figure, that household debt rises influence consumption. This is highly correlated with GDP growth. However it is worth noting that the analysis in this section indicates that a debt-led level of consumption is unsustainable, under present low levels of income, and high cost of debt which result in household cash flow pressures. In Chapter 2, under the section of financial development and household debt the literature noted that a debt-led consumption and growth benefits the economy less, compared to debt raised for investment. Therefore the South African growth path which seem to be debt-driven has faced multiple serious

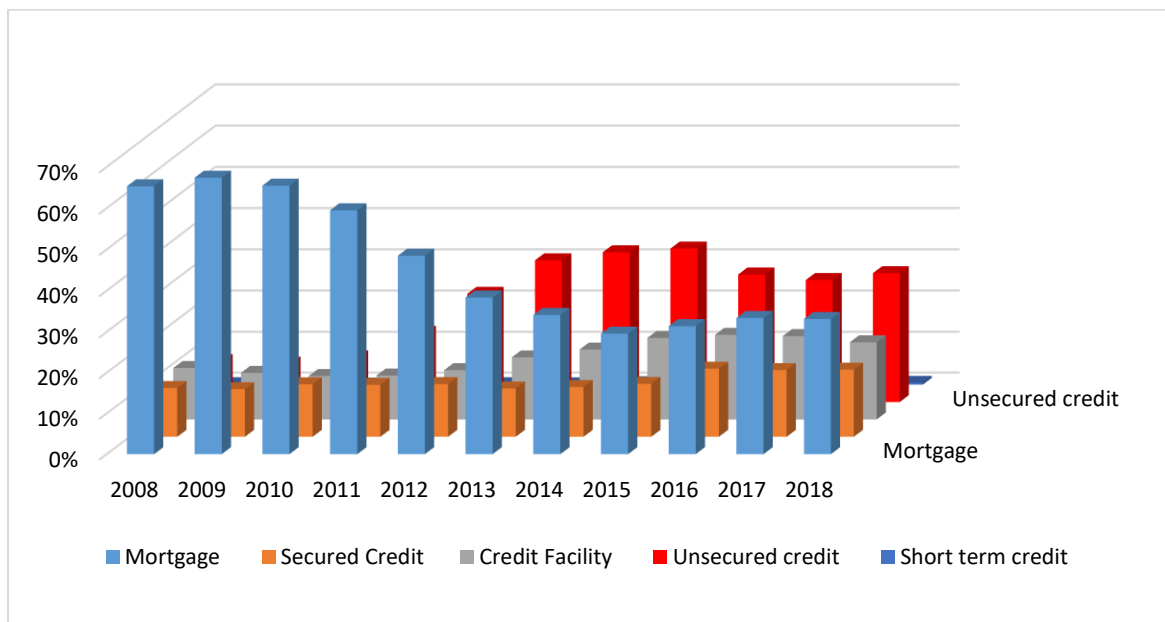
issues which hinders its growth.

High debt levels also impact not only on consumption, but also high numbers of defaults, which in turn affects the profits on the micro-lenders and other formal financial institutions. The impact has come through from the National Credit Act Amendment (NCCAA) which pioneered household debt relief and provision by the lenders. This happened amid poor loan performance in June 2018, whereby a high number of consumers with impaired records eligible for debt intervention and write-offs impacted the profitability, cash flows and sustainability of most retail credit providers, and in particular micro-lenders (SARB, 2018). This in turn affects, firstly employment opportunities created in the financial sector, and further to that those with bad credit record stand less chances to secure jobs, since the credit history has been used as a recruitment tool of understanding the 'personal financial management' by the prospective employee of the finance sector. This is the other reason behind that poor growth of microfinance which has had a number of other economically destructive consequences.

This emergency noted above is a reflection of high levels of over-indebtedness in South Africa, which is a problem with both demand and supply-side reasons. These findings fits well within the theory of financialisation discussed in line with the experience from the US and the UK economy, which were the countries characterised by 'debt-led' growth, with households consumption increasingly financed through stagnant real wages and higher indebtedness and it turned out to be more vulnerable to financial crises as soon as the bubble bursts.

Figure 4.8 below, showing the trends of the Non-Performing Loans (NPL) per product, highlight different income group's specific product exposure; we link those findings to the discussion of this section. It is worth noting that, indeed post the housing bubble of 2008, the Credit Regulator's amendments have tightened the risk parameters on the product which led to the crisis even in South Africa. The mortgages composition of the NPL book has declined since the financial crisis and strikingly the said unsecured lending it is indeed taking the lead in terms of the NPL, and followed by the credit facilities granted by the retails store.

Figure 4.8: Non-Performing Loan (NPL) ratio (2008-2018)



Source: NCR (2018a)

Detailed discussion on defaults is found in the data obtained from the SARB and Experian Default index (CDI) of March 2019 depicted in Table 4.3 below. The Index tracks 14.2 million consumers with 17.9 million active credit facilities (secured and unsecured) with R1.57 trillion in outstanding debt. The information contained in this source reveals that more households in South African are under growing financial strain, which shows an escalation in the rate of first-time credit defaults year-on-year. According to the Experian (2019), in March 2019 defaults on the unsecured personal loans, held mainly by lower-income earners recorded a high level of 8.74% (2018), compared to 8.41% recorded in March 2016. The secured facilities (vehicle finance and homeloans), are tracking lower.

Table 4.3: Summary on credit defaults between (2016-2019)²

Experian CDI	CDI 2019	CDI 2018	CDI 2017	CDI 2016	New Default Balances March 2016	New Default Balances March 2019
Composite Index	4,01	3,24	3,4	3,81	R13 450 691 836	R14 822 681 615
Home Loan Index	1,60	1,69	1,90	1,90	R3 666 443 491	R3 289 703 816
Vehicle Loan Index	3,26	3,99	2,83	2,85	R2 883 752 763	R3 730 492 803
Credit Card Index	7,09	6,65	5,96	7,72	R1 776 066 190	R1 902 413 452
Personal Loan Index	9,04	8,41	8,00	9,56	R5 124 429 392	R5 900 071 544
Standard of Living	2019	2018	2017	2016	Percentage Growth 2016-2019	
Wealth to do	2,68	2,46	2,55	2,43	10%	
Up and Coming	2,80	2,64	3,09	3,90	-28%	
Settlement Traditionalist	4,42	4,23	4,14	4,72	-6%	
Loyal Labours	4,80	4,68	4,18	4,26	13%	
Blue Collar Communities	6,88	6,96	5,95	5,74	20%	
Young Urban Survivors	7,52	7,59	6,74	6,09	24%	
Rural Traditionalist	6,80	6,19	6,27	6,02	13%	
Outskirts Families	6,18	5,94	5,99	5,44	14%	

