

Microfinance and Poverty Alleviation in South Africa¹

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Summary

1. South Africa's highly skewed income distribution and economic structure has produced a large number of so-called 'unbankable' households. The commercial retail-banking sector cannot profitably serve such households, which exist within the 'informal economy', and depend significantly for cash income on state transfer payments, such as pensions, and affective transfers from employed relatives. Political attempts to 'exhort' South African banks to serve such people on social grounds are pointless, and contradict the government's broader emphasis on a globally competitive economy.
2. State-sponsored SMME microenterprise/microfinance programmes are not a solution to the financial service needs of these households. SMME microcredit policy is a subset of growth and employment policy, and is not directly oriented to poverty relief or social development. The emergent commercial microcredit industry is also largely unsuitable to poverty relief, both in that it caters for the employed and/or those with formal bank accounts, and that it is not developmentally oriented.
3. There is a strong argument that most attempts to provide 'traditional' microfinance services to economically marginalised households in South Africa will fail – in the sense of reaching the poorest of the poor effectively – without elements of subsidisation, cross-subsidisation, and/or voluntarism on the part of the implementing agencies. In South African conditions, the gap between the earning and borrowing power of the poorest of the poor and the cost structures of conventionally-conceived microfinance initiatives is simply too great. This is an historical and social, rather than technical, issue. This problem can be addressed, however, if the definition of 'success' is defined appropriately, to include social opportunity costs and benefits.
4. For this reason, microfinance policies intended to meet the needs of economically marginalised households must carefully define the *developmental challenge* if they are to be effective. Broadly, there are two views of this challenge: (a) that it is to provide sustainable microfinance facilities to the poor to facilitate income generation or reduce the costs of poverty; or (b) that it is to use microfinance to develop, mobilise, and leverage hidden social assets in resource-poor communities to address poverty and vulnerability. Unfortunately, in the past, lack of clarity about these different forms and functions of microfinance has led to debate at cross-purposes, with some implicitly assuming an SMME microcredit focus, whilst others assume a social mobilisation focus.
5. Within such debates, the hegemonic South African paradigm has long been 'SMME microfinance', with its attendant foci on 'sustainability' and 'professionalism'. This has served to obscure the social benefits of alternative forms of microfinance, both lending and saving, as well as the developmental opportunity costs of *not* exploring these options.
 - a. Firstly, the SMME microcredit paradigm, with its emphasis on quantitative and financial measures, is not oriented to or skilled in identifying and capturing harder-to-measure qualitative impacts of social mobilisation microfinance, both on individual households and communities. The SMME microcredit paradigm tends to adopt an income approach to poverty, as opposed to the more holistic sustainable livelihoods/asset vulnerability approach implicit in alternative microfinance. Because the SMME microcredit paradigm does not adequately incorporate more qualitative impacts, it is also unable to assess adequately the *need* for alternative microfinance systems, even if they require an element of subsidisation.
 - b. Secondly, the SMME microcredit paradigm can actively *block* experimentation and innovation in support of alternative forms of microfinance, by insisting on inappropriate and, in some senses, irrelevant evaluative criteria. Advice drawn from SMME microcredit practitioners (who are relatively more abundant, given their roots in and affinity to the formal finance sector) tends to eliminate alternative microfinance strategies early on in programme design processes.
6. The document concludes by arguing that the developmental challenge for the Department of Social Development is to explore ways in which it, as the state institution mandated to address poverty and vulnerability, can explore, learn about, and incorporate alternative

forms of *social* microfinance into its programmes. In the first instance, addressing this challenge requires the Department firstly to familiarise itself with the various microfinance paradigms.

1 The South African Microfinance Context

South Africa has the highest Gini coefficient in the world, having reportedly regained this unhappy status from Brazil. South Africa's 'first world' economy is oriented to the very highest standards of globalised consumption, and formal sector incomes and lifestyles reflect this. By contrast, the real incomes and 'lifestyles' of the very poor, particularly in rural areas, are comparable to those in the poorest 20% of countries. As the SATOUR catchphrase used to say, South Africa is truly "a world in one country".

Income in South Africa is closely linked to economic status: whilst the middle and upper classes inhabit the 'formal' economy, the poorest are largely 'informally' employed, if at all. Such households are not merely 'formally unemployed' and therefore waiting for job creation strategies to absorb them; they *permanently inhabit* a dependent segment of the broader South African economy, in which opportunities for jobs, or for independent and self-sustaining entrepreneurial capital accumulation, are minimal.

In South Africa, an economically 'advanced' and globally integrated minority – both black and white – coexists with a *dependent and marginalised* majority. South Africa's poor majority lack access to basic means of survivalist production, such as land, because of unresolved issues of settler dispossession, now translated as 'property rights issues'. Moreover, unlike postcolonial societies elsewhere in Africa, in Asia, the Caribbean, and Latin America, South Africa's advanced manufacturing and retail distribution sectors severely constrain opportunities for small-scale manufacturing, the salvation of the poor in many countries.

The poorest of the poor in South Africa are thus dependent for their survival on the commoditised economic circuits of the formal economy, albeit without the necessary *cash* incomes to participate in it. The *things* that sustain and enhance life are available only as purchased commodities, not as directly produced items of use. The poorest of the poor are structurally precluded from access to the exchange-value – the *cash* – necessary to obtain these commodities, as well as from the opportunities to produce them themselves. To be truly poor in South Africa, therefore, is to be without means of *achieving consumption*.

One result of this brutal economic one-two punch is an extraordinary dependence on state transfer payments, such as pensions, and inter-household income transfers. This is especially marked in rural areas. Another result is the high incidence of predatory economic crime, such as hijackings and bank robbery. Left with few options, people *must* find cash to survive, with or without formal sector opportunities.

This dualistic economic structure² is one of the defining factors of South African poverty, which poverty alleviation strategies must take into account. It has important implications – some not so obvious – for microfinance practise in South Africa.

² This section requires some unpacking, since the concepts *dualism* and *dependency* have had specific meanings in earlier analytical discourse.

In the 1950s and 50s, the concept of economic 'dualism' was used to explain – in reality, only to describe – conditions in many late-colonial societies, in which small extractive or proto-manufacturing sectors coexisted with massive 'traditional' sectors. It was assumed that the inevitable growth of the former would eventually absorb and transform the latter.

In the 1960s and 70s, the concept of dualism was transformed both qualitatively and spatially. In 'dependency theory', the relationship between the economically advanced 'core' and the dependent 'periphery' was seen as exploitative and causal, with growth of the former dependent on continued underdevelopment of the latter. The theory also recognised the existence of multiple states of dependency, both within and between economies.

By the late 1980s, dependency theory had given way to a curiously non-partisan version of 'trickle-down' theory. On both left and right, it was increasingly argued that, now that the mercantilist structures of the colonial period had been abolished, and artificial economic sustenance, provided by the cold war rivals to smaller dependent countries, was coming to an end, 'genuine' growth would eventually absorb the previously 'traditional' or 'dependent' sectors. That is, if the correct policies were adopted: this is reflected in the 'Washington consensus' and its national equivalents, such as the South African GEAR policy.

By the mid-90s, however, some analysts increasingly recognised that the specific nature of productivity-based and globalised late-20th century economic growth, both technologically and spatially, creates conditions in which a 'dependent' sector continues to exist even with relatively rapid quantitative growth. This is described as the '70/30 society', in which a majority of the population is condemned to *long-term unproductive and non-causal dependence* on the advanced, globally-integrated sector, in the form of transfers of exchange value through state welfare policy and/or affective relations. The 'informal' sector does not perform any useful function for the 'formal' sector other than to absorb and hide the unemployable. High-tech and/or export-oriented growth does not require large quantities or 'reserve armies' of labour, even if moderately skilled. The globalisation of production means that in any given 'developing' country, only a relatively small part of the population is required to achieve apparently reasonable *per capita* GDP growth – 'jobless growth'. This dualistic pattern is reproduced by a combination of free and rapid capital flows and continued (even strengthened) international barriers to labour mobility, and is marked by increasing income disparities.

