

**MICROFINANCE SUSTAINABILITY VERSUS DEVELOPMENT
OBJECTIVES: AN ASSESSMENT OF THE SOUTH AFRICAN
ENVIRONMENT**

Thesis submitted in partial fulfillment of the
requirements for the

MASTER OF ARTS DEGREE

in

POLITICAL STUDIES

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December 2008

Abstract

In a world where almost half of the population lives in poverty, the alleviation of poverty is a serious developmental challenge for many states. Microfinance has grown in popularity as a means for achieving poverty reduction all over the world. Due to the success of microfinance institutions, such as the Grameen Bank, in achieving self-sufficiency and improving the lives of its clients, the expectations for similar institutions are high. MFIs attempt to find a balance between business and development goals. It is not necessarily a contradiction to be a business seeking profit as well as being an institution committed to development. However, the values coupled with these two objectives are sometimes conflicting. Thus it is important to see how equilibrium can be achieved and to note what sacrifices must be made in order to reach a balance. This thesis will focus on examining and assessing the challenges faced by South African MFIs in balancing development goals while at the same time having to be self-sufficient. The Small Enterprise Foundation will be used as a case study to consider the particular experiences of a South African MFI. The evaluation of the unique challenges that the South African landscape presents will provide a context in which to understand microfinance operations and a clearer understanding of the particular problems and challenges faced by the South African micro-finance industry in balancing the achievement of development goals against the imperative to be self sustainable in providing services to the poor. Through that understanding the common conception of what makes a “successful” MFI will also be challenged.

To my friends and family,

*For encouraging me to aim for the stars and
catching me when I fall*

*For loving me as much when my head is in the clouds as
when my feet are on the ground*

*For laughing at my jokes and
helping me laugh at myself*

And for being proud of me no matter what

List of Acronyms

AMFISA- Association for Pro Poor Microfinance Institutions for South Africa
ANC – The African National Congress
BEE – Black Economic Empowerment
BRAC – Bangladesh Rural Advancement Committee
CASHPOR – Credit and Savings for the Hardcore Poor
CMN – Community Microfinance Network
COSATU – Congress of South African Trade Unions
DTI – Department of Trade and Industry
FFH – Freedom From Hunger
GDP – gross domestic product
HSRC – Human Sciences Research Council
IMAGE – Intervention with Microfinance for AIDS and Gender Equity
MCP – Microcredit Program
M-CRIL – Micro-Credit Ratings International Limited
MFI – Microfinance Institution
MFRC – Microfinance Regulatory Council
MFSA – MicroFinance South Africa
MIS – Management Information System
NGO – nongovernmental organizations
PMPC – Paglaum Multipurpose Cooperative
PWR – Participatory Wealth Ranking
ROSCA – Rotating Savings and Credit Associations
SAMAF – South African Microfinance Apex Fund
SEF – Small Enterprise Foundation
SSA – Statistics South Africa
SMME – small, medium, and micro enterprises
TCP – Tšhomišano Credit Programme
VAT – value added tax
VIP – Visual Indicator of Poverty
UN – United Nations (UN)
UNCDF – United Nations Capital Development Fund
UNDESA – United Nations Department of Economic and Social Affairs
UNDP – United Nations Development Program

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Chapter 1: Introduction

In a world in which almost half of the population lives on less than two dollars per day (World Bank, 2008), the alleviation of poverty is a serious developmental challenge for many states. Microfinance has become a popular buzzword in development discourse all over the world. The 2006 Nobel Peace Prize went to a microfinance institution, the Grameen Bank, and its founder, Muhammed Yunus; the United Nations (UN) demonstrated its support for microfinance by designating 2005 as the International Year of Microcredit; and even politicians and world leaders, such as former US president Bill Clinton and celebrities, such as Oprah Winfrey, champion microfinance as an effective poverty alleviation strategy (Coogan, 2008; Montagne, 2007). With such popularity and excitement surrounding the idea of microfinance, it is important to critically evaluate the successes and challenges of microfinance institutions (MFIs) in order to establish whether or not microfinance is truly as appropriate a development tool as the publicity suggests.

1.1 Microfinance Institutions: Balancing Development and Business Goals

MFIs can provide a broad array of financial services such as loans, money transfers, savings opportunities and insurance to low-income households and, as the name suggests, customers usually deal with smaller sums of money than customers of conventional banks (Mwenda & Muuka, 2004). Much of the current focus of microfinance, however, is on microcredit, which is essentially the provision of small loans to clients. The Grameen Bank of Bangladesh has been one of the most successful and prominent MFIs and its success led to the establishment of many other MFIs drawing on its methodology. One such MFI is the Small Enterprise Foundation (SEF) in South Africa, which adheres to the philosophy of providing credit to unbanked sectors without employing usurious rates of interest.

For institutions like the Grameen Bank and the SEF, microfinance is a mechanism that uses business as a means for promoting development. Loans are given to clients who are traditionally considered 'risky' or 'un-bankable'. Interest rates must be high enough to sustain banking operations and potentially even make a modest profit, but not so high as to create an undue burden on borrowers. Unlike banks, such institutions are often non-profit institutions or 'social businesses', meaning that profits are reinvested in the business in order to benefit the community that it serves (Prasso, 2007).

Microfinance has proven to be a successful strategy for development in some circumstances, but it can also have drawbacks. Depending on the context in which the MFI operates and how it operates in that context, the problems that it faces can be lesser or greater. MFIs attempt to find a balance between business and development goals. It is not necessarily a contradiction to be a

business seeking profit as well as an institution committed to development, but the values associated with these two objectives are sometimes conflicting. Thus, it is important to see how equilibrium can be achieved and to note what sacrifices must be made in order to reach such a balance. For example, business goals demand that an MFI be sustainable, which can make the development goal of serving the poorest of the poor tricky, as it is more difficult to make money on the small loans that suit the very poor.

In theory, microfinance promises to eliminate the ‘bottomless pit’ problem of development aid. In many circumstances, development aid is not a long-term strategy to effect change, but merely an ameliorative measure that requires a long-term commitment to its own continuance. Food aid illustrates this point as it solves the immediate problem of preventing starvation, but it is a resource that gets used up and immediately needs to be replenished. Rather than just giving a community food or money, which will be depleted and create a constant need for more, microfinance uses money in such a way that it can be recycled, never being drained and always being renewed, as clients repay money with interest. Furthermore, proponents of microfinance claim that increased access to financial resources not only improves a person’s financial welfare, but that social development also ensues through improved health, social empowerment, and various other benefits (Ledgerwood, 1999; Johnson & Rogaly, 1997; Wright, 2000). On the other side of the debate, critics question whether a strategy that fails to address the structural causes of poverty can effectively attack poverty (Elahi & Danopoulos, 2004).

1.2 Research Goals

This thesis will focus on examining and assessing the challenges faced by MFIs in balancing the achievement of development goals while at the same time having to be self-sustainable. The SEF will be used as a case study to consider the particular experiences of a South African MFI. I will begin with a general examination of microfinance and will then focus on the SEF to explore what lessons may be learnt from its experiences. The main research goal of my thesis is to use the example of the SEF in order to outline the particular problems and challenges faced by the South African micro-finance industry in balancing the achievement of development goals against the imperative to be self-sustainable. A further goal of my research is to evaluate the appropriateness of the common conception that a ‘successful’ MFI is one that achieves operational and financial self-sufficiency.

1.3 The SEF as a Case Study

The SEF takes its methodology from the Grameen Bank of Bangladesh and seeks to balance development goals with business goals. The SEF’s articulated development goals include: socially

and economically empowering the poor, raising living standards, improving business skills, and demonstrating the bankability of the poor. Business goals require the institution to be financially self-sufficient and ideally even profit bearing. The SEF is one of South Africa's most successful MFIs, but is still not perfect by any means. For this reason, the SEF serves as a good case study to evaluate a relatively effective institution's successes and failures. It also promises to be an ideal case for assessing the trade offs between business and development goals because it has preserved its commitment to development goals *and*, according to the Community Microfinance Network (CMN), it was the first South African MFI to achieve 100% operational self-sufficiency (CMN, 2005). However, even though it has reached operational self-sufficiency it has struggled to maintain such success (Baumann, 2002). Furthermore, the SEF serves as a useful example due to their longstanding activity – the SEF was launched in 1991 – and their diversity of programs, as they have targeted and non-targeted programs in order to reach people from different socio-economic backgrounds (Baumann, 2004a; Hietalahti & Linden, 2006). Furthermore, there is a breadth of documentation and literature available on the SEF's progress and organizational learning. For example, the SEF took part in the Ford Foundation's Imp-Act program, which sought to assess performance, understand how impact is achieved and to improve impact (Copestake et al., 2005).

1.4 Research Methodology and Limitations

The primary method of data collection for this research was the qualitative analysis of primary and secondary literature. The primary literature was gathered from web sites, official documents, press releases, annual and project reports of the SEF. Phone and email correspondence with the SEF helped clarify and supplement the information gained from these sources. The secondary data was sourced from journal articles and books discussing microfinance in general and the SEF in particular. The secondary sources helped provide me with an understanding of how microfinance institutions operate in general and what criteria are usually given when deciding whether a particular MFI is successful or not. Using this information, I was able to examine and assess the SEF. A significant limitation to my research was that I lacked the funding to do field research in Limpopo with the SEF. I did, however, compensate for this through maintaining dialogue with SEF staff through email and telephone.

1.5 Terminology

Discussions of microfinance include reference to many terms, which require careful definition. Oftentimes, the words 'microfinance' and 'microcredit' are used interchangeably. Three broad types of microfinance providers are recognized: 'formal institutions (such as rural banks and cooperatives), semiformal institutions (such as NGOs) and informal sources (such as friends,

relatives, moneylenders and shopkeepers)' (Momen & Begum, 2006, p.1271). Technically, the term 'microfinance' is sufficiently broad to include informal lenders such as family members or moneylenders. However, in the popular discourse of microfinance in the development sphere, microfinance has taken on a nobler connotation of banking with development goals. In this thesis, I will focus on institutional microfinance and thus exclude informal lenders from my discussion.

An important term that comes up in discussions of microfinance institutions is the *double bottom line*. While most traditional businesses have a financial bottom line to measure success, MFIs have an additional bottom line that measures social or development success.

When assessing the success of MFIs, the terms self-sufficiency and sustainability frequently come up. Self-sufficiency is often divided into operational and financial self-sufficiency. Operational self-sufficiency is a measure of the level to which operating income covers operating expenses. The formula for finding if an institution is operationally self-sufficient is as follows: $\text{Operating Income} / \text{Total Operating Costs}$. Financial self-sufficiency measures the level to which operating income covers *adjusted* operating expenses. Expenses include all operating expenses that are included in operational self-sufficiency along with the cost of inflation to equity and the value of subsidies. The formula for finding if an institution is financially self-sufficient is as follows: $\text{Operating Income} / \text{Adjusted Operating Expenses}$. Sustainability, on the other hand, refers to ongoing financial self-sufficiency. If an institution is sustainable than it is able to self fund its long-term operations and growth through its operating revenues.

1.6 Chapter Breakdown

This introductory chapter is followed by a chapter, which focuses on a general discussion of microfinance starting with a discussion of the Grameen Bank and its beginnings in Bangladesh. Different schools of thought are examined to get a full perspective of the debate surrounding microfinance as an effective development strategy. Furthermore, this chapter looks at limits to microfinance and the constant tension that institutions must face between development and business goals.

In the third chapter, the scope of the research will narrow to the South African landscape. South Africa's economic and social environments are discussed to set the context for the discussion of microfinance within the country. A historical overview of microfinance in South Africa will be given to provide context for the discussion of the SEF.

Chapter Four delves into the experiences of the SEF in order to draw lessons from this institution. Following from that, Chapter Five concludes the research with a discussion of lessons learned and recommendations.

Chapter 2: An Overview of Microfinance

2.1 *A Short History of Microfinance*

Muhammad Yunus, often thought of as the pioneer of microfinance, started the foundations of the Grameen Bank while doing field-work in Bangladesh. He saw that women were getting loans from local lenders who were charging usurious rates and at the end of the day these women made just enough money to pay back the lenders and to buy a little food. The next day the cycle would start again. The women were never able to get ahead or to create any wealth because all of their potential profits were paid in interest to local loan sharks. Yunus noticed that poor people were essentially slaves to their circumstances. Their labour was a commodity that they did not even own because they did not have the means to make their labour work for them. For example, Yunus noticed that women were getting paid about 40 cents per day to separate rice from dry straw, just enough to survive but never enough to get ahead, but if they owned a small paddy and processed the rice then they could earn over four times that amount (Yunus & Jolis, 2003). This is a testament to the old adage 'you have got to have money to make money'. If these women could borrow money at a fair rate to buy a little plot of land and cultivate the crops on their own then not only would they have a steady income, but they would also be building equity and personal wealth.

The Grameen Bank started with Muhammad Yunus loaning a group of 43 women a total of \$27 (Yunus & Jolis, 2003). The processes followed by the Grameen Bank were designed to be easy to understand, as many of the people being served do not have a strong working knowledge of banking. Instead of having a complicated system, all loans were initially set up to last for one year with payments being made each week. An equivalent of R1 000 loan with 20% interest will be completed exactly one year from the day that it is taken out and a regular weekly payment will be made of approximately R23. This way, loan repayments are kept small and manageable and repayment expectations are set up right from the beginning. The Grameen Bank also uses solidarity lending which consists of borrowers coming together to form a loan group where each person is held accountable for each of the others' loans as well as her own. Solidarity lending helps cut down on costs and uses peer-pressure and peer-support to ensure repayment. Group meetings are another important aspect whereby every borrower comes together for weekly meetings in order to make payments, solicit advice, and create transparency in the banking process. Positive and negative reinforcement is used to ensure consistently high repayment rates that average 98% (Gross, 2008). Positive incentives include the ability to take out larger and larger loans once a borrower has a proven track record of fiscal responsibility, and the negative incentives are peer pressure and the potential to lose future financial resources. The Grameen Bank had great success and a revolution in development ensued resulting in the emergence of institutions like the highly successful Bancosol

in Bolivia and Credit and Savings for the Hardcore Poor (CASHPOR), which has 24 programs in 8 countries (Glosser, 1994; McDonnell, 1999).

Much research and discussion of successful microfinance has focused on the Grameen Bank. This is not because there are not other successful MFIs, but merely because the Grameen Bank is one of the pioneering institutions in microfinance and because they are one of the most recognizable and highly praised institutions especially after recognition from the Nobel committee. Some other notable international success stories include the Bangladesh Rural Advancement Committee (BRAC), which had a 4.3% return on assets¹ in 2000 with 65% of its clients considered very poor² (Littlefield et al., 2003). In 2001, 70% of India's SHARE Microfin Limited (SML) clients and half of Cambodia's Ennatien Moulethan Tchonnebat (EMT) clients were very poor, but these two institutions had a lower return on assets of 1.1% and 2.3% respectively (Littlefield et al., 2003). Microfinance institutions now serve over 100 million people on six continents and operate in some of the poorest countries like Bangladesh and India while also finding a place in wealthier countries like the United States (Furneau & Brown, 2007; UNCDF, 2005). MFIs can be as divergent as the people they serve and the countries they serve them in. Some MFIs supply individual loans with no solidarity or gender-targeting component, while other MFIs are government run programs that provide any combination of savings, credit, and insurance. The common thread is that financial services are geared toward a smaller scale than traditional banks provide.

Microfinance has also taken shape in the form of Rotating Savings and Credit Associations (ROSCA) or Stokvels, as they are referred to in South Africa. ROSCAs are simple community groups that form to provide an avenue to save and borrow money. A group of people will come together and give money at regular intervals to a member of the group on a rotating basis until all members have received the money they deposited. For example, ten members will come together on a monthly basis giving R50. The first month a member will receive R500 and each successive month a new member will receive R500 for 10 months until all members have given and received a total of R500. This is a simple savings and borrowing system but allows members a means for saving that may be safer than keeping money in the home, while also providing incentive and peer pressure for savings.

Organizations such as Kiva have also sprung up to serve as an intermediary for individuals to get involved in microfinance on the giving end. Kiva has relationships with many MFIs providing an avenue for individuals to research specific microfinance clients and his/her proposed

¹ Return on assets is a measure of profitability that calculates an average financial return over a period of time. It is calculated as a percentage and the higher the percentage, the better the returns.

²The very poor are those who live on less than one dollar per day.

project. A person can then choose to finance a portion or the entirety of clients requested loan amount, with a promise of retrieving their investment at the end of the loan cycle. Kiva finds MFIs that meet their criteria to partner with and while Kiva is responsible for vetting the MFIs it funds, it is not responsible for the day-to-day operations of the MFIs. The default rate is approximately 1.8% amongst all its partner MFIs and each individual lender bears the risk if a client defaults on his or her loan.

Kiva posts on their website individuals and their proposed projects for which they need loans. For example, one can view requests for loans such as one by Yaw Adjei from Ghana who needs \$350 for spare car parts so that he can expand his car repair and parts business, with the profits going to support his family of 6. One can also view a request by Nita Morequio of the Philippines who needs money to buy a pump boat to expand her fishing business. Once an individual decides which project to lend to, they send money to Kiva via the Internet, which then distributes the money to a partner organization in the home country of the client and in turn the MFI distributes the loan to the client. For example, if a donor were to choose to give to Ms. Morequio of the Philippines, then he/she would send money to Kiva which would then send the money to Ms. Morequio's MFI, Paglaum Multipurpose Cooperative (PMPC)³, with a request for Ms. Morequio's project to be funded. PMPC is then responsible for distributing the money to Ms. Morequio and collecting loan repayments which are eventually sent back to Kiva and, in turn, to the lender.

The prevalence of moneylenders charging usurious rates is a problem in countries as disparate as Bangladesh and the United States. A woman in Bangladesh needing money will pay an interest rate of 10% per month, 10% per week, or even more to a local loan shark (Cowen, 2006; Weber, 2002). In the United States many people use 'pay-day loan' services or pawn shops to get a loan that they would not qualify for in a bank. People using this service will pay up to an effective annual interest rate of 521% on their loan from a popular and legal short term loan business (Money Tree, 2008). It can be easily seen how without access to affordable banking services a small setback in daily life, like an illness in the family, can send a family into an almost inescapable cycle of poverty.

MFIs' mission is to bank this group of 'un-bankable' people. Many of them use the lessons of the Grameen Bank and are modelled after aspects of the bank such as the use of solidarity lending, group meetings and no collateral constraints. However, no two MFIs are the same as external and internal conditions are invariably different. One similarity between most, however, is the constant struggle to balance a desire for social benefits and a demand for operational and financial self-sufficiency.

³ PMPC is a co-op that offers a wide range of financial and other services. As a co-op, the members of PMPC are also its clients. Weekly meetings serve as a place for repayment of loans and social and business networking (Marzec, 2009)

2.2 *International MFI Standards*

International standards for a successful MFI are centred on the double bottom line concept, whereby MFIs must necessarily be financially and socially responsible. The Pink Book, the first consensus publication of its kind in microfinance was written in 1995 by the Committee of Donor Agencies for Small Enterprise Development and the Donor's Working Group on Financial Sector Development. It outlined guidelines that donor agencies should look for in successful MFIs. These guidelines have remained relevant today and are largely in line with the United Nations Capital Development Fund (UNCDF) and the United Nations Department of Economic and Social Affairs (UNDESA) framework for appropriate financial institutions, specifically appropriate MFIs. (UNDESA & UNCDF, 2006) The Pink Book's framework explains MFI best practices as consisting of high outreach to low-income clients *with* financial sustainability (CDASED & DWGFSD, 1995). In elaborating on MFI best practices, the Pink Book elaborates on three dimensions that indicate a successful MFI, namely institutional strength, quality of services and outreach, and financial performance.

According to the Pink Book, for an MFI to be considered institutionally strong they must have structures set up to run an effective business, ie. competent staff, good management structure, transparent financial reporting, high productivity and accurate management information systems. When looking at an MFI's quality of service and outreach, the MFI must focus on serving the poor in an appropriate manner. This means that the services an MFI provides must be something that clients need and are appropriate to their unique situations and should include savings when possible. Furthermore, MFIs should make progress in expanding client outreach and continuously adjust operations to improve delivery and client satisfaction. The final dimension demands that MFIs demonstrate a strong level of financial performance. In order to do so, MFIs must ultimately be moving to full financial self-sufficiency with a guideline of reaching this level in five to ten years. Furthermore, the MFIs must maintain strong portfolio quality, meaning that they must keep default and arrears to a minimum. In essence, the Pink Book defines a successful MFI as an institution that provides an important service to the very poor but is run like an effective business, where the financial bottom line matters.

