# CREDIT ACCESSIBILITY AND RURAL DEVELOPMENT IN THE FORMER CISKEI: AN OVERVIEW OF KEISKAMMAHOEK.



**Dissertation**

**Submitted in partial fulfilment of the requirements for the degree of Master of Social Science (Rural Development), in the Department of Sociology and Industrial Sociology, Rhodes University.**

**By**

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# DECLARATION

Except for references specifically indicated in the text, and such help as I have acknowledged, the dissertation is wholly my own work and has not been submitted for degree purposes at any other University.

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**ABSTRACT**

This study focuses on the issue of credit accessibility for the rural poor. Taking cognisance of the critical role played by innovative micro-lending mechanisms in the sphere of rural development, the study reaffirms the need to enhance access to financial services by rural communities. However, it also reveals the fact that there are numerous impediments to access to credit for the people living in parts of the Keiskammahoek District of the former Ciskei. Key among the impediments has been lack of awareness about the existence and the activities of micro-lending institutions. This has, in a large measure been blamed for many of the rural poor people's failure to approach such institutions for funding.

As a result, the affected people's efforts to fully actualize themselves economically have to a certain extent been hampered. Consequently, as its core argument, this study views as crucial the need to tackle all the attendant impediments. It also suggests that as the first step, the government, NGOs as well as formal and informal lending institutions should endeavour to disseminate the requisite information on micro-financing and in enhancing the affected people's institutional capacity to effectively use credit obtained for commercially productive ventures. Without sorting out the basics first, credit extension even when easily availed may not have the desired impact. At worst, it may actually complicate the poverty situation as the people grapple with piling debts.

CONTENTS

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# CHAPTER 1: INTRODUCTION

## 1.1 Context and justification of the study

The definition of rural development has variously been viewed as being contentious, an aspect that makes consensus in the matter unlikely. However, for the purposes of this study there is a need for a general definition which covers some of the main objectives of rural development as a practice. Rural development is defined as "improving the living standards of the mass of low-income population and making the process of their development self-sustaining" (Tapson, 1990:562). Clearly, the fundamental aim must be to enable that mass of the rural population who are now in poverty to earn, by their own efforts, the basic human needs including food, clothing, shelter and health services, and the resources and opportunity to use and develop their skills and capacities. Rural development recognises that improved food supplies and nutrition, together with basic services, such as health and education, not only directly improve the rural poor, but also indirectly enhance their productivity and their ability to contribute to the national economy.

The changes that occurred in South Africa following the democratic elections in 1994 brought to the fore some of the rural development issues that had hitherto been largely ignored by the previous political dispensation. The current government has the onerous task of effecting change in order to uplift living standards of especially the rural poor and to make the rural areas more attractive for habitation in order to stave off rural-urban migration. A major feature of the contemporary South African economy is the presence of untapped human resources and under-used natural and physical resources in the face of abject poverty especially among the rural communities. This scenario is especially evident in the former homelands which the Strauss Commission argues, "are overcrowded and unproductive yet capable of producing agricultural surpluses" (Strauss,1996:1).

Consequently, provision of appropriate financial services in the said areas is viewed as one of the important mechanisms in a strategy for unlocking development potential (Strauss,1996:1). Besides considering issues such as tenure security, efficiency of land use, ease of land transfer, and promotion of investment in land and new technology, a rural development agenda must also consider availability of credit as one of the critical economic development issues. These policy issues will most likely have to be applied in all the former reserves and one such area is the former Ciskei which falls under the Eastern Cape Province.

Former Ciskei is largely rural, with a substantial proportion of rural residents being land holders, with arable holdings averaging a few hectares (see Chapter 4). It is a former independent homeland, underdeveloped and still reeling under what has been described as "endemic poverty" (Charton, 1980:10). Going by the observation made by the Strauss Commission (1996:1), that such areas have untapped human resources and under-used natural and physical resources, the question would be, how can such resources be put into more productive uses? Arguably, as stated above, capital investment is likely to enhance the exploitation of such resources. Yet, capital is a scarce and expensive factor of production and for this reason, it becomes largely inaccessible to the poor especially in the rural areas.

While credit accessibility would be considered critical for the rural poor, it is more often than not either cumbersome, too complicated for the rural people or simply non-existent. Where it exists, it could even be exploitative and thus discouraging for potential borrowers. Most of the people residing in the rural areas of the former Ciskei are either low income earners or are not involved in any gainful employment. Conventionally, commercial banks tend to avoid extending credit to such people because of the administrative costs involved when dealing with small loans and because of the risk of widespread default. People, therefore, resort to other sources of credit namely government loans, the Land Bank (lately), and micro lenders some of which are informal. Because the informal lenders are largely unregulated, they tend to charge very high interest rates and only a very small number of people can afford such expensive capital without running into worse financial quagmires. Yet, more and more people have inevitably to rely on the informal lenders especially for finances meant to supplement the borrowers' consumption needs. This in turn would imply that only a very small number of people would be able to invest in productive agricultural and non-agricultural commercial activities. The focus of this study is mainly on this small minority of people who may desire credit for investment into productive enterprises. It will thus not consider the very large majority who may desire and use credit only for the purposes of survival. As discussed in Chapter 2, people demand credit for various reasons and among the rural poor it is difficult to distinguish between credit that is meant for supplementing consumption needs and that which is meant for productive purposes. Ordinarily, some among potential customers may demand credit ostensibly to engage in a productive venture only to end up using the same money to meet sudden consumption needs triggered by for instance, a bad crop harvest. Under these circumstances, one can only be able to ascertain whether a given credit facility was for further production purposes or for consumption, after the said facility has been utilized although even then, achieving precision would still be a problem.

Hypothetically, easing credit accessibility in former Ciskei would enable some potential entrepreneurs to exploit the available resources more effectively be it in agriculture or even in micro-enterprises. This would not only enhance their capacity to develop their own areas but also to ultimately contribute to overall national development. However, this hypothesis can only be tested through an empirical study aimed at reviewing the issue of credit accessibility in relation to rural development in the area.

## 1.2 Objectives of the study

As observed in the section above, availability of affordable financial capital, has in addition to other factors, been long recognised as an important factor in economic development. For example, a land owner may require a number of labourers (who could be family members) and some basic farm inputs to produce a given crop. The farm inputs required to combine with labour in order to produce an output, form part of the land-owner's capital stock whose accumulation is enabled by availability of finance. In recognition of the role that capital plays in enhancing development and in further acknowledgement of the fact that the said input is also generally scarce, this study has among other things attempted to find answers to the following questions:

i) What is the role of credit in rural development?

ii) what is the current situation with regard to credit accessibility in former Ciskei?

iii) What are the impediments to credit access in the region?

iv) How can the impediments be removed in order to enhance rural development?

### 1.3 Methodology

A review, for comparative purposes, of case studies of successful credit extension schemes from other parts of the world was used with the hope that they would contribute positively to our understanding and appreciation of such mechanisms for rural development. The operations of the Grameen Bank of Bangladesh, Faulu Project (Kenya) as well as those of the Murang'a Farmers Savings and Credit Cooperative Society (Kenya)provided the envisaged comparative case studies cited in an effort to get possible answers to the first research question.

For the purposes of this study, the Keiskammahoek District which was a part of former Ciskei, was used as a case study. The choice of Keiskammahoek was motivated by the fact that the poverty situation as identified in the first section above obtains in the region. Moreover, other studies (though not similar to the proposed one) have been carried out in the area and it was envisaged that the basic "infrastructure" laid by the preceding studies would save the proposed study some valuable time and resources. The study utilized both primary and secondary data. The former was obtained through questionnaires to small-scale farmers and owners of micro-enterprises while the latter emanated from various publications.

The data arising from the sources indicated above was analysed in the light of the stated objectives of the study. The analysed data was then used in answering the rest of the research questions (ii to iv) enumerated in Section 2 above.

### 1.4 A summary of the chapters

Chapter 2 of this study gives a detailed account of the role of credit in rural development. The discussion starts off with a brief introduction followed by the classifications of credit. The latter section expounds on the distinction between credit for consumption purposes and that which is obtained for production purposes be it in small scale commercial farming or engaging in small and micro-enterprises. The discussion then moves to various aspects and forms of credit as well as agencies involved in extending such credit. Problems associated with extension of short-term production credit are analyzed followed by a brief look at the issues involving agricultural credit for small-scale farmers and micro-lending for micro-enterprises.

Section 2.9 shifts the focus from the preceding sections and sets off a discussion into the numerous theoretical explanations that are given for the persistence of high interest rates for micro-finances especially considering the fact that recipients of such credit are almost invariably among the poorest people in any given society. The issue of the high default risk associated with micro-lending is discussed in detail while citing some of the empirical studies that have been conducted in an attempt to explain the said phenomenon of high interest rates. Section 2.10 ushers the study into a review of three case studies that have generally been viewed as successful cases of micro-lending institutions. The argument is that in spite of the perception that low income earners are a risky group to lend to because of high default rates, there are cases where micro-lending schemes have succeeded. Default has been minimal in such cases and the schemes have helped their memberships to obtain financial resources that they would otherwise have not been able to gain access to. In general, the discussion in the entire chapter aims at providing an answer for the first research question listed under the goals of the study; what is the role of credit in rural development.

Chapter 3 shifts the attention of the study into a general discussion of rural credit in South Africa. The focus is more on the current situation with regard to micro-credit in the country. However, as a starting point and for the purposes of putting the study into proper perspective, an attempt is made to discuss the factors that may have contributed to the current poverty situation especially among the black African people in South Africa. This is partly traced to the issue of colonial land alienation coupled with racially-motivated differential lending policies which were quite evident especially in the operations of the Land Bank after the Anglo-Boer war. The rest of the chapter discusses the policies of the current government with regard to micro-lending and also the current micro-lending endeavours by various lending institutions. From the discussions in this chapter, it is noted that formal lending institutions especially the commercial banks in South Africa, like any others in different countries tend to steer clear of micro-lending ostensibly because of the default risk factor.

Research questions 2 and 3 are discussed in chapter 4. Firstly, a historical background of the area of study is discussed including the area's social-economic set up. This first section of the chapter revisits the issue of land alienation and betterment planning because these issues are deemed to be at the heart of the current forms of livelihood in the area. With the aim of examining the current situation (with regard to credit accessibility in the former Ciskei), the chapter gives an account of the research design and discusses the findings of the field study undertaken in various locations of the Keiskammahoek district of the former Ciskei. Data analysis is also contained in this chapter.

Chapter 5 is the closing chapter of the thesis and its focus is mainly on conclusions. Arising from the discussion in the preceding chapter (Chapter 4), an appraisal of the research findings is done and this is followed by a section that offers a number of suggestions on the way forward with regard to ways of enhancing rural-credit accessibility for the rural poor in general but more specifically to the people living in the rural district of Keiskammahoek. The closing sections of the final chapter gives a brief outline of the limitations of the research and finally offers a few suggestions on the direction of future research in the area of rural credit.

# CHAPTER 2: THE ROLE OF CREDIT IN RURAL DEVELOPMENT

## 2.1 Introduction

Credit is arguably one of the most significant bases of capital accumulation. Mellor (1966:314) views credit as a device for facilitating the temporary transfer of purchasing power from one individual or organization to another. The act of extending credit has further been defined as a transfer of property rights on a given object (e.g a sum of money)in exchange for a claim of specified objects (e.g specified sums of money) at specified points of time in the future (Baltensperger, 1987:715). Therefore, the process would involve the lender supplying something in the current period to be paid back by the borrower at a specific date in the future. The cost of foregoing the use of money at the present moment so that the lender can extend credit to the borrower is paid up by the latter in the form of interest.

Credit provides the basis for increased production efficiency through specialization of function. Skilled farm managers with small financial resources may be brought together with those with substantial financial resources but who lack farm management ability. Such a merger may be more productive than if the two groups were working individually. The unfortunate bit however, is that as Mellor (1966:315) warns, credit may be used in a manner which is damaging to either party, and institutions for credit provision may be inadequate to the needs.

In rural areas, credit is needed for various reasons. Some people go for credit in order to be able to meet some basic needs while others require credit for entrepreneurial purposes i.e to start up small businesses or to engage in small-scale farming. It is mainly the latter group that is important for the purposes of this study. However, as will be observed below (see Section 2.2), it is hard sometimes to differentiate between credit obtained for consumption and that which is obtained for production purposes. The dividing line between the two forms tend to be quite thin especially in the less developed countries.

## 2.2 Classifications of credit

There is a wide range of credit classifications. It can be classified according to the type of borrower or lender e.g domestic or foreign, the length of repayment period (short term or long term credit), the type of security provided by the debtor (e.g a housing loan), or the use of the loan by the borrower, (e.g vehicle finance). Credit may also be secured for production purposes. Consumer credit refers to loans used to purchase items for family consumption while production credit is that which is used to purchase instruments of production.

While the distinction used is based on the nature of the article or articles directly purchased with the proceeds of the loan, it is arguably, conceptually unsatisfactory since the articles actually purchased with a loan may not represent the articles actually added to consumption as a result of the loan. The difficulty in distinguishing between consumption arises mainly because of the nature of the rural households. Among the rural poor the household is often both a unit of consumption as well as production (Mellor, 1966:315). Consequently, credit acquired for production purposes is also likely to be utilized, at least in part, for consumption.

Thus, a more useful distinction may be drawn between types of credit which are used in a manner which provides no more than maintenance of a static long-term consumption pattern and credit which allows expansion of inputs and hence an expansion in production and the income base. On the basis of such a criteria, any amount of credit that does not directly result in increased level of the recipients' output would be considered as consumption credit. This is a particularly useful concept because credit which allows an expansion of income base provides a means of easing repayment and also meets the larger policy goal of increased production and increased rural welfare.

Production credit may be used for the increased purchase of inputs (basic implements) among for instance, residents of former reserves or for new, high-technology inputs within the context of modernization and technological change. In general, within small-scale agriculture the interest rate structure tends to be made on the demand side more by the utility of consumption than by its productivity (Mellor,1966:315). On the supply side, small-scale loans high risks, and high administrative costs of consumption credit tend to drive costs up.

It may be argued that credit markets may improve the welfare of all parties involved in the transactions as well as society in general (Adams, 1984). Especially in times of emergencies, access to credit could provide a means to reduce risk. Financial intermediation can facilitate investment in large capital items such as tractors. It can enable farmers to purchase items, years before they could otherwise afford to. It may also help smooth out changes in income due to life cycles by facilitating savings during a person's productive years and opportunities to use interest during old age (Roth,1999).

### 2.3 Credit as an instrument of oppression

The general view in the less developed countries appears to be that, credit is a powerful device of oppression. Mellor (1966:316) notes that "much of the literature of protest of low-income societies deals with the peasant who has fallen into the clutches of the moneylender". Quite often, such problems arise from the borrowers' inability to stick to repayment schedules. Credit in a stagnant low-income agriculture is tendered essentially by definition in a largely modest production and income situation. Credit received therefore, tends to simply place new and continuing burdens of interest against static incomes leaving even less than before for consumption until such time, if ever, when the principal can be repaid. The heavy burden of interest and principal falls on a financially weak lot. Compounding the problem, the vagaries of weather and other natural hazards provide significant fluctuations in income around a low and critical margin, and the cultivator falls further and further into debt in order to maintain minimum subsistence.