1.1 Microfinance and the Poor

Much discussion about microfinance starts from an observation that the poor lack access to financial services, credit, and savings facilities. Very often discussion does not go beyond this observation, and the associated call for remedies, to discuss exactly *how and why* access to microfinance – savings and/or credit – would help to address poverty, particularly the most intractable kind outlined above. At the outset then, let us examine some aspects of the South African microfinance context.

1.1.1 Commercial Retail Banking

South African retail banks evolved to serve the needs of the white population, and their geographical coverage, institutional structures, and business practises developed accordingly. South African banks are rooted in the British ‘high street’ tradition, with small branch operations or agencies providing a personalised service. Many middle-class retail-banking products have traditionally been cross-subsidised by commercial banking operations.

Because of the high overheads involved, the high street approach is unviable for commercial retail banking to small-balance, low-income customers³, who have traditionally depended on a combination of postal banking and rotating savings and credit schemes (stokvels). Both options involve alternative approaches to financial transaction costs. In postal banking, such costs are subsidised by other postal services, whilst ROSCAs lower transaction costs through collectivity. Significantly, the only recent retail product development relevant to the poor has been so-called ‘society scheme’ accounts, which provide basic account facilities to savings collectives.

This situation is getting worse, not better. Since 1990, the South African banking sector has become more internally competitive, dependent on overseas lines of wholesale credit, and open to foreign investment. Most importantly, retail banks are now constrained to maintain *globally* competitive returns on shareholder equity (ROE). Failure to do so can attract hostile takeover bids, as was the case in 2000 when Nedcor, backed by offshore shareholders, attempted to absorb an unwilling Stanbic.

Global finance industry analysts are particularly alert to cross-subsidisation, and this, combined with competition from non-traditional financial service providers such as supermarkets (e.g. point-of sale banking), has spelt the death-knell for traditional high street banking. Retail banks have instead moved aggressively to convert their clients to ‘faceless’ electronic banking, with mixed success.⁴ Some banks, such as the BOE/NBS and ABSA groups, have done reasonably well; others, such as Standard and FNB, have struggled to overcome their archaic management traditions. As in the UK, resulting disaffection with declining service quality during this sea change has led to widespread public criticism of banks.

Simultaneously with this exogenously driven change of tack in retail banking, the South African Reserve Bank has gradually tightened the regulatory environment, as part of the government’s drive to attract foreign investment. The most important changes involve increased reserve requirements, a key index of perceived banking sector stability. In order to meet these requirements, South Africa’s banks will have to increase operating margins, creating further pressure to generate higher uniform rates of return across all retail operations.

Both sets of changes – competitive and regulatory – have thus impelled a substantial *rollback* of retail banking services. This has affected both low- and middle-income customers. For their part, low-income households in the informal sector are now substantially farther away from access to commercial banking facilities than they were at the beginning of the 1990s.

1.1.2 Political Response

Paradoxically, as these processes unfolded, South African retail banks have come under mounting political pressure to extend their services to the poor. This has been most visible in housing finance, but increasingly, the paucity of general financial services has also come under scrutiny. For example, late in 2000, the Communist Party and COSATU launched a public

Although this view still recognises a ‘dual’ economic structure, therefore, relative to earlier models, the relationship between the two sectors has been reversed.

³ As the ill-fated Community Bank quickly discovered in the early 1990s.

⁴ This was compounded by the dramatic increase in cash-in-transit and bank robbery during the 1990s.

campaign against the banks for their failure to serve the poor, which attracted more than a little middle-class sympathy.

The ANC government has adopted a contradictory stance vis-à-vis the banks. On one hand, some in cabinet, particularly housing minister Sankie Mthembi-Mahanyele, echo the populist refrain and demand that banks 'do the right thing' by extending services, particularly credit, to the poor. On the other hand, economic Ministries such as Trade and Industry and Finance largely avoid the issue, knowing very well that such populist criticisms are both misplaced and ineffectual in a globalising economy. For its part, the South African Reserve Bank has remained aloof.

Nevertheless, the combination of political and popular disaffection from both low- and middle-income South Africans worries the banks. To deal with this, banks have opted to create separate 'off-book' institutions specialising in the low-income market. This allows them to maintain the ROE of their core traditional operations at levels that satisfy global markets, whilst extending some services to the previously unbanked.

Given their lack of experience in this area, however, and the essentially political – as opposed to commercial – logic of the strategy, such institutions (PEP bank, Africa Bank, Cash Bank, The Perm, etc.) have had mixed results. Significantly, most of the new structures are not based on branch operations in low-income areas, but on card-based electronic services that presuppose a client visit to an urban centre. This is costly, and a high security risk to the client. This suggests that the overall trend of these initiatives has been to recreate a 'stripped-down' version of the same banking practises and assumptions operative in the existing retail sector.

1.2 Alternative Finance Institutions

During the mid-1990s, whilst the retail banks were still indecisive about their approach to low-income consumers, a number of alternative financial institutions emerged.⁵ These had both developmental and commercial motivations, and were not intended as replacements for retail banks. Both shared a recognition that it was fruitless to speak of 'extending the market' for retail finance 'downward': there is, in fact, *no viable market*, as understood by traditional banking institutions, amongst the very poor.

1.2.1 SMME Microcredit Initiatives

Small, Medium, and Microenterprise (SMME) microcredit programmes are based on the recognised need for credit facilities for such businesses, but also the recognition that the commercial banking sector does not provide them. Within government, SMME policy is understood as an element of broader economic growth and employment strategy. Accordingly, most of these initiatives are government-sponsored, principally by the Department of Trade and Industry (e.g. Khula Finance Limited).

Despite their differences, these programmes have several elements in common:

1. They focus on *microlending for microenterprise* as part of the overall drive for *job creation*, rather than on provision of financial services for their own sake. Economic growth and job creation – rather than, for example, survivalist self-employment – is seen as the major solution to poverty.⁶ This is related to a deep-seated assumption that South Africa's economy is essentially a 'distorted' version of a 'first world' system, and that if these 'distortions' are corrected through appropriate industrial strategies, sufficient jobs can and will be created to relieve poverty.⁷ The likely structural persistence of a 'non-formal' sector, which characterises much of Africa, Asia, and Latin America, has seemingly not been factored into policy planning or microcredit practise.

⁵ This argument is not directed at parastatal housing finance initiatives, such as the recently collapsed Gateway Home Loans, but applies to them *mutatis mutandis*.

⁶ See, for example, <http://www.khula.org.za>.

⁷ This is related to the intellectual heritage of ANC economic strategy thinkers, many ex-unionists, who lived and studied in Europe during the 80s and early 90s. There they were exposed to 'post-Fordist' theorising that saw in SMMEs the driving force of a diffused 'new manufacturing economy' in places such as northern Italy, Bavaria, etc. This is in contrast to the experience in much of Asia and Latin America, where deeply dualistic economies – albeit much more integrated than previously acknowledged – have persisted, particularly in urban areas. The role of capital accumulation, and thus of credit as a facilitating factor, is seen in 'first world' terms, and the massive structural barriers to job-producing accumulation by microenterprises in a monopoly-dominated open economy such as South Africa's are downplayed.

