The Sustainability of Microfinance Institutions in South Africa

A Research Report

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Abstract

Microfinance targets the poor and very poor, both in urban and rural areas. It has become a common method of poverty alleviation in many developing countries. Several microfinance institutions have adopted a social mission to eradicate poverty by providing credit to the poor. In the past, microfinance organizations used to focus on farmers in rural areas. Modern microfinance programs are focused on the population that is largely neglected by the formal financial sector, specifically women. Due to the perceived risk in this type of uncollateralized lending, private equity markets are not keen on financing microfinance institutions. Furthermore, microfinance institutions are seen as socially motivated as opposed to being financially motivated. For that reason, their profitability and sustainability has come under question in the last decade.

Two approaches to the issue of sustainability exist. The dominant institutionist approach argues that microfinance institutions should focus on being sustainable as this will improve their chances of alleviating poverty. The welfarist approach disagrees with this view by arguing that focusing on sustainability will result in the neglect of the poorest of the poor.

This study analyses the sustainability of microfinance in South Africa by using a case study research approach. The study explores the challenges to sustainability in South Africa. The results of the study indicate that the microfinance institutions are not profitable nor self-sufficient. The most notable challenge to this sustainability is the high personnel costs. South African MFIs experience higher operating costs than their African counterparts. The study also indicates that the more financially sound microfinance institutions have a lower level of depth outreach than the more subsidy dependent institutions.

DECLARATION

I, Teboho Lekatsa hereby declare that the work on which this dissertation/thesis is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor any part of it has been, is being, or is to be submitted for another degree in this or any other university.

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For Nkhono Puleng, Nkhono Mamakhalemele, Nkhono Majuniya, Ausi Diboletso, Siphiwe and Bokang.

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CHAPTER 1 INTRODUCTION

1.1. Introduction

The existence of microfinance finance institutions today is largely attributed to the pioneering work of Mohamed Yunus who is the founder of the globally replicated Grameen Bank (Sengupta and Aubuchon, 2008). The Grameen Bank of Bangladesh provided credit to women in the rural areas in the 1970s (Sengupta and Aubuchon, 2008; Battilana and Dorado, 2010). The concept of credit provision to the rural population can be traced back to 19th century Europe when microcredit organizations provided credit to rural farmers and the poor (Hollis and Sweetman, 1998).

Microfinance targets the poor and very poor, both in urban and rural areas. It has become a common method of poverty eradication in many developing countries (Hollis and Sweetman, 1998; Gibbons and Meehan, 2002).

Several microfinance institutions (MFIs) have adopted a social mission to eradicate poverty by providing credit to the poor (Goldberg, 2005; Gibson and Meehan, 2002). Although microfinance organizations in the past used to focus on farmers in rural areas (Hollis and Sweetman, 1998), modern MFIs programs are focused on the population that is largely neglected by the formal financial sector, specifically women in rural areas (Goldberg, 2005).

Historically, MFIs have relied on subsidies in order to meet their mission of poverty eradication (Morduch, 2000). There is an ongoing debate within the microfinance literature regarding the dependence of microfinance institutions on subsidies and grants. The debate is between welfarists who argue that an MFI's main focus should be the eradication of poverty on a large scale. Welfarists argue that institutions that focus on sustainability end up providing loans to the less poor and not the poorest of the poor (Morduch, 2000; Robinson, 1995). This argument is based on the premise that institutions that do not rely on subsidies have to ultimately transfer the costs of their sustainability to their clients. Therefore, the inherent cost of an institution's sustainability can be afforded

by the poor but not the very poor (Morduch, 2000, Robinson, 1995). On the opposite end, institutionists argue that institutional sustainability is a necessary condition for institutions to be sustainable (Morduch, 2000, Woller and Dunford, 1999; Gibbons and Meehan, 2002).

1.2. Research problem

The contemporary issue in microfinance literature is whether MFIs should continue their dependency on subsidies because they have a social mission. The alternative is to wean off subsidies in order to achieve institutional sustainability and higher outreach. Some studies conclude that non-subsidized MFIs tend to last longer and serve more borrowers than subsidized MFIs (Sweetman and Hollis, 1998). Other studies conclude that there is no trade-off between sustainability and outreach (Kereta, 2007). In other words, microfinance institutions can be sustainable without compromising their ability to serve more clients. However other studies conclude that there is a trade-off between sustainability and outreach (Cull *et al*., 2006).

The debate still continues as some MFIs in developing countries have experienced no trade-off between sustainability and outreach while others have. There are limited studies on the issue of sustainability in Africa; one was conducted in Ethiopia (Kereta, 2007) and one in Uganda (Okumu, 2007).

The literature states that there is positive correlation between outreach and subsidy dependence. An MFI's ability to serve the poorest of the poor is likely to be compromised when an MFI focuses on being sustainable (Buckley, 1997; Morduch 2000). The study expects to find a higher depth of outreach in institutions that are less operationally sustainable and profitable. These types of MFIs lean towards the debated "welfarist" school of thought which prioritizes reaching the poor over sustainability. Similarly the study expects to find a higher breadth of outreach in and lower depth of outreach in institutions that are more operationally sustainable and profitable; the "institutionist" school of thought.

1.3. Rationale and purpose of study

In South African, a number of government organizations such as the Small Enterprise Development Agency (SEDA) and NGOs such as the Women's Development Bank have been formed specifically to address the issue of limited access of microfinance to rural areas. It is therefore important that MFI's institutional makeup be subject to study. This will allow them to improve where necessary. It will also provide insight regarding the challenges MFIs face and also contribute towards policy formulation. South African MFI sustainability ability to provide access to the poor and very poor, also known as outreach, have received little academic attention.

1.4. Objectives of the study

The main objective is:

- To establish whether South African MFIs are institutionally sustainable.

The subsidiary objective is:

- To identify the constraints to operational and financial sustainability and;
- To find out whether or not MFI's in SA have sound corporate governance.

1.5. Delimitations and Assumptions

The following section discusses the delimitations and assumptions of the study.

1.5.1. Limitations

The following limitations apply to the study:

- The study is limited to formal microfinance institutions and will therefore not focus on the informal microfinance lending companies like loan "sharks" and small loan businesses.
- The study will focus only on formal micro finance institutions in South Africa.

1.5.2. Assumptions

The research study is based on the assumption that:

- Formal microfinance institutions in South Africa maintain audited financial records and;
- Microfinance institution managers are interested in knowing whether their institutions are sustainable or not. Therefore, microfinance institutions will co-operate in the provision of audited financial records for data collection purposes.

1.6. Overview

This study consists of five chapters. Chapter 2 reviews the literature on the sustainability of microfinance. The chapter also provides the study's theoretical framework.

Chapter 3 discusses the research design and methodology. It details the research instruments used, the data collection method and data analysis.

Chapter 4 presents the results of the sustainability measures. The results of the sustainability measures are compared to the international benchmarks. It also provides insight into the why the results are observed, based on the theoretical framework.

Chapter 5 provides a summary and conclusion of the study. It also states the research's limitations and makes recommendations for future study.

CHAPTER 2 LITERATURE REVIEW

The review of existing microfinance literature provides the theoretical framework that serves as a platform for this study. Section 2.1 of this review will briefly discuss the origins of microfinance as a tool for poverty alleviation. Section 2.2 discusses sustainability and what it means in the context of microfinance. In addition, the section reviews the hotly debated schools of thought regarding the sustainability of microfinance institutions. This debate forms the basis of this study's enquiry. Section 2.3 discusses the challenges that MFIs face in their quest for sustainability and Section 2.6 concludes.

2.1. Introduction

Ledgerwood (1999) states that "microfinance arose in the 1980s as a response to doubts and research findings about state delivery of subsidized credit to poor farmers." In the 1970s government agencies were the predominant method of providing productive credit to those without access to credit facilities."

Much of the current literature credits the growth of microfinance to the founder of the Grameen Bank which was established in 1976 in Bangladesh; Professor Mohammed Yunus (Sengupta and Aubuchon, 2008). The Grameen Bank model has since been replicated in various developing countries.

2.2. Microfinance Institution Sustainability

Most microfinance institutions operate outside the formal financial sector which is mostly equity funded. As a result, most MFIs are funded through grants and subsidies. A large majority of MFIs have been argued to be unsustainable. When sustainable, MFIs compromise their ability to provide finance to the very poor (Woller *et al.,* 1999; Morduch, 2000)

The use of the term sustainability by those who are against subsidy dependence (Institutionists) and those who encourage subsidy dependence (Welfarists) appears not to have a fixed meaning. The term is used interchangeably with terms such as financial

self-sufficiency, profitability and financial viability (Buss, 1999; Ledgerwood 1999; Schreiner 2000, Woller and Schreiner, 2006).

Ledgerwood (1999) refers to self-sufficiency instead of sustainability and the focus is not on equity as in Buss' (1999) definition but more on operations. Ledgerwood (1999: 217) provides the following definition: "financial self-sufficiency indicates whether or not enough revenue has been earned to cover both direct costs. These costs include financing costs, provisions for loans losses, and operating expenses, and indirect costs, including the adjusted cost of capital."

Schreiner (2000:3) provides the following definition: "sustainable microfinance organizations meet their goals now without harming their ability to meet their goals later." Schreiner's (2000) definition leans more towards Ledgerwood's (1999) emphasis on operations but it also emphasizes perpetuity of the organization.

Woller and Schreiner (2002; 2) state that in microfinance "program sustainability has become more or less synonymous with financial self-sufficiency. Financial self-sufficiency is the non-profit equivalent of profitability." These variations in focus indicate the point of diversion between the two schools of thought.

For the purpose of this study, the sustainability of MFIs shall mean "whether or not enough revenue has been earned to cover both direct costs. These costs include financing costs, provisions for loans losses, and operating expenses, and indirect costs, including the adjusted cost of capital (Ledgerwood, 1999)."

There are two predominant views regarding the sustainability of MFIs. The first view is that of "welfarists" who state that MFIS should not focus on sustainability. However, the focus should be on outreach and poverty alleviation as this is the mission of a majority, if not all MFIs. The "institutionists" on the other hand argue that MFIs should endeavor to be sustainable and self-sufficient while still addressing the mission of poverty alleviation as the main focus. (Woller *et al.,* 1999, Morduch, 2000).

2.2.1. Welfarists – Pro Subsidy

The following section reviews the opposing arguments of inistitutionists and welfarists regarding the sustainability of MFIs.

Welfarists place greater emphasis on an MFI's ability to provide financing to the poor and the poorest of the poor in larger numbers. Although they are not averse to the idea of self-sufficient and sustainable MFIs, welfarists are of the opinion that the attainment of sustainability would be at the expense of the outreach to the poorest of the poor (Morduch, 2000). Based on an analysis conducted on 72 MFIs, Conning (1999) argues that extending credit to the poorest of the poor bears higher costs than extending credit to other segments of the market. More significantly, private capital or leverage may be much harder to achieve for MFIs that target the poorest of the poor. Conning's (1999) conclusion suggests that MFIs that do not rely on subsidies might in fact not accommodate the very poor and only focus on the near poor as argued by welfarists

Welfarists also argue that MFIs can be sustainable without being financially self-sufficient. To support this argument, welfarists state the subsidies or donations are a form of equity, therefor MFIs can be sustainable without being financially self-sustainable (Morduch, 2000). In contrast, institutionists argue that financial self-sufficiency is a necessary condition for sustainability and the welfarists' view that subsidies can sustain MFIs is wrongly skewed (Robinson, 1995; Morduch, 2000; Woller *et al*., 1999).

2.2.2. Institutionists – Anti Subsidy

Contrary to the welfarist argument of a value based approached to poverty alleviation; institutionists argue that in order to have a sizeable impact on poverty alleviation, large financial intermediaries have to be at the forefront (Woller *et al*., 1999).

The funds from donors cannot be expected to flow indefinitely. Therefore MFIs have to consider sourcing private capital at some point. In order to do that, MFIs have to prove to

be self-sufficient in order to attract capital (Woller *et al.,* 1999; Morduch, 2000; Robinson 1995; Gibbons and Meehan*,* 2000).

Hollis and Sweetman (1998) studied six European microfinance organizations in the 18th century. They investigated the institutional designs that facilitated success and sustainability. They concluded that subsidized loan funds were more fragile and lost focus more quickly than those that obtained funds from depositors.

Institutionists have designed and propagated a set of "best practices" which should be adopted by industry to encourage institutional self-sufficiency (Woller *et al.*, 1999; Gibbons and Meehan*,* 2000). Best practices are practices that improve institutional efficiency and effectiveness in areas such as (Woller, *et al.,* 1999):

- management;
- management systems,
- finance and accounting and;
- product design.

Ledgerwood (1999:4) states that sound microfinance activities based on best practices play a decisive role in providing financial services to the poor through sustainable institutions. However, best practices are not regular practice for many MFIs. Best practices prescribe a situation where MFIs achieve sustainability while serving the poorest of the poor. In microfinance literature, this situation is referred to as the win-win situation.

This win-win proposition is based on the logic that MFIs that assume a financial intermediary role and are not dependent on subsidies are able to grow without the financial limitations of subsidy budgets. Therefore, such institutions can increase their outreach to the poor more than they can under donor funding. The key basis of this proposition is that the poor demand credit and not necessarily cheap credit. This is significant because it implies that the poor can afford credit if it is appropriately priced.

Table 1 summarizes recent empirical evidence that supports both arguments. Cull *et al*. (2007), Gutiemez-Neito *et al.* (2009) and Hermes *et al*. (2011) found a trade-off between sustainability and outreach. These results mean that there is not a situation where an institution can be sustainable while reaching the poorest of the poor. On the other hand, Mersland and Strom (2010) and Quayes (2012) found no trade-off between sustainability and outreach. The results of these studies mean that there is a situation where sustainability and outreach to the poor can be achieved. Therefore, there is no consensus that the adoption of best practices will ensure financial sustainability and an increase in outreach.

Table 1: Summary of empirical research on the trade-off between social and financial performance

Publication	Methodology	Data source	Outreach var.	Fin. efficiency var.	Conclusion
Cull et al. (2007): Financial performance and outreach: a global analysis of leading microbank	OLS	MicroBanking Bulletin, 124 MFIs, 49 countries, 1999–2002	Avg. loan size/GNP per capita, avg. loan size/ GNP per capita of poorest 20% of population, percentage women borrowers	Financial selfsustainability ratio	Trade-off: yes but magnitude depends on lending type
Gutie´rrez-Nieto et al. (2009): Social efficiency in microfinance institutions	Data envelopment analysis	MIX Market, 89 MFIs, unknown number of countries, 2003	DEA outputs: number of active women borrowers, poorest benefit dummy	DEA outputs: gross loan portfolio, financial revenue	Low positive relationship between outreach and financial efficiency; except one, no socially efficient but financially inefficient MFIs exist, NGOs more outreach
Mersland and Strom (2010): Microfinance mission drift?	Panel data estimation with instruments	Ratingfund, 379 MFIs, 74 countries, 1998–2008	Avg. loan size, main market, lending methodology, gender bias dummy	Avg. profit, avg. operational cost, Portfolio-at-Risk 30 days, age, assets	No evidence of trade-off. In contrast, more financial efficiency could lead to more outreach
Hermes et al. (2011): Outreach and efficiency of microfinance institutions	Stochastic frontier analysis	MIX Market, 435 MFIs, unknown number of countries, 1997–2007	ln(avg. loan size), percentage of female borrowers	Cost function: total costs	Trade-off: more financial efficiency implies less outreach since more efficiency can only be achieved by focusing less on poorest clients
Quayes (2012): Depth of outreach and financial sustainability of microfinance institutions	OLS, logistic regression, 3SLS	MIX Market, 702 MFIs, 83 countries, 2006	Avg. loan size/GNI, percentage of women borrowers	Gross loan portfolio, total equity, debt to equity, total expense ratio, cost per borrower, Dummy = 1 if operational selfsufficiency, loan loss reserve ratio >1	No trade-off except for low-disclosure MFIs

Source: Louis *et al.* 2013

Morduch (2000) critiques the arguments that support the win-win proposition that forms the basis of the institutionist argument. The summary of Morduch's (2000) critique is that the argument relies on empirical assumptions that cannot be easily generalized. Morduch (2000) further states that most empirical studies on best practices do not provide comparable attributes on factors that ensure best-practice.

In acknowledgement of the predominant institutionist view (Morduch, 2000), it is essential to raise the question; what are the challenges that MFIs face in achieving sustainability without compromising outreach?

2.3. Challenges to MFI Sustainability

The following section reviews the challenges faced by MFI as identified by the literature.

Ledgerwood (1999:4) highlights the many challenges that MFIs face. The list below highlights some of the issues:

- Many MFIs never reach either the minimal scale or the efficiency necessary to cover costs.
- Initial capital is often in the form of subsidy or grant due to the lack of private capital.
- Some MFIs target a segment of the population that has no access to business opportunities because of lack of markets, inputs and demand.
- Some MFIs mismanage their funds and fail to meet future cash needs and, consequently face liquidity problems.
- Some MFIs do not develop the financial systems or skills required.

2.3.1. Limited Access to Capital

Muller and Udhe (2008) state that competition for funding has increased due to the increased number of MFIs. As a result, the profitability of MFIs has become important for all MFIs, even those that operate as non-profit organizations.

Non-Profit Organizations are the most common entity choice for MFIs (Ledgerwood, 1999). According to Chu and Otero (2002), a majority of funding used by NGOs is often in the form of grants and concessionary loans. These statements illustrate the context of many MFIs by implying that at least six out of ten MFIs are likely to be NGOs and likely to be financed by grants and concessionary loans.