Source: Experian (Credit Default) 2019 - Own workings

The discussion in this section also best fit with the review done on the impact of financial development on household debt, which touches on the idea of microfinance, which has since seen to be facilitating unsecured credit to the household. Therefore, the negative performance depicted in Figures 4.3 above, confirms what the literature uncovered that the idea of microfinance is deemed to be far more fragile and impact the financial sector negatively in terms of defaults and impairments (Bateman, 2012). Hence he postulated that, in actual fact the assumed objective for microfinance appears to more precarious and de-stabilises the economy through defaults and impaired books of unsecured lending to household which is found also in the case of South Africa.

These trends highlight the financial distress encountered by the South African households struggling to adhere to their debt obligations, whilst some are taking on

² **Wealthy to do:** refers to the most affluent group, who are well educated and enjoy most of the opportunities the country presents. Highly educated wealthy individuals residing on exclusive estates in luxury homes in prime city suburbs. **Up and Coming:** A largely youthful and ambitious group of aspirational people, looking to make their mark and embrace the country's marketplace. **Settlement Traditionalist:** Hard-working, well established families living in good homes in settlements in and around urban areas. **Loyal Labours:** Groups or individuals living in industrial, mining or farming communities, hard-working usually in blue-collar jobs. **Blue-collar Communities:** Large, extended families with modest incomes, living in townships both urban and on the outskirts of rural and bush areas. **Young Urban Survivors:** Young individuals living in densely populated urban environments, working to get by and adapting to circumstances in order to thrive. **Rural Traditionalists:** Traditional households headed by an older person or grandparent and the mid-generation having left to work in the city or died. **Outskirts Families:** Impoverished Grant Reliants Families and individuals reliant on rent-free housing with meagre or modest incomes and simple but hard lives Families with children relying on government grants and living rent-free in informal dwellings.

more debt to fund their everyday expenses. The contributing factors to this trends could also be attributed to the impact of the VAT increase and fuel price hikes which reduced the disposable incomes and household cash flows of those acquiring debt for personal expenses. According to the Experian report of 2019, when zooming in to the demographic parameters driving the above discussed outcomes, the worst first-time credit defaults for personal loans were the 'Penniless Grant Transients-Outskirts Families'. The affluent groups default rates have increased by lower percentage compared to the middle to lower income class. This indicates that adults and, or young single co-habiting couples reliant on social grants in one or two-roomed informal dwellings, contributed significantly to an increasing Index from 8.41% in June 2018 to 9.04% in March 2019.

The report further confirms that although debt service of the mortgage loan has improved which is mostly attributed to the affluent income group as shown in table 4.4 below. There has been a trend on defaults which was attributed to the blue-collar communities or the Indigent Township Families, households with low incomes, who were retrenched and formerly unemployed, young families in small properties (shared-housing) or densely populated bush areas. In June 2018, the Index was the worst performing, with an overall percentage of 8.41%. Also on other credit facilities like vehicle finance the low-income group was the worst performing group, with a 6.65% in June 2018 (2017: 5.96%). The literature on financial development posit that the above discussed precarious outcomes leads to social tensions, and widens level of inequalities.

The profile of formal credit defaults is further noted on table 4.4 below which confirms the credit default per income groups which at the same time reflect the facility that each segment is exposed to. The highest is mortgage loans which are predominately held by higher-income groups- wealth to do. By contrast, the personal loans majority is held by low- and middle-income earners, from up and coming to young urban survivors and rural traditionalist.

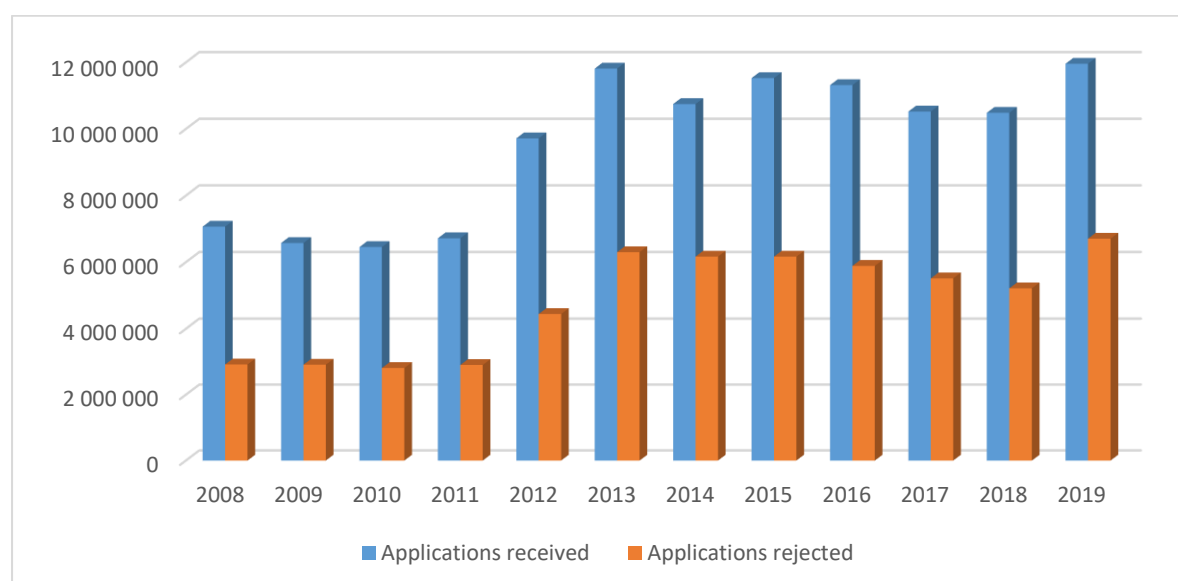
Table 4.4 Income group defaults rates per product (2019)

	Home Loan	Vehicle Loan	Credit Card	Personal Loan
Wealth to do	50%	37%	44%	20%
Up and Coming	26%	20%	20%	10%
Settlement Traditionalist	8%	11%	10%	15%
Loyal Labours	9%	13%	11%	13%
Blue Collar Communities	3%	9%	6%	19%
Young Urban Survivors	3%	5%	5%	10%
Rural Traditionalist	1%	2%	2%	6%
Outskirts Families	0%	1%	1%	2%

Source: Experian (Credit Default) 2019 - Own workings

Figure 4.9 below shows that most ‘financial institutions’ willingness to extend loans to households deteriorated – as indicated by the credit application rejection rate that rose to 53.65% in the last quarter of 2018 from 41.06% of 2016.