2.3 *Debates Surrounding Microfinance*

Increasingly, international organizations that focus on developmental issues emphasise microfinance as a strategy for reducing poverty. For example, the United Nations Development Program (UNDP) has asserted that the provision of microfinance 'has become one of the key driving mechanisms towards meeting the Millennium Development Goals, specifically the overreaching target of halving extreme poverty and hunger by 2015' (Brown, 2004, p.2).

Microfinance promises to offer sustainable poverty alleviation with modest initial cost. Furthermore, microfinance is meant to capitalize on people's potential to create and work as opposed to providing charity, which can be an endless drain with no incentive to utilize personal talents. However, there is no consensus on the utility of micro-finance as a viable and consistent tool to achieve development objectives.

2.3.1 Arguments in Favour of Microfinance

Microfinance is a grass-roots response to the failure of many state-led development policies. The 'Green Revolution' of the 1960s and 1970s is an example of such failure in macro-policy, as vast amounts of money were sent to poor countries to develop their agricultural sector with Western methods. Unfortunately, many believe that the policy was not only ineffective, but also destructive as it reduced living standards, increased debt, exacerbated corruption and succeeded in a deeper uneven distribution of resources (Woller & Woodworth, 2001). Other development-related endeavours, such as infrastructure development through the building of roads, hospitals, and factories can potentially be effective, but do not do enough in the short-term to alleviate the desperate circumstances of so many people (Remenyi, 1991). Microfinance proponents see access to financial resources as one way to reach the poorest immediately, as macro-level policies have done little to improve the living standard of the poorest, and they will most likely be unable to make any drastic change in their livelihoods in the near future. Proponents of microfinance acknowledge that it might not be a perfect solution but it does offer benefits to those who most need it and something must be done now or masses of poor will die waiting for a solution (Woller & Woodworth, 2001).

The pro-microfinance school of thought believes that aid should be directed away from charity and focused on development that will be sustainable, both in regard to physical and intellectual capacity. Aid should not be welfare, but should instead be a way of providing resources to empower people to develop and use their own talents and resources to work their way out of poverty rather than rely on outside assistance which will most likely not remain a constant resource (Aliber, 2001). This approach is cost-effective because aid is not just spent but is recovered then spent again. A development rather than charity-based approach has also been commended for achieving its goals without degrading the poor (Woller & Woodworth, 2001; Yunus & Jolis, 2003).

Speaking in defence of microfinance, Yunus argues that all humans are innately entrepreneurial and have the ability to succeed if only the playing field were equal (Yunus, 2008). Microfinance helps level the playing field. Furthermore, microfinance provides services that people normally seek but at a more reasonable rate. If access to credit does not exist, then oftentimes people have no option but to resort to borrowing from informal moneylenders who have usurious

loan rates that keep borrowers in poverty rather than helping them out. Pro-poor MFIs aim to get people out of the cycle of poverty so that people can accumulate capital and assets and then build upon it while the MFI regains costs in order to perpetuate aid.

One of the greatest claims to success of microfinance is its contribution to empowering women. The empowerment of women is seen as an integral part of most contemporary development strategies (Cheston & Kuhn, 2002; Daley-Harris, 2002). Many MFIs prioritise women's capacity building, as women are often the poorest and most vulnerable segment of the population. Oftentimes MFIs target women and in some cases even completely exclude men in order to ensure outreach and reduce the chances of mission drift. Proponents of microfinance believe that microfinance is inherently empowering for women as not only is poverty disempowering, but access to finances and the ability to make decisions about money is also empowering (Mayoux, 2002). Kabeer (1998) found that the mere the act of bringing financial resources to the household, regardless of whether or not they had primary control over the money, still provided some benefits for most women. In addition to financial growth, the group structure of many MFIs gives women opportunities to form social networks, access information and build social and business skills, all of which improve her individual capacity. Moreover, microfinance has been instrumental in helping to break down gender and cultural barriers as can be seen in increased political participation and improved community status of female microfinance clients as will be described later.

Some may argue that microfinance is limited in that it works in the same capitalist framework that oppresses the poor and that what needs to change is the structural conditions in which poverty arises. In defence of microfinance, Yunus and Jolis (2003) recognize that structural conditions do indeed cause poverty and that microfinance does work within the same capitalist framework, but argue that capitalist tools can be used in a new way to create change. They believe that through participating in the economy, one can change the economy. But, one must not participate in the prescribed way, but rather in a socially conscious way that will help achieve social objectives (Yunus & Jolis, 2003). One way to do this is to introduce so-called 'social businesses', which are businesses fuelled by social goals and not profit motives. Participation can be an opportunity to make incremental changes that ultimately challenge and transform traditional structures. Social businesses allow for a change in the traditional structure of collateral based loans and allow for loans are distributed without collateral which, in turn, can help challenge traditional gender roles as women around the world often make less income and therefore have less collateral. For example, Cheston and Kuhn (2002) point-out MFIs' ability to challenge traditional barriers that have excluded the poor in general and women in particular. MFIs have been able to change the way that people do banking by, in some cases, eliminating collateral requirements. In a 2008 lecture, Yunus showed his disregard for traditional structures of banking when he stated that his theory in

banking was ‘to take a look at what traditional banks do and do the opposite’. Microfinance might not present a radical challenge to existing structures, but it does challenge some and help to transform others.

2.3.2 Criticisms of Microfinance

A first criticism relates to the idea that people are inherently entrepreneurial. Critics argue that successful entrepreneurs in both the developed and undeveloped world are usually exceptional and innovative. Karnani (2007) observes that the average worker in the developed world is an employee, not an entrepreneur despite their better circumstances due to enhanced education and access to financial resources. In the developing world, the vast majority of microfinance clients work in hawking or small-scale production; they have no employees, as their businesses are too small to achieve efficiency of scale and they make paltry earnings. Entrepreneurship is a difficult route of employment with many risks and few benefits for most (Karnani, 2007; Milner, 2000). Feiner and Barker (2007) criticise supporters of microfinance for holding the neo-liberal view that poverty is a situation that people can, more or less, will themselves out of with hard work. Policy makers supporting microfinance are accused of selfishly supporting a development tool that works within the existing structure, thus evading responsibility for improving structural problems while blaming the victims of failed policy by claiming that their individual behaviour and lack of initiative is the cause of their poverty (Cockburn, 2006; Feiner & Barker, 2007).

Other critics question the very theoretical premise that microfinance is based on, arguing that the lack of microfinance is not the reason for poverty, therefore the provision of microfinance is an inappropriate tool for eradicating poverty (Elahi & Danopoulos, 2004). They theorize about the complexity of poverty, that has many contributing factors such as loss of land rights and poor education and health services (Feiner & Barker, 2007). By ignoring those structural issues and attacking poverty from only one angle, some may benefit, but poverty on the whole is bound to remain trapping more and more people in the cycle. Thus, improving the infrastructure that disadvantages the poor and building conditions of inclusion is thought to be the most effective way of eradicating poverty for all rather than alleviating it for some as microfinance does (Feiner & Barker, 2007). Dichter (2006, para. 22) poignantly asks ‘is the goal [of development] to ease the pain or to cure the disease?’

Other critics challenge the effectiveness of microfinance in alleviating poverty, arguing that the development returns are not sufficient to merit such positive attention, nor the vast amounts of donor aid (Dichter, 2006). The Canadian International Development Agency emphasizes the need for anti-poverty strategies to be more inclusive than mere financial access. Additional services must be provided, such as education as most existing MFI clients make only modest gains. The poorer

the client the less they tend to benefit (MacIsaac, 1997). Karnani (2007) explains that the reasons for the disparity in benefits between very poor and modestly poor clients is that the very poor are living at levels of subsistence, therefore they are less willing and less able to take risks as their very survival depends on the day-to-day success of their business. Less poor clients can take more risks as they have more of a financial cushion to sustain them if they decide to innovate or modernize their business.

Investing in large-scale state-supported business is considered by some to be a more effective way to provide employment for the poor and reduce poverty. Karnani (2007) insists that governments should invest in larger businesses, as they are more effective in eradicating poverty. Since there are limited resources for development initiatives, money should go where it will provide the most improvement. To illustrate his point, he gives an example of clothing manufacturing. A microfinance client who wants to produce clothing would have to take out a loan to buy a sewing machine and fabric, and then begin to repay her loan. While she will own her sewing machine at the end of the loan, and thus increase her assets, Karnani asserts that she would make very little money due to high interest rates and high levels of competition. In contrast, if a clothing factory was opened, many jobs could be provided without women needing to take the risk of self-employment. The clothing factory could take advantage of economies of scale and advanced technology. Thus some argue that supporting microfinance is a very limited tool for poverty alleviation and argue that the more assured approach of job creation through big business is preferable. As Cockburn (2006, p. 9) puts it ‘the trouble is that microloans don’t make any sort of a macrodifference.... Microloans are micro-Band-Aids in a scale of things.’

Even Microfinance institutions themselves have offered criticism of aspects of microfinance. In 2004, the Development Finance Forum, which includes many leading MFIs, published a paper that questioned the conventional and popular views of microcredit and recognized microfinance’s limitations in helping the poorest (Development Finance Forum, 2004). These development specialists recognize that microfinance can have limited benefit in poverty alleviation; therefore they assert that microfinance might be an ineffective poverty-reducing tool in certain circumstances (Mosley & Hulme 1998). While recognizing these limitations, they still believe in microfinance’s ability to be an effective development strategy in some contexts, but stress the importance of continual examination and evaluation of the effectiveness of practices.

The criticisms discussed above suggest that microfinance may not be as beneficial as advocates believe, but do not go as far as to suggest that it actually does harm. However, other critics argue that microfinance can actually be harmful, especially for women. Many cases have been reported where husbands or male family members take control of women’s loans for their own purposes (Cheston & Kuhn, 2002; Milner, 2000). This can increase a woman’s dependency while

also putting her in the difficult position of being responsible for the repayment of the loan; thus further trapping her in the cycle of poverty and debt. Additionally, there have been limited studies that show that domestic violence in the household may increase once women join an MFI (Goetz & Gupta, 1996). Reasons for this are blamed on the 'backlash effect' whereby women gain increased confidence due to their involvement in the MFI and begin to challenge gender norms in the home. This assertion of rights and challenging of traditional male authority causes conflict in the home and can lead to violence. While this is an important consequence to keep in mind and should be watched closely, most researchers actually find the opposite to be true (Cheston & Kuhn, 2002; Hashemi et al., 1996; Robinson, 2001; Working Womens Forum, 2000). Further concerns arise because microfinance increases the burden placed on women. When a woman starts a business, her responsibilities often double, as in most cases she is not able to abdicate her household responsibilities (Cheston & Kuhn, 2002; Mayoux, 2002). Unfortunately this is a worldwide phenomenon that women experience by living in a patriarchal world. It is a criticism that is valid across cultures and societies. For example, since the feminist revolution in the developed world, women have faced the double burden of working full time in the business sector then coming home and being expected to perform most of the household chores. Ideally, household responsibilities should be shared between men and women but such changes in gender roles are not likely to change overnight.

2.3.3 A Defence of Microfinance: The Middle-Road

When looking at the debate surrounding microfinance, one finds more literature in defence of microfinance than opposed to it. This is partly because practitioners of microfinance write much of the available literature. Most current literature touts the successes of microfinance but closer examination shows that even proponents of microfinance do not believe that mere access to financial services is a universal remedy to poverty alleviation. Instead it is a tool that can be used in combination with other strategies (Daley-Harris, 2002; Johnson & Rogaly, 1996; Woller & Woodworth, 2001).

Some critics use Bangladesh as a counter example to the success of microfinance, as Bangladesh is still one of the poorest countries in the world, although it has a reputation for having some of the most successful and long running microfinance programmes with the largest depth of outreach (Cockburn, 2006; Karnani, 2007). A more thoughtful approach might be to look at the contributions that microfinance has made to Bangladesh's progress while being sure not to ignore its still substandard general living conditions and thus the limitations of microfinance. There is no doubt that Bangladesh is extremely poor, but evidence reveals that Bangladesh has made vast improvements and may be on its way up and out of poverty. Daley-Harris (2006) cites many

examples of Bangladesh's success in development: By 2004, Bangladesh had achieved the Millennium Development Goal on gender parity in primary and secondary schools; fertility rates have halved from 1970 to 2004; deaths of children under the age of five have fallen from 239 per 1 000 in 1970 to 77 per 1 000 in 2004; and Bangladesh has overtaken India in reducing its child mortality rate. More examples of microfinance success in Bangladesh are described in Khandker's (2005) 13-year study of three MFIs⁴. The study that showed microfinance was directly related to an overall reduction in moderate poverty by 40%. Furthermore, the study showed that not only did microfinance seem to have a positive correlation to program participants transitioning out of poverty each year, but also a positive impact was observed for non-participants in villages where MFIs operated as a result of suspected spill over effects of improvements achieved via microfinance. While microfinance is certainly not the only reason for each and every gain, these successes and their links to microfinance should not be ignored.

The general consensus in development circles seems to be that there is indeed some benefit from microfinance; although the extent of the benefit is debateable (Maes & Foose, 2006). Depending on the circumstances, microfinance might be instrumental in pulling large numbers of people out of poverty. Or as some critics claim, microfinance is beneficial to some extent but it is not the best use of resources (Fiener & Barker, 2007; Karnani, 2007; Milner 2000) At other times, its main purpose might be to smooth consumption (Zeller, 2001). This means that even if a person's net worth does not increase with access to loans, they are able to manage better when times are lean. So during lulls in business one need not go hungry or go without absolute necessities. It would be a disservice to development policy to assume that microfinance is a cure-all for poverty, but it would also be a disservice to poor people to ignore a development tool that could provide relief simply because it does not solve all the problems of poverty or bring everyone out of poverty.

2.4 Development Goals

With so much governmental and non-governmental funding going toward microfinance all over the world it is important to assess the implications of such a development strategy. Ideally the benefits of funds directed toward microfinance should be at least as beneficial as if funds were directed toward another type of aid, as donors would certainly want to get the most benefit for their money. The difficulty in calculating benefit is that not all impacts are easily measured or quantifiable. It is difficult to measure, for example, increased self-confidence and then to put a monetary value on it. This research will not attempt to evaluate the worth of particular development goals but it will look at the stated development goals that microfinance claims to achieve and the effectiveness of MFIs to achieve such stated goals.

⁴Khandker's study included the Grameen Bank, BRAC, and Rural Development Project 12 (RD-12).

2.4.1 Economic Goals

The most common goal of MFIs is to pull people out of poverty. Poverty has many implications such as social, political and economic marginalization. The most obvious aspect of poverty that microfinance aims to correct is economic. Having access to savings facilities and loans ideally helps reduce vulnerability especially in times of emergency or during times when business is slow or less productive. The economic benefits of microfinance can be seen in the following studies, some of which date back twenty years. A World Bank study conducted in the 1990s observed that 5% of microfinance clients in three of the largest MFIs in Bangladesh graduated out of poverty each year and maintained their financial status over time as well (Kandker, 1998). A study by the Grameen Bank found that incomes of members were 28% higher than those of non-members in villages where the Grameen Bank operated and 43% higher than people who lived in non-Grameen villages (Hossain, 1988). The MFI BRAC observed that household expenditure increased by 28% and assets increased by 112% for clients who had stayed in their program for more than four years (Zaman, 2000). McNelly and Dunford (1999) found that Ghanaian clients in the MFI Freedom From Hunger (FFH) diversified and increased their sources of incomes. FFH clients apparently reported an increase of \$36 in net monthly income and 86% of clients had more than one source of income, whereas non-clients surveyed during the same period increased income by \$18 and only 50% of reported more than one source of income (Morduch & Haley, 2002). Statistics like these are numerous and suggest that microfinance initiatives have not only achieved the development goal of addressing poverty, but have also managed to make more general improvements to their clients' economic well-being.

2.4.2 Health-related Goals

Improving health is an important part of poverty relief as malnutrition is one indicator of poverty and severe illness is one sure way to enter into, or return to poverty, as health care can be costly in regard to missing work and actual medical expenses. With improved health of self and family members, one can better secure their future. Some MFIs recognize this and provide additional services such as limited health education. Others also mobilize communities and outside donors to improve sanitation and drinking water (Littlefield et al., 2003). For example India's Self Employed Women's Association initiated a water campaign in 1995 that used local and international resources to improve and expand upon existing water facilities (Panda, 2006). While there is not generally direct health care services or health education in all MFIs there does seem to be a strong correlation between increased earnings and increased spending on health and nutrition. One empirical example can be seen in a study undertaken by WISDOM in collaboration with World Vision and Johns Hopkins School of Public Health. The study examined the nutritional status of

clients of a World Vision MFI in Ethiopia. When looking at the nutritional status of male and female clients, there was a huge discrepancy in the malnourishment of children; children of male clients were twice as likely as children of female clients to suffer from poor nutrition. Furthermore, the quality of food varied as well; however, there was a marked gender-related difference here. After joining the MFI, female clients were able to improve the quality of the family's diet by 37.1% whereas male clients improved quality by only 19.6% (Musalima, 2006). Thus, microfinance seems to improve the nutrition of the families of recipients, but the positive effects are far greater when women are the recipients. Similar studies were performed in Bangladesh where the World Bank saw a significant positive effect on height-for-age for children and it found that a 10% increase in credit resulted in a 6.3% increase in arm circumference (Chowdhury et al., 2003). BRAC's study found similar results in clients and also found that malnutrition declined more and more as the length of membership increased (Chowdhury & Bhuiya, 2001).

2.4.3 Social Goals

Microfinance appears to also bring social benefits. There is anecdotal evidence that the mere access to financial resources increases people's dignity by giving clients a resource that they were once excluded from. Thus, clients are now afforded the same rights as more privileged people. Furthermore, when one can control his/her own finances rather than asking family members or friends for loans, one can maintain much more dignity as financial problems can more easily be kept private (Porteous, 2004). The Norwegian Nobel Committee even describes microcredit as 'an important liberating force' (Norwegian Nobel Institute, 2006, para. 4). Additional social benefit is realized with the targeting of women, who are generally a more marginalized group. As mentioned earlier, many studies have shown that much more so than men, women invest their resources in the welfare of children and the household (Chant, 1997; King & Lomborg, 2008; Kiviat, 2008; Todd, 1996). Giving women access to finance has been a way to break down some traditional barriers of repressive social and economic conditions as the provision of microfinance allows women to fulfil roles that they typically have not in the past.

By improving equality between the sexes, many other social goals are achieved. In a UN study that took place in over 40 developing countries, it was shown that as women gain equality there was an observed decline in birth rates (Yunus & Jolis, 2003). The Grameen Bank proved this to be true, and also demonstrated a link between financial access and such empowerment. Clients have dramatically lower birth rates than the national average in Bangladesh and clients are twice as likely to use family planning measures than the national rate (Yunus & Jolis, 2003). There seems to be a correlation between economic empowerment and social empowerment. Once a woman perceives that she can take care of her own business and finances she translates that realization to

other aspects of her life and realizes her ability to effect change in other important areas. For example, the Nepalese Women's Empowerment Program recorded that 68% of clients had more decision making power within their families in areas traditionally dominated by men such as family planning, buying and selling property, sending daughters to school and negotiating children's marriages (Littlefield et al., 2003). Another study showed that involvement in MFIs actually reduced domestic violence due to increased empowerment. Working Women's Forum found that 28.7 percent out of 40.9 percent of its members who had experienced domestic violence were able to stop it (Working Women's Forum, 2000). However, it should be noted that, as mentioned earlier, a small number of studies have in fact shown an increase in domestic violence for female microfinance clients (Goetz & Gupta, 1996).

2.4.4 Political Goals

As described above, MFIs tout economic empowerment as going hand in hand with social empowerment, whereby women have increased their power to control their own lives in respect to business decisions, use of money, and family planning issues. The Grameen Bank also believes that economic empowerment leads to increased political participation. Evidence of this was seen in 1996 when more women voted in the national election than men, which the Grameen Bank attributes in part to the Bank's influence as borrowers are encouraged to vote and an emphasis is placed on the poor's ability to influence politics as they make up the majority of the population (Yunus & Jolis, 2003). Participation in microfinance processes may also encourage increased political participation on the part of women. As Essa Ben Hamida, co director of Tunisian MFI ENDA Inter-arabe, puts it microfinance 'constitutes an apprenticeship of democracy' (2000, p. 9). The structure of group lending is set up in such a way that participation is typical and regular. Women gain experience in voicing their opinion and being listened to in group and centre meetings. This increased confidence in participation on a small scale can translate into involvement in larger scale events, especially with the encouragement of a well-respected organization (Yunus & Jolis, 2003).