2. Because they are a subordinate aspect of economic growth strategy, SMME microcredit programmes, with some exceptions, are biased towards those perceived to have a better chance of creating jobs through successful *entrepreneurship*. This tends to pre-select those who already possess some *individual* assets, such as confidence, education, experience, physical capital, etc. By contrast, again with some exceptions, such programmes do not recognise, value, or seek to harness collective 'social' assets of the types identified, for example, in Sustainable Livelihoods Theory.⁸
3. Government-sponsored wholesale institutions like Khula (Trade and Industry) and the National Housing Finance Corporation (Housing) regard their equity exactly as would a private commercial institution. Despite the fact that the state is the major shareholder, such institutions' number one priority is not social development, but "protecting their shareholders' interest" in standard fiduciary terms, i.e. achieving maximum financial returns with minimum risk. This is sometimes associated with a desire to obtain 'AAA' ratings from offshore credit rating institutions. This conservative stance severely limits the scope for innovation and precludes co-operation with many non-traditional microfinance institutions that work with the very poor.
4. Partly because of this, SMME microcredit orthodoxy assumes the relevance and priority of rapid internal *financial sustainability* as a benchmark of success. In terms of Khula financing agreements, for example, this is usually to be achieved within a 2-3 year period. Financial sustainability fully factors in the cost of finance as well as the cost of operations. One of the most important factors in the cost of finance is opportunity cost, which is the 'value' or 'return' of the next best use of the assets and/or equity in question, typically by comparison to an alternative fully-commercial investment option. This has two broad implications, which highlight important contradictions in SMME microcredit policy:
 - a. Firstly, it has the effect of pricing *wholesale* capital in market terms, despite the fact that the MFI in question may not be operating in a *retail* market at all, since many potential clients are excluded from commercial retail banking, as described above. The externalities and developmental value of providing microfinance – of actually making otherwise unavailable finance accessible to those who need it⁹ – is typically reflected only in a small 'risk discount' in capital pricing conventions. Interest subsidisation, by contrast, is taboo, even where the government is the major shareholder.
 - b. Secondly, the opportunity cost of *not* providing such finance is not factored into the equation. This is particularly inconsistent, since these 'social' opportunity costs are the mirror image of the positive externalities associated with access to microfinance, such as job creation, improved health, education, etc. – in other words, the ultimate aim of the exercise itself. They are the costs of continued ill health, lack of education, vulnerability, etc. – the costs of *not doing* as opposed to *doing*.
5. Finally, the skill profile, executive requirements, and resulting operational costs of SMME microcredit programmes are typically assumed the same as those of the formal financial sector. It is supposed that a 'proper' microfinance programme requires financial expertise first and foremost (as opposed to social development competence, etc.), and that such skills must be priced at market rates. Besides a self-perpetuating bias towards an orthodox microcredit model, this assumption leads to operational cost profiles that effectively preclude the poorest of the poor. The overheads associated with banking sector-based professional financiers, sophisticated hierarchical management operations, and expensive, bank-like physical plant means that the average principal

⁸ "Microcredit serves best those who have identified an economic opportunity and who are in a position to capitalize on that opportunity if they are provided with a small amount of ready cash. Thus, those poor who work in *stable or growing economies*, who have *demonstrated an ability to undertake the proposed activities in an entrepreneurial manner*, and who have demonstrated a commitment to repay their debts (instead of feeling that the credit represents some form of social re-vindication), are the best candidates for microcredit. *The universe of potential clients expands exponentially however, once we take into account the broader concept of 'microfinance'.*" http://www.cgap.org/html/mi_faq.html#3. Emphasis added.

⁹ And, significantly, who government policy explicitly acknowledges to be in need, both for individual reasons (poverty) and collective reasons (economic growth).

outstanding per client required to sustain the operation is far beyond the reach of the poorest of the poor.

Taken together, these factors have shaped the South African microfinance environment in such a way that the poorest of the poor remain excluded from the mainstream, not only of the commercial finance system, but of the ostensibly 'developmental' microfinance system as well.

1.2.2 The Commercial Microlending Industry

In the last five years, a substantial South African microlending industry has emerged.¹⁰ Although, as in all societies, there have always been 'township' moneylenders in South Africa, the 'formal' microlending industry is a new development, both in its extent and the fact that it is subject to uniform regulation.

The average microlending industry loan is about R1 600, the bulk of them over a term of one month. The industry caters mainly to employed or semi-employed individuals. Until recent legislation forbade the practise, microlenders commonly took ATM cards and PIN numbers from borrowers, indicating that their target market overlaps with that of the retail banks.¹¹

Although it fills an important gap, the microlending industry is not an appropriate alternative for most marginalised, survivalist households. Microlenders target clients with regular incomes, in urban areas or larger towns, where transaction costs are less. Possession of relevant documentation, such as payslips and ID documents, is a prerequisite for a loan. Many very poor South African households, by contrast, particularly in rural areas, lack even these documents.

2 Approaches to Microfinance

The enduring foci on banking services, SMMEs, job creation, and microlending have led to a conflation, in South African development discourse, of 'microfinance' and 'microcredit'. Microfinance is seen by many as an aspect of economic policy rather than as a value-adding activity in its own right. Moreover, it is seen as an essentially *individual* transaction between service provider (banks, parastatals, or NGO-based MFIs) and household. Initiatives to encourage collective microfinance activity, to reduce the transaction cost of banking, or to build community assets, for example, are poorly understood and have not received high priority.¹² Perhaps most importantly, 'microfinance stakeholders' are rarely defined to include such alternative institutions, severely limiting their access to policy-formulation processes. This bias is reflected in an ongoing reliance on 'experts' from the formal sector or existing DTI-based SMME programmes in policy design, monitoring, and evaluation of microfinance initiatives.

Recently, however, government has begun to question the wisdom coming from this source. Minister of Trade and Industry Alec Irwin recently disclosed that the government had lost R68 million in the last four years on failed SMMEs, more than half of that in the past year.¹³

In this context, there may be a *diminishing* consensus about what microfinance is supposed to be. Indeed, in addition to the SMME microcredit paradigm, several other contenders have recently entered the microfinance ring.

¹⁰ See <http://www.mfrc.co.za/>.

¹¹ More recently, some microlenders have been accused of requiring borrowers to sign blank Consents to Debt Judgement forms as an alternative form of 'security'.

¹² Interestingly, in this respect, many South African microfinance practitioners are more conservative than the World Bank-based CGAP initiative (see www.cgap.org), the *de facto* 'standard' in global microfinance. Whilst CGAP recognises the need for saving, a poverty-alleviation focus, and the various externalities associated with non-loan financial services, South African discourse has tended to focus almost exclusively on the microenterprise/microcredit angle. For example, the Microfinance Regulatory Council defines microfinance as "a broad term used to describe *money lending* on a small scale to consumers, for starting a small business, paying for student fees, burial payments, buying building supplies, buying furniture, clothing and so on (emphasis added)". <http://www.mfrc.co.za/info/faq.asp>

¹³ "Failing Small Businesses Cost Millions", online *Mail & Guardian*, July 4, 2001 (www.mg.co.za/news). The operating costs of such SMME microcredit programmes are also coming under increasing scrutiny. The marbled reception areas, panelled offices, company cars, and credit card expense accounts may have been necessary to attract executives from the commercial finance sector, but they were not necessary to address South African poverty. In retrospect, perhaps, neither were the executives.

2.1 Microfinance as a Substitute for Transfer Payments

One alternative vision of microfinance is that which gave rise to the Department of Welfare/Department of Social Development's MicroSave Programme/Social Finance Programme.¹⁴ the desire to find an alternative way to reach women eligible for the Child Support Grant and other 'survivalist' welfare transfer payments.¹⁵

When the Department of Welfare approached the UNDP about setting up a microfinance programme in 1998, it was clear that one important motivation was to reach CSG-eligible women, particularly in geographic areas statistically identified as 'poverty pockets'. At the time, the DOW's Chief Directorate: Social Development was looking for ways to spend the Department's R203 million slice of the Poverty Alleviation Programme, a cabinet-based, off-budget initiative to address poverty 'directly'. DOW officials evidently thought it would be possible to speed up 'delivery' to such households by creating a 'microfinance' programme to support organisations working in these areas. This would bypass the cumbersome qualification procedures for accessing the CSG – particularly the lack of ID documents and birth certificates in rural areas – and relieve some political pressure on the government.

