THE EXTENSION OF BANKING SERVICES TO RURAL AREAS IN LESOTHO

NTHABISENG ANASTACIA SEKHOTHU

A research report submitted to the Faculty of Commerce, Law and Management, University of the Witwatersrand, in partial fulfilment of the requirement for the degree of Master of Business Management.

Johannesburg
September 2006

ABSTRACT

The purpose of this research was to determine barriers and enablers that influence banks in the extension of their services to rural areas in Lesotho. The initiatives taken by the Lesotho government and the Central Bank of Lesotho in motivating rural banking in Lesotho were investigated and all existing banks in Lesotho were taken into account to determine the reasons for their reluctance to extend to rural areas.

This research comprise one case study of a Rural Savings and Credit Group (RSCG) scheme which was initiated by the Lesotho government and established by the Central Bank of Lesotho to encourage extension of banking services to Lesotho rural areas. The key stakeholders investigated in this case were the Central bank, government ministries (Trade and Industry, Agriculture, and Finance), banks, NGOs, and the rural communities.

Findings from the research uncovered that, banking services can make a contribution to the well-being of the rural communities in areas of both development and sustainability. It also revealed that success can only be achieved if all stakeholders can be fully committed in their roles towards the extension of banking services to rural areas in Lesotho.

THE DECLARATION

I, Nthabiseng Anastacia Sekhothu, declare that this research report is my own, unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

Nthabiseng Anastacia Sekhothu
22 September 2006

DEDICATION

I would like to dedicate this research to:

- My beloved son, Rorisang
- My friends, especially Dr Miguel Kiasekoka for his support and encouragement throughout my MBA programme.
- My whole family, for all the sacrifices they have made and the patient support afforded to me throughout my studies.

ACKNOWLEDGEMENTS

I would like to express my sincere gratitude to my supervisor, Dr Louise Whittaker, for her invaluable guidance, support and encouragement throughout this research. I would also like to thank all the people who agreed to participate in interviews and those who provided me with information through the contribution of material and comments.

TABLE OF CONTENTS

ACRONYMS

BASP	Basic Agricultural Support Program
CBL	Central Bank of Lesotho
FSSP	Food Self-Sufficiency Program
GB	Grameen Bank
LADB	Lesotho Agricultural and Development Bank
LAPIS	Lesotho Agricultural Production and Institution Support Program
LDC	Less Developed Countries
LISP	Local Initiative Support Program
LNDC	Lesotho National Development Corporation
LPB	Lesotho Post Bank
M	Maloti (Lesotho currency)
NGO	Non Governmental Organization
RSCG	Rural Savings and Credit Group
SARB	South African Reserve Bank
SWACAP	Soil and Water Conservation and Agro-Forestry Program

1 BACKGROUND TO THE RESEARCH PROBLEM

Lesotho is a country with a total area of 30,355 square kilometres. It is dominated by high altitudes with mountains and very limited arable land. About three-quarters of the country are 1,800 metres above sea level and are rural. It has a population of 2.2 million, three quarters of which is located in the rural areas, (Lesotho Bureau of Statistics, 2003).

It is a country completely landlocked by South Africa. It is therefore dependent on South Africa for almost all major services including banking. There are no full banking facilities or branches in the rural areas. All the financial institutions are concentrated in the main city, Maseru, with very little representation in the rural areas. This shortage of banking services results in a daily inflow of rural people into South Africa for even simple transactions such as opening accounts and making deposits (FinMark Trust, 2005).

For these communities, any attempts to get finance fail because as non-South Africans, South African banks only hold their investments but do not offer them other services such as loans. On the other hand banks in Lesotho also deny them credit because they do not hold bank accounts in Lesotho. This is a constraint for the rural communities as it blocks their efforts to utilise all banking services which could help them to undertake projects that could lead to self-sufficiency. This constraint may be attributable to the structure of the banking system in Lesotho as explained below.

1.1
<u>The content of the Research</u>

1.1.1 Lesotho Financial Structure

The Lesotho financial sector is structured in such a way that the financial sector falls under the Ministry of Finance, with control mainly in the hands of the Central Bank of

Lesotho (CBL). Until recently, the banking sector comprised three commercial banks, namely, Nedbank, Standard Bank, and Lesotho bank. Now added to the list is the First National Bank which commenced business in November 2004, and Post bank which opened in January 2005. All these banks are completely South African with the exception of Post bank which is 100% government-owned. During the study, the Lesotho bank was in the process of merging with Standard bank, (Standard Bank Lesotho, Personal Communication, 2006).

Lesotho Post Bank (LPB) objective is mainly to provide banking services to the rural and un-banked communities. It was granted a licence after meeting the capital requirement of M5 million instead of M10 million as required from commercial banks to open business in Lesotho. The LPB operations are limited to accepting deposits, but not other services such as granting loans or foreign exchange.

What makes LPB crucial to the study is its infrastructure network with Lesotho Postal Services, and its long-term objective. Its objective in the words of Lesotho Post Bank CEO is:

> **"To offer banking options and affordable services to everyone focusing on the poor and rural communities, expand and introduce new banking products, and to ensure that rural people have access to banking services."**

LPS has opened 11 branches and intends using most of the 47 Post Office branches.

The Lesotho government, through the Central Bank, in an effort to encourage full financial services in the rural areas, has undertaken rural communities development projects in which all financial institutions all over the world are invited to participate. The Post bank was the first to accept this invitation and started to open branches in the rural areas (Central Bank, 2006). The purpose of the study was to determine why commercial banks were not extending to rural areas, the barriers that hinder their involvement and commitment, and also explore the enablers required to help overcome those barriers.

1.2
Relevance of the research

This study is to help to explore barriers which are preventing banks from extending their services to Lesotho Rural areas, and factors that can help to make banking services possible in the rural Lesotho. It is hoped that the results of the research will help rural communities, Lesotho Government, CBL, and banks to consider ways of dealing effectively with all the barriers and find suitable solutions to extension of banking services to the rural Lesotho. It is believed that with good relationships between the government, the Central bank, and the banks in Lesotho and other banks considering having their footprint in Lesotho, extension of banking services to the rural Lesotho can be achieved.

Though reference was drawn from the literature based on other countries, this study identifies factors that are particularly applicable to banks in Lesotho and Lesotho rural areas. It is hoped that the outcome of this research will serve to increase interest in the field. This is considered important as the concept can lead to further research by bank researchers, academics, and all those with earnest interest in the extension of services for the development of Lesotho rural communities. It is meant to trigger and challenge their interest so that they can use the finding from this study as an outline and basis for further study.

In addition, with a better understanding of the issues related to banking services to rural areas, the identification of issues of concern can assist the Lesotho government in formulating appropriate strategies which could be attractive to other stakeholders.

1.3
Assumptions about the Problem

In exploring the need for extension of banking services to rural communities, it was necessary to investigate how such services could enhance the development of these communities, and the government role in helping to overcome barriers and motivating banks to buy into the idea. This was because of the assumption that for rural communities to be self-sufficient and achieve sustainable development they need assistance and one crucial aspect of community development is through access to banking services such as savings and credit (Mwenda, 2005). Based on this assumption, the role and initiatives taken by the Lesotho government through the Central Bank to encourage commercial banks in the country and other international financial bodies to take part, was regarded as the enablers, and therefore explored. Access to information at CBL was authorised M.M. Molefi, personal communication, 16 September 2005.

It is assumed that studies around this area may have been conducted, even if not in the same context or specific to Lesotho. This study is intended to expand on any such previous studies but specific to banking services directed to Lesotho rural communities.

1.3.1 Reasonableness

The researcher's assumption was that extension of banking services to rural areas is necessary for sustainable development of rural communities based on the literature from Sah & Stiglitz (1992), Von Pischke (1993), Todaro (1997), and Mwenda (2005). It is even more so in the Lesotho context, based on the fact that three-quarter of the country is rural.

1.4
Limitations and Delimitations of the Research Project

It was intended that the report would cover provision of banking services to rural communities in general, that is, individuals, firms, groups, and rural-based projects. Because all the banks in Lesotho are South African, banking regulators in the study refer to both the CBL and South African Reserve Bank (SARB).

Although most of the literature applied generalises financial intermediation in rural areas, the report is confined to services relating to banking. The researcher therefore uses the words *financial* and *banking* services interchangeably throughout the whole report. *Rural* is used as synonym for *village* as used in the literature from other countries (Kaboski & Townsend, 2005) in the report.

1.5
Statement of Research Problem

The objective of this research is to determine the barriers and enablers to extension of banking services to the rural communities in Lesotho. It explores the requirements for extension of banking services to rural areas. Rural Community banking was intended to refer to any form of financial intermediation through commercial banks, credit unions, building societies, insurances, and donors' financing. But in conducting field studies, it was found impossible to ignore the informal financial institutions completely because of the linking role they play between commercial banks and rural communities. The informal financial services such as, funeral societies, stockvels, moneylenders, and any such community-based cooperatives are therefore included in the study.

1.6
Sub-problems

1. To determine the strengths and weaknesses of past rural financial intermediation programmes
2. To determine the requirements for extension of banking services to rural areas
3. To determine the barriers which hinder banks from extending their services to rural areas
4. To determine enablers that can help to overcome the barriers to extension of banking services to rural areas and ensure success.

2 LITERATURE REVIEW:

This chapter outlines the literature used to derive the propositions against which the research was conducted. It sets out with an introduction to the concept of Lesotho rural areas with literature on rural areas in Developing Countries. It covers the definition, the drivers behind rural banking, a description of the various rural /village banking models in other countries, technologies used to reach rural areas. This is followed by an overview of how in other countries government had intervened through effective policies, and how in Lesotho, the Central Bank has started with initiatives to encourage extension of banking services to the rural communities. Regulations, policies and laws that control the financial sector in Lesotho, form part of the literature. (FinMark Trust, 2005) is used as a guideline and examples of enablers and functionality constraints present in Southern Africa.

2.1
<u>The rural sector</u>

The rural sector in most Less Developed Countries (LDCs), according to Sah & Stiglitz (1992), is characterised by subsistence farming where farms are run by extended families and output is shared amongst family members. In addition, there is a prevalent degree of sharecropping. Sah & Stiglitz (1992) advise that government policies should be in the light of these for any form of financial intermediation.

Furness (1975) has the same views as Sah & Stiglitz (1992). He states that subsistence economy is doomed to comparative poverty and can only be raised to a higher level through finance. His use of the term finance includes money, credit, and the whole structure of financial institutions. He emphasises how finance can contribute greatly to the standard living of societies by helping man to become more productive.

Sah & Stiglitz (1992), and Furness (1975), are supported by Todaro (1997) who suggests policies that can create appropriate rural-urban economic balance, the thrust being in the integrated development of the rural areas, spread of small-scale industries, and reorientation of economic and social investments towards rural communities. He perceives that government investment and incentives, through services and income redistribution to the rural poor can eliminate perceptions that there are no economic benefits to be derived from such areas.

2.1.1 The Structure of Rural Banking

The concept of village banking in Southern Africa is defined by Mwenda & Muuka (2005) as based on simplified banking systems at low cost, and in areas that are beyond the reach of commercial banks. It has been developed with two basic elements: Community Ownership and Linking with Commercial banks (Mwenda & Muuka, 2005). They quote Ximiya (2000), who defines a village bank to be a community-managed facility that operates as a Financial Services Cooperative (FSC) and has varied functions that include:

- encouraging the poor people to save
- establishing a community capital base for the community to access funds
- means for handling and managing housing, welfare and agricultural subsidies
- Ensuring attention is paid to basic social infrastructures such as roads, clinics, and schools in their communities.

Furness (1975) answers how these social concerns can be solved by provision of financial services to the well being of societies. He says the structure of financial institutions can contribute to the standard of living of a society by helping them become more productive. According to him transactions between lenders and borrowers are very difficult because many customers lack the knowledge to judge relative benefits of alternative investments and are ignorant of procedures that have to be followed. He emphasises the important role that financial intermediaries can play in developing Countries.

Banks operate as finance providers and therefore they represent the main source of external finance for rural communities (Binks & Ennew, 1996). Banks prefer to operate in a perfect market setting where information is perfect, costless, and readily available with no uncertainties regarding present and future trading conditions. However information in the real world is not perfect or costless, more so in rural areas where the market is characterised by risks and uncertainty regarding future conditions. From the banks' perspective, they have incomplete information regarding the underlying quality of the project and the management of the groups, giving rise to the problem of adverse selection (Stiglitz & Weiss, 1981).

Furthermore the management of these groups may fail to perform to their full capabilities, giving rise to the problem of moral hazards. This arises because it is too costly for banks to effectively monitor progress, thereby resulting in equilibrium credit rationing and a shortfall in debt provision (Binks & Ennew, 1996). The information problem can not only lead to good lending prospects being rejected by banks, but it may also result in poor prospects being accepted (Tucker & Lean, 2003).

2.1.2 The effects of financial intermediation to economic growth

The importance of financial intermediation to growth is also supported by Odedokun (1998) who says there is evidence that points to the importance of financial intermediation on growth, especially in the context of developing economies. Given this evidence, Odedokun (1998) contends that governments should view access to financial intermediation as key to development at grass-root levels. He states that the expected micro-impacts are the justification for efforts by governments and non-government organizations to improve access to financial intermediation. According to him, this requires the increase of the emergent of microfinance initiatives directed at agricultural projects in rural areas. But he also points out that despite the prevalence of these initiatives, there has been little evidence of their success.

2.1.3 Government Intervention and Politics

Yaron et al (1998) agree that governments have traditionally used subsidized credit programs to promote agricultural growth, but the approach had generally failed to improve incomes and alleviate poverty in rural areas, as a result, it has led to the mistaken belief that rural credit programs cannot be profitable. According to them, there is a new approach which seeks to raise standards of living in rural areas. This approach casts governments in a very different role. Governments are required to set favourable legal and policy environments for rural financial markets, and address specific market failures cost effectively through well-designed and self-sustaining interventions.

This approach can be highly successful as shown by The Village Bank system of Bank Rakyat Indonesia, where without relying on subsidies, the program has generated enormous profits for the bank by using simple, innovative, and largely replicable techniques, providing evidence that financial services can be extended to low-income rural communities (Yaron et al 1998).