In 1997, over 1750 Grameen members (1485 female and 268 male) and 1570 of their family members were elected to local offices, which represented 6% of local elected representatives in the country. This shows the dramatic influence that Grameen members had, as there were only 2.1 million borrowers in a country of 120 million people, accounting for only 1.8% of the population (Kaltenheuser, 1997; Segal, 1997). In 2006 Daley-Harris noted that more than 13 000 women have been elected to local government positions in Bangladesh. Further evidence of political participation is seen in the Philippines' Opportunity Microfinance Bank, Centre for Self-help Development in Nepal, Fund Opportunity in Russia, Bolivia's Freedom from Hunger and many

others which have observed increased political mobilization and have witnessed examples of MFI clients running for political office (Littlefield et al., 2003).

2.5 Business Goals

It can be argued that there are a lot of benefits for development organizations that operate more like businesses, as sound business principles are necessary for any organization to be efficient (Fisher et al., 2002; World Bank, 2001). Many aid and governmental organizations have the reputation of being inefficient and bloated whereby much of the money that is meant for development is actually going toward administration costs. A Bangladeshi research institution estimated that 75% of foreign donor aid received in the past 20 years was not spent in Bangladesh; it was spent on equipment, supplies, and consultants from the donor country (Yunus & Jolis, 2003). In situations where fiscal responsibility is not prioritised, corruption and waste are certainly more likely. However, when an organization is held accountable for its financial decisions and must meet certain business goals, it is more likely to use money effectively.

While an institution whose mission is to be financially self-sufficient has greater motivation for efficiency and innovation, they must be cautious not to lose motivation to accomplish other goals such as servicing the poorest of the poor and realizing development goals. Serving the very poor and achieving development goals can be very costly, so they are goals that can be easily compromised if an MFI prioritises self-sufficiency and the achievement of business goals above all else. Montgomery (1996) cites examples of peer groups and loan officers putting extreme pressure on clients even when they face hardships beyond their control. He then relays stories of women's livestock, assets and even a house being taken away due to default. While a traditional bank may repossess items in order to recoup loan losses, an MFI that takes away a woman's only shelter clearly disregards its social mission. It is in cases like this where typical banking practices cannot be implemented and a certain level of understanding must be achieved if an institution is to effectively serve the very poor. To be able to meet their business goals, MFIs have had to develop some new and innovative strategies.

2.5.1 High Interest Rates

In order to reach the business goal of becoming financially self-sufficient and even profit bearing, MFIs must charge sufficiently high interest rates. The Grameen Bank, for example, charges 20% interest, which is relatively high in relation to other banking institutions that give out larger loans, but a 20% interest rate is not as high as local moneylenders (Armendariz de Aghion & Morduch, 2005). Some microfinance institutions have to charge significantly higher interest rates than commercial banks to cover costs. Costs can be high for many reasons such as inefficiency,

risk, increased transaction costs, lack of competition, high default rates, and low repayment rates among other things. To be able to meet their business goals, MFIs have had to develop some new and innovative strategies.

There is a risk that MFIs rely on changing high interest rates to cover cost rather than innovating through the use of solidarity lending, increasing loan officer productivity, and improving client retention rates. In India, MFIs charge between 24% and 36%, whereas traditional bank loans tend to be between 6% and 8% (Cockburn, 2006). *Compartamos*, a Mexican MFI charges effective interest rates of 110% in order to recoup costs; these interest rates are essentially in the same calibre as loan sharks and are certainly not an 'alternative' that will help people out of the cycle of poverty (Woller, 2000).

In some cases, MFIs get away with charging such high rates because there is no competition driving costs down and because poor people are excluded from the formal banking system. If the only alternative to microfinance is a local moneylender then the MFI has a lot of liberty in setting the interest rate. When there is a great demand for credit and little competition then the lender can charge high interest rates as there are no other options for borrowing money. Competition can lead to innovation and better service from credit providers, but competition may increase default rates, as clients are not so worried about staying on good terms with a particular MFI if there are many other credit options. MFIs often offer basic financial education to clients or staff to improve loan repayment success levels. However, the provision of education might also decrease earnings because the additional costs must be absorbed in some way, either through higher interest rates, lower staff salaries, or through an increase in donor funds. If costs are absorbed through higher interest rates or lower staff salaries, MFIs run the risk of swelling default rates as clients might leave and go to a cheaper MFI or staff may be lured to work for other more profitable institutions. Bloated subsidization from donors is also not ideal as it might drive out competition and decrease innovation.

2.5.2 Solidarity Lending

Loaning to the very poor was traditionally considered more risky for traditional banks as the very poor have little or no collateral to guarantee their loans. If a bank or MFI does not have collateral then ideally, a it would like to know which clients are most likely to default so that they will only serve the responsible clients. However, that kind of information is not easy to know as it is difficult to predict the future especially if there is no loan history to demonstrate a client's propensity for repayment, as there would not be with the very poor. One way that MFIs have reduced this risk is through implementation of solidarity lending, as it requires clients to form a group of people and the members of that group will guarantee each others loans. Risk is reduced

since the entire group is responsible for the loan even though the each loan is taken out in an individual's name. Therefore there is peer pressure to repay the loan, as many peoples' credit is dependent on one's own repayment, and if peer pressure fails to work then there are other clients to help with repayment. Additionally, by choosing a solidarity group one is more likely to choose responsible members therefore the MFI benefits from community knowledge. If a woman has a choice of who is in her credit group and she knows that she can choose between a dependable friend or a less dependable friend she will choose the person who is in her best interest and thus the MFI's best interest. Generally, solidarity lending helps institutions reduce risk in two ways: financial institutions do not need to collect information about risk of clients as people do that automatically during group selection and, due to the nature of solidarity lending, payments are guaranteed by the entire group, not just one person (Hawkins, 2003). By using this system MFIs, by default, loan to less risky people as group members have vetted them and if they are not as reliable as hoped then the group members are there as a guarantor that will ensure repayment. The success of this strategy can be seen in MFIs such as the Grameen Bank and the SEF that have repayment rates upwards of 95%, which is actually even higher than traditional banks. Further benefits of solidarity lending include decreased overhead costs through the use of weekly group meetings. These meetings can help cut down on administration costs, as everyone meets once weekly and loans are collected so loan officers do not have to make the rounds. These group meetings also provide opportunities to ask questions, get advice, and exchange information.

However, the system does not always work as well as it was designed to. In some circumstances groups are formed where members are not as knowledgeable about each other's histories as would be desired. Therefore the group fails to adequately vet clients and the group can actually undermine the security of the loan rather than reinforce it. If there is little loyalty within the group and some members are not acting responsibility with repayment then other clients may feel little incentive to work hard for those who are not (Abbink et al., 2006). Other problems arise with solidarity lending when people do not live in very densely populated societies (Armendáriz de Aghion & Morduch, 2005). Sparsely populated areas can make group meetings a difficult requirement for some to comply with as meetings may be far away for some and the time required by these meetings and by travelling to and from the meetings can be very costly to the client, both financially and in opportunity costs, making the transaction costs prohibitive (Maes & Foose, 2006). In some cases, solidarity lending might be appropriate during a client's first few loan cycles, but may become inappropriate with time. Clients who need smaller loans might be most effectively served by solidarity lending as it cuts down on costs and has a higher depth of outreach but as the loans get larger the solidarity model may no longer be appropriate. With larger loans it may be prohibitive for borrowers to guarantee others' large loans especially if the economic disparity

between group members increases (Hawkins, 2003; Lapenu & Zeller, 2001). If someone's business grows rapidly and they need a large loan, other group members may not be able or willing to commit to the loan group especially if their net worth has not grown at the same rate.

Therefore, while solidarity lending may be effective most of the time it cannot be viewed as the only way to serve communities. Products must be designed effectively for clients and be able to grow and adapt to their needs. It is innovation such as solidarity lending that initially allowed MFIs to break the traditional banking mould and serve a traditionally non-lucrative section of the population productively. That innovation must persist to meet changing demands and environments if efficiency and business success are to endure.

2.6 Conclusion: Balancing Development and Business Goals

In some situations, where MFIs do not focus on development goals, elevated rates may be charged due to high opportunity costs. For example, if a financial institution loans money to a client and recovers all costs and makes 1% profit then the institution is not losing money and some would see that as a success. However, for an institution solely interested in profit, it may seem like a loss if they know that they could have recovered their money and made a 10% profit by loaning to a wealthier client as bigger loans are usually more profitable. Thus to achieve development goals, the MFI *must* have a goal beyond merely making money, and it must be constantly mindful of both goals to avoid mission drift.

For MFIs to be sustainable while still achieving their development goals, they must be innovative. MFIs may need to take some time to establish effective systems. Solidarity lending and group meetings are examples of innovations that MFIs have adopted in order to balance development and business goals.

Chapter 3: The South African Context

3.1 *The State of the South African Economy*

According to Statistics South Africa, which uses a national poverty line of R431 per person per month, 48% of the population lives in poverty (Statistics South Africa [SSA], 2008a).⁵ Using another measure of poverty, the UNDP estimates that 11% of South Africans live on less than a dollar a day, which is what the UN and World Bank describe as ‘extreme poverty’ (UNDP, 2008). Additionally, there is an estimated unemployment rate of 30% (SAARF, 2006). However, statistics are difficult to verify as the unemployment rate was calculated for only those who were looking for work; the rate is much higher – 63% – if it includes adults like students and retired people who choose not to work, or those who have given up on searching for work. Only about a third of those classified as ‘employed’ have secured full-time work (SAARF, 2006). Furthermore, much of the labour force is engaged in informal businesses and it is difficult to gauge how many of those informal businesses or their revenues are counted in statistical calculations (Balkenhol, 2006). However, it is uncontroversial to say that there is a sizeable portion of the South African population that would be considered among the very poorest by any recognized international standard.

The story of high rates of poverty and unemployment is not an uncommon one in developing countries. What sets South Africa apart is its distinct history of colonialism and apartheid. This unique experience has created a social and economic climate unlike others, whereby there is a clear and vast difference between the so-called first economy, which employs a minority of the population, and the second, which absorbs the majority.

The separation between the so-called first and second economies is widely regarded by theorists and policy makers as an impediment to the economic success of the majority of citizens (Baumann, 2001; Department of Provincial and Local Government [DPLG], 2006; Department of Trade and Industry [DTI], 2005; Rogerson, 2007). On one level there is a highly functional and successful ‘first’ economy that is globally integrated; those participating in its formal sector have livelihoods more closely resembling the life-styles of Europe than the rest of sub-Saharan Africa. Contrarily, there is a ‘second’ economy, which consists of the majority of the population—mainly black—who live at a level closer to South Asian Countries (Baumann, 2005). The African National Congress (ANC) (2004) describes members of the second economy as marginalized people who work mainly

⁵ Statistics South Africa is the national statistics board of South Africa, which produces official censuses and surveys. They established the poverty line as a measure of money needed to meet basic, minimal living standards. The majority of this measure is determined to be food purchases. The South African Medical Research Council determines that the minimum energy requirement per person is 2261 kilocalories. Statistics South Africa determines the average cost to meet this requirement based on typical foodstuffs purchased by low-income peoples. To determine the amount needed for essential non-food items, Statistics South Africa ascertains what items very poor households are willing to forgo food to purchase. These two figures combined and adjusted for inflation comprise the poverty line.

in the informal sector but also including the unemployed. The informal sector includes businesses and employees that are not legally registered and usually do not pay taxes, provide benefits, or follow labour legislation. Often these jobs are casual or temporary with few employees (International Labour Organization [ILO], 2003).

With the rapid expansion of the South African economy into the global sector and a dramatic decline in sectors, such as mining, that used to provide large numbers of people with employment, there is a considerable surplus of labour that can no longer be used. Unskilled workers are being replaced as a result of improved technology and the formal economy can no longer absorb the extra workers, as they have not been trained for other types of work. Unfortunately, the informal economy is also unable effectively to absorb the unemployed, thus keeping unemployment rates high. Since there are few linkages between the formal and informal economy, the informal economy has few opportunities for growth into the formal sector. Without these linkages informal businesses have a limited number of customers, who generally consist of other marginalized workers, and therefore earnings remain low (Aliber et al., 2006). Former President Thabo Mbeki (2003) described South Africa's dual economy using the analogy of a two-storey home where rich South Africans inhabit the top floor and the poor inhabit the bottom, without ladders to reach the top floor. These economies operate separately with very few links connecting them. It is almost as though two separate countries and systems were placed in one and forced to coexist.

Related to the issue of two economies is extreme economic inequality. South Africa has one of the highest Gini coefficients in the world, meaning that the gap between rich and poor is enormous (Clur, 2006). The majority of the population makes very little money, while a small elite earns incomes dramatically higher: the poorest 10% of the population earns 94 times less than what the top 10% of the population earns (SSA, 2008b). This inequality explains how South Africa can be rated as a 'middle-income' country even though the majority of the population would actually be considered low-income by the same standards.

Various laws have contributed to this situation: under apartheid, those classified as black, coloured or Indian were systematically excluded from rights to land, liberty, and mobility among other things. The colonial and apartheid governments sought to separate everything along racial lines. From the late 1800s the colonial government sought to demarcate separate areas of land for whites and for blacks, with these policies culminating in 'grand apartheid', in terms of which in the 1960s and 1970s 'homelands' were created. These homelands were designated as separate independent 'Bantustans' for blacks, much like the Native American reservations of the United States. The homelands designated for the majority of the population comprised only 13% of the total land area of the country and were generally isolated with little infrastructure and almost no tax base (Aliber, 2001). So black people were crowded onto small areas of often-unproductive land and

provisioned with few environmental resources. The outlawing of sharecropping also left most without the option of subsistence or income from personal agricultural holdings (Aliber et al., 2006). Furthermore, the National Party government did not invest in infrastructure in the homelands as they were thought of as sovereign states, making economic opportunities scarce for blacks. All of these policies made it easier to exploit people through low-paying jobs in the South African manual labour sectors such as mining, which drew a large percentage of migrant labourers (Catchpole & Cooper, 2003). The decades of segregation of people and labour have left South Africa with an ingrained economic duality.

In the face of these extreme levels of poverty and inequality there is a strong demand on the government to help the poor. In an address to parliament in 2004, former President Thabo Mbeki spoke of a three-pronged approach that the government would use to address poverty: 'encouraging the growth and development of the First Economy, increasing its possibility to create jobs; implementing programmes to address the challenges of the Second Economy; and building a social security net to meet the objectives of poverty alleviation' (Mbeki, 2004). Unfortunately, the third prong in the government's strategy for poverty relief is limited as resources are strained due to the social security system's drift from its original intention of temporarily assisting a few in need, to being a major mechanism of support upon which many people depend (Aliber, 2001). Statistics suggest that around a quarter of the population receives government grants, which means that the South African government is eager to develop more long-lasting and sustainable methods of aid (Joffe, 2008).

The first prong in the strategy also has its limitations for immediate relief of poverty, as the first economy has little current need for a dramatic increase in labour. Since the first economy competes on a global level, much of its profit is made through utilizing highly skilled workers and labour-saving technology (Aliber et al., 2006). There are no longer high numbers of big businesses that require such labour-intensive work as when the mining industry was thriving. Therefore, while government support for first economy businesses will boost the economy generally, it will most likely have little effect on the daily lives of the majority of the country's poor in the near future.

Thus it is that second-economy interventions seem to have the most potential for immediate and far-reaching poverty relief. In this context of poverty, inequality and inadequate job opportunities, the government has implemented development policies like facilitating microfinance expansion in order to bolster the second economy and support the creation of small, medium and micro enterprises (SMME). Microfinance is thus meant to fund entrepreneurs to establish or build SMMEs in order to reduce poverty and unemployment.

3.2 *A History of Microfinance in South Africa*

Microfinance has been active and thriving in Asia and Latin America for decades, but Africa has been slow to adopt this development strategy, with the result that its programs are generally smaller and less advanced (World Bank, 1996). This is especially so in South Africa, which only really began implementing microfinance after apartheid. Until the end of apartheid in 1994, the vast majority of the population had little or no access to credit, with statistics from 1993 estimating that three-fourths of the adult population were un-banked (Porteous & Hazelhurst, 2004). Banks and MFIs thus have a lot of ground to make up to serve the population. There has been improvement in the area of banking since then, as in 2004 about half of the adult population had some sort of formal bank account (Porteous & Hazelhurst, 2004). However, even though progress has been made there is still a large section of the population that is marginalized. Banks do not or cannot properly serve the entire population and have a regrettable history of creating disincentives for poor clients, such as requiring proof of employment and demanding high opening balances to open accounts. For unemployed or informally employed clients, these obstacles make formal banking impossible (Cross, 2003). Further discrimination occurs against illiterate clients: there have been reports of clients being required to stand in special queues as banks claim that to serve the illiterate is more time consuming (Cross, 2003). Obstacles also come with the mere cost of doing business in traditional banks, as they charge fees for having an account, making deposits and making withdrawals. Alternative avenues of money exchange are also costly, such as money orders through the Post Office, which charge 14% for a R200 remittance (Cross, 2003).

Some of these transaction costs have been offset by government programmes, which pay the maintenance costs of bank accounts, while some banks have reduced fees or even eliminated some fees for clients with low bank balances. But clients who do not live nearby banking facilities must travel long distances to make transactions, which is expensive and time-consuming. Unfortunately this problem is not improving in the formal banking sector, as many banks are closing branches in rural areas if they are not profitable (Cross, 2003).

In reaction to poor financial access and products, there have been movements demanding improvement. One such demonstration of the insistence on change was the South African Communist Party's October 2000 'Red October Campaign.' Marches were held in over 25 cities in SA and demands were made for

better banks, which meet [clients'] needs; lower bank charges and interest rates; no red lining; banks which invest in [townships] and rural areas; state regulation of the Credit Bureaux; A NEDLAC Summit on changing the banks; the government to pass laws to make banks serve the people and re-invest [money] in [local] communities. (Congress of South African Trade Unions [COSATU], 2000, p. 1)

In response to this, the financial sector came together in 2003 to create the Financial Sector Charter. The government was involved in a supportive role but businesses got together voluntarily to address problems in the sector, possibly, in part, to pre-empt any actions from outside the financial sector that would affect the sector. The FSC is indicative of the increasing pressures for change in the financial sector.

MFIs are another especially promising means to bridge this gap in access as many MFIs operate with specific goals and aims designed for poorer clients. Furthermore, microfinance has become an especially popular development strategy for the overburdened government due to its promise of sustainability. South Africa has an extensive microfinance industry: it benefits at least 8 million people and is estimated to be worth about R25.2 billion (Nduru, 2005). However, the majority of MFIs remain in urban areas (HSRC, 2002), which means that a large percentage of the population is not being served or reaping the benefit of finance. This section of the population is disproportionately rural, Black and female (DTI, 2005). Some MFIs try to fill this void by targeting poor women in rural areas, but a survey by FinScope estimates that urban adults are still twice as likely to access banking resources than rural adults (Porteous & Hazelhurst, 2004).

Microfinance in South Africa is a very young industry but has seen dramatic growth in the last two decades. Institutional microfinance was essentially established in the early 1990s when, on the last day of 1992, the exemption from the Usury Act was signed into law, resulting in the elimination of price controls on small loans and the effective de-regulation of the industry. Thus, the exemption from the Usury Act essentially marked the beginning of the popularity and rapid expansion of the microfinance industry. The dominant role of the SA government in microfinance growth has been to create an enabling environment through de-regulation, but the state has also been more directly involved through the establishment in 1996 of Khula and the National Housing Finance Corporation (NHFC).⁶ Khula was designed to provide financing loan guarantees to financial institutions without having a direct relationship with individual borrowers. Unfortunately, progress was slow: Khula relied on providing financial help to already established organisations and it was assumed that there was a sufficient number of functioning MFIs and NGOs for the purpose. However, at that time the microfinance industry was immature and limited in size (Von Broembsen, 2003).

By the late 1990s, the microfinance industry had gained momentum and many MFIs were very successful. However, the lack of regulation left the industry open to abuse. In 1999 the government amended the Usury Act and established the Microfinance Regulatory Council (MFRC)

⁶ Khula was created to provide a variety of services including wholesale loans to MFIs, and to limit financial institutions' risks by guaranteeing loans to people who would otherwise not be approved for loans (Department of Trade and Industry [DTI], 2005). The NHFC was created in 1996 by the South African government to offer housing finance among other things to ensure housing for low and moderate income households (National Housing Finance Corporation, 2003)

to protect consumers from abuse by MFIs and to streamline and standardize the industry (Kirsten, 2006). These changes created dramatic problems in the financial industry (Economist, 2002). MFIs and even established banks faced collapse as a result of abrupt changes in policy, such as the ban on card-and-PIN collection whereby banks retained clients' bank cards and PIN numbers to ensure on-time payment. Many institutions suffered if their recovery methodology was thus limited and did not include other loan recovery strategies.