Subsequent interaction with the DOW confirmed this as their main goal, although Departmental officials clearly had little understanding of how microfinance could accomplish it. This led to lengthy debates about 'targeting'. DOW officials variously insisted that funds be used for microloans (despite the emphasis on saving in the programme design), and go only to specific magisterial districts; to specific groups within larger programmes; and finally, in utter violation of microfinance principles, that they only go to pre-identified individuals. The NGOs partners accepted these conditions, ignored them, or withdrew from the programme.¹⁶

In this respect, DOW was (unconsciously) trying to use microcredit 'directionally'. This is a bad idea for two reasons. Firstly, once microcredit clients are aware that they are targeted, they tend to treat loans as grants, resulting in low rates of repayment, if any at all. Secondly, as CGAP notes, microcredit is not always appropriate where opportunities for viable microenterprise are absent:

Often times governments and aid agencies wish to use microfinance as a tool to compensate for some other social problem such as flooding, relocation of refugees from civil strife, recent graduates from vocational training, and redundant workers who have been laid off. Since microcredit has been sold as a poverty reduction tool, it is often expected to respond to these situations where whole classes of individuals have been 'made poor'. Microcredit programs directed at these types of situations rarely work. ... What needs to be avoided is directional use of microfinance to sort out developmental challenges in situations where the basis of peoples' livelihood is destroyed.¹⁷

Although DOW was not targeting households in a disaster situation, the motivation was analogous. DOW sought to 'create' a livelihood situation for exceptionally vulnerable women in South Africa's dependent, marginalised economic sector by 'pushing' resources at them. International participants at the 'Round Table' discussions in October 1998 advised strongly against this. Nevertheless, DOW officials returned to this earlier motivation when assessing

¹⁴ Terminology has changed confusingly during the last few years. The Department of Social Development was originally called the Department of Welfare; the Social Finance Programme was the MicroSave Programme. Both name-changes took place in 1999-2000.

¹⁵ Under constitutional pressure, the (then) Department of Welfare modified its Child Maintenance Grant policy in 1998 to include all women with incomes under R1 100 p.m. with dependent children under seven. Previously, the main CMG recipients had been single parent 'coloured' households, largely in the Western Cape.

¹⁶ The variables determining NGO response were the organisation's need for funding and its sense of political strength vis-à-vis the Department. Some NGOs accepted funds in special deals with DOW officials eager to disperse funds, with both parties lacking an understanding of the programme's intent. Subsequent reviews of these NGOs' use and/or misuse of these funds have contributed significantly to the argument that the SFP needs to be 'redesigned'. This illustrates how the combination of a government department desperate to throw money at poverty, and NGOs desperate for funds, can cause long-term damage to an otherwise worthy developmental effort.

¹⁷ http://www.cgap.org/html/mi_faq.html#3

applicant NGOs' business plans, throwing the early implementation phase of the Programme into chaos.¹⁸

Microfinance programmes are complementary to, but not a substitute for, transfer payments or other forms of statutory entitlement (such as the CSG, pensions, and disability grants). Transfer payments are intended to ensure the *survival* of those in poverty until they can get out of it. Not everyone who faces survival challenges can benefit from microcredit in particular, and not everyone who accesses it succeeds. Microfinance, both savings and credit, is not a substitute for transfer payments.

2.2 Savings Mobilisation as a Public Good

Recently, the South African government has begun to emphasise the importance of saving as part of the nation's overall economic health. Finance Minister Trevor Manuel, for example, recently gave the keynote speech to the Savings and Credit Associations Africa 2001 Congress, emphasising the importance of saving facilities for low-income households, not only for its own sake, but to increase the national savings rate. Manuel explicitly referred to the commercial banks' failure to provide such services. In the housing field, Minister Sankie Mthembi-Mahanyele recently launched a National Savings Initiative to harness household resources for housing, and (less probably) to leverage bank loans for the poor.

National Savings Initiative

2.3 Reducing the Cost of Financial Services

Not having access to financial services imposes costs on households, communities, and the broader economy. Besides lack of access to credit, lack of savings facilities discourages the practise, which contributes to South Africa's overall low savings rate. It also increases households' vulnerability to endogenous and exogenous shocks, such as illness or natural disaster. The *White Paper on Social Development* recognises this by identifying personal savings as the first element in the national social security system.¹⁹

To address this need, some initiatives have sought to bridge the gap between commercial retail banks and the poor, particularly in rural areas, through 'microbanking'. The Financial Services Association, for example, creates 'Village Banks' that act as intermediaries between individual households and retail banks based in larger towns. Essentially, they reduce the transaction costs of banking (and thus of poverty) by collectivising multiple transactions, reducing transport costs, and time.

¹⁸ In retrospect, it is clear that DOW officials had little understanding of the difference between 'programmes' and 'projects', and treated the MSP as if it were another vehicle for project grant financing. This was entirely at odds with the conclusions of the Round Table consultative processes, the advice of consultants hired to work on the project (including the author of this document), the practises of the pilot partners, and the Programme Support Agreement between the UNDP and DOW. The Chief Director of Social Development subsequently entered agreements under the MSP with some NGOs (e.g. the African Co-Operative Action Trust) that were clearly conceived as project grants.

These problems point to lack of capacity at DSD, which is not entirely the present government's fault. Indeed, some problems are rooted in the Department of Welfare's apartheid past. DOW's traditional 'core competency' was to provide transfer grants to individuals (pensions, disability, Child Maintenance Grants) or subsidies to selected service organisations (crèches, old-age homes, etc.) – until 1994, mainly for white, coloured, and Indian South Africans. This capacity is not necessarily suited to identification, management, and assessment of numerous small community development projects, or microfinance programmes. Although the 1997 White Paper on Social Welfare commits the Department to 'developmental social welfare', DSD has had little institutional assets or experience in this area, at national or provincial level. The speed with which DSD can reorient itself in this regard is limited by budget constraints, public service regulations, and the constitutional relationship between national and provincial governments.

Despite policy pronouncements, therefore, until recently, the institutional assets and human resources of the DSD have remained unsuited to a large-scale project-based developmental funding programme, complete with pre-project assessment, capacity-building, and suitable monitoring and evaluation systems. Nevertheless, because the Poverty Alleviation Programme (of which the SFP forms a part) has been driven by a need (at least partly political) to disburse funding within an exceptionally short period – from project identification to final disbursement in less than six months – DSD has had to allocate project funding without the necessary rigour. This explains many of the problems experienced with PAP projects during 1996-1998. DSD's reaction to these problems since then, however, has been to err on the side of caution – to such an extent that PAP funding has gone unspent, leading to public outcry.

¹⁹ http://www.polity.org.za/govdocs/white_papers/social971.html

2.4 Social Asset Mobilisation through Collective Savings and Credit Movements

Collective savings and credit movements use group savings to mobilise very poor households, mainly women, into autonomous grassroots savings groups. Crucially, for such programmes, the *method is the output*. The *direct* outcomes of savings and credit mobilisation are intangible: they are comprised largely non-material changes in the quality of life, attitudes, and activities of households and communities, which in turn leverage and facilitate other, material changes. The exception is access to a community-based credit pool, the effects of which are expressed in terms of what *might happen* if women *did not* have access to it – i.e., vulnerability.

The 'outputs' of active women's savings and credit collectives in poor communities include:

- **Social Assets:** solidarity, increased confidence, an enhanced skill base, increased community self-knowledge, capacity to self-manage finance and development processes, and so on. These qualitative impacts are difficult to measure.
- **'Leverages':** enhanced access to state resources, preferential participation in development programmes, increased attention from donor organisations, etc. These can be measured, but are often not seen as 'outputs', but rather 'privileges'.
- **Reduced Vulnerability:** To members of individual savings and credit collectives, access to a community-controlled savings pool is a significant factor reducing vulnerability to exogenous and endogenous shocks to their livelihood strategies.