A further problem in the low-income countries are the high interest rates which are partly blamed on high administrative costs arising from very small loans and in part from high risks. Risks to the lender tend to be great due to the low incomes and great natural hazards. The likelihood of oppression arising from these circumstances is great because of the risks to the lender and the measures he may apply to minimize those risks. The lender may find that his best chance of securing repayment is to maintain a tight control over the borrower through control of his produce and himself (Mellor, 1966 and Basu, 1997). Such tight controls provide room for unscrupulous moneylenders to be oppressive unless the farmer has alternative sources of credit. To enforce repayment, a moneylender would ordinarily be reluctant to lend to a person who has defaulted to someone else. This provides a clear basis for oppression of the borrower by unscrupulous moneylenders. This 'exploitation' arises, not so much from conscious collusion among moneylenders, or an unusual degree of immorality among moneylenders but, rather from the nature of the credit and borrowers and the resultant credit system. Ultimately, the credit system that emerges under the circumstances appears to be oppressive although it might be based on rational and legitimate factors (rational to the extent that it is based on the considerations of fairly genuine fears of default by borrowers).

### 2.4 Credit agencies

Credit in low-income countries is provided largely by private, relatively small-scale lenders. Credit is fungible, meaning that since a unit of credit from one source is equivalent to a unit of credit from another, a particular amount of credit would yield an equal amount of satisfaction notwithstanding the use it is put into and its source. This notion of fungibility is especially important in rural financing where the distinction between production and consumption is weak among poor small-scale farmers (Roth, 1999). The moneylender is most frequently a small trader who sells to and buys from farmers and extends credit as part of his operations. Frequently, he is a prosperous farmer in relative terms.

Repayment may either be in the form of money or agricultural produce. For those countries with landlord-tenant system, the former is the principal source of credit. Moneylenders tend to have a simple mode of operation. They make the loan on the spot perhaps even on an oral basis, although normally some type of note is taken. Cooperative agencies and various forms of government-backed credit agencies generally have a much more bureaucratic form of administration, placing them at a severe competitive disadvantage to private moneylenders. In general, the moneylenders operate within the brackets of the social relations established within a given community over time. Such norms of social relations may however, not be binding enough and some of the moneylenders devise their own ways of dealing with their clients.

As mentioned earlier, interest rates charged by moneylenders in low-income countries are generally regarded as being high. For instance, the All-India rural Credit survey (1957) indicated that interest rates averaged at around 20 per cent. That having been just over 40 years ago, and taking into account the fact that most of the low-income economies have been performing badly over the past three decades, it is possible that such interest rates still remain quite high, partly on an account of annual increases in the rate of inflation. For example, in Kenya, normal bank lending rates are well above 23% and depending on the bank's risk assessment of potential clients, the rates could be adjusted upwards to about 35%. This scenario has prompted a heated debate with some legislators preparing a Bill requiring the Central Bank to rein control over interest rates (Daily Nation, Special report: 2000). The high interest rates are consistent with the general understanding that there is shortage of capital and inhibitions to save which trace from low incomes (Mellor,1966). However, since opportunities for productive investment are few relative to saving capacities in rural areas, pure interest in the sense of return on money itself is relatively low in the rural sector of low-income countries. As exemplified by the Kenyan example cited above, high interest rates are explained largely by high risk and administrative costs as is true of consumer credit in high-income countries.

Although administrative costs of handling small loans are high, the low wages and salaries reduce the absolute level of such costs (because the amount of credit is generally small) but they still represent a substantial item in the cost of providing credit. Ordinarily, if average loan per farmer is low, just the process of seeing the borrowers and collecting the interest and principal takes so much time that only a small total sum of money on loan can be handled and that from that small volume, the lender must make his or her living.

In addition, the money lender faces major possibilities of losing his principal and interest. This happens because as pointed out above, he is lending to low-income persons subject to considerable income instability. A lender dealing with high-risk small loan business in the less developed countries generally experiences a high collection rate. Yet, the collection has to be done frequently otherwise, the lender would not remain in business. Successful money lenders choose their borrowers carefully and supervise carefully enough to ensure a high rate of collection. In a way, the risk is transformed into higher administrative cost through tight supervision (Rhyne and Otero, 1992).

Since it is only a modest amount of capital that is required to enter the money lending business, it can easily be done on a part-time basis by a prosperous peasant as well as middlemen. Mellor (1966:319) argues that ease of entry serves to keep interest rates in line with the costs of administration and loss from bad loans. When profit margins increase, more entries can be expected. Although rare, in rural areas with a prosperous peasant farmer class, relatively low returns to investment, traditional consumption patterns, and poor investment opportunities outside the local area, the local pure interest rate may be relatively low.

Money lending in subsistence agriculture is such that the private moneylender enjoys a strong competitive position relative to alternative agencies. Success in rendering consumer credit to low income rural people probably requires that the lender: a) Knows the community thoroughly so that he can sort out the good from the bad risks and, even more importantly, he or she knows how to manage different types of risk situations; b) have intimate knowledge of each of his borrowers so that he can work out terms and administrative procedures quickly, make the loan quickly and administer collections effectively; and c) provide constant surveillance and supervision of the loan, know changing conditions of the borrower, and adapt to those as they occur (Mellor,1966). It makes it almost impossible for a government agency operating through bureaucratic procedures based on standard rules to compete in such a business. They are more likely to compete in production credit where the risk may be lower because of the expanding income base which thereby reduces problems of selection of borrowers and supervision.

Even if the competitive nature of the market is theoretically supposed to prevent widespread exploitation by moneylenders, in practice however, individual cases of exploitation may and still do arise. Thus a sense of social justice may call for providing an alternative to the money lender. The task is, however, considerably more difficult if the money lenders are generally competitive because the alternative must operate at a comparatively high level of efficiency if it is to compete.

### 2.4.1 Cooperative credit agencies

These institutions initially play a small role in low-income small-scale farming. Particularly because of the stereotype of oppression by moneylenders, establishment of cooperative forms of credit take in a lot of effort unless such cooperatives are in prosperous trading activities. In most less developed countries, cooperatives tend to be largely administered by the government and government employees, with the rural people playing a largely passive role. Because of being initiated in what is arguably, low-income agriculture context, the success of such organizations has not been very remarkable. Some end up competing with moneylenders in offering consumption credit even though the tying of loans to production instruments may give the appearance of production credit. It is common for savings and credit organizations affiliated to co-operative societies to extend loans to their membership. Such loans although mostly sought for production purposes may not always be used for this purpose but may be used to bridge a consumption gap within a client's household. The Muran'ga farmers savings and credit co-operative society (cited in Section 2.10.3) is a case in point. It is noteworthy that this practice is not necessarily injurious to the overall objectives of such co-operative agencies although failure to balance it with prompt repayments of loans adversely affect an agency's financial base.

In addition, some of the organizations in question suffer from poor administration because they are dominated by civil servants who sometimes get transferred quite frequently. The normal bureaucracy of government operation thereby tends to have its rigidity emphasized by uninterested administration, with no mechanism for local interests to exert themselves for better administration. Farmers' interests are often further reduced by cases of fraud, favouritism, and embezzlement of funds.

Cooperative credit programs could probably be made more effective if tied to programs of technological change which generate higher returns to production and income-increasing investment. The moneylender has no traditional advantages in this type of lending. It may therefore, be argued that cooperative credit programs might better accompany or follow programs of technological change, not precede them as has been general in development programs. Credit programs tend to come too soon because they are dramatic in meeting a stereotyped problem. They also tend to be easier to organize than a program of technological change but, the envisaged advantage may be largely illusory.

However, even when cooperative credit is tied to technological change it will be competing with the flexibility and hence speed of operation of the moneylender. Moneylenders have the capability and flexibility to match lower risk and administrative costs with lower interest rates, particularly to the more prosperous farmers who begin to borrow for production purposes. Moreover, once the conditions are ripe for cooperative credit, their success will still demand training of large numbers of personnel to work with and development of appropriate organizational national or regional structures.

Other lending agencies include formal commercial banks which normally extend loans to those who own considerable assets or have a permanent formal employment. Such institutions seldom lend to poor, rural individuals. In the former Bantustans there were a number of parastatals which provided rural credit i.e KwaNdebele Finance and Investment Corporation. Such credit which is offered by parastatals is largely subsidized by the state. Rotating Savings and Credit Organizations (ROSCAS) or stokvels, traders, semi-formal moneylenders, Non Governmental Organizations (NGOs), landlords, friends and family and pawnshops also play an important role as rural credit providers. The Pawnshops make use of physical collateral that the poor can provide. Roth (1999) notes that unlike many other lenders, pawnbrokers are able to reduce the transaction costs of selling the collateral of defaulting borrowers because they have shops.

ROSCAS, although they may not be a steady source of finances for an entrepreneur who may need financial relief frequently, work well among groups of individuals who know each other well. Basically, the members gather preferably in the current beneficiary's residence and over a drink deliberate on a few matters regarding their scheme and then make pre-determined contributions to the host. At the end of the day, the host is left with a lump sum amount of money which may be enough to either start up a small business, pay school fees or even pay outstanding bills. In some instances, members start self-help projects in which case they complete whatever projects they choose, in a rotating fashion. For example, in semi-arid areas in Kenya where women are forced to walk long distances to fetch water, they have come together into groups that save funds collectively and eventually build concrete water tanks for each member.

Unfortunately, most the lending agencies that were parastatals within the former homelands, appear to have collapsed as the respective homelands crumbled under the wave of democratization and the eventual elections of 1994. The other lending agencies listed above are discussed further in Chapter 3.

### 2.5 Problems associated with extension of short-term production credit

Because of their inter-temporal nature, credit transactions tend to be quite risky. A lender can never with certainty, predict what may happen in the future and whether the debtor will actually repay the loan. The possibility of the debtor defaulting is always rife especially in micro-financing. A borrower may default not out of choice but from an inability to repay for a variety of reasons; failed enterprise, job loss or even crop failure. Whatever the reason, the implication would be that the lender must ascertain whether there is a reasonable chance of being repaid.

Generally, short-term credit does not differ greatly in its conditions from the standard conditions of consumption credit as rendered by the traditional moneylender. The timing of credit requirements for production technology is precise but there is no reason why the moneylender cannot meet these just as he or she quickly meets urgent money needs for consumption as they arise. Mellor (1966:321) argues that the special problem of short-term credit arises not so much from the problem of adapting traditional money lending procedure from consumption credit to production credit needs. The key challenge is that of providing operating procedures for cooperatives and other new credit institutions which are as suitable and attractive to the borrower as those of the moneylender.

Short-term production must be timely, must have a convenient repayment program suited to the money flows from the cropping cycle, and the procedures for obtaining it must be reasonably simple. In contrast with these needs, cooperative credit tends often to involve so much bureaucratic red-tape that few of the conditions are met. Many trips to the office may be required by the farmer, thereby making it less convenient and adding to the real cost, and quite possibly reducing the timeliness with which the credit is provided. Indeed, rigidities of procedure may force repayment patterns which do not suit the particular production cycle facing the farmer.

A further problem may arise as the government-controlled cooperative credit agencies try to mitigate against problems and risks arising from poor supervision of loans by imposing more burdensome requirements of security.

There are also some problems associated with intermediate-term credit. Intermediate-term credit can be defined as credit with a repayment period of greater than one year but not extending beyond five years. It is usually obtained for purposes of financing capital of intermediate-term life such as wells, livestock and machinery. In many respects, this form of credit poses more serious development problems than short-term credit. The main problem arises due to the fact that the finances in question would have to be quite substantial in relative terms and therefore in case the project fails, the losses would be enormous thus placing the borrower in even greater difficulties.

Not only are local moneylenders better situated to provide short-term credit, but farmers themselves are frequently in a position to save only to the extent necessary to meet their immediate subsistence needs. It is also easier to establish additional institutions of short-term credit. In any case, within the context of subsistence farming, loans of intermediate-term character tend to be less important and so local institutions are normally not well equipped to handle them.

### 2.6 Agricultural credit for small-scale farming

In subsistence farming, problems of finance and credit arise in large part from a seasonal cycle of production which is superimposed on a largely non-seasonal or steady pattern of total consumption (Mellor, 1966:310). Consequently, even production inputs tend to be required either steadily throughout the year or at concentrated periods at times other than at harvest. Therefore, provision for consumption or production inputs requires either a saving process from the past harvest or credit borrowed against a future harvest. This contrast in seasonality of production and consumption patterns, make savings and credit demands to at times be reasonably substantial relative to net income. In addition to the needs of seasonal financing, a farmer may need intermediate and perhaps even long-term financing. Land transfer in the small-scale subsistence farms generally tends to be passed on through inheritance and therefore such transfers may not require financing. In case one wants to enlarge their farm's size (either by purchase or rental), such transactions tend to be financed directly from savings rather than with credit. Enlarging ones' farm size especially in areas under communal tenure (as is the case in most of the former homelands in South Africa) may be difficult but, it is possible that with the on-going process of land reform, provisions might be made to allow for such transactions to be effected. These transactions would be more workable under conditions of individual tenure. However, it must be pointed out that as it is, the process is currently bedeviled by numerous problems (see Williams, 2000) and clear tenure systems may not be decided any time soon more so with the resurgence of the political power of the traditional leaders. The latter are generally opposed to individual tenure because it would strip them most of their powers.

A number of other capital items of long life span must be financed, including some of the simple tools of cultivation, wells and attachments for irrigation and general land improvements. Capital to be financed with an intermediate-term life span include work-stock such as bullocks, milk animals and a number of items of tools and equipment. These long and intermediate-term capital assets are also largely financed by family savings and inheritance.

Working capital and subsistence finance form another vital component of rural finance. There is also the need for credit to cushion against unusual events such as crop failure, which reduce the income of a particular year well below average. Ideally, lenders need to be more sympathetic while setting the terms for repayment under the aforementioned circumstances. Farmers who live in the marginal areas often encounter such events and the magnitude of their credit requirements may be such that they would require several years to pay off the debt thus giving this credit need some of the characteristics of intermediate or long-term credit. Such credit needs often provide the basis for oppression by the money lenders (Mellor, 1966:312).

### 2.6.1 Financial needs of technological change.

It may be argued that financial needs of technological change are quite often superimposed on the financial needs of small-scale agriculture. Initially the capital outlay for such developments is relatively small. However, such needs mount rapidly with successive technological advances. In the case of intermediate-term financing, the burden placed by dynamic development may be substantial, since requirements may be large in absolute terms and built upon a very small base i.e dynamics of demand may call for rapid expansion in milk production with a consequent financial burden of a large percentage expansion in number of dairy cattle. Moreover, a rapid growth in power requirements per unit of land in accompaniment with technological change may require large expansion of financing for woodstock, tools and equipment.

Although annual rate of depreciation of such capital may be small compared with the incomes, the massing of requirements for initial financing in a single year of acquisition may provide a heavy burden compared to annual income and existing credit facilities. Particularly where existing credit institutions are keyed largely to short-term needs, Mellor (1966:313) argues that requirements for medium-term credit may represent a significant bottleneck to development.

## 2.7 Sources of financing farm capital needs

In small-scale farming, the primary source of financing for farm capital is through direct investment from the income stream of the individual family. This happens to not only be the first resort for financing but also the dominant source. Internal financing is particularly important in low income agriculture than in a high income dynamic one mainly because: in a high-income agriculture land transfers represent a very large financing burden while they rarely occur in the low-income kind of agricultures, in the latter, a near-static technological base does not provide the basis for expanding financial needs and also the static income base does not provide the repayment basis for expanding borrowing (Adams and Vogel, 1986; Mellor, 1966).

However, if incomes are very low, annual fluctuations in income may provide recurrent crises which can only be met by outside borrowing. Under such circumstances, future income problems are compounded due to the burden of added interest, resulting in a spiral of increasing debt and declining disposable income. Such financial difficulties gradually increase the importance of external sources of financing relative to internal sources. It may eventually lead to a loss of assets, as the debt burden becomes too great to carry, and even to a change in status from land owner to landless labourer or tenant. Once this cycle of debt begins, Mellor (1966:314) notes that it becomes hard to break except through a fortuitous sequence of good crop years.