Yaron et al (1998) express their opinion that provision of affordable financial services to the rural population is an important component of development strategy. They state that direct interventions in rural financial markets to stimulate growth and reduce poverty was popularized by Keynesian economics in the 1950s which suggests a blend of targeted credit programs, interest subsidies, and other government policies as long overdue development strategies which governments should follow. According to them, many governments were inspired to design fiscal interventions at the macroeconomic level. But they agree that direct interventions at micro-level have generally been disappointing and have tended to retard, rather than promote, the development of financial services in rural areas.

Their explanation is that traditional policies were based on serious misconceptions about the real challenges facing rural communities and were directed more toward the symptoms rather than the causes of inadequate rural financial intermediation. But they contend that more recent developments in the provision of rural financial services (both savings and credit) have demonstrated that proper institutional design and compliance to appropriate policies can be profitable and increase the potential to generate substantial and sustainable achievements and broad institutional outreach to rural areas.

Designing viable direct financial interventions in rural markets has gained a growing recognition that governments should first and foremost facilitate the workings of the market so that private participants can allocate resources efficiently in response to price and profit signals. The most common means Indonesian government applies in addressing these issues is by encouraging financial institutions to offer loans at below-market rates (Yaron et al 1998).

But it should be considered that the low rates can also be detrimental to banks. Governments therefore, need to be sensitive to the banks' views and work closely with them without jeopardising relationships because as Von Pischke (1993:59) states "banks and other financial institutions occupy a certain position of power in the total structure of the economy, but are subject to too much government scrutiny and regulatory policies. As a result formal finance becomes an attractive target for governments with limited sources of income from other economic activities. Attempts to change access to finance affect relationships within a society." He argues that intervention should be more than just economic or financial. He says it should be there to respond and address social issues such as privilege, authority and power. He contends that these issues are fundamentally political, and frequently influence the direction of finance by either stimulating or retarding development.

Von Pischke (1993) advises about the problems banks can face when they provide cheap loans. He says cheap loans attract applicants with political status who exploit the programmes. Over time the programmes benefit these politicians instead of the communities for which they were intended. The credit exploitation by politicians results in credit arrangements which fail to attract support from communities, banks, depositors, international donors, and all those who could support some area-specific rural credit arrangements. He therefore, suggests involvement of suppliers of finance as partners. Von Pischke (1993:60) states: "to increase the flow of rural assistance permanently and reliably, governments in developing countries must endeavour to work with, rather than against, financial-market forces."

In an effort to work together with banks as suggested by von Pischke (1993), Lesotho government, through Central Bank is trying to promote access to basic banking services by the rural and Low-Income Communities. The Central Bank of Lesotho has established a Rural Savings and Credit Groups scheme (RSCG). The objective of the scheme is to provide access to financial services to the rural and low-income communities. This initiative comes upon the recognition that these communities are marginalised in terms of banking services and they get very limited assistance to enable them to play a part in economic activities of the country (Central Bank of Lesotho, 2004).

In support of Pischke (1993), Central Bank of Lesotho (2004) points out that given the power of banks in Lesotho and their roots in South Africa, formal credit to small- and medium-scale enterprises is constrained. This is because of the lack of commercial contract enforcement capacity. In addition CBL (2004) report points out that the prospects for sustainable micro-finance has been undermined by a subsidised UNCDF credit program for small-scale enterprises.

The Government, with the World Bank's assistance has developed a rural and micro enterprise finance scheme. The focus for CBL is on the importance of moving microfinance programs to a cost recovery basis and introducing measures to address risk minimisation of failures. In addition CBL has formulated policies intended to encourage rural communities and banks to realise the need to be committed and involved in working together for the success of rural banking initiatives. This focus is supported by findings of Koboski & Townsend (2005) on the impact of effective policies for rural micro-finance institutions.

Promoting a conducive policy environment is a prerequisite for an efficient financial system, rural development and effective poverty alleviation. Of particular importance are: macroeconomic stability, deregulated interest rates, exchanges rates and agricultural prices, and a legal system that protects property and land-use rights, the autonomy of financial institutions and regulatory (IFAD, 1999).

2.1.4 Effective Policies for rural banking

In defining what constitutes effective policies for rural banking, Cameron (1972) expresses an opinion that an effective policy is the policy that contributes positively to economic development. He says the first and most essential function of any banking system is to act as an intermediary between savers and borrowers. This function already exists in urban areas; it is shared by most financial institutions, both formal and informal, therefore can be applied in rural areas as well, he points out. The second function is the provision of entrepreneurial talent and guidance to the communities in which they operate. Such flow of rural assistance through effective banking systems can work in the promotion and facilitation of economic development. Banks need to seek out profitable undertakings in areas of manufacturing, commerce, and other productive activities in rural areas (Cameron, 1972).

Kaboski and Townsend (2005) support Cameron (1972) on the benefits that can be derived from effective policies. They use variation in policies and institutional characteristics to evaluate the impacts of village-level microfinance institutions in rural Thailand. To identify effects, they examine policies related to the successful/unsuccessful provision of services as exogenous variation in effective financial intermediation. Their findings are that institutions with good policies, can promote asset growth, consumption smoothing and occupational mobility, and therefore can decrease money-lender reliance. “Specifically, cash-lending institutions, production credit groups and especially women’s groups, have been found to be successful in providing intermediation and benefits to their members” state Kaboski & Townsend (2005:3). The policies they identify as important to intermediation and benefits are: the provision of savings services, especially pledged savings accounts; emergency services; and training and guidance.

There seems to be a consensus that commercial banks can play a crucial role in the intermediation process as they handle a large share of funds flow from lenders to borrowers. Cameron (1972) points out that although banks have the economic power and competitive strength to play this role, their authority is limited by restrictions imposed by laws and regulatory authorities which create reluctance on their part. Kaboski & Townsend (2005) add that the effectiveness of intermediation may also be influenced by other factors, such as unfavourable resource endowment, and government policies.

Bessis (2002) on the other hand argues that reluctance is not only caused by restrictions and regulations. He says it is also caused by risks involved in extending banking services to rural areas which he terms un-bankable. He states that because banks' profits are derived from providing loans to customers who have the ability to pay back within agreed timeframe, they are faced with the risk of losses in case of non-payment of granted loans if not well managed.

Default risk is defined as a major source of loss and it is customers' failure to comply with obligations to service debt, leading banks to insolvency (Bessis, (2002). This is because measuring credit risk is difficult and judgemental, especially in rural areas where data is scarce. Based on the scarcity of data, banks have to resort to capturing portfolio effects and building models to assess the likelihood of default. (Bessis, 2002:15-21) sums up risks as major constraints faced by banks in considering extending to rural areas as:

Country risk:

Local crisis such as poor management by Central banks or government in debt-structuring policies. Included in this type of risk are economic factors, and legal restrictions.

Liquidity risk:

Refers to inability to raise funds at normal costs. It also refers to how risky borrowers perceive the bank and its lending policies.

Market risk:

Refers to market sensitivity to price changes. This is perceived critical in emerging markets therefore needs proper monitoring of the market portfolio

Interest Rate risk:

Since banks generate their income and costs that are interest-driven, interest volatility directly affects banks' earnings.

Solvency risk:

Refers to banks' inability to absorb losses. It requires matching deposits received with loans given.

Operational risk:

Refers to internal risk monitoring of people, processes, technical, and information technology.

Fleisig & de la Peña (2003) contest the issues of risks. They argue that risks are inherent to any business, and can be reduced by appropriate policies. They say some rural finance and rural development projects, otherwise well-designed, fail because they call for non-legal behaviour. Their view is that rural financial intermediation fails as a consequence of poor implementation of appropriate policies, and non-compliance where such policies exist. Their key recommendations to overcome risks highlighted by Bessis (2002) are:

- Promote micro-credit viability by changing laws to permit portfolios of unsecured loans to serve as collateral for refinancing loans from the formal sector.
- Broaden such land-use rights projects to include a clear and simple legal mechanism for transferring land-use rights and using them as collateral.
- Reform laws relating to savings and borrowing status of the poor, such as age of majority, homestead, literacy, and civil registration in order to facilitate the poor, illiterate, women and young heads of households in legally conducting business with the formal sector, including signing contracts, opening businesses, and borrowing.

- Reform laws related to the status of farmers, so that farmers can pursue commercial enterprise and participate in commercial transactions that will generate deposits required by banks.
- Reform laws related to cooperatives and non-governmental organizations, so that they can perform functions like lending and borrowing on behalf of their members and undertake commercial activities with members as beneficiaries.
- Limit regulation of rural financial institutions to those taking deposits; do not subject non-financial lenders and financers (dealers, brokers, and farmers) to financial regulation.
- Permit the use of the domestic stock as collateral for loans.
- Reform commercial codes that govern rural business, remove economically unsound provisions, and introduce the minimal set of rules needed to run a modern business.

It is emphasised that prudential regulation and supervision of financial institutions is crucial for the evolution and stability of financial systems. Only with properly regulated local financial institutions, which mobilise savings and attract private capital, can there be sustainable rural development (IFAD, 1999).

2.1.5 Importance of savings in rural areas

Hassan & Renteria-Guerrero (1997) analyse the importance of savings mobilisation in rural areas and the effects that increasing financial intermediation bring about in the monetary policy and the economy in general. According to them, mobilisation of savings plays a crucial role.

They perceive that the importance attached to savings at Grameen Bank (GB) is what makes it different from other development banks. They point out that GB has taken banking services to communities where those services were unavailable, and this spread of banking facilities to rural areas, has helped popularize money as a means of transactions. When banking facilities become readily available, monetary transactions become more attractive than other forms of transactions such as barter. The monetised economy gain results in efficiency because the demand for money raises (Hassan & Renteria 1997).

The benefits of banking services, particularly saving, to rural communities are the key to solving economic growth of the rural sector. In order to derive benefits and enjoy access to other banking services such as loans, rural communities have to be sensitised that (Alam, 2003):

- Savings are generated from self-earning
- Savings are initiated and supervised by the financing banks
- Savings are deposited with the financing banks
- Customers know about the purposes of their savings
- Savings are returned back to customers as capital for production
- Capital formation is done through depositing savings with the financing banks
- Savings are utilized in productive sectors
- Savings are utilized in a proper way to create job facilities
- Saving habits develop network relations within the co-workers and with financing banks.

Kaboski & Townsend, (2005) highlight some outcomes which are predominantly consistent with the theory of effective policies:

1) Institutions that succeed in membership, savings mobilization, training services, and lending, are institutions that have higher positive impact on households because cash loans are associated with the stability and expansion of services. Such positive impacts of village institutions result in asset growth among those institutions and policies with successful provision of intermediation services.

2) Institutions with effective policies can help to smooth responses to income shocks. These policies include benefits such as offering emergency services, and training services. Households in villages with these benefits are less likely to reduce consumption in a year with a bad income shock.

3) An increase in job mobility.

4) The most robust result is that institutions overall help reduce reliance on Money-lenders. Their interpretation is that village institutions loosen households' constraints on formal credit

They emphasise that the overall results show that institutions and policies correlated with the success and stability of services are also significantly associated with positive impacts on households.

Yunus (1997) recognises effective policies for micro-credit as a powerful tool in the struggle to end poverty and dependence. He points out that Micro-credit became a worldwide poverty-alleviating idea through its first "Micro-credit Summit" held in Washington, DC in February 1997. To show the confidence on the outcomes of effective policies, the Summit proposed to launch a global movement to reach 100 million of the world's poorest families, with credit for self-employment and other financial and business services by the year 2005 (Micro-credit Summit, 2004).

He points out that in spite of this confidence displayed in micro-credit programs, scepticism remain about their ability and efficacy to contribute to sustainable poverty alleviation in the Third World (TW) countries. Such scepticism is explained to attributable to the fact that rural people have very little educational qualifications and professional skills. They are therefore unable to understand how to save in a proper way, for example using savings in productive ways to eliminate poverty and improve their standard of living. It is important to start with developing their saving mentality and arrange their lending activities in such a way that the borrowers initiate group savings before they apply for loans.

An example of the Islamic banks can be followed where banks start by contacting their potential customers from time to time, to discuss various issues concerning their projects of interest, and to monitor the progress of the group savings in order to develop the proper savings mentality. Thus, the Islamic banks establish close contacts with the rural communities and educate them in how to save, plan how and in which way to spend their savings. In developing this saving mentality, they assist them to accumulate their idle funds and to use the same for productive purposes (Alam, 2003).

2.2
Interpretation of the Theory

The literature as stated above shows that there is need for extension of banking services to rural areas. But it also highlights constraints associated with this issue and suggests various ways of how to overcome barriers.

2.3
Application of the theory to the Research Problem

The theory derived from the literature is applicable to this particular research problem as it is primarily on rural financing initiatives. It suggests strategies for effective application. Though not much literature specific to Lesotho could be found, all that has been found is relevant, based on the assumption that rural areas have commonalities all over the world – more so, in the developing countries context (Todaro, 1997).

2.4
<u>Uniqueness of the Research</u>

This research is unique because it highlights the effectiveness or ineffectiveness of government/CBL financial projects to rural areas. It investigates methods and incentives necessary to achieve banks' willingness to extend services to rural areas. The CBL scheme case study gives an insight about the rural people banking needs. It addresses some issues about what the scheme does, CBL long-term goal about banking services in rural areas, and the requirements for access to banking services through it.

To the researcher's knowledge, the case study on the scheme is one of the initiatives by the government and CBL to encourage banks to extend their services to rural areas, but no previous formal research on extension of banking services to Lesotho rural areas has been done thus far.