Savings and credit is the basic element in the development strategy. The process starts with a crisis credit fund established from the small change available to most households, collected in daily visits by treasurers. *Daily* saving is regarded as critical, since it produces the twin social and financial outcomes of the process.

Women who are interested in taking part are drawn into the training process and shown how such crisis credit funds work in other communities. Even when the savings fund is minimal, women begin to borrow small amounts. This could be for medicines, to hire a taxi to find work or go to hospital, or to give money to children for schoolbooks. These small loans are repaid very quickly. Women are encouraged to make their own rules about this fund, and interest charges vary. Despite the small amounts involved, such savings pools fulfil crucial crisis needs.

Another outcome is that women get community acknowledgement for having created these resources. Through the process of savings and credit, women's role is increasingly recognised by men. The financial management skills they have acquired and increased access to credit resources changes the role of women within the community and increases their status. Savings groups thus form the basis of women's community participation. Women are particularly attracted to this activity and soon find that it transforms their relationships with each other, within their families, and within the community as a whole. Community members soon find that communication processes developed through the savings organisation become a vital channel linking the whole settlement. Because women control these channels, this means they become centrally involved in broader community development processes.

The management of the credit process serves many capacity-building purposes. After starting with very small amounts, women gradually work with larger amounts. As more and more communities participate in and refine this decentralised, accountable, and transparent process, they become attractive organisations to which to lend. This is because they absorb much of the administrative cost financial institutions say prevents them from serving the poor.

Once savings groups have been organised and gained some experience with credit for crises and income generation, their 'external' credit line begins. Credit-worthiness needed to access external finance is demonstrated by presenting the network as an institution that 'guarantees' the individual co-operative. As the demand for credit grows and the skills for managing it increase, the local savings and credit groups come to their NGO partner to replenish and augment their capital. With networking and constant communication based on a horizontal community exchange strategy, each group gets information about who has paid how much, and develops the skills necessary to manage progressively larger amounts of money.

The NGO-based loan funds used in such programmes are not intended to be operationally or financially self-sufficient. They argue that their goal is not to "make the poor bankable", but to

use microfinance to build social assets and leverage them to obtain various externalities and access to other resources. Nevertheless, the loan portfolios involved can be quite substantial.

Such programmes' specific contributions thus are (i) to use collective savings both as a credit resource to help reduce households' vulnerability, (ii) to mobilise poor communities, especially women, to reclaim their latent ability to take responsibility for their own development, and (iii) to create viable grassroots institutions that can help to deliver and utilise outside development resources more effectively. The *indirect* benefits of this approach are many:

- Communities of the poor take time to study their own problems and identify priorities for themselves.
- They develop skills and capacities to articulate the solution they seek to resolve their problems.
- They develop capacity to identify strengthen and demonstrate the resources they hold within their communities, and use that to leverage resources from the outside that they need.
- They are confident to work with professionals without losing their own perspective.
- They have the strength and internal accountability to ensure equity and proper distribution of resources that they have obtained through their negotiations.
- Once they know something they will encourage, assist and train their peers into being able to do the same.

3 The Developmental Challenge

No one can deny the importance of microcredit for microenterprise; access to savings facilities for the poor; the need for savings for both national and individual economic well-being; and the importance of social asset mobilisation through savings and credit. In this respect, all of the microfinance perspectives discussed above – with the exception of the misguided desire to replace transfer payments – are important and deserve support.

The question, however, is whether all these forms of microfinance practise are *appropriately* recognised, understood, and incorporated into social development strategies that acknowledge the long-term, exclusionary, structural nature of South African poverty, as discussed at the beginning of this document. Relatedly, *are* they receiving needed support? If not, what forms of support and resources do they need and warrant?

3.1 Support for Microfinance Initiatives in South Africa

There has been relatively little co-ordinated government support for microfinance initiatives other than SMME microcredit. Nevertheless, some forms of microfinance practise, even if not yet appropriately supported, are nevertheless more *recognised* than others.

3.1.1 SMME Microcredit Programmes

As noted above, nearly all government-supported microfinance activities since the early 90s have been subsumed under SMME microcredit policy, an important branch of industrial and economic policy. The centrepiece of this initiative is Khula Enterprise Limited, which is funded primarily by the Department of Trade and Industry.

Khula, whose motto is "Financing South Africa's Entrepreneurial Spirit to Grow and Prosper", provides wholesale loans and loan guarantees to Microfinance Institutions (MFIs). Its total capital employed (end FY 2001) is R1 142,3 million. Khula provided 234 090 loans to SMMEs and NGOs between 1997 and 2000, including 85 269 in 2000, in addition to 152 237 credit guarantees to banks.²⁰

The sheer scale of this operation and the amount of public finance involved indicates the importance government attaches to SMME microcredit. Nevertheless, Khula's track record of reaching the poorest of the poor is dismal. In line with DTI's emphasis on employment creation,

²⁰ "Failing Small Businesses Cost Millions", *Daily Mail & Guardian*, July 4, 2001 (www.mg.co.za/news); see also <http://www.khula.org.za>

the overwhelming majority of Khula's clients are MFIs that provide loans to entrepreneurial, as opposed to survivalist, microenterprises. This biases such programmes towards those with existing assets. Part of the reason for this is the strict operational rules Khula imposes on its clients,²¹ which make poverty-alleviation lending all but impossible. The highly respected Small Enterprise Foundation, for example, has used its Khula funds as equity in its Microcredit Programme, which caters to better-off clients, rather than its poverty-oriented Tšhomišano Credit Programme. It is doubtful if TCP would be able to reach its clients under the conditions imposed by Khula.²²

Whilst there is no doubt that Khula-supported MFIs are important, therefore, they are not easily able to reach the large majority of South African households that live on the very fringes of the formal economy, or as dependent recipients of cash transfers from it.

The larger problem is not only that existing MFIs cannot reach the very poor, however; imposition of Khula's orthodox approach may actually *prevent* innovation. As Trade and Industry Minister Erwin observes, "most entrepreneurs (sic) get involved in business purely for survivalist purposes"; but "there is a lack of research by retail finance institutions into appropriate products" for this "market". Khula, however, requires its MFI clients to adhere to financial protocols and sustainability measures relevant to microenterprise lending where there *is* a market, not where there is *no market* to speak of, where the majority of potential 'clients' are economically-marginalised 'survivalists'. Kula's stance effectively squelches any inclination by client MFIs to "research ... appropriate products" for these survivalists.

As argued above, the effect of this inappropriate juxtaposition of market logic and social development need is to place not just microcredit, but microfinance in general beyond of the reach of such households. Given that most MFIs are oriented exclusively to SMME microcredit, and that the overwhelming thrust of government support is premised on this model, there has been next to no policy exploration of alternative uses for, and models of, microfinance. The effect of government microfinance policy, such as it is, is thus to disregard the economically marginalised and dependent majority, who are the most vulnerable to poverty and its effects.²³

Such a situation is a direct outcome of the obsession with microcredit orthodoxy. Households that are not candidates for entrepreneurial microcredit are largely discarded by South African microfinance policy. In a breathtaking tautology, CGAP calls it "self-exclusion":

As we are finding out, a great number of poor, and especially extremely poor, clients exclude themselves from microcredit *as it is currently designed*. Extremely poor people who do not have any stable income – such as the very destitute and the homeless – should not be microfinance clients, as they will only be pushed further into debt and poverty by loans that they cannot repay. As currently designed, microcredit requires sustained, regular, and often significant payments from poor families. At some level, the very cause of poverty is the lack of a sustained, regular, and significant income. Even though a family may have a significant income for extended periods, it may also face months of no income, thereby reducing its ability to enter into the type of commitment demanded today by most MFIs. Some people are just too poor, or have incomes that are too undependable to enter into today's loan products.²⁴

Through its striking conflation of *microfinance* and *microcredit*, however, this quotation raises critical issues: can survivalist households who cannot use *microcredit* as defined in the orthodox

²¹ In this respect, Khula has been accused of incompetence by several client MFIs, which incompetence apparently led to the demise of at least one, the Rural Finance Facility. Ex-RFF directors argue that Khula ignored or misinterpreted a voluntary report from RFF that reflected a change in the basis of its arrears calculations, which had the effect of causing a temporary 'blip' in its performance indicators. Khula accepted this explanation, and in fact recommended less stringent arrears calculations, but at the same time insisted on changes to loan procedures – specifically, a suspension of lending under loan officers with a repayment rate below 80% – that resulted in a further deterioration of repayment performance, as clients assumed that they would not receive further loans even if they repaid. Khula subsequently decided not to rollover its loan facility to RFF, causing the organisation to become insolvent. Khula justified this by arguing that RFF was unviable, although the proximate cause of deteriorating performance was Khula's own interventions. As the director of another MFI puts it, "Khula's incompetence can work for or against you. They often just leave you alone if you report that everything is OK. If they come to look at you, on the other hand, their lack of basic understanding can cause serious 'problems' where there really aren't any."