Ordinarily, small-scale farmers' savings from current incomes are determined partly by their marginal propensity to save as well as the marginal productivity of the capital in their use. A low rate of saving may be as a result of increased expenditure in the current period or due to low returns to investment. A low rate of return of investment may be related to uncontrolled risks of a weather, price or technical nature, or from basic unprofitability of available innovation. As to which one of these factors is the most limiting is always indeterminate and hence it is often unpredictable what response will arise from changing any one of the factors. What is clear however, is the fact that the returns to investment in peasant agricultures is normally low and hence low returns are likely to be an important limiting factor to increased saving and investment.

In subsistence farming, apart from the credit agencies discussed in Section 2.4, the main sources of external financing are gifts and interest-free loans on the one hand and credit on the other. Gifts and interest-free loans often play an important role in a traditional agriculture, providing a basis for transferring purchasing power from one person to another in rotating situations of crisis and need. Such transfers work mainly within family or relatively cohesive social units. As society achieves greater levels of economic development and commercialization, such forms of finance decrease in importance, while credit increases in importance.

## 2.8 Financing Rural Micro-enterprises

Micro-financing is regarded as an instrument for reducing poverty in a manner that is financially self-sustaining. Politically, it appeals to the left as being redistributive and a direct approach to alleviating poverty and to the right as facilitating the emergence of an independent self-sustaining group of people contributing to the productive capacity of a given country (Mosley and Hulme, 1996:783). Financially, institutions such as Grameen Bank of Bangladesh and Bancosol of Bolivia have often achieved higher loan recovery rates than those achieved by commercial Banks in the same country in spite of lending to poor individuals making it appear that a reliable organizational technology for lending to the poor in developing countries now exists (see Chapter 3). The same cannot be said for lower income groups which have tried to go the same way.

Elements in the technology envisaged in Grameen and Bancosol Banks of Bangladesh and Bolivia respectively are the freedom to charge interest rates which cover costs, provision of savings facilities and the adaptation of financial services to local demand through "mobile lending". Various institutional initiatives including the World Bank based Consultative Group to Assist the Poorest (CGAP), the micro-credit summit held in Washington in February 1997, as well as the Dhaka-based Grameen Trust have been taken to diffuse that technology. The initiatives are predicated on the premise that they are likely to make a large contribution to reducing the level of world poverty.

One of the implicit assumptions underlying such initiatives is that, existing technology (made possible by the organized credit micro-lending institutions) reduces poverty. The relative lacklustre performance of the poorer micro-financing institutions could be attributed to factors such as the fact that the poor are probably more opposed to taking risks. It could be argued that poor borrowers, given the choice tend to take out small, subsistence-protecting loans, seldom invest in new technology, fixed capital or even the hiring of labour but rather in working capital or in a majority of cases- protecting their consumption standards. Consequently, loans to the very poor are not normally able to produce dramatic changes in borrower income. There is also a greater risk that unlucky or improvident borrowers may be forced by their greater exposure to debt into selling assets which will permanently lower their income possibilities.

In contrast, loans to relatively higher income groups are more often used for "promotional" activities such as purchase of fixed capital and hiring of labour from outside the borrower family. This notion derives from the assumption that since the relatively well-off have enough money for their immediate consumption needs, the extra finances that are borrowed would most likely be directed to purchases of additional stock of capital. In addition, higher income families can commonly access larger loans because of their savings capacity and ability to offer collateral and this widens choice of productive investment opportunities.

Due to the volatile nature of micro-financing, financially sustainable financial institutions charge relatively higher interest rates which act as a screen to deter borrowers whose projects have low rates of return. They tend to operate savings schemes which provide a limited degree of insurance to protect repayments if projects fail to yield expected returns and serve to screen out prospective borrowers who lack financial discipline. Such financial institutions also tend to collect loan instalments frequently or from close to the borrowers premises and this tends to deter borrowers with projects yielding low returns. However, it is the astronomical levels of interest rates that generate the most controversy in micro-financing. Ultimately, the main concern is about those poor members of the society that may not be able to pay such high interest rates. Yet, because their choices are very limited, they inevitably have to borrow the expensive capital from the said lenders. This issue of risk and the attendant high rate of interest is discussed further, in the section below.

## 2.9 Theoretical explanations for the persistence of high interest rates

### 2.9.1 Default risk

It is generally acknowledged that micro-lenders charge significantly higher rates of interest than experienced in any other form of lending. But why is this the case? And why do the rural poor still take up such loans in spite of the high costs? Basu (1997:269) outlines a persuasive theoretical explanation first articulated by Mckinnon (1973) and Shaw (1973), of why lenders in the informal rural credit market continue to enjoy a very high rate of interest and why the commercial banks fail to take advantage of such a market. The two authors (Mckinnon and Shaw) strongly advise against government's imposition of ceiling interest rates in the micro-finance credit market. They argue that the ceiling on interest rates not only distorts the functioning of the credit market but also helps large borrowers to obtain loans at a subsidized rate.

Thus, they argue that the ceiling on interest rates which is initially imposed on banks and which is based on the idea that smaller and poor borrowers would receive loans at a cheaper rate soon becomes counterproductive. Thus the ceiling on interest rates itself prevents the smaller and poorer borrowers from entering into the orbit of the organized money market. This happens because the envisaged requirement does not permit banks to incorporate into the calculation of the interest rate the additional risk and administrative costs that are involved in each small loan and as a result the ceiling itself reduces bank's incentive to lend to those borrowers who offer higher risk.

As a result of such a regulation, banks advance loans only to those who offer lower risk and better security which implies that only the rich industrial class and wealthy landlords receive loans at a cheaper rate than would have been without the ceiling, leaving the poor borrowers to seek loans from the unorganized and expensive credit market. Removal of such a ceiling would therefore, allow banks to incorporate extra loadings that are associated with the additional risk and the extra transaction costs that are involved in small loans. This would eliminate the bank's disincentive to loan to small and poor borrowers.

The above argument rests on the concern over the risk of default by potential borrowers. But, can the default risk be offered as the reason for persistence of high interest rate? Basu (1997) argues that the combined effect of the default risk and the excess demand phenomenon (or the monopoly power) should increase interest rates to a high level, and thus it is necessary to examine how these higher rates will compensate for the resulting additional risk. As underscored elsewhere in this study, the lender always has to contend with the uncertainty of loan repayment by those he lends money to, especially with regard to micro-finance. A distinction can be made between risk and uncertainty. While the former is calculable to its precise magnitude, the latter is not possible to calculate. The two arise because there is a time difference between the advancement and the repayment of loans and during this interlude the borrower's situation may alter and this may force borrowers to default on loans.

Recognition of the risk factor implies that every lender, whether a banker or private moneylender must calculate the probability of default risk of their borrowers. This would allow the lender to decide whether to advance a loan and also to determine the effective interest rate. Suppose a lender advances a loan of $L_0$ with the anticipation that the borrower will at some future date return $L_1$ amount where $L_1>L_0$. The lender, on the basis of this promise from the borrower advances $L_0$ amount of loan.
$L_1>L_0$ because of the interest rate r
i.e $L_1=(1+r)L_0$ where r is determined by :

$$r = \frac{L_1 - L_o}{L_o}$$

Above is the interest rate that the lender expects to receive when the default risk is zero. In the presence of default risk the actual interest rate is referred to as the effective interest rate that a lender would receive and it may deviate from the quoted interest rate that a lender would have received since there remains a possibility that a portion of the loan will not be repaid (Basu, 1997:270). It follows therefore, before disbursing the loan, a lender would have to calculate the probability of occurrence of this fraction and incorporate it in the interest rate. If there exists the probability $\pi$ that a fraction of the loan $q$ may not be repaid (meaning that an amount of $\pi q$ may not be repaid), then the actual amount a lender will receive i.e $L^*$ may deviate from $L_1$ . We can therefore write,

$$L^* = (1 - r)\,(1 - \pi q)L_0.$$

However, Basu (1997) argues that there is no plausible reason to suppose that removal of interest rates ceiling would attract commercial banks to engage in micro-financing especially in the rural areas because however high the level of interest rates, there is always a substantial portion of the loan that would remain unpaid. It is also highly unlikely that a rural lender would benefit from such a high interest rate. Quite clearly, Basu's argument rules out either the default risk or the combination of default risk and the excess demand phenomenon and even the monopoly power as explanations of why interest rates are high in the rural areas.

### 2.9.2 Lenders' monopoly power over borrowers

The other argument that attempts to explain the reason for the persistence of high interest rates in the rural credit market is that which attaches the existence of the phenomenon with monopoly power of lenders over the rural borrowers. One of the main proponents of this argument was Bhaduri (1973) who formulated a model in an attempt to show the source of landlords' monopoly power to extract surplus from tenants. This belief influenced the establishment of the institutional credit agencies to counteract such power especially in India.

However, such agencies appear not to have been very successful and the question is whether their failure can be attributed to corruption among the administrators of the agencies or to the fact that the belief was based on inaccurate analysis which alluded to a peripheral variable. Bhaduri's model depends on whether it is able to portray precisely the relationship that prevails between Landlords and their tenants which can give rise to the monopoly power of the lender over the poor borrower. Bhaduri (1973) carried out a Survey of 26 villages from the Eastern region of India in which he divides the landlord's incomes into two parts; that which accrues from leasing out their land and the other from lending activity.

Both forms of earnings come from the tenants that the landlords have leased their land to. At this point, Bhaduri interlinks two markets; sharecropping and the credit market and advances the argument that given the output, any changes in tenancy legislation that attempt to improve the tenant's well-being, can be counteracted by landlords merely by changing the interest rate (Basu,1997:271). Such changes in the interest rates would partly serve to maintain the status quo with regard to the landlord-tenant relationship. However, Bhaduri concentrates mainly on the consumption loan which is largely in the hands of landlords, and thereby isolates the loan market which is in the hands of professional moneylenders.

Peasants tend to borrow during the lean season (just before harvest) when there is widespread food shortage. Landlords would then set the interest rate in nominal terms, but the interest rate in real terms deviates significantly from the one in nominal terms mainly because the price of food varies between pre-harvest and post-harvest periods. Most loans are advanced just prior to harvesting period when the price of food is high and the contractual terms are such that loans should be repaid with interest immediately after harvest when food prices are very low. It is therefore, according to Bhaduri (1973), the price difference between the two periods that pushes up the real interest rate.

Bhaduri's analysis is however, faulted because of his failure to distinguish the two markets that he cites. The close linkage between the sharecropping and the credit markets gives rise to the political power of the landlords as a group in the village community. He further argues that technological change leading to increased production of paddy would eventually benefit the tenants and diminish the political power of the landlords. He therefore overlooks the possibility of the landlord changing the sharecropping arrangement as output of paddy increases.

Moreover, as Basu (1997) points out, one does not even require an interest rate to make the poor borrowers perpetually indebted since their wages barely cover the minimum subsistence level and just advancing part of the wages in terms of the loans would be sufficient to make them indebted. This counteracting argument by Basu also appears to miss the mark in that, it fails to appreciate the connection between indebtedness, risk and high interest rates.

There is still an on-going debate with regard to the nature of the rural credit market. Is it monopolistic as Bhaduri (1973) appears to be arguing? While the high cost of its capital would lead one to believe that the market is indeed a monopolistic one, it would appear like there is a relative ease of entry in some cases - a feature that runs counter to the core underlying assumption of a monopolistic markets. Moreover, arising from our analysis, it is actually not feasible for individual moneylenders to unilaterally raise interest rates because borrowers are likely to look for a moneylender charging less. Again, the assumption that in a monopoly the 'firm' is a price-maker is also violated. In such a case where contending lenders are competing for customers, then the market may take the form of a perfectly competitive structure which, in theory, is supposed to bid interest rates down. However, if a potential incentive to collude exists, the market may be viewed as more of an oligopolistic type rather than the two types explained above. Generally, a market is considered to be oligopolistic if it consists of a few sellers of a given commodity. The implication is that such sellers can *inter alia* be able to arrive at a tacit agreement on pricing of the commodity to the detriment of consumers. In our case, the lenders would be able to collude in order to charge high interest rates for their funds.

## 2.10 Case Studies of Rural Credit schemes

### 2.10.1 The Grameen Bank

There are numerous successful rural credit schemes in various parts of the world and especially in Asia. Perhaps the most well acknowledged one is the Grameen bank in Bangladesh. In 1994, after 18 years in business, the bank had 1045 branches, serving more than 2 million clients (Khandker et al.,1995:82). The institution's profit expectations are very modest and generally, the shareholders (80 per cent of whom are borrowers with the state holding a stake of 20 per cent) comprise mainly the rural poor.

The Grameen bank sets interest rates to cover operating costs, resulting in high positive real lending rates and positive returns on assets. However, it has achieved a debt recovery rate in the range of 98 per cent which come from its poor landless clientele spread over more than 34,000 villages (Jain,1996:79). Approximately 95 per cent of Grameen's beneficiaries are women- a phenomenon that is most probably as a result of the expectation that women would be more honest and amenable to the rules that govern the transactions of the Bank . The bank emphasizes service quality over subsidy in the cost of credit, in line with emerging consensus about effective rural credit for the poor (Yaron, 1992; Desai and Mellor,1993; Adams, Graham and Von Pischke, 1991). The delivery mechanism which takes credit close to the poor borrowers and the large outreach of the bank, with emphasis on coverage of poor landless and women, are therefore identified as important factors behind the bank's success.

The bank has had a very positive impact on the welfare of the poor through its support to new viable economic opportunities. Its positive real interest rate, moderate subsidy dependence and encouragement of savings through compulsory savings programs have also been highlighted as some of the factors that have ensured the banks success. However, the most remarkable aspect of Grameen bank's operation has been its high loan recovery rate as noted earlier. This has contributed to the bank having a low cost of credit (net of cost of transactions and bad debt), and has attracted low-cost funds from the government and the international donor system. The bank operates under a unique policy having discarded the traditional financial collateral with social collateral, by making a group of five borrowers responsible for the repayment of each other's loan (Jain, 1996). This is probably one of the most important determinants of its success.

By lending only to borrowers organized in small groups who assume collective liability for repayment of loans, Grameen bank succeeds in solving the screening, incentive and enforcement problems associated with micro-entrepreneurs. However, the view that Grameen bank replaces traditional collateral (as argued above) with social collateral has been challenged by Jain (1996). He argues that in practice the bank does not enforce its policy of making the members of groups jointly liable for repayment of loans. Rather, the low default rate of the bank is as a result of "a combination of several organizational policies which were designed to steer organizationally the behaviour of its large number of functionaries and borrowers along a credit-responsive mode" (Jain, 1996:14-17). Jain's view notwithstanding, the effectiveness of social collateral in enforcing loan repayments among a more or less homogeneous rural group has been found to be remarkable in its success in various places including the case study cited in Section 2.10.2. The bank has also registered success in limiting costs by among other things, restricting the number of services it offers (ensuring that its efforts are not too thinly spread), decentralizing decision-making and limiting paperwork. By locating close to its client base, Schoombie (1998:7) argues, the bank has been able to reduce its overall transaction costs.

### 2.10.2 Faulu Kenya

Organized in almost a similar manner as the Grameen bank although at a much smaller scale is the Faulu Kenya programme. *Faulu* is a Swahili word meaning 'succeed' and the organization's prime mission is explicitly spelt out in its slogan 'enabling people to succeed through small business loans'. The organization runs a loan programme seeking to empower small business owners to expand their businesses, so that with increased income they can meet their development needs and those of their families.

Since its inception in 1992, the organization has extended over 6,200 loans amounting to about Ksh. 97million (R10 million) with a remarkable repayment rate of 100 per cent. This is a unique kind of success considering the risks involved in micro-financing. The loan clients often experience large growth in their businesses. As a result, the programme not only helps to improve its client's income but also helps create more jobs through the multiplier effect.