The effect of the source of funds on sustainability has polarized views in the literature. For instance, Buckley (1997) argues there is a positive correlation between outreach and donor funding. This is in the context of outreach being dependent on sustainability. In other words, outreach is in most case possible when the institution is sustainable. On the opposing end, Rhyne and Otero (1992) argue that outreach can be achieved through commercial loans and savings mobilization.

2.3.2. Governance

Another key component of the MFI sustainability debate is the internal governance of microfinance institutions. Harstaska (2004), stresses the importance of governance on performance while Hartarska and Mersland, (2012) argue that the use of accounting ratios alone is an insufficient measure of sustainability. Governance is a key component because an MFI's management and board are the ones tasked with achieving sustainability. (Lapenu and Pierret, 2006; Labie, 2000; Ledgerwood, 2000).

Therefore, MFI governance is reviewed within the context of sustainability. Questions such as; what is typical MFI governance, is there a trend towards sustainability driven governance and what are good governance factors, need to be addressed.

What is governance? In microfinance literature, governance refers to "the relationship between the board of directors and the management of the MFI (Lapenu and Pierre: 10, 2006)." Lapenu and Pierret, (2006) state that "good functioning" of the board is not sufficient to ensure a sustainable MFI, and that all other stakeholders must be considered in the definition of governance.

The presence of effective corporate governance can steer an MFI in the direction of achieving financial sustainability through strategic decision making (Rock *et al.*, 1998). An institution that has governance with a strong strategic focus is also better suited to deal with mission drift (Lapenu and Pierret, 2006). Rock *et al.* (1998) argue that aligning the interests of the directors with the interests of the institution is the key to strategic decision making.

Empirical, country specific studies indicate that internal governance in MFIs is a key factor to financial and social success (Muller and Udhe, 2008). These studies identify the following key success factors of internal corporate governance for strengthening MFI performance (Muller and Udhe, 2008): constitution, experience, remuneration, board independence and establishment of board oversight (Rock *et al*., 1998; Labie, 2000).

On the contrary, a study by Mersland and Strom (2007) found no empirical evidence that indicates that strong corporate governance in formal banks has an impact on the financial success of microfinance institutions.

Lapenu and Pierret (2006; 30) propose that institutions should be able to make sure that the foundation for good governance is in place. This foundation is made up of six fundamental elements:

- A shared strategic vision;
- A reliable and quick management information system to make decisions and aid monitoring;
- Decision-making processes that are clear, well-adapted and coherent with the governance structure;
- A level of staff training, capacity and involvement that ensures decisions are executed;
- An efficient monitoring system, and;
- Ability to prevent and overcome internal and external crises.

Labie (2000) supports this view by stating that the first step to good governance is to improve the control relationship between an MFI's board and its management.

2.3.3. Board Efficiency and Performance

A study on how managerial compensation, board independence, and auditing affect performance revealed that not all known governance mechanisms affect performance (Harstaska 2004). The study found that some traditional control mechanisms such as performance compensation are ineffective while mechanisms like board independence affect performance positively (Hartaska and Mersland, 2012; Hartarska, 2004).

Hartaska and Mersland's (2012) study estimated a stochastic cost frontier to measure the cost minimization goal of an MFI and to also measure output. The aim of the study was to identify mechanisms that promote governance in rated MFIs. The study reveals that:

- the joint role of CEO and Chairman of a board reduces efficiency (Mersland and Strom, 2007);
- managerial efficiency increases with boards that have up to nine members and less, and;
- the presence of donors in a board is less beneficial than the presence of creditors/clients on the board.

Mersland and Strom (2007) use a sample of rated MFIs to study the effect of corporate governance in MFIs. Their study found that ownership type of an MFI does not affect the productively. In other words, Non-profit MFIs or commercial MFIs can both have boards that affect performance positively or negatively.

Barry and Tacneng (2011) analyzed the effects of MFI organizational structure and external governance on its performance. The study used a panel of 281 MFIs in Africa from 1996 -2008 and found that the different institution types have varying financial and operational performance. More prominently, the study suggests that NGOs are the entities most likely to achieve the social goal of increasing outreach. However, these

institutions are less likely to achieve outreach while simultaneously achieving sustainability. Furthermore, external governance (regulation) is found to increase efficiency and productivity of MFIs without improving its portfolio quality.

Campion (1998) conducted a survey of 42 MFIs in Africa, Asia, Latin America and Europe. The focus of the survey was to identify the main issues related to the governance of MFIs. The survey also aimed to define effective governance practices in MFIs and subsequently develop guidelines for effective governance of MFIs. The survey revealed that an MFI's institutional structure has a limited role in determining the governance practices. In other words NGOs, For-profit MFIs, government institutions, and cooperatives tend to have similar governance practices.

In a study of 202 MFIs from 2001-2006, Tchakoute-Tchuigoua (2010) investigated the relationship between MFI type (legal status) and performance. The study revealed that there is a significant difference in financial performance, efficiency, size, solvency and portfolio quality dependent on the legal status of the MFIs. The study does not indicate any difference in profitability between NGOs and private MFIs. However, there is a difference in sustainability, with private MFIs being more sustainable than NGOs. The study further finds no difference in efficiency between NGOs and private companies. This seems contradictory because efficiency (cost reduction) is necessary for MFI sustainability. The author states that it is only when portfolio quality is used as an indicator for performance that private entities outperform NGOs.

Campion's (1998) survey highlighted that the there is an alignment of interests between management and board. This observation challenges the agency problem that is often faced in corporate governance where there is a misalignment of goals between management and board. In corporate governance the agency problem is combated by several mechanisms, one of them being incentivization and competitive remuneration.

2.3.5. Human Capital Efficiency

Whether they receive subsidies or not, MFIs charge high interest rates in order to cover their costs (D'Espallier *et al.*, 2011). MFIs mainly incur four types of costs, these include financing costs, provisions for loan losses, operational costs, and adjusted costs of capital (Ledgerwood, 2000). This raises the question as to whether the reduction of some of these costs might help reduce a portion of the administration costs and therefore increase in net profits. Hudon and Traca (2011) argue that subsidies have a positive impact on efficiency. However, after a certain threshold subsidies tend to make the institution less efficient.

Bhutt and Tang (2001) cited in Hudon and Traca (2011:968) argue that subsides to microfinance NGOs tend to end up funding inefficiency and poor management practices. This supports Morduch's (2000) argument that subsidies somewhat take away the responsibility of efficiency from management because several donors continue to fund poor performing MFIs as opposed to "punishing" them. The ultimate effect of this inefficiency is continued subsidy dependence and unsustainability.

In the same breath, subsidies also allow MFIs to invest in human and infrastructure efficiency (Hudson and Traca, 2011). Therefore the subsidies can indirectly improve efficiency, but only up to a certain threshold. This threshold could ideally be the point where the MFI moves towards sustainability and the donor gradually reduces the subsidy to zero.

In Africa, one of the most significant constraints to sustainability and growth is the scarcity of skilled manpower. Senior MFI managers reportedly lack vision and managerial capacity to create efficiencies (Ashcroft, 2008). Furthermore, the corporate governance is reportedly poor in a number of MFIs across Africa. Ashcraft (2008) argues that the poaching of staff, insufficient training and rising salaries make human resources one of the most difficult to control. Bauman (2005) found personnel costs as a percentage of total assets to be five times more than the global average. The costs faced by MFIs can

generally be classified as costs relating to the provision of financial services (direct costs) and non-financial service costs (indirect costs).

The Micro Banking Bulletin (1998) cited in Morduch (1999) conducted a comprehensive survey that indicated that only MFIs that serve the poorest of the poor could only cover 70% of their total costs. As a result MFIs that aim for greater outreach require donors, or in certain instances government to subsidize their costs (Khawari, 2004).

2.3.6. Repayment Rates

Microfinance's strong appeal is due in part to the recorded high payment rates (D'espallier *et al.*, 2011). Superficially it would be logical to assume that if MFI sustainability depends on cost reduction and income generation, high repayment rates should make this goal easy to achieve. However, several MFIs fail to be sustainable for various reasons, one of them being the inability to generate sufficient income to cover costs. Therefore, this suggests that a high payment rate can be inhibited by other factors.

Nawai and Shariff's (2012) study of factors that affect the repayment performance of microcredit programs in Malaysia found 10 factors. Amongst the ten factors was religious education, which would probably be specific to religious countries and not generalizable. Al Azzam *et al*. (2012) also found religious background to be a strong determining factor in repayment rates in Jordan. However, factors such as age, gender, business experience, total household income, distance to the lender offices, period of loan approval and loan monitoring (Nawai and Shariff, 2012) can be generalized.

The more prominent factor in repayment ability in microfinance globally has been gender. The literature presents a widely held view that women are generally less of a credit risk than men (Sagamba *et al*, 2013; D'espallier *et al*., 2011; Sharma and Zeller, 1997). It is evident that MFIs prefer female clients as illustrated by the famous Grameen Bank. The founder of the new wave of microfinance, Mohamed Yunus started the Grameen Bank by issuing small loans to women in rural Bangladesh (Bateman and Chang, 2012). Many MFIs

are encouraged to target women in anticipation of high repayment rates (D' espalier *et al*, 2011).

D'espallier *et al*. (2011) investigated this widely held belief by using a global data set of 350 MFIs in 70 countries. The study confirmed the belief by indicating that a higher percentage of female clients is associated with lower portfolio risk. The study further revealed that NGOs, individual-based and regulated MFIs benefit more from focusing on women. Implicit in D'espallier *et al*. (2011) study is the fact that MFIs follow prudential banking principles despite the higher rate of information asymmetry and lack of collateralization.

One of the more prominent microfinance innovations is the provision of loans on group basis (Baland *et al*., 2013; Kodongo and Kendi, 2013). This method of group-lending is meant to reduce the information asymmetry by transferring the responsibility of screening clients onto the other members in the group. The premise is that individuals in a group within a certain society are likely to know the credit worthiness of other potential members. Therefore, risk screening that can be more difficult to do, is done more efficiently by group members. There is no strong empirical evidence regarding the advantages and disadvantages of group lending versus individual lending in terms of repayment rates (Sharma and Zeller, 1997). Sharma and Zeller (1997; 1734) argue that this lending method might also contribute to higher default rate for the following reasons:

- when loans are received on the basis of joint liability, members might choose to finance a riskier project due to the shared risk;
- there is no clear way of selecting an ideal group size. If the group size is too big it poses communication and coordination problems. As a result the information gathering and group monitoring advantages are reduced;
- there are also disincentives attached to reneging on contracts, as each member expects that the effect of their action on other members is diluted.

Besides the group lending methodology as a way of ensuring payment, loan officers are also tasked with ensuring that clients make the repayments. They form an integral part of many MFIs, particularly MFIs with remote clients. Loan officers are the link between clients and the institution. Loan officers meet with clients in the early phases of securing a loan and once the loan is issued, they may in some cases collect the repayments from the client's villages/towns (Dixon *et al*., 2007; Sagamba *et al*., 2013).

2.4. Conclusion

The debate regarding the trade-off between institutional sustainability and outreach to the poor still continues. The results of some studies conducted do not support the "institutionist" view although there is some level of agreement that subsidies do not create better institutions. MFIs face a number of challenges in an attempt to achieve sustainability. When MFIs move towards sustainability, they raise the cost of borrowing and therefor exclude the very poor from accessing microfinance. Loan officers are under pressure to increase repayment rates and this affects their productivity. Group lending promises to reduce the information asymmetry that plagues microfinance. However, group lending can also contribute towards higher loan delinquency.

CHAPTER 3 RESEARCH METHODOLOGY

3.1. Introduction

This chapter details the study's research methodology. Section 3.2 details the research design. Section 3.4. discusses the sampling and case study selection. Section 3.5 discusses methods used to measure sustainability and assess governance. Section 3.6 discusses the research design validity.

3.2. Research Design

The study conducted an in-depth analysis in order to fully describe the sustainability of MFIs. In order to achieve this, the study not only assessed the financial performance of MFIs, it also assessed the reasons why some MFIs achieve sustainability while others do not. Since the study sought to answer a "how" and "why" type of question a descriptive qualitative research approach was adopted (Kumar, 2012). Therefore, the study adopted a multiple case study research approach using two South African MFIs as cases. Case study research is characteristically guided by theoretical framework in the data collection and generalization of the results (Yin, 2009). As a result, the research design was guided by microfinance theory which is based on empirical research that has emerged from microfinance literature.

The MFIs' financial statements were used to extract information on financial performance and sustainability. Firstly, the research established the sustainability of MFIs by using financial performance indicators that are prescribed by the literature. Secondly, a questionnaire was administered to the management of the case study MFIs. Thereafter, the results of the questionnaire and the literature were used to explain the results of the financial performance and sustainability analysis. Lastly the questionnaire results were used to assess the MFIs' corporate governance.

A quantitative methodology was not chosen for this study because it would only serve to answer the main research question: are South African MFIs sustainable? It would not explain the reasons why some institutions achieve sustainability while others do not. It

would also not allow for the assessment of the MFIs' corporate governance, which is mainly qualitative.

3.3.1. Theoretical Framework

The predominant theory states that microfinance institutions that rely on subsidies and not income from operations tend to be less financially sustainable (Morduch, 2000, Robinson, 1995; Hollis and Sweetman, 1996, Navajas et al. 1998; Woller and Dunford, 199). Theory also states that when microfinance institutions are sustainable, this sustainability is achieved at the cost of reduced client outreach (Navajas et al. 1998; Morduch, 2000)

Microfinance literature states that microfinance institutions are likely to be sustainable when:

- There is low loan delinquency.
- Low operating costs and high operational efficiency.
- MFIs provide appropriate products that suit the clientele.
- MFIs set interest rates that are not too high but high enough to cover all operating costs.
- Management has a strong governance and presence of a board of directors.
- The MFI has a long term strategic vision.

Conversely, microfinance literature states that microfinance institutions are likely to be unsustainable when:

- There is high loan delinquency.
- High operating costs.
- Mismatch between product provision and clientele requirements.
- The absence of a board of directors and poor governance.
- The MFI does not have a long term vision and clients are aware of this.

3.4. Sampling

Case study research does not follow the same sampling logic as other methods of research. This is due to the fact that case study research does not aim to make statistical inferences about a population. Case studies aim to make analytical generalization as opposed to statistical generalization. As a result, units to be investigated are not randomly sampled from a population. In case study research, the selection of the "case" is based on the representation of the case. In other words, a case can be selected because it represents a critical test of existing theory. The case may also be selected because it is a rare or unique circumstance. A case may also represent a typical case, revelatory or longitudinal (Yin, 2009).

The above criteria are significant considerations for selecting single and multiple case studies. However, for multiple case studies, another consideration in the design is given. The design follows replication logic as opposed to sampling logic. Replication logic is analogous to the logic used in multiple experiments (Yin, 2009; 54). Therefore, each case is selected so that it either predicts similar results (literal replication) or predicts contrasting results but for anticipatable reasons; theoretical replication (Yin, 2009).

The rationale for this selection was driven by the theoretical framework cited in the literature review and stated above.

3.4.2 Case selection and Exclusions

The selection of the case units was based on their age, mission statement, the presence of a board of directors and corporate governance. The selected cases have the same mission statement: provision of finance to the poor. One institution provides financing for entrepreneurial females in the rural area of Mpumalanga. The other microfinance institution provides financing for entrepreneurial females in the rural area of Limpopo. The two MFIs are similar in mission statement, corporate governance and clientele. Most importantly, both microfinance institutions aim to increase their clientele. The two microfinance institutions are considered typical microfinance institutions because of their

practices, clientele and mission statement. This is in line with the literature definition of a microfinance institution.

The following institution types were not considered in the selection of cases. Although they fall under the definition of MFIs, they are not the most common form of MFI in South Africa whereas NGOs are the most common form of MFI in most countries (Ledgerwood, 1999):

- Credit unions
- Savings banks and postal savings banks
- Loan cooperatives
- Government SMME finance institutions

3.5. Measures

The section below discusses the performance indicators used to measure sustainability. It also discusses the indicators used to assess the characteristics of good corporate governance.

3.5.1. Operational and Financial sustainability

In order to measure the sustainability of microfinance institutions the study utilized the CGAP Technical Guide as recommended in the Good Practice Guidelines for Funders of Microfinance (CGAP 2009). The guide is a tool used by funding agencies that design or monitor projects; and agencies that finance MFIs or community-managed loan funds. A number of studies on microfinance institution sustainability have used this guideline in their analysis of microfinance performance (Mustafa & Saat, 2012). The assessment of MFI performance focused on outreach, collection performance, financial sustainability and efficiency.

The following parameters were used to measure the financial performance of MFIs:

1. ***Outreach*** – this indicator measures the number of active clients and the level of poor clients reached. The number of active clients includes borrowers, depositors, and other clients who are currently accessing any financial services.