3 RESEARCH QUESTIONS

1) *Why did past initiatives for extension of banking services to rural areas fail?*

2) *What are the requirements for the extension of banking services to Lesotho rural areas?*

3) *What are the barriers/constraints that need to be dealt with in order to get banks to extend their services to Lesotho rural areas?*

4) *What are the enablers that should be considered by the Lesotho government, banks, and rural communities do to ensure successful extension of banking services to the rural Lesotho communities?*

4 RESEARCH METHODOLOGY

4.1

Research Method

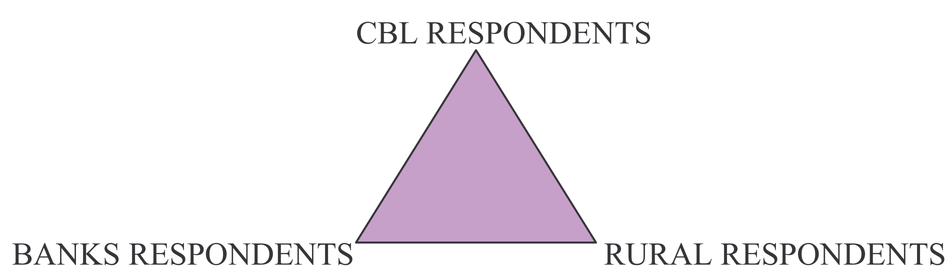
In the study, a four-stage strategy as recommended by Yin (2003) was followed:

- Design the case study.
- Conduct the case study.
- Analyse the case evidence.
- Develop the conclusion, recommendations and implications.

In addition the strategy was guided by considering what questions to study, what data was relevant, what data to collect and how to analyse the results (Yin, 2003: 20). Time was adhered to as planned in the implementation plan.

The research methodology chosen to perform the research was the qualitative case study research method. This was because it is recommended that for case study methodology, multiple sources of evidence (triangulation) converging in the same set of facts of findings be used, Yin, (2003). The data collection sources are complementary and confirm findings in order for a case study to be reliable.

Figure 1



4.1.1 Qualitative Research

Patton (1990) agrees and recommends three types of collecting data in qualitative study:

1. In-depth, open-ended interviews which consists of direct quotations about experiences, opinions, feelings and knowledge.
2. Direct observations detailing descriptions of people activities, level of interactions and behaviours.
3. Written documents from organisations, records, publications, reports and personal diaries.

The attractiveness of qualitative data is also supported by Miles & Huberman (1984) who refer to it as rich descriptions occurring in local contexts enabling the researcher to go beyond initial presumptions and frameworks.

Miles & Huberman (1984:21) suggest three steps in qualitative analysis:

1. *Data reduction*: Selection, simplification, abstraction and transformation of raw data to by summarising, coding, making clusters and writing memos in order to sharpen, discard and organise the information to reach a more effective conclusion.
2. *Data display:* the display of the data allows effective conclusions and decision making.
3. *Conclusion drawing and verification:* Explanations, patterns, regularities and propositions are assessed through data collection and analysis.

4.1.2 The Case Study Research Method

Yin, (2003) indicates that case study research in one of the many methods used in social science research. Others include experiments, surveys, histories and the analysis of archival records. He suggests three conditions to be considered in making a choice of a research method, namely:

- The type of research questions

- The control the researcher has over actual behavioural events, and
- The focus on contemporary phenomena in contrast to historical phenomena

The study about extension of banking services to rural areas justified itself to the application of a case study method mainly because of its exploratory investigation nature. The investigations focused on the contemporary events as the intention was to determine the applicability of the topic in the contemporary context. There was no need for control of behavioural events such as required in laboratory experiments. Instead the interviews were conducted freely and data collected were facts based on direct observations and person- to- person communications. The questions asked were exploratory 'what and why' questions as recommended by (Yin, 2003) rather than the quantitative questions like 'how may'. Thus the conditions stated above were met.

4.1.3 Design and Scope of the Research

The design and scope of the study is based on one case investigated at different angles relating to the extension of banking services to Lesotho rural areas. Two Lesotho rural villages, Quthing in the south, and Leribe in the north were identified for the study. Rural villages in both these districts have groups (registered and unregistered) pursuing banking services. Quthing was selected because the RSCG has already been implemented and the researcher wanted to know how it was being conducted. Leribe on the other hand, was selected because of numerous commercial group schemes that have been established by factory workers after job loses following the closure of textile factories in the district (CBL, 2006).

4.1.4 Number of case studies

One case study was conducted. This case is the focus of the whole study in which facts were gathered from various sources and conclusions drawn from those facts. The concentration was on RSCG scheme at Central Bank and policies pertaining to proper management and sustainability of this scheme to answer research questions in Section 3 of the report. This was not a sampling research and the selection of case areas was done purposefully so as to maximize what could be learned in the period of time available for study (Tellis, 1997). This was therefore a case study qualitative research (Yin, 2003).

Yin (1994: 18) explains research design as "logic that links data to be collected and conclusions to be drawn to the initial questions of study". When designing a case study, it was important to adhere to the case study protocol; which highlights the importance of the ability to determine the required skills and to develop and review the protocol (Tellis, 1997). It is recommended that the researcher must be able to ask good questions, be able to interpret responses, be a good listener, be flexible and adaptive so that s/he can react to various situations, have a firm grasp of the issue being studied and be unbiased by preconceived notions (Yin, 1994). Throughout the study all these points were adhered to.

In order to conform to triangulation of the case study methodology, although data was collected from various individuals, these individuals were specifically selected because they either formed part of or were relevant to the main three groups of the case. This is recommended for multiple sources of evidence converging to the same set of facts (Yin, 2003). The main groups in the case study are: Government/CBL, Banks, and Rural communities.

4.2 Population and Sample

4.2.1 Population of study

The population in this research was all the banking officials, CBL and the Lesotho ministry of finance, rural communities and their chiefs, and anyone or organisation with an interest in the benefits that can be derived from providing banking services to the rural Lesotho. From this population the sample drawn consisted of banks' managers, village chiefs, community representatives, CBL, and Lesotho Government Ministries (Agriculture, Finance, and Trade) representatives.

4.2.2 Sample, size and methodology

For the purpose of triangulation, the above stated stakeholder groupings was considered sufficient. The nature of the sample design was not random as only people who have enough information and are directly involved in the scheme and banking and know the barriers and enablers to the extension of banking services to the rural Lesotho were selected. Furthermore, the community representatives were selected based on their interest, involvement in the scheme and efforts taken to address their plight to have access to banking services at their areas.

All in all, the sample size therefore consisted of twenty-four respondents:

- 10 in- depth interviews of community members
- 2 village chiefs
- 2 District Agricultural Officers
- 2 Field Facilitators (from Ministry of Agriculture and Cooperatives)
- 5 senior bank managers (one from each of the 5 banks in Lesotho)
- 1 CBL representative
- 1 NGO representative
- 1 government official from the Ministry of Trade and Industry.

It was understood that the sample size could be viewed as small, but this was because of the limitation of rural villages under observations, and the number of banks in Lesotho.

4.2.3 Interview Participants:

Before the actual interviews were conducted, permission from participants and arrange appointments were set telephonically and by field visits where telephone access was not possible as indicated below:

Who	**Why**	**How access was authorised**
Nedbank Business Manager	Views on extending services	Telephonically
Standard Bank Business Manager	Views on extending services	Telephonically
First National Bank Manager	Views on extending services	Telephonically
Lesotho Bank Business Manager	Views on extending services	Telephonically
Lesotho Post Bank CEO	Growth strategy	Telephonically
CBL Head of Rural Finance Scheme	Initiatives, policies and progress	Telephonically
Chief of Leribe	On his and community views	Visit
Chief of Quthing	On his and community views	Visit
Community representatives	Community views	Visit
Ministry Representatives	Insight of banking rules and policies	Visit

District Agricultural Officers	Ministry's involvement	Telephonically
World Vision Representative	Field work	Telephonically

4.3
Data Collection

4.3.1 Type of Data

- Primary data: Semi-structured in-depth interviews and a case study
- Secondary data: CBL/Governments documents, books, journals, and Internet

4.3.2 Methods of gathering Data

The researcher started by phoning the nominated respondents, and to community representatives where there was to telephone access, undertaking field to invite them to participate, informed them of the purpose of the study including, the expected duration of the interview and asked for appointment with them. Upon acceptance, telephonic follow-up communications were made to thank the respondent for willing to participate in the study and to confirm details such as the place, date and time of the interview. As an incentive for their participation in the study, respondents were informed that they would each get a copy of the research report, and they were guaranteed that their responses would be treated confidentially and their names would remain anonymous.

4.3.3 Semi-structured in- depth interviews:

In-depth interviews were conducted with participants indicated in 4.2.3. All interviews were semi-structured to allow participants the freedom to say their views without being restrictions. But caution was taken to let them stick to the topic of study and not go off-track.

4.3.4 Case Study

<u>*CBL Rural Savings and Credit Group Scheme*</u>

CBL rural finance scheme is a newly established scheme aimed at promoting rural financial intermediation throughout the country. In its policy the target is the low income and rural communities and advocates a linkage banking programme whereby these communities are linked to the formal banking sector through a savings and credit approach. The objective of this policy is to encourage rural sector borrowing for development and productive activities and thus improve their standard of living.

The scheme was started in April 2005, and so far there are 136 groups, out of which 65 are registered. Only 49 of the registered have bank accounts and only three groups have obtained credit from commercial banks under cover and guarantee of the scheme. These groups come from the districts of Berea and Quthing, respectively. The total loan portfolio guaranteed by the CBL, in this regard, is M81, 050 so far. More applications for finance are under process with appraisal at different stages of development. The scheme is gaining popularity among the rural communities with a bias towards poultry, piggery, vegetable production, school feeding programme, tapestries, wool and mohair production (Central Bank of Lesotho, 2004).

4.3.5 Places where data will be gathered

The data from rural communities was collected from two of the rural villages in Lesotho (Quthing and Leribe), while data from CBL/Government and banks was gathered from Maseru where all the banks are located.

4.3.6 Selection of the Case:

The purpose was to get all sides of the story, therefore unbiased information. From the chosen case the perspectives of CBL, government, banks, and rural communities were studied and conclusions drawn from data gathered.

4.4
<u>Choice of Data Analysis Strategy</u>

In choosing data analysis strategy, it was considered that case studies have no fixed reporting format and understood that every case is unique (Tellis, 1997). Leedy and Ormrod (2005: 136) say that a case study researcher often begins to analyse data during data collection process to avoid overwhelming data and also because preliminary conclusions are likely to influence the kind of data he seeks out and collects in later parts of the study. In this study data analysis were guided by following steps as recommended by Creswell (1998) and Leedy & Ormrod (2005: 136):

1. Organisation of details about the case arranged in a logical order.
2. Categorisation of data to help cluster the data into meaningful groups.
3. Interpretation of single instances for the specific meaning they had in relation to the case.
4. Identification of patterns and underlying themes that characterise the case more broadly.
5. Synthesis and generalisation. Construction of an overall portrait and conclusions drawn that had implications beyond the specific case that was studied.

4.5
<u>Reliability and Validity</u>

Tellis (1997) commends that case study methodology is often criticised that the study of a small number of cases cannot offer grounds for establishing reliability and generality of findings and that results are not widely applicable in real life issues. Yin (2003) however argues that this criticism does not hold. The point being that the case study methodology is not meant to represent a sample. The goal of the researcher is not scientific generalisation but rather to expand and generalise theories, Yin (2003).

Yin (2003:10) states: “Validity of case study research is confirmed by using multiple sources of evidence resulting in the ability to deal with a full variety of evidence” Yin, (2003:10). Using multiple sources ensures accuracy and alternative explanations and this is done to confirm validity of the research process. While it is not looking for cause-effect relationship, case study methodology is good at comparisons and adds to the body of knowledge Yin (2003). In support, Leedy (1989) and Perry (2001) recommend case study methodology as most common and appropriate reliability and validity test to all social science methods.

Yin (2003) recommends four tests to ensure reliability and validity of case study research, and they are:

1. *Construct validity:* this often criticised in case study research that subjective judgments are used in data collection instead of developing a sufficiently operational set of measures. To insure that validity was maintained, multiple sources of evidence were applied (in-depth interviews, observation, and documentation). This was to ensure the correctness of operational measures for the concepts being studied.

2. *Internal validity:* Yin (2003:34): “establishing a causal relationship, whereby certain conditions are shown to lead to other conditions, as distinguished from spurious relationships.” Internal validity is described as being more of a concern in causal or explanatory case studies than in exploratory or descriptive because the researcher may fail to observe certain influential factors when applying the cause/effect logic. There is however, a concern that in studies where events cannot be directly observed, making inferences may be incorrect. Care was taken

in data analysis to ensure that the resulting conclusions and evidence were truly accurate.

3. *External validity:* "establishing the domain to which a study's findings can be generalised" Yin, (2003:34). The case chosen was not readily generalisable to the broader population, but for analytical purposes, the information gathered was generalised to draw a conclusion on the effect and sustainability of the initiative taken by the government of Lesotho and CBL to motivate rural finance projects and banks to extend services to rural communities.

4. *Reliability:* This is about demonstrating that the operations of the study can be repeated without changing the results (Yin, 2003). In case studies when the study is repeated by another researcher, the results and conclusions drawn should not differ. The research was carefully conducted with this view in mind, in order to avoid errors and biases.

Development of a formal case study protocol provided the reliability that is required of all research (Tellis, 1997). In addition, the researcher personally conducted the interviews, which is recommended: "In qualitative research, both validity and reliability are derived from rigor of the researcher's presence, the nature of the interaction between researcher and participants, the triangulation of data, the interpretation of perceptions resulting in rich, thick description of the phenomenon under study, which sheds light on an issue" Merriam (2001: 29).

5 BACKGROUND TO THE RURAL SAVINGS AND CREDIT GROUPS (RSCG) CASE

In Lesotho, as in many other African countries, domestic resource mobilization efforts are frustrated by the inability of the financial sector to mobilise and allocate domestic savings efficiently (Sah & Stiglitz, 1992). In this country, financial intermediation is still in its primary stages as evidenced by an absence of diversified financial instruments and institutions. The dominant institutions are the commercial banks, which, unfortunately, have very weak connections with the rural economy. These banks cite high covariant risks and high transaction costs as deterrents towards dealing with this section of the economy (Central Bank of Lesotho, 2006).

Given the skewness of population distribution towards the rural areas in Lesotho, it therefore becomes apparent that these banks are not providing the highly needed banking services such as savings and credit to a vast majority of the population. Moreover, they are not spread adequately throughout the economy particularly the rural areas where the bulk of the population live and work. Banks' reluctance to extend to rural areas has always been a concern to the government of Lesotho even in the past, hence some past initiatives which unfortunately failed to be sustainable (CBL Personal Communication, 2006).