The programme observes quite a simplified entry criteria. One has to be a Kenyan citizen, be over 18 years old, be a small business owner e.g shop-keeper, vegetable seller, carpenter, welder, black-smith, tailor, butcher, hairdresser etc, and the business must have been operational for at least six months or if one intends to start a business, he or she must be guaranteed by other experienced members of the group.

Faulu makes business loans to people who belong to groups that meet regularly. Although the organization prefers working with groups of approximately 30-40 people, group sizes can vary from 15 to 60 or more. The groups comprise individuals who are already involved in small businesses and are at least able to break-even (cover costs of their operations and at times register some modest profits). The group members guarantee each others' loans and are able to receive loans through the following programmes:

1. *On-lending Group.* Cohesive groups that have experience in savings and lending to their members can access Faulu loans as On-lending groups. Faulu makes one loan to each On-lending group which then on-lends to its members according to their business needs. The groups may meet either weekly or monthly depending on their cohesion and management skills. They generally make their loan repayments at regular agreed periods. For applicants without credit management skills, Faulu facilitates training to ensure that the loans will be effective and in tandem with the organization's prime objective as stated earlier.

2. *Solidarity Group.* More recently formed groups that do not meet the criteria of entry as On-lending groups, (especially the credit management aspect) are incorporated into 'solidarity groups'. Faulu handles the loan tracking through individual loans officers while the group is given the requisite training which would help it to progress to eventually become an On-lending

group.

It is worth noting that the groups do not work as easily as indicated above. Whereas the first group (*On-lending*) comprises of more seasoned borrowers and seasoned business persons with a reasonable probability of succeeding in their ventures, the latter (*Solidarity*) group basically comprises of starters some of whom may not necessarily be committed. For more or less obvious reasons, the failure rate is more pronounced among the ventures that are undertaken by members of solidarity groups.

Besides loans disbursement, Faulu also offers its clients learning modules on a variety of topics to meet their needs i.e techniques of better business management, preparing business plans, marketing one's business and book-keeping among others. Although most of the organization's activities are concentrated in an urban area, the programme can also be applied in rural trading centres provided markets in such areas are stable throughout the year. Seemingly, a form of micro-lending so organized may have the potential of being replicated in rural areas of South Africa especially in areas where people receive regular remittances in the form of pension and other earnings.

### 2.10.3 Murang'a farmers savings and credit cooperative society.

The cooperative society is located in a rural district in the Kenya highlands. It was initiated by the government with the aim of making the average small-scale farmer benefit from procurement of loans and resources that would help increase his or her farm output. Its membership includes members of registered marketing societies that would pay the farmer through the society, employees of the cooperative society, Tea or Coffee growers, milk farmers etc. Shareholders comprise the class 'A' members and they would normally be required to have a minimum of 100 shares at Ksh100 (R10) each. All the shareholders enjoy the right to vote during the Annual General Meeting. Business people who only get banking services from the Society pay ledger fees and other levies which serve to boost the societies' funds. However, such business people are not eligible for loans.

Extension of a loan requires the applicant to produce a document that the co-operative society refers to as a 'certificate of production'(i.e Coffee or Tea) which must be signed by the relevant officers at the factories. This ensures that only genuine farmers are granted the loans. Such loans tend to serve a variety of needs such as school fees, Coffee and Tea picking labour, hospital/medical bills, famine relief, working capital etc. There are also development loans for ventures such as building houses, water tanks among other things.

The cooperative society charges a relatively moderate interest rate of 16 per cent and a member gets one and a half times the monetary value of his/her shares. The repayment is strictly 6 to 12 months and a farmer can clear one loan and apply for another immediately. To mitigate against the default risk, the cooperative society demands that each applicant gets two guarantors (also members of the Society) whose assets and those of the applicant are traded in to recover the loan in case of repayment problems. Shares, Coffee and Tea bushes and Title deeds are some of the mostly used items as collateral.

In the event of using the loan money for other activities other than the one in the loan form, a borrower may incur an early re-call of the loan although this rarely happens. Each applicant is also liable for a small loan handling fee. The target group for this lending institution is purely farmers. However, since the level of output partly determines the amount of loan an individual farmer can apply, the lending procedure tends to benefit the more progressive peasant farmers. This serves as a disadvantage to those who hold relatively smaller pieces of land.

The cooperative society also holds educational workshops for its membership and also organizes in-service courses for the farmers. Among the challenges facing the Society are; adverse effects of the liberalization of Coffee and Milk markets (although there are more players in the market, such societies are assuming more business-like activities that are not necessarily consistent with the needs of the membership), misuse of loans by some farmers, intermittent slumps in output which affects loan repayments, the small sizes of the farmer's holdings, political incitement leading to destruction of Coffee bushes, non-payment for the farmer's produce by government agencies among other problems. It must however, be pointed out that the cooperative society has been able to transform the livelihoods of its rural membership and in doing so, contributed to rural development in Murang'a district. It is unlikely that any commercial bank would have been willing to extend credit to the small-scale farmers in the region due to the volatility of such ventures.

As pointed out in Section 2.10.3, the crucial question that arises from the three case studies is; can such specialized micro-lending institutions be replicated in South Africa and especially in Keiskamahooek district, our main case study in this thesis? To what extent are they applicable? These questions will be considered further in chapter 4 which deals with rural credit accessibility in the aforementioned district of the Eastern Cape.

### 2.11 Conclusion

From the preceding analysis, it may be argued that establishment of efficient forms of rural financing is a vital aspect of rural development. Consequently, appropriate policies need to be effected to provide rural households with incentives to save (the proceeds arising from either small-scale farming or micro-enterprises) and make it possible to use such savings effectively to promote development. Accumulation of savings would enable potential entrepreneurs to have some start-up capital and make them more credible to the lending institutions. It is also clear that commercial banks tend to largely steer clear from micro-financing especially in rural areas as a way of hedging against risk. The high interest rates charged by moneylenders to rural borrowers are viewed as necessary in order to ensure effective screening of the borrowers. Ultimately, its only those who desperately need the credit and have the ability to repay, that would go for it. However, the problem with this idea is the fact that the high interest rates could actually end up keeping off the more serious and risk-conscious borrowers. In the event of this happening, a real possibility of invariably attracting potential defaulters is enhanced.

Low interest rates discourage savers by reducing the attractiveness of intermediated financial assets which would tend to diminish availability of loanable funds to those willing to obtain credit for productive ventures. Low interest rates also encourage the diversion of borrowed funds to consumption purposes. Interest rate ceilings force lending institutions to ration borrowers. Increased collateral requirements and reallocation of transaction costs to borrowers are often used as substitute rationing mechanisms. It may therefore be argued that with a positive real rates of interest policy, the imperfections in the rural credit market may be redressed and this could lead to increased savings and investment which would in turn enhance the borrowers' credibility..

The detailed account on the risks and transactions costs involved in rural financing provided in the previous sections point out to the possible reasons for the failure of many attempts to establish sustainable micro-lending institutions in many low-income countries. It should be noted, however, that there are those institutions that have been able to come up with relatively effective and sustainable lending mechanisms. Such institutions have been able to establish them selves because of being able to mitigate the risks and reducing their transactions costs through among other things, utilization of insurance (i.e borrowers obtain crop insurance), interlinking credit transactions with other transactions in order to establish a firm lender-borrower relationship, utilization of credit guarantees and third party references.

In the next chapter, the focus of the study will be on rural credit specifically in South Africa. It is hoped that an analysis of the pre and post-1994 period with regard to rural financing would help to place the discussion on Keiskammahoek into proper context. It would also serve to enhance our understanding of how the national policies with regard to matters of rural credit impact on the target areas.

# CHAPTER 3: RURAL CREDIT IN SOUTH AFRICA

## 3.1 Background

It is quite difficult to treat the issue of credit extension in isolation from the unique historical context of South Africa. Economic activities and all forms of capital accumulation in general were to a large extent influenced by a set of laws and policies that were essentially discriminatory on a racial basis. Consequently, most of the pre-1990's government policies were geared towards not only to the marginalization of the black section of the South African population but also to systematic dispossession of crucial means of production that would offer some hope of the emergence of a black propertied class. It was a process whose formal angle took a turn with the numerous pieces of land legislation starting with the 1894 Glen Grey Act. The passage of this particular Act, Mloughlin (1936:35 in Hendricks, 1990) argues was intended to lead to proletarianization of the African peasantry. Its chief motive was not the development of an enterprising African peasant class but first and foremost the mobilization of labour. Keegan (1987:18) points out that by the 1890s the peasant producers of Basutoland had become so successful that they were posing a real threat to the Boer farmers. This prompted the latter to petition the government to intervene and assist them.

Subsequent land policies enabled by various Acts of parliament reflect a continuation of the envisaged policy under the Glen Grey Act. Indeed, numerous attempts were made in the years that followed the passage of the Glen Grey Act of 1894, to consolidate not only segregationist policies but also to dispossess increasing numbers of Africans of their land holdings and to drive them into forced labour to serve the needs of the white capital. While the colonial government was impoverishing the African people and constraining their development, their white counterparts were able, especially after the Anglo-Boer war, to commercialize their agriculture through subsidies, grants, transport concessions, favourable credit facilities, tax relief and the availability of African labourers (Bundy, 1979:116 in Hendricks, 1990). The implication was that even the aspiring black farmers and entrepreneurs found themselves heavily constrained by legal provisions that criminalized such aspirations among the African people.

Keegan (1987) further argues that the development of capitalist agriculture rested mainly on the state support in terms of providing a labour force which implied undermining black productive independence and also the sharecropping economy where black farmers had been quite successful. Indeed, survival on the land was reliant on cushioning by the state against the destruction of capital resources. Thus, the initial capitalization of white farming was largely dependent on a high level of state interventionism.

### 3.2 Differential rural-financing in pre-1994 period

Perhaps one of the most important and significant interventions of the capitalist state was in the institutionalized provision of loan capital, thereby providing a more sympathetic, flexible and reliable alternative that prevented the beneficiaries from resorting to private capital providers. Land banks were established in the Orange River Colony (ORC) and the Transvaal in 1907-8, and were superseded by the Union Land Bank in 1912. The establishment of land banks whose facilities were available to whites only in the new colonies coincided with the transfer of responsible government to local whites (Keegan, 1987:112). The colonial authorities were increasingly yielding and exemplifying their firm commitment to a capitalist and white-dominated rural economy. There were apparent and deliberate moves towards the entrenchment of state-motivated differential financing on the basis of race. Consequently, in the years after the formation of the Union, there was greater liquidity in agrarian commerce and more generous provision of even private loan capital.

The sudden influx of loan capital into the countryside after the Union was followed by a sharp increase of commercial activity. However, the heavy borrowing that followed as well as post-war (first World war) depression led to indebtedness and relative poverty among some of the white farmers. The easiest target in a bid to find the solution to the problem at hand then was to impoverish the African people further through further alienation of their land and prohibition of sharecropping and labour tenancy. This policy was enforced through the passage of the Natives Land Act of 1913. The said Land Act was aimed at stifling the independent black tenant farmers.

In general therefore, Keegan (1987) suggests that the accumulation and eventual monopolization of capital resources by white farmers necessarily went hand in hand with the process whereby a black labour force, dependent on selling its labour in order to survive was created, maintained and controlled. The result was the creation of a white-supremacist rural economy which was fully state-backed. Under the circumstances, rural financing was skewed in favour of the white farmers and white entrepreneur class in general. It was only after the formation of the much discredited quasi-independent homelands that state-sponsored financial institutions were established with the aim of extending credit to the rural poor.

Within the urban areas, Simon and Birch (1992:1030-31) argue that with the intensification of segregationist policies and ultimately the enforcement of apartheid from 1948 onward, the level of official harassment and persecution increased drastically. The imperative of total white domination sought to ensure that Africans remained temporary sojourners, tolerated only as long as their labor power was needed by white capital and in domestic service.

The capacity of black businesses to compete with those of white capital was greatly diminished. Under the Group Areas Act of 1950, for example, it became illegal for Africans to own or operate businesses in "native locations", while during the 1960s, the department of Bantu administration prohibited the zoning of land within African townships for industrial purposes. Consequently, innercity slums and nearby townships were summarily demolished and the inhabitants removed to the bantustans or, if they qualified to remain in the urban areas under the pass laws, to new planned and strictly controlled areas far away from white suburbs (Simon and Birch, 1992:1031).

It may be argued therefore that the differential provision of credit on racial basis derived mainly from segregationist policies of the state which were institutionalized through the various Land Acts beginning with the Rhodes-crafted Glen Grey Act of 1894. This policy of segregation became even more prominent with the coming to power of the Nationalist Party in 1948. It is important to note that though the African people could not qualify for credit offered by formal lending institutions, there were numerous informal lenders (including associations such as Stokvels) that tended to fill the gap. However, lending from such sources as can be expected was largely (although possibly not entirely) for consumption purposes and not for investing into productive ventures. The focus of this study is mainly on micro-lending for purposes of investing in farming or small enterprises. In the next section therefore, a detailed discussion of the credit situation in the post-1990 South Africa will be carried out.

### 3.3 Current situation with regard to rural financing

The democratization of South Africa following the 1994 elections has gone through various phases. One of the most critical areas where special attention was needed and still continues to be needed is in poverty alleviation. Although among the African people there is endemic poverty even in the urban areas, some of the most affected people are those in the rural areas and one way of assisting them to gain a capacity for self-reliance is certainly to empower them with means of production. To this end, the financial sector still has a critical role to play. There have been calls for the financial sector to open up traditional banking services (deposit and credit facilities) to micro-enterprises, enterprises that consist of self-employed owners, some family members and at the most one or two paid employees, typically operating in the informal sector of the economy (Schoombee, 1998).

Arguably, the informal sector, individuals and micro-enterprises whose economic activities are not fully reflected in the official economic statistics is one of the main sources of employment for many black households. It is estimated that 67 per cent of all black households live in poverty and 44 per cent of the potential labour force of whom 83 per cent are black, cannot find employment in the formal sector. Lipschitz et al, (1995) and Terreblanche, (1995) argue that the informal sector has managed to "employ" an estimated 12 per cent of the potential labour force. This would imply that the sector has a potential to generate further job opportunities for the unemployed.

Prime among the major constraints faced by micro-enterprises and even small- scale commercial farming is the lack of financial facilities (Riley, 1993). By 1990, the share of blacks in formal credit and hire purchase advances was only 5 per cent while their share of income and population was 36 and 70 per cent respectively. As recently as the mid-1990s, the Reserve Bank estimated that 60 per cent of the South African population remains un-banked (Wiese, 1996). With the lack of formal credit, most blacks have been forced to rely on the semi-formal and informal financial sectors, intermediaries operating outside the ambit of various financial regulatory authorities. Lipschitz et al, (1995) estimate that informal group-based rotating savings and credit associations (Roscas i.e Stokvels, locally) have been responsible for about 40 per cent of total credit advanced to blacks. As noted in Chapter 2, commercial banking sector or the formal financial institutions tend to avoid extending credit to low-income earners, especially the rural poor due to the risks involved. In South Africa, until the end of 1992, banks were discouraged from lending to micro-entrepreneurs due to low usury rate ceilings in comparison to the costs involved in serving this market segment.