2. ***Portfolio quality*** – this indicator measures the MFI's ability to collect loans. The collection of loans is critical to the MFI's success. It is also a proxy for the MFI's general management competence. This indicator is considered one of the more revealing indicators because well performing MFIs seldom have bad management and vice versa. For this indicator the Portfolio at Risk (PAR) ratio and Write-off Ratio will be utilized.

    a. **Portfolio at Risk** for loans outstanding for more than 30 days is the most widely accepted measure of portfolio quality. It shows the portion of the portfolio that is "contaminated" by arrears and therefore at risk of not being repaid. The older the delinquency, the less likely that the loan will be repaid. High delinquency makes financial sustainability unachievable for an institution (Isern *et al.,* 2007). Generally speaking, any Portfolio at Risk exceeding 10% should be a cause for concern, because unlike commercial loans, most micro loans are not backed by bankable collateral (Microrate, 2003:6; Rosenberg, 2009).

        $$\text{PAR} = \frac{\text{Outstanding balance of loans with payments past due}}{\text{Portfolio outstanding (including amounts past due)}}$$

    b. **Write-off Ratio** represents the loans that the institution has removed from its books because of a substantial doubt that they will be recovered. The writing off of a loan is an accounting transaction to prevent assets from being unrealistically inflated by loans that may not be recovered. The writing off of a loan affects the gross loan portfolio and loan loss reserves

equally. Unless provision reserves are inadequate, the transaction will not affect total assets, net loan portfolio, expenses or net income. Write-offs have no bearing on collection efforts or on the client's obligation to repay (Microrate, 2003: 13; Rosenberg, 2009).

$$\text{Write-off Ratio} = \frac{\text{Value of loans written off during period}}{\text{Average gross loan portfolio during period}}$$

3. ***Financial Sustainability and Profitability*** – this indicator measures the MFIs ability to maintain and expand the financial services they offer while covering all their costs and generating net income.
    - For subsidized MFIs: Operational Self-Sufficiency (OSS), Return on Assets (ROA) and Adjusted Return on Equity (AROE) will be used:

$$\text{ROA} = \frac{\text{After-tax profits during period}}{\text{Starting (or period-average) assets}}$$

$$\text{OSS} = \frac{\text{Operating Income during period}}{\text{Operating expenses + financing costs + provision for loan losses during period}}$$

    - For non-subsidized: Return on Equity (ROE) will be used.

$$\text{ROE} = \frac{\text{After-tax profits during period}}{\text{Starting (or period-average) equity during period}}$$

4. ***Efficiency***- this indicator measures how much an MFI earns on loans versus how much it spends to make them and monitor them. This is one of the most important indicators because the high cost of issuing loans is what characterizes microfinance worldwide.

a. **Cost per client** indicates how much it costs the retail financial service provider to serve each client. Because it does not penalize smaller loans, cost per client is a better efficiency ratio for comparing institutions. The 5 year trend analysis for MFI B was inflation adjusted using historical CPI data and 2011 as the base year.

$$\text{Cost per client (or loan)} = \frac{\text{Personnel and administrative expense}}{\text{Period-average number of active client or loans}}$$

b. **Operating Expense Ratio** is the most widely used indicator of efficiency. It allows for a comparison between an MFI's portfolio yield with its personnel and administrative expenses. This is how much an MFI earns on loans versus how much it spends to make and monitor them. However, it has the effect of making an MFI that issues small loans look worse than an MFI that issues large loans, even if both are efficiently managed.

$$\text{Operating expense ratio (OER)} = \frac{\text{Personnel and administrative expense}}{\text{Period-average gross loan portfolio}}$$

3.5.2. Governance

Although the literature on microfinance institutional governance is relatively new and scant, there are studies that highlight the factors that make up good governance (Pistelli et al, 2012; Lapenu and Pierret, 2006).

This study adopted the guidelines and findings of Pistelli *et al.,* (2012) pilot project on the measurement of governance in microfinance. The aims of Pistelli *et al*., (2012) study was to enhance the understanding of MFI Board structure, policies and activities. A few studies on governance in microfinance exist (Mersland and Strom, 2007; Hartarska, 2004; Rock *et al*., 1998; Hartaska and Mersland, 2012). However, none of them aimed to develop benchmark indicators. The findings of Pistelli *et al*., (2012) study were used as a benchmark because it is the first and only study to develop indicators and benchmarks for microfinance governance. Pistelli *et al*., (2012) study tested a new set of governance

indicators in 2011 among a sample of 162 MFIs across 57 countries. These indicators were selected by the Institutional Governance Working Group of the World Microfinance Forum of Geneva (Pistelli *et al*, 2012). The measurement of governance focused on the following areas:

1. *Board Structure and Characteristics*

A good Board should encompass a range of expertise and experience as well as represent key stakeholders and maintain a significant degree of independence. The indicators are; number of Board members and number of independent Board members (Pistelli *et al*., 2012:12).

2. *Board Activity and Engagement*

To assess Board activity and commitment towards an MFI, questions regarding meeting frequency and attendance were asked. To evaluate Board effectiveness in developing policies addressing key business drivers, MFIs were asked which Board policies had changed within the last 3 years. The indicators are frequency of Board meetings, Board meeting attendance and, Board policy changes (Pistelli *et al*., 2012:13)

3. *Risk Management*

As an organization increases in complexity, separating the CEO function from the Chairman function serves to reduce negative effects of power concentration and the risks associated with losing a key person ("key person risk"). A widely accepted factor of good risk management is establishing an independent risk management and internal audit function. The indicators are; separation of Chairman and CEO, funder voting rights on committees and, presence of risk management and audit functions.

3.6. Data Collection and analysis

Case study research relies on multiple sources of evidence with the convergence of data (Yin, 2009; 18). In case study research, data collection and analysis are guided by theoretical propositions.

3.6.1 Data Collection

The data collection consisted of two steps. Firstly, financial statements was collected from the selected case study units. Due to the sensitivity of the information contained in the financial documents, one MFI requested that it not be directly mentioned by name in the study. Therefore neither MFIs are mentioned by name in the study. They are referred to as MFI A and MFI B.

The MFIs were requested to provide a minimum of 3 years annual financial statements. MFI B provided 5 years' worth of financial statements for analysis while MFI A only provided two years' worth of financials. For that reason, the inter case comparisons will be made on the two years (2010 and 2011) of data that both MFIs have provided. Since only MFI B provided 5 years annual financial statements, a comprehensive trend analysis of the MFI's performance was conducted to investigate whether or not the MFI is moving towards or away from sustainability.

Secondly, a structured questionnaire was used to collect data relating to governance performance and insight into managerial practices. The MFI executives were the only recipients of the questionnaire because they have control over the institutions governance. The questionnaire contained both open-ended and closed ended questions. The closed ended questions collected data relating to the institutions operational practices, human resource management and management policy. The open-ended questions collected data relating to the performance measures.

An Adobe PDF and MS Word document was sent to the executives. This was to allow the respondents the option of completing the questionnaire electronically on the MS Word

document. Respondents then emailed the complete MS Word document to the researcher.

Self-administered questionnaires have the advantage of reducing interviewer bias, being convenient and more likely to encourage truthful responses due to lack of pressure and intrusion. Conversely, their method of administration makes the response time slow and response rate low. For this reason, the respondents were given 4 weeks to complete the questionnaire.

3.6.2. Data analysis

The sustainability data collected was calculated into ratios using the guidelines set in the CGAP Technical Guide (2009). The financial statements were adjusted for inflation and implicit and explicit subsidies such as access to funds on a grant or soft loan basis. This subsidy adjustment is prescribed in the in literature (Ledgerwood, 1999; CGAP 2003). Adjusting the financial statements allowed for a more meaningful comparison of performance among MFIs with differing amounts of subsidies.

The Micro Banking Bulletin Sub-Saharan Africa Microfinance Analysis and Benchmarking Report 2010 was used to compare the performance of the case study MFIs to those of the continental MFIs. There was no publication of the benchmarks data post 2010.

The Micro Banking Bulletin is a benchmarking source for the microfinance industry. The benchmarks focused on the following peer groups for these specified reasons:

- **Southern African MFIs** – Country factors such as poverty levels, economic environment and population densities are heterogeneous. However, due to geographical and SADC membership, the Southern African countries are more likely to have more similarities than Eastern, Central or Western African countries.
- **NGO Entities** – MFI A and MFI B are both registered as Non Profit Organizations.

- **Young, New and Mature MFIs** – This is to account for the age differences of the two cases and attempt to increase the similarities of the benchmark panel MFIs and the cases.

The questionnaire collected ordinal, nominal and scale data. The data was captured using SPSS Statistical software. SPSS is a data management and analysis tool which is commonly used in Social Science research (www.uwindsor.ca). The software allowed for the input of data and comprehensive analysis of data by generating tabulated reports, charts and descriptive statistics.

The analysis was interpreted by using the theoretical framework on causes of inefficiency, governance issues and institutional capacity matters. As a result, the questionnaire data was interpreted in reference to the performance ratio by looking for patterns described in the theoretical framework.

3.7. Criticism of Case Study

Case studies are commonly criticized for the lack of rigor and too much reliance on the researcher as a data collection tool. Other research methods are considered to be more rigorous due to the existence of numerous methodological texts which provide researchers with specific procedures to be followed (Yin 2009).

The second and most important criticism is the inability to make scientific generalizations from case studies (Yin, 2009). However, Yin (2009) argues that case studies make generalizations on theories as opposed to statistical generalizations after analyzing a sample. In cognizance of this criticism, this research followed the following validity procedures to ensure rigor in the study and consistency in data collection and analysis.

- Construct Validity: In order to gain further insight into the phenomenon. The use of multiple sources of evidence assisted in establishing a chain of evidence. After the data was collected, follow up questions were conducted in order to corroborate the data collected from financial statements and questionnaire.

- Internal Validity: Internal validity was addressed through pattern matching. The theoretical framework that guided the data collection had put forward observations that were likely to occur. The case study design phase addressed the existing theories and potential rival theories. The study observed the patterns which are consistent with the theoretical framework and also identified inconsistencies. Since two cases have been selected in the case study, the researcher focused on how and why certain operations were observed in one case and not the other. The study also linked the analysis of the theory reviewed in the literature to the data collected.
- External Validity: The use of two cases allowed for inter case comparisons and made analytical generalizations through replication logic. Specifically, the two cases have been selected because they possessed different theoretical conditions. The study expected different results from the cases but for predictable reasons. If the results of the data analysis were different as predicted, theoretical replication would be claimed.
- Reliability: In order to achieve reliability, a case study protocol was used in the data collection phase. Case study protocol is a set of questions that the researcher uses to guide the data collection. A log of the financial statements collected was kept in order to ensure consistency in data collection. The questionnaire had the same questions for both cases and equal time was allowed for responses. After data collection, follow up questions were conducted to ensure construct validity.

3.8. Conclusion

This chapter detailed the design and methods of the study. It also described the data collected. The quantitative data was analyzed using GCAP prescribed accounting ratio. The results of the ratios were benchmarked against other African and international MFIs using the MicroBanking Bulletin. The questionnaire data was analyzed using SPSS software and theoretical framework. The chapter also discussed the choice of cases and

justified the use and selection of the case units. Case study criticism was highlighted and remedies to the criticism were presented.

CHAPTER 4 EMPIRICAL ANALYSIS AND DISCUSSION

4.1. Introduction

This chapter presents and discusses the findings of the financial statement analysis and the responses of the surveyed institutions. Section 4.2 begins with an analysis of operational self-sufficiency and profitability, portfolio quality, outreach and efficiency in order to determine sustainability. The MFIs are compared to the benchmarks and amongst each other in order to identify variations and similarities. Thereafter, Section 4.3 analyses the governance of the MFIs using the survey responses. Section 4.4 provides a summary of findings and section 4.5 concludes.

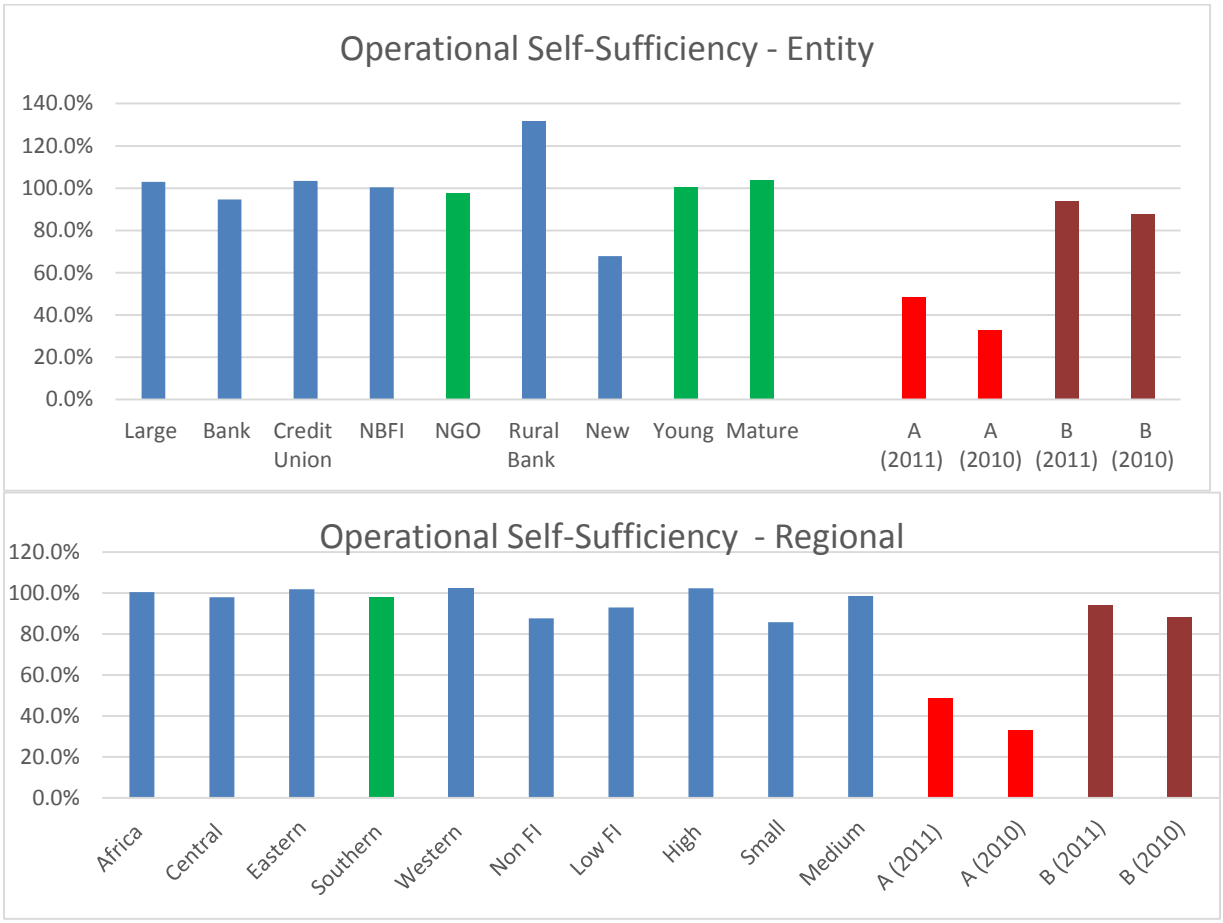
4.2. Sustainability Analysis

4.2.1. Operational Self-Sufficiency and Profitability

Figure 1 indicates that MFI A and B did not achieve an operational self-sufficiency of a 100% or more. Therefore both MFIs are not operationally self-sufficient. MFI A's operational self-sufficiency ratio increased by 15% between 2010 and 2011 while MFI B's increased by only 6%. The benchmark comparison indicates that both MFIs underperformed NGO, Young, Mature and Southern MFIs on a regional comparison.

The disparity in the performance is partly influenced by the age difference. The average age of the NGO MFIs in the benchmark data set is ten years. MFI A is 5 years old. MFI A's operational self-sufficiency is closer in comparison to New (3 years old) than Young MFIs (7 years old). MFI B is twenty one years old. It outperforms New MFIs but fails to outperform Young MFIs even though it is fourteen years older. This indicates the level of South African MFIs inability to generate sufficient revenue to expenses or to keep operating costs low.

Figure 1: Operational Self-Sufficiency



Source: Microfinance Information Exchange 2010 and MFI Financials Statements

Operational self-sufficiency is directly affected by the factors discussed below. The first factor is an institution's ability to generate income by pricing its interest rates correctly and efficiently collecting fees (Conning, 1999; Robinson 1996). MFI A and MFI B collect interest income and services fees. In the case of MFI A, the interest received and services fees are only 51% of total operating expenses. In a self-sufficient institution, interest received and service fees should be more than expenses. At the very least, interest and service fees should be equal to the expenses. The latter applies to MFI B, where the revenue from interest and fees is 97% of total operating expenses.

The second factor is an MFI's ability to effectively collect loan repayments, thus maintaining a strong portfolio quality. The ability to collect payments reduces the loan provision expense. MFI A's portfolio at risk and write-off ratio are higher than MFI B.