This did not deter the government from backing financial development initiatives that support SMMEs. In fact the government has emphasized financial access and the promotion of microfinance initiatives as a part of Black Economic Empowerment (BEE) and poverty reduction policies targeted at informal workers, of whom almost 90% are black and the majority are women (Rogerson, 2007; Devey et al., 2006b; Devey et al., 2005; Terblanche, 2006). The new ideology of the 'Rainbow Nation' is one of equality and inclusiveness, and the lack of financial services is thought to be not only a symptom, but also a cause of social exclusion (Hewitt, 1998). Additionally, scholars have noted the potential for general economic upliftment with the improvement of financial services. Calderon and Liu (2003) studied the effects of financial development on economic growth and found that development in the financial sector, especially in developing countries, leads to economic growth. Furthermore, Littlefield, Murdugh, and Hashemi (2003) claim that overall levels of poverty can be reduced with access to appropriate financial services.

In his 2004 State of the Nation Address, President Mbeki introduced a new South African Microfinance Apex Fund (SAMAF) to be administered by the DTI in response to insufficient service provision by existing institutions for the poorest. SAMAF is meant to expand the scope of the government's outreach by providing different products to those forming part of Khula; it offers financial intermediation while also providing loans directly to entrepreneurs, often through partner organisations. SAMAF reaches smaller clients and only provides loans up to R10 000 whereas Khula generally provides loans of between R10 000 and R250 000 (Khula, 2005). The government expanded its programs to improve financial access, on the assumption that financial accessibility is a necessary tool to bridge the gap between the first and second economies (Kirsten, 2006). Two recent studies have found that one of the primary constraints preventing informal workers from starting businesses was lack of access to capital (Chandra & Rajaratnam, 2001; Skinner, 2006). With over half the adult population excluded from formal financial institutions, the gap is certainly wide. The government has also updated its credit legislation, most recently through the National Credit Act, which went into full effect in 2007. The act modified existing regulations with the aim of protecting consumers and the financial sector through a more clearly defined regulatory framework.

Recently, there has been criticism of Khula's ability to actually help the poor as there are strict rules governing who qualifies for loans. For example, a criterion for participation in one of Khula's programs is that lenders must insist that borrowers make a 10% down payment on all loans, which effectively excludes the very poorest segment of the population (Nigrini & Shoombee, 2002). Thus, some MFIs servicing the poor do not qualify for Khula funding, while institutions that serve better-off clients do qualify for Khula loans. Khula also has problems with outreach and targeting. In Khula's loan guarantee program only 60% of loans are given to people from previously disadvantaged backgrounds, and a study by Makina and Malobola (2004) has shown that Khula's outreach to both very poor and rural clients is disproportionately meagre compared to their provision of services to the urban middle-poor (Nigrini and Shoombee, 2002; Rogerson, 2008). Therefore, Khula has had limited success in its mission of alleviating poverty, at least for the very poor (Baumann, 2004b).

Several professional organizations have been formed in the microfinance sector to serve as a means for networking and advocacy. These organizations have voluntary membership with a division of membership along the lines of development. MicroFinance South Africa (MFSa) is the largest representative organization of MFIs in South Africa and it serves as an advocacy group that promotes growth and regulation of the industry in a free market setting (<http://www.mfsa.net/>). MFSa is a business minded group that focuses on the industry for purposes that primarily seek to improve the economic opportunities of microlending for MFIs. On the other side of the divide is the Association for Pro Poor Microfinance Institutions for South Africa (AMFISA), which includes 14 microfinance institutions that specifically target poor clients. The AMFISA seeks to bring together pro-poor MFIs in order to promote poverty eradication through microfinance and to lobby for increased government and donor support of its mission (<http://www.amfisa.org.za/>). The AMFISA is a more socially driven group that focuses on advocating development goals and the potential for MFIs to serve those goals. This schism in the industry demonstrates a clear divide between development and business goals. While the definition of microfinance does include the institutions represented by both of these groups, there is often an implied distinction when speaking of microfinance, and certainly in this research, to refer to the latter group, which provides financial services with a social mission.

A lot of hope has been invested in MFIs and small business development as means of alleviating poverty and unemployment. There is certainly a demand for credit and a desire for entrepreneurship, as Finmark Trust's 2003 survey established that 43% of respondents 'often think [they] would like to start [their] own business but [they] cannot get credit' (Finmark Trust, 2003, pg 27). However, the effects of microfinance are not guaranteed, as different institutions implement different policies with varying results, and no South African MFIs have been able to live up to the

achievements of the most successful MFIs in other parts of the world. For example Beehive, which is one of the oldest MFIs in South Africa with its first loan granted in 1996, was never able to reach sustainability and has faced foreclosure, a problem not uncommon amongst MFIs in South Africa (Beehive, 2003). The microfinance industry is as diverse as the problem of poverty itself, and even if a microfinance model was successful in one context it might not be successful in another. Ideally, the needs of the community should determine the shape that the MFI takes, but unfortunately it is not always clear how best to serve the community.

3.3 *Challenges facing South African Microfinance Institutions*

South Africa's situation presents many unique challenges stemming from its apartheid history and the inequalities that are a product of that history. A discussion of some of the challenges that all South African MFIs face will provide insight into the kind of environment MFIs must work within and the implications they must consider when implementing any products or development strategies.

3.3.1 *High Costs*

As mentioned earlier, there is a wide gap between the first and second economies with vastly unequal income levels between the two. The sizeable first economy in South Africa makes qualified loan officers costly to employ, as they are marketable to the first economy. MFIs struggle to pay competitive salaries, as their profits are small (Baumann, 2005). South African MFI staff expenses, as a percentage of total assets, are almost five times the world average (Baumann, 2005). This demonstrates that South Africa's dual economy and extreme levels of inequality make MFIs much more expensive to run than they are in countries with a more integrated economy, such as Bangladesh, where staff-related expenses are far less burdensome.

Poor transport to rural areas makes access and efficiency particularly difficult, as costs associated with accessing rural areas can be prohibitive (Reinke, 1998). Furthermore, business goals are more difficult to achieve in rural areas as costs are more and returns are less. For example, urban areas are often more densely populated and have better infrastructure, so staff members are more productive and transactions tend to be both more numerous and larger (Lapenu & Zeller, 2001). When businesses have high costs in one area, like salaries, they must make it up in other areas, such as through increased productivity. This has proved to be problematic, as serving a large number of clients in remote areas is difficult. Unfortunately many of the strategies that MFIs can use to offset these costs are strategies that will neglect the most needy clients. For example, in order to offset the low profit from small loans, a loan officer must serve many clients. A single R100 000 loan at 15% interest will make the same profit as one hundred R1 000 loans at 15%, but the work

required to service the smaller loans is 100 times greater. One strategy some MFIs use in order to be more profitable is to increase loan amounts slightly; after all, fifty R2 000 loans are easier to manage than one hundred R1 000 loans. Unfortunately this has the consequence of either not targeting the most needy and underserved population or irresponsibly lending too large sums to poor clients.

Another strategy to address this problem is to go to more densely populated areas. As already pointed out, urban clients are more profitable as a loan officer can reach many clients in a short period of time with fewer transportation expenses. However, urban clients have more access to financial services and rural clients remain the most underserved. Another option for South African MFIs to compensate for their high overhead costs is to charge higher interest rates than typical bank loans. Some South African MFIs charge effective interest rates of between 70 and 80 percent (Hietalahti & Linden, 2006). Such rates are lower than those of informal moneylenders but still cost the MFI's clients a considerable amount. In the South African context it is difficult for pro-poor MFIs with development goals to remain true to these development goals.

3.3.2 Education

South Africa has a high concentration of big businesses and few SMMEs, which is probably a cause and effect of SMMEs' low levels of sustainability (Bbenkele, 2003). In fact, only about 50% of new small businesses last longer than three months (Ladzani & van Vuuren, 2002). Reasons for this are numerous, but the provision of credit is thought to bolster a business's security by giving owners more resources; thus microfinance could help create more successful SMMEs. However, credit alone may not be enough for poor clients, as many microfinance clients have very little education and a concomitant low level of financial literacy (Porteous & Hazelhurst, 2004). It costs more to reach financially illiterate consumers and risks are thought to be higher with clients who have little business knowledge or experience. Therefore the question arises as to whether financial and business education needs to play a bigger part in MFIs' services, to ensure greater success on the part of small businesses. However, as mentioned earlier, this involves further costs for the institution. In order to provide such a service, an MFI either has to risk losing profit or pass the costs onto the clients through higher interest rates. There is a lot of pressure from donors not to do the former, as any additional services MFIs provide that do not reap monetary benefits can be difficult to account for in a climate where costs are already exorbitant and operational and financial self-sufficiency are such a widespread marker of success. If they do the latter, they risk losing clients to other cheaper MFIs, which can also be costly to their bottom line, as their initial investment in training and educating the client will be lost.

The Grameen Bank's Mohammed Yunus does not encourage the provision of such education, arguing that all people are innately entrepreneurial and that forced education can even inhibit entry into microfinance groups due to, among other things, the increased time commitment. However, not all theorists agree with that presumption; furthermore every community is different and thus has different needs. Dissimilar histories imply that similar solutions might not be completely effective. The Human Sciences Research Council (HSRC) confirms that Grameen ideology may need to be modified, observing that poor business skills in South Africa most certainly limit microfinance's capacity to reduce poverty on its own (HSRC, 2002). Unfortunately, this further complicates the issue of sustainability and effective access for MFIs.

3.3.3 HIV/AIDS

Sub-Saharan Africa has a higher rate of HIV infection than any other part of the world, and the World Bank estimates that appropriate treatment of the illness in the region will cost in excess of 2.3 billion dollars a year (Economist, 2000; UNAIDS, 2008). The latest South African National Department of Health figures show that HIV prevalence is about 28%, based on the 2007 National HIV and Syphilis prevalence survey. However, in any assessment of the impact of HIV/AIDS on people it is important to look not only at those who are infected but also at those who are affected. HIV/AIDS affects an estimated 75% of households in sub-Saharan Africa (Achola, 2006). So even if a person is not afflicted with the illness, he or she is likely not only to know someone who is, but to be close to someone who is. Thus, it is not uncommon for a person to take on the economic burden of helping a family member with medical costs, burial costs, or even caring for an orphaned child.

In a 1999 study in Côte d'Ivoire, UNAIDS found that when a family member suffering from AIDS becomes sick the average household income declines by between 52% and 67%, while health expenses increase by 400% (UNAIDS, 1999). A study in Zimbabwe reported similar findings: affected households made lower profits from businesses and had lower incomes overall (Barnes et al., 2003). Reasons for this decline are twofold: illness prevents not only the sick person from working, but also family members, as often they must care for the sick relative or plan and attend funerals for the deceased. So economic activity decreases for both HIV/AIDS *infected* people and HIV/AIDS *affected* people.

Since economic activity declines and costs rise, already poor MFI clients are put in a more vulnerable position. Precarious circumstances can lead to late payments, or an inability to repay altogether (Parker, 2000). For those clients who are in solidarity groups, the burden of repayment then falls on the remaining group members. In circumstances such as this, many sick clients either drop out of lending programs due to an inability to maintain their business and the demands of the

loan, or are forced out of groups due to the burden or potential burden that they will cause to the rest of the group (Achola, 2006).

Not only does HIV/AIDS have dramatic financial consequences for clients, but it also negatively affects MFIs. In extreme situations, an MFI may have to write-off a loan altogether in the case of death. Even less severe situations have dramatic repercussions for the sustainability of an MFI. Repayment rates can fall and delinquencies can rise for both sick clients and clients who must care for sick family members. Even in the best-case scenario, when loans are recovered, costs still increase for MFIs, as loan officers must spend extra time tracking down clients and monitoring the loan repayments, thus decreasing productivity.

The MFI also suffers when clients drop out due to illness. One of the ways that MFIs profit is through retaining a strong client base and through that client base's exponential increase in loan amount. Initial costs for initiation into MFIs are usually not made up by the client's first loan interest payments. The MFI justifies this by assuming that the client will graduate to progressively larger loans, thus bringing in sufficient income to cover start-up training costs and more. If a client drops out of the program then the MFI not only misses out on that client's interest payments, but must also find new clients who start out with small loans and require training. Thus the cost of maintaining and expanding the MFI rises as client exit rates increase.

MFIs are adversely affected by HIV/AIDS not only amongst clients, but also amongst staff members. The leading problem that MFIs face from staff is absenteeism due to illness, attending to illness, or attending funerals (Achola, 2006). Low attendance rates lead to lower loan officer productivity, and therefore lower productivity all round. Further problems arise when staff members leave employment due to illness, death, or family illness. Recruiting and training staff members is a costly operation and the loss of a staff member represents the loss of an investment in addition to the cost necessarily incurred in finding a replacement. Moreover, when a MFI loses a staff member they are not only monetarily disadvantaged but also deprived of knowledge, experience and important relationships that are formed with clients.

Although South Africa is one of the 50 wealthiest nations in the world, it is among the 30 with the lowest life expectancy (Dorrington et al., 2001; UNDP, 2003, 2004). With such a high rate of HIV/AIDS, this discrepancy is not likely to change anytime soon. The health of clients is therefore an important concern that MFIs must take into account when providing services as the vast majority of their clients are affected by the pandemic and will need services that cater to their unique needs.

3.3.4 Security

Crime is a very serious matter for most South Africans. In response to public concern, the government has made crime issues central in public discussions. In his 2007 State of the Nation Address, former president Mbeki mentioned crime 16 times and in his 2008 State of the Nation Address he expressed grave concern over the high rates of crime, especially violent crime. While actual reported rates of crime are comparable to those of Australia or Canada, the factor that distinguishes South Africa is the extreme violence associated with crime, making it one of the most dangerous countries in the world that is not at war (South African Police Service, 2003; Stone, 2006).

Studies have shown that crime has negative affects on small enterprise development, growth, and sustainability (Cichello et al., 2006; McDonald et al., 2008). It therefore also affects MFIs. In the financial year 2007/2008, over 2 million crimes were reported with 52% of them theft, 9% robberies, and 7% damage to property (McDonald et al., 2008). This is a large number of crimes that potentially affect small businesses. Unfortunately, these numbers are misleading, as many businesses do not report all crimes to the police: 38% did not report personal robberies and 14% did not report robberies experienced by their businesses (Burton et al., 2003; Clarke et al., 2007). Reasons for this lack of reporting are various, including the perception that the crime was too insignificant, poor service from police, low chance of arrest, and low likelihood of recovering property (McDonald et al., 2008). The fact remains that crime is actually more detrimental to business than the statistics would suggest.

The impact of crime on small businesses is profound in both direct and indirect costs. Direct costs include the loss of merchandise and money or damage to property. Indirect costs include disruption to business, health-related expenses due to violent crime, loss of customers due to safety concerns, and security costs. Small businesses operating in townships or informal settlements and those working in the informal sector are particularly vulnerable, as crime rates are generally higher than in other segments of society. In the 2003 National Victims Crime Survey 80% of people believed that while at work they and other staff are at serious risk of crime (Burton et al., 2004). These concerns have serious implications for small business growth.

In a situation such as that obtaining in South Africa today, where crime is pervasive and there is widespread fear of the violence associated with it, many people are understandably reluctant to put themselves in a more vulnerable position. In the 2003 National Victims of Crime Survey, over 25% of respondents said that they would not start their own business because they feared violent crime. Further studies by Trade and Industrial Policy Strategies and the Development Policy Research Unit at the University of Cape Town in 2005 confirm this, as respondents rated crime as the most serious hindrance to starting a business (Cichello et al., 2006; McDonald et al., 2008). Not

only must prospective entrepreneurs take into account regular business considerations of profit and competition, but they must also evaluate the risk of becoming a target of crime because of their increased assets and losing everything (Gough et al., 2003).

For those who do decide to risk starting a business, crime can make sustaining the business difficult. Various studies from all over the world have demonstrated that crime is a severe obstacle to business success (Gaviria, 2002). Several studies conducted in South Africa have confirmed these discoveries, with about 50% of people stating that crime affected their business's viability, and rating crime as one of the top four major constraints to doing business (Clarke et al., 2007; Grant Thornton South Africa, 2008; McDonald et al., 2008). Most small businesses operate on small margins, so any loss of income or products makes the profit margin even lower or non-existent; moreover, most do not have the resources to insure their business against theft or vandalism. Furthermore, the costs of security measures represent a disproportionately higher share of their expenses than those of larger businesses (McDonald et al., 2008).

Further problems arise when it comes to expanding and improving a business. Studies in Europe, Asia, the USA, and Jamaica found that crime delayed or prevented the expansion of businesses, either because of worries about the future effects of crime or because of increased crime-related costs (Krkoska & Robeck, 2006; Shuler, 1998; World Bank, 2004). Similar results have been reported in South Africa, with the recognition of crime as a hindrance to growth being most marked in townships and informal settlements, where almost a third of business owners cited crime as a reason that they would not expand or improve their business (McDonald et al., 2008).

Crime is certainly an important issue that all South Africans must face. For poor entrepreneurs and small business owners, who have very few resources to begin with, any additional expense or loss can have severe consequences. Crime, crime prevention, and crime perception are at the forefront of business owners' minds, and therefore those working with small businesses, such as MFIs, must be aware of the associated risks that businesses face.

3.3.5 Patriarchy

The South African constitution is one of the most progressive constitutions in the world, if not the most progressive. It provides protections against discrimination based on gender, race, sexual orientation and religion. However, the adoption of new laws does not guarantee the adoption of new attitudes. Patriarchy remains a dominant reality in most societies in the world. It creates situations of oppression and discrimination, whereby women are disadvantaged through social institutions. The majority of microfinance customers in South Africa are black women, who face the dual disadvantage of racial and gender discrimination. Certain racial problems rooted in the past have been discussed above, but gender issues also need to be highlighted to illustrate the hardships

faced by many microfinance clients. It is important for any MFI to take into account the circumstances, difficulties, and perceptions of clients when products are being designed to best serve their interests, and it is important to be able to anticipate barriers to their success.

Many women in South Africa are discriminated against because of their gender. In many situations this is merely a result of convention. However until recently certain laws made such discrimination a legal reality such as:

- The Black Administration Act of 1927 codified the legal distinction between Whites and Blacks, in terms of which Blacks were subject to the customary law of male primogeniture, meaning that women could not inherit property (Fagan et al., 1997). This customary law was deemed unconstitutional in the 2004 Bhe case (Grant, 2006; Tebbe, 2008).
- The Black Administration Act of 1927 section 11(3)(b) gave married black women the legal status of minors, meaning women were legally inferior to men as they could not enter into contracts, own property or enjoy the other rights of a fully-fledged citizen (Nkomo, 2000; South African Law Reform Commission, 2008). Repealed under the Recognition of Customary Marriages Act of 1998 in 2000.
- KwaZulu Legislative Assembly Act on the Code of Zulu Law (Act no. 16 of 1985). Section 27(3) gives women legal adult status but makes her subject to the marital power of her husband. This means that while a woman has the right to enter into contracts, her husband retains power within the family and has the right to decide most facets of his wife's life, such as issues relating to clothing, personal associations, and employment status (Nowrojee & Manby, 1995). Repealed under the General Law Fourth Amendment Act 132 of 1993.
- Section 44 of the Insurance Act of 1943 stipulated that married women, but not married men, could not reap all or some of the benefits of life insurance policies made in their names by their husbands. Repealed in 1996 in the Brink versus Kitshoff case (Brink v. Kitshoff, 1996).

While laws have changed to protect women, cultural traditions are still strong influences on everyday life and identity. Outside of the cities, customary laws prevail as the main system of justice, and traditional adjudicators prevail as the main enforcers of the law. Traditional courts still administer customary law in over 80% of rural villages (South African Law Commission, 2003). These courts bar women from serving as judges and still work within a patriarchal culture that discriminates against female litigants (Haffajee, 1999). Difficulties arise when attempts are made to reconcile the problems of patriarchy with the desire to reclaim and preserve cultural traditions that were treated as inferior during the years of colonialism (Nhlapo, 1995). An overwhelming pride in traditional African culture is dominant in many places, and patriarchy is a pervasive aspect of that

culture. Women therefore face the dual challenge of coming to terms with their rejection of certain aspects of their own culture, as well as the daunting prospect of contesting social and cultural institutions that many cling to now that they have the newfound freedom to do so.

3.3.6 Limited Business Opportunities

People are still suffering the consequences of the 1913 Natives Land Act and subsequent apartheid era legislation. No less than 72% of those living below the poverty line are rural dwellers, and the poorest provinces in South Africa are those that include the biggest former homelands (Aliber, 2001). The unique situation of South Africa sets it apart from other African countries. South Africa's first and second economies, as described above, have a big impact on business opportunities. For example, many stories touting the success of microfinance tell the story of a woman investing what for her is a large sum in a sewing machine but she is, in turn, creating a livelihood strategy that will benefit her for years. Unfortunately, in South Africa this scenario is not so simple. Due to South Africa's successful formal businesses, micro-entrepreneurs must compete on a much higher level. An independent clothing maker cannot produce garments as quickly or cheaply as a large manufacturer. Furthermore, small manufacturers do not have the marketing or transportation capacity of the formal sector, which means that their product is not marketable on any large scale. The first economy has little need for many of the second economy's products, so the potential for development is limited in this area. Budding micro-entrepreneurs find it difficult to justify starting a business that will have such stiff competition from the first economy.