Informal financial intermediaries must continue to play an important role in the informal sector. However, it is quite clear, considering the supply conditions, that micro-enterprises demand for credit cannot be fully met by informal financial institutions. Furthermore, micro-enterprises are not only interested in credit but also in deposit facilities. This is partly the reason why formal financial institutions need to play a more prominent role in rural and micro-financing in general. They must serve micro-entrepreneurs because as Schoombee (1998:1) observes, governments are not suited to undertake these retail functions. It is further argued that a recent commission of inquiry into the provision of rural financial services in South Africa stated that Provincial Development Corporations are high cost providers of a limited range of financial services to a limited number of black entrepreneurs. Their average loan size is large, reflecting either an affluent clientele or project lending. "Outreach is limited and the subsidy cost to the state of these institutions is unsustainable" (Strauss Commission, 1996:54).

In the White Paper on National Strategy for the Development and promotion of Small Business in South Africa, the government acknowledges the scarcity of public resources available for small business support (RSA, 1995) and emphasizes that preference will be given to policies which strengthen small business access to private resources.

Like elsewhere in the world, South Africa's formal lending institutions' failure to serve the rural poor and to micro-entrepreneurs in general is due to a combination of high risks, high costs and low returns associated with such business (See Chapter 2). However, besides the obvious hurdles faced by rural borrowers anywhere else in the world, the problems of those in South Africa are compounded by racial prejudice which has absolutely nothing to do with rational business considerations. To offset the perceived high risks, bankers screen potential borrowers to ascertain the risk of default, devise incentives for borrowers to fulfil their promises and develop various enforcement actions to ensure that those who are able to repay do so (Hoff and Stiglitz,1990:237). This is a costly and difficult task to undertake especially while dealing with micro-entrepreneurs. Lack of accurate information often leads to information asymmetries between borrowers and the lenders.

To mitigate against such asymmetries, banks demand collateral from their clients. However, the rural poor and micro-entrepreneurs lack such collateral. Consequently, banks set interest rates at a high level in order to 'bar undesirable' clients and hedge against the high risk exposure. Even when they charge high interest rates, banks are still reluctant to provide credit to the rural poor (Besley, 1992: 7-11). This would be in line with the assumption that beyond a certain level of interest rate, then, a lending institution can only attract potential defaulters. 'Serious' borrowers are averse to excessively high rates of interest. The latter group of borrowers rationally weigh their risk-return possibilities and base their decisions purely on the expected returns from a given investment. If the cost of capital is deemed to be too high relative to expected returns, the borrowers opt out of the transaction in a bid to stave off possible losses. The cost of capital is signaled by the behaviour of interest rates .

On their part, micro-entrepreneurs also incur substantial costs in the form of transportation costs, time taken to undertake trips to the bank which may be quite a distance from where the borrowers reside. These problems and costs tend to put off the rural poor who may also feel intimidated by the 'bank's environment and the paper work that may be involved in such transactions. Under the circumstances, even in the new South Africa, many poor people needing credit turn to the informal lenders. The latter are able to successfully attempt to circumvent the aforementioned problems by using what Schoombee (1998:2) views as innovative technics to minimize information and transaction costs. Citing the example of the practices of Roscas (informal group-based rotating savings and credit associations - also known as stokvels in local parlance), Schoombee (1998) avers that informal lenders have developed innovative forms of collateral. Rosca members have a strong commitment to save because future borrowing depends centrally on members past savings record. This incentive disciplines them and acts as a self-regulating mechanism to eliminate those lacking the requisite commitment to repay future credit.

Since the commitment to repay is regarded as being less than the commitment to save, Roscas successfully solve the problem through strict screening of members (who are usually well known to each other), provision of a strong incentive to honour commitments (the possibility of being 'banished' from the group), and by encouraging members to monitor each other (a collective responsibility borne out of the understanding that if a member defaults, all of them suffer). Though enforcement of such discipline (loans repayment) is not always easily done, "social collateral" appears to be quite significant as a measure of creditworthiness. It also controls the informational costs.

### 3.4 Micro-lending in South Africa

Although formal banks tend to shun the informal sector in South Africa, it is argued that this does not necessarily imply a similar level of scarcity with regard to deposit and credit facilities. This is because other informal intermediaries have increasingly moved in to close the gap. Stokvels are one such informal credit institutions. They are basically group-based rotating savings and credit associations operating in the informal sector.

Schoombee (1998) argues that in terms of number of clients, stokvels are the most important informal financial intermediary. They are estimated to have over 10 million members out of a population of 40 million. While these figures could be a bit off the mark, a more reputable view has been advanced by Mills (1993), that more than one third of the black population over the age of 16 years in major metropolitan areas participates in stokvels. Although reliable data on stokvel activities in rural areas is largely non-existent, the Strauss Commission (1996:64), has pointed out that case studies do indicate that stokvels exist in most of the rural settlements.

The main inhibiting factor to these institutions is that they cannot loan funds in excess of what their members save. For them to increase the amounts that they can lend, members' savings will have to increase appreciably. The propensity to save is in turn hinged on the level of income and therefore the latter must increase first. Except in cases of a sustained bumper harvest in several consecutive seasons, or another source of cheap funds, the rural poor may not be able to experience the requisite increase in income.

Apart from the stokvels, there also are credit-granting non-governmental organizations (NGOs). They gained importance world wide in the 1980s as vehicles of delivery of development finance. They cashed in on the failure of traditional development finance which places lots of emphasis on financing large scale infrastructure projects through a Development Bank, to significantly reach the poor (Schoombee, 1998). The emphasis now shifted to funding programmes that more directly benefitted the poor. Donors concluded that given their commitment to social-welfare goals, their non-profit orientation, their closeness to the community, and their high levels of motivation, NGOs were best placed to deliver such programmes. The main focus is on the creation of financially sustainable institutions aiming at providing micro-entrepreneurs with both credit and deposit/saving facilities. Schoombee (1998) refers to this strategy as the financial systems approach to development finance.

He further argues that local credit-granting NGOs do not play as important a role in credit delivery to micro-entrepreneurs in South Africa as in most other developing countries such as Bolivia, Bangladesh and Indonesia. To confirm this conclusion, he argues that two recent studies on various credit-granting NGOs commissioned by the Development Bank of Southern Africa and Khula Enterprise Finance, found that they had less than 24000 clients and that they faired poorly in regard to financial stability (DBSA/ Khula, 1997). Therefore, in general, their outreach is quite limited if a comparison can be made between the number of people they serve against the millions who constitute the potential market. They are also legally constrained from taking deposits.

It is probably the latter legal inhibition that constrains NGOs from playing as an effective role in South Africa as their counterparts in other countries. It may be argued therefore that, an amendment of the legislation to allow NGOs to accept deposits would yield positive results as far as rural financing is concerned. This is because firstly, micro-entrepreneurs demand this service. Secondly, for them to become self-sufficient financially, NGOs need to take deposits. The Strauss Commission (1996:40) observes that there is frustration among NGOs over this legislation and it could very well be contributing to such NGO's financial weakness which impacts negatively on their capacity to extend credit to the rural poor.

It is for this reason that the Commission (1996:20) recommends that the legislation be amended to allow NGOs to accept deposits. The Commission further proposes that the NGOs be added to the two tier banking system (banks and mutual banks) as a third tier. They should be allowed to do so without being subjected to the stringent and often costly requirements which apply to the other two tiers. This proposal might however, become attractive even to the current mutual banks which may prefer to operate within the third tier in order to off-set some of the requisite costs of remaining in the second tier. The other option is for such NGOs to actually turn themselves into 'banks' although this could be a bit premature. Schoombee (1998) points out that PRODEM, a Bolivian NGO has been able to successfully turn into a bank - BancoSol. However, the same cannot be said with regard to the transformation of Corposol - a Colombian NGO -into Finansol (Chu *et al,* 1996).

### 3.5 The Position of Formal Lending Institutions

As noted in Chapter 2, there are examples of specialized banking institutions that have registered a remarkable success in micro-financing i.e the Grameen bank of Bangladesh......by literally *"walking bare-footed where bankers fear to tread"* in the words of Ghate (1992). The question remains as to whether South African banks can actually emulate such examples and build up capacity to undertake out similar activities for the benefit of the rural people who are either actual or potential micro-entrepreneurs.

It is worth noting that among the four major banking groups in South Africa, Nedcor, Standard and ABSA have recently commenced new divisions to serve the un-banked sector in the economy while the fourth, First National Bank opted for a linkage scheme with stokvels. However, as Schoombee (1998) observes, these initiatives do not specifically target micro-entrepreneurs, but rather attempt to serve low income, but salaried blacks. Nedcor's Peoples bank and Standard Bank's E-Bank, are examples in this regard (Schoombee, 1996). In spite of the relatively low risks in this venture, the banks have not achieved much success. The fast growth of the 'formal' section of the micro-lender industry (those belonging to the Association of Micro-lenders) which numbers 1200 operators with approximately one million clients and an annual turnover of at least R2,5 billion (Du Plessis, 1995) is evidence of this.

To qualify for a loan from the Association of Micro-lenders, among other thins, the applicant has to present at least three month's current wage slips, has to have an active bank account which has been used for at least three months and must own an operational card. The fact that a client of a formal bank with stable employment in the formal sector of the economy has to approach micro money-lenders for a loan does not reflect favourably on bank's commitment to serve this section of the community (Schoombee, 1998).

ABSA's NuBank adopts a different strategy from that adopted by the People's Bank and E-Bank. It aims to serve that segment of the market traditionally regarded as unbankable, those earning less than R1400 per month, and the small self-employed. This group of the unbankable is further divided into deep rural (earning less than R500 per month in sparsely populate areas), rural transitional (earning between R500 and 1400 per month in relatively populated areas) and urban. The bank has a loan book of 10 million , with loan sizes varying from R500 to R6000, averaging approximately R2000, with an average repayment term of twelve months. In 1998, it is noted that after less than two years in operation NuBank's three branches were already breaking even. This, they achieve by charging cost-covering interest rates currently 50 per cent per annum, and keeping default and operating costs to a minimum by replicating informal financial intermediaries' successes in this regard.

In its first financial year, the bank wrote off loans to the value of only 2.4 per cent of its assets. This was largely attributed to the effective scrutinizing of prospective borrowers ( character assessments by staff drawn from the local community) and intensive loan collection. Although security costs for safeguarding savings are high, operating costs are still kept low by keeping processes and documentation as simple as possible and by operating from no-fuss banking halls (Schoombee, 1998). Simple documentation and procedures not only enables the bank to employ relatively junior staff, thus saving on personnel costs but also to limit the transaction costs for the clients by locating branches at close proximity to their intended clientele.

All the four banking groups (ABSA, Standard, Nedcor and First National) are also operating small business units. The only drawback is that they still insist on formal collateral which as observed earlier, is mainly lacking among the rural poor or even to micro-entrepreneurs. They do not lend less than R30000 and their services, Schoombee (1998) avers, are as a rule not available to micro-entrepreneurs. The Standard bank had started what was known as Business Growth Plan as a pilot project in 4 black townships in April 1993, granting loans to individual entrepreneurs without demanding the conventional forms of collateral. Although the bank succeeded in maintaining bad debts below 4 per cent of the portfolio, (out of the total amount of money lent by the bank the project, at least 96 per cent of it was expected to be repayed) was terminated at the end of 1996 (Schoombee, 1996). According to Montagnon (1998), the decision to withdraw was due to the high level of operating costs, high wage rates, security costs for staff working in 'high risk' areas in terms of incidences of violence, the unwillingness to charge full-cost and consequently very high interest rates, because of the image that could be created of a powerful bank charging excessive interest rates to their poor clients and the low loan level at which the Usury Act becomes applicable.

Schoombee (1998) argues that the NuBank scheme has a potential of succeeding where the Standard pilot scheme failed. NuBank could succeed by serving large numbers of micro-entrepreneurs profitably. Both initiatives cited above appear to have succeeded in keeping loan defaults to acceptably low levels, limiting operating costs for themselves and transaction costs for their clients by emulating successful informal financial intermediaries in this regard. The only difference between the two is that while NuBank charges high, full-cost lending rates, Standard was not prepared to run the risk of being ostracized for seemingly 'exploiting' their poorer clients. This difference, according to Schoombee (1998:9) is the "decisive factor in determining the longer term viability of ABSA's initiative".

Ultimately, the more specialized and independent a bank's micro-finance unit, the better the chances for success (Baydas *et al,* 1997). The reason for this being that it makes it easier to implement appropriate lending methodologies, policies (especially concerning interest rates) and procedures. Schoombee (1998) points out the fact that since Standard's initiative was only a programme within the Business Unit of the Retail Marketing Division, it could for instance explain the bank's reluctance to charge cost-covering lending rates. On the other hand, NuBank being a fully independent division within the ABSA Group, has been successful in doing just that.

Creating specialized divisions/ programmes to serve micro-entrepreneurs appears to be a more feasible strategy than setting up banks that exclusively deal with micro-entrepreneurs. Moreover, given the extensive branch network of South African banks, the potential outreach is far greater than that of the latter strategy. However, there are still many areas with potential clientele who need such banks at closer proximity than they are presently. There are banking institutions especially in Asia, which have operated profitably while serving micro-entrepreneurs (i.e the Grameen bank). It could happen in South Africa but, it requires that full-cost pricing be made possible.

Baydas *et al* (1997) argue that South Africa is the only country in a study of 17 commercial banks involved in micro-finance in South America, Asia and Africa, where interest rates have not been fully regulated. This would imply that if interest rates were de-regulated, then, formal financial institutions could be encouraged to venture more into micro-financing. There are, however, tradeoffs that need to be considered before implementing such a policy.

### 3.6 The Role of the State in Rural-financing

Small businesses have a major role to play in the South African economy in terms of employment creation, income generation and output growth. The Department of Trade and Industry (DTI,1998), notes that the small, medium and micro-enterprises (SMMEs) account for approximately 60 per cent of all employment in the economy and 40 per cent of output. They are also viewed as a crucial means by which most of the low-income earners could actualize themselves and help to narrow the high unequal distribution of wealth that is a major feature of the South African economy.

Consequently, the government has attempted to outline its goals in various policy documents starting with the Reconstruction and Development Programme (RDP,1994), the Strauss Commission (1996), and the DTI's (1998) discussion document on financial access for SMMEs. Specifically, the RDP identified several areas of government intervention: "the government must, in consultation with financial institutions, establish non-discriminatory lending criteria, especially in respect of creditworthiness and collateral; reform the law on women and banking to ensure equality; require banks to give their reasons when turning down a loan application; establish community liaison boards; develop simpler forms for contracts and applications, and create an environment which reduces the risk profile of lending to small black-owned enterprises and requires banks to lend a rising share of their assets to small, black-owned enterprise" (RDP,1994:4.7.3).

In the DTI (1997) discussion document, similar issues to the ones cited above are raised. Generally, the main concern of government is that previously disadvantaged individuals do not have adequate access to formal financial institutions and, therefore, are forced to seek relatively expensive amounts of credit from alternative financial intermediaries some of which could be operating illegally. In DTI's view, the access is constrained particularly because of lack of collateral, bad or no credit histories, an exaggerated risk perception of previously disadvantaged borrowers, discrimination on the basis of gender and race and inability to afford the current levels of interest rates. The latter reason would appear to be quite contradictory to the view that interest rates should be de-regulated to allow formal lending institutions to charge rates that are consistent with both the risk and the high operating costs. It is mainly on this issue that the government and the banking sector disagree on the best option for increasing the credit access for the aspiring small-scale entrepreneurs as well as small-scale farmers. It is worth noting the fact that this is a difficult issue to pass judgement on.

Most of the lending institutions are motivated by profit maximization and therefore, giving them a free hand to determine the rates of interest may result in their fixing such rates at prohibitively high levels that would further complicate access of their funds to the rural poor. On the other hand, government has a duty to protect that section of its populace that is weakest economically and more especially so because the said section constitutes a substantial segment of the national constituency. This demands a balancing act by both sides, a middle-range solution that allows the lending institutions to reasonably cover the risk element without charging oppressive interest rates to potential clients.