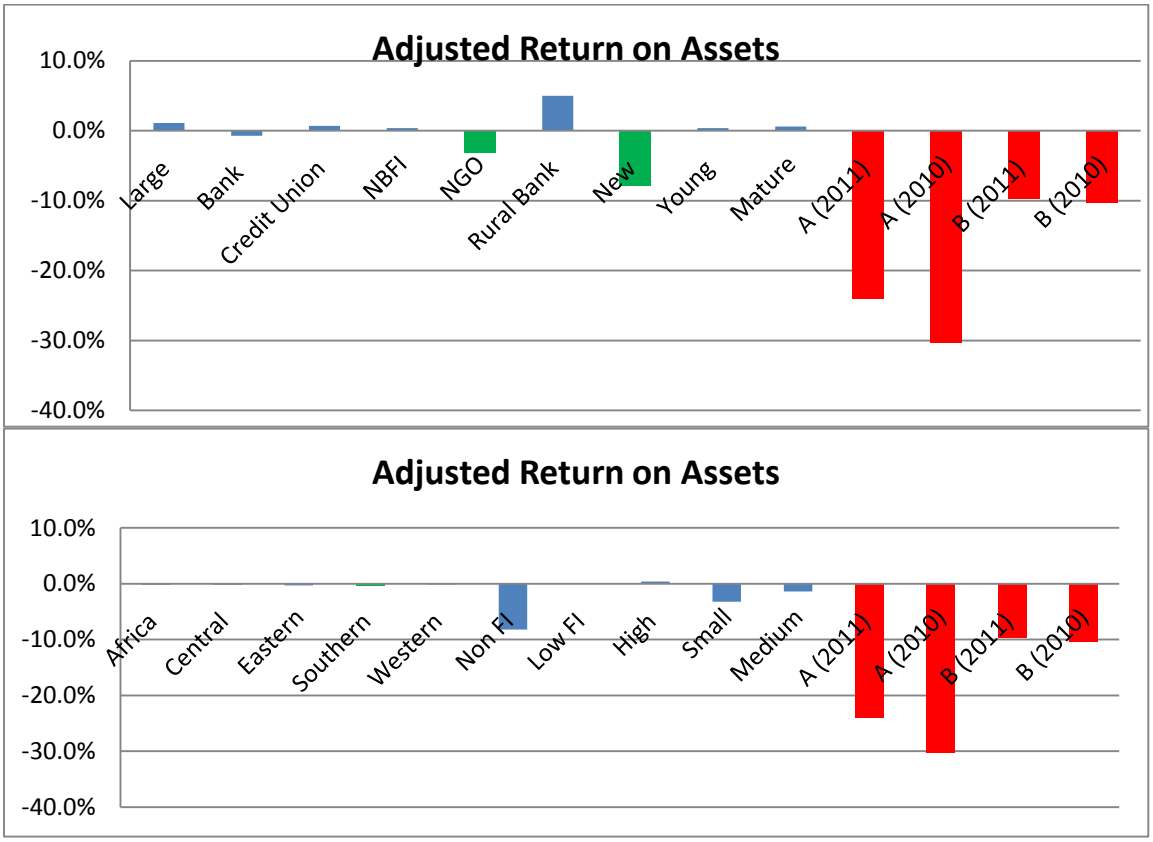
The third factor is an MFI's ability to effectively manage its operating expenses. MFI A exhibited a higher cost per loan and operating expense ratio than MFI B.

4.2.1.1. Adjusted Return on Assets

Figure 2 indicates that MFI A and B did not achieve a positive return on assets. This means that MFI A and B are unable to yield a positive income after inflation and subsidy adjustments. Furthermore, when the MFIs' liabilities are treated as if they were at market costs, the operating income is not sufficient to absorb that adjustment. Therefore both MFIs are not profitable. MFI A's negative return on assets decreased from -30% in 2010 to -24% in 2011 while MFI B's decreased by a marginal 0.5%. The benchmark comparison indicates that both MFIs underperformed NGO, Young, New and Southern MFIs on a regional basis.

Although both MFIs achieved a negative return on assets, Figure 2 indicates that MFI B performed better than MFI A. According to Mersland and Strom (2007) the return on assets is directly affected by average loan size disbursed. MFI A's average loan size is approximately R1800 while MFI B's is R2300. A higher average loan improves the return on assets while a lower average loans size reduces the return on assets.

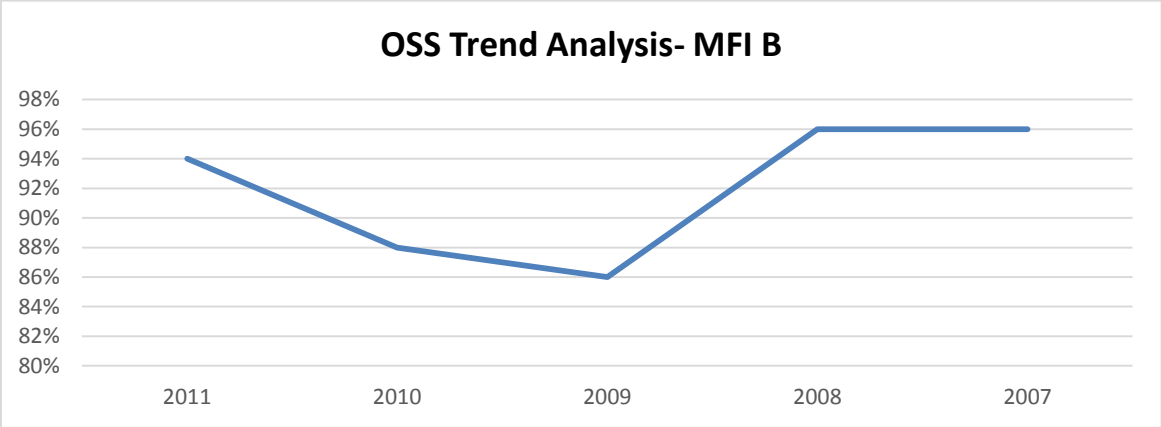
Figure 2: Adjusted Return on Assets



Source: Microfinance Information Exchange 2010 and MFI Financials Statements

A five year review of MFI B's operating self-sufficiency in Figure 3 indicates that MFI B experienced an operational self-sufficiency of 96% for 2007 and 2008. In 2009 it sharply decreased to 86% and only increased by 2% in 2010. The ratio then increased by 6% in 2011. The data indicates volatility in the MFI B's revenue and subsidies. In the 5 year period, the MFI did not achieve a 100% ratio on operational self-sufficiency. In 2009, MFI B experienced an after tax adjusted profit but the financial expense, loan-loss provision expense, and operating expenses were high. This resulted in the sharp decline in operational self-sufficiency in 2009.

Figure 3: Operational Self-Sufficiency Trend Analysis



Source: Microfinance Information Exchange 2010 and MFI Financials Statements

In the absence of grants, an MFI that does not reach sustainability will eventually decrease its loan fund capital as operating expenses increase more than the revenue. As a result the MFI will have a smaller pool of funds to loan to borrowers, thus reducing its ability to serve the poor.

4.2.2. Portfolio Quality

As mentioned, this indicator measures the MFI's ability to collect loans and maintain a portfolio that is unlikely to be lost due to unpaid loans.

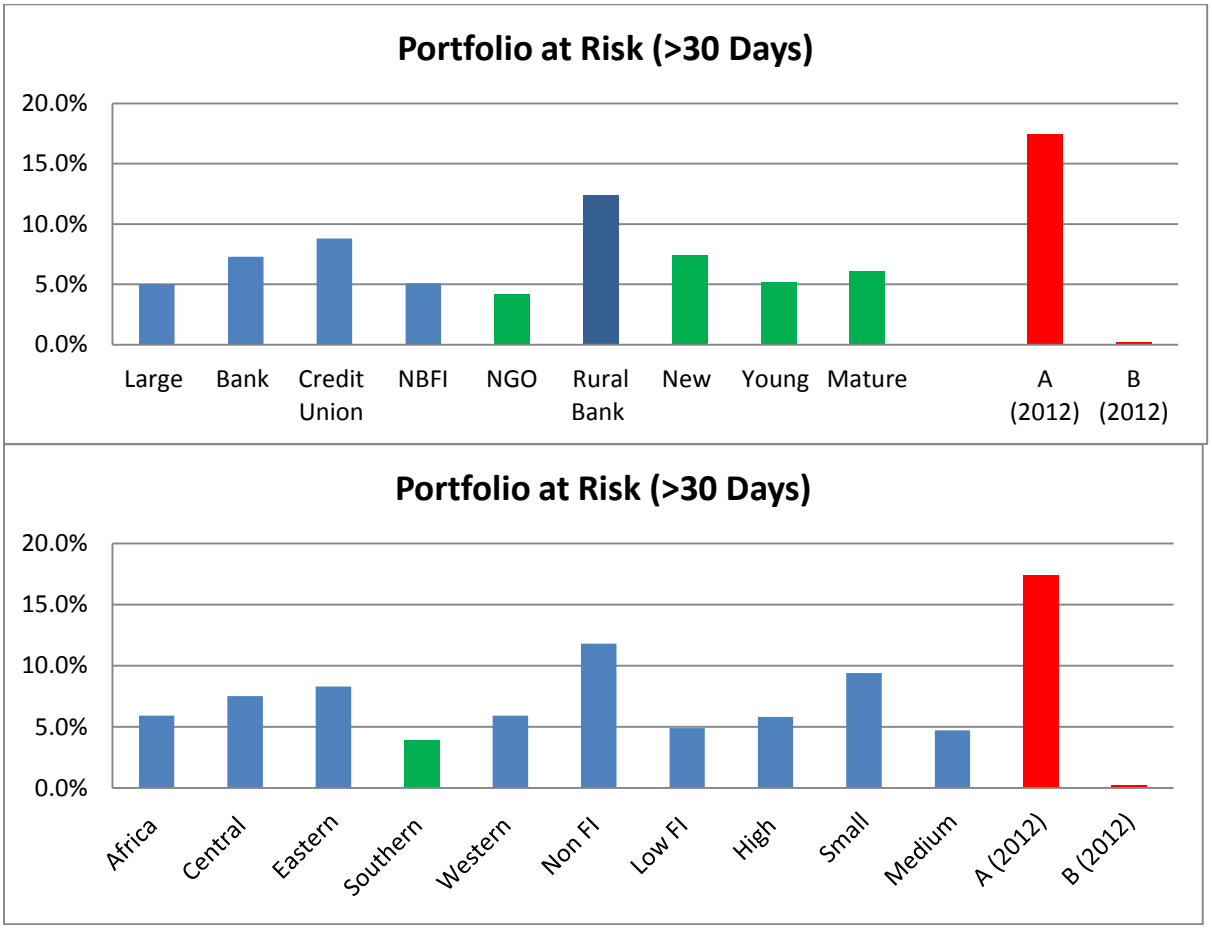
4.2.2.1. Portfolio at Risk

Figure 4 indicates that MFI A had a portfolio at risk of 17%. This is approximately four times higher than the NGO and Southern MFIs benchmark. This means that 17% of the portfolio was at risk of not being repaid. MFI A indicated that on average 61-80% of their clients return for loans. The remaining 20-40% possibly do not return due to previous failure to pay. Even the Young and New benchmarks in Africa exhibited a lower portfolio at risk than MFI A. Younger MFIs are expected to have higher portfolio at risk because they have not built a strong database of low loan risk clients. The longer an MFI trades the likely it is to improve its client screening capabilities. A high share of unrecoverable

loans can significantly diminish the portfolio's income generating ability. High portfolio at risk and write-off ratio reduce the MFI's assets on the balance sheet and hence it's ROA.

As Figure 4 indicates MFI B had an extremely low portfolio at risk when compared to other MFIs in the benchmark. The reason for this glaring difference in the benchmark performance can only be speculative in the absence of empirical study on African MFI loan portfolio quality.

Figure 4: Portfolio at Risk



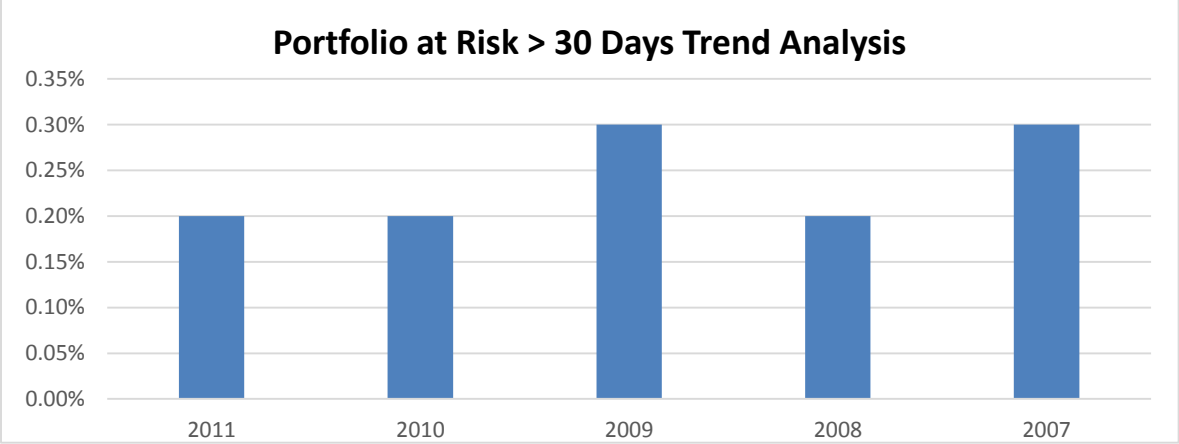
Source: Microfinance Information Exchange 2010 and MFI Financials Statements

An investigation into MFI B's low portfolio at risk reveals that it has been consistently low at an average of 0.24% for the five years under review as indicated in Figure 5. The survey results revealed that MFI B's main clientele is female and it uses group lending method to administer loans. When asked to explain the low ratio, MFI B attributed this to the group

lending method. Furthermore, its loan officer meet with clients twice a month in order to address payment challenges that they may be facing. However, MFI B did not reveal the specific actions taken to address these challenges. MFI B also stated that "clients have so much respect for MFI B as an institution that they do not want to disappoint us, so they prioritise repaying us to maintain a good relationship." The literature suggests that clients are mainly motivated to pay their loans promptly when they have confidence that the MFI will continue to provide loans.

As stated in the literature, strong portfolio quality in microfinance is driven by gender and a group lending methodology. Another likely reason is the high retention rate. When asked about the retention rate, MFI B stated a rate of 80%-100%. If 80-100% of the clients return for loans then the risk of lending to risky clients is reduced because the MFI already knows the client's profile. It is therefore in a good position to filter out potentially bad clients thus reducing the risk of default.

Figure 5: Portfolio at Risk Trend Analysis



Source: Microfinance Information Exchange 2010 and MFI Financials Statements

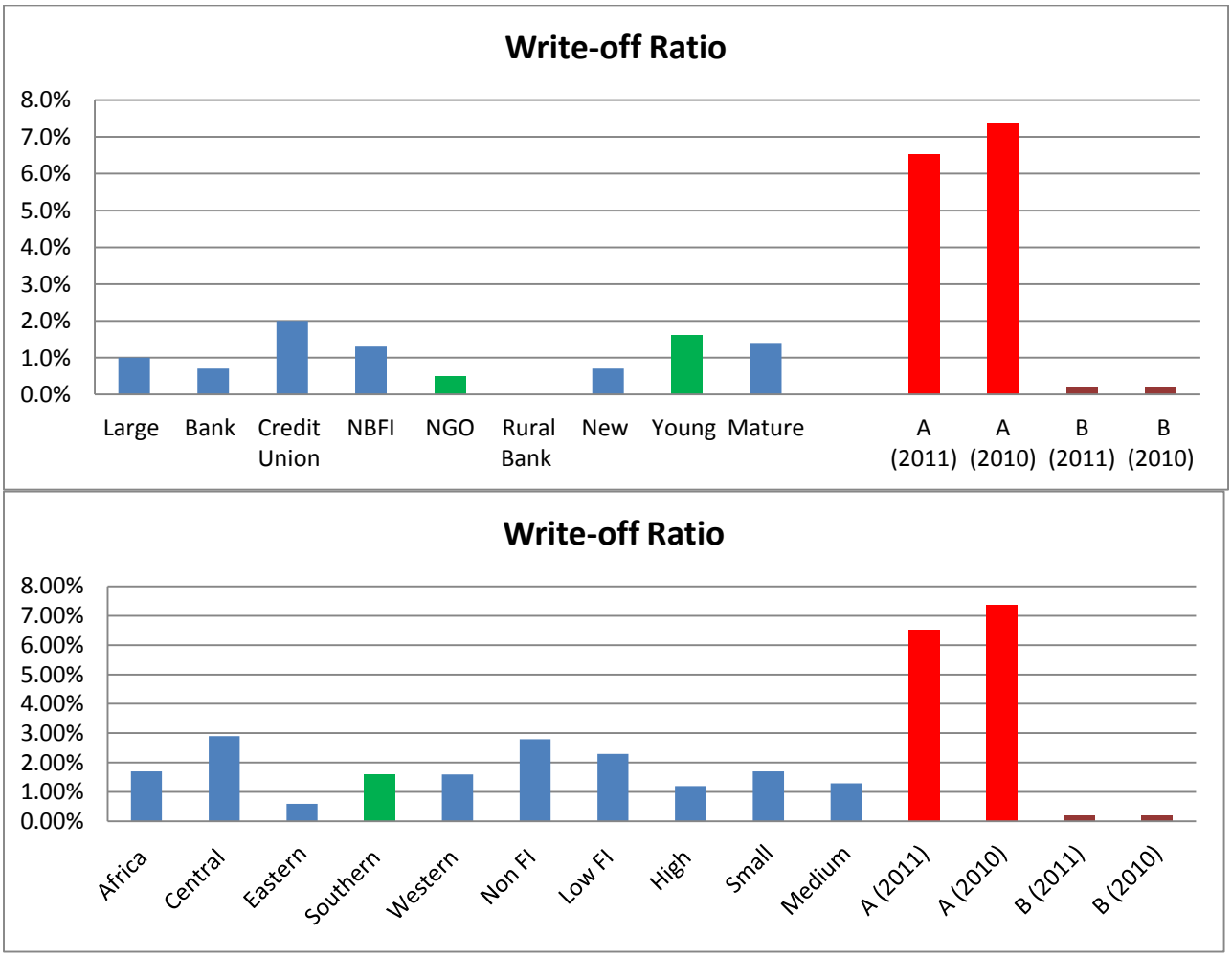
4.2.2.2. Write off- Ratio

This ratio represents the percentage of an MFI's loans that have been removed from the balance of the gross loan portfolio because they are unlikely to be repaid. A high ratio

may indicate a problem in the MFI's collection efforts. However, write-off policies vary, and that makes comparisons among MFIs difficult.