Figure 4.9: Credit Approvals and Declines (2008-2018)



Source: NCR (2018a)

This consequences follows from the poor performance of the household loans advanced with high default rate and impairments raised on NPL as depicted in Figure 4.8 and Table 4.3 above, which reinforces inequality in those looking for finance to better the standard of living, student loans, starting small business and, or construct shelter for the family. These outcomes provides an evidence to what is seen under the literature of Chapter 2, as Cecchetti, Mohanty and Zampolli (2011) discloses that the

current high debt levels weakens the ability of the financial corporates (instability) to survive demand fluctuations and further to that it increases their vulnerability to funding shocks and the evidence was provided in the case of US found in the study by Baccaro and Howell (2017), that an increase in the household debt-to-income ratio in the US was largely facilitated by the deregulated credit markets, witnessing a high degree of 'financialisation' which has indicated that debt-led growth also has direct impact on the rising inequality. In relation to Figure 4.6 above, the further stated such outcomes of high private credit to GDP ratio lowers employment growth significantly in the microfinance enterprises and SMEs.

This section has provided us with the detailed analysis on household finances, starting from access to finance we noted that the although the systems claims to be open (inclusive) the dynamics still portrays history of the country and not addressing inequality, this points to an unequal access, which should benefit the previously disadvantage group instead of being a debt trap and resulting in a debt-drive growth path, whilst the cost of debt rises creating problems with affordability.

4.3.2 HOUSEHOLD ASSETS AND CAPITAL FORMATION HELD WITH FORMAL FINANCIAL INSTITUTIONS.

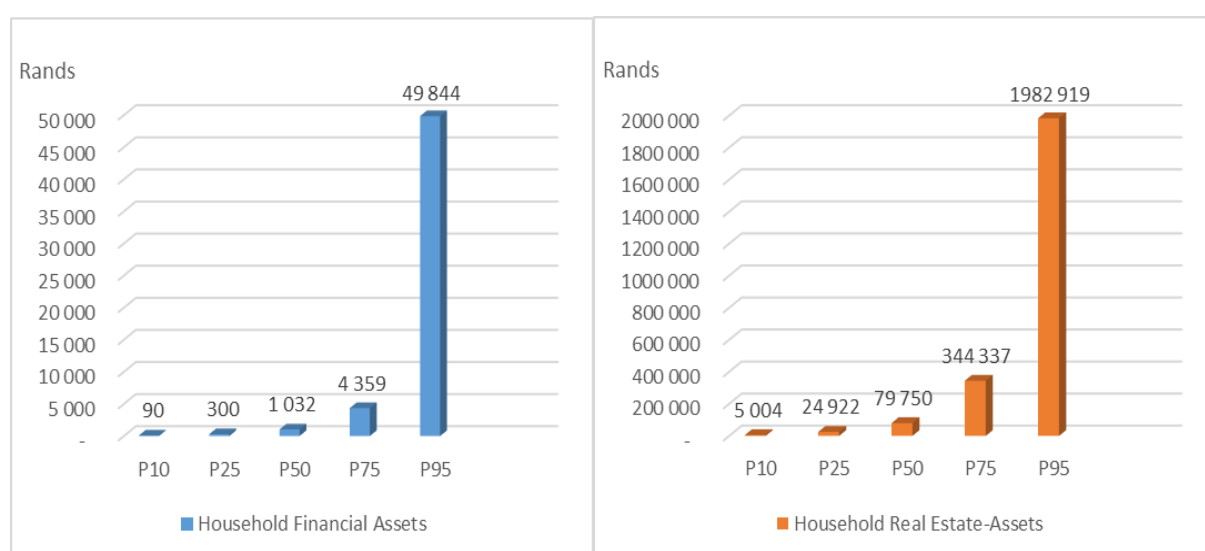
Turning to the analysis of the household financial assets held by different income groups we also note very diverse engagement with extreme levels of wealth inequality. The information (data) used in the analysis of this section is obtained from the National Income Dynamics Survey (NIDS) (Daniels and Khan 2019).

Figure 4.10 below shows that the financial assets of the household categorised in the 95th percentile are R50 000, compared with a R90 and R300 at the 10th and 25th percentiles respectively. More surprisingly is that even those at the median and 75th percentile, R1 032 and R4 300, respectively, hold very low levels of financial wealth. Also wealth in the form of real estate is unequally distributed, but marginally less so at the median and 75th percentile. The aforementioned outcomes has resulted in wealth inequality in South African being much higher, with a Gini Coefficient of 0.83, than income inequality, with a Gini Coefficient of 0.6. Furthermore inequality in financial

assets held by the household of South Africa is extremely high, at 0.97, indicating an almost entirely unequal distribution of financial assets as seen in Table 4.5 below.

The work done by Daniels and Khan (2019) previously documented the findings which outlined persistent inequality as discussed above, and showed a more disaggregated picture of the unequal distribution of financial wealth, with the top 1% holding 96-97% of financial assets and the top 10% holding 99-100% of all financial assets. However, Orthofer (2016), argued that the methodology applied when capturing wealth data, specifically pension funds and long-term insurance assets, was poor as it doesn't capture the tax implications on wealth. Her argument was noted and acknowledged under-sampling of the rich in NIDS.