In response to this reluctance of formal financial institutions to provide financial services to the rural poor, micro finance institutions in the form of informal and semi formal intermediaries started to emerge and assume greater importance. These institutions have been in existence for a long time in Lesotho with Credit Cooperatives being the oldest semi-formal financial institutions. They mobilised savings from members and extended credit to other members in need of funds.

In recent years, a number of informal financial institutions mostly the rotating savings and credit associations as well as burial societies known as "Mpate sheleng" have grown in popularity. The data gathered during the research indicates that although these informal and semi formal institutions help in providing essential financial services to rural communities, but there still remains a considerable need for improved scope to be covered by banks.

Secondly, the little savings that are accumulated are used mostly for consumption purposes such as financing burial activities. Thirdly, the informal or semi-formal nature of the operations of these institutions, have become preferable to the rural people because of lack of options. They would rather use the informal institutions they have around them than the hassle of travelling long distances to the banks where they are not certain that their needs will be met. Past attempts by the authorities in Lesotho to overcome these deficiencies have so far not been successful. In large part, these attempts focused on injecting funds into rural communities without encouraging and building a culture of saving in their areas (Central Bank of Lesotho, 2006).

It was in view of problems such as these, that in recognition of the potential role that can be played by banks in enhancing the lives of the rural communities in Lesotho, and the failure of previous efforts, that the Lesotho Government, through the Central Bank, took a policy decision in 1999 to actively promote financial intermediation to low income and rural households. The purpose of selecting the CBL rural finance scheme (RSCG) as a case of study, is to explore and outline the Central bank's approach towards achieving this objective.

The primary objective of RSCG scheme is to contribute towards the improvement in the standards of living of the low-income and rural communities. The objective seeks to facilitate and encourage banking services extension to this segment of society. The proposed policy seeks to build on the strengths of existing informal village institutions and facilitate linkage with commercial banks to channel funds into the rural communities. A key feature of the scheme is that it seeks to embrace existing informal savings and credit associations. Its policy approach proposes mechanisms through which financial resources at the disposal of the village and banking institutions can be increased and supplemented without destroying the culture of saving inherent in both institutions (Central Bank of Lesotho, 2006).

The scheme policy also recognises that a key strength of the village institutions is the elementary nature of their operations, the simplicity and objectivity of the rules governing the conduct of their members, and the democratic nature of the groups. These strengths should be retained. However, some degree of regulation and formalisation of their activities is necessary, if not vital, in order to facilitate the link with commercial banks and an injection of additional funds into the village groups (Central Bank of Lesotho, 2006). In order for the scheme to be successful it aims to address the following aspects:

5.1
Linkage Banking

A key shortcoming of rural informal savings and credit associations was found to be the limited nature of their savings relative to their investment needs. In order to expand the pool of funds at the disposal of these groups, RSCG policy tries to encourage commercial banks to forge links with the informal groups. This entails informal groups depositing their funds with commercial banks, which in turn extend credit to the groups using such savings as collateral. In this way, the Government and CBL are trying to establish mechanisms through which banks can extend their services to the rural-based informal groups (Central Bank of Lesotho, 2006).

Some of the main reasons for the failure of the rural communities to get banking services such as loans from commercial banks are the high risk element and high information costs. The latter is caused by an existence of information asymmetries within the sector while the former is a legacy of high covariant risk resulting in high loan defaults and delinquency (Bessis, 2002). Lack of material collateral has also contributed significantly towards making rural borrowers unattractive to commercial banks (Central Bank of Lesotho, 2002).

Any policy aimed at integrating the rural sector into the rest of the economy can only make a limited contribution if it does not adequately address the risks and high information costs. It is a RSCG scheme policy stance that the Central Bank of Lesotho encourages linkages between the rural financial sector and commercial banks by laying emphasis on the relaxation of these constraints. The virtue of linkage banking is that it makes good use of the already existing informal networks as mitigation against the above mentioned constraints. For example, limitations imposed by intrinsically high information asymmetries on the provision of adequate credit facilities to the informal sector can be solved by the adoption of group lending which relies on joint liability, peer pressure and other forms of social collateral (Central Bank of Lesotho, 2004).

The fact that all members in villages informal credit schemes know each other very well, already implies that costs of information gathering is eliminated, once a working relationship is established between the formal financial sector and the informal sector. Therefore it is not only be the rural communities who stand to gain from the linkage structure as the formal sector would also benefit from the ability to access the majority of the rural population at low costs and risk (Ministry of Trade and Industry, Cooperatives and Marketing, 2002).

The linkage banking policy approach is achieved by securing the loans of the informal sector through encouraging group savings and a credit guarantee fund that the Government has established at the CBL. The guarantee fund is essential initially to kick-start the process and will eventually be phased out following exit mechanisms and conditions as stipulated below (Central Bank of Lesotho, 2004):

- Government and donors are expected to be the main contributors of the fund.

- So that the guarantees are not subject to abuse by unscrupulous or wilful defaulters, proof of exhausting all efforts of recovery are required before invoking the guarantee. In this regard commercial banks are required to submit periodical monitoring and loan tracking reports to CBL.
- Loan and guarantee applications are a one-stop process. Groups submit to the commercial banks which in turn appraise group projects, submit to CBL for guarantee approval and finally disburse loan funds to successful applicants. Reports on all applications (both rejected and approved) should be submitted to CBL for verification on transparency.
- Regarding exit mechanisms, the graduation period is stipulated to be five years, within which subsequent loans can be offered provided the previous ones had been serviced well. This would allow for a revolving fund to facilitate extension of loan facilities to other groups to benefit from.

5.2
Eligibility Criteria

In order to ensure that only the low income and rural based communities benefit from the scheme, the applying groups are eligible for assistance under the scheme only if (Central Bank of Lesotho, 2004):

1. It is registered under an appropriate legislation.
2. It has been in existence for at least the last six months. This is proved by the ownership of a bank account by such a group that it has been active for the last six months. In cases where such an account does not exist, sufficient proof of the existence of the group for the last two years is required.
3. It has at least eighty percent (80%) of its members as Lesotho rural citizens. The other 20% of non-citizens should have at least been resident in Lesotho rural areas for a continuous period of two years.

4. It has at least eighty percent (80%) of members (rural) that are not formally employed.

In addition, a credit guarantee to applying groups through commercial banks is provided (Central Bank of Lesotho, 2004) subject to the following conditions;

(i) That the funds obtained will be used for investment purposes. That is, only income generating activities such as poultry farming, tapestry, weaving, small scale agriculture and any similar small micro enterprises will be considered for the guarantee.

(ii) That the maximum loan to be extended to a group is within the ranges of a minimum of M5000 and maximum of M50000.

(iii) That short-term and medium-term credit is provided for a maximum period of 60 months.

(iv) That both start-up and working capital is extended to groups with varying repayment terms and periods depending on the nature of business and type of group.

(v) That Rural Savings and Credit Groups have an acceptable record of savings and are able to prove a genuine course for cooperation.

6 ANALYSIS OF THE CASE

In view that the sub-problems highlighted and research questions asked would be answered, the report starts off with the evaluation of past initiatives at rural financial intermediation with particular reference to both shortcomings and positive attributes. This is followed by Sub-Section two which answers questions two on the requirements for the rural banking as was considered necessary by the government in order to avoid repetition of mistakes made in the past. This forms part of the requirements of the RSCG scheme, which is a case of this study, and it answers the second research question.

Subsequently, research questions three and four on barriers and enablers to extension of banking services to rural areas are explored.

6.1
Sub-problem one – Evaluation of past rural financial intermediation initiatives.

> ***Research Question 1: Why did past initiatives for extension of banking services to rural areas fail?***

The evaluation of past approaches to Rural Financial Intermediation Policy indicates that past efforts at rural financial intermediation in Lesotho were spearheaded by the Government, on the one hand, and a host of Non-Governmental Organisations (NGO's) on the other. This strategy followed the then current trends within the developing world when the role of governments in the running of the economy was still perceived as very paramount (Central Bank of Lesotho, 2006). These efforts can be generally classified into:

6.1.1 Past rural finance Institutional Set-Up

As part of its efforts to provide essential financial services to the low- income and rural communities, the Lesotho Government established a range of specialised financial institutions including the Post Office Savings Bank in 1966, the Lesotho Agricultural Development Bank (LADB), the Lesotho National Development Corporation (LNDC) in 1972, and the Basotho Enterprise Development Corporation (BEDCO). These organisations obtained their funds mainly from government.

> "The effect was that government intervention tended to be excessive and political, resulting in benefits not being derived by the intended rural communities. While the purpose for which these institutions were formed remained sound, their operations were less than optimal because of the non-performing nature of their loans. It therefore came as no big surprise that many of them were either forced into bankruptcy (LADB) or restructuring (Lesotho Bank)" (Central Bank representative, 2006).

6.1.2 Financial Intermediation by Private Organisations

This category encompassed NGOs, and all other approaches by Donors and Private Voluntary Organisations. It needs to be pointed out that the government still had a significant role in this category through offering the much-needed support to these organisations. In this category, the strategy was largely based on offering subsidy-oriented credit and institutional support to the rural farming or cottage industries by the rural communities as a way of enhancing their standards of living (Central Bank of Lesotho, 2006). The group lending approach was adopted as a way of minimising the notoriously high transaction costs and covariant risks that are perceived inevitable when dealing with the rural sector (Bessis, 2002).

The Lesotho Agricultural Production and Institution Support Program (LAPIS), which was heavily supported by USAID, is a typical example of an NGO supported group financial extension scheme aimed at accessing agricultural credit to the rural sector. Other credit support programs were promoted under the Basic Agricultural Support

Program (BASP), the Food Self-Sufficiency Program (FSSP), the Local Initiative Support Program (LISP) and the Soil and Water Conservation and Agro-Forestry Program (SWACAP) (IFAD, 2003)

None of these programmes helped the poor to understand the importance of savings. In addition, the institutions only assisted them with finance without working in collaboration with banks to instil the concept of rural banking. The implementation of these initiatives was faced with a number of problems. Besides the problems experienced by government and donors, the involvement of NGOs in the implementation of rural finance support was hindered by skills and capacity problems (Central Bank of Lesotho, 2002). It has been observed that the involvement of NGOs can sometimes inadvertently destroy an otherwise promising project. Lack of capacity and skills on the part of many NGOs and other service providers is regarded as the main causes for their failure to provide relevant training courses that address the needs of the intended groups (Adhikary, 1998; Rogerson, 1999)

6.1.3 Duplication of Efforts

A striking feature of past efforts at rural financial intermediation in Lesotho could be described as lack of unity (Central Bank representative, 2006).

> "While all organisations were meaning well, each came with its own model of providing credit to the rural communities. The effect of this was a great confusion on the part of intended beneficiaries. Furthermore, the programs tended to be too expensive to implement and monitor due to high degree of efforts duplication. It therefore comes as no surprise that most of these efforts have largely failed. The lesson we learnt was that there is a need for a coordinated effort to avoid duplicative and costly programs, if rural communities are to benefit from such initiatives."(Central Bank representative, 2006)

6.1.4 Credit as Opposed to Savings Initiatives

The study revealed that one of the biggest shortcomings of most financial intermediation schemes aimed at the rural communities was too much dependence on credit finance. This was found to be typical of many NGOs and government supported rural financial schemes in Lesotho. In many of these schemes finance was availed to the rural communities at concession terms thus focusing only on credit disbursements without any attempt to incorporate savings deposit services.

The research uncovered that rural communities regarded such schemes as donations which did not require much commitment on their part.

> "Some of us were given funds for crop farming but we thought they were donations. If they were loans, then the terms of loans were not clear or strict. We knew that for large amounts we were expected to pay back something, but, only if we made enough profits from the sale of the crops. Most of the time this was not possible as we usually got just enough for consumption and never had anything left to save or service the loan with" (Community representative, 2006).

As stated in the literature, a combination of savings and loans services has the advantage of enhancing the outreach performance and financial sustainability of the schemes (Hassan & Renteria-Guerrero, 1997). Such a system provides a relatively inexpensive source of capital for re-lending. Since today's depositors are tomorrow's borrowers, a savings program creates a natural pool of clients. In this way, supply creates its own demand. Additional benefits of this system include accumulation of assets by households to use later as collateral or, even better, self-financing of future investments (Ledgerwood, 1999).

6.1.5 A Concessionary Terms

Past rural financial intermediation efforts by both government and NGOs were based on a wrong assumption that, in order to be successful, credit to the rural communities should be highly concessionary. The government injected large sums of money into the rural farming community and provided these communities with the cheapest credit terms available. The consequence of this was very costly and unsustainable credit schemes (Central Bank representative, 2006).

This was further aggravated by the fact that these injections were externally sourced in as far as the rural communities were concerned, a factor which stunted popular support since the intended beneficiaries did not have a sense of ownership to the program. It is not surprising therefore that many of these schemes either failed or are just on the brink of failure due to high rates of defaults and delinquency (Ministry of Agriculture and Food Security, 2005).

6.1.6 Weak Implementation and Poor Monitoring Strategies

The failure of some credit schemes, most notably the LADB, was due to lack of an effective monitoring and recovery mechanism to ensure that the objectives of the schemes were met. Many of the repayment problems were in the form of loan delinquency and default. In communications with CBL representative, it was stated that it was not only borrowers who were responsible for the defaults which led to failure of the programmes. It was quite conceivable that, in a lot of these cases, lenders had not complied with the loan contracts, as well as with their duties, responsibilities and obligations as reflected in the design of the credit program (Central Bank of Lesotho, 2006).

The Central Bank representative continued to say that lenders did not properly screen loan applications, process the loans in time and apply effective loan monitoring and recovery programmes. This view was shared by the Ministry of Agriculture representative:

> "The delay in processing of loans was particularly detrimental for agricultural credit since in this sector, the timing of a project is very crucial given the volatility of all factors that determine productivity. The significance of other loan management issues such as the loan size and usage as well as the structure of the loan disbursements and repayment was ignored (Ministry of Agriculture and Food Security representative, 2006).

While these factors seem to have been integrated into the design of many credit schemes, the study revealed that the project implementation either diverted from the original or the implementation was simply poor.