There is also stiff competition within the second economy as there are inadequate opportunities for business. Unemployment is higher in rural areas than in urban areas, which is contrary to the situation in most other African countries (Aliber, 2001). The reason is that large proportions of the rural poor lack access to land, and thus lack access to a basic means of production. Retail and whole trade accounts for about half of all informal work, which indicates the limited production capacity of the informal sector and hence the limited range of businesses that the informal sector can accommodate (Devey et al., 2006a; Rogerson, 2007; Skinner, 2002). Furthermore, the second economy generally operates solely within its own realm. Most of the products created by the second economy are bought by members of the second economy, who lack significant purchasing power. Currently, microenterprises employ about 20% of workers in South Africa, but the resulting contribution to gross domestic product (GDP) is only 5% (Baumann, 2005). In other words, micro-entrepreneurs make very little money and the second economy is a difficult route out of poverty.

Further difficulties come with the inherent limits of microfinance outreach, in part due to limited business opportunities. There is a limit to how many people can actually be effectively

served by MFIs. MFI clients generally work in similar fields and provide similar services, which means that there is a limited demand for the types of business that microfinance generally supports. However, as businesses grow and diversify and tap into new markets, there will hopefully be more opportunities for new clients.

3.4 Conclusion: A Difficult Environment for 'Successful' Microfinance

South Africa presents many unique challenges for microfinance institutions, and because of the relative newness of the industry in the country, MFIs have few historical examples to guide them. MFIs have the difficult task of implementing a development strategy in a country with a unique history, which has vast social and economic implications to this day. Decades of institutional discrimination have left the country hugely unequal on many levels. With only a decade and a half of legal equal rights, inherited inequalities have only begun to be addressed, while problems such as AIDS and crime also require urgent attention. According to international standards, most South African MFIs would not be considered 'successful,' as the self-sufficiency of an MFI is one of the prime indicators of its success. However, the South African context must be looked at for what it is – unique. South Africa is one of the costliest places in the world to implement microfinance operations, and the brief history of microfinance in the country has provided little time for it to adapt to the environment. While MFIs can take some lessons learned from microfinance practitioners around the world and apply them to the South African context, no development blueprint can be borrowed from other countries, even other African countries, without modification. All of these factors make South Africa a difficult place to operate MFIs, but it is to be hoped that as the industry matures, practitioners will develop a clearer idea of how best to serve this distinctive landscape.

Chapter 4: The Small Enterprise Foundation (SEF)

As indicated above, most MFIs in South Africa are not considered successful in the traditional sense because they have not been able to reach self-sufficiency. Only two MFIs, The SEF and Marang Financial Services, have been able to reach operational self-sufficiency (Porteous & Hazelhurst, 2004). However, the SEF has not been able to maintain self-sufficiency and it currently relies on donor funding to keep afloat. When compared to 124 international MFIs in a Micro Banking Standards Project (2001) report, the SEF measured below average in operational self-sufficiency, loan size and productivity. It should be noted, however, that this trend is common for all South African MFIs, mostly due to the extreme income inequality in the country. Salary expenses are five times the world average and nearly three and a half times the African average, while client loans, and thus interest incomes, are on a par with MFIs that pay much lower salaries (Baumann, 2005). Therefore, context is important when measuring the success of the SEF, as a relatively successful MFI in South Africa might not actually meet international standards, which demand financial self-sufficiency.

The SEF was launched in 1991 and is modelled after the Grameen Bank (Hietalahti & Linden, 2006). The SEF operates in the Limpopo province where many areas that used to be designated ‘homelands’ during the apartheid era are located. These areas are rife with poverty and lacking in infrastructure, as little attention was paid to them during the years of isolation. In the areas that the SEF serves, unemployment levels are estimated to be as high as 80% with very few opportunities for employment; 64% of the population lives below the unofficial poverty line, while 40% live below half that level (Baumann, 2004a; Mayoux & Simanowitz, 2001). Initially the SEF implemented the Microcredit Programme (MCP), which was successful as far as financial goals were concerned. However, SEF staff soon realized that most clients were not amongst the poorest in the community, which was the intended target clientele (CMN, 2003). Thus, the Tšhomišano¹ Credit Programme (TCP) was created as a separate programme aimed particularly at the very poor, emphasising the SEF’s clear development mission to reach out to the poorest (Baumann, 2004a). The SEF now incorporates two programmes: the MCP, which supports existing entrepreneurial ventures owned primarily by women, and the TCP, which only serves very poor women, usually with little or no entrepreneurial experience.

4.1 *Loan process*

When the SEF first goes into a community, the SEF staff members speak to the elders of the community, introduce the fundamentals of the SEF, and get their consent to start operations in the

¹ Tšhomišano is the Northern Sotho word for ‘working together.’

village (Heitalahti & Linden, 2006). To join the MCP program, clients must have an existing business that has been operating for at least six months. Men are allowed to join the MCP program at a rate of one man per group of five, although they are not actively targeted. For the TCP program the SEF establishes who in the community falls below half the poverty line by using a wealth ranking system, which will be described later. At this stage, staff members talk to potential clients and motivate them to join the programme. This is a key element, as many of the poorest have little confidence and think that starting a business is beyond their capacity, especially in the case of the TCP, where most clients have little or no business experience. Apart from the initial differences in targeting, the structures of the TCP and the MCP are the same, although TCP clients participate in more regular impact monitoring and receive more support from SEF staff, as they are a more vulnerable group due to their low socio-economic status and general inexperience in entrepreneurial activities.

4.1.1 Group Formation and the Role of the Centre

The SEF practises solidarity lending, based on the Grameen Bank model, where clients form groups of five, which are then evaluated by staff members. Loan officers assess the strength of each group to help ensure group success and identify weak members, as strong members are important for the well-being of the entire group and organization. Each member applies for her own loan but the group must guarantee the loans of each member. If one member encounters trouble with repayment, it is the responsibility of the entire group to assist. The SEF has several criteria for group formation, which are intended to help build strong groups with minimal conflicts, but some clients have found the restrictions too constraining (Stark & Nyirumuringa, 2002). Group formation criteria include the following: clients cannot be family members, they must be within 15 years of each other in age, and they must live nearby (Stark & Nyirumuringa, 2002). During this initial process, group members join a centre. Each centre has a maximum of 8-10 groups, which meet fortnightly to repay loans, collect savings (which are then taken to the local Postbank² by two elected centre members), and to perform other administrative tasks such as data gathering.

The centre is an important aspect of the institution as it serves as a place to facilitate learning, monitor performance and make transactions. Clients perform most of the duties at the centre, while the SEF staff generally only observe. The centre committee leads the centre and consists of elected clients who perform operational and maintenance tasks for the centre. Rituals play a vital role in the efficient functioning of the SEF's operations. Rituals are ingrained in the organization's methodology in order to enable people with any level of education to run a complex

² Postbank is a division of the South African Post Office that offers low cost banking options to even some of the most remote locations as it utilizes the already existing system of Post Offices throughout the country.

system of record keeping and repayment monitoring, and to create a level of transparency that invites confidence in the system while facilitating auditing and internal controls. These rituals are essentially procedures that are implemented in ways that make sense culturally and functionally (CMN, 2002). Each ritual has a clear purpose and is consistently monitored to maintain a strict level of adherence. For example, at every meeting the repayment process consists of the client giving her payment to a centre official and the centre official counting each bill or coin out loud, in front of the whole centre. This display provides positive reinforcement by ensuring transparency within the centre, and demonstrates to the entire centre that each other member is present and has paid her instalment. If a client is not able to repay her loan then centre members can intervene to help her. The process provides an additional negative motivation to pay: clients feel under pressure to pay or else be publicly shamed, as the whole centre will know if they have not paid. Through practices such as this, clients' progress can be monitored, solidarity within the centre is reinforced, and loan discipline is emphasized through regular and consistent expectations and actions.

4.1.2 Training

Once the group of five is formed and meets the SEF's standards, members start training sessions on credit and savings methodology and the duties and responsibilities of group members. After the centre incorporates the new group and the members complete their training, a senior manager examines their knowledge of the SEF and the training material to confirm that they have satisfactory knowledge. Before the disbursement of loans, clients must develop a business plan with the help of a loan officer and also demonstrate their ability to save through a group savings account at the local Post Office (Mayoux & Simanowitz, 2001). This planning stage is particularly important for the TCP program, as many clients have little or no experience of starting or running a business. Staff members spend time facilitating discussions and questioning business plans to ensure their success. The SEF is clear that staff members' role should be one of facilitation, as clients must come up with their own business plan and demonstrate their commitment to it (Mayoux & Simanowitz, 2001). The role of the SEF is to question and dig deeper into the plan to ensure that it has been fully thought through. Group members are also present during each other's business planning sessions, to strengthen group support and buy-in, and enable group members to learn from each other and offer suggestions.

4.1.2 Savings

The SEF strongly encourages savings, and while savings facilities are not available through the MFI due to national laws restricting them from taking deposits, the SEF still considers savings to be an important part of their programmes. This can be seen in many ways, starting with the initial

requirement of group savings accounts in each client's introduction phase. These accounts bear the name of the group as a way to help foster solidarity among members, but the money saved is still each client's own. Saving is further emphasized at every fortnightly meeting, when MCP members are required to deposit a minimum of R10, and TCP members a minimum of R5, in their Post Bank accounts (CMN, 2003). All savings and loans are methodically tracked in centre ledgers and loan officer ledgers, and clients are provided with receipts for their own records. While members can withdraw savings at any time as long as there are two members present to co-sign at the Postbank, the SEF discourages this by linking savings with higher future loans. In order to move on to a higher second loan, clients must have R40 in their savings account; to move on to a higher third loan clients must have R80 in their savings account and so on, in increments of R40 (Calmeadow, 2002). Estimated client savings at Post Office banks were R6.4 million in 2007 (SEF, 2007). Savings are meant to serve both as a sort of insurance for clients, so that they have personal resources to turn to in times of crisis, and as a way for them to build personal assets.

4.1.3 Ongoing Support

After loan disbursement, clients are expected to use the monies within a few days to implement their business plan. For all first and second loans, SEF Field Officers follow up and check client progress and loan utilization; thereafter spot checks are carried out on loans. Group leaders check on each of the group member's loans throughout the cycle of the loan and report progress at centre meetings on a fortnightly basis (Mayoux & Simanowitz, 2001). Group leaders thus eliminate some overhead costs, as they perform essential monitoring and relieve Field Officers of certain duties. Furthermore, the involvement of group leaders and fortnightly progress reports at centre meetings lead to a sharing of knowledge and group solidarity. Client participation plays an important role in the operations of the SEF. This serves the dual purpose of reducing operating costs by passing duties along to clients, and increasing client empowerment by allowing women an active role in business and in determining their own future. By its very nature, solidarity lending is meant to provide opportunities for support and mutual learning on an ongoing basis. Centre meetings and members of the group's responsibility for guaranteeing each other's loans encourage an environment of mutual support, as the successes and failures of others become one's own. In cases where the group and centre cannot help with a problem, SEF staff can intervene and offer additional support, but only as a last resort, because it is empowering for clients to know that their peers can be problem solvers. By seeing members of one's own socio-economic class succeeding and demonstrating ingenuity without the need for help from a better educated or wealthier person, one is able to imagine the same possibilities for oneself.

4.2 *Targeting the poorest*

The SEF's original strategy for attracting poor clients was inactive targeting. By designing a product meant for their target audience – through small loan sizes, the location of the MFI and by only allowing one man per group – the SEF thought that their target clients – poor women – would be attracted to the organization while others would not (Mayoux & Simanowitz, 2001). By setting up operations in one of the poorest provinces and by primarily serving women who are the poorest and most vulnerable, the chances of reaching the poorest seemed greatly increased. Additionally, by only offering small loans, the SEF sought to discourage better-off clients. However, it turned out that these clients joined the program in the hope of quickly graduating to bigger loans (Mayoux & Simanowitz, 2001). In this instance, inactive targeting was only partially successful, as in 1994 the SEF ascertained that only 30-40% of its clients were very poor (SEF, 1999).³ These findings were contrary to the stated goals of the SEF.

The SEF learned a lesson that many microfinance practitioners have learned, that when serving both the poor and non-poor, the poor will eventually be driven out of the program, or intimidated so as not to join in the first place (Roper, 2003; Yunus & Jolis, 2003). MFIs must have a commitment to serve the poor and a specific strategy to reach the poor. This is necessary because the less poor will inevitably become the preferred clients as they are more profitable and a better credit risk. Less poor clients, by definition, have more resources and are therefore better able to cope with repayments, especially if any problems arise. Less poor clients are thus more desirable to have as group members both because they are more likely to repay their own debts and because they have a greater capacity to help other clients with repayment if problems arise. The result is that less poor clients will select other less poor clients to be their group members.

Additionally, they are more desirable to loan officers as their loan amount will increase more quickly, thus enabling the MFI to make more profit with less effort. Furthermore, many of the poorest of the poor find it intimidating to join an organization that caters for wealthier and more experienced clients, as the institution seems as though it is meant for 'others' and that the very poor do not belong. The SEF also found that many women were intimidated by having men included in groups, as they felt that the men dominated discussions and the women had a difficult time expressing their opinions (Simanowitz et al., 2000).

The SEF thus began actively to target the very poor by introducing the TCP. In order to create a less intimidating environment for the poorest segment of the population, which consists mainly of women, men were excluded from the poverty-targeted program. Further targeting came with the implementation of the Visual Indicator of Poverty (VIP) test, to ensure that only the very poor would be served by the TCP. The VIP test, which has been used in countries such as Malaysia

³Very poor is defined as those living below half the poverty line.

with some success, consists of fieldworkers rating a person's poverty based on their living conditions (Simanowitz, 1999). Thus housing standards became the determining factor for acquiring loans in the TCP. While the VIP test was quick and affordable, these initial targeting practices proved not to be very reliable, as field workers and potential clients found that some better off clients were receiving loans while poorer clients were being denied them. Problems with the VIP test were observed in instances where people had reasonable housing and thus were excluded from the TCP, while the chief breadwinner was no longer in the picture and the family's income was well below the target amount. In other cases, people were living in very poor conditions but only because they were in the process of building a new home, or because their main residence was elsewhere (Simanowitz, 1999). The VIP test resulted in the SEF mistakenly offering loans to some of the wealthiest members of the community and denying loans to some of the poorest.

In response to this seemingly inaccurate targeting practice, the SEF developed the Participatory Wealth Ranking (PWR) approach and tested it for effectiveness. The PWR process begins with a meeting with representatives from the entire village where the process is explained (Simanowitz, 1999). Then a simple map is drawn with all households identified. Each household name is written onto a card, which is then distributed to three reference groups, each group consisting of three to five people. Each group then sorts the household cards into piles from poorest to wealthiest. While this sorting process occurs, a TCP staff member facilitates conversation to gather more information about households and to learn more about the community's perceptions of poverty. The PWR system requires that at least three reference groups rank each family to ensure consistency. If there are too many inconsistencies, another reference group is added to ensure that the data is sound. At this juncture, staff members decide on a cut-off point and start the recruitment process for TCP members. Furthermore, there is an internal audit department that spot checks procedure to ensure validity (International Fund for Agricultural Development, 2006).

The PWR has garnered a great deal of positive international attention for its ability to identify very poor families, and MFIs such as BRAC have implemented this ranking system within their programs (Maes & Foose, 2006). By cross checking information from a minimum of three reference groups the SEF can be relatively sure that the information gathered is reliable.

While the PWR is a valuable tool for the SEF, it has been noted that the PWR is not the most effective targeting method for all programs (Hatch et al., 2002). For example, since PWR is based on a community's knowledge of its members, if the community does not have close ties then there would be problems with the reliability of the rankings (Simanowitz et al., 2000). Some programs find that other wealth ranking systems are more appropriate in their contexts, such as the MFI CASHPOR in Malaysia, which has found the VIP test to be an effective strategy for determining poverty (Simanowitz, 1999). The VIP is a cheaper and faster method of determining

poverty, which might in the end be more appropriate and expedient. In some cases formal wealth ranking is not necessary at all: for instance, programs that utilize community self-selection do not really have a need for an official wealth ranking system like PWR. Additionally, programs that seek a broad spectrum of wealth levels have little need for wealth ranking strategies.

4.3 Microcredit Programme (MCP) and Tšhomišano Credit Programme (TCP): A Delicate Balance

In 1997 the SEF had its first sustainability workshop, at which its poor profit performance was presented to managers. Poor profits stemmed from expenses from expanding operations, an increased salary burden due to a union strike, and the inherently difficult task of serving the poorest. In order to keep the client burden minimal, the SEF focused on strategies for reducing costs and improving efficiency (Kuwik, 2002). With these changes, the SEF planned on being financially self-sufficient by 2003, and as the TCP's performance improved the SEF prepared to eliminate the MCP altogether in order to focus solely on the most poor. However, it soon became clear that the TCP could not become as profitable as the organization had hoped, so the more profitable MCP would continue to be necessary to cross-subsidize the TCP.

Poor profit performance has remained an issue within the TCP, which because of its focus on poverty and its use of additional staff support with business planning and problem analysis, is comparatively staff-intensive and therefore costly. The MCP requires less supervision and so fieldworkers are able to serve more clients (Mayoux & Simanowitz, 2001). Furthermore, due to the smaller loan distributions, the TCP creates less revenue. The constant struggle to keep the TCP affordable once again peaked in 2002 when the SEF experienced a decline in operational self-sufficiency (CMN, 2002). The average loan size declined, and therefore revenue from interest also declined. The reasons for this downturn included poor management at branch and zonal levels and the mishandling of poorly performing fieldworkers (CMN, 2002).

Another reason for the decline in revenue occurred at the client level. In some cases clients were unable to grow their businesses, which meant that loan sizes did not increase. In other cases TCP clients were so successful that they graduated out of the TCP and joined the MCP. For an MFI that wants to alleviate poverty, graduation out of the TCP is a sign of success; but every graduation out of the program means that the TCP loses a more profitable client in exchange for a less profitable new client (Baumann, 2004a). The constant turnover of experienced clients is costly, as new clients incur more start-up costs due to training, and bring in less interest revenue because they necessarily start out with smaller loans. The TCP is, thus, a much more costly program to operate. The higher costs and lower revenue impose a burden on the SEF, especially with regard to its desire for sustainability.

Nonetheless, the SEF has prioritized its targeting of the very poor, and in order to ensure its viability it cross-subsidizes the TCP with the MCP's profits. The SEF maintains the TCP's poverty focus and uses the MCP as its main profit-making program (Kuwik, 2002). While the SEF laudably continues to prioritize poverty targeting, the organization has to be careful not to overestimate how many of the poorest of the poor it can serve, or the MCP will not be able to effectively cross-subsidize. Currently, about 68% of the SEF's clients come from the TCP with the remaining 32% in the MCP (SEF, 2008). An appropriate balance must be achieved so that the maximum number of very poor clients can be served without rendering the entire MFI vulnerable.

Fortunately, the SEF also benefits from outside donor support, so it can currently afford to serve more of the very poor even though its operations cost more than it makes in interest. The SEF has benefited from subsidization from institutions such as Kuhla and overseas donors such as USAID, but cannot depend on a constant influx of donor financing (CMN, 2002). This is a particular concern to many MFIs, especially in the first years of operation, because much of the learning comes from on-the-job experimentation and impact assessment. According to the CGAP donor guidelines on good practice, it is estimated that international pro-poor MFI programs like the TCP require a minimum of five to ten years of subsidies to become feasible (Consultative Group to Assist the Poor, 2004). It seems likely that this period is longer in the South African context due to the unique challenges facing South African MFIs. Without an appropriate period of time to iron out the kinks in a program and find a system that works effectively for each specific context, a microfinance program is doomed to failure. There is no doubt that the SEF has benefited greatly from donor support in respect of the time that it has afforded the SEF to learn from experience and build up its programs in a responsible way. Furthermore, donor funding has allowed the SEF to focus on the TCP and grow its outreach to the poorest. However, they remain under constant pressure from donors to reach self-sufficiency, as this is a standard expectation in the international microfinance sector (Calmeadow, 2002). If donor funding decreases, the SEF will be even more hard-pressed to find an optimal balance whereby they can serve enough MCP clients effectively to cross-subsidize TCP activities without losing sight of their primary goal of serving the very poor.