Figure 4.10: Financial and real estate assets by income percentile (2017/2018)



Source: Daniels and Khan (2019)

Table 4.5 Gini coefficients (NIDS data, 2017/2018)

Income	0,61
Property Assets	0,83
Retirement Assets	0,79
Financial Assets	0,97
Net Worth	0,83

Source: Daniels and Khan (2019)

Table 4.5 above presents the Gini coefficients of various financial measures in the data related to wealth from NIDS wave four and wave five. Focusing on the wave five estimates, we see that household income inequality (0.61) is much lower than wealth inequality (0.83) in South Africa. Further inequality for financial assets is exceptionally high, at 0.97, implying an almost completely unequal dispersion of financial assets in the country. Table 4.6 provides further insight into the univariate distributions of assets and liabilities by showing the minimum, maximum, and mean values of each variable. The table alludes to the inequality in the distribution of both assets and debts. This can be seen by looking at the differences between the medians and means of each variable. For instance, the median of total debt in the weighted sample is R7005 while the mean is R115 049. This is a mean to median ratio of 16.42, illustrating that the observations at the top end of the debt distribution skew the mean radically. For total assets, the ratio of the mean to median (6.99) is less stark, but still illustrates the extent of the inequality.

Table 4.6: Distribution of components of assets and liabilities – weighted

Assets	Min	P10	P25	P50	Mean	P75	P95	Max
Total Assets	401	9 064	25 642	100 456	702 621	396 811	3 515 425	344 000 000
Financial	1	90	300	1 032	52 633	4 359	49 844	344 000 000
Real Estate	1	5 004	24 922	79 750	570 927	344 337	1 982 919	98 300 000
Vehicle	20	24 577	40 284	79 750	133 889	16 912	398 129	8 385 535
Business	70	1 301	5 004	25 177	220 426	99 223	983 821	10 000 000
Retirement	55	12 653	43 000	150 061	681 529	496 115	3 021 294	32 500 000
Livestock	9	420	1 593	13 745	40 944	57 520	154 460	689 064
Possessions	9	4 665	9 959	25 020	38 729	60 047	400 314	24 600 000
Liabilities	Min	P10	P25	P50	Mean	P75	P95	Max
Total Liabilities	2	496	1 856	7 005	115 049	45 268	569 816	17 000 000
Financial	2	400	1 496	5 000	23 239	17 314	99 146	2 541 220
Real Estate	149	59 029	105 904	225 550	548 765	547 428	1 554 438	16 700 000
Vehicle	100	9 869	41 674	90 000	140 667	193 093	467 802	983 064
Business	300	1 991	2 518	6 043	34 392	20 000	99 223	545 727

Source: Daniels and Khan (2019).

In comparing the outcomes above against the mean values to confirm the magnitude of distribution per income group, the table above shows that income is the key indicator

of wealth. Those with a high income in South Africa have a higher opportunity of accessing wealth through acquisition of assets and they have easy access to finance. This confirms the findings of the literature and the credit analysis covered above, that of all the assets types, real estate (mortgages) remains the key assets acquired by the high-income groups. On the financial assets side the information further confirms the findings of the literature on inequality, the information shows that in South African financial assets constitutes a smaller share of overall household assets, instead financial debt accounts for two times of the assets held by lower – middle income groups as depicted above. Bhorat and Khan (2018) noted that the small share of financial assets serves as a liquidity constraints faced by the household. This is particularly the case in the middle of the income distribution in South African.

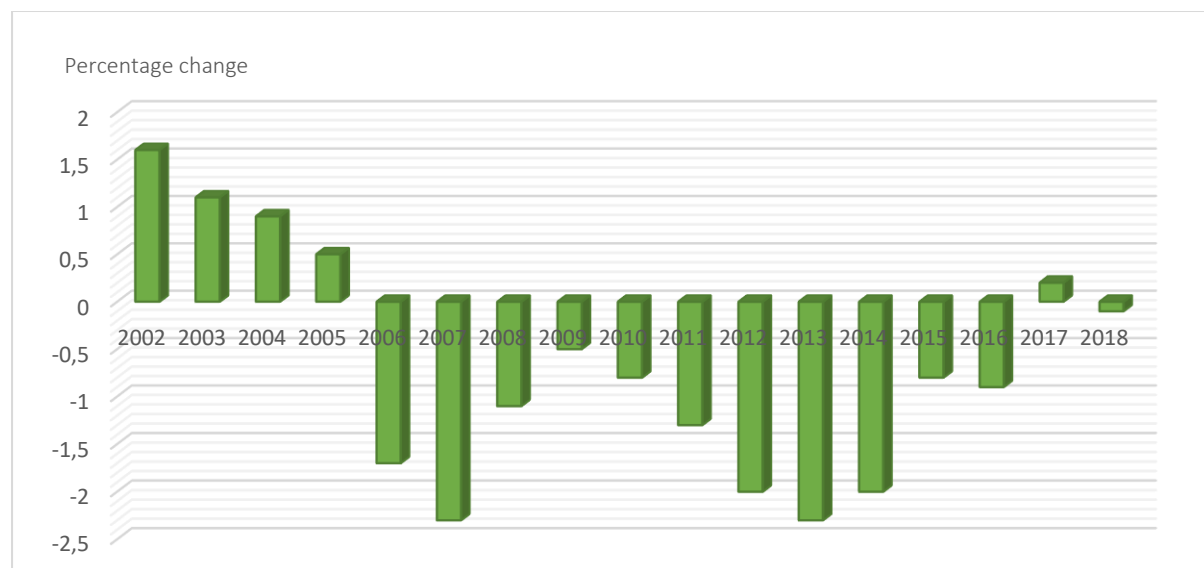
The high number of financial assets held by those of high net worth (P95) households with a higher propensity to save demonstrates similar results to those discussed under the literature of financialisation, whereby the wealthier, high-income group, turn to hold more financial wealth in risky assets (such as shares, mutual funds, and bonds) held with fund or asset managers. Although, internationally, the aforementioned financial assets represent an important source of wealth for households, especially because they tend to be held by wealthier households (Davies and Shorrocks, 2000). In the South African context, Bassier and Woolard (2018) show that for the top 1% of the population incomes from shares, profit and capital gains represent almost 50% of their total income and that one of the key drivers of South Africa's income inequality is the higher growth rate of capital income compared to labour income. These authors provide evidence to the discussion of the literature under financialisation that income from capital grew annually by 10 to 20% for the top 5% of the population, while the economy grew by only 4%.

Now, turning to another component of the household financial assets which is savings held with formal financial institution mainly 'banks' – we see, in Figure 4.10 below, a downward trend in household savings as a percentage of disposable income since 2002. The information in Figure 4.11 below shows that household savings held with commercial banks has been performing badly since before the financial crisis of 2007/08. This could be reflecting that money was put into financial products by higher-income households rather than bank assets. However, as stated in Chapter 3, the

focus of this study is on financial inclusion which is more interested on the majority of the South African population which is the previously disadvantaged group with less access to the well-established investment platform.