²² In fact, SEF mixes its equity, but for reporting purposes to Khula, it relies on the MCP.

²³ This is mirrored in South African housing policy, where housing finance strategies are consistently geared to the 20% of potential beneficiaries who have some hope of accessing commercial mortgage finance. Except for the capital subsidy, the remaining 80% have been largely ignored, not because there are no financial models that can help meet their needs, but because such models are not based on 'the market'. Prioritisation of 'the logic of the market' over the needs of the poor – which needs are partly rooted in deliberate apartheid policies, not just 'market distortions' – is one of the most striking features of post-1994 South African policy.

²⁴ http://www.cgap.org/html/mi_faq.html#2. Emphasis added.

SMME model, and who may constitute the majority of South Africa's economically marginalised population, benefit from *other* forms of *microfinance*? What forms of microfinance practise, if any, are relevant to reduce the vulnerability and powerlessness of such households? What would such interventions cost? What would be the benefits? What are the costs of *not* providing such services, both to the households and to the broader society? Can and should these externalities/opportunity costs be factored into programme design?

3.1.2 Financial Services Programmes

Financial services programmes are undeniably of interest to government, as Finance Minister Manuel's speech to the Savings and Credit Associations Africa 2001 Congress indicates. The general concept of microbanking is inherently attractive, despite the relatively small numbers of South African households involved. SACCOL, for example, has 28 affiliated organisations with about 10 000 members. The Financial Services Association has been actively courted by government for many years, despite the fact that from 1996 to 2000 it had not managed to expand beyond a handful of pilot village bank schemes. With DOW support under the SFP, however, it has expanded to reach about 14 700 clients, although probably not sustainably.

Financial services organisations such as credit unions, savings and credit co-operatives, and village banks fill an important gap for low-income households, particularly the working poor. Access to basic savings and credit products is important to the unemployed and pensioners, too, particularly in rural areas. Nevertheless, besides reducing the costs of banking, such schemes' ability to affect poverty *positively* is limited:

- Firstly, participation presupposes sufficient cash income to make banking a portion of it a rational livelihood strategy. Many very poor households are not aware of their savings capacity and therefore do not participate in such programmes. This may bias such programmes towards the better off. Many SACCOL affiliates, for example, are based on employer groups.
- Secondly, such programmes tend to focus on *individual* financial needs, albeit at the lower transaction costs facilitated by collectivity.
- Thirdly, financial services schemes may not emphasise or provide access to credit, or do so in ways that are not useful to the poorest households. SACCOL groups do provide loans, however.

Although financial services programmes are worthy of support, and are necessary and useful for many households, they are not a sufficient approach to poverty-oriented microfinance. Their main contribution is to reduce the costs of banking, and to help increase the propensity to save, not necessarily to mobilise the social assets of the poorest of the poor.

3.1.3 Savings and Credit Networks

The major South African savings and credit network has long been the South African Homeless Peoples' Federation (Federation),²⁵ supported by its NGO partner, People's Dialogue.²⁶ The Federation's size and history are both blessing and curse. It was a People's Dialogue proposal to DOW for support funds in early 1998, based on a successful pilot in the Western Cape, and its strong reputation, that sparked the policy process leading to the MSP/SFP. On the other hand, the Federation's identification with housing, bias towards urban areas, and reputation for isolation hamper its attempts to work with DSD poverty programmes. Until recently, the Federation has also been largely unique, so that, despite its size – more than 120 000 households – government officials have been wary of supporting it, fearing accusations of bias and favouritism. Moreover, despite public support from some luminaries, notably Housing Minister Mthembu-Mahanyele and ex-Land Affairs Minister Derek Hanekom, many in the ANC, particularly at local level, regard the Federation with suspicion, given its size, assertive style, and consistent refusal to align itself with any political party.

²⁵ See <http://www.dialogue.org.za/>.

²⁶ The author once worked for People's Dialogue as manager of its Utshani Fund, and continues to have a close association with the Federation.

The Federation has received government support via the state housing subsidy.²⁷ Until the MSP/SFP, however, it had not received significant support for its core business, which is building its network of grassroots women's savings and credit collectives, as explained above. These grassroots institutions are the indispensable precondition to all Federation achievements. Expanding these *nsukuzonke*²⁸ requires inputs of several kinds. The principal vehicle for Federation expansion is horizontal exchange and community training programmes, in which existing groups teach and support new groups. This involves expenditure on things like transport, meals, etc., which are typically acceptable for professionals, but not for beneficiaries. There is also the inevitable element of NGO support costs.

The problem is that none of the costs of supporting the expansion of savings and credit collectives can be easily and directly offset by specific returns. As noted above, the *direct* outcomes of Federation-style savings and credit mobilisation are intangible, in the sense that they are comprised largely of non-material changes in households and communities, which in turn leverage and facilitate other, social and material changes. The exception is access to a community-based credit pool, the effects of which are primarily expressed in terms of what *might happen* if women *did not* have access to it.

In both cases, however, potential donors fixated on measurable indicators and 'deliverables', public and private alike, have a hard time seeing their way clear to support such initiatives. As noted above, it is the *indirect* impact of such initiatives that is important, but to date few funders are willing to take responsibility for this. As a result, the Federation's Utshani Fund has been unable to access finance for non-housing purposes other than through the MSP/SFP.

In the last two years, several additional savings-based initiatives have emerged, particularly in the Western Cape, including the Kuyasa Fund, the Five-in-Six Project, Women in Need, the West Coast Community Foundation, the Cape Town Refugee Forum, and various other small groups. Such groups are now forming a network amongst themselves to share experiences and build capacity.

3.1.4 Summary: What is the Development Challenge?

Based the above, we argue that:

1. **SMME microcredit programmes** to facilitate microenterprise and job creation have been well supported in government policy, although their effectiveness can be questioned. They are not a one-stop solution to poverty, however, since the long-term dualistic nature of South Africa's economy, and barriers to overcome it, are related to exogenous as well as endogenous factors. Many very poor households are unable to participate in such programmes, partly because of the assumptions around which they are designed.
2. **Microbanking initiatives** are beginning to receive the recognition and (hopefully) support that they deserve. Nevertheless, these programmes essentially only reduce the cost of accessing financial services, a factor contributing to poverty. They do not necessarily go beyond this to address poverty positively, by mobilising latent social assets in households and communities.
3. **Savings and credit networks** have not received recognition or support commensurate with their existing and potential contribution to poverty alleviation amongst the economically marginalised majority. Although such programmes are familiar to policy-makers, they tend to be seen as housing-specific and urban-oriented, and their broader developmental impacts, both direct and indirect, are not well understood.