4.4 Business Pressure

Since its inception, the SEF has faced pressure from its donors to become a financially self-sufficient institution, as current international standards demand that MFIs follow the example of institutions such as the Grameen Bank, which has maintained long-term self-sufficiency. This pressure is a very real influence in the SEF's business practices and policy decisions. While the SEF was still running at a loss, the year 1999 saw a vast improvement in self-sufficiency. The increase in income was partially due to an increase in clients (the number of outstanding loans increased by

68%), but it was also due to a sharp spike in interest rates charged. In 1998, the effective interest rate on loans was 39% whereas in 1999 the rate was raised to 57% (SEF, 1999). Consequently, the SEF was able to cover 30% of costs in 1998 and 56% in 1999, with continued progress toward operational self-sufficiency as can be seen in figure 1. One can gauge how strong the pressure to become self-sufficient was from the fact that the SEF was pushing to increase income by 20% or more yearly, an optimistic goal for any business. But for a MFI to yield to this kind of pressure might of course serve to undermine its development goals.

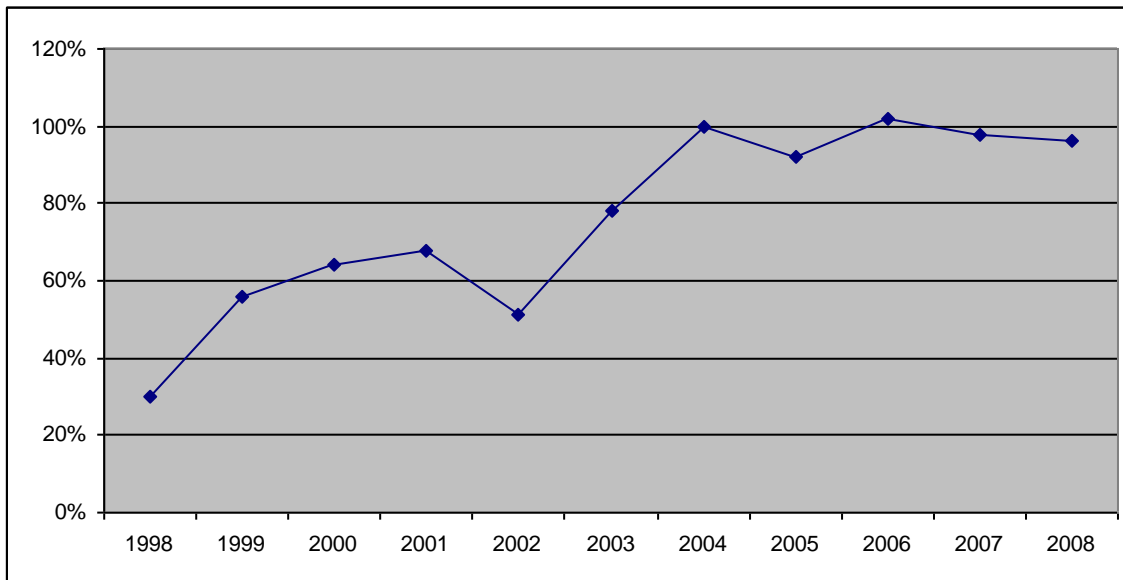


Figure 1 – SEF's Operational sufficiency (SEF, 2008,2007, 2004, 2003, 2002, 2000)

As stated earlier, interest rates were increased to improve the SEF's operating expense ratio. An increase of 18% in one year is a huge leap at the expense of the clients, and over time the SEF's interest rates have increased even further. By 2006, all first time loans had an effective interest rate of 82.15% (Heitalahti & Linden, 2006). Subsequent loans have lower interest rates but are still high, ranging from 70.1% for 12 fortnightly instalments to 79.6% for 10 monthly instalments. With the exception of the first loan, all loans have higher rates if the loan is for a longer term, and further increases in rates are incurred when loans are repaid monthly as opposed to fortnightly. Some changes were necessarily made after 1 June 2007, when the implementation of the National Credit Act effectively capped interest rates at 27.6%. However the SEF handled the transition smoothly, introducing an initiation and service fee to cover losses in interest revenue (SEF, 2007). These high interest rates and fees exemplify the value that the SEF places on sustainability. While the rates are high compared to typical bank loans, they are not necessarily inappropriate as it is more costly to serve poor clients. Furthermore, the rates are not nearly as high as those of local money lenders,

who have been reported to charge an effective interest rate of 360% or higher (Stark & Nyirumuringa, 2002).

The SEF is not unaware of the burden that high interest rates and additional charges such as initiation and service fees place on its clients. Senior management has expressed concern over the organization's seeming over-reliance on interest rate hikes rather than innovation and productivity to improve profit margins, and has made efforts to make operations more efficient on the staff side through moves such as de-centralization (Kuwik, 2002). However, the ever-present pressure for self-sufficiency has prevented the SEF from substantially lowering the cost of its product to clients. Pressure for MFIs to become operationally and financially self-sufficient is not necessarily a bad thing, especially if an MFI is allowed sufficient time to build its business in a responsible way with strong clients and sound practices. By becoming self-sufficient, an MFI is not dependant on the whims or demands of donors. It is also more secure as a financial institution, so clients do not have to worry that services will cease due to institutional failure.

Institutions must, however, be cautious that achieving self-sufficiency does not come at the cost of other goals such as sound business practices and development objectives. The pressure for self-sufficiency induced the SEF to take action that sacrificed development goals and led to institutional insecurity. This is evident in their 1999 decision to change the incentive scheme from one that encouraged a strict adherence to timely payments to one which encouraged larger loans for stronger clients (Calmeadow, 2002; SEF, 2001). In other words, to expedite self-sufficiency, SEF management sought to maximize existing resources by giving the most successful clients larger loans in order to receive more interest income. This new policy rewarded loan officers for the size of their portfolio, which in effect encouraged them to push larger loans on clients, some of whom could not manage the increase (SEF, 2001). While the intention might have been only to offer loans to a select few, there was no follow-up to ensure that the loan sizes were appropriate. By creating financial incentives to push larger loans but providing no safeguards to guarantee the suitability of the loans, the incentive scheme was flawed and very susceptible to abuse. It is the responsibility of the loan officer to assess the business on its merits and potential for growth when recommending larger loans, but the SEF's policy of rewarding loan officers for supplying larger loans was essentially an incentive for them to ignore what was best for the client.

The incentive scheme led to a steep increase in dropouts⁴ and late payments, which resulted in a period of poor performance for the SEF. The incentive scheme was eventually discontinued and replaced with incentives that focused on the quality rather than the size of portfolios (CMN, 2003). The introduction of innovative policies such as the incentive scheme are indicative of efforts to

⁴ Drop out is defined as any member who does not take out an additional loan within 3 months of last loan instalment (Simanowitz, 1998).

provide better service to clients and keep costs low, but unfortunately not all innovation leads to success. Luckily, the SEF seems to respond quickly to problems and was able to reverse much of the damage caused by its over-zealous growth policy. Greater attention is now given to ensuring that loan sizes are appropriate. Loan officers determine loan sizes on the basis of business performance and individual performance (savings, repayment, meeting attendance), and currently loans for MCP clients are capped at R10 000 (SEF, 2007). On an institutional level, greater emphasis has also been placed on the vulnerable position that inappropriate loan sizes can place clients, client groups, and the SEF.

While the SEF does depend on high interest rates and fees to maintain operations, it also emphasizes employee performance and the regular monitoring of efficiency. In the 1998 financial year, demands on field workers in the MCP were increased: they were expected to raise their client base to 400. This proved to be a difficult task as only eight were able to exceed 350 clients by the next year (SEF, 1999), and the average number of clients served per field officer in both programs was only 177 (SEF, 2000). There has been some subsequent improvement in staff outreach as in 2007 field workers served an average of 261 clients, but the goal of 400 clients seems to have been an unrealistic one and a source of unnecessary pressure on employees.

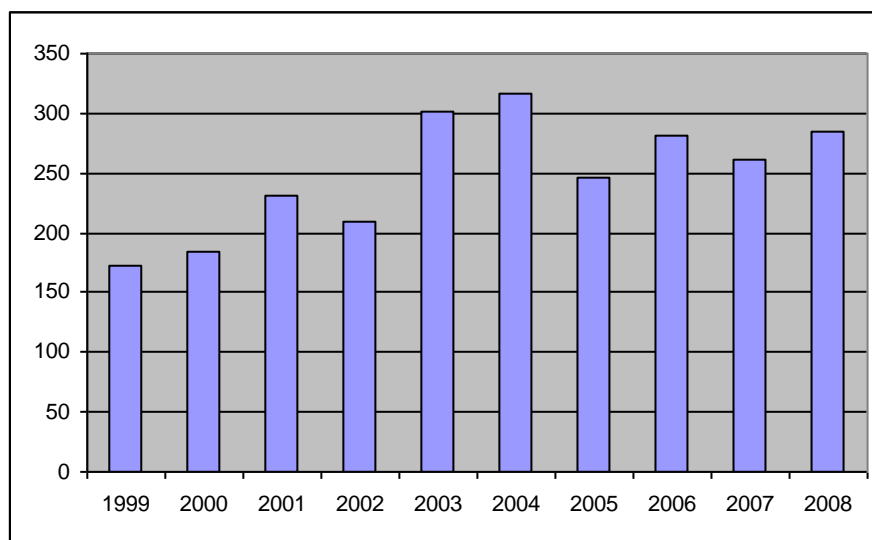


Figure 2 – Clients per loan officer (SEF, 2008, 2007, 2004, 2003, 2002, 2000, 1998)

Further action to improve efficiency was taken through the introduction of a decentralization policy, in terms of which more responsibility was given to field staff and branch managers, in order to reduce operating costs. Essentially, the idea was to give more power to those who actually had the most contact with clients so that they could serve them more flexibly and more immediately (Kuwik, 2002). A problem with this idea, however, was that many employees, due to the legacy of

apartheid, lacked any quality formal education. The SEF has taken it upon itself to fill the gaps in the education of its employees, which in itself is another cost that will only pay off in the long term.

Another strategy the SEF uses to reduce costs is to pass duties on to clients through centre committees and group leaders. Having clients take on administrative duties enables the SEF to operate in a more cost-effective way, reducing staff costs and thus the interest rates of the clients. Since the SEF clearly outlines the procedures that staff and clients are to follow, they are able to maintain consistency in operations and ensure a specific level of service and structure (CMN, 2002). While clients play an active part in the operations of loan centres, there is structured inclusion of paid staff in order to serve the interests of both clients and the institution. Clients have expressed the need for transparency and security in the safeguarding of their resources, and this is met by the presence of SEF staff in a monitoring role. But the more time that field workers spend monitoring centre meetings and operations, the less time they can spend serving additional clients and recruiting new business. This leads to increased overhead costs for the SEF and a dependence on outside staff (CMN, 2002). Certainly, the more functions that can be passed on to clients the greater the reduction in costs, but – to the extent that the institution has less control over its activities – the higher the risk factor.

4.5 Development Commitment

While the SEF must maintain smart business practices and achieve a certain level of business success to satisfy donor needs and keep its own operations sound, it must also prioritize development goals. Specifically, the TCP's aims are

to help the very poor [with the sub-aims to] 1) Socially empower the poor, 2) Economically empower the poor, 3) Raise the living standards of the poor, 4) Expose the poor to business, and assist them in gaining business skills, [and] 5) Demonstrate to other financial institutions (e.g. banks) that the poor are bankable. (Mayoux & Simanowitz, 2001, p. 4)

Since the MCP is maintained primarily as a tool to cross-subsidise the TCP, one can assume that the MCP subscribes to the same values.

Since 2004 the SEF has been able to consistently achieve an operational self-sufficiency rate of over 90%, and in some years has reached 100%. The organization would presumably have been able to reach and maintain total self-sufficiency earlier if it had not prioritized growth in the pro-poor sector. The SEF has been growing at a rate of 25% for the past 5 years and such growth is costly (SEF, 2007). Complete and continued self-sufficiency has purposely been put off in favour of expanding outreach, especially to the very poor, as can be seen in figure 3, which demonstrates the SEF's continued focus on growing its pro-poor program, the TCP.

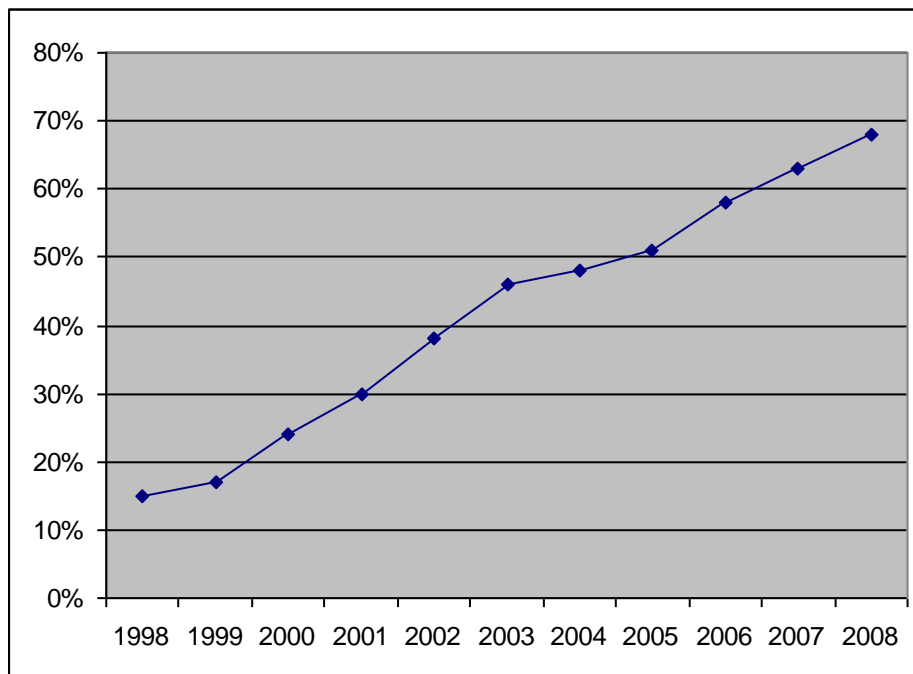


Figure 3- Percentage of the SEF made up by TCP clients (SEF 2008, 2007, 2004, 2003, 2002, 2001, 2000, 1999, 1998)

Both out of respect for development goals and in order to keep costs down and work towards sustainability, the SEF has created a system that is conducive to client interaction and support, a system based on horizontal learning. The emphasis is placed on clients improving their own lives and learning from each other, which ought to lead to gains in confidence, self-esteem, skills and community respect, all of which are aspects of the development goals pursued by the SEF. The system starts at the group level, with the group of five members providing a constant support structure. The relationships within groups are close, given that group members must guarantee each other's loans and constantly monitor each other's progress and business activities. The next level of support and learning comes at the centre level, where every fortnight groups get together and clients can solicit advice and share knowledge within a larger pool of resources. While ongoing support is available from SEF staff, the structure of the program is set up in such a way that the SEF's main role is to help clients to help themselves and each other. This is modelled on the Grameen Bank's approach, which considers people to be innately entrepreneurial and thus suggests that outsiders cannot enter into a situation and 'teach' people what to do. Not only is an outsider often unable of knowing what others need, but it is also disempowering to take away a person's self-determination.

The SEF subscribes to the policy that an institution should not impose solutions; instead, an institution must listen to the needs of clients and respond accordingly. A development institution cannot merely implement a plan; development must come from the ground up. Needs must be

identified by the community and implemented by the community. This ensures community buy-in and guarantees that development plans are truly appropriate, for something that works in one village may not be appropriate or even feasible in another village. While the SEF does recognize that it has important insights and experience to share with clients, it does try to include clients as active participants in business operations, not just at the centre level but also on policy levels. This is evidenced by the SEF's holding workshops that include client representatives to comment on policies (Mayoux & Simanowitz, 2001). Further expansion of client participation in policy decisions is planned for the future in the form of elected board members, but this has yet to be implemented because of concerns that MCP clients will dominate the board (CMN, 2003).

Women's empowerment is associated with the SEF's development goals as well. While the SEF does not have a specific gender 'empowerment' policy, once again, the structure of operations is set up in such a way as to promote women's empowerment. The structure starts with an emphasis on targeting female borrowers. Currently 99% of borrowers are women (SEF, 2007). The TCP is designed exclusively for women, and while the MCP is open to men, women are primarily targeted. By providing financial resources to women, the SEF believes that women's sense of security, self-determination, and self-esteem will improve (SEF, 1994). Financial access reduces a woman's dependence on handouts and allows her to realize her own capacity for self-help. Furthermore, the group structure is meant to increase community interaction, solidarity and mutual respect. The SEF also places an emphasis on employing women but has had difficulty in hiring and retaining qualified women (CMN, 2003). This emphasis on increasing female employment is a positive step toward motivating clients, as it will provide female role models for the community and inspire other women to believe in their own capacity and potential.

In addressing the SEF's commitment to development goals, each of their own development aims will be assessed, to evaluate whether or not they have been able to avoid mission drift and maintain their stated goals in the face of business pressure.

4.5.1 Social Empowerment

The SEF's goals and structure are designed to endorse social empowerment; however, the criteria for determining whether social empowerment is being achieved are very difficult to define. In a 2009 seminar with leading industry professionals from the likes of The Gates Foundation, Unitus, The Grameen Foundation and Global Partnerships, social performance monitoring was listed as one of the key critical challenges facing microfinance in the future. An international social performance task force of practitioners, networks and donors has been established to begin tackling the task of monitoring, standardizing definitions and tracking social performance. They have listed four indicators that help determine the achievement of social goals in a simple and verifiable way.

These indicators include: *outreach to the poor and excluded*, whereby financial services are offered to women and the very poor in diverse geographical areas and especially in places where no other financial services are provided; *adaptation of services to target clients*, whereby diversity in financial services are measured as well as rates and staff and client interaction; *improving clients political and social capital*, whereby frequency of meetings and client participation are measured along their influence on personal and family decisions and local and national government; *social responsibility*, whereby MFIs' policies regarding staff, clients and the community are evaluated by looking at issues such as sensitivity to local culture, providing living wages, and providing appropriate and affordable products. All of these indicators are evaluated with financial performance still seen as a necessity to a successful MFI and important to the sustenance of the MFI and its ability to socially empower clients (CERISE, 2005).

In 2008, Micro-Credit Ratings International Limited (M-CRIL)⁵ rated the SEF on its social performance in similar dimensions as 3 of the indicators listed by the social performance task force. According to the task force, the SEF scored the highest possible rating for its depth of outreach with 'excellent systems and adherence to social mission and values' related to outreach. For social responsibility and appropriateness of services, the task force rated the SEF as "good/satisfactory systems and adherence to social mission and values. Overall, M-CRIL rated the SEF as having 'very good systems and adherence to social mission and values,' the second highest rating possible according to the M-CRIL rating system (M-CRIL, 2008, p. 16).

The indicator not evaluated by M-CRIL – *improving clients political and social capital* – is a difficult dimension to evaluate, as it can be quite subjective. Currently, the main evidence for social empowerment is anecdotal. Francina Malai, an SEF client, explains her newfound social and economic empowerment,

SEF has made a difference because I can now regard myself as someone who is working and can provide for her family. I have been able to build a successful business. SEF has helped me both economically and socially. It has given me a loan, business advice and sense of community (SEF, 2003, p.1).

SEF client Jane Mashego demonstrates her increased social and political capital; "SEF has empowered me and I have been able to not only provide for my family, but for my community too. I am a leader in my community, I teach other women how to sew clothes and also I serve as an advocate for the disabled in securing them housing" (SEF, 2008, p. 2). The SEF has also served to support members' interests, demonstrating that clients have a voice in the politics of their community. While the SEF's influence is generally confined to advocacy, it has extended its influence to national issues such as: fighting for better service delivery regarding pensions,

⁵ The top microfinance rating agency with over 480 assessments completed in 27 countries. They do risk assessments of MFIs as well as social ratings.

challenging local Tzaneen hawking regulations, lobbying for higher quality service at Post Offices, and representing clients' interests in national discussions of rural poverty (Mayoux & Simanowitz, 2001). While it may be difficult to quantify the success of the SEF in improving social and political capital, anecdotal evidence suggests that there is progress in these areas.