6.1.7 Weak Management

While many of the government supported initiatives aimed at income generation at the rural settings have achieved some success, rural banking schemes have never succeeded. Most of these schemes were plagued by failure, in some cases almost criminal. Their management did not follow sound banking and business practices. Cases of negative real interest rates and alarmingly poor debt collection led to the bankruptcy of many of these schemes (Central Bank of Lesotho, 2002).

6.1.8 Conclusion

It is apparent that although the government, NGOs and other financial providers had realised the need for financial assistance in rural areas, there was no clear policies of how to approach the problem. There were no set rules to be followed. Whatever strategies each financial unit had, was poorly implemented or duplicated by another unit. This indicates a clear lack of cooperation where each did as it pleased without proper direction from management. It was pointed out by the Central Bank representative that there were no policies or guidelines and the management of such initiatives was poor. It is therefore, understandable that without clear policies, the management of those projects lacked proper control and did not feel accountable for their success of failure. Normally in such cases, government steps in, but when it does, its intervention tend to become excessive; a case that worsens than solve the problem (Kaboski & Townsend, 2005)

6.2

Sub-problem Two: Requirements for banking services in Lesotho rural areas

> ***Research Question 2: What are the requirements for Extension of Banking Services to Rural Areas?***

Most countries develop rural financial policy out of a realisation that market forces, left on their own, tend to discriminate against the low income and rural communities (Todaro, 2006). Based on this realisation, the Central Bank of Lesotho undertook a rural intermediation program with an overriding objective of developing mechanisms through which banking services could be channelled to the rural areas. Hence the researcher's decision to investigate the selected case. This was because this program, among other things, probes the research problem and answers the question about the requirements of extension of banking services to rural areas. The requirements are summed up as follows:

6.2.1 Improving Rural Incomes through Banking Loans

The amount of savings mobilised by the rural in their informal financial institutions is very limited to make any significant contribution to the standards of living of the members. Intervention through banking services such as loans, into the already existing funds from their village group schemes to enhance the standards of living of these rural communities was found to be necessary (Central Bank, 2006). In this way, the amount of credit that the groups could get from both commercial banks and own savings would be large enough to make a significant impact on their income levels. With this credit, small scale enterprise industry and small scale farming, all mainstays of the rural self employed groups, can be resuscitated thus going a long way towards alleviating poverty by providing the needed jobs for the rural communities. A further spill-over effect of this approach would therefore be growth and an improvement of income distribution within the economy (Government of Lesotho, 2003).

6.2.2 Contribution towards the Improvement of Economic Conditions of Women

As in many other developing countries, the Quthing District Agricultural Officer pointed out that:

> "The vast majority of women in rural Lesotho work in informal and agricultural sectors. This is in addition to their daily chores of caring of the young and the old. Being outside the formal sector, they do not participate in most formal programs hence formal financial institutions do not extend credit to them as they are regarded as a high risk".

This is a big problem experienced by village groups which comprise married women members. One member stated:

> "I am a woman member of a village financial scheme. My group applied for a loan under the RSCG scheme from one of the banks. We were told that all married women members should first get permission letters from their husbands. This is a problem for us because our husbands are in the mines in RSA and we cannot get such letters immediately. Now the whole group has to suffer because we cannot meet this requirement."

The research moreover, indicated that the laws were biased against women in Lesotho in that it is almost impossible for them to get credit from formal banking institutions despite the fact that women tend to contribute relatively more of their incomes to financing household costs. Therefore, there is need for a policy that would endeavour to improve the economic conditions of women, rural and urban, by offering them a channel through which they could be able to access credit. This emanated from the realisation that Lesotho rural women were the most active in informal credit groups (Ministry of Agriculture and Food Security, 2003).

6.2.3 Facilitating Access to Basic Banking Services by Rural Communities

As already mentioned, a great proportion of the rural population in Lesotho is without any form of banking accounts. This proportion of the "un-banked" population has been increasing over time particularly after the commercial banks' adoption of the M500.00 minimum balance requirement. In order to counteract this position, some banks introduced ATM linked accounts with minimum opening balances of M50.00. It was however observed that despite this move, the poor and jobless particularly the rural people could still not access banking services. Retrenched men from South African mines, who are mostly rural people who had banking accounts when they still worked, are also negatively affected. They are no longer able to access banking services therefore have withdrawn whatever savings they had had. The savings withdrawn are used for consumption and whatever is left is buried in secret places for safe-keeping (Central Bank representative, 2006)

A practical way out of this situation is through providing basic banking services to this section of the population. Obviously, given the non-profitability of servicing these communities, as indicated by banks during the study, commercial banks cannot be looked upon to provide for these groups without any intervention by the Government. The promotion of rural banking can go a long way towards achieving this objective while also increasing income levels of the rural communities by providing them with basic accessibility (Central Bank of Lesotho, 2006).

6.2.4 Inefficient Allocation of Funds between Commercial banks and the Informal Financial Sector

The failure of the market to allocate financial resources to where they are needed the most is manifested by the simultaneous existence of excess liquidity within the commercial banks and the shortage of credit to the rural sector (Central Bank of Lesotho, 2006). Under these circumstances, it would be expected that interest rates for credit from the informal financial sector to the rural groups would be relatively higher than within the commercial banks. This could encourage commercial banks to go to the rural areas. However, due to inefficient markets and many other structural factors such as the informality of rural intermediary groups, the commercial banks persist to have excess reserves even though there is a significant demand in rural areas for such credit. From these observations, the need for an intervention mechanism to try and assist the market is required. The Central Bank agreed that another way to go about promoting the extension of banking services to the rural sector is to encourage cooperation and linkage between the informal rural financial sector and the commercial banks so as to qualify them into active role players in pursuit of much more efficient credit allocation mechanisms (Central Bank of Lesotho, 2006).

6.2.5 To Encourage Savings for Investment Purposes

Disclosure during the study was that, in Lesotho one of the most common forms of informal finance was the Savings and Credit Group (SACGs). In a lot of these groups, accumulated savings are not used for investment purposes but rather to finance consumption. The same applied to other forms of non-formal schemes such as the burial societies which are meant to provide support to their members in times of adversity. Given the pressures of unemployment in Lesotho following massive retrenchments of Basotho men from South Africa, there is now a need to transform these schemes by encouraging productive use of funds (Central Bank representative, 2006). The investigated RSCG scheme at CBL, aims at, among other things, emphasising the very point of undertaking investment expenditures with the credit sourced from their savings rather than using it for consumption purposes.

6.2.6 Conclusion

For any financial initiatives towards extension of banking services to rural Lesotho, the examples of Islamic financing system on savings need to be followed. As already noted, the organizations within Islamic financing system do not start lending before the groups savings are initiated, the lending rules themselves educate the clients about the advantage of savings with banks. Moreover, bank officials, through personal contact, discuss various issues regarding the disadvantages of not saving with banks and drawbacks of the informal village saving habits. Thus, it is concluded that the rural group scheme members are educated about how to make proper utilisation of their savings in productive ways. New saving habits are thereby being institutionalised. By giving them a proper understanding of the value of their savings, the lending banks encourage the rural communities to start saving from the little they have in their hands (Alam, 2003).

6.3 Sub-problem Three: Barriers which hinder banks from extending their services to rural areas

Research Question 3: What are the barriers/constraints that need to be dealt with in order to get banks to extend their services to Lesotho rural areas?

6.3.1 Profitability of the Rural Market

In interviews conducted with banks' representatives, what could be concluded was that there were not enough incentives to go to rural areas. They insisted that the rural market was not profitable at all. All the CBL initiatives were understood but the bottom-line issue is the biggest barrier. As a representative from Standard Bank put it:

> "It doesn't make any economic sense at all to move to the unprofitable rural market yet we are operating in profitably where we are. It's good the government has taken steps to assist the rural population to get banking services, must remember that banks' main objective is to make profits."

6.3.2 High Costs

"Transactional and operational costs" were stated by Nedbank representative as a barrier since the banking activities would not be in volumes that commercial banks would accept as viable. The fact that CBL rural finance scheme had tried to minimise this problem is not regarded as convincing enough to warrant banks to serve the rural communities. Other costs which she stated, included infrastructures, security, staffing and administration.

6.3.3 Risks Associated with rural banking

All risks discussed in the literature were quoted as barriers, but lack of high profits was stated as the biggest concern. According to discussions with banks' representatives, banks are not able to extend their services to rural areas due to the non-profitability nature of the rural sector. This is clearly demonstrated by the little interest shown by commercial banks and their poor uptake of the Central Bank RSCG scheme. It is also exacerbated by the high minimum balance stipulated for saving accounts.

Given what CBL has done through the RSCG program to minimise banks' exposure to risks, it was clear from the study that the reluctance to extend to rural areas is not because the Central Bank's rural banking initiatives are not known to banks, but it is because banks do not regard these initiatives as enough to earn banks high profits. This view was shared by all banks' representatives.

6.3.4 Legal framework

Central Bank representative pointed out:

> *"*Because most commercial banks are foreign, the CBL regulatory authority is weak. CBL cannot put too much pressure on commercial banks as it also has to abide by certain rules governing foreign banks. Consequently, commercial banks have the freedom to adopt their own policies."

This was disputed by one government representative:

> "It may be true that CBL requires cooperation of the banks, but it is through the weak policies of the CBL that protects and allows commercial banks excessive freedom which render them uncontrollable. Commercial banks know this and they are using it to their advantage. There is a need for a more strict legal policy that should put pressure on banks to consider not only the commercial aspects of their businesses but also the social aspects of communities in which they operate."

6.3.5 Conclusion

This research has shown that the main barrier for banks to extent services to rural areas is quoted as high costs that make the rural market unprofitable. The commercial banks in Lesotho have been concentrating in urban areas they do not have any financial products designed for the rural market such as mobile banking, and they have no immediate plans to extend to rural areas. It was revealed that banks' profits are derived from providing loans to customers who have the ability to pay back, and at rural areas they would be subjecting themselves to the unnecessary risk of losses. The research also revealed that commercial banks do not support the Central Bank rural finance scheme. They believe that the scheme will fail; quoting repayment default risk as the main cause that will fail the scheme. Default risk is defined as a major source of loss and it is customers' failure to comply with obligations to service debt, leading banks to insolvency (Bessis, (2002).

Although an in-depth assessment is beyond the scope of this report, the second major constraint which stakeholders emphasised is the cost and effectiveness of contract enforcement. The existing regulatory and legal frameworks lead to commercial banks' reluctance to extending their services to rural areas. The examples provided include: Women being treated as minors in the eyes of the law, and lack of legislation to enforce land and property rights.

6.4

<u>Sub-problem Four: Enablers that can help to overcome the barriers to extension of banking services to rural areas and ensure success</u>

> ***Research Question 4: What are the enablers that should be considered by the Stakeholders do to ensure successful extension of banking services to the rural Lesotho communities?***

6.4.1 Helping Expand Banks' Customer base

The study revealed that, loan applications of the schemes are approved under the guarantee of their savings with commercial banks. Any loan applications in excess of their savings are to be guaranteed under the guarantee fund hence the groups have to apply for such a guarantee. In this way, savings of the RSCG schemes together with the interest earned can provide the commercial banks with a relatively cheap source of capital for re-lending (Central Bank of Lesotho, 2006).

> "Apart from providing collateral for loans from the banking sector, these savings can also be used, in the long-run, for self-financing smaller group projects. What this implies therefore is that in order to make this working relationship functional, Central Bank with its agencies assist Rural Saving and Credit Groups with opening savings accounts with commercial banks, thus expanding banks customer base" (Central Bank representative,2006).

6.4.2 Registration of Village Group Schemes

The prerequisite for accessibility for rural groups to banks is the implementation of the strategy that facilitates the registration of cooperative groups. This transforms the groups into legally recognisable entities hence it facilitates the linkage-banking program. In itself, this legal status acts as a further guarantee of commercial loans. In order to avoid opportunistic behaviour, as already mentioned under the requirements, only groups that have been in existence for at least six months with an acceptable record of savings and are able to prove that they have a genuine need for cooperation, are considered for registration (Central Bank of Lesotho, 2006).

Rural communities and their chiefs view registration as a step in the right direction, but point out that it does not grant individuals automatic access to banking services, even for those belonging to group schemes.

> "Banks do not recognise the registered schemes as comprising of different individuals with different needs. Even as members of a registered schemes which have bank accounts, they still make it difficult for rural people to open individual accounts. To me this means that rural people can only have some access to banking services as groups. It also means that those rural people who do not belong to group schemes or do not have such schemes in their villages will never have access to banking services.
>
> To me, in addressing the issue of extending banking services to rural areas, everybody in rural villages should be considered, without any exclusions" (Chief of Leribe rural village, 2006).

In the registering of these rural community financial groups, the Central Bank is trying is to satisfy the commercial banks that they are dealing with legal entities even though on an informal basis. As such, groups of between ten and twenty members are envisaged as appropriate. A democratically elected committee for each group then becomes responsible for the mobilisation of savings from group members on a mutually agreed frequency and amounts. The same committee is also responsible for maintaining proper accounts and working directly with the commercial banks (Ministry of Trade and Industry, Cooperatives and Marketing, 2003).

While commercial banks deal with a group as one client, granting of loans at a group level to individual members is still on peer guarantees just as the collection of payments is the responsibility of such a committee. Lending to group members attracts some interest to facilitate adequate servicing of the bank loan. Terms of loans are determined by each group at the rate not lower than the minimum commercial rate. An incentive for the banks is the significantly reduced transaction costs through transferring operations to the groups (Lesotho Bank representative, 2006).

6.4.3 Procedure for Guarantee Application

A group desiring to benefit under the scheme is required to apply for the loan and guarantee from the commercial bank. The procedure is that upon receiving an application, the commercial bank appraises and forwards it to the Central Bank to satisfy itself that the application meets the criteria and conditions already stipulated. Following this procedure, CBL can then approve and forward the approved application to the relevant commercial bank which would in turn disburse the loan under advice to the Central Bank. Reports on all applications (rejected or approved) have to be submitted to the Central Bank for check on justification. The decision on timeframes for loan approval rests with commercial banks with the maximum loan-processing period proposed to be one week. This procedure is also meant to show commercial bank that CBL completely supports rural groups and does not want to expose banks to too much risk (Central Bank of Lesotho, 2004).