These outcomes are then similar or worse when now turning to the analysis of the savings culture in South Africa. What is observed below is a low performance of savings as a percentage of disposable income is the results of the above discussed high credit exposure, low levels of disposable income, high levels of unemployment, inflationary pressures and other disincentives to save. Hence the outcomes depicted on the Figure, together with high levels of household debt, as shown in Figure 4.3 and 4.4, dampens the ability of households to contribute to overall savings and consumption. The low overall savings rate has been noted as a critical factor impacting financial stability and sound and prudent financial systems. In order to encourage increased savings, the National Treasury has been exploring various savings vehicles and in since 2012 they have committed to the various proposals for potential tax incentive, hence the banks have piloted a lot of tax-free savings accounts lately.

Figure 4.11: Household Gross savings % of Disposable Income (2002-2018)



Source: SARB: 2019

According to SARB, (2018), the growth in the household deposits or keeping money in the financial system through savings account continues to decline, in 2015 an

average was 13.8% to and it is 8.9% for 2018 followed by a further deceleration of 7.8% recorded 2018 alongside the relatively constrained household income growth. Also the maturity preferences on notice deposits diverged significantly since 2015, hence the banks continue to offer enticing savings and investment products to attract stable deposits and savings. The more liquid cash, cheque and other demand deposits remained relatively stable during between 2017 and 2018, with growth moderating slightly from 6.3% in September to 4.3% in January 2019. This shows that money kept (held) in the accounts without any obligations or for short term is easily accessible and withdrawn by the household, hence the motive for short-term deposits is showing a decline. In a way, it would be much safer to conclude that the above outcomes confirms that over and above the exposure of different incomes groups into debt markets, the low income household have not actively participated in accumulating savings and other forms of assets or utilise the loans proceeds effectively. Therefore the lower percentage of savings to disposable income reflects that less money is channelled for productive investment purposes.

4.3.3 THE ANALYSIS OF TRANSACTIONAL SERVICES WITH FORMAL FINANCIAL INSTITUTIONS.

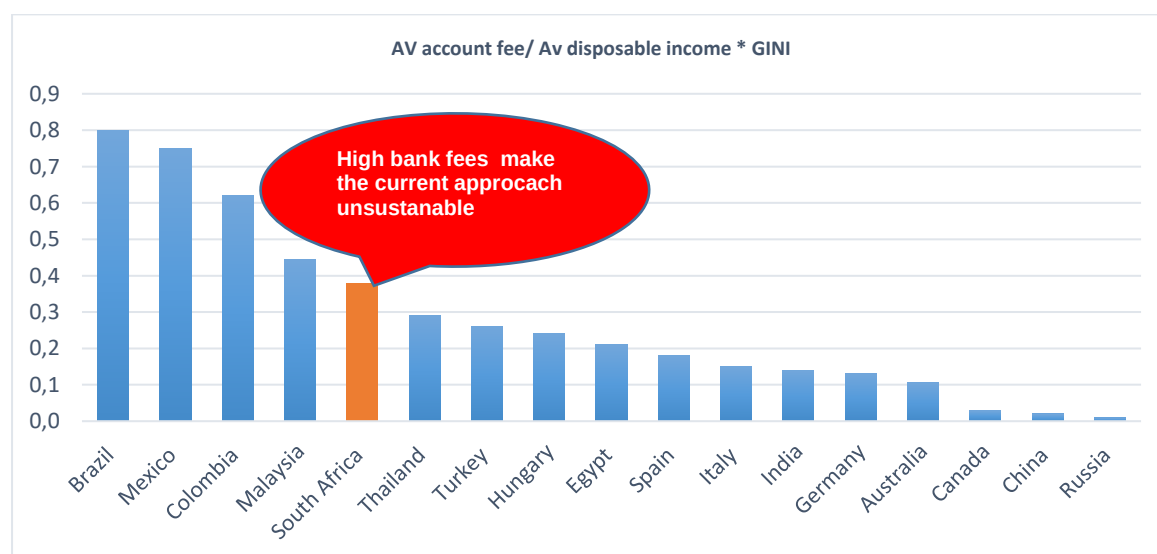
This access to finance has come together with features depicting further inequality present in the financial sector, in the form of pricing or cost of attaining better service from the sector. Hence some low-income or unemployed groups remain discouraged by the formal financial services, although the number of clients not served has decreased which captures mostly the SASSA account users in it as they have since been enrolled to transactional service through the SASSA cards.

The study conducted by the Banking Association of South African (BASA, 2018) shows that the lower-income earners constitute a significant share of most retail banks' customer account portfolios in terms of client numbers, however the product-development efforts of these banks (retail players noted in Chapter 3) seem to place more focus on offerings targeted for the middle - to higher-income earners. These findings appears to be reflect more extensive efforts of availability of information, financial literacy, and pricing which seem to appeal only to the needs and expectations

of middle-to higher-income earners. According to BASA, (2018), the internal pricing strategy of some of the ‘big four’ banks is clear and up-front about the benefit derived from focusing its efforts primarily on middle- to higher-income group rather than the low-income group. The efforts are noted from the ground roots of marketing as most customer-facing product communication are still not appealing to the illiterate population of South Africa as they are available only in English and Afrikaans language, despite the fact that 77% of the adults speak another language as their main (home language) (BASA, 2018). This has significant implications for clients understanding of the financial product features and pricing (interest and fees).

It remains confusing that most banks still price for electronic information services that may be expected to be provided at little or no cost. For example, the mobile Short Message Service (SMS) notifications and statement fees. Some prices could further discourage a low-income customer from using a transactional account, given the risk of incurring additional charges when they have a low balance in their bank account. They may be reluctant to use online or telephone banking as they further need to spend on cost like data and airtime to access such electronic services, hence the services still doesn’t address the unequal access to finance. In comparison with other countries figure 4.12 below shows that South Africa’s bank fees are higher than those in developed countries like Italy and Germany, hence unaffordable to the low income segment.