4.5.2 Economic Empowerment

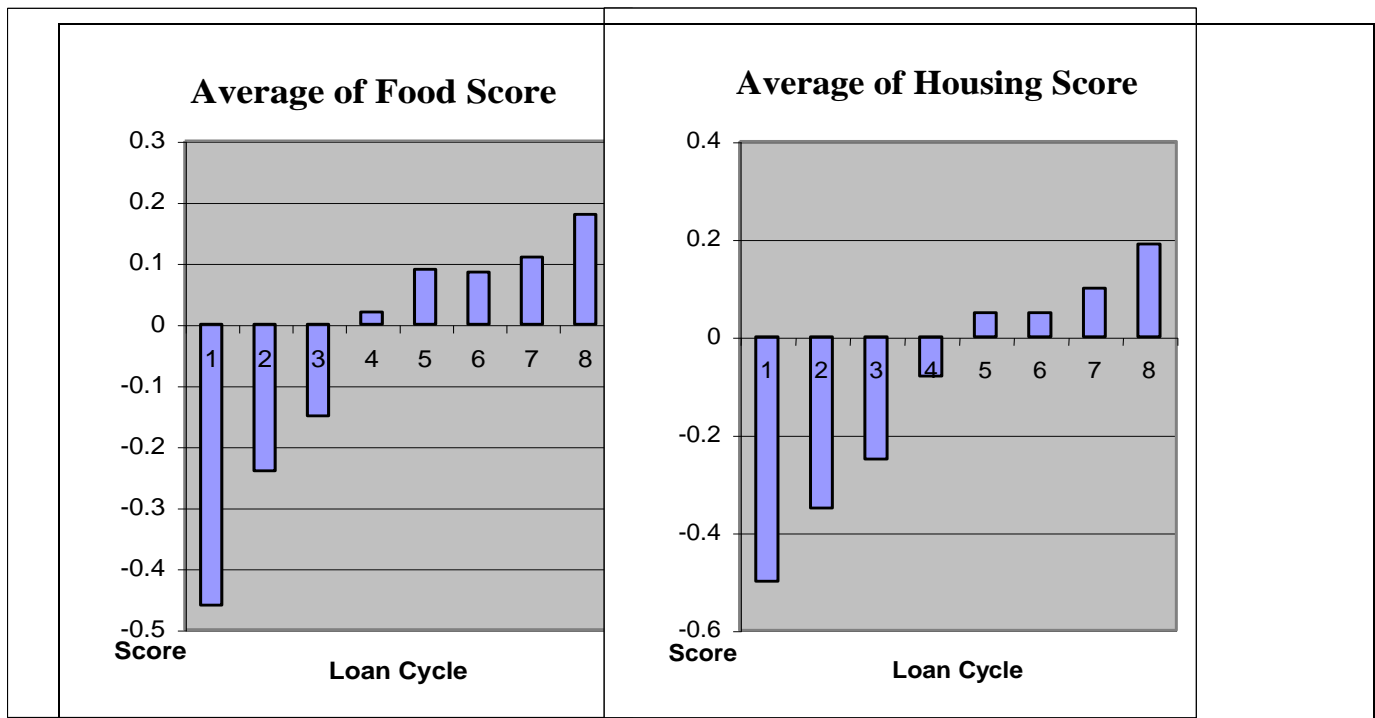
The main way that the SEF demonstrates its commitment to development goals is through serving the poorest segment of the population regardless of the difficulties that this creates. Over 50% of TCP clients are in the poorest third of the population, which means that additional time and money are spent in targeting and serving those clients (CMN, 2003). However, it is in its service to this marginalized group that the SEF actually achieves its development goals. 'By choosing the characteristics of the people [they] wish to target [they] are also targeting the program's benefits' (Simanowitz et al., 2000, p. 8). The SEF's success in targeting the poor has been confirmed by a study comparing 124 international MFIs, the SEF scored better than average in reaching the poorest segment of the population (MicroBanking Standards Project, 2001). The PWR also compared favourably with an external poverty assessment instrument from the Consultative Group to Assist the Poor (CGAP), which sampled 500 households in Limpopo – 201 SEF clients and 299 non-clients from the same communities – to test the applicability of the instrument for MFIs in South Africa (Van de Ruit et al., 2001). Although this instrument measured different criteria and had a different focus, the results nevertheless corresponded closely, thus verifying the robustness of the PWR system. Furthermore, M-CRIL has given the SEF the highest rating in depth of outreach (M-CRIL, 2008). Thus, by giving the very poor access to financial resources, the SEF is economically empowering them, i.e. providing economic opportunities not previously available.

4.5.3 Raising Living Standards

In evaluating whether living standards improve for clients, one can look to clients own evaluation of two indicators of quality of life. Figure 4 demonstrates that after only one loan cycle, the average client sees dramatic improvement in her satisfaction with the food she eats and the home she lives in. A client testimonial from Mamayila Baloyi reinforces these statistics;

my family was very poor before I became a Small Enterprise Foundation member and started my spaza (shop). We didn't make decisions; we didn't have options. Now I can pay school fees, so my children go to school and we eat meat with our meals. (SEF, 2002, p.1)

Thus, anecdotal and statistical evidence gathered at the beginning of each loan cycle by loan officers seem to indicate that living standards are indeed rising and are directly correlated to involvement in the SEF.

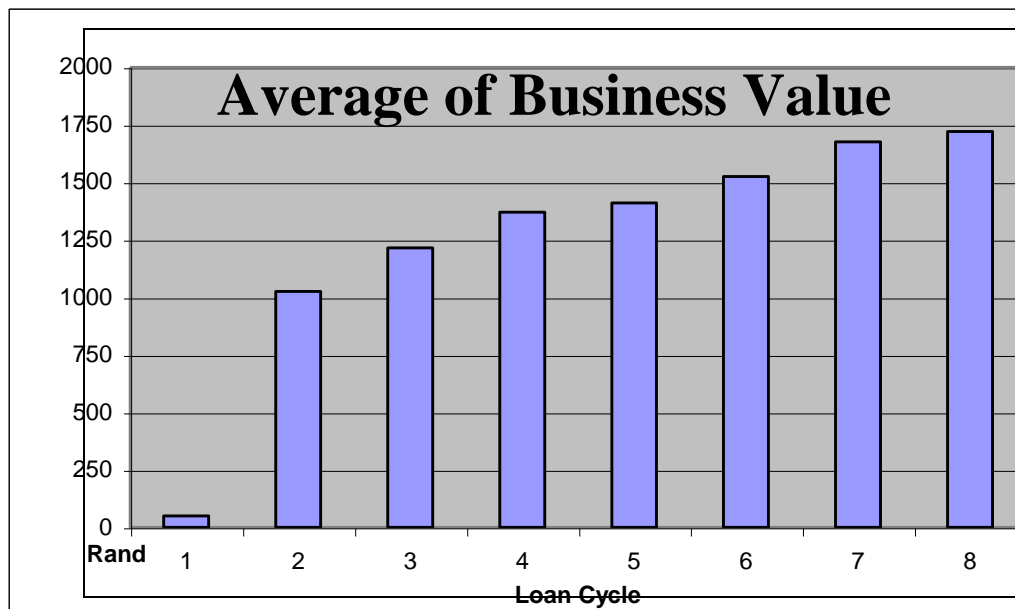


Note. Adapted from SEF's 2008 Annual Financial Data (SEF, 2008, pg 10).

Figure 4 – Client self-assessment of poverty indicators after successive loan cycles.

4.5.4 Improving Business Skills

The structure of the SEF's fortnightly meetings and the use of solidarity lending groups is meant to facilitate horizontal learning. Thus, clients learn from each other on a regular basis and have a forum to solicit advice from their peers and SEF staff. Furthermore, the process of applying for each loan facilitates business learning, as clients work with group members and SEF staff to create business proposals. The figure below demonstrates the improvement in average business value, which undoubtedly requires improved business skills. SEF client Arsnath Selepe reiterates this assertion, "without the loans from SEF my business would have collapsed; it is because of SEF my business is still going and I am able to sustain my family" (SEF, 2007, p.2).



Note. Adapted from SEF's 2008 Annual Financial Data (SEF, 2008, pg 10).

Figure 5 – Average business values of clients after successive loan cycles.

4.5.5 Demonstrating Bankability of the Poor

The SEF demonstrates the bankability of the poor in many ways, namely its very low rates of default and arrears –at 1% and 0.2%– showing that the very poor are not necessarily financially risky loan recipients (SEF, 2008). Furthermore, the SEF has been able to garner respect in the financial and political world as an institution with substantial political capital, as it was able to take an active role during the planning and drafting of the National Credit Act, as advisor to the National Credit Regulator. This important role is demonstrative of the increasing respect that MFIs are receiving as legitimate financial institutions and, in turn, the increased respect that poor people are receiving as bankable clients. As advisor to the National Credit Regulator, the SEF's suggestions were for the most part well received, and the organization adapted to the provisions of the Act without much difficulty. The only real challenge the SEF experienced with respect to the National Credit Act related to the new requirement to charge value added tax (VAT) on fees (SEF, 2007). As stated earlier, the new National Credit Act limits the amount of interest that the SEF can charge clients, so it has to make good this loss by charging initiation and service fees. Unfortunately, the tax law in South Africa now obliges the SEF to charge the prescribed 14% VAT on all fees. Interest is not a taxable item, but the clients' financial burden is increased as they must now pay VAT on loans that they would not have had to pay tax on in the past, since a large part of the loan (the service fees) has become a taxable item. The SEF is investigating ways to absorb this cost to limit the additional financial burden placed on clients (SEF, 2007). Furthermore, the SEF is attempting to discuss with the National Treasury ways to address the VAT on fees charged by developmental

credit providers, in order to solve this problem on an institutional level (SEF, 2007). So far it has had no success.

4.6 Institutional Learning

In order to keep development goals at the forefront of operations, the SEF has placed a high priority on regular impact monitoring and institutional learning for its poverty focused program, the TCP. The SEF has not only introduced its own monitoring and learning processes, but has also participated in national and international sector studies, such as a worldwide impact study funded by Ford Foundation. This study served to expand and improve upon impact assessment while facilitating inter-sector learning. Additionally, the SEF has taken part in numerous workshops with national and international microfinance practitioners in order to learn from others and share information in designing better programs (Imp-Act, 2001, CMN, 2002). The SEF is also actively involved in the Microcredit Summit and the CGAP, which are two of the most well-known and highly-regarded MFI analyst groups in the world (CMN, 2003).

Since late 1997, the SEF has institutionalized impact monitoring as a central part of its operations (SEF, 1999). Such monitoring puts the SEF in a much better position to serve clients and improve the business operations of the organization. MFIs need continuously to check and re-check progress and adapt accordingly. Impact assessment and monitoring is a part of standard practice, as data is most often collected in a way that piggybacks on procedures already in place (Campher, 2005). This ensures that data collection occurs regularly and is not dismissed as a nuisance. Furthermore, continuous monitoring is essential for quick response and modification, and since impact monitoring is a part of routine operations it is an institutionalized aspect of the organization. The potential for institutional learning is thereby increased. This institutional learning is beneficial for serving clients more effectively and for monitoring business practices to ensure that they remain sound.

While impact monitoring is a fundamental part of the SEF's practices, the assessments are not traditional reports. Reasons for this are many. Traditional impact assessments, like donor-driven reports meant to prove the validity of spending, are costly and time consuming. The SEF's Managing Director John de Wit dismissed this type of report due to its limited usefulness in efficiently and effectively improving policy and operations (Development Finance Forum, 2004). The statistics and dense data offered by traditional impact assessments are not particularly helpful in the production of real solution-oriented evaluations. This is not to say that there is no place for rigorous statistic-driven assessment, but since the goal of the SEF is to enhance staff skills, serve clients more effectively and modify program policy in an efficient and easily accessible way, that type of assessment is not appropriate as an only method of evaluation (Campher, 2005). Many in-

depth and detailed studies are performed when specific issues arise that require a deeper understanding; such studies have included investigations into savings, dropouts, and business profiles (SEF, 1999). However, due to the highly detailed and time-intensive nature of such studies, for most issues they are not necessary or cost-effective. The SEF employs several ongoing monitoring tools to ensure that its services are effective and appropriate, including client-level impact monitoring, dropout monitoring, assistance to vulnerable groups and centres, and a Management Information System (MIS) (Baumann, 2004a).

4.6.1 Client-level Impact Monitoring

The SEF's typical impact monitoring is low-cost, immediately useful and a part of day-to-day operations; it consists of a customer self-evaluation system that is simple and relatively quick and measures changes in customers' life conditions. Data is initially taken when a client joins the TCP, then the same types of data are taken at regular intervals thereafter, either at fortnightly meetings or at the beginning or end of each loan cycle, depending on the data. Some information is objective, like savings and loan amounts, attendance, household income and expenses, while some is subjective, like housing and food satisfaction levels (Baumann, 2004a).

The repetition of processes contributes to the validity of information as it helps guard against bad or inaccurate information. Because the monitoring is a part of everyday operations, data is consistently assessed and reassessed (Simanowitz, 1999). Many studies that occur only infrequently are merely a representation of how services affect a client at that particular time. By repeating the process, the organization can get a more complete view of the effects of services. For example, if a person is having a particularly difficult week with business or repayment, their evaluation of services and the MFI might be much more critical. While the information provided can still be useful it is not necessarily true of their general attitudes towards the institution. If one were to evaluate the SEF's services only at that one point in time, or even sporadically, one would assume that the issues plaguing that woman at that particular point in time were a total reflection of her satisfaction with the organization and services. However, since impact monitoring is a regular part of operations at SEF, field workers can see if her problems are becoming a pattern or merely reflect a lull in business. Thus, one of the most important functions of the impact monitoring system is that it serves as an early detection system. Furthermore, the system's longitudinal nature enables the SEF and its clients to see the impact of services over time.

Not only is the data collected important to the institution, but also the process of collection is itself important to both the institution and client, especially when it comes to subjective data. During each loan cycle clients are asked to assess certain aspects of their living standards, such as food and housing satisfaction (Baumann, 2004a). These assessments are tracked over time so that

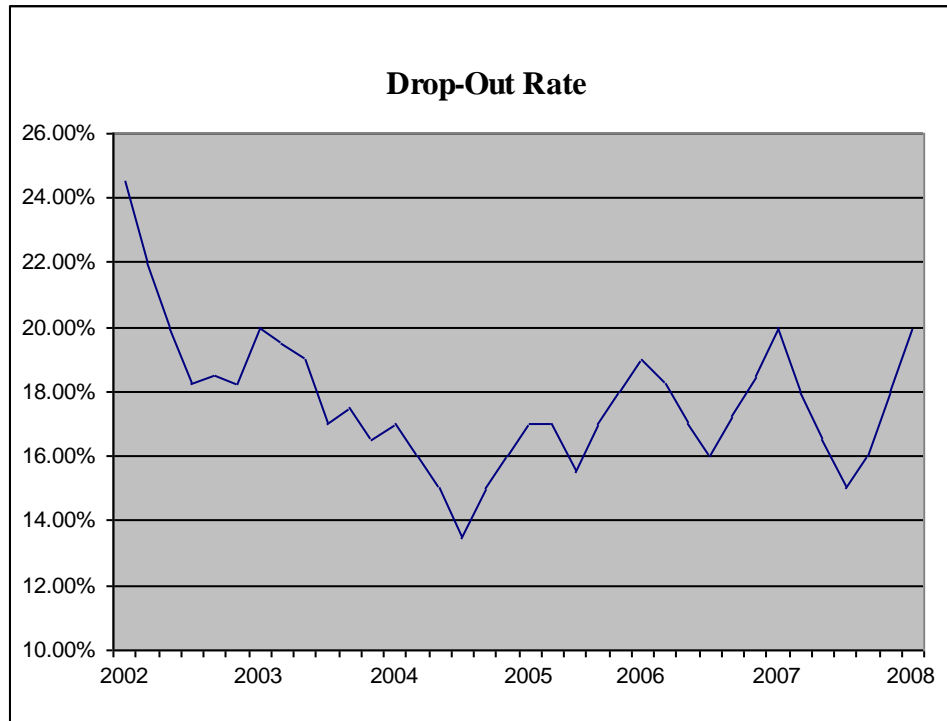
clients are able to see their own growth since first entering the program. Each time a client is asked to assess her satisfaction, she has sight of her history of assessment and can therefore see if she feels that things are improving or not. This also presents an important opportunity for loan officers to probe for problems or difficulties that may occur. Furthermore, the participatory nature of the process allows for open communication and gives clients a forum to be heard by the organization, which in itself can be empowering. In short, the system is based on ‘[improving] impact, [not proving] impact’ (Simanowitz, 2000, p. 114).

4.6.2 Dropout Monitoring

The SEF has struggled with high dropout rates for over a decade. In other words, the SEF has experienced difficulty in getting members to take out additional loans after the completion of a loan cycle for whatever reason. In September 1997 they reached their highest level of dropout at 31% (SEF, 1999). Since then the SEF has struggled with fluctuating dropout levels, with another dramatic dropout increase in 2001 and 2002. Dropouts are a particular problem because they are costly to MFIs as the initial costs associated with inducting new clients are high, and those costs are only made up later after clients take out larger and larger loans. The SEF cannot recover the costs of training and high initial supervision with the interest made on initial loans. An MFI can only recover those costs after clients become repeat borrowers and take out larger loans over time. In recognition of this problem, the SEF implemented a multi-pronged strategy to limit the number of dropouts. This strategy was based on increasing support to more vulnerable clients by improved loan proposal and planning, business skills development, a greater focus on group support and problem solving, and more one-on-one time with field workers (SEF, 1999). They also used this opportunity to learn from their mistakes, for it is assumed that clients drop out because services are not desirable or appropriate for whatever reason, so dropout rates reflect failures or gaps in the institution’s services. In order to understand the reasons for clients leaving the program, the SEF developed a dropout monitoring system, whereby dropout numbers are monitored and a sample group interviewed on a monthly basis to observe trends. This enables the SEF to take corrective action before problems become widespread (Simanowitz, 2000; Calmeadow, 2002).

Dropout rates have remained problematic, but the dropout monitoring system has allowed the SEF to take quick action to correct institutional problems. In 2001 and 2002 there was a sharp spike in dropouts; the SEF quickly realized that this was due to their inappropriate incentive scheme and they took immediate action to correct the problem as can be seen in Figure 1 (Baumann, 2004a). Once again, the SEF saw an increase in dropouts from 2004-2007. The SEF deems 18% to be an acceptable level of dropouts but is currently facing a rate of 21% and must take action to lower the rate to more acceptable levels (SEF, 2007). This goes to show that institutional learning must be an

ongoing process as an organization and its operations do not remain static. Even if one problem is solved for a time, situations are always changing and a problem may crop up again with new dimensions and issues that must be addressed. This can be seen with figure 6, where dropout rates continuously seem to ebb and flow, improving for a time, only to deteriorate once more until new solutions are found.



Note. Adapted from SEF’s 2008 Annual Financial Data (SEF, 2008, pg 6).

Figure 6 - Dropout Rates for TCP clients.

4.6.3 Vulnerable Groups and Centres

A group is considered ‘vulnerable’ if it fails to perform in any one of three areas, namely: savings, attendance, and repayment (Baumann, 2004a). Similarly, a centre is deemed vulnerable if transgressions in these areas reach a certain critical level. Savings, attendance and repayment have always been important to the SEF and compliance has been fundamental to their operational policy. Therefore, tracking these indicators has not been an undue burden as centre meetings have always recorded attendance and enforced savings and repayment. The SEF views non-compliance with these procedures as a warning sign of potential problems. Therefore these indicators are tracked in a way that enables branch managers to become aware of potential problems with centre members and for zonal managers to visit centres to provide additional support (Imp-Act, n.d.). When a centre is deemed vulnerable, branch and zonal managers assess the situation and take immediate remedial action. The SEF uses this as a method of catching problems before they become severe. The

organization employs a system of checks and balances by having several levels of management responsible for problems to ensure that they do not go un-addressed.

4.6.4 Management Information System (MIS)

The SEF tracks important operational and impact-oriented data in a central MIS, which can then be transferred to databases so that management can quickly and easily analyse complex data in order to spot trends (Baumann, 2004a). Many different types of data are stored in the MIS, including operational information like loan amounts, fieldworkers, and branch profile; client profiles such as age, business type, family composition and initial poverty score; and client changes gathered from impact monitoring information. The combination of this information is meant to help determine the extent of the SEF's outreach, to assist in program development and to monitor changes in client status. For example, by running a simple report, management could recognize that the trend in dropouts in 2001 was related to increased loan portfolios (Baumann, 2004a). The MIS is a useful tool to analyse data by combining multiple variables. It is generally not much used by loan officers or branch managers, as it is not as useful as first-hand evidence in immediate impact monitoring. The MIS is mainly used to track data longitudinally and generate a broad overview of operations.

4.6.5 Institutional Learning in Action

An example of institutional learning in action is the SEF's re-evaluation of fortnightly meetings. In an effort to reduce time commitments from staff and clients, the SEF attempted a pilot project within the MCP involving monthly rather than fortnightly centre meetings. The SEF piloted this program and reviewed its impact on dropouts, savings and attendance. It found that reducing the number of meetings had a negative impact, so fortnightly meetings were reintroduced (SEF, 1999). While not all remedial actions are effective, the SEF clearly responds to client needs and concerns and seems to be always trying to perfect its product. This can be seen in the dramatic decrease in dropout rates from 35% in April 1998 to 14% in April 1999 due to dropout monitoring which allowed the SEF to recognize and quickly act to reverse policy (Simanowitz, 2000). Without such a thorough monitoring system it is doubtful that they could have responded as quickly or effectively, which would have caused more problems on a business level and on the client level.