In recognition of the fact that the key constraint to the development of small enterprises is lack of access to capital, the DTI put in place a set of incentives designed to leverage greater private and non-governmental sector investment in SMMEs. Consequently, two new institutions, Khula Enterprises Finance Limited and Ntsika Enterprise Promotion Agency, were established in 1996 to create increased delivery capacity to SMMEs. The two institutions provide support infrastructure and absorb a portion of the risk and cost of private investment in SMMEs. However, the perception that SMME investment is not an economically viable investment, still prevails.

The current position by government is still very much based on the desire to significantly increase the level of commercial and NGO lending to SMMEs at interest rates not inflated by unreasonable risk perceptions; to improve the outreach and efficiency of both conventional and alternative financial institutions, especially in unserved rural areas; and to stimulate the provision of start-up and small-scale equity products for SMMEs (DTI,1998). It is envisaged that a comprehensive and integrated policy framework and implementation approach would address the above objectives.

With regard to farming credit, the government through the Department of Land Affairs (DLA) established a loan facility-Land Reform Credit Facility (LRCF) following a 1998 study conducted by the department. The outcome of the research indicated that there was a much greater scope than was being realized within the land reform programme for the establishment of commercially profitable projects on redistributed land. The key obstacles to the establishment of profitable projects had been identified as being lack of finances and effective organizational, technical and managerial supports to new farmers and land reform participants beyond the point of land acquisition (LRFC Evaluation Report, 2000).

According to the draft evaluation report (2000:10), "the LRFC provides for the establishment of a revolving credit facility from which loans with deferred repayments will be made to reputable lenders for the purpose of financing farm land and / or equity purchased by farm workers and emerging farmers in commercial farming and agri-business ventures". The loans are neither subsidized nor guaranteed by the Facility and therefore, demand that borrowers apply prudent business practices if their ventures are to succeed. Khula Enterprise Finance Ltd is charged with the role of administering the LRCF. The Facility has a simplified selection criteria so "designed to emphasize access to land and productive farm ownership opportunities for previously disadvantaged South Africans" (*ibid*).

The LRCF has been in existence for just a short while but there appear to be some problems with regard to the manner in which the project is being implemented. Although the draft evaluation report hails the LRCF generally as having been a success thus far, it is instructive that a review of the said draft report reveals major weaknesses in the way the Facility is being administered. Questions abound with regard to how well the issue of the imbalance of land ownership and access to agricultural resources is being handled. A further question that has been posed (Draft response to LRCF evaluation report, 2000) is whether the Facility can still be seen as part of the land reform programme (meant to *inter alia* correct the imbalances institutionalized by apartheid) if the beneficiaries of apartheid (white commercial farmers) are also counted as its intended beneficiaries.

The draft response notes that only 24 formerly disefranchised households and 13 individuals with such backgrounds have benefited from a scheme that has thus far costed R14.6 million. Clearly, there are serious concerns that need to be addressed before the implementation can continue. As things stand, it is unlikely that the stated objectives will be attained.

With regard to the operations of the Land Bank, some changes have also been effected to make the institution more inclusive and responsive to a wider range of clientele. The amendments of the Land Bank Act of June 1998 made the restructuring more meaningful. Numerous restrictions were lifted - meaning that the Bank can now lend to any person or legal entity and make advances "for any purpose connected with or incidental to farming or agriculture" (Land Bank Act, No. 13 of 1944 as amended in June 1998). The Bank's 1998 annual report outlines various areas that the then Minister for Agriculture and Land Affairs identified as being of special interest.

Of particular relevance to this study were two policy statements: that the Bank should avail new, appropriately designed financial products that would facilitate access to finance by new entrants to agriculture, from historically disadvantaged backgrounds; and that it (the Land Bank) should contribute to wider rural development by enhancing rural livelihoods, assisting employment creation and improving environmental care. There is, therefore, an indication that a commitment exists in government, to address the question of discriminatory lending that had been in practice over decades. However, it should not be lost to keen observers that although favourable pronouncements and commitments may have been explicitly made, in practice a lot still remain to be done (see Hendricks,2000 and Williams, 2000).

### 3.7 Conclusion

The new South Africa is still trying to find the best way of effecting rural financing. The analysis of the current situation reveals the fact that there has been a widespread recognition of the need to ease access to credit for millions of poor South Africans especially those who were formally marginalized. It is indisputable that the racially-motivated differential financing that was practiced during the pre-1990 period had far-reaching effects on the livelihoods of the African people. It may be argued that it is partly due to lack of a history of financing the poor that the new South Africa is still grappling with what options to take almost six years after the democratic elections of 1994. The formal lending institutions appear to be putting forward a persuasive case with regard to the need for interest rates de-regulation. On the other hand, the government seems determined not only to legislate for a ceiling interest rate policy but also to continue persuading both the banks and non-bank lending institutions to make cheap funds available to the poor. There is need for such persuasion efforts to be stepped up and more especially with a view of reaching an amicable and workable solution. This needs to be done with due consideration of the need to correct the ills of the past associated with racial prejudice which favoured one racial group over the others and confined the latter group in poverty. Without the consideration of the historical context of the present problem, it is likely that the neo-liberal forces will push for a solution that will be less than optimal for the rural poor.

In the next chapter, the focus of the study will be shifted to a specific rural district in what was formerly the Ciskei 'homeland'. The chapter will mainly focus on what the situation is like on the ground by enumerating and discussing the peoples views with regard to the issue of credit accessibility in the region. This will hopefully help in identifying the merits of the existing strategies, their possible weaknesses and the people's views on how they could be improved.

# CHAPTER 4: CREDIT ACCESSIBILITY IN THE FORMER CISKEI (KEISKAMMAHOEK DISTRICT)

## 4.1 Background

The focus in this chapter is on the case study area and mainly an analysis of the factors that affect credit accessibility. The first section gives a brief historical background of the area which informs the current pattern of property ownership in the area. This is an important aspect because property ownership be it a piece of land or a business ultimately determines the king of goods and services that individuals demand. The same applies for credit - the ability to repay is a key question among the both the borrowers and the lenders. Conventionally, land held on the basis of individual title gives its holder certain rights with regard to transfers through sale and other transactions. The same rights cannot be enjoyed by people living under a commonage because land is held by the King or a Chief as is the case in South Africa and especially within the former homelands.

Keiskammahoek District has changed hands several times since the 18$^{th}$ century. It was initially occupied by the Khoi Khoi people who were later dislodged by the Xhosa mainly through conquest. However, in some instances the loss of land by the Khoi Khoi was through commercial transactions in which they traded off their land for cattle from the Xhosa. In 1853, however, the Xhosa were faced by a militarily stronger foe, the British, who conquered them and added the region to the larger Cape Colony. Later, most of the land hitherto occupied by the Xhosa was parceled out to the Mfengu people who had been collaborating with the British.

In 1937, Keiskammahoek became an independent magistracy (de Wet, 1997:2). There was a gradual decline of the white population as most of them sold their land to the government under the provisions of the 1936 Native Trust and Land Act. The government was to convert the farms into Trust settlements for blacks. At the same time, there was also an increase of the coloured population and by 1951 the racial composition was just over 90 per cent, 5 per cent and roughly 4.9 per cent for Africans (blacks), Whites and Coloureds respectively.

From the 1950s onwards the area became increasingly exposed to the influence of the national social, political and economic policies and especially apartheid. Tribal authorities were established as the local government in the late 1950s, self government and the formation of political parties came in the 1970s while 'independence' was granted to the Ciskei homeland in 1981(De Wet,1997:14). Betterment planning was effected, as was the case in other African-inhabited regions of the Eastern Cape, from the 1960s onwards. De Wet (1997:14) further notes that real wages in the mining and manufacturing sectors rose remarkably in the 1970s while industrial decentralization was a key feature of the region in the 1980s. There were also job opportunities that emerged as Ciskei established its bureaucracy. However, it has also been noted that the region has experienced economic decline and rising unemployment in recent years. This obviously impacts negatively on an already impoverished population living in the area.

**4.2 The social-economic set up**

One of the key factors that have influenced the social-economic outlook of Keiskammahoek has been the betterment planning. The betterment-related policies adversely affected the people's means of livelihood and served to entrench poverty even further. When betterment was launched in 1939, it was ostensibly meant to be a government policy aimed at conservation of the rural areas. It was meant to reverse the trend of soil erosion and degradation that had been occasioned by congestion, although the colonial authorities blamed the problem on 'poor farming methods practiced by the natives' (Yawitch, 1981). However, there were also some political undertones to this policy and it is the latter motive that prevailed while the former was jettisoned with time. Westaway ( in De Wet and Whisson, 1997:20) argues that the conservationist discourse revolving around the issue of betterment "tended to be panic-ridden, it was prescriptive in a very narrow, condescending and dogmatic fashion, and monolithic. Arguably, the bureaucrats and the politicians were to a certain degree at variance when it came to what actually needed to be done.

Betterment, where implemented, resulted in the rearrangement of rural areas. Such rearrangement again differed from location to location depending on the prevailing land tenure system. It also resulted in changes in the power relations at the local level. It enhanced political control of the colonial government over the African people. Betterment planning also marked a significant shift of authority from communal location headmen over resource allocation to government appointed "chiefs" under the 1951 Black Authorities Act. It entailed a drastic emasculation of the chieftaincy and favoured sycophants who would enhance the political control over 'their subjects' for the benefit of the colonial government. True representation had been progressively assaulted and demolished via various policies that aimed at dis-empowering the traditional African leaders to ensure minimum resistance to the government political machinations. Under the circumstances created by both the progressive land alienation and the betterment policy and their enabling pieces of legislation, the affected peoples' means of livelihood were largely diminished.

In their study of income and economic welfare at Keiskammahoek, Leibbrandt and Sperber (1997:113) noted that people in Rabula, Burnshill and Chatha were heavily reliant on remittances from absent members. Cash receipts had grown at 4.8 per cent, 4.8 per cent and 2.7 per cent per annum between 1949 and 1940 for Rabula, Burnshill and Chatha respectively. However, besides the remittances, the people in the area had other modest sources of income such as pensions, crop incomes, stock incomes etc. Different locations in the area have varying standards of living which is partly a function of the different land tenure systems mentioned earlier as well as the differences in the main sources of income. Likewise, unemployment, poverty and inequality vary in the same pattern. For instance, unemployment rate was found to be higher in Rabula and Chatha than in Burnshill (Leibbrandt and Sperber, 1997:126-130).

As noted earlier, betterment largely failed to make the African people better off. In Ciskei, Yawitch (1981) argues that betterment did for the most part leave people agriculturally worse off than before. For example, in the village of Chatha within Keiskammahoek district, Deliwe (1997:69) points out that betterment actually resulted in people ending up with less arable land than before. Other agricultural initiatives have been attempted since but they do not appear to have a significant positive effect on people's livelihoods. Capital intensive irrigation schemes such as Keiskammahoek, Shiloh and Tyefu, while benefitting the few farmers involved, have had limited spin-off, and had not paid for themselves by the mid 1990s (Deliwe, 1997: 69).

In an attempt to move away from both top down management and capital intensive agriculture, the farmer support programme (FSP) was initiated in the mid 1980s. FSP was an agricultural and development project planned and financed by the Development Bank of Southern Africa (DBSA). The objective was to finance agriculture in the homeland (Ciskei) through a loan scheme, so as to improve agricultural production, and ultimately promote commercial agriculture. Its target group was small farmers, the reason being the fact that centrally managed large scale agricultural projects, which excluded small farmers, had come to be seen as a failure in development terms. According to Van Rooyen et al (1987:207), although such large scale schemes had increased the level of production, they were not cost effective.

The project was also motivated by the persuasive argument that traditional farmers were poor but efficient and that such poverty was as a result of lack of access to agricultural inputs and to the market and that removal of such constraints would enable them to eventually compete favourably with their relatively better endowed counterparts in commercial farming. Although equality of incomes could not be agreed, there was a deliberate attempt to achieve the achievable - equality of opportunity. This was the goal of DBSA. The programme itself followed the principle of economic recovery and therefore, loans had to be repaid. Repayment depended on the item being needed for economic recovery. The rates were increased as farmers started registering some returns from their investment.

Some of the major elements of FSP included the supply and funding of inputs and production assets to farmers, mechanization services, marketing services, extension services, demonstration and research, training, policy formulation etc. In his study of the programme, Deliwe (1997:93) notes that the supply and funding of inputs appeared to be operating fairly well while mechanization services appeared to be dogged by under-qualified mechanics. With regard to extension services, the bias appears to have been more towards irrigation farmers. Modest gains also appear to have been achieved on the other key fronts but virtually nothing had been achieved in the area of marketing.

Deliwe (ibid: 93) also avers that the Ciskei Agricultural Board set up a loan policy suitable to the goals of FSP. In the section below, the focus of the study will shift to the conduct of the field study and the subsequent analysis of the data that was obtained. The aim of the field work was to get first hand information with regard to credit accessibility, from operators of small businesses as well as small-scale farmers.

### 4.3 Data analysis

This section offers an analysis of the data that was collected from various parts of Keiskammahoek. As indicated elsewhere in this study, key among the aims of the study was to find out how accessible micro-credit was to the rural poor of Keiskammahoek. With so much talk about the need to avail credit to the rural poor as one of the ways of effecting rural development as well as promoting poverty reduction, one got the impression that micro-financing was actually up and running especially in the areas where it was most needed. To be sure, there may be some rural areas of South Africa that have fairly well running micro-credit schemes which may be having positive spin-offs for the rural poor. However, as will be observed in this section, nothing could be further from the true position especially with regard to the areas that were covered in this study.

The other notion that ultimately became clouded as data filtered in was that, there exists a critical mass of people in the rural areas with the requisite information about lending agencies, business acumen and the necessary skills in agricultural production ready to take advantage of well organized lending-schemes. All these important 'ingredients' appear to be largely non-existent. This could be taken as a pointer that under the prevailing circumstances a mere provision of credit, however cheap may not achieve the intended purpose. Hence, the need for a lot more ground work by all lending agencies and as well as all the parties involved in the efforts to promote rural development through entrepreneurship.

This study intended to interview a randomly selected sample of about 50 respondents. The sample was to include both the owners of small businesses as well as the small-scale farmers in the different locations in the Keiskammahoek area. Half the number of the respondents were to be small-scale farmers while the rest were to come from the category of owners of small businesses. The respondents hailed from Lower Rabula, Ngxondoreni, Lower Zingcuka, Cata, Kwa Ndele and Burnshill areas. For various reasons, out of the intended 50, only 37 respondents ended up participating in the study by answering the questions posed in the questionnaires. Out of the 37 who participated, about 65 per cent were small-scale farmers while the rest were owners of small businesses. In some instances it became necessary to pose additional questions as a follow-up on the ones already included in the questionnaire for the purposes of obtaining more information. Data collection involved visiting the field between June 1999 and April 2000 during which period efforts were expended in replacing some of the questionnaires in cases where respondents had 'disappeared' as well as in collecting those that had been completed and conducting further interviews.

There were obvious difficulties in achieving the residents' cooperation especially because of the nature of the study. While some business people viewed the researcher with mistrust presuming that he was from the Government revenue department and was thus investigating tax evasion, others including some small-scale farmers viewed him with suspicion because as they alleged, some people had in the past gone around in the area promising to organize credit for them only to swindle them and disappear. One particularly unfortunate incident which was recounted again and again by different respondents was a case of a man who had promised the Kwa Ndele area residents that he was going to help them obtain credit from the Land Bank. He went ahead to collect R30 each from unsuspecting residents and then disappeared never to be heard of again (unfortunately, it was not verifiable as to whether the matter had been reported to law enforcement agents and if so, what action had been taken). There was therefore, that mistrust which was largely explicable although it really underlines the special problems that honest rural credit schemes may face in such an area. There would be need for a serious confidence-building effort to be expended in order to get round some of the well founded cynicism among the people.