When compared to the NGO, New and Young MFIs in Figure 6 MFI A has a higher write-off ratio. As it is with the portfolio at risk, new and young MFIs are expected to have a higher write-off ratio than older MFIs. It is therefore not uncommon for MFI A to have a high write off ratio. However, at 6% and 7% it is exceptionally higher than the benchmark. As it was with the portfolio at risk, MFI B's write-off ratio is significantly lower than the benchmark.

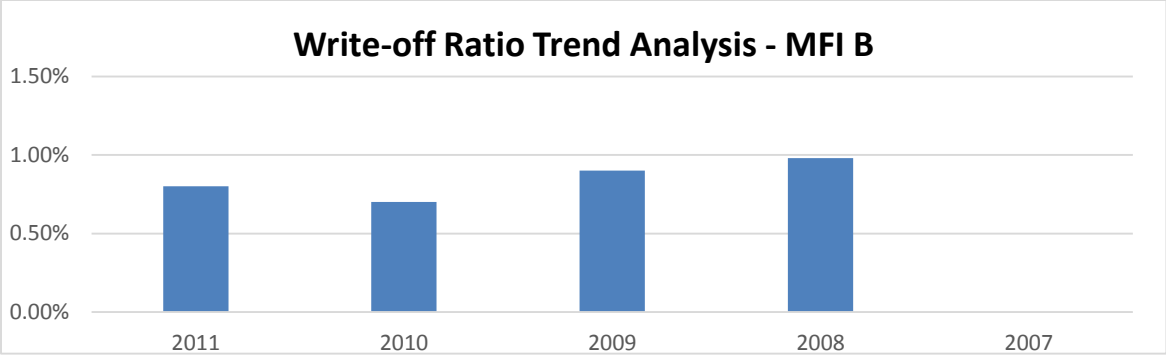
Figure 6: Write-Off Ratio



Source: Microfinance Information Exchange 2010 and MFI Financials Statements

An investigation into MFI B's lower write-off ratio revealed that the ratio remained below 1% over the 5 year period under review as Figure 7 indicates.

Figure 7: Write-off Ratio Trend Analysis



Source: Microfinance Information Exchange 2010 and MFI Financials Statements

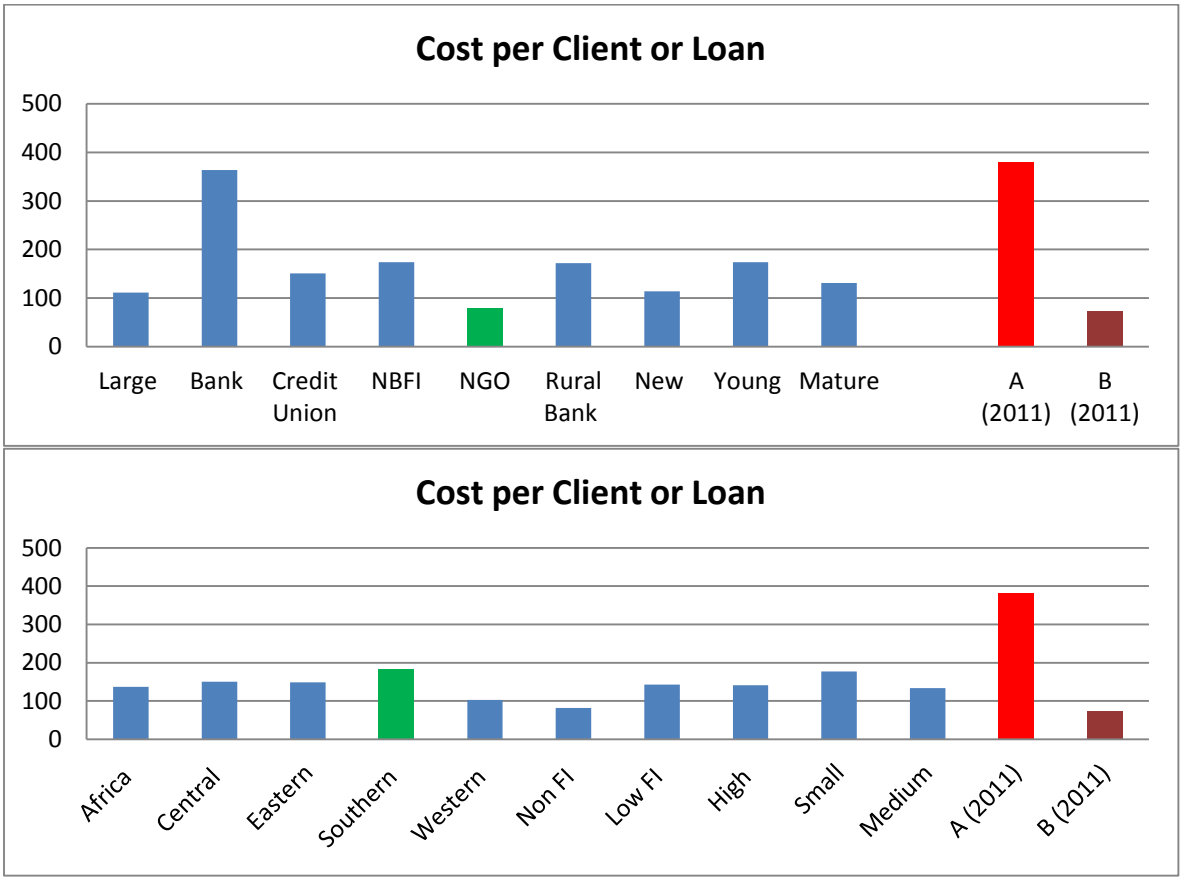
A comparison of the two MFIs indicates that MFI A had a higher loan delinquency than MFI B. Both MFIs use group lending method to administer loans. This might be the main reason for the strong portfolio quality for MFI B and also the reason for a poor portfolio quality for MFI A. The use of group lending methodology to issue loans provides a screening and peer pressure mechanism which inherently reduce the payment risk. However, this same methodology can create wild-fire delinquency as clients watch their peers default, they lose confidence in the MFI's ability to serve them in the future (GCAP, 1999).

4.2.3. Efficiency

4.2.3..1. Cost per Client

Figure 8 indicates that the cost per client for MFI A was extremely higher than all MFIs in the benchmark. Compared to the NGO cost per client of 78, MFI A was 381. MFI A cited South Africa's high cost of labour and low population densities in the MFI's primary market as the main contributor to these high costs. When compared to other regions, MFI A had high cost per client while MFI B's was lower than the benchmark. MFI B also cited high personnel costs as it's the main contributor to its costs.

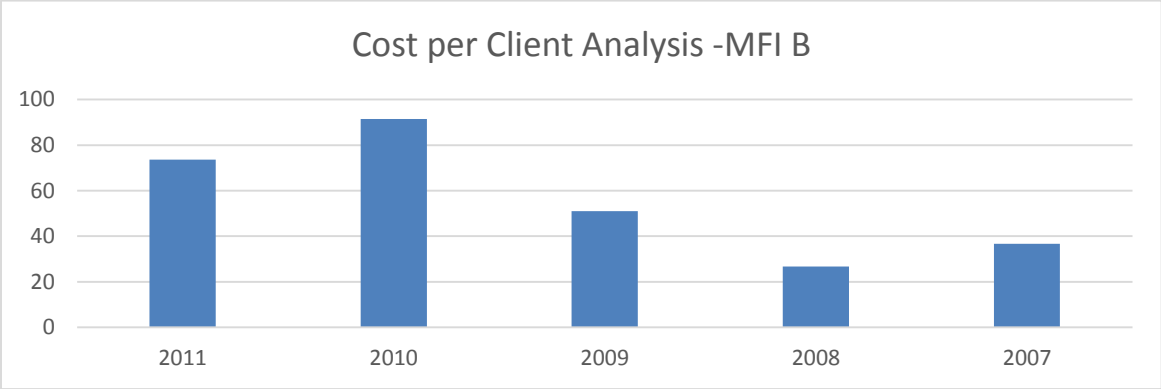
Figure 8: Cost per Client Benchmark (Dollar Value)



Source: Microfinance Information Exchange 2010 and MFI Financials Statements

A five year analysis of MFI B's cost per client in Figure 9 indicates that it was low in 2008 and then it increased by 50% in 2009 and 2010. Although the ratio decreased in 2011, it did not decrease to its lowest level of 27. In 2008 when the ratio was at its lowest, the number of clients had increased by 22% from the previous year. From 2009 to 2011, the number of clients increased by a steady average of 14% yet during that period the ratio was a bit volatile.

Figure 9: Cost per Client Trend Analysis



Source: Microfinance Information Exchange 2010 and MFI Financials Statements

4.2.3.2. Operating Expense Ratio

Figure 10 indicates that, MFI A's operating expense ratio was 99% in 2010 and 76% in 2011. This ratio was significantly higher than the NGO (38%), New (59%) and Young (42%) benchmark. Younger MFIs commonly have high operating expense ratios. MFI B's ratio was 36% in 2010 and 32% in 2011. In both years, the ratio was below the NGO benchmark of 38%. Although MFI B is six years older than the average age of the Mature benchmark, it underperformed by 7%.

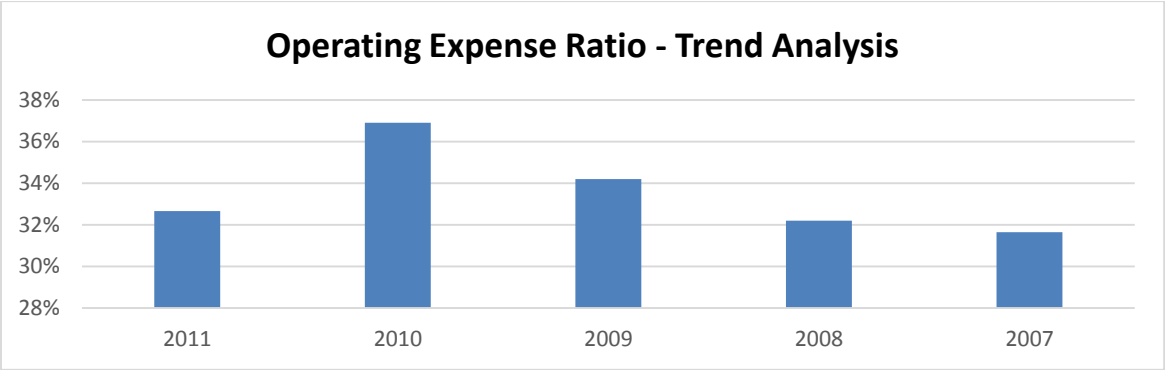
Figure 10: Operating Expense Ratio

Source: Microfinance Information Exchange 2010 and MFI Financials Statements

A comparison of MFI A and B in Figure 1 indicates that MFI B had lower operating expense ratio. A reason for this disparity is that older MFIs tend to have lower operating expense ratio (Gonzales, 2007). Therefore, MFI B is expected to have a much lower operating expense ratio because it is fifteen years older than MFI A. One explanation for this efficiency is that subsidies have a positive impact on efficiency. However, after a certain threshold subsidies tend to make the institution less efficient (Hudon and Traca, 2011). Furthermore, MFIs that serve more than 2000 clients tend to have a lower operating expense ratio than MFIs that serve a smaller client base. MFI A has 1079 clients while MFI B has 87293. However, after 5000 clients, the operating expense ratio ceases to be lower than that of smaller clients MFIs (Gonzalez, 2007).

As the literature suggests, MFI B's operating expense ratio should be almost constant or declining at a slow rate but that has not been the case as Figure 25 below indicates. Figure 11 shows that MFI B's operating expense ratio increased over a period of 4 years and only decreased in 2011.

Figure 11: Operating Expense Ratio Trend Analysis



Source: Microfinance Information Exchange 2010 and MFI Financials Statement

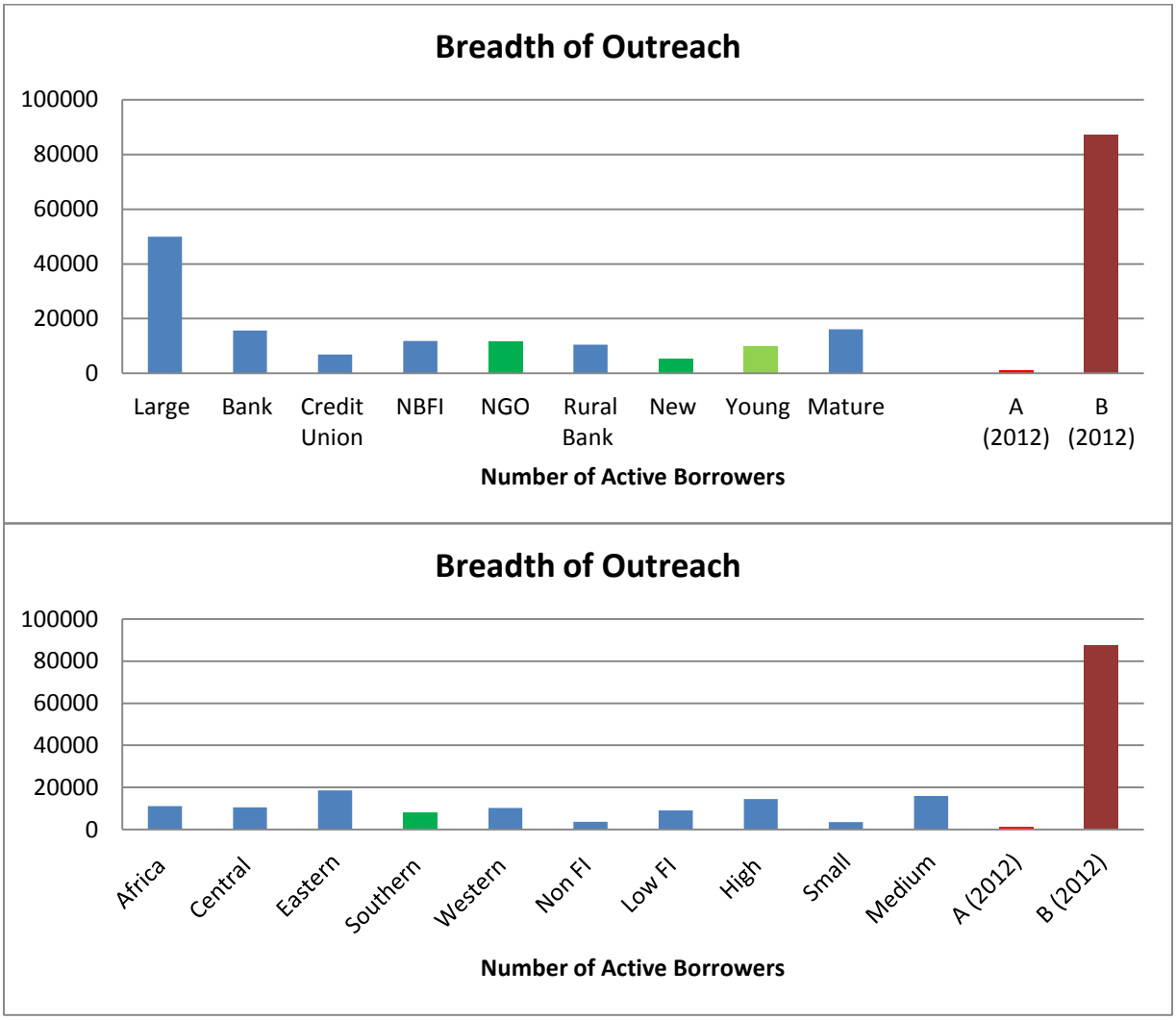
4.2.4. Outreach

4.2.4.1. Breath of outreach

As mention above this indicator measures the number of active clients. The number of active clients includes borrowers, depositors, and other clients who are currently accessing any financial services.

Figure 12 indicates that MFI A did not reach as many clients as MFI B and the benchmark. MFI A had 1079 active clients while the NGO and New MFI benchmark had 11067 and 5160 respectively. As mentioned group lending is considered to reach poorer clients than individual lending. However, even with group lending methodology, MFI A has not managed to reach as many clients as the benchmark. MFI B outperformed all MFIs in the benchmark at 87273 active clients. Factors such as portfolio size, population density and lending methodology affect client outreach. These factors vary from MFI to MFI. Although the number of clients is the widely used proxy for measuring breadth of outreach, it skews comparisons because of the factors that affect client outreach.