6.4.4 Establishment of a Group Credit Guarantee Fund

In order to further motivate commercial banks to extend services to these informal groups, the Government has established a guarantee fund, which could be used to provide credit guarantee to commercial banks in case of any loan defaults by the groups (Central Bank of Lesotho, 2006).

The Head of Rural Finance division explained:

> "This fund will be gradually phased out as the program progresses and the banks establish some confidence to serve the rural communities. It will be invested in securities so that accrued interest plus the capital can be used to settle default claims by banks. The fund will only be resorted to in case of the event of the failure of the savings guarantee."

However, since the objective of this fund is to reduce rather than totally eliminate risk faced by the commercial banks, she explained that a risk sharing arrangement between the commercial banks, the CBL managed guarantee fund and the informal groups had to be agreed upon.

> "The virtue of such a system is to induce responsibility on all stakeholders so that, while groups are expected to avoid misuse of loans and to cultivate a good repayment record, the banks are also urged to follow sound lending policies in the form of timely loan processing, effective loan monitoring and recovery. Any failure to comply with the loan contract by any of these stakeholders will not be blamed solely on that member alone but rather all stakeholders should shoulder a proportion of the loss" (Central Bank representative, 2006).

The best that the guarantee fund does is to shoulder the greater potion of the risk with both the banks and groups sharing the rest of the risk on the agreed proportion. The risk sharing ratios disclosed during the study are 50% for the fund with the remaining 50%

divided on a 60% to 40% ratio for both commercial banks and informal groups respectively. Moreover, any claims from this fund have to be supported by concrete evidence that the best was done by the commercial bank to follow good banking practices and to monitor and try all possible means to recover the loan amount (Central Bank of Lesotho, 2006).

6.4.5 Rate of Interest Applicable

The maximum interest charged on loans extended through this program was revealed to be at prime rate.

> "Since the bank loans to the rural groups have an adequate security, this interest rate ceiling is considered to be acceptable to the commercial banks as most risk is covered" (Central Bank representative, 2006).

When the rural community representative thought about the interest charged on loans granted, one responded:

> "We think it is a good rate but for us interest is not an issue. We pay higher rates when we borrow from village money-lenders anyway. We don't mind interest as long as the accessibility to loans when needed is easy. For example if I needed funds for an urgent need from a money-lender, I wouldn't mind that interest is double or more what the banks offer, as long as I get it immediately. So the fact is, regardless of the rate recommended, for us getting any form of service from banks is difficult"

6.4.6 Training and Technical Assistance

It was acknowledged in the interviews that banking illiteracy within the rural sector stems from a lot of cultural and economic bartering background hence why it is largely unprofessional at least in the sense of a competitive highly dynamic market economy.

The Central Bank of Lesotho is actively leading other stakeholders; the Government, commercial banks and NGOs, in providing training and technical assistance in order to upgrade the activities of the rural sector so as to include them into the rest of the financial and economic activities (Leribe District Agricultural Officer, 2006).

The training which had been offered so far was on a minimal basis to equip group members with only necessary tools, such as, courses in project management and basic principles of bookkeeping and accounting. During my visit to the villages, field workers from government ministries who had already undergone training were the ones involved in the training rural communities. This was because the emphasis put by CBL on training to avoid repetition of past mistakes as already discussed where most rural financial intermediations were rendered unsuccessful by lack of training, gross incompetence in following sound banking and business practices, and lack of professional financial staff (Ministry of Trade and Industry, Cooperatives and Marketing, 2002).

In these training programmes, the risks of subjecting rural groups to highly theoretical training programs that do not exactly meet their needs is recognised by CBL. In order to avoid imposing the terms and conditions of the training program onto the intended beneficiaries, the design of the program was seen to be more demand driven rather than obligatory by the banking sector. The design and implementation of such a training program was regarded to be integrated into a needs-assessment exercise. This was not the case as interviews with the groups revealed that rural groups were still apprehensive of such training programmes. Central Bank has realised this and agree that a more user-friendly training approach is still required particularly in terms of savings and investments (Central Bank representative, 2006).

This was echoed by rural community member who said:

> "A lot of rural people do not understand the training programmes provided. We need to be trained on activities which provide knowledge on how we can generate

> income and be able to save. We also need to be trained about how the market operates. For example, we were trained on piggery and chicken farming and most people who jumped into these activities after that training, are now faced with problems that they were not warned about during the training sessions. Issues such as where to buy or to whom to sell were ignored. The supply of chicken, for example, is not local. It is comes from South Africa, and it is controlled, limited, and unreliable. Even in cases where supply is not a problem and we manage to produce enough for sale, we don't have enough market for our produce. These are some of the issues that need to be highlighted in trainings provided."

In terms of rural communities, the study discovered the root to be lack of skills and literacy. All the problems they highlighted during the interviews showed that the amount of training they had been given by government agencies did not cover key areas such as market study, the importance of saving and timely monthly repayment of their loans. They knew nothing about penalties for failure or delays. In their groups' constitutions, some had rules for failure to pay and security to put in place to the group, but it was clear that they did not understand much about what it meant. This was indicated by the value they attached to the securities they offered. For example some had offered security of old coal stoves which had the market value of almost zero. Some understood the idea of security and the value attached. These were individuals who were identified as a bit literate. They were the ones who were leaders in their groups. They had put their livestock as security.

Unfortunately even their chiefs were completely banking illiterate. Any disputes brought to them were not dealt with properly. There was an incident in Quthing where out of ten members in the group, six were in arrears ranging from two to six months. The other four were literally paying the full loan repayments for the un-paying six. They had taken two of their members who were 4 -6 in arrears before the chief. The ruling was that they should sell the security held (old stove and a goat) to recover the arrears. This had not helped much because though the goat had some value, the stove was not saleable at all. During the interview the goat owner was back to paying her share of the repayment. The stove owner on the other hand was still not paying. They didn't know what else to do with this member.

When the researcher prompted why they had not reported the matter to the field workers or CBL, one member responded:

> "What field worker? Do you mean the lady who comes here once a month and spends less than an hour looking at our stock of pigs and chicken and then writes in her note-book? We always thought she is an inspector. She never asks us our problems. We are afraid of voluntarily telling her our problems because she might note them down in her note-book and go and report us to the big banks. Then we will lose everything. No madam, we would rather pay for the ones who are not paying. Do you know how many others are waiting to get their groups loan applications approved? We will be jeopardising their chance to get it; that would be selfish, we cannot do that"

Clearly, they did not have proper information to make informed decisions. They knew the importance of the rural finance scheme to their village and were prepared to sacrifice and suffer silently rather than jeopardise the opportunity for others. There was only one government field worker for that area. She had no idea there were problems. She said she did not spend time with this particular group because she was based far away from them.

> "I am closely monitoring progress in the area close to where I live. You will see for yourself what I mean when you go to Mphaki village tomorrow. I only come to this village once a month; sometimes I don't come at all because I haven't been provided with a car to move freely between the villages. I do what I can where I am but obviously I cannot cover all villages allocated to me without transport. I am not surprised that this group is experiencing problems, I admit, I am not always there for them when they need guidance and assistance."

The bank which had granted his group a loan, did not know there were problems within this group because it was getting regular repayments. When asked whether the bank was doing any follow-ups after granting loans, the representative of this bank responded:

> "There is no cause for us to worry, as long as the repayments are coming through, we don't investigate the schemes operations."

CBL on the other hand was also of the impression that all was going accordingly. The research revealed that it was not only rural communities who lacked the necessary knowledge, but field workers were also in need of training in people skills, marketing and management skills so that they can deal with rural communities effectively.

6.4.7 Credit to be Based on Group's Savings

It however needs to be reiterated that for any credit scheme to be successful, it has to be backed by a complementary savings scheme. This can facilitate the borrowing of the rural groups from the commercial banks based on the savings accumulated which can be used as collateral of these groups. Moreover, it can ensure that rural groups deposits in the formal sector are reciprocated by a reverse flow of resources from the banks to the rural communities through savings based credit. Initially, loans from the commercial banks to the rural groups could be required to be backed by 100% savings deposited with the commercial bank. However, as time goes on and the groups gain some reputation, commercial banks could then start trusting them and be willing to extend more banking services to them (Ministry of Trade and Industry representative, 2006).

This policy approach adopted by CBL is to call for a continuous effort by the government and other stakeholders, at relaxing the savings constraints as opposed to concentrating solely on the credit side.

> "The basic idea is to try to align the rural financial sector operations with that of the commercial banks by adopting market determined interest rates on both savings and loans. While this strategy could enhance efficiency within the rural communities by encouraging profitability, it could also guarantee sustainability of the relationship between the two sectors and encourage the extension of banking services to the rural" Central Bank representative, 2006).

6.4.8 Incentives

It is not only the banks that are encouraged into extending services to the rural areas. Rural communities are also encouraged to take the programme to a higher level and become full participants in banking services. In order to encourage them to perform to the required level, Central bank has proposed the following incentives (Central Bank of Lesotho, 2004):

- Certificates of good performance (covering good level of entrepreneurship, good track record and high repayment rates) by any institution of CBL and commercial banks' choice would be awarded. Such certificates while serving to recognise good performance, in addition they help in building the groups' profile in negotiating trading terms and additional credit facilities on subsequent loan cycles.
- Performance rewards based on the above criteria would be paid to best performers. This could be offered by way of commission or interest deposited into the group's account at the end of each loan cycle.

- A stepped loan process would be followed to provide for higher amounts to facilitate expansion when activities grow and clients gain experience in managing capital. This would not be automatic but would be determined by commercial banks.

- Special training programmes would be offered to best performing groups. In addition, exchange visits and study tours including trade fairs locally and internationally especially within the African region would be organised to promote, motivate and enhance the quality of group operations.

- Funds for servicing this initiative would accrue from the interest generated on the guarantee fund principal amount.

During the research, community members confirmed that they knew about these incentives but have never heard of any rural finance group which had been awarded any of the incentives.

6.4.9 Conclusion

While the Central Bank of Lesotho and the government have created the incentives for commercial banks to provide rural communities with services, the resistance by the commercial banks seem to be high. Without the willingness from commercial banks and a strong commitment from other stakeholders, commercial banks will always find a way of ignoring the banking needs of the rural communities. There is more work to be done by all the stakeholders to sensitise banks on their social role and responsibility to the communities in which they operate and not concentrate on high profits only.

7 POLICIES RECOMMENDED TO STAKEHOLDERS

7.1

Policies to promote Village Financial Sectors to Formal Banking Level

Since CBL explained that the long-term objective of the government is to build the capacity of the village financial sector to the semi-formal level, there should be a policy that envisages the establishment of rural community and development banks that will offer appropriate services to the neglected rural sector. Considering the democratic structures, sensitivity to the needs of customers and low transaction costs, these institutions can undoubtedly be in a good position to offer basic financial services on a broader scale to the rural masses of society.

Therefore the strategy of achieving this long-term objective should basically involve retaining and encouraging the inherent characteristics of the informal financial sector. The policy should set out to ensure that in the long-run, the established savings and loan associations become more professional in their approach, but still retain their grass roots base. They should still be based on voluntary membership, self organised and self managed with peer guarantees still used to complement whatever material collateral they can accumulate amongst themselves. The degree of regulation should also be as minimal as possible with only simple by-laws enacted for purely facilitative purposes.

The basic principle here is therefore to encourage and acknowledge the source of birth and survival of these informal co-operatives, which emanates largely from the Sesotho traditions. It is recommended in this regard that, the intentions of the policy be to induce an all-inclusive gradual and long-term process of transformation of the rural financial sector which would ultimately culminate in changed savings and investment attitudes of the rural poor.

Rural savings and credit groups should be self-sustaining in the long run and need promotion from the scheme to facilitate a revolving fund approach from which many other subsequent groups to benefit from. The researcher viewed five-year duration of the loan as acceptable as during this period, rural communities, with appropriate training, would have achieved growth and development to attract banks to realise that they are in fact bankable.

7.2

Need for Coordination and Unity in Rural Financial Intermediation Strategies

Given the wide variety of efforts by both the NGO community and the government at rural financial intermediation, it was quite clear that there was some duplication. This therefore calls for a coordination effort by the government and Central Bank to ensure that all activities promote national monetary and financial policies and address the issue of promoting banking in rural areas.

7.3

Regulatory Aspects of the Policy

Appropriate regulation of the rural finance should be one of the key factors in determining the effectiveness of extension of baking services to rural areas. The success of RSCG programme will influence the long-run strength and sustainability of rural banking initiatives which will ideally see banks extending services to rural areas. The programme must retain the essence of informality within the rural groups as it is this characteristic that makes them ideal for the future of rural banking. However, the policy must also introduce some degree of formality and regulation necessary to facilitate the injection of funds from formal financial institutions.

While CBL has decided that the best way to formalise these groups would be to make them legal entities through registration under a relevant piece of legislation, upon request during research, such a legislation document could not be produced. Initially, it was expected that the groups would register either under the Societies Act of 1966 or under the recently passed Co-operatives Act, 2000. However, upon further examination the government and CBL decided that neither of these Acts would suit the purpose.

CBL found the Co-operatives Act to be generally very restrictive, both in terms of the requirements for registration and the rules governing the behaviour of members. For example, the Act lays out a clear and detailed procedure for the appointment and election of a Management Committee and also states what the functions of these committees will be. The Act also stipulates the establishment of a Central Co-operative Fund and a Reserve Fund that each group will have to contribute to. According to CBL, the Act could not be used as such an arrangement would go against the whole idea of retaining the simplistic nature of informal groups and if used, would likely discourage registration, to the detriment of the entire policy.

The Societies Act is much simpler and therefore has the advantage of encouraging registration. However, CBL quoted the looseness of the Act to be a disadvantage. For example, the Act does not state what the societies by-laws should cover. Theoretically, this means it is possible for everyone and no one in the group to be held accountable for the actions of other members. It also contributes to a lack of uniformity throughout the whole network of credit groups and this would not be looked upon favourably by the commercial banks. In addition, the monitoring authority would find it difficult to regulate and check the behaviour and performance of these societies (Central Bank representative, 2006).