Given this, we argue that 'the development challenge' facing the government, particularly DSD in its attempts to develop an appropriate microfinance policy, is to educate itself about the various forms and functions of microfinance, to relate these clearly to its poverty-alleviation goals in the context of South African poverty, and to weigh the *broader* costs and benefits of various options. This requires an open, exploratory, and innovative stance, involving interaction with and evaluation of practitioners based on *what they are trying to achieve*, not what received microfinance orthodoxy thinks they *ought to achieve*.

²⁷ Although various provincial governments presently 'owe' the Federation over R40 million in unpaid subsidies, for houses already built with bridging loans.

²⁸ "Every Day" in isiZulu.

3.2 Sustainability

To meet this development challenge, the first step is to grapple with conceptions of sustainability, and the elements to incorporate into its measurement, and to come up with a definition appropriate to poverty-alleviation strategies.

3.2.1 Sustainability Strategies

One challenge shared by all the microfinance approaches discussed above is the need to bring the costs and benefits of their activities into some rational and expressible relationship. The orthodox microfinance position demands 'sustainability', which is understood in two aspects.

- **Operational self-sufficiency:** the ratio between income from programme activities, and their costs, including salaries, office costs, consumables, and so on.
- **Financial self-sufficiency:** the ratio between total programme income and operations cost, financial costs (the cost of equity employed), and loan loss provision. A stricter measure defines financial costs to include these items plus adjustments for subsidised equity (implicit cost) and inflation.

In addition to these measures, analysis may also include adjusted returns on assets and equity. These can be compared to commercial uses to assess the 'opportunity cost' of employing these assets and funds in the programme in question.

In their operations, some microfinance programmes are stricter than others in aspiring to meet these criteria. For example, most conventional MFIs (such as those that borrow from Khula) are held to strict financial self-sufficiency. On the other hand, microbanking programmes like the FSA subsidise project start-up with donor funding; once in place, the model is designed to move the project to operational self-sufficiency within a specific period. Since no external equity is involved, financial sustainability is not an issue. Similarly, poverty-alleviation microfinance initiatives like the Small Enterprise Foundation's Tšhomišano Credit Programme strive for operational self-sufficiency after a period of subsidisation with donor funding. This is preferred to financing expansion through retained income, which is seen as "asking the poor to pay their way out of poverty". In SEF's case, however, adjusted returns on assets and equity are not as critical, since they seek to alleviate poverty first and foremost.

Both the microbanking (FSA) and poverty-alleviation microcredit (SEF) models deal with individual households, despite the fact that both do so through the mediation of community-based collectives. They also seek to deliver specific financial services that can be measured quantitatively. This allows them to track the relationship between the costs of programme inputs and the income from programme outputs relatively easily. In the FSA's case, a Village Bank either earns enough income to cover the costs of its microbanking services or it does not. For SEF, interest income from lending activities either covers its operational costs or it does not. In this respect, programme income serves as a *proxy* for whatever beneficial changes occur because of their activities.

By contrast, savings and credit-based social mobilisation programmes like the South African Homeless Peoples' Federation cannot track the input-output relationship as easily, since the inputs (NGO costs, exchange and training activities, etc.) are not directly related to 'outputs' that can be measured easily and/or quantitatively, such as interest income, participant fees, etc. As noted in Section 2.4 above, the savings and credit model consists of an identity between method and output; the creation of women's savings collectives is seen as a goal in itself because of its externalities and the social assets created.

3.2.2 The Cost of 'Doing Microfinance' in South Africa

Despite their various objectives and methods, all South African microfinance programmes share another feature: the relatively high cost of 'doing development business' in the country.

For example, microcredit institutions such as the Small Enterprise Foundation, Rural Finance Facility, Kuyasa Fund, and others, have attempted to move beyond the 'suit-and-tie' SMME microcredit model in order to reach the poorest of the poor, but eventually to do so sustainably. Such programmes are typically based on a combination of payroll deduction and pension guarantee (for the formally employed) and/or group solidarity lending (for the informally employed), or loan management systems developed specifically for low-income markets, such

as the furniture retail chains. These programmes rely on fieldworkers, loan officers, area managers, and so on, often drawn from skilled or semi-skilled members of the target communities. Some such initiatives, particularly SEF, are cognates of the Grameen Bank and its derivatives throughout the developing world.

South Africa's social structure, however, has more in common with Latin America than the rest of Africa or Asia. Because of South Africa's highly skewed income distribution, its large middle and upper classes, and the political emphasis on 'racial' equalisation of economic and professional opportunities, the income and consumption patterns of middle-class development workers are shaped by the standards of the economically 'advanced' minority. This is especially true of skilled young black graduates, for whom NGOs must compete with the state and private sectors, both of which are under intense pressure for affirmative action. In a context of an overall shortage of relevant development and technical skills, due to the historical weakness of the South African secondary and tertiary education systems, this drives up real NGO salaries to levels significantly above those in many African and Asian countries.

This creates a difficult paradox for such programmes: although the real incomes of the poorest of the poor are comparable to those in the rest of the developing world, the relative salary structures needed to attract and retain the staff on which they depend are higher than for many other developing countries, particularly those used as benchmarks of MFI efficiency. This is compounded by the dearth of opportunities for higher value-added (i.e. manufacturing) microenterprise amongst clients, a direct outcome of South Africa's relatively developed domestic manufacturing and retail distribution sectors. This constrains the size and duration of microenterprise loans, reducing the average principal outstanding. This in turn limits the interest income needed to pay for programme staff.

By contrast, community-based microbanking initiatives, which do not require expensive financial executives, loan officers, or an extensive field structure, are relatively more able to cover their staffing costs (their acknowledged funding needs notwithstanding). Savings and credit programmes, on the other hand, inhabit the worst of both worlds. They must also pay competitive salaries to undertake their work with the poorest of the poor, but because there is no direct, measurable, quantitative relationship between inputs and outputs, they must resort to more innovative ways to justify their operational costs to donors. Such programmes face continual pressure to reduce staff costs, despite the fact that the holistic skills required are in such short supply, and the multi-faceted social outputs have such 'observable' – albeit difficult to quantify – impacts on poverty.

Put another way, then, South Africa is an expensive place to run a microfinance programme, no matter what the variety. In the case of microcredit programmes, loan packages that that would produce portfolios able to meet average salary and operational costs in South African conditions would not be affordable to the poorest of the poor. Such programmes struggle to be 'efficient' – unless, of course, a broader approach to cost/benefit accounting is adopted.

3.2.3 Sustainability, Opportunity Cost, and Public Policy

An important question, then, is whether, given the historically determined cost structure of conventional microfinance in South Africa, and the exclusionary and dualistic nature of South African poverty, it is *logical* to use conventional sustainability measures and benchmarks as the arbiter of success or failure – and of worthiness of support from government or other sources. The contradiction can be stated bluntly: the high cost of the financial experts assumed necessary to run conventional microcredit programmes is often a principal reason for their apparent inadequacy in conventional sustainability terms.

Part of the problem is that many microfinance practitioners, with technical backgrounds in finance, as opposed to social development, tend to focus on the *quantitative* income aspect of poverty to the exclusion of its *qualitative* vulnerability, asset, and empowerment aspects. The dominant attitude is "if you can't measure it, it's not relevant". This is at odds with current social development thinking, influenced by Sustainable Livelihoods Theory,²⁹ which recognises the multi-faceted nature of poverty, and the role microfinance can play in alleviating it. As CGAP itself notes,

²⁹ Two useful sources on this approach are the UNDP SLA site (<http://www.undp.org/sl>) and the International Institute for Sustainable Development (<http://iisd1.iisd.ca/>).