Figure 12: Breadth of Outreach



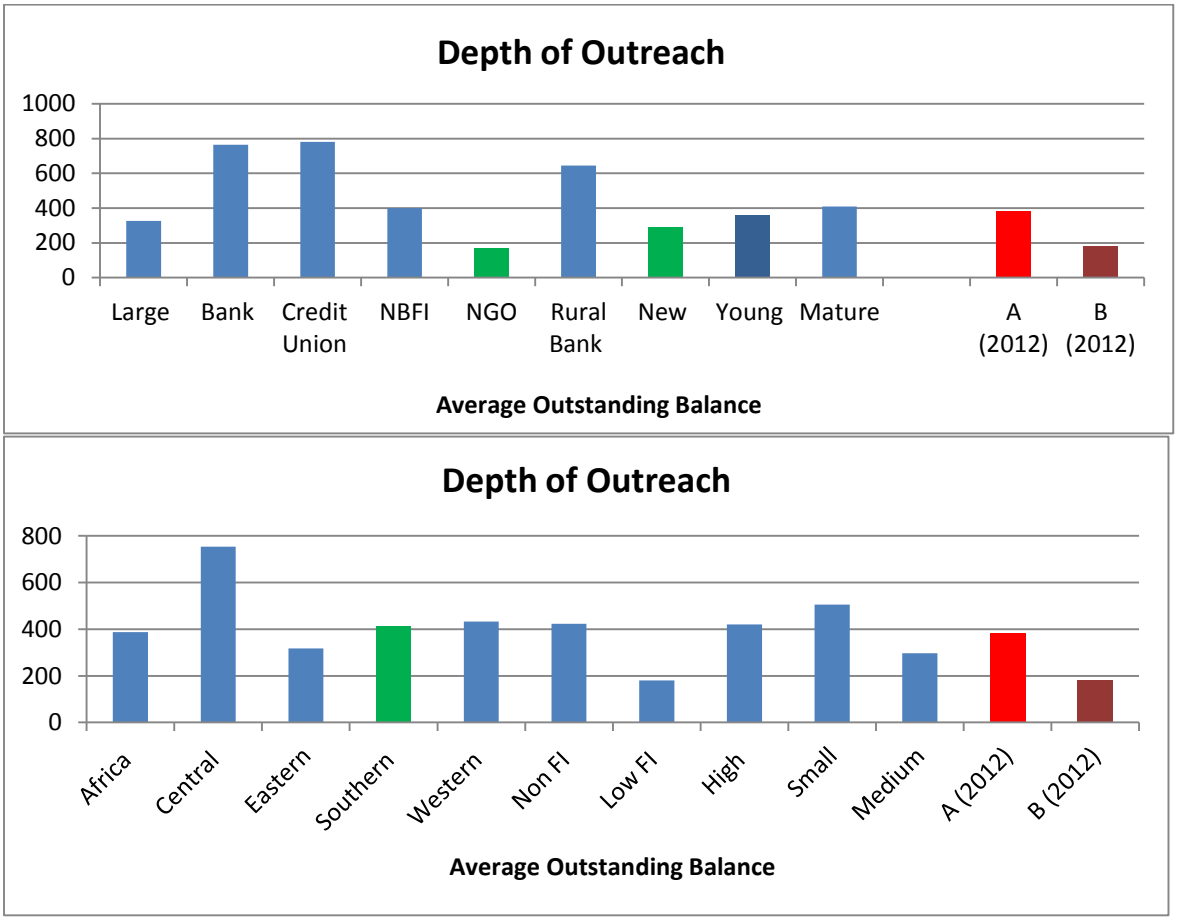
Source: Microfinance Information Exchange 2010 and MFI Financials Statements

Breadth of outreach has to be viewed in conjunction with depth of outreach because there is often a trade-off between the two (Cull et al, 2000; Morduch, 2000; Navajas *et al*., 1998).

4.2.4.2. Depth of Outreach

Depth of outreach measures the ability to reach the poorest of the poor who are excluded from formal financial services. As Figure 13 indicates, in terms of servicing the poorest of the poor, MFI A performed better than other benchmark NGOs, New, Young MFIs and MFI B.

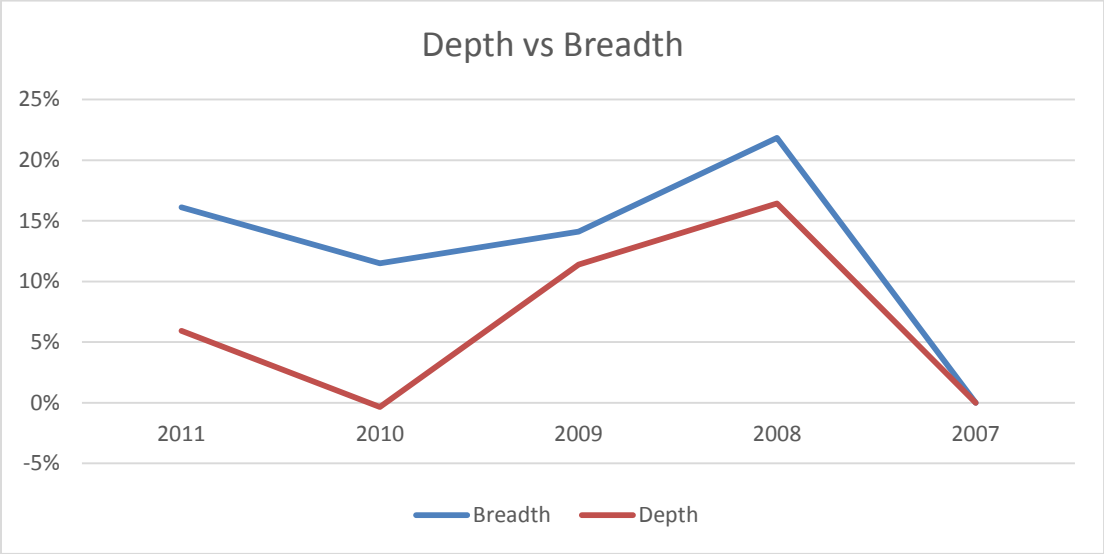
Figure 13: Depth of Outreach



Source: Microfinance Information Exchange 2010 and MFI Financial Statements

Although MFI B had the highest breadth, it had a lower depth of outreach than MFI A, New, Young and the Southern benchmark. However, it performs on par with NGO MFIs. This observation suggests that there is a trade-off between MFI B's ability to reach the poorest of the poor and reaching less poor clients. Figure 14 presents MFI B's outreach growth pattern over 5 years. It indicates that MFI B increased its level of depth by an average of 8% per annum between 2007 and 2011. In contrast, the breadth of outreach increased by 16% per annum on average during the same period. It is evident that it reaches more clients per year yet it does not reach the poorest of the poor at the same rate.

Figure 14: Number of board members



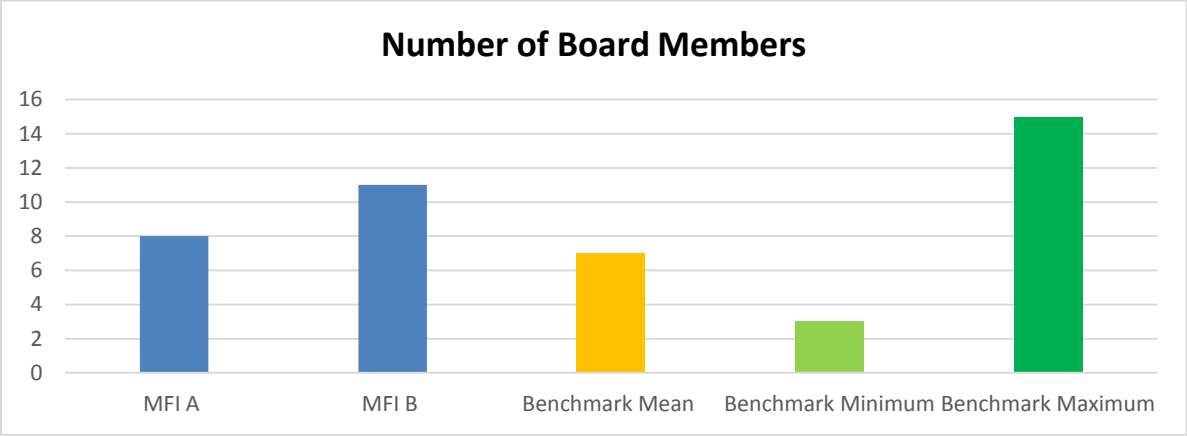
Source: MFI Financial Statements

4.3. Governance

4.3.1. Board Structure and Characteristics

This indicator aims to gather information on typical Board sizes in MFIs and to test whether better-performing institutions are characterized by a certain Board size. Mersland and Strom (2007) conducted a study that found that managerial efficiency increases with boards that have up to 9 members and less. MFI A between has 7 and 9 board members, while MFI B has more than 10 board members. As Figure 14 indicates, the benchmark average is 7 members, and a maximum of 15 members.

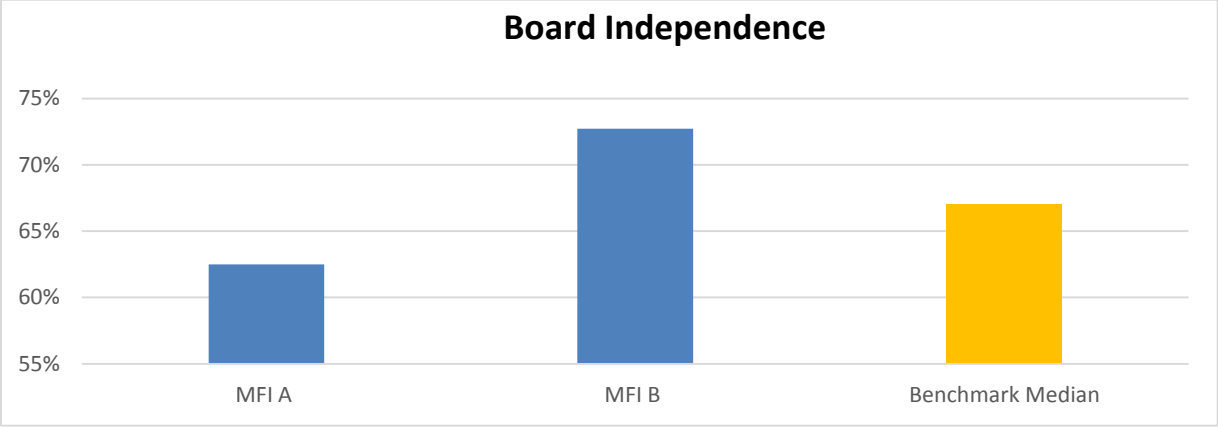
Figure 15: Number of board members



Source: MFI Survey Results and Micro Banking Bulletin 2012

On a board independence level, 63% of MFI A's board members are independent as indicated in Figure 16. The benchmark median is 67%. This means that MFI A's board is marginally less independent that the microfinances surveyed in 57 countries around the world. MFI B's board is 6% above the international level of independence.

Figure 16: Board Independence

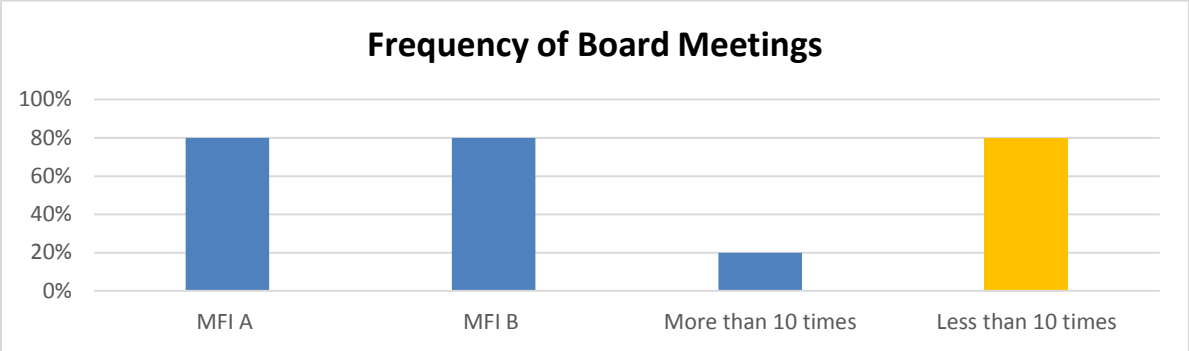


Source: MFI Survey Results and Micro Banking Bulletin 2012

4.3.2. Board Activity and Engagement

To assess Board activity and commitment towards an MFI, MFIs were asked how frequently board meetings are held and what changes in board policy had taken place in the past 3 years.

Figure 17: Frequency of Board Meetings



Source: MFI: Survey Results and Micro Banking Bulletin 2012

Of the MFI's surveyed, 80% indicated that their board meets less than 10 times a year while only 20% meet more than 10 times a year. MFI A and MFI B's boards meet less than 10 times a year. Since the international norm is less than 10 times a year, MFI A and B are on par with the international norm as Figure 17 indicates.

The MFIs were asked what Board policies had changed within the last 3 years. This evaluates Board effectiveness in developing policies and addressing key business drivers. MFI A and B were asked whether the board had policy changes regarding the following key sustainability issues:

a) Increasing clientele/Increasing volume of loans
b) Reducing clientele/Reducing volume of loans
c) Profitability/Surplus of the instiution
d) Staff efficiency
e) Acquiring private capital for growth
f) None of the above

Both MFI A and B responded "none of the above." With the exception of response "b", this response implies that the salient factors of sustainability and outreach have not formed part of the institutions agenda in the past 3 years. It is possible that the MFIs did have sustianability on the agenda 4 or 5 years ago. When asked what agenda has taken priority in the past 3 years, both MFIs did not indicate what policy changes have taken

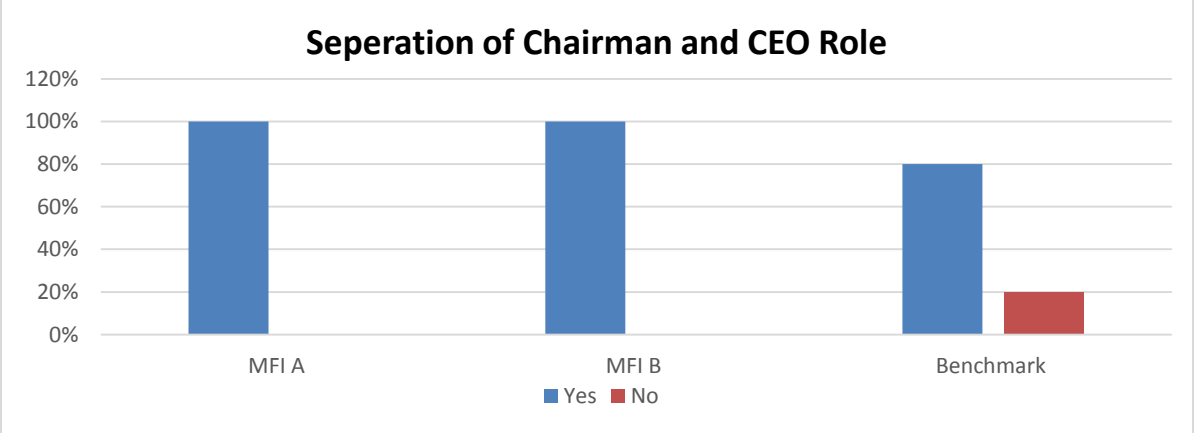
place. There was reluctance to reveal the board's agenda on account of confidentiality. The issue of sustainability does not explicitly and actively dominate the MFI's board agenda.

4.3.3. Risk Management

A widely accepted factor of good risk management is the establishment of an independent risk management and internal audit function. Furthermore, an organization needs to separate the CEO function from the Chairman function. This separation serves to reduce negative effects of power concentration and the risks associated with losing a key person ("key person risk"). It is important to keep in mind, however, that such separation may not be apparent in fast-growing MFIs (Pistelli et al, 2012).

Figure 18 indicates that MFI A and B's case, the roles of chairman and CEO are served by separate individuals. Of the MFI's in the benchmark sample, 80% indicated that the roles are separate. MFI A and B are on par with the majority of its international counterparts. A study conducted by Mesrland and Strom (2008) found that a joint CEO and Chairperson role reduces board efficiency.

Figure 18: Role Separation

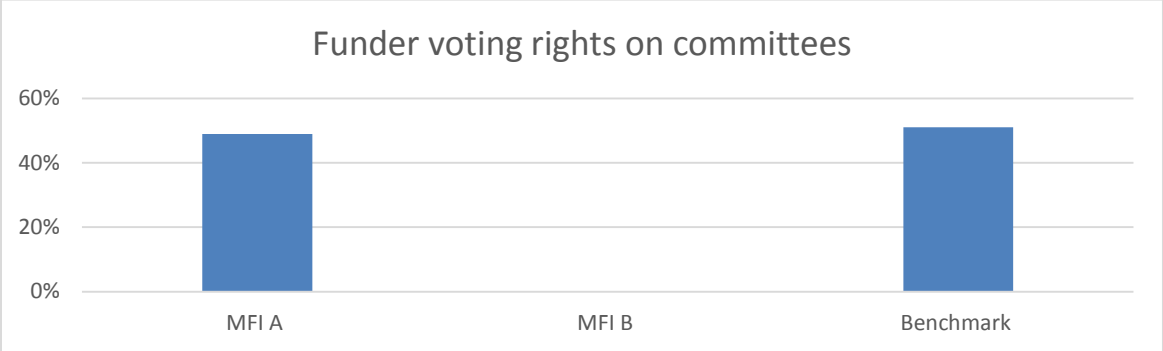


Source: MFI: Survey Results and Micro Banking Bulletin 2012

Similarly, collecting information on voting rights allows for the assessment of the extent of power concentration at the Board level. MFI A's funder voting rights are less than 50%

while MFI B grants funders no voting rights on its board committees. On the international benchmark, funders get more than 50% voting rights on board committees as indicated in Figure 19.