Figure 4.12: South Africa’s Bank Fees with other Countries (2019)



Source- BCG – accessed 2020

The fee structure of South African banks is up to four times higher than countries such as Germany, Australia and even India. However, this is partly due to the high operating costs of banks and the proliferation of cybercrime. In 2015, cybercrime cost South African businesses approximately R5.8 billion (\$450 million), and while all businesses have taken proactive measures to combat this threat, banks spend three times as much on IT security as non-financial organisations of the same size.

Notwithstanding that more than 70% of adults have transaction accounts, only 24% make more than three monthly transactions such as withdrawals, deposits or card swipes. Many people are willing to run the risk of loss and theft associated with cash to avoid the fees, resulting in more than 60% of all purchases being paid for in cash (BCG 2019).

These findings support the claim documented in the financial development literature that there exist information asymmetries or financial imperfections, such as information on transactions costs, which affect mainly the poor who lack credit histories and collateral. Furthermore, the literature reveals that at early stages of development, only the high-income groups are eligible to access financial services due to their affordability of the fixed cost incurred in order to join the financial coalition, causing a broader income inequality.

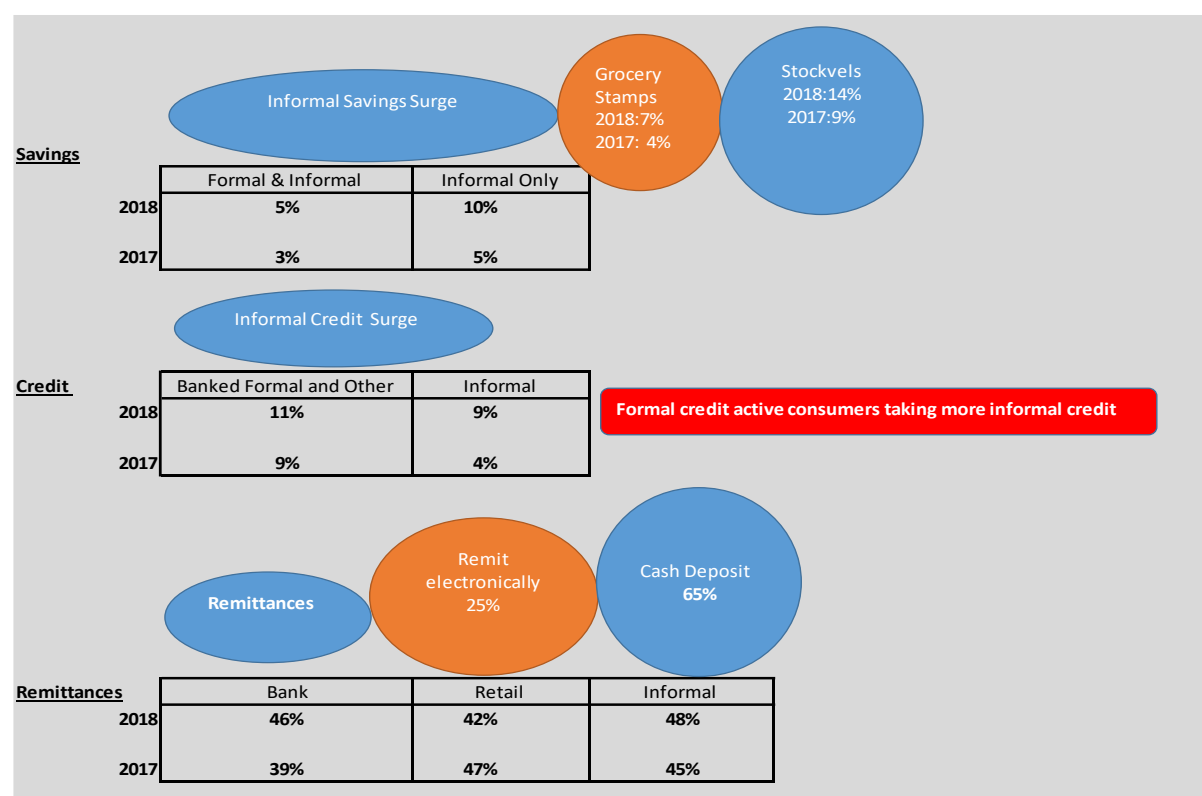
4.3.4 HOUSEHOLD LIABILITIES AND SAVINGS HELD WITH INFORMAL FINANCIAL INSTITUTIONS.

The current South African economic situation presents a large number of households relying on the informal economy, with severe unemployment, among the youth and adult, increasing inequality and high levels of indebtedness. Hence, most poor and vulnerable people struggle to cope with economics shocks, access safe, affordable and convenient financial services. Although the percentage of adults with a bank account has shown an increase since 2004, the percentage of youth and adults using some form of informal financial service has also increased, in 2016 the figure was at 56% in 2018 it was at 80% (FinMark Trust, 2017). Among other African countries South Africa has also shown a growing trend in the culture of household participation in the

informal financial services (saving group and stokvels) which establishes mutual benefits (relationship) with households supporting the group and in turn are also supported by the group. This relationship is barely possible with formal financial institutions where it is impossible or more difficult to access loans, whilst people's savings are charged with monthly fees and earn very little interest income. Thus, most vulnerable people feel less need to keep their money in a bank account where it does nothing. They want their money to grow while they can both save and borrow.

The research report conducted by the FinMark Trust in 2018, identifies five main areas in which Savings Group and Stokvel members use their loans and share-out money, namely for house construction and renovation, groceries, school fees and uniform, to start and run small income-generating activities and to cope with emergencies. The outcomes also depicted in Figure 4.13 below, which shows the formal financial institution losing a bit of their client base as both credit and savings held with informal services doubled between 2017 and 2018. This was recorded in formal financial institution, and it further shows that the South African household now have a new drive to save regularly, and have discovered the importance of buying using cash instead of utilising the revolving store credits. This is also shown in terms of remittances whereby the household prefers to use cash 'transactions' (65% cash deposit) and 25% electronic transaction, this could also be due to high level of illiteracy in South Africa. However, their participation in the savings group and stokvels have also taught them to spend money wisely and rely less on the illegitimate loan sharks. Some members raise money from their formal financial institutions and contribute to each other's need and development. According to the (FinMark Trust, 2018), majority members use three to four types of services, including bank accounts, savings groups, food and school fees stokvels and some form of insurance against death.