The SEF's impact monitoring provides opportunities for the institution to learn at many levels in order to improve its operations and better serve its clients. Individual monitoring affords loan officers a chance to intervene if clients have difficulties so that problems do not become overwhelming or snowball into bigger problems. Group and centre vulnerability indicators catch problems that have become systemic and require intervention on a higher level, and dropout

monitoring provides critical learning opportunities to correct problems that have become severe. While the SEF hopes to avoid dissatisfaction and dysfunction, in the event of these developing the monitoring system can retrieve important information to help address the immediate problem and prevent other possible problems. Its intensive system of monitoring impact demonstrates a clear desire to provide effective and beneficial services, while also furnishing the institution with feedback concerning its business practices.

4.7 Conclusion: Finding Equilibrium

While the SEF is one of the most successful MFIs in South Africa, it is not entirely successful by international standards in the areas of self-sufficiency, growth and efficiency. The SEF has been unable to reach goals for client and portfolio numbers set by one of its donors, USAID, even after they revised goals and lowered expectations (Calmeadow, 2002). One reason for this inability to reach self-sufficiency is the high cost of staff in South Africa. After 10 years of lending, the SEF reported an administrative costs ratio⁶ of 115%, which is incredibly high compared to the rest of the world where similar programs would have ratios closer to 50% or 60% (Calmeadow, 2002). The largest portion of costs goes to employee salaries. The SEF can only recruit and keep workers if they are paid salaries commensurate with other financial institutions and development organizations. In 1997, the salary burden increased as about half of SEF's staff joined the Paper, Printing, Wood and Allied Workers Union. This forced salaries to increase much faster than inflation, causing already high operational expenses to rise even higher (Kuwik, 2002).

Unfortunately, the SEF also has to deal with the added expense of losing employees to job poaching. SEF employees become particularly marketable to other organizations after their extensive on-the-job training and work experience. The SEF has to compete with private sector and government employers who are always looking for competent employees. External conditions lure employees away, while internal conditions can help push employees out of the SEF. While salaries are, and must be, on a par with market levels to retain employees, they are not on the high end of the spectrum. Further impetus to leave the SEF comes from the sometimes difficult work conditions, which involve living in undesirable locations including sometimes isolated villages with few amenities, as is common in many parts of Limpopo (SEF, 2007). Many loan officers live in difficult conditions and are under increasing pressure to manage more clients and take on more responsibility in order to offset costs. The SEF must balance employee needs with client needs, as dissatisfying and losing members of either group is costly.

Furthermore, growth is difficult as the SEF is adamant about maintaining its poverty focus and the very poor have limited business opportunities. The SEF's clients have a business

⁶ Administrative costs ratio is a ratio of administrative expenses to gross income received from loan interest.

breakdown as follows: 50% are involved in hawking, 24% work in retail, 19% in manufacturing, 5% in entertainment, and 3% in service, catering, and other businesses (CMN, 2003). With a limited demand for such products and services, MFIs must be careful not to flood the market with excess supply or clients will not have a good chance of success. The SEF has estimated that only about 18-20% of the total population in Limpopo can actually be effectively served at any given time by the TCP due to the limited opportunities and the similarities of business opportunities available to the very poor (CMN, 2003). The SEF recognizes that they must limit the number of clients so that similar businesses do not over-saturate the market and become unprofitable.

Since its inception, the SEF has had to write off R246 912 in loans due to deaths and to reschedule R339 411 due to illness. HIV/AIDS is thought to be one of the major contributors to these losses. While these figures may seem high, they are very low when compared to other microfinance institutions in South Africa (SEF, 2007). The SEF, however, anticipates that HIV/AIDS will become a bigger problem for clients and staff members, and acknowledges that these numbers are somewhat misleading as many sick clients actually leave the program before full-blown illness sets in. Therefore, we can assume that HIV/AIDS has an impact not only on repayments but also on dropout rates, which are also costly to MFIs.

Although the SEF has struggled to achieve complete success in the eyes of the international community - whereby it is operationally and financially self-sufficient - it has recorded many impressive achievements. For instance, it has consistently had very high repayment rates of around 99% (Mayoux & Simanowitz, 2001). Fortunately for the SEF, it is perhaps the only option for affordable microfinance in Limpopo, and therefore clients have a big incentive to maintain successful operations and to enforce rules and monitor each other. Furthermore, clients have an incentive to repay loans. This could account for the remarkable repayment rates that the SEF enjoys, while other MFIs in the country and the world are less successful. If clients have only one option for affordable finance and their livelihood is dependent on that finance, then they are less likely to ruin relations with the source of the finance for fear of losing their livelihood. However, the organization's ability to maintain such high rates is also undoubtedly due to good staff support and client education, and also the policy of solidarity lending, which involves peer pressure deterrents. The promise of larger loans following loan repayment and business success creates further incentives for timely repayment. Late payments have been consistently low, at rates of around 0.5%, due to a no-tolerance policy for arrears (Calmeadow, 2002). In this regard the SEF is a world-leader and its strict client discipline is an exemplary strategy for achieving success in microfinance operations.

Data also seems to suggest that the SEF is successful in having a positive impact on clients. Financial empowerment can be seen in many ways. Nearly 50% of TCP clients grow their

businesses and accumulate enough assets to have sufficient constant income to 'graduate' out of the TCP, meaning they no longer meet the poverty criteria (CMN, 2003). Internal longitudinal impact assessments also show a constant and pronounced average improvement in poverty indicators such as increased satisfaction with housing and food and an increase in savings and average business value. Satisfaction with food nearly doubles by the second loan; average business value starts at nearly zero but averages around R1 600 by the eighth loan; and savings increase nearly four-fold by the ninth loan (CMN, 2003). An external impact study consisting of closed-ended and open-ended questions confirmed many of the SEF's results in regard to improved financial and food security. Furthermore, the majority of clients reported increased self-confidence and a desire to participate in community activities, as well as a strong appreciation, especially amongst TCP clients, for the support and knowledge that the SEF provides (Hietalahti & Linden, 2006).

Thus, while the SEF is not completely successful according to international standards in regard to sustainability and efficiency, it must be recognized that South Africa is a particularly difficult climate for MFIs. The SEF has made clear its goal of sustainability, but it has also made clear its goal to maintain effective service to the poorest segments of the population. The organization has struggled to achieve the appropriate equilibrium between these two goals, as was demonstrated when over-ambitious plans for growth led to an incentive scheme which induced loan officers to push inappropriate loans. By keeping development goals central to all aspects of operations like targeting, day-to-day practices, and retrospective assessments, the SEF is able to resist extreme business pressures and quickly take remedial actions to rectify policy that becomes detrimental to clients. The SEF's focus on responsible growth and outreach to the poorest, and its record of positively affecting the lives of clients demonstrates that it is generally quite successful at finding this balance. In this regard the definition of 'success' may need to be revised to include the qualitative benefits of MFIs and not just their quantitative benefits.

Chapter 5: Conclusion

Microfinance seems to be, at least for the foreseeable future, a workable development strategy, which is transforming the development landscape. The values and innovations of MFIs have begun to influence broader development strategies and the business sector. While there is still disagreement regarding the benefits of microfinance and its ability to pull people out of poverty, most people do believe that it at least provides some benefits. And since the hype surrounding microfinance is not likely to subside in the near future, focusing on the methods that provide the most benefit and refining best practices might be the optimal way forward for the present.

According to international standards, a pro-poor MFI requires an average of 5-10 years of operation before it becomes financially self-sufficient (CGAP, 2004). This is most likely an over-ambitious goal in the South African context, especially if an MFI is to serve the very poor. South Africa presents many serious challenges for MFIs, most notably its income inequality, which is rated among the most extreme in the world (UNDP, 2008). This income inequality results in high expenses and low returns for South African MFIs. Furthermore, due to South Africa's dual economy there are relatively few entrepreneurial opportunities for the very poor, as competition is high, profit margins are small, and demand is limited. The primary customers available to the poor are themselves very poor. But while the South African environment is a difficult one in which to operate, the SEF seems to be an example of success.

Along with the general challenges that the South African context presents, the SEF faces further challenges by working in one of the poorest regions of the country with some of the poorest people in the region. Working primarily in rural areas increases costs due to lowered efficiency, and fewer opportunities for clients create less opportunity for business and income growth. However, in spite of all this, the SEF has had remarkable business success by South African standards, and has achieved impressive developmental success as well.

5.1 *SEF Successes*

Many easily quantifiable benefits have been observed as accruing to SEF clients, such as increased housing and food security, increased savings and increased financial security due to a steady source of income. Additionally, the SEF has contributed to an array of less quantifiable benefits, beginning with the basic process that the SEF subscribes to. The process of solidarity lending and participatory monitoring is empowering in itself, as it treats each person as though they have innate worth, skills, and potential. An SEF client exemplifies this empowerment when she says that before joining the TCP she felt like 'nothing...now [after joining TCP] she feels proud of what she has achieved.... She [feels] part of the community and [can] assert her identity and sense

of worth' (Mayoux & Simanowitz, 2001, p. 14). The organization's ability to achieve this success comes from the very structure of its operations, starting with its targeting practices and continuing through the participatory nature of all its operations. Along with these development successes, the process also contributes to its business success. While operational self-sufficiency has not been attained for an extended period, the South African context is a difficult one for achieving self-sufficiency and the SEF is still a leader in South Africa for business success and can be commended for serving a poorer population than most.

5.1.1 Targeting the poor

In 2000, the United States passed a bill mandating that all USAID microfinance funds must benefit the very poor (Maes & Foose, 2006). This bill was passed in response to a growing awareness that most MFIs were not effectively reaching the very poor. The SEF, however, has been able to do what many MFIs cannot do, and is a leader both in South Africa and in the world in terms of its ability to reach the poorest of the poor. A strong targeting framework and an impressive institutional desire to serve the most vulnerable portion of the population drive this outreach. The SEF has been able to develop a system, the Participatory Wealth Ranking (PWR), which efficiently and effectively targets the poorest of the poor, as has been corroborated by external studies. Management decided to implement this targeting system, even though it meant additional expenditure, when they discovered that the SEF was not reaching the poorest people. Further expenses have come from the SEF's decision to emphasize growth in the more costly TCP rather than the MCP, which is demonstrated in a 5% increase in the percentage of TCP clients in SEF with 68% of the SEF's clients being from the TCP (SEF, 2008). The dedication to reaching the poorest is clear in this regard, as the SEF has intentionally chosen to hold fast to this goal even at the expense of self-sufficiency. If they were more relaxed and willing to compromise their targeting goals then they could have focused operations on wealthier populations and could thus more easily achieve and maintain self-sufficiency. However, through a strong commitment to reaching the very poor and a strong targeting system, the SEF is able efficiently to find the most vulnerable members of a community and provide them with needed services, resulting in a depth and breadth of outreach impressive according to any standard.

5.1.2 Increasing Skills and Providing Support

The nature of solidarity lending provides opportunities for support and mutual learning on an ongoing basis, and also serves the purpose of reducing operating costs by passing duties along to clients and increasing client empowerment. The SEF's strategy to achieve development goals is to create a system that is conducive to client interaction and support. Clients learn through doing and

through interacting with other clients, while the SEF facilitates that learning and provides a safety net with the structure of the program and the supervision of SEF staff.

The group and centre structure creates an optimal environment for increasing entrepreneurial skills. Business skills are developed from the initial client intake, as SEF loan officers work with clients to develop business plans. Those business skills are further cultivated throughout each loan process and through the fortnightly meetings at which group and centre members can solicit advice and share knowledge within a larger pool of resources. Solidarity lending also facilitates the expansion of social networks and support systems. By being a member of a group that guarantees each other's loans, clients have a constant support system and a group of people who have a vested interest in their success. The groups provide not only financial assistance in times of need but emotional and business support as well.

Training and capacity building along with the learning provided by the group and centre structure provide clients with vital skills for succeeding in business. Thus the SEF is able to assist clients and see them succeed, which serves both development and business goals. By capitalizing on individuals' skills and partnering them with people who have other skills, the SEF is able to facilitate horizontal learning and support in a cost-effective way. Thus the very structure of the SEF's program is beneficial both for clients and for the bottom line.

5.1.3 Impact Monitoring

The SEF's commitment to impact monitoring has proven to facilitate better service to clients and better business practices. The participatory nature of its impact monitoring provides opportunities for clients to evaluate their own situations and learn from their experiences, as well as serving as an important tool for institutional learning. Thus the SEF is able to evaluate client satisfaction and address problematic issues in order to avoid negative implications, both financial and developmental, for the institution.

By using several different types of impact monitoring, the SEF is able to address problems at the beginning, middle and end stages of their lifespan. Individual monitoring provides the opportunity for intervention if clients have difficulties, so that problems do not escalate. Group and centre vulnerability indicators catch problems that have become systemic and require intervention on a higher level, and dropout monitoring provides critical learning opportunities to correct problems that have become severe enough to compel clients not to return for further loans. This intensive system of monitoring impact demonstrates a clear desire to provide effective and beneficial services, while also providing the institution with feedback regarding best business practices.

5.2 *The Future of the SEF*

In order to better serve clients, the SEF has recognized the need for additional services in the community and now offers child-education loans for MCP clients as well as insurance as an intermediary institution (Bester et al., 2006; FinMark Trust, 2006).⁷ While these services are highly desirable to clients, the SEF has never offered consumption loans before, and intermediating insurance is breaking new ground for them as well. The SEF must be cautious not to over-expand and in the process blur its main focus and expertise, which is the provision of microfinance for small enterprises. Sometimes when businesses expand too quickly or expand too far beyond their primary expertise the business as a whole suffers. In the past the SEF has favoured creating slow, solid, and sustainable growth over rapid expansion. If it maintains that focus then it stands a good chance of following in the footsteps of the Grameen Bank, which has successfully expanded its product line.

While the SEF is clearly adept at adapting its product, potential areas for growth lie in the institution adapting products to better serve clients infected with or affected by HIV/AIDS. Currently, the impact of HIV/AIDS on the MCP and the TCP is not obvious as many clients drop out before illnesses become too problematic. However, this trend may change if the rate of infection continues to rise. Furthermore, the SEF may want to design products, such as more flexible loans, that are more appropriate for ill clients. The SEF participated in the Intervention with Microfinance for AIDS and Gender Equity (IMAGE) study, along with the Rural AIDS Development Action Research Programme at the University of the Witwatersrand and the London School of Hygiene and Tropical Medicine. The study combined microfinance with a series of training sessions dealing with HIV/AIDS, relationships and gender (Epstein & Kim, 2007). The interventions used in this study, however, will most likely not be sustainable on a broad scale, as they require a lot of additional resources and would need a constant influx of donor funding. However, the SEF could take some of the lessons learned from this study and apply aspects of them to better serve their clients.

Another issue that may loom larger in the future is the problem of over-indebtedness. Many MFIs face problems due to clients taking out more than one loan with multiple institutions. Oftentimes this leads to over-indebtedness, whereby clients become overburdened with debt and cannot manage repayment. This leads to various problems between the MFI and its clients. Currently there is little competition in Limpopo, so the SEF has largely been able to avoid this problem. However, if the trend of rapid microfinance expansion continues in South Africa then the SEF will need to find ways to address this issue.

⁷ The SEF has identified an insurance provider and negotiated a special policy with them to serve its clients. The SEF will perform most of the administrative work associated with the policies – selling policies and collecting payments – in order to keep costs down.

5.3 *A New Model for Success*

One can see that development goals are a main focus of the SEF's operations, but business goals are vital too, as the SEF cannot attain or maintain financial and operational self-sufficiency without the achievement of such goals. Zeller and Meyer (2002) discuss the 'triangle of microfinance' as a model to rate success, in that MFIs must try to balance financial and operational self-sufficiency, outreach, and impact. My own research has focused on a similar balance between the business goal of self-sufficiency and development goals, which include outreach and impact. There does indeed seem to be a trade-off between business objectives and developmental objectives, as Hulme and Mosley (1996) suggest. The challenge can be seen in terms of a simple cost-benefit analysis. Self-sufficiency is desirable, but if an MFI prioritizes this over all else then it might not be effective in impact or outreach. If a program is not run properly it can lead to over-indebtedness and the benefits may not outweigh the costs. There also seems to be a correlation between increased services and increased impact, so minimalist MFIs are potentially sacrificing impact for self-sufficiency (Zeller & Meyer, 2002). Whereas if a program is successful in enhancing the livelihood of the majority of its clients by providing them with increased education and confidence and security, then it may be worth more than the amount of subsidy it receives. However, if an MFI creates many social benefits but is run inefficiently and is costly, it may be on balance an inappropriate use of resources. Only by looking at the negotiation between business and development goals can one discern the success of an MFI.

The SEF would have most likely have been able to more easily maintain financial and operational self-sufficiency if it did not focus the majority of its services on the very poor. Its depth and breadth of outreach is remarkable, however, and it has provided services to a segment of the population that has few other options. The SEF does not seem to overemphasize its self-sufficiency goal at the cost of the welfare of clients, as the organization does not rely only on raising interest rates to cover costs. The SEF has demonstrated a commitment to innovation and increased institutional efficiency to offset costs and, while it might not be fully sustainable, the SEF is nearly operationally self-sufficient at a rate of 96% and financially self-sufficient at rate of 95% (SEF, 2008). The tangible benefits of increased income and savings, as well as the anecdotal stories of social benefits such as empowerment and confidence building, seem to be well worth the cost.

MFIs must balance their goals. In this case it is possible that neither development nor business goals may be able to be fully reached. For example, if only business goals are met and focused upon then development goals may be completely ignored or vice versa. The difficult thing is to put a value on development goals, but money and thus financial goals are easily quantifiable. However, a balance is necessary, because by totally ignoring development or business goals then more is lost as development goals require good business performance as successful business

performance means that more money is being retained to circulate amongst more clients. On the other hand if MFIs only focus on self-sufficiency then development goals may be sacrificed, as mission drift is highly likely.

The costs of microfinance as an intervention must be looked at not only in terms of the money it costs donors and the government and the impact that it provides, but also in terms of the opportunity cost of such programs. In other words, could the money given to MFIs be used in a better way elsewhere? The SEF's ability and potential to create income is a major benefit in a country with a high unemployment rate that many other unemployment interventions have been largely unsuccessful in addressing. On another level, benefits are difficult to measure as much of the progress that the SEF claims to promote is not easily quantifiable. However, the SEF's system of solidarity lending and participatory impact monitoring does seem to provide several opportunities for increasing social benefits. Additionally, one must keep in mind the opportunity cost of *not* providing financial services. The mere act of decreasing vulnerability and smoothing consumption has enormous value, especially for those who are living at the poorest levels.

When one is assessing the achievement of MFIs such as the Grameen Bank and the SEF, it is important to stress that there is no blueprint for success: one cannot merely copy a program, set up a system, and let it run. The SEF has clearly not come up with a perfect system because it still encounters problems on a regular basis and must constantly adapt and modify programs the better to serve its clients. The SEF will never be able to find a perfect system, as the clientele and environment are constantly changing. The best MFI seems to be one that is set up in such a way as to be able to modify its practices to adapt to changing variables within the program, while still retaining a strong foundation and structure so that there is no mission drift. For example, the Grameen Bank has shown its ability to remain effective and to adapt, as it has gone through several transformations including a full-scale overhaul of its program starting in 2000 with the advent of Grameen II. All the while, it has managed to maintain its commitment to serve the very poor and kept its values of quality service at fair rates. While the SEF is based on the Grameen Bank, it has not taken Grameen's program and replicated it indiscriminately. Similarly, other South African MFIs cannot just replicate the SEF's program wholesale and expect the same results.

However, what can be replicated are the principles behind the SEF that has led to its success. The SEF has proven that a system of constant input and feedback and a strong commitment from staff and management to maintain its core values and mission are essential to success in both a business context and a development context. The SEF treats failures as opportunities for learning and growth and thus potential success, as can be seen with dropout and impact monitoring. It constantly evaluates operations in order to pre-empt problems and in order to adapt to the changing needs of clients. Strong institutional values are also imperative, as can be seen in the SEF's core

principles. These values commit the institution to improving the lives of clients. Sustainability and institutional performance are important, but business goals should not be attained at the expense of clients' welfare.

Microfinance is not a panacea for poverty reduction, but by assessing how institutions such as the SEF are able to balance business goals with development objectives one can increase the impact of such interventions. This research has found that the SEF has a great deal to contribute to an understanding of effective microfinance in practice, particularly in the South African context. It is hoped that, by understanding the successes and challenges of the SEF, development strategies can be improved and more benefit can be derived from donor funding that spent on this popular intervention.

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