In general, respondents gave information about their various sources of livelihood which ranged from businesses to farming. In a few cases, the people who had small businesses such as butcheries, general shops, hardware shops among others, also happened to be in some form of employment. They had apparently been able to set up their businesses by saving some money over time and eventually investing the same into their preferred businesses. This group also happened to be the relatively wealthier compared to the small-scale farmers (at least going by their incomes which were in some cases substantially higher). Among the group that was subsisting mainly from the land, due to the arid nature of the region and the unreliable rainfall pattern, there was a greater reliance on pension and family support although quite a number of the elderly respondents complained that the latter source was rare. The small-scale farmers were mainly producing vegetables.

The table below gives a summary of some of the data that was collected. As illustrated, out of the 37 respondents 32 per cent were over 60 years old while 59 per cent were between 36 and 60 years old. Only 8.1 per cent of the respondents were in the category of under 35 years. This could be explained by the pattern of land ownership or right of use where the older members of the community would hold land and probably bequeath it to the younger generation. Another possible reason for the low number of land-owners of below 35 years of age would be the fact that many may have left home for the urban areas in search of jobs and what they perceive to be better livelihoods. Many younger people may have become discouraged by the seemingly unprofitable agricultural activities that the older members of the community have been engaging in over the years. Moreover, school completion for many young people offers them the opportunity to go and look for jobs in the urban areas.

**Table 4.1: A summary of the data collected on credit accessibility at Keiskammahoek**

| **Age (Years):** | **Number of respondents** | **Percentage of the sample** |
|---|---|---|
| 26-35 | 3 | 8.1 |
| 36-45 | 9 | 24.3 |
| 46-55 | 9 | 24.3 |
| 56-60 | 4 | 10.8 |
| >60 | 12 | 32.4 |
| **Gender:** | | |
| Male | 20 | 54 |
| Female | 17 | 46 |
| **Education:** | | |
| Matric | 6 | 16.2 |
| Lower | 29 | 78.4 |
| None | 2 | 5.4 |
| **Income (Rands per month)** | | |
| <500 | 9 | 24.3 |
| 500-1500 | 18 | 48.6 |
| 1500-2500 | 2 | 5.4 |
| 2500-3500 | 2 | 5.4 |
| 3500-5000 | 3 | 8.1 |
| >5000 | 2 | 5.4 |
| Declined | 1 | 2.7 |
| **Financial institutions** | | |
| Aware | 15 | 40.5 |
| Not aware | 20 | 54 |
| Have applied | 12 | 32.4 |
| Not yet applied | 3 | 8.1 |
| **Main Impediments** | | |
| Unemployment | 12 | 32.4 |
| Market | 10 | 27 |
| Collateral | 10 | 27 |
| Infrastructure | 11 | 29.7 |
| Lack of awareness | 20 | 54 |
| Finance and equipment | 19 | 51.3 |
| Insecurity | 12 | 32.4 |
| Short-term nature of the credit | 4 | 10.8 |
| Distance travelled | 7 | 18.9 |

Not unexpectedly 54 percent of the respondents were males while the rest (46 per cent) were females. Although the community is quite patriarchal, it is instructive that there are numerous female-headed households which also means that under such circumstances, the females would be the custodians of their respective families' factors of production (mainly land in this case). Although most of the respondents averred that they had attended school, only 16 per cent of them had an education of matric level and above while a whopping 78 per cent of them had dropped out between standard one and standard 10. About 5 per cent of the respondents had never been to school at all.

Most of the respondents (about 73 per cent) earn a monthly income of R1500 and below and out of the 73 per cent, one third of them earn less than R500. Consequently, most of the people living in the Keiskammahoek region are largely impoverished. This is quite a significant percentage of people living under the poverty line and it indicates the dismally low potential for the success of businesses in the area. Only 19 per cent of the respondents indicated that they earned over R2500 and out of the this number, 71 per cent of them earned less than R5000.

One of the most significant findings of the study was the fact that out of the 37 respondents, an incredible 20 (54%) of them argued that they had never heard about micro-finance institutions and therefore had never approached them for loans for either business or farming purposes. However, out of the 17 who admitted that they knew of the existence of such lending institutions, about 71 per cent of them said that they had applied for loans. They however complained about various hurdles that they had to go through in order to qualify for the said loans. While some complained about the long distance they had to travel in order to reach such institutions, others argued that they failed to qualify because they could not provide the requisite collateral. One of them pointed out that she had used her fridge as a security. This however, gives an indication of the amount of money that could be borrowed under such arrangements. It is unlikely that one would get sufficient investment funds if they are not able to provide securities of higher value. Probably the small amount of credit arising from such a transaction would be used to supplement the meager family incomes for consumption purposes.

The point expressed above underlies some of the problems that were cited in Chapter 2 about the difficulties experienced in trying to draw a distinction between credit for production purposes and that which is meant for purely consumption purposes. In an area such as Keiskammahoek, it is not difficult to see why there exists the possibility that credit ostensibly sought for production purposes could end up being consumed in part if not the whole amount. The low levels of income and the fact that the means of livelihood are scarce lends support to such a possibility.

Again, while respondents were quite emphatic on the fact that they needed credit to enable them to carry out various farming-related activities, the fact is that it would be downright inaccurate to suppose that all of them would be committed entrepreneurs or small-scale farmers. It is possible that a good number of them may either not be having the capacity to utilize the credit productively or may be actually desiring to obtain credit in an effort to supplement their consumption needs. However, if the credit obtained ends up being used to meet the basic nutritional needs for the family, it may be argued that, at least in part, the overall welfare of the household in question has been enhanced although on the other hand the intended purpose (that of promoting greater production) will have been compromised. The problem in this case would be the fact that the current beneficiaries of credit who go ahead to supplement their consumption needs with it may not be able to repay to the lending institution. A widespread trend of this nature would lead to the collapse of credit schemes which would further affect development efforts adversely.

Among the main impediments to the expansion of businesses as well as farming activities, unemployment featured quite prominently. Many of the respondents lamented about the high rate of unemployment across the region and blamed the phenomenon on the numerous cases of theft which affected businesses and farming alike. Farmers complained that fencing their plots was increasingly becoming futile because the thieves had taken to carrying away the fencing materials after cutting through such plots.

Owners of small businesses blamed the high rate of unemployment for their poor sales which threatened to ruin their businesses, especially in the event of their creditors recalling their matured loans. Besides the astronomical rate of unemployment, a substantial number of respondents also complained about lack of markets. They argued that although they were sometimes able to produce a surplus, their efforts were being hampered by lack of local markets. This could partly be attributed to the low incomes earned in the area.

Overall, most of the farmers interviewed appeared to be still in the initial stages of developing their projects. This could partly explain the reason why they argued that they did not have sufficient information on how they could obtain credit. Some of them had benefitted from government grants in the past and this had made them form the impression that it was probably only the government (department of agriculture) that was involved in funding small-scale farming activities.

Some of the potential borrowers averred that they were afraid of borrowing from the lending institutions because if their projects failed, they would then lose the little possessions that they owned as such lenders attached their property in an effort to recover their funds. Although this is always a general fear among potential borrowers almost in all instances, it is instructive that for the more informed individuals, they are able to know how much they can stake out. Besides, they also know that financial institutions are in addition to extending credit to clients, supposed to offer them financial advice which would enable them to invest their credit prudently. As things are (at least during the study) some of the farmers observe that they have trouble selling their little produce and therefore chances of making profits which would eventually enable them to make loan repayments are quite limited.

From some of the responses from the interviewees, one got the impression that there was an unreasonable expectation on how the government should help the small-scale farmers. There was the expectation that the government agricultural officers should approach the farmers, get to know about their financial difficulties and then recommend that they be given grants rather than loans. While it is partly understandable why some felt that only grants would really bail them out of the their financial quagmire and unlock their development potential, it is worth noting that given the increasingly dwindling government expenditure on social programmes nationally, government may be the wrong source from which to seek such assistance. Ultimately, it may be argued that ignorance about how the lending institutions operate could be one of the key factors stifling rural credit accessibility in the Keiskammahoek.

Most of the small-scale farmers who were interviewed live in remote areas away from the urban centre which would otherwise provide a market for their produce. The communication lines especially the roads are in a bad condition and prove to be impassable during the rainy season and this makes the farmer's marketing efforts all the more difficult. Due to high rate of the unemployment (as discussed earlier), most of the farmers use their farming projects as sources of income to be used for day to day transactions in support of their families. Consequently, many are unable to save money that could be reinvested in the expansion of their farming activities.

The fact that most of the membership of some of the farming projects happen to be over 50 years old becomes quite significance when one considers the sustainability of such projects. Due to their already lackluster performance, such projects do not really endear themselves to the majority of the youthful people who would rather migrate to the urban areas in search of often elusive job opportunities. The ages of applicants for credit from the lending institutions could also contribute to the unwillingness of such institutions to 'trade'. This maybe out of the rational consideration that the rate of default among the people of such relatively advanced age could be quite high especially if such loans are long-term. Yet, the fact that credit to this group may be one of the most viable ways of achieving greater poverty reduction in the area, need not be underscored. They form the largest group of the people active on such farmlands. They could be relied upon, if not for any other reason, to demonstrate to the younger generation the fact that they can indeed eke out a decent livelihood from small-scale farming.

**4.4 Conclusion**

In this chapter, issues revolving around credit accessibility for the people living in the rural areas of Keiskammahoek were considered. It is quite clear that there is a myriad of factors that influence credit accessibility in the area. Lack of information about the existence of micro-lending institutions and how they operate is obviously one of the most glaring challenges. Dissemination of such information by the local government leadership or even by community based organizations (CBOs) would come in handy to hundreds of potential borrowers who continue to wallow in abject poverty for lack of knowledge of possible opportunities provided through such lending institutions. It is difficult to view unemployment from any other angle other than that of the vicious circle of poverty that is partly attributable to the country's colonial legacy.

The issue of land alienation and the destruction of the African peasantry may very well be the genesis of the current poverty and unemployment in the area. In part, the colonial land policies are to blame for the small and economically unviable parcels of land held by the African people in the area. However, it is important to lay strategies on how to get out of the vicious circle of poverty and in spite of the enormous challenges cited above, there is a huge unexploited potential for rural development in the area. Easing access to credit would be one of the means by which such potential could be unlocked. However, indications are that in the short-term supportive structures need to be put into place first if credit is to have the intended impact. Such supportive structures ought to include *inter alia,* improvement of the general infrastructure but more importantly enhancing people's awareness and capacity to utilize the credit in prudent and productive ventures. In the next chapter, the focus of the study will be on recommendations and conclusions.

# CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Introduction:

From the discussions in the previous chapters it is quite clear that provision of financial services to rural entrepreneurs and producers could be one of the most effective means of tackling poverty, creating broad-based economic growth and enhancing overall rural development. As was noted in the two case studies in Chapter 2, increased incomes particularly in the hands of women come in quite handy as they are invested in health, education, housing of the family, and creating substantial new demand for goods and services which is critical for further growth and development.

Polkinghorne (1995:2) points out that it has been demonstrated in various parts of the world that NGOs, specialized financial institutions and commercial banks can provide responsive financial services to low income entrepreneurs and producers in a profitable, sustainable manner, at rates that cover the high costs of making very small loans. By 1995, over 500 million of the world's economically active population run micro and small enterprises. Out of this number, fewer than 10 million of the enterprises have access to financial services form sources other than moneylenders. Moreover, in most countries, banks provide next to no financing to micro-enterprises and the self-employed (Polkinhorne, 1995:2). Furthermore, Polkinhorne (1995) makes the observation that non-traditional specialized intermediaries, including NGOs, reach under 2 per cent of this potential market while banks tend to focus mainly on the top 20 per cent of the economically active population. Consequently, less than 2 per cent of the world's low income entrepreneurs get access to financial services.

Montagnon (1998:9) avers that South Africa has both an active micro lending industry and a sophisticated commercial banking system with a high application of technology. Therefore, in theory, its banks ought to be well placed to enter the market. The formal sector continues shedding jobs and it is estimated that unemployment currently stands at about 40 per cent , and nearly 70 per cent of all black households live in poverty. Besides having the potential to spur job creation in the informal sector, micro-lending may help mitigate the risk of social unrest created by the continuing huge income disparities in post-apartheid South Africa. However, many South African banks generally view micro-lending as an expensive business offering poor returns. The current focus among banks is towards bringing their bloated cost /income ratios better into line with international standards. The apparent apathy is partly borne out of previous dismal performance by the banks in micro-lending.

### 5.2 An appraisal of the research findings

Overall, the findings of this study were quite disconcerting in the sense that the single most serious problem considered by the majority of the respondents to be the most intractable, was lack of awareness about operations of micro-lending institutions. While it was clear that some respondents obviously knew that banks could advance loans to them, they nevertheless declined to borrow such funds because of what they described as prohibitive collateral requirements as well as the perception that commercial banks always charge high interest for their credit funds.

Although a lot has been said about the need for rural credit, the Keiskammahoek case study reveals the depth to which this commitment to micro-lending has gone, so far. While our case study could very well be an exception, it is unlikely that other regions could be experiencing anything appreciably better than the people of Keiskammahoek. It is quite evident that very little information dissemination has been undertaken by the concerned parties.

Most of the commercial banking institutions could escape some blame for the lack of awareness that pervades the community but, certainly the government agencies and even NGOs cannot easily be absolved. The lack of awareness about the activities of lending institutions may partly be considered as a serious indictment on the local government representatives in the region. There appears to be a poor quality of representation because one would have expected that such leaders would be able to identify productive opportunities for those they purport to represent in an effort to occasion rural development in the area. However, individual potential borrowers also need to take the initiative to try and find out what opportunities there could be, for them to actualize themselves either in small businesses or small-scale farming.

It is worth noting the fact that although there are numerous factors that may have contributed to the lack of awareness among the majority of the respondents, their level of education could also very well be a contributory factor to the general ignorance. About 78 per cent of the respondents indicated that they had not been able to obtain at least a matric level of education. This is quite a high proportion of the people in the area. The majority had dropped out of school quite early for various reasons. It may be because of either the fact that at the time when they were growing up there was no much value attached to education or because successive governments (the apartheid and the Homeland governments) had failed to encourage learning among the people.

The problem of unemployment that featured quite prominently among the factors blamed for the poor business performance and soaring crime is very much related to the education problem. In most of South Africa, there is a huge pool of unskilled labour arising from an inappropriate education system that was meant to keep the African people, in particular, ignorant. Consequently, most of the unskilled people are unable to find gainful employment opportunities and this makes some of them to resort to crime. Some residents of Keiskammahoek (at least 32% of the respondents) cited insecurity as one of the main impediments to their entrepreneurship. Problems of burglary, theft of fencing materials, livestock among other things, taken cumulatively can be significant disincentives to entrepreneurial activities as the Keiskammahoek case study reveals.

With regard to commercial banking institutions, their view with regard to micro-lending (as noted in Section 5.1) is not very positive. In deed, the few attempts to engage in micro-lending have mainly been in the urban areas and even there, the efforts have not yielded good results. One of the notable disappointments was the Community Bank. It had been set up as a mutual bank in the mid-1990s with support from both government agencies and commercial banks to serve the low income market with home loans and small enterprise funds. Montagnon (1998: 10) notes that the Community bank which offered loans of between R500 and R5000, got off to an apparently good start with a low initial rate of arrears. It was helped by a USAID guarantee scheme and a non-profit-making development partner, Community Banking Foundation, to promote its outreach. However, it collapsed over its high cost structure largely because of its determination to open branches.