Poverty is multi-dimensional. By providing access to financial services, microfinance plays an important role in the fight against the many aspects of poverty. For instance, income generation from a business helps not only the business activity expand but also contributes to household income and its attendant benefits on food security, children's education, etc. Moreover, for women who, in many contexts, are secluded from public space, transacting with formal institutions can also build confidence and empowerment. ... Experience shows that microfinance can help the poor to increase income, build viable businesses, and reduce their vulnerability to external shocks. It can also be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic *agents of change*.³⁰

A significant problem remains, however: if we are to include the 'qualitative' aspects of poverty and its alleviation in microfinance programmes, how do we factor them into cost-benefit analysis? What does it 'cost' to empower groups of poor women to play an active role in social development? What does this achieve, both directly and indirectly? What is it 'worth'? Is it better to accept subsidised microcredit, for example, or to set up separate programmes that achieve the desired quantitative goals? Should government fund the expansion of grassroots savings groups, even if this means paying for operational costs? What examples are there to guide policy-makers on these issues?

The rationale for this document is that policy-makers are not yet discussing such questions seriously. Indeed, they may not even be aware of them: microcredit orthodoxy dominates South African microfinance discourse to such an extent that alternatives are often shot down by 'the experts' before they have even begun. This was almost the case during the consultation phase of the original MicroSave Programme, when Khula-based staff attempted to prevent the DOW from becoming involved in microfinance, on the grounds that this would 'interfere' with their own programmes. A characteristic strategy of this negative effort was to emphasise formal financial sustainability above all else, hold this up as the most important evaluative criteria for any government intervention, and argue that the Department of Welfare lacked the necessary experience and, more tellingly, the *mandate* to enter this 'technical' field.³¹

Such unhelpful attitudes find fertile ground in the fiscal policies and regulatory practises of the South African government. The Department of Finance sits astride the government like an all-powerful despot, its officials seconded to every line department to enforce ruthless conservatism, causing officials in social delivery departments like Housing and Social Development to avoid risk and innovation just as surely as is always the case under any absolutist rule. As a result, certain types of state-civil society partnership are simply regarded as *a priori* 'impossible', especially those that might involve management of public funds by the poor. One way to get around these GEAR-driven strictures is to resort to tortuous definitions and cunning rhetoric in programme design, which can easily bounce back later if officials choose to interpret them literally.

Clearly, of all government departments, the Department of Social Development is the one explicitly mandated to take a broader, qualitative view of poverty and strategies to alleviate it.³² As Khula operatives correctly argued in 1998, it is not mandated to run another branch of SMME microcredit policy. The bulk of its own programmes are welfarist transfer systems or subsidies to essential social services such as crèches and old-age homes. This role is recognised as necessary, not only for humanitarian reasons, but because the social and economic costs of *not* providing such services.

Given its institutional rationale, then, it would seem logical for DSD to explore the broader costs and benefits of a variety of microfinance strategies rather than to fixate on narrow income-oriented understandings of poverty and orthodox, business-school models of sustainability.

³⁰ http://www.cgap.org/html/mi_faq.html#2. Emphasis added.

³¹ Confusion and lack of co-ordination within the UNDP also played a role here. Whilst it was providing resources for the design of the MicroSave Programme for DOW, UNDP South Africa was also supporting the KhulaStart Programme as part of its global MicroStart programme. There was little evident co-ordination between the UNDP staff involved, and the consultants employed to assist DOW (including the author) essentially had to sort out this political minefield on their own. We may not have done a very good job. At one point, Khula staff reportedly contacted Minister of Trade and Industry Alec Erwin directly in a cabinet meeting to alert him to the 'threat' from the MSP. Subsequently, then-Minister of Welfare Geraldine Fraser-Moloketi came under cabinet pressure not so much to justify what the MSP *was to be*, but what it *was not to be*. DOW staff devoted much of their time during the latter half of 1998 to this negative conceptual process rather than to understanding what was actually being proposed. This contributed to the chaos during the final stages of programme design in late 1998 and early 1999, the effects of which are still being felt.

³² The *White Paper on Social Development* is explicit in its multi-faceted, empowerment-based approach to poverty, as well as the important of savings and collective action in addressing it.

This is not the place for a detailed discussion of the policy, programme design, and monitoring and evaluation strategies that could capture the quantitative and qualitative costs and benefits of alternative microfinance programmes. Hopefully this will be part of the discussion on future welfare policy, starting with the DSD's Social Finance Programme.³³ The first step, however, is to acknowledge the need for the discussion.

4 Conclusion

In South Africa, the hegemony of Khula-style microcredit orthodoxy has all but precluded these questions. At the risk of hyperbole, the instinct of many 'microfinance experts' is to go straight to MFI financial statements, to calculate 'sustainability' and various 'ratios', with an almost visibly gleeful anticipation of identifying presumed inadequacy. As often as not, their expert contribution seems to consist not in assessing whether non-traditional microfinance programmes achieve their multi-faceted goals, and the costs and benefits thereof, but in demonstrating their own arithmetical competence.

Although admittedly it may appear otherwise, this paper is not intended as a part of a bloody-minded vendetta against SMME microcredit practitioners and experts in this field. It is more an expression of frustration at the state of discourse on microfinance and poverty alleviation in South Africa today. SMME microfinance is an indispensable part of South Africa's economic policy. The technical finance skills employed by orthodox practitioners are highly valuable, and many alternative initiatives suffer for lack of them. Indeed, many SMME experts understand and engage constructively with 'non-SMME' microfinance programmes.

But there are at least as many so-called experts who seem to regard microfinance alternatives with a disdain born of a misplaced sense of technicist superiority and lack of appreciation of a poverty-alleviation focus. The point of this document is that alternative microfinance institutions should be given the *choice* to use orthodox techniques, not have them imposed *a priori* by the design and assumptions of government and donor support programmes. Government policy-makers interested in the uses of microfinance for poverty alleviation *must* make the effort to understand the complexity of this field, and to question the received wisdom, both from the 'experts' and from the Department of Finance. Unless they are made aware of the issues at stake, however, in their haste to 'deliver', they are unlikely to do so.

It is not solely the government's fault that alternatives to the SMME microcredit orthodoxy are not well understood and supported. Facing a conceptually hostile development environment, which assumes the primacy of top-down delivery and technical control, alternative microfinance practitioners tend to retreat into defensive isolation. Their struggles to obtain recognition and support are accordingly conducted on a one-to-one basis with government, which greatly reduces the chances of success. The long shadow of NGOs politics also comes between potential allies, emphasising doubtful *ideological* compatibility rather than commonality of *practise*.³⁴ Unless and until such organisations put aside their fears, rivalries, and isolationism, they will probably fail to influence government policy effectively. They must do so not for themselves, but for the poorest of the poor whom they seek to serve.

The Department of Social Development's Social Finance Programme is the only South African government initiative outside of housing that has attempted to interact with and support alternative microfinance initiatives, but is in a state of flux due to serious implementation problems. Its contribution so far is small in the overall context. Because of its welfarist traditions and internal discontinuity over the last few years, DSD is largely dependent on outside advice in attempting to formulate an appropriate microfinance policy.

South African development debates need to recognise the long-term, structural, and exclusionary nature of poverty within the dependent and marginalised section of the population, and the limitations this imposes on SMME and orthodox microcredit policy more generally as an approach to poverty. The poor simply cannot wait as long as it will take the formal sector, in the form of emergent small businesses, to absorb them and their activities into the mainstream economy. Government must acknowledge programmes that use microfinance as a means to

³³ And possibly a future BRCS discussion document.

³⁴ Increasingly irrelevant NGO groupings based on late-80s and early-90s conditions continue to be given preferential access to government policy processes. NGOs working with the poorest of the poor in a facilitative, rather than delivery mode need to explore alliances based on their common purpose rather than outdated politics.

mobilise poor households and communities to create, reclaim, and harness social assets as part of appropriate livelihood strategies. The qualitative externalities and assets that are mobilised thereby must be explored and comprehended, and ways to capture them in monitoring and evaluation devised. The social opportunity costs of failing to provide support to poverty-alleviation microfinance programmes, both microsaving and microcredit, must be examined and factored into calculations of sustainability. As a first step, the microcredit orthodoxy in South Africa must be explored, critiqued, and challenged.