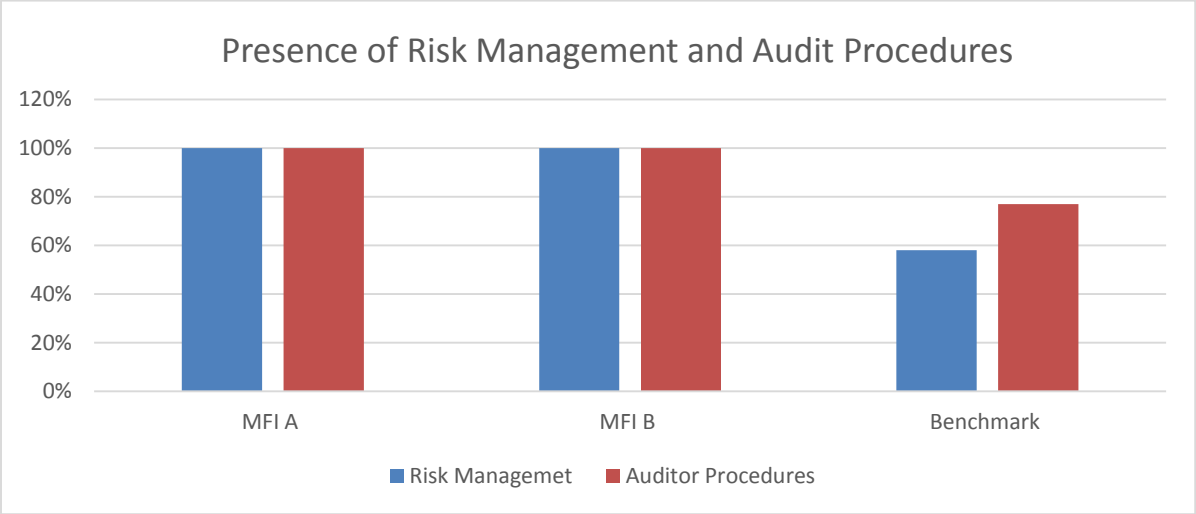
Figure 19: Funder voting rights



Source: MFI: Survey Results and Micro Banking Bulletin 2012

Hartaska (2004) argues that boards with more donors with voting rights can lead to fewer borrowers and achieve lower levels of operating self-sufficiency. Hartaska (2004) alludes to the fact that donors tend to emphasize serving the poor hence diverting attention from sustainability. Furthermore, the ability of donor representatives to raise funds easier than the MFI acquiring a commercial loans, tends to lower incentives to achieve high levels of operating self-sufficiency. As the sustainability analysis indicated, MFI A and B have not achieved operational sustainability and financial profitability. However, MFI A achieved a higher depth of outreach than MFI B and the benchmark. One explanation might be a stronger presence of funder voting rights on MFI A's board or directors.

Figure 20: Presence of Risk management and audit procedures



Source: MFI: Survey Results and Micro Banking Bulletin 2012

MFI A and B responded yes to having risk management and audit procedures. Of the benchmark MFIs, only 58% indicated that they have risk management procedures and 77% responded yes to having audit procedures. As Figure 20 reflects, a majority of benchmark MFIs have risk management and audit procedures. MFI A and B are visibly on par with the international practices.

4.6. CONCLUSION

The primary purpose of this study was to find out:

"Whether South African MFIs are institutionally sustainable?"

The two cases were individually assessed using performance indicators that focused on profitability, operational self-sufficiency, portfolio quality, efficiency and outreach. The financial ratios used to measure the profitability and self-sufficiency revealed that both MFIs are not profitable nor self-sufficient because they both did not achieve an operational self-sufficiency of 100 nor positive adjusted returns on assets. The MFIs expenses far outweighed the revenue they generated. Although MFI B was in a better financial position and is more likely to achieve self-sufficiency in the immediate future, MFI A was not in such a position. MFI A was more subsidy reliant than MFI B. MFI B is

slowly weaning off the use of subsidies for portfolio growth. However, it still depends on donations to subsidize operations.

As previously mentioned, the literature states that MFIs that move towards sustainability tend to do so at the expense of the depth of outreach. Furthermore, MFIs that are more subsidy dependent tend to serve the poor (depth) more than MFIs that are less subsidy dependent. In the 5 years reviewed, MFI B's profitability and self-sufficiency improved. However, its depth of outreach grew at a slower rate than its breadth of outreach. On the converse, MFI A which is more subsidy depended had a higher depth of outreach than MFI B and the benchmark

When compared to the benchmark, MFI B exhibited higher portfolio quality and outreach. This indicates that it has a healthy loan portfolio that is not at risk of being lost to outstanding loan repayments. Due to its healthy and large loan portfolio, MFI B's outreach has managed to outperform continental counterparts.

When compared to the benchmark, MFI A exhibited below average portfolio quality and breadth of outreach. It's portfolio at risk was significantly higher than the benchmark and MFI B. If the portfolio at risk is not controlled, MFI A could suffer a reduction in the portfolio size and income earned from lending operations.

The African benchmark data indicates that over time, young MFIs such as MFI A improve their operational self-sufficiency and profitability, although not all of them achieve this. This implies that MFI A is likely to exhibit the results that MFI B exhibited when it matures, depending on how it manages its portfolio areas and expenses.

The subsidiary objectives of the study are:

1. *To identify the constraints to operational and financial sustainability;*

The analysis of the performance indicators revealed personnel costs as MFI A and B's most significant constraint. The operational efficiency and cost to client of MFI A was significantly higher than the benchmark. The survey responses corroborated this finding.

Respondents from both institutions cited high salaries as the biggest operating expense. MFI A argued that the salaries are due to the very high cost of reaching clients who reside in low density areas. It is likely that other rural based MFIs experience the same constraint since most rural areas are not as densely populated as urban areas. Therefore, the observed contributor to the high operating costs in MFI A can be generalized for rural MFIs in South Africa because the environment that they operate in is similar and the country's labour laws apply. MFI B argued that there is a mismatch between competitive salaries it has to pay and low income generated due to the loans sizes and high levels of poverty in the areas it serves.

2. *To ascertain whether or not MFIs in SA have sound corporate governance when compared to the benchmark*

The assessment of corporate governance revealed that both MFI A and B have sound governance structures when compared to the benchmark. Both MFIs are aware of the risks inherent in their operational activities and have risk and audit structures to manage it. The frequency of board meetings and attendance of board members indicated commitment towards the goals of the institution.

With regards to the long term strategic vision of achieving sustainability, the issue of sustainability did not explicitly and actively dominate the MFIs board agenda. However, based on the responses on subsidy depedence and portfolio growth, both MFIs indicated an intention to wean off subisidies, generate sufficent income to sustain operations and access commerical loans for growth.

CHAPTER 5 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Summary and Conclusion

Microfinance institutions worldwide have a mission to provide finance to those with limited or no access to finance. In most countries the poor are excluded from the formal banking sector. Microfinance is characterized by small loans, uncollateralized lending and donor dependence. In order to continue serving the poor and realize the goal of serving the poorest of the poor, MFIs need to be profitable and self–sufficient. For South African MFIs, the move towards profitability and self-sufficiency is constrained by a low density clientele and high personnel costs. These constraints make sustainability for South African MFIs a target unlikely to be achieved in the immediate future.

This chapter provides a summary of the previous chapters, the main results, and recommendations for future studies.

The introduction chapter proposed the research question: are South African MFIs institutionally sustainable? The literature review sought to contextualize the importance of sustainability in microfinance. In addition, the prevalent opposing views on the matter were reviewed and used to guide the theoretical framework of the study. The dominant "institutionist" view states that MFIs should be sustainable if their goal of providing access to the poor is to be realized. While the "welfarist" view agrees in part that MFIs should be sustainable, it fears that the drive for sustainability is at the cost of reduced access to the poorest of the poor. Therefore, the ideal situation would be where MFIs are sustainable while simultaneously reaching the poorest of the poor. A win-win situation. Furthermore, the literature review discussed some of the sustainability constraints and success factors highlighted in the literature.

The research methodology chapter proposed the use of a multiple case study research approach. Two exemplary microfinance institutions were selected based on specific characteristics and availability of audited information. Primary data in the form of financial statements and surveys was successfully collected from both cases.

Chapter 4 analyzed the data and discussed the results. The analysis of the performance indicators showed that both MFIs are not profitable nor self-sufficient because they both did not achieve an operational self-sufficiency of 100% nor a positive AROA. They are therefore not sustainable. The MFI's expenses far outweighed the revenue they generated. Although MFI B is in a better financial position and it is more likely to achieve self-sufficiency in the immediate future, MFI A is not in such a position. The most prominent constraint in the sustainability of MFIs in South Africa is the high personnel costs. The benchmark of African MFIs do not incur half the personnel costs that South African MFIs do. The comparative analysis of MFI corporate governance revealed South African MFI's corporate governance fairs well when compared to international MFI's.

5.2. Research Limitations

The main limitation of this study has been data constraint and MFI willingness to participate in academic research. In the data collection phase, one of the MFIs were unable to provide data for the three years requested. Hence a review of the trend in certain performance indicators could not be conducted. During the data analysis phase, follow up questions to some survey responses could not be answered. One MFI cited confidentiality while the other did not respond. Therefore, certain yet minimal "why" questions could not be answered. In particular, the researcher could not find out why performance indicators such as portfolio at risk and write-off ratio for MFI A were remarkably higher than the benchmark. As a result further insight into the constraints to the MFI sustainability could not be gained.

5.3. Recommendations

Based on the results of the analysis, the study recommends that South African MFIs should aim to manage their portfolios better. MFIs could start by identifying the factors that influence client delinquency. It might be that the group lending method is not efficiently screening clients. In some cases the clients might not be using the borrowed funds for productive purposes and thus failing to repay the loan. Due to the characteristically small size of the loans, MFIs should aim to increase their retention rates

because the cost of issuing loans to the same clients is lower than it is for new clients. Therefore MFIs should ensure that at least 70% of its loan portfolio consists of return clients, while 30% should be new clients.

Since personnel costs are considerably high, MFIs should seek innovative ways to issue and collect loans. The use of technology such as cellphone banking can reduce the issue of remoteness and personnel costs. Some Kenyan MFIs are making use of cellphone banking to reach clients in remote rural areas. The use of cellphone banking can also increase the number of active clients. Increasing the number of clients will allow the younger and smaller MFIs to achieve economies of scale necessary to improve efficiency.

5.4. Further Research

The research on microfinance in Africa is growing, however, not a lot of empirical studies exist on South African microfinance in particular. Based on the findings of this study, the following areas are recommended for further study:

- The causes of loan delinquency amongst South African MFIs.
- The impact of the South African government's labour regulations on microfinance cost efficiency.
- What technology innovations can be introduced by MFIs to reach the poorest of the poor in rural areas of South Africa?

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Annexure A: Questionnaire

Questionnaire Cover Page

Dear Sir/Madam
The Sustainability of Microfinance Institutions in South Africa

My name is Teboho Lekatsa and I am a Masters student at UCT Graduate School of Business. I am undertaking a research project to describe the sustainability of microfinance institutions in South Africa for the purpose of the challenges they face and reviewing efficiency levels. Two exemplary NGO microfinance institutions have been selected for the study. This research is for ta thesis which is in partial completion of a Masters of Commerce in Development Finance.

I therefore kindly ask that you complete the following questionnaire regarding the funding, productive efficiency, clientele profile, governance and management and incorporation of your institution.

The following questionnaire will require approximately 30 minutes to complete. There is no compensation for responding nor is there any known risk. In order to ensure that all information will remain confidential, please do not include your name. Copies of the research will be provided to my Thesis Supervisor, Mr Barry Standish.

The data collected will provide useful information regarding the challenges faced by microfinance institutions in South Africa. It will contribute towards the body of knowledge and hopefully positively influence policies that will encourage microfinance as a development tool in South Africa.

If there are areas of discussion which you feel should be included in this study, please notify me on the contact details included below. Your suggestions will be highly appreciated.

Please indicate if you would like a summary copy of this study. If you require additional information or have questions, regarding the questionnaire or study, please contact me telephonically on 079 321 7257 or email me at Teboho.astakel04@gmail.com. You may also contact my supervisor, Mr Barry Standish with respect to this research, at 021 785 4051.

Thank you for taking the time to assist me in my academic endeavors.

Kind regards,
Teboho Lekatsa

Research Questionnaire

This questionnaire is designed to solicit information for purely academic purposes. All information provided will only be used for the Master of Commerce in Development Finance 2012, University of Cape Town, Graduate School of Business. The contents of this form are absolutely confidential. Information identifying the respondent will not be disclosed under any circumstance.

Section A: Background Information

1. Name of organization (coded 1 and 2 for anonymity)
   - 1 ☐
   - 2 ☐
2. Year of Incorporation: ……..
3. Type of Entity (Please choose 1):
   a) Private Company (PTY LTD) ☐
   b) Section 21 Company (Nonprofit Company) ☐
   c) Credit Union ☐
   d) Loan Cooperative ☐
   e) Other (Please specify :……..)
4. Number of employees: ……..
5. Founding Mission Statement (Please select the statement that best reflects the founding mission statement):
   a) To alleviate poverty in rural areas with the main focus being **social return** as opposed to financial return. ☐
   b) To alleviate poverty in rural areas with the main focus being **financial return** as opposed to social return. ☐
   c) To alleviate poverty in rural areas with the main focus being **financial return** AND **social return.** ☐
   d) Other (Please specify):…….

6. Niche Clientele (Please select 1):
    a) Female ☐
    b) Male ☐
    c) Equally services male and female ☐

7. Initial/Starting sources of funding:
    a) National Government ☐
    b) Local Donor ☐
    c) International Donor ☐
    d) Commercial Loans ☐
    e) Equity (Shareholders or Funders) ☐
    f) Other (Please Specify):……

Section B: Services, Retention Rates, Loan Delinquency

8. Drop out and retention rates: On average, how often do your clients return for repeat loans?
    a. 0-20% ☐
    b. 21-40% ☐
    c. 41-60% ☐
    d. 61-80% ☐
    e. 81-100% ☐

9. Taking deposits is an essential service that South African MFIs should provide:
    a. Agree ☐
    b. Strongly Agree ☐
    c. Neutral ☐
    d. Disagree ☐
    e. Strongly Disagree ☐

10. What is your main loan delivery method?
    a. Group Lending ☐
    b. Individual Lending ☐
    c. Equal ☐

Section B: Governance and Management

11. Board Structure and Characteristics
    a. Number of board members
        i. 1-3 ☐

ii. 4-6 ☐
iii. 7-9 ☐
iv. More than 10 ☐
v. 0 ☐

b. Number of independent Board Members
i. 1-3 ☐
ii. 4-6 ☐
iii. 7-9 ☐
iv. More than 10 ☐
v. 0 ☐

12. Board Activity and Engagement
a) Frequency of Board Meetings (Per Year)
i. 1-3 ☐
ii. 4-6 ☐
iii. 7-9 ☐
iv. More than 10 ☐
v. 0 ☐

b) Board Meeting Attendance (Per meeting)
i. 0-19% ☐
ii. 20-40% ☐
iii. 41-60% ☐
iv. 61-80% ☐
v. 81-100% ☐

a) In the past 3 years, did the Board change policies concerning: (You can select more than 1)
i. Increasing clientele/Increasing volume of loans ☐
ii. Reducing clientele/Reducing volume of loans ☐
iii. Profitability/Surplus of the institution ☐
iv. Staff Efficiency ☐
v. Acquiring private capital for growth ☐
vi. None of the above ☐

13. Risk Management
a. Separation of Chairman & CEO
i. Yes ☐
ii. No ☐

b. Funder Voting rights on committees
    i. More than 50% ☐
    ii. Less than 50% ☐
    iii. No voting rights ☐
c. Presence of risk management and audit procedures
    i. Yes ☐
    ii. No ☐

Section C: Depth of Outreach and Future Plans

14. Increasing our clientele by issuing more loans in the next 3 years is important for our organization.
    a. Strongly Agree ☐
    b. Agree ☐
    c. Neutral ☐
    d. Disagree ☐
    e. Strongly Disagree ☐

15. If Answered **Agree or Strongly Agree** in Q10 question above, where would you get additional funds to accommodate more loans?
    - Equity (Existing funds earned from operations) ☐
    - Savings collected from clients ☐
    - Donors ☐
    - Commercial Loan ☐
    - Government Concessionary loan (Soft Loan) ☐
    -

16. If you answered Neutral, Disagree or Strongly Disagree, please specify:
    ……
    ……
    ……
    ……
    ……
    ……..

Section D: Operational Efficiency

17. What productivity constraints do you think apply to your institution?
    a. Rising staff costs without an equal rising in interest income generated

b. Increasing number of loans also increases loan delinquency in the same proportion
c. No identified productivity constraints
d. Other (Specify: ……)

18. As a percentage of total expenses, which interval do you think salaries fall under?
    a) 10 – 25% ☐
    b) 26 – 50% ☐
    c) 51 – 75% ☐
    d) 76 – 100% ☐

19. Staff productivity incentive schemes are essential to improve efficiency
    a. Strongly Agree ☐
    b. Agree ☐
    c. Neutral ☐
    d. Disagree ☐
    e. Strongly Disagree ☐

20. In the past 3 years how many employees (Loan officers and administration staff) have gone to for training courses? (As a proportion of total number of employees)
    a. 0% ☐
    b. 1-25% ☐
    c. 26-50% ☐
    d. 51-75% ☐
    e. 76-100% ☐

Section E: Financial Sustainability

21. Besides interest income from loans disbursed to clients, do you have any sources of income?
    a. Yes ☐
    b. No ☐

22. Is your institution dependent on any of the following for to meet monthly operational expenses:
    a. Subsidy /Donations/ Grants ☐
    b. Commercial loan ☐
    c. Concessional loans (at below-market rates) ☐

d. Donations ☐
e. Revenue generated from operations (Profits) ☐
f. Other
(Specify)……

23. Being able to meet monthly operational expenses from income generated from issuing loans is a strong item on our board's agenda.
    a. Strongly Agree ☐
    b. Agree ☐
    c. Neutral ☐
    d. Disagree ☐
    e. Strongly Disagree ☐

24. If you answered **Neutral**, **Disagree** or **Strongly Disagree**, please specify why:
    ……
    ……
    ……
    ……
    ……
    ……..