Other efforts by commercial banks to set up their own operations have been similarly discouraging. The Standard bank had started a micro-lending division in 1992 which built up a portfolio of R1.5 million in loans by the time the experiment was stopped in 1996. The main problem was not bad loans but high operating costs. High wage costs coupled with other security issues because the staff were operating in areas with a high incidence of violence largely hampered operations. To cover the high operating costs a high interest rate was inevitable. Officials of the Bank reckoned that they needed annual rates of between 50 and 100 per cent to make a reasonable return. However, this level of interest rate was going to be much higher than the Usury Act ceiling of 29 per cent on loans in excess of R6000 (Montagnon, 1998,10). Consequently, to avoid bad publicity on account of charging high interest rates to its poor customers, the bank withdrew from the venture. Therefore, up to now, the conventional commercial banking sector plays a very minimal role in the provision of micro-finance in South Africa. That role is played mainly in the urban areas. The rural areas do not appear to have been given much consideration.

### 5.3 A suggested way forward

Most of the works on micro-credit for the rural poor the world over have tended to focus on economic or financial policies of rural credit programmes. They have pointed out that the widely favored policy of subsidizing rural credit does not work. The studies have thus drawn attention to other aspects of successful rural credit programmes such as efficient and flexible lending mechanisms, with an emphasis on quality of service and savings mobilization (Jain, 1996:88). Financial self-sufficiency of rural credit programmes became the central recommendation and the 'subsidy dependency index' became the centerpiece to assess the efficacy of rural financial institutions (Yaron, 1992b). Most such studies also recognized the importance of social factors, particularly of social/group pressure among borrowers for compliance with repayment norms. The latter appears to have been utilized with remarkable success elsewhere as observed in the case studies on Faulu project in Kenya as well the Grameen Bank in Bangladesh.

Although there may not be a long history of success of such schemes in many parts of South Africa, since the prevailing conditions in the rural areas are not radically different from those cited in the case studies discussed in Chapter 2, it may be worthwhile trying to establish them. It is however, important to try and address the problems cited in the Keiskammahoek district first before going into the technical requirements for successful rural credit schemes. Firstly, there is need for greater efforts to be expended in the dissemination of the requisite information about the existence or availability of financial institutions that can extend credit to aspiring small-scale farmers and owners of micro-enterprises.

To this end, all development agencies be they private, NGOs or government departments need to make concerted efforts to ensure that opportunities of the nature described above do exist and that it is in fact possible for individuals to take up loans and use them to expand their productive activities. NGOs which have an edge over the other players in terms of the ability to interact with grassroots communities should particularly play a key role in enhancing peoples' awareness. The government can also do the same through its Agricultural extension officers as well as through its local government structures.

There is also a critical need to pay greater attention to infrastructural development. Although it may not be possible to tar all the feeder roads because of the prohibitive costs, it should be borne in mind the fact that without passable roads, even the small-scale farmers trying to succeed in an already difficult environment are likely to be discouraged. Transport problems arising from poorly maintained road networks ultimately add to overall costs of production and once these costs are translated to higher food prices in the urban centres, the small farmer's produce becomes less competitive leading to poor sales and the possibility of such produce going bad. Most of the people in Keiskammahoek produce maize and vegetables. The latter are highly perishable and failure to reach the markets while still fresh may cause huge losses for the farmers especially in cases where they have to compete with large-scale commercial farmers whose enormous material resources give them a much more competitive edge than the former. Similarly, operators of small enterprises need proper and reasonably priced transport in order to get their regular supplies of commodities from the wholesalers in the urban areas. If the cost of transport is high on an account of the roads being impassable, it acts as a disincentive both to the current business people as well as those aspiring to start up. Regular maintenance through the use of cheaper and more readily available materials such as gravel may suffice for most of the feeder roads and this could contribute to lower transportation costs for the people residing in the rural areas of the District.

One of the other major difficulties experienced by small scale farmers as well as owners of small enterprises is that of convincing lending institutions that their ventures are viable and therefore do qualify for funding. Borrowers are required to demonstrate to the lending institution especially the banks that their potential ventures will be profitable and that they will be able to repay the loans etc. They are also required to have some managerial skills and the ability to positively withstand possible competition. For the lending institutions to effectively assist micro-entrepreneurs to overcome the challenge of viability, they need to adopt a number of important principles and practices.

They need to accept the fact that low income entrepreneurs and producers are worthwhile clients of financial services who are in most cases willing and able to repay at the high interest rates needed to cover the costs of small loans. They, just like other potentially well-off borrowers, would prefer rapid and reliable access to financial services. On the other hand, the lending institutions especially the commercial banking sector generally argue for high interest rates ostensibly in order to cover the costs of making small loans. It is however, necessary to consider the appropriate level of the interest rates to be charged on fledgling businesses. The question of fairness of the set interest rates needs to be addressed by both the banks and government. The obtaining solution should neither discourage the banks from operating small loans for potential micro-enterprises and small-scale farmers nor should it end up discouraging the latter from seeking such loans. There is need for government to reign control over the informal micro-lenders who operate well outside the provisions of the South African Usury Act.

Although our case study did not reveal this, (i.e many of the respondents pleaded lack of knowledge of any lending institutions) it has been argued that most of the innovation and reach in South African micro-lending has been by NGOs and other specialized financial intermediaries that focus on providing finance and business development services to poor entrepreneurs and producers (Polkinghorne,1995:7). The only problem is that such specialized institutions are still few compared to the minimum lending volumes needed to cover operating and financial costs, many are weak in institutional capacity, and most have not yet seen their potential roles as major actors in finance and enterprise systems.

Besides the problems experienced by potential borrowers, there are numerous hurdles to the establishment of solid micro-enterprise financial services. While as noted earlier, subsidies to borrowers are neither needed nor helpful, the institutions providing financial services do need to be subsidized while they move to break-even volumes of lending. Polkinghorne (1995:7) notes that experience of leading micro-lenders around the world indicates that it will take an efficient lender three to five years to cover operating costs, including loan loss provision, and five to seven years to build the volumes needed to cover full commercial financing ad operating costs. These estimates are based on the assumption that from the outset, the lending institution is charging borrowers effective interest rates that would cover the operating costs and loan loss provisioning of an efficient lender, the full opportunity cost of capital, and inflation.

It is however, worth noting the fact that most commercial lending institutions will only make a significant commitment to this sector only if they see it as profitable in three years or less, if they can obtain a guarantee coverage, if they are able to charge interest rates that enable a profit to be realized once the portfolio is up and if they can get access to capacity building and product development inputs. Commercial banks will therefore need to undergo substantial changes in attitudes, organizations and lending technologies if they are going to play a major role in enhancing micro-lending. The commercial banks' large financial resources, widespread branch structures and capacities for savings mobilization and lending make their participation all the more crucial.

Innovations made in recent times in loan products and technologies could largely contribute to drastic reduction of costs and increase the attractiveness to banks of lending directly to small and micro-enterprises. It is suggested that most banks can be expected to be more active in the direct financing of small enterprises with loans exceeding R30,000 (Polkinghorne, 1995:7). Some choose to wholesale micro-loans which often average R6000 or less, through specialized intermediaries, such as efficient NGOs. However, it is possible that this expectation of banks becoming more active in direct micro-financing could be a misplaced one - their cost-cutting and down-sizing strategies appear to be running counter to such tendencies. Guided by the motive of profit maximization, they increasingly appear to be giving a disproportionately greater attention to the more affluent clients.

The NGOs and other financial intermediaries without the capacity to cross subsidize micro-enterprise lending while they build lending volumes may need to obtain institutional subsidies for a number of years. Mostly such institutional subsidies would normally be provided by donors in the form of operating grants, against highly specific project expenditure budgets. Often, where this has been done, the funding has not been linked to the institution's achieving standards of financial performance and reach. There is need for such a linkage to be established in order to ensure accountability and success of such schemes.

Savings mobilization is generally regarded as an important requirement for successful micro-lending institutions. While it may be a bit unrealistic to expect a high rate of savings for the impoverished people, savings even at modest rates could eventually enable individuals or groups to accumulate sufficient capital for investment purposes and it also provides a cushion against unforeseen circumstances in the enterprise or family. Regular savings by clients may also benefit groups because the cash accumulated could substitute for traditional collateral requirements.

In an effort to prop up fledgling micro-lending institutions that are already demonstrating effectiveness and commitment, the government and external donors need to provide small amounts of grant funds to them as initial operating capital for about 2 years. Such support should be on the basis of presentation of a clear business plan, partnership agreement and the setting up of performance standards to be met within the two years. Furthermore, capitalization should also be availed for institutions that meet performance standards. This would help them build up their loan portfolio which they could use as leverage in mobilizing funds from the local banking institutions. The envisaged grants can be provided over a period of five years in tranches against strong business plans as well as continued compliance with performance standards. Polkinghorne (1995:8) suggests that R500,000 to R2 million should be sufficient to help bring a lending institution's portfolio to a size in which operating costs and full financial charges could be recovered with interest rates and fees to the clients.

Refinance from development banks at rates commensurate to the average cost of capital for financial institutions should also be made more accessible to micro-lending institutions. It may be necessary to offer a small subsidy in the initial three to five years to induce the commercial banks to undertake the institutional changes needed to make micro and small enterprise lending profitable.

The government should also encourage linkages between formal financial institutions and NGOs in order to promote mobilization of banks' resources for micro-enterprises as well as small-scale farmers. The Reserve Bank and the Land bank could avail more accessible credit lines and partial loan guarantees to specialized financial intermediaries, NGOs and commercial banks that meet performance standards and work with low income entrepreneurs and producers. As noted in Chapter 3, LRCF is already running although there are still some teething problems that need urgent attention and on the other hand, the amendments in the Land Bank Act has allowed for purposeful restructuring with specific emphasis to rural development especially for the benefit of the previously disadvantaged segments of the population. It is however, necessary for the government to continue to promote and fund non-government operations that develop the small and micro-enterprise sectors. Moreover, simplified and appropriately designed taxation policies for small businesses and the financial institutions that serve them need to be developed.

Micro-lending institutions serving the rural poor, especially women, need to build organizations , loan delivery systems and performance that enable significant reach and sustainable operations. For such institutions to succeed, they need to go to rural places where most of the poor reside and also design services that meet needs for convenient and rapid access to small working capital loans with limited paperwork. Some of the less educated rural people may feel intimidated especially when the process of obtaining credit involve filling in numerous forms and being taken through unfamiliar procedures that make them feel inadequate. The low income clients should be helped to build confidence and experience as borrowers and business owners.

Reasonable repayment rates may be secured through responsive services, relationships of mutual accountability and use of non-traditional collateral as means to reduce risks. To ensure low transaction costs, simplicity, efficiency, concentration and where appropriate, group mechanisms should be used (Polkinghorne, 1995:10). The lending institution would eventually assist in the mobilization of savings to help the clients to increase control over their economic futures, provide a substitute for traditional collateral and give the financial intermediary a sustainable source of loan funds. Mobilization of savings could be made more efficient by building convenient collection locations, encouraging small savings, giving depositors ready access to their funds as well as ensuring that deposits are safe and provide fair returns.

Although it is difficult for commercial banking institutions to think about alternatives to their quest for securities, it need not be lost to observers the fact that most of the rural poor may not be having title deeds to the pieces of land that they occupy. If such a huge proportion of people residing on communal lands are denied credit for lack of security, efforts to combat rural poverty will not be very fruitful. Hence, there is need for alternative and more innovative types collateral to be considered. It is also necessary to hasten the land tenure reform process in the direction that ultimately serves both individual needs as well as the overall welfare of the rural communities and the entire economy. Although there are real sociological issues to be considered while determining the appropriate tenure system, the common practice is that those who hold individual titles to land are often the most likely to obtain credit especially from the formal lending institutions.

Finally, although the focus of this study was mainly on accessibility of rural credit to the poor people aspiring to go into small-scale farming as well as those intending to start up small enterprises, it must be emphasized that credit should be seen as a tool, not in isolation but in conjunction with other catalysts for development such as training and technical and managerial assistance which is suitable to the unique circumstances of each situation. Failure to identify needs and absorptive capacity of the credit recipient may create severe long-term problems. In fact, in some cases credit could be a source of problems rather than a solution. Credit obtained far too easily could be disastrous for both the recipient, the lending institution and the general economic productivity. Each case however, needs to be considered individually since the prevailing conditions in different areas are by no means homogeneous.

### 5.4 Limitations of the research

Data collection from the field proved to be one of the most daunting tasks in this study. The field was far from the University and it involved travelling for a couple of hours by unreliable public transport. Besides the transport problems, there were very low levels of cooperation on the part of many of the respondents. About 70 per cent of the first set of 50 questionnaires were never returned because the would-be respondents disappeared with them and never showed up again. Attempts to use the local government office at Keiskammahoek did not help much either. The local government representatives were unreliable and unhelpful and showed very little interest in the exercise. They were reluctant to help in following up some of the respondents although they had initially indicated that they would do so.

Ultimately, a new set of questionnaires had to be prepared and taken back to the field again. This was obviously costing a lot in terms of time and scarce financial resources. However, for the second batch of questionnaires the strategy of administering them was revised and this entailed conducting the questionnaires with the help of a Xhosa speaking research assistant. The use of a Xhosa speaking research assistant was particularly helpful in breaking down the language barrier which was a serious problem at first.

However, the biggest limitation was posed by lack of finances. Although, it would have been better to interview more respondents over a longer period, unavailability of financial resources rendered such plans unfeasible. It would have been worthwhile to stay in the field a little longer in order to interact with people engaged in NGO projects and to find out whether they had intentions of going into micro-lending at some point and what problems they are experiencing in the current period.

### 5.5 Suggestions for further research

Although quite a number of studies have been done on micro-lending, most of this research has mainly been urban-oriented. A lot more concern has been shown for the urban poor and the unemployed than has been the case for the millions residing in the rural areas. Consequently, even the commercial banking institutions have not ventured much into rural financing. Only NGOs appear to be making an attempt to go into rural financing. It is a vast sector and a commitment to serving it should go beyond making public pronouncements of intent as have been the case so far especially from the government.

It is, therefore, the suggestion of this study that more financial resources be committed to research revolving around micro-lending in the rural areas. There is need to establish what innovative means of micro-financing should be used to serve the rural poor. It is quite clear that rural credit accessibility is dismal (at least arising from the Keiskammahoek case study) for various reasons. Further studies need to be conducted in order to find out how the various development agencies can carry out awareness campaigns as well training or demonstration sessions for aspiring micro-entrepreneurs and small-scale farmers. There is also need for research into the question of enhancing capacity building within the rural communities in order to produce skillful youths who can engage in self-employment.

### 5.6 Conclusion

Most of the African people living in the rural areas remain impoverished for reasons ranging from the colonial legacy of land alienation, subjugation, exploitation and discrimination and a general lack of factors of production in some cases. Rural-credit accessibility is critical if tangible development is to be attained from the existing potential. A lot of work still need to be done in training and sensitizing the people about opportunities that may help them pull out of poverty. A lot more still needs to be done to convince lending institutions that considering extending credit to the rural poor would be in their interest in the long-term. Social-economic stability of South Africa is crucial to everyone whether in the corporate world or struggling in the small and micro-enterprises both in the urban and rural areas. The sooner such stability is enhanced and guarded through schemes to uplift the poorer members of the society the larger will be the overall benefits to all the sectors and individuals. Small-scale farming and micro-enterprises have the potential of providing the much needed job opportunities which continue to dwindle in the formal sector due restructuring. Schemes aimed at addressing rural financing for purposes of promoting job creation and development have succeeded elsewhere and they can succeed in South Africa as well. It is a challenge that requires concerted efforts from the lending institutions, government, NGOs and even the potential beneficiaries - the rural poor.

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