Given the contextual inadequacy of both the Societies Act and the Co-operatives Act, it would be advisable to formulate a new piece of legislation that is specifically designed to enable the registration of rural groups that intend to participate in the scheme. There is a need for a clear regulatory body or framework under which registration can be done.

7.4
<u>Institutional Arrangement</u>

In order to ensure the sustainability of the program, a government based coordinating unit will have to be formed. While the CBL has been a steering institution in the beginning of the programme, the government will be looked upon to sustain the scheme through an appropriately tailored organisational set-up. In addition, in order to take advantage of their experience and to eradicate duplication of efforts, all other organizations that have similar programs should be invited to participate within this broader all-inclusive framework.

7.5
<u>Implementation</u>

It was established in the report that the basic philosophy of the scheme is the mobilisation of savings based credit for the rural groups that are deemed to be too costly and too risky, to be serviced by the commercial banks. It was also noted that the idea of savings based credit requires a conscious strategy to ease savings constraints as a prerequisite for accessing credit to the rural communities. In order to achieve this objective, the strategy of linkage banking was presented. Since this strategy basically entails forging links between the rural financial sector in the form of rural cooperative schemes and RSCGs on the one hand and commercial banks on the other, implementation strategy should encompass the needs of both groups.

7.5.1 Needs Recognition and Assessment of Rural Group

The starting point for the formulation and implementation of an aggressive rural intermediation policy is a commitment of the Central Bank to a conscious attempt at identifying the priority needs of the rural sector. This is regarded as essential for formulating strategies to meet their needs.

The thrust of such an exercise should be to make an assessment of the constraints inhibiting the growth of the sector from the point of view of the intended beneficiaries, rather than that of the policy maker, in this case the Central Bank of Lesotho. This should bring into focus areas of weaknesses in translating policy and program intentions into reality. It would also guarantee the sustainability of the program by inducing a sense of ownership in it by the very people it is intended for. An achievement of this will require a survey of the views of the rural sector participants in order to identify the constraints they are facing and possible remedy measures. The experience gathered from this exercise highlighted the need for further research that will look into integration, re-formulation and implementation of an appropriate policy with active involvement of all stakeholders.

The logical starting point should therefore be identifying the intended beneficiaries and sensitising them about the project. This exercise would basically involve an analysis of their problems and their views on how best they think they can be assisted. This strategy, which would acknowledge the fact that the beneficiaries are in a better position to know more about what they need than policy makers, should be aimed at integrating their views into the implementation of the financial intermediation policy. Critical as well is the views of the other stakeholders, particularly the commercial banks since they are expected to lead in extending services to rural areas.

A study of informal financial intermediaries to determine their characteristics, location, constraints and views should be undertaken by the CBL through its Research and Rural Finance Divisions. Further studies are therefore necessary to better meet the needs of the rural people. For instance, the proposed linkage banking strategy can benefit a lot by alerting the commercial banks to the kind of clientele, their location and many other characteristics. Moreover, detailed implementation strategies can be agreed upon in consultative meetings with stakeholders.

7.6

Sustainability of the Project

When considering the research questions in section three and throughout the report, it was mentioned that the success of the initiative to provide rural communities with banking services will be determined by the CBL rural finance scheme effectiveness, growth and sustainability. The effectiveness of the project refers to the influence of the project to the willingness of the banks to take their services to rural communities, and for these communities to effectively use those services to enhance and maintain growth and economic development in the long-term. The sustainability on the other hand refers to increasing effectiveness and continuity even when the project ends. Thus, banks providing services without any push from Central Bank or government projects in place.

8 SIGNIFICANCE OF RESEARCH

This research was conducted with the view to contribute to the knowledge base about banking in Lesotho, and lay out some ways into the concept of rural banking. It is intended to be used by government and banking authorities, stakeholders including the rural communities, to help find ways to attract banking institutions to extending their services to rural areas. Furthermore, it is expected to be of significance to other researchers, as an academic reference for future studies in rural banking.

8.1
<u>Recommendations to Stakeholders</u>

CBL, Government and its agencies need to work together towards building a better relationship with banks in order to succeed in encouraging them to provide banking services to rural areas. During the interviews, it was clear that there were a number of issues that needed attention. There were untapped synergies that were discovered but ignored by these groups. The synergies included information sharing. Banks were found to be unwilling to share even the simple information about why they were still declining the loan applications when yet all the requirements stipulated in the case were met. They could not even share with CBL the number of defaults if any so that there could be a follow-up by the relevant agencies.

Improvement of the relationships would lead to stronger and quicker implementation as all concerned would know what each expected. This process of building stronger ties needs to be initiated by CBL and strongly supported by the government. Due to the multi-disciplinary nature of the programme, it is clear from the study that cooperation and collaboration among all stakeholders is crucial. They should all be involved and committed in the implementation and monitoring of the case study programme, to ensure that banking services reach the rural mass of the population. Their commitment and cooperation is crucial in ensuring success in extension of banking to rural areas.

8.1.1 The Role of the Government

The government has an important role to play in the extension of banking services to rural areas. Some of suggestions are:

- Increase the number of field workers and clearly define their roles
- Provide field workers with the necessary resources to do their work efficiently
- Consider tax concessions to those banks which show commitment
- Create a supportive legal system to ensure compliance and speedy recovery of bankers' dues to ensure an efficient financial system. Perhaps create a dedicated judicial body that ascertains that debt recovery cases are dealt with swiftly and efficiently
- Examine the feasibility of promoting commercial farming activities that would be insurable under crop insurance policy to enable rural communities to become bankable
- Provide necessary support to rural communities in terms of training, access to suppliers, and markets to sell their produce

8.1.2 Central Bank Role

As suggested by Von Pischke (1993), it is the duty of the Central bank to play a pivotal role and implement strategies necessary in any poverty reduction activities. The CBL as the regulator of the country's financial system can influence through its developmental strategies, interventions that would enable commercial banks to extend services to the rural areas. There is evidence from the study that CBL is trying hard to put strategies which should simplify banks' access to the rural communities. But it can improve by:

- Creating awareness about the features of the scheme and its intention to promote banking services to rural areas.
- Be proactive, collect data, and monitor progress made by banks in mobilisation of extension of banking services to rural areas. In addition, it should monitor the

village financial institutions in communities to learn success strategies to see if such strategies can work for banks too

- Consider mobilising the Post Bank to be the wheel for rural community reach as their footprint has already reached rural areas
- Ensure that close relationships with all stakeholders is maintained
- Reduce entry barriers, consider prescribing lower capital requirements in the case of potential financial institutions interested rural banking
- Work closely with World Vision as their selected NGO, to ensure performance delivery.

8.1.3 The Role of Commercial banks

From the data gathered during the interviews, banks' representatives stated that the reluctance of banks to extend their services to rural areas, were mainly the cost of building or renting office space, low transactions volume, and high operations cost. But there are ways around these concerns. What is suggested is that in order to extend their outreach, they can do so by:

- Entering into commercial agreements with the existing informal and semi-formal institutions based in the rural areas
- Providing mobile banking services to rural areas one or twice a week
- Being committed to the rural finance scheme and view efforts made by CBL and the government which include credit risk guarantee fund as a positive support and honour their part.

8.1.4 The role of Lesotho Post Bank

In view of the LPB operational viability, it should strive to get permission to perform all banking operations. In pursuing this, it should start:

- Training its staff in risk assessment, appraisals, monitoring and management techniques
- Enlist the cooperation of the chiefs and develop village councils which would be used in public gathering where benefits of banking would be explained
- Take advantage of the already existing Post Services infrastructures in rural areas by opening more branches

8.1.5 The role of NGOs

Although Central Bank has managed to establish a significant network with NGOs, and has employed the services of World Vision Lesotho as the consultants in managing and extending the scheme to all ten districts, there was no clear direction or strategies set by World Vision on how they would go about the programme. Their capacity and skills to handle such a project could not be verified during the study. Their explanation was that the project had just been presented to them by CBL and they had not formulated any strategies yet. This could pose a problem as the programme was already up and running and some groups had already been granted credit and savings facilities by banks.

It is also argued by rural community members that:

> "These officials spend too much time on meetings and planning rather than on improving the delivery mechanisms which provide support and intervention; they don't even involve us in those meeting."

But the Central bank's view is that it is benefiting significantly by forming a working relationship with NGOs so as to integrate their experiences into the formulation and implementation of the envisaged policy. Interaction between the NGOs and the Bank was facilitated through a stakeholder workshop whereupon representatives of government, informal financial groups, the banking sector and the NGOs meet to share experiences and views on the best policy approach. NGOs are best suited as conduits in the areas of identified training and capacity building for target groups, being the best institutions that are closely located and linked with these groups. Without the support and intervention of NGOs in their promotional and supervisory role, it may not be easy to monitor and evaluate groups' performance. Therefore, NGO intervention would enhance group performance through a series of training programmes.

In conclusion, it is important to mention that most members of the rural communities in Lesotho are completely illiterate. It is therefore, suggested that all stakeholders bear this in mind and try to manage this problem, and identify appropriate ways of educating them about the use of banking services. If each of the stakeholders could play their roles as recommended, it would mean that this study had achieved its intended goal.

9 SUMMARY

From this study it is apparent that there is a growing understanding in Lesotho that there is need for extension of banking services to Lesotho rural areas. This understanding is born out of recognition of the economic role that rural communities can play in rural areas, such as poverty reduction and self- employment. This is a view shared worldwide. Delivering banking services to the rural communities through sustainable mechanisms will have to be pursued and adopted to follow the best practices required around the world.

There is need to engage all financial institutions, both formal and informal to incorporate their activities into an efficient country's financial system whose scope covers the whole population. Given that a large portion of the population in Lesotho is based in rural areas, commercial banks with their branch network only in urban areas, are failing to effectively mobilise rural banking to many households. This has a negative impact on the country's economy as adoption of improved technologies and practices to improve the economy is not being utilised by the majority on the economy.

Since the CBL is the leader in rural finance programmes, it should see to it that there is close coordination between stakeholders. The concept of extension of banking services to rural areas should be on everybody's agenda especially commercial banks.

10 CONCLUSION

The extension of banking services to the rural areas in Lesotho can contribute greatly towards economic development by generating employment opportunities and mobilising rural savings towards productive sectors. It is revealed from the literature that the rural sector is one of the most neglected sectors of economy in almost all least developed and developing nations of the world. Among others, rural communities suffer from lack in working capital, institutional credit facilities and poor management in their financial group schemes. Due to the shortage of capital they are compelled to borrow funds from local moneylenders at a high rate of interest. This practice brings endless miseries to the rural communities. With regards to the burden of debts of the rural poor there is a proverb in developing nations, which says, ‘The rural poor are born in debt, lives on debts and die in debts’ (Alam, 2003).

It is observed from the study that most of the rural people are savings minded and they try to save from whatever little earnings they have. Unfortunately the efforts of these people remain unattended. Lesotho commercial banks do not consider the issue of rural savings as an important factor for generating working capital for the rural communities. Institutionalisation of saving habits already established through the Central Bank RSCG scheme through lending procedures might contribute to a greater extent in developing saving mentality among rural communities.

10.1
<u>Suggestions for Future Research</u>

The following have been identified as impending subjects for future research:

- Flexible banking entry requirements to allow Informal financial institutional to be developed into community banks and allow more banks to be opened in Lesotho
- Use of Mobile Banking and other delivery mechanisms as alternatives to branches to reach rural areas

- Need for improvement of infrastructures such as roads and electricity to enable banks to reach rural areas through use of modern technology
- Lesotho Post Bank as a potential wheel for the extension of banking services to the rural masses
- Improvement of financial regulations particularly in addressing rural communities and women need to be researched
- Close monitoring and supervision of rural finance activities by trained field workers
- Continuous training and development of rural communities on banking risks and benefits

REFERENCES

Alam, M.N. (2003): Institutionalisation and Promotion of Saving Habits through Bai-Muajjal Mode of Financing (A unique means of mobilising rural savings towards productive sources): *International Journal of Islamic Financial Services 29(2/3), [http://www.xe.net/ucc/convert.cgi], (accessed 14 July 2006)*

Bessis, J. (2002): *Risk Management in Banking,* second edition, Chichester: J. Wiley.

Binks, M. & Ennew, T. (1996): *Financing Small Firms: Small Business and Entrepreneurship,* 2nd edition, Macmillan: London

Bureau of Statistics, Ministry of Finance and Development Planning, (2003): *2001 Lesotho Demographic survey:* Analytical Report, Volume 1

Cameron, R. (1972): *Banking and Economic Development: Some Lessons of History,* first edition, New York: Oxford University Press.

Creswell, J. W. (1998). *Research Design: Qualitative & Quantitative Approaches*. London: SAGE Publications.

Firnmark Trust and Genesis Analytics, (2005): Access to financial services in Lesotho *[http://www.finmark.org.za/researchmaterial/workingpapers/2005/Lesotho_March.pdf], (accessed 6th November 2005)*

Fleisig, H.W. & de la Peña, N. (2003): Legal and Regulatory Requirements for Effective Rural Financial Markets: *Centre for the Economic Analysis of Law [http://www.emaraldinsight.com], (accessed 2 November 2005)*

IFAD, (1999): *Challenges, opportunities and options for the development of rural financial institutions*: Working papers in Rural Finance: Rome, Italy

IFAD, (2003): *Project completion report of Rural Finance and Enterprise Support Project:* Working Papers in Rural Finance: Rome, Italy

Furness, E.L. (1975): *Money and Credit in Developing Africa: Studies in the Economics of Africa,* first edition, London: Heinemann Education Books Ltd.

Hassan, M.K & Renteria-Guerrero, L. (1997): The experience of the Grameen Bank of Bangladesh in community development: Case study *International Journal of Social Economics 24 (12) [http://www.emaraldinsight.com], (accessed 7th November 2005)*

Kaboski, M. & Townsend, R.M. (2005): Policies and Impact: An Analysis of Village-Level Microfinance Institutions, *Journal of the European Economic Association* 3(1):1-50, *[http://www.emaraldinsight.com], (accessed 2 November 2005)*

Ledgerwood, J. (1999): *Microfinance handbook: An institutional and Financial Perspective,* Washington D.C: World Bank

Leedy, P.D & Ormrod, J.E. (2005): *Practical Research, Planning and Design,* eighth edition, New Jersey: Pearson Education, Inc.