Figure 4.13: How South Africans are leveraging informal and formal financial markets (2017-2018).



Source: FinMark Trust 2018 – own workings

By adding informal services to their financial portfolio, the households enables the prospects of reaching greater financial stability and ability to meet a variety of needs, i.e. they are not always eligible to raise money (loan) to deal with an emergency like a funeral. Over and above looking at access to finance, there are more benefits derived by the poor and vulnerable household from this platform which comes with no price. The members gain more skill and education (financial literacy), management and commitments through the group's sharing of advice. Research conducted by the African Response in 2017 showed that about 8.6 million (23.4%) of the South African adult population participate in at least one savings group or stokvel. The Save Act, which is the biggest organisation promoting Saving Groups in several provinces around South Africa, has since reached over seventy thousand members in both urban and rural areas.

In overall the discussion above points out or links to the argument made in the literature review which discovered that financial development is not primarily benefiting only the wealthier parts of society intentionally. The idea is that most poor households

have opted to rely more on informal and local social networks such as Stokvels for raising funds, hence this is found also in the discussion above. Evidence to this is found in the literature, denoting the study by Greenwood and Jovanovic (1990), whereby they developed a model which predicted a nonlinear relationship between financial development and income inequality that depends on the standard of living or the state of economic advancement.

4.4 CONCLUSION.

This chapter has therefore provided a basis upon which to understand the state of the household integration into the financial system in South Africa. We have interrogated, in depth, the extent, nature, and unevenness of household engagement in formal and informal financial markets in South Africa and their alteration over time. This approach sheds light on the participation of the household and it gives context to a number of critical aspects of how these participants influence the economy through financial sector (formal and informal). The analysis of this chapter have vested more onto the assessment of what the literature entails in line with the evidence of what is seen in South Africa regarding the role of finance. In general the results have shown interesting features which confirms that financial development is seen in South Africa as more adults have shown improved access in to the financial system also comprising the use of SASSA card which allows for transactional service. However, there seem to exist some drawbacks of economic imbalances, the analysis shows that the role of finance in the household sector is still obscured as it shows no sign to be eradicating the issues of the past and striving to be inclusive. However the critical aspect to note is that borrowing behaviour and financial inclusion cannot be understood in isolation, which is one reason why the government enacted the National Credit Act to regulate the creation of a more efficient market to access credit at affordable rates. Access to micro-credit is also an important element in improving one's quality of life and should therefore also be used to measure financial inclusion. For example, low income households access this type of credit to pay for education, transport to work, etc.

This study finds domestic credit to be negatively related to income inequality, as the most critical and 'assets' backed credit for economic use and income generating is only accessible by those with high income. This is an interesting finding for financial

institutions to find innovative ways to tap into the household market in order to address income inequality. Hence in the central part of the investigation on the relationship between finance and inequality it is evident that a lot is still to be done, mainly by the state and the regulators, as the financial sector seem to be still lacking robust solutions to the issue of inequality faced by the country of South Africa, starting from access to finance up to product offering and development.

In summary, the outcomes shows that although the financial sector has expanded by way of providing more credit solution to the households, this has first not yielded any positive results, because the products offered have resulted in increased household debt. From this growing participation rate of the household in the financial sector, one would be safe to argue on the basis of inequality, that certain critical factors of credit, like the credit history on record, collateral and solvent financial position still appeals to be a conservative and secured way of lending and it only benefit the privileged to secure credit facilities which are crucial for production and raises their incomes further i.e assets based finance (mortgages). Therefore the previously disadvantaged group is left with unsecured credit which is very costly and incorporates more unbearable transactional costs (fees) with minimal disposable incomes from informal sector.

Hence from this point one would be safe to conclude that the growing household integration in the financial system is precarious with sudden uncontrollable defaults noted above which de-stabilises the financial stability at large. Hence the rural and more vulnerable household continues to partake in informal financial services to meet their financial needs with less or no obligations. In this regard this chapter has shown that many Savings Group and stokvels members whilst using their basic bank account from the cheaper bank to receive payments. Nevertheless, the report shows that they feel that they have learnt and prefer to continue save with their groups - social networks, when they are more financially stable, they tend to join additional informal groups to increase their wealth rather than change or increase their relationship with the formal sector. This is a clear indication that unless forced into the formal sector by either employment or a serious economic improvement, South African poor and vulnerable household will keep using formal services only marginally and default to the informal sector when discouraged or declined by the formal sector for adverse conduct on debt obligations.

CHAPTER 5.

5.1. CONCLUSION

This thesis was born from the growing global concern on the role of finance in the economy. The concern in South Africa particularly was mainly on the growing involvement of households in the financial system, which has since expanded post the global financial crisis (housing bubble) of 2007/08. The crisis which obligated many countries to broaden the scope concerning their financial regulatory systems in order to achieve financial stability. In this regard, the thesis was tasked to firstly, characterise this phenomenon ‘financial inclusion’, and therefore identify its essence and its impact on household in order answer the critical questions as to “How should we understand this phenomenon in the case of South Africa and to what extent does it reflects or portray the premise of financialisation or that financial development?”

Starting with the first concern of charectarising the current state of financial inclusion is South Africa. The first leg on the state of financial inclusion was highlighted in Chapter 3 of this thesis, whereby the study analysed the current landscape of the financial sector. The analysis showed how important the household has become to the sector of finance with the fast paced growth of the assets and liabilities held with the financial sector since the year 2008 to 2018 with an average growth of (20%). In Chapter 3, we have also witnessed the household taking a larger share and outperformed the non-financial corporates in terms of the deposits in the financial sector. These results capture the development of multiple financial products and services targeted to the households which directs the monies into the financial system – i.e establishment of the post banks, Mzansi account, SASSA master cards, etc.

It is for these reasons that the analysis of Chapter 4 shows that the financial sector of South Africa appears to be fairly inclusive although it has serious limitations. On the positive side, the sector showed improved figures as the number of those with access to basic financial product increased from 46% of 2004 and now sits at 80% as of 2018, and those categorised under ‘excluded’ by the financial system has reduced to 7% in

2018 from the 38% recorded in 2004. On the negative side, the analysis and the literature on the access to finance reflect that, generally, the majority of the population in many economies engage with financial institutions and other lenders on highly unequal terms, notwithstanding in ways specific to South Africa.