25. What would you say are the constraints to South African MFI's generating enough revenue to cover operating costs and financing costs?

    ……
    ……
    ……
    ……
    ……

Annexure B: Benchmark Indicators

Sub-Saharan Africa Benchmark Tables

	Africa	Central	Eastern	Southern	Western	Non FI	Low FI	High FI	Small	Medium
INSTITUTIONAL CHARACTERISTICS										
Number of MFIs	153	18	43	24	68	12	32	109	71	37
Age	11	13	11	10	12	8	10	12	9	12
Total Assets	8,189,126	12,767,059	10,743,089	4,803,972	6,354,586	1,854,893	4,202,707	9,032,628	2,478,592	8,746,860
Offices	12	12	15	12	12	5	7	17	7	13
Personnel	122	161	210	159	108	29	81	166	52	159
FINANCING STRUCTURE										
Capital/Asset Ratio	24.2%	16.0%	23.2%	36.8%	23.1%	46.2%	46.1%	19.9%	29.1%	28.1%
Debt to Equity	2.41	4.00	3.14	1.12	2.15	1.17	0.99	2.96	1.25	2.56
Deposits to Loans	55.5%	154.8%	48.6%	30.5%	59.5%	0.0%	21.2%	80.7%	45.6%	59.2%
Deposits to Total Assets	37.1%	72.0%	33.0%	17.9%	40.9%	0.0%	12.3%	49.3%	28.3%	37.6%
Portfolio to Assets	63.1%	45.6%	69.6%	62.8%	63.8%	75.1%	66.1%	62.0%	62.8%	61.2%
OUTREACH INDICATORS										
Number of Active Borrowers	11,079	10,554	18,560	8,116	10,201	3,585	9,053	14,513	3,530	15,888
Percent of Women Borrowers	62.0%	42.8%	56.0%	61.8%	70.2%	62.9%	75.1%	52.4%	60.8%	57.1%
Number of Loans Outstanding	11,478	10,554	17,358	8,544	10,899	3,752	9,053	14,765	3,530	16,354
Gross Loan Portfolio	4,467,193	4,750,407	6,428,499	2,459,966	4,274,389	1,381,194	1,993,986	6,428,499	1,489,165	4,980,547
Average Loan Balance per Borrower	412	754	369	479	432	434	180	477	534	297
Average Loan Balance per Borrower/GNI per Capita	59.4%	76.5%	47.0%	57.7%	60.1%	50.5%	32.9%	68.5%	66.3%	46.4%
Average Outstanding Balance	388	754	318	415	432	423	180	421	506	297
Average Outstanding Balance/GNI per Capita	57.9%	76.5%	45.5%	59.7%	57.5%	50.5%	32.9%	67.5%	61.9%	46.4%
Number of Voluntary Depositors	30,833	30,338	42,683	12,000	29,790	0	13,812	43,655	9,032	31,263
Number of Voluntary Deposit Accounts	30,680	30,338	41,710	11,074	29,925	0	13,812	45,062	9,134	31,263
Voluntary Deposits	2,700,076	7,237,868	2,895,451	1,040,527	2,613,391	0	450,906	5,519,417	894,902	3,140,963
Average Deposit Balance per Depositor	101	354	74	83	109	0	37	122	108	68
Average Deposit Balance per Depositor/GNI per Capita	15.0%	42.5%	14.0%	10.0%	15.0%	0	5.0%	20.0%	15.0%	14.0%
Average Deposit Account Balance	94	346	64	75	108	0	30	116	108	63
Average Deposit Account Balance/GNI per Capita	15.0%	39.5%	13.0%	11.0%	15.0%	0	5.0%	19.5%	15.0%	13.0%
MACROECONOMIC INDICATORS										
GNI per Capita	639	1,095	547	444	639	639	593	639	639	639
GDP Growth Rate	3.8%	1.6%	5.0%	4.3%	3.8%	4.5%	4.4%	3.5%	3.8%	4.0%
Deposit Rate	5.3%	3.8%	6.7%	10.6%	3.5%	10.7%	7.9%	5.3%	6.7%	5.3%
Inflation Rate	9.0%	5.5%	12.0%	8.4%	4.0%	13.1%	9.7%	8.4%	9.0%	9.0%
Financial Depth	25.5%	20.5%	23.5%	22.3%	33.7%	28.9%	23.9%	25.5%	25.5%	25.5%
OVERALL FINANCIAL PERFORMANCE										
Return on Assets	-0.2%	-0.2%	-0.3%	-0.4%	-0.1%	-8.2%	0.1%	0.4%	-3.2%	-1.4%
Return on Equity	2.3%	4.4%	2.7%	-1.6%	3.0%	-18.4%	1.3%	4.5%	-4.4%	-4.1%
Operational Self-Sufficiency	100.4%	98.0%	101.8%	98.0%	102.2%	87.6%	93.0%	102.3%	85.8%	98.5%
Financial Self-Sufficiency	98.8%	94.2%	99.1%	97.6%	100.1%	85.8%	88.1%	101.6%	86.0%	98.5%
REVENUES										
Financial Revenue/Assets	21.8%	13.1%	23.7%	32.3%	18.4%	31.8%	36.7%	19.1%	23.7%	21.6%
Profit Margin	-2.9%	-6.2%	-0.9%	-2.4%	-4.7%	-16.5%	-13.5%	0.4%	-17.1%	-1.6%
Yield on Gross Portfolio (nominal)	30.4%	25.1%	32.3%	49.0%	24.0%	52.1%	53.5%	26.2%	36.6%	30.4%
Yield on Gross Portfolio (real)	22.1%	13.7%	18.1%	43.6%	21.6%	27.8%	40.0%	18.2%	23.8%	23.1%
EXPENSES										
Total Expense/Assets	24.0%	13.9%	25.6%	38.9%	19.6%	37.4%	42.8%	19.6%	29.5%	23.7%
Financial Expense/Assets	2.7%	1.9%	3.4%	2.5%	2.6%	4.8%	2.4%	2.8%	2.3%	2.6%
Provision for Loan Impairment/Assets	1.4%	1.1%	1.3%	2.0%	1.1%	2.8%	2.3%	1.1%	2.1%	1.4%
Operating Expense/Assets	18.1%	10.6%	20.2%	25.3%	15.9%	26.6%	33.5%	15.4%	19.5%	17.8%
Personnel Expense/Assets	8.4%	4.2%	11.4%	15.9%	6.2%	12.0%	15.6%	6.9%	9.3%	7.9%
Administrative Expense/Assets	9.7%	6.1%	9.7%	11.8%	8.4%	16.7%	17.3%	8.3%	11.1%	11.6%
Adjustment Expense/Assets	2.6%	4.6%	2.7%	3.0%	1.8%	3.5%	4.0%	2.0%	2.9%	3.2%
EFFICIENCY										
Operating Expense/Loan Portfolio	30.1%	29.3%	30.4%	50.0%	26.1%	44.6%	56.5%	25.4%	40.9%	30.5%
Personnel Expense/Loan Portfolio	13.8%	12.8%	15.4%	23.5%	11.5%	15.2%	27.0%	12.0%	16.0%	14.1%
Average Salary/GNI per Capita	918%	491%	1326%	1213%	804%	923%	1415%	894%	882%	895%
Cost per Borrower	137	150	149	182	103	82	143	141	177	134
Cost per Loan	132	130	143	170	105	86	137	131	177	134
PRODUCTIVITY										
Borrowers per Staff Member	93	81	102	71	97	93	104	84	61	104
Loan per Staff Member	99	81	106	67	109	97	104	89	65	104
Borrowers per Loan Officer	234	232	215	170	326	250	219	245	165	235
Loans per Loan Officer	248	232	222	172	326	250	219	283	172	258
Voluntary Depositors per Staff Member	254	240	267	104	280	0	120	308	156	276
Deposit Accounts per Staff Member	257	240	277	104	306	0	120	312	163	283
Personnel Allocation Ratio	43.6%	41.9%	47.2%	49.9%	36.7%	51.5%	51.5%	36.9%	40.6%	46.1%
RISK AND LIQUIDITY										
Portfolio at Risk> 30 Days	5.9%	7.5%	8.3%	3.9%	5.9%	11.8%	4.9%	5.8%	9.4%	4.7%
Portfolio at Risk> 90 Days	3.1%	3.5%	4.1%	2.2%	3.0%	3.6%	3.1%	3.1%	3.8%	2.3%
Write-off Ratio	1.4%	2.9%	0.6%	1.6%	1.6%	2.8%	2.3%	1.2%	1.7%	1.3%
Loan Loss Rate	0.8%	1.8%	0.1%	1.4%	1.0%	2.1%	2.1%	0.8%	1.0%	1.0%
Risk Coverage Ratio	55.6%	61.2%	65.0%	90.0%	47.3%	63.0%	88.3%	51.8%	56.8%	59.1%
Non-earning Liquid Assets as a % of Total Assets	17.1%	46.9%	18.3%	19.0%	14.4%	7.9%	17.0%	18.7%	15.9%	16.4%

	Large	Bank	Credit Union	NBFI	NGO	Rural Bank	New	Young	Mature
INSTITUTIONAL CHARACTERISTICS									
Number of MFIs	45	16	38	50	46	3	28	26	99
Age	14	12	13	9	11	14	3	7	13
Total Assets	45,049,090	55,195,401	8,581,116	8,332,792	4,468,197	-	3,916,670	3,374,890	10,743,089
Offices	42	15	40	10	10	7	7	7	20
Personnel	466	368	163	118	91	133	64	82	191
FINANCING STRUCTURE									
Capital/Asset Ratio	18.2%	17.7%	19.0%	26.6%	30.6%	16.6%	32.5%	27.0%	22.1%
Debt to Equity	3.67	4.67	2.87	2.19	1.68	5.02	1.12	2.43	2.81
Deposits to Loans	62.3%	82.2%	118.4%	43.1%	29.1%	177.4%	34.3%	58.5%	61.5%
Deposits to Total Assets	44.8%	58.9%	64.4%	28.7%	18.8%	77.3%	20.9%	28.2%	44.7%
Portfolio to Assets	64.3%	56.0%	56.1%	69.3%	67.2%	46.7%	66.2%	65.3%	62.6%
OUTREACH INDICATORS									
Number of Active Borrowers	59,961	15,638	6,840	11,817	11,607	10,475	5,160	10,030	16,121
Percent of Women Borrowers	62.5%	55.9%	36.8%	62.0%	79.7%	34.4%	68.9%	57.4%	56.4%
Number of Loans Outstanding	61,536	13,590	7,749	11,817	12,430	10,475	5,831	9,786	16,354
Gross Loan Portfolio	30,156,457	30,109,671	3,968,681	5,564,206	2,018,315	6,762,392	2,247,777	2,077,922	6,428,499
Average Loan Balance per Borrower	378	918	893	415	169	646	294	497	469
Average Loan Balance per Borrower/GNI per Capita	48.4%	157.9%	142.6%	47.6%	31.1%	101.1%	32.4%	71.4%	61.4%
Average Outstanding Balance	326	765	782	400	169	646	294	358	410
Average Outstanding Balance/GNI per Capita	47.9%	142.7%	133.6%	46.5%	29.8%	101.1%	32.4%	78.1%	58.4%
Number of Voluntary Depositors	165,690	124,414	39,422	30,732	19,455	110,047	16,627	24,741	43,465
Number of Voluntary Deposit Accounts	165,979	109,183	41,125	30,732	19,947	110,047	18,442	23,459	46,007
Voluntary Deposits	22,576,640	41,154,191	5,039,512	2,031,001	785,412	10,458,885	519,938	891,148	3,661,254
Average Deposit Balance per Depositor	114	196	155	75	48	99	56	109	111
Average Deposit Balance per Depositor/GNI per Capita	17.5%	25.0%	25.5%	11.0%	9.0%	15.5%	9.0%	14.0%	19.0%
Average Deposit Account Balance	107	163	144	74	50	99	52	101	111
Average Deposit Account Balance/GNI per Capita	16.0%	25.0%	25.0%	10.0%	8.0%	15.5%	7.5%	14.5%	17.0%
MACROECONOMIC INDICATORS									
GNI per Capita	639	509	641	639	639	639	639	544	639
GDP Growth Rate	3.8%	4.2%	2.4%	3.9%	4.1%	4.5%	4.0%	4.1%	3.7%
Deposit Rate	5.3%	9.9%	3.5%	6.0%	7.9%	11.3%	8.2%	6.7%	5.3%
Inflation Rate	8.5%	12.0%	3.4%	10.5%	10.8%	19.3%	10.4%	10.4%	8.5%
Financial Depth	28.6%	32.4%	24.1%	23.7%	30.4%	34.3%	28.0%	23.7%	25.5%
OVERALL FINANCIAL PERFORMANCE									
Return on Assets	1.1%	-0.7%	0.7%	0.4%	-3.2%	5.0%	-7.9%	0.4%	0.6%
Return on Equity	8.9%	-2.2%	7.6%	1.7%	-5.4%	32.5%	-13.4%	1.8%	4.6%
Operational Self-Sufficiency	108.3%	94.6%	103.4%	100.4%	97.6%	131.8%	67.8%	100.4%	104.1%
Financial Self-Sufficiency	107.2%	95.6%	102.3%	98.5%	95.7%	131.8%	67.8%	99.6%	102.9%
REVENUES									
Financial Revenue/Assets	21.3%	24.7%	15.3%	27.3%	28.2%	21.8%	27.3%	36.9%	18.8%
Profit Margin	6.7%	-4.7%	-3.4%	-1.6%	-4.5%	24.1%	-47.5%	-0.4%	2.2%
Yield on Gross Portfolio (nominal)	24.6%	40.6%	21.6%	36.6%	45.5%	27.8%	45.3%	49.0%	24.5%
Yield on Gross Portfolio (real)	18.2%	25.8%	17.8%	23.2%	26.2%	7.2%	34.2%	27.8%	17.6%
EXPENSES									
Total Expense/Assets	18.8%	25.4%	15.0%	31.0%	31.7%	16.3%	38.6%	37.5%	17.9%
Financial Expense/Assets	2.9%	2.0%	1.3%	3.6%	3.7%	3.1%	3.1%	2.6%	2.7%
Provision for Loan Impairment/Assets	1.1%	1.8%	0.9%	1.4%	1.9%	0.7%	2.4%	1.4%	1.1%
Operating Expense/Assets	15.1%	18.8%	12.1%	25.4%	26.4%	12.6%	32.5%	30.7%	14.2%
Personnel Expense/Assets	7.3%	9.0%	5.0%	10.4%	13.6%	0.0%	13.1%	15.2%	6.2%
Administrative Expense/Assets	7.4%	9.9%	6.5%	12.5%	12.2%	12.6%	12.8%	12.9%	8.1%
Adjustment Expense/Assets	1.7%	3.9%	1.3%	2.9%	3.5%	-	2.9%	3.9%	2.2%
EFFICIENCY									
Operating Expense/Loan Portfolio	22.4%	36.4%	21.8%	37.6%	38.5%	23.4%	59.0%	42.3%	25.1%
Personnel Expense/Loan Portfolio	11.7%	15.7%	8.8%	15.9%	18.5%	0.0%	26.6%	16.7%	11.8%
Average Salary/GNI per Capita	1009%	1636%	781%	1091%	918%	0%	950%	1221%	878%
Cost per Borrower	111	364	151	174	78	172	114	174	131
Cost per Loan	102	285	146	166	78	167	114	162	126
PRODUCTIVITY									
Borrowers per Staff Member	149	64	48	96	141	79	68	100	97
Loan per Staff Member	149	52	53	99	141	79	68	99	102
Borrowers per Loan Officer	399	220	250	213	283	544	146	232	283
Loans per Loan Officer	444	221	300	222	284	544	158	227	293
Voluntary Depositors per Staff Member	317	276	347	230	136	703	138	255	284
Deposit Accounts per Staff Member	408	240	383	256	146	703	147	257	297
Personnel Allocation Ratio	45.2%	36.7%	24.1%	47.7%	52.4%	8.7%	47.6%	47.2%	40.6%
RISK AND LIQUIDITY									
Portfolio at Risk> 30 Days	5.0%	7.3%	8.8%	5.1%	4.2%	12.4%	7.4%	5.2%	6.1%
Portfolio at Risk> 90 Days	3.1%	4.5%	4.0%	3.3%	2.0%	11.7%	3.0%	2.8%	3.4%
Write-off Ratio	1.0%	0.7%	2.0%	1.3%	0.5%	-	0.7%	1.6%	1.4%
Loan Loss Rate	0.2%	0.0%	1.5%	0.9%	0.4%	0.0%	0.7%	1.5%	0.8%
Risk Coverage Ratio	49.2%	62.2%	40.8%	63.0%	72.5%	-	72.9%	77.7%	49.5%
Non-earning Liquid Assets as a % of Total Assets	18.3%	21.6%	22.2%	17.7%	13.7%	32.9%	15.9%	20.7%	17.0%