Merriam, S. B. (2001): *Qualitative Research and Case Study Applications in Education,* third edition, San Francisco: Jossey- Bass Publishers.

Miles, M.B & and Huberman, A.M. (1984): *Qualitative Data Analysis: A Sourcebook of New Methods,* California: Sage Publications.

Mwenda, K.K. & Muuka, G.N. (2004): Towards best practices for Micro Finance Institutional Engagement in Africa Rural Areas: Selected Cases and Agenda for Action, *International Journal of Social Economics 31(1/2)*, *[http://www.emaraldinsight.com], (accessed 11 November 2005)*

Ododokun, M.O (1998): Financial Intermediation and Economic Growth in Developing Countries, *Journal of Economics Studies 25(3) [http://www.emaraldinsight.com], (accessed 11 November 2005)*

Patton, M. (1990): *Qualitative Evaluation and Research Methods,* Newbury Park: Sage

Perry, C. (2001): Case Research in Marketing, *The Marketing Review*, 1, 300-325

Rogerson, C. (1999): *In Search of the African Miracle: Debates on Successful Small Enterprise Development in Africa,* unpublished Research Report, Johannesburg: University of the Witwatersrand

Sah, R. & Stiglitz, J.E. (1992): *Peasants versus City-Dwellers: Taxation and the Burden of Economic Development,* first edition, New York: Oxford University Press.

Stiglitz, J. & Weiss, A. (1981): Credit Rationing in the Markets with Imperfect Information, The American Economic Review, 71, 390-410

Tellis, W. (1997): Application of a Case Study Methodology: The Qualitative Report 3(3) [*http://www.nova.edu/ssss/QR/QR3-3/tellis2.html],(accessed 10th November 2005*)

Todaro, P.M. (1997): *Economic Development,* sixth edition, Massachusetts: Addison-Wesley Longman Limited.

Tucker, J. & Lean, J. (2003): Small firm finance and public policy, *Journal of Small Business and Enterprise Development*, 10(1)

Von Pischke, J.D. (1993): *Finance at the Frontier: Debt Capacity and the Role of Credit in the Private Economy,* second edition, Washington, D.C: The International Bank for Reconstruction and Development/The World Bank.

Ximiya, W. (2000): Village Banking in South Africa*, [http://www.wsp.org/English/afri], (assessed 11th November 2005)*

Yaron, J. (1998): The Village Bank System of Bank Rakyat Indonesia: Case Study, *Journal of Economics Studies 25(3), [http://www.emaraldinsight.com], (accessed 2 November 2005)*

Yaron, J., Benjamin, M. & Charitonenko, S. (1998): Promoting Efficient Rural Financial Intermediation, *The World Bank Research Observer, 13(2), 147-70, [http://www.emaraldinsight.com], (accessed 22 January 2006)*

Yin, R.K. (1994): *Case Study Research - Design and Method, Applied Social Research Methods Series 5,* 2nd edition, London: SAGE Publications, Inc.

Yin, R.K. (2003): *Case Study Research - Design and Methods, third* edition, Thousand Oaks: SAGE Publications, Inc.

Yunus, M. (1997): Micro-credit Summit, Opening Plenary, Washington, DC, *[http://www.emaraldinsight.com], (accessed 2 November 2005)*

Yunus, M. (1998): "Poverty alleviation: is economics any help? Lessons from the Grameen Bank experience," *Journal of International Affairs, 52(1) 47-65, [http://www.emaraldinsight.com], (accessed 2 November 2005)*

SOURCES

Central Bank of Lesotho, (2002): *Financial Intermediation in Lesotho: Problems, Causes and Solutions*

Central Bank of Lesotho, (2004): *Blueprint on a Vision for the Institutional, Legislative and Supervisory Framework if the Financial Sector in Lesotho*

Central Bank of Lesotho, (2004): *Annual Report for the year*

Central Bank of Lesotho, (2006): *Draft of proposed contract to be entered into between CBL and NGOs for RSCGs mobilisation*

Central Bank of Lesotho, (2005): *Quarterly Credit Review for the period ended December 2005*

Government of Lesotho, (1966): *The Societies Act*

Government of Lesotho, (1989): *The Moneylenders Act*

Government of Lesotho, (1999): *The Financial Institutions Act*

Government of Lesotho, (2000): *The Central Bank of Lesotho Act*

Government of Lesotho, (2000): *The Cooperative Societies Act*

Government of Lesotho, (2003): *Poverty Reduction Strategy, Maseru*

Ministry of Agriculture 2002): *Rural Finance and Enterprise Support Project*

Ministry of Agriculture and Food Security, (2003): *Agricultural Sector Strategy*

Ministry of Agriculture and Food Security, (2005): *Lesotho food security policy and strategic guidelines*

Ministry of Trade and Industry, Cooperatives and Marketing, (2002): *White Paper on the Development and Promotion of Small Businesses*

Ministry of Trade and Industry, Cooperatives and Marketing, (2003): *Research Paper on Causes and Determinants of poor Cooperative Performance, Department of Cooperatives*

APPENDIX A: RESEARCH PLAN

Time Plan, Progress to date and expected completion

TASK	Time taken	Apr-06	May-06	June-06	July-06	Aug-06	Sept-06
Recruitment and selection for participants	2 weeks						
Data Collection	3 weeks						
Data Analysis	4 weeks						
Draft of research report	4 weeks						
Final report	2 weeks						
Binding and submission	1 day						

APPENDIX B: DETAILS OF THE PARTICIPANTS

Respondents' Names	Position	Company	Comments	Conclusion
Mrs N Bereng	Head of Rural Finance department	Central Bank of Lesotho	CBL officials doing the field work themselves to ensure success	Will ensure that RSCG scheme succeeds or else CBL and the government will seek other options to extend banking to the rural areas
Ms N Moshoeshoe	Business Relationship Manager	Nedbank	Loan applications received but not yet processed	No interest or commitment shown
Mrs Nyeoe	Head of Business operations	Standard Bank	Rural market too costly and risky	Bank representative thinks CBL should do more before Standard Bank can commit itself
Mr R Tsosane	First National Bank	First National Bank	Recently opened, putting up mini ATMs in Rural areas to test the product/market	A South African branch controlled in RSA. Not involved in the RSCG Scheme CBL scheme.

Mr Mokoaleli	Relationship Manager	Lesotho Bank	Approved some loan application but for only those who already had bank accounts	Sceptical about RSCG Scheme but have some semi-operational branches in some rural
Mr M Vumbukani	Lesotho Post Bank CEO	Lesotho Post Bank	Recently opened. Not yet fully operational, limited products but already has branches in rural areas	Only licensed to take deposits but in negotiations with CBL and government to introduce other products designed specifically for the rural communities
Mr L Mofolo	Field Facilitator	World Vision	World Vision has just signed a contract with CBL	Will be working with rural communities to ensure the success of the rural finance projects
Mrs M Tsasanyane	Quthing DAO	Ministry of Agriculture		Supports rural finance initiatives
Mr M Lefosa	Leribe DAO	Ministry of Agriculture		Supports rural finance initiatives
Mrs M Hanyane	Director Field Services	Min of Agriculture	RSCG can only work if banks can cooperate	Believes banks should show more commitment
Mrs M Lekhetho	Field Facilitator	Ministry of Trade and Industry	Rural communities need assistance in sustainable developmental projects	Supports all types of rural financial intermediation
Mrs L Motanyane		Ministry of Finance	Rural communities need to be encouraged to save	Supports rural banking initiatives
Chief. M Theko	Chief	Leribe	One interview	Support the

				initiative to bring banking to villages
Chief. H Lerotholi	Chief	Quthing	One interview	Supports RSCG and Committed to assist in disputes within groups
• Mrs Seqenane • Mr Mokuoane • Mr. Motanyane • Mr T Sejakhosi • Mrs Ramahohle	Community representatives	Quthing	One interview each	Need banking services and are working hard to make RSCG scheme a success
• Mr Lengopeng • Mr Mokuoane • Mrs M Mafa • Mrs S Santi • Mrs Koali • Mr M Lipholo	Community representatives	Leribe	One interview each	Need banking services and are working hard to make RSCG scheme a success

APPENDIX C: CONSISTENCY MATRIX

Sub- problems	Literature	Research Questions	Data Sources	Data Analysis
To determine the strengths and weaknesses of past rural financial intermediation programmes	Alam (2003), Cameron (1972). IFAD (2003)	*Why did past initiatives for extension of banking services to rural areas fail?*	IFAD, Central Bank	Case study
To determine the requirements for extension of banking services to rural areas	International journal of social economic (2004)	*What are the requirements for the extension of banking services to Lesotho rural areas?*	In-depth interviews with community members	Case study
To determine the barriers which hinder banks from extending their services to rural areas	Todaro (1997), Bessis (2002), Fleisig & de la Pena (2003)	*What are the barriers/constraints that need to be dealt with in order to get banks to extend their services to Lesotho rural areas?*	Banks' representatives, Centre for the Economic Analysis of Law Journal	Case study

To determine the enablers which can help to overcome the barriers to extension of banking services to Lesotho rural areas	Mwenda, K.K. & Muuka, G.N. (2004)	*What are the enablers that should be considered by the Lesotho government, banks, and rural communities do to ensure successful extension of banking services to the rural Lesotho communities?*	In-depth Interviews and Secondary data	Case study

APPENDIX D: INTERVIEW BOOKINGS

Setting up an in-depth interview with the respondent:

Getting through to the Switchboard Operators at different banks

1. Hello, my name is Nthabiseng Sekhothu. I am a MBA student at Wits Business School and I am currently conducting research on extension of banking services to the rural areas in Lesotho. May I speak to Mr. / Ms……………please?

Got through,

Mr. / Ms…………… my name is Nthabiseng Sekhothu. I am a MBA student at Wits Business School and I am currently conducting a research on extension of banking services to rural areas, and you could be willing to take part in the study.

unavailable:

2. When would it be convenient to call him/her?……………. Thank you I will call back later then.

Personal visit to set-up an interview: (community members and chiefs)

In Sesotho language:

3. Hello Mr. / Ms……………….., my name is Nthabiseng Sekhothu. I am a MBA student at Wits Business School and I am currently conducting a research on how banking services can be extended to your communities. Mr. /Ms…………………… from………………………… has recommended that I speak to you about the possibility of your participation in the research because of your involvement and interest in the area. The research I am conducting explores the barriers and enablers to extension of banking services to rural areas. It requires in-depth interviews and I would be honoured to discuss these issues with you. The discussion will not take more than an hour of your time. Your contributions will be anonymous, your name will not be mentioned or linked to any of the statements or comments you will make.

I think the results will add value to you and other Lesotho people interested in the banking services at grass-root level. By being part of the research, you will receive a copy of the findings. I would even be happy to make a presentation of the findings at a date of your choice. Would you be interested in participating?

Scheduled date, time, place of interview.

Referred me to someone else:

4. Hello Mr./ Ms……………….., my name is Nthabiseng Sekhothu. I am a MBA student at Wits Business School and I am currently conducting research on extension of banking services to Lesotho rural areas, Mr./Ms…………………… at/ in………………………. has recommended that you would give more insight into this issue. The research I am conducting explores the barriers and enablers. Would you be interested in participating in this study?

Scheduled date, time, place of interview

APPENDIX E: IN-DEPTH INTERVIEWS

Opening Statement on the day of the interview:

Good day,

Thank you for agreeing to contribute to this research study. The interview will not last longer than an hour. Your contributions will be anonymous, neither your name nor company will be linked to any statements or comments made.

As I explained in our last conversation, I am exploring barriers and enablers of banking services to Lesotho rural communities. The issues I would like to discuss are based on the three research questions:

The relevant interview questions were then presented to the respondents, translated to Sesotho where necessary. Then the probing and prompting followed until all the questions had been answered:

- *To what extent do Lesotho rural communities need financial services in their areas and how what would be the benefits of such services?*
- *What are the constraints that need to be dealt with in order to get banks to extend their services to Lesotho rural areas?*
- *What are the chances of success to failure?*

Questions to Central Bank of Lesotho Representative

1. What has the government done to promote extension of services to rural areas?
2. Why was the project started?
3. What are the objectives of the project?
4. Who are the drivers behind the scheme? What are their specific roles?
5. What role does the government play in the programme?
6. To whom is the scheme aimed at?
7. What are the requirements?

8. Which areas have qualified and what banking services have they received?
9. What kind of awareness campaigns have you undertaken? To who were they directed? What modes of communication were used? And how were they conceived?
10. What is the role of commercial banks in this programme?
11. Are there any other initiatives that are the government and CBL are taking to promote banking services in rural areas?

Questions to Lesotho commercial banks' Representatives

1. Why are banks only concentrated in urban areas?
2. Do you have any plans to extend to rural areas? What marketing strategies are you employing or intending to employ to reach such areas?
3. What kind of banking services do you have in rural areas? If none, why?
4. What prompted you to offer these services?
5. What kind of market segments do you have?
6. What do these market segments know and understand about banking services?
7. How have they expressed their interest in banking services?
8. What kind of benefits are these communities getting from these services
9. What benefits do you get?
10. What is your competitive advantage in these areas?

Questions to Rural District Administrators

1. How many banks do you have in your district? Who are they?
2. What kind of services do they provide for the communities in your district?
3. Are you aware of the CBL rural finance scheme intended for rural communities? If yes, how they you know about it? If no, what kind of information do you have access to relating to banking services?
4. How is the information disseminated to the communities in your area?
5. In your opinion, what are the advantages and disadvantages of banking services in rural areas?

Questions to rural chiefs and communities' representatives

The interviews here were very informal and unstructured to prompt as much information as possible and with as much ease as possible.

The questions were all in Sesotho (local language), and were based on their knowledge and how they perceive banking services. The CBL rural financing scheme was discussed at length to establish whether they knew about it, how they came to know about it, and what benefits they thought it would bring.

For those who knew about it, the process was investigated in terms of the requirements for qualification.

Closing statement to respondent

Thank you very much for your time and the information. I appreciate your contribution to this study, and as soon as the results of the research are available I will send you a copy.

Goodbye