Striking is that many emerging economies seem to share the same experience to date, on access to finance, which demonstrates that rather than addressing the issues of the past 'credit apartheid', the new systems of control, exclusion and risk management have developed alongside unequal forms of financial inclusion. This is found in both the analysis and literature, as the majority of the household which are excluded from secured, incomes-generating, long-term credit facilities rely on more expensive and precarious short-term unsecured alternatives. This leads them being to being extremely over-indebted, while new technology has reorganised the detection of defaulting clients, which further affects credit records and employment opportunities in the same finance sector. These uneven findings, in terms of integration, reflect that a small number, predominately whites, continue to benefit and dominate the banking elite and profits substantially in South African out of the 'financial inclusion', rather than addressing and delivering pro-poor financial solutions-benefits to the black majority.

In answering the critical question of "how should we understand financial inclusion in the case of South Africa, and determine which theory between financialisation and financial development best reflects or explain the current state of the phenomena in South Africa". This Chapter of analysis finds four critical economic variables which are connected to the literature reviewed in Chapters 2. The variables shows that the phenomena has a direct impact on them, which are: 1. Household debt; 2. Inequality; 3. Employment; and 4. financial stability at large.

Firstly, on the impact of finance on household debt the increasing debt levels which comes with high cost of debt service and high defaults (NPL) rates in the case of South Africa. It follows the premises of the discussion in the literature review with covers the string of the financial crisis that occurred through household integration in the financial markets, starting with the Great Financial Crisis (GFC). This is covered under both theories of financialisation and financial development, acknowledging the impact of

high debt levels on growth prospects in many countries. The financial development literature further points to the fact that the increasing households' credit proves to put the savings appetite at risk especially for countries with lower liquidity. This is also witnessed in South Africa with a very bad performing rate of savings as unsecured credit granted to household increases. Furthermore, the notion of micro lending in South Africa seem not to resolve the economic imbalance as noted by Bateman (2012), most people (average creditworthy households) who secure microfinance loans don't utilise them for productive use but rather finance their daily living, transport to work and maintaining their living standards by absorbing short-term cash flow shocks.

On the impact of finance on inequality the theory of financialisation seem to place more focus towards the marginalisation of labour due to new (advanced) technologies which favour skill-intensive production correlated with the wage share and also the first (early) access into the international stock markets by the high income groups. This is a very rich analysis and approach on the subject matter with interest on investigating the basic access into the financial system. Hence it is found that financial development literature captures the issues faced by the country of South Africa well as shown in Chapter 4 and this literature covers indicators analysed in Chapter 4 from the types of credit available to the different incomes groups up to the defaults and NPL per products acquired, financial assets, microfinance and informal markets.

Furthermore, as the economy of South Africa grows or develops, the financial system opens up, but it doesn't necessarily become fairly reachable and 'affordable' to the poor households of the country. As there still exist constraints impacting the majority and those in remote areas. These limitations ranks from the information asymmetries, product knowledge and financial literacy faced by the households. Hence when we discussed about the technical information like credit history on record, collateral and solvent financial position the sector still appeared to be a conservative and secured way of lending and it only benefit the privileged minority households in South Africa, for them to secure credit facilities which are crucial for production and raises their wealth further. This also powered the findings on unequal access, and the debt-drive growth path with problems of affordability as the previously disadvantaged group is left with unsecured credit which is very costly and incorporates more unbearable

transactional costs with minimal disposable incomes from informal sector. The impact on financial stability comes as a spiral effect or formed from the rising debt level, unequal access and uncontrollable defaults which renders instabilities or de-stabilises the financial sector and further impact employment in this sector.

Hence as the financial system development, the state of financial inclusion in South Africa seem to be needing more attention from the regulatory perspective to strive and balance the benefits by first addressing the inequities created by apartheid. As Mishi *et al.* (2007) assert that a well-functioning financial system is the one that is not exclusive but inclusive. The failure to eradicate these imbalances could be the reason of the growing household participation in informal financial markets as the deprived rural and more vulnerable household continues to partake in informal market to meet their financial needs with less or no obligations. Therefore, theoretical foundations of this thesis suggest that as financial inclusion has been a priority and a global concern, regulatory bodies of various ministries of the states should take a lead to ensure that it serve the majority or results in pro-poor growth and development. Henceforth, this could be an interesting subject for further investigation on the household number, reasons and sum of assets (cash) leaving the formal financial system to the informal channels, as this topic in South Africa is steadily gaining momentum amongst other issues on the role of finance.

As some of the banks phased out and replaced the Mzansi account initiative which was predominately driven by regulatory requirements to address the real problems of the country on financial inclusion as opposed to profit potential. This has proven minimal efforts and willingness by the conventional banks in participating towards low margin products offering and support the developmental objectives of the state. Hence they remain profit driven and still retain expensive financial service which does not really address the problem of the country (financial inclusion). Thus, one could deduce that the expensive cost of product and service discussed on Chapter 4, the lengthy bank requirements such as payslips and bank statements to access formal financial sector services such as loans are still seen as onerous. In addition, banks also have lengthy processing timelines that low-income earners may view as restrictive, especially when they have personal or family emergencies such as, funerals, or needing money to travel to work and, or to buy food. It is this rigidity that prevents

some South Africans from participating in formal service, hence why some low-income earners still prefer using cash instead of digital channels.

Hence, more than 40% of South African households use stokvels (trust-based models used to save money that provide a safety net for emergencies and offer social interaction for the purpose of entertainment or advice. These community-based models are mostly prevalent in lower-income populations and provide the flexibility and support structure that is perceived as lacking in the banking industry.

There is no doubt that South Africa has experienced a tremendous improvement in the level of financial inclusion. However, the growth in financial inclusion in South Africa shows that it may be reaching its saturation point if regulation doesn't influence the business model of the conventional bank to participate and not duplicate any service intended for development (financial inclusion). As noted in chapter 4 of this thesis, going forward focus should turn to quality financial inclusion to address pressing issues such, a need for cheaper, faster, accessible and convenient financial products and services transcends economic means (i.e, all income groups equally need them). Ensuring adequate training and development to the illiterate, to ensure productive use of financial services, relatively low level of digital payments and risk cover to motivate savings and reduce over-indebtedness. Furthermore, the definition of 'fully served' will have to examine the depth and appropriateness of each product (savings, insurance, credit and payments) component.

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