



# **Financial inclusion: A look at the institutional and credit organisational enablers in the South African market.**

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by  
Loise Gitonga  
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Supervised by: Joshua Abor



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## **Abstract**

To serve the underserved markets successfully companies have to re-evaluate their strategies and approach towards the poor; this is also true for financial institutions and governments seeking to address financial exclusion or looking to fully bank the under banked in their economies. This study examines the regulatory enablers put in place by the South African government; the organisational enablers in form of financial institutions; and the products or services these institutions offer the under banked or unbanked in the society. In examining the products and services offered four factors were taken into consideration i.e. availability, acceptability, affordability and target market awareness of the product.

The study was carried out using a deductive qualitative approach; the hypothesis was 'some of the macro and micro enablers required when seeking to serve the underserved are missing in South Africa'. From our analysis; there are very specific positive steps being taken to enhance the macro environment. Hopefully as these undertakings are established the micro-environment will improve. Such improvements are expected to include; increase in strong, reliable national players serving the underserved; increase in providers of good and safe services for the underserved and enhanced awareness among consumers on the products available for them.

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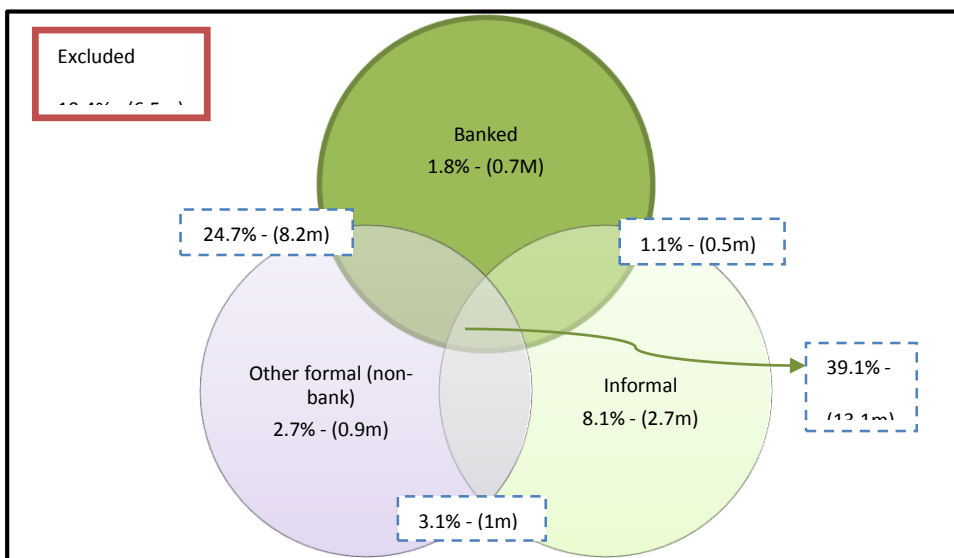
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## Chapter 1: Introduction

### 1.1 Introduction

According to Finscope (2012), approximately 65% i.e. 34million of South Africa’s population belongs to the ‘economically active’ age group but only 67% of them are banked. Of the banked, 96% are underserved and rely on alternative financial service providers (AFSPs’) for some of their financial needs. Figure 1 (Finscope, 2012) depicts the situation better.

**Diagram 1: Overlap in financial product usage in South Africa**



Source: Finscope, 2012

In totality only 1.8% of South Africans rely exclusively on banking products for their financial needs although 99% of the banked hold a transaction account with the bank (Finscope, 2012). Others rely on AFSPs’ such as; non-bank service providers e.g. insurance companies, retail stores issuing store cards, remittance service providers or micro-finance institutions; or Informal service providers e.g. farmers associations, savings groups and private money lenders.

The non-bank service providers are regulated by the National Credit Regulator however not all are rigorously regulated or required to report or disclose their activities regularly (Finscope, 2012). The informal service providers are self-regulated and approximately 51.4% of the economically active use the informal sector and 8.1% of people purely rely on the informal sector (Finscope, 2012).

Jeffries (2007) considered the failure of financial institutions to offer inclusive financial services to all a type of market failure that is particularly prone to excluding the poor. Arora & Leach, (2005) in Moloj, (2009) said reasons for such failure can be attributed to individuals, financial institutions or the macro environment.

Individuals may choose to stay away from the financial sector for various reasons e.g. financial illiteracy, having an 'illegal status' among others. However financial exclusion is not so much about individuals as it is about financial institutions and government creating and sustaining an enabling environment. Wessie (2007) found companies serving the underserved market need to be strategic, innovative and adaptable. In addition Anderson & Billou (2007), noted the products of such entities need to be available, acceptable, affordable and known to the target market. Government and regulators on the other hand need to ensure the macro environment is conducive for banks and their target market.

## **1.2 Problem Statement**

South Africa has made some attempts at addressing financial exclusion however the under and un-banked still predominantly use semi or non-regulated service providers and are often the victims of fraudulent activity or oppressive financial terms.

Several studies have identified the role of government and financial institutions as a key enabler to financial inclusion but little has been done by way of comparing the infrastructure in South Africa to that of other emerging markets; or comparing the credit products offered by AFSP's to those of commercial banks to understand why financially excluded persons prefer their services.

This study therefore seeks to examine: the institutional i.e. regulatory infrastructure established by the South African government and how that infrastructure supports or fails to support financial inclusion; the organisational infrastructure in the country and how it supports or fails to support financial inclusion; and lastly the nature of products or services institutions registered with the National Credit Regulator (NCR) are providing consumer and how they facilitate inclusion.

### **1.3 Research Objectives, Questions and Scope**

The objectives of this study are:

- i. To examine the institutional and organisational infrastructure in SA and how this infrastructure supports financial inclusion.
- ii. To highlight areas in which the infrastructure can be enhanced to further support financial inclusion.
- iii. To compare credit products offered by the AFSPs' in SA versus those offered by commercial banks to identify areas of weakness or strength in serving or aspiring to serve the underserved.

To achieve the stated objectives the researcher asked the following questions;

- i. What is the institutional infrastructure of SA and how does it support financial inclusion?
- ii. What is the organisational infrastructure of SA and how does it support financial inclusion?
- iii. What innovative regulatory or organisational solutions have been adopted elsewhere to address financial inclusion? In particular India.
- iv. What improvements can be made to the regulatory and organisational environment to enhance financial inclusion in South Africa?
- v. What are the characteristics of credit products offered by AFSPs' and commercial banks in SA against the following characteristics; availability, acceptability, affordability and the target market knowledge of the product (Anderson & Billou, 2007).

- vi. How do the credit products offered by commercial banks compare to those offered by the AFSPs' in regard to the four mentioned characteristics?
- vii. How can banks – the principal agents of financial inclusion, improve on the credit products they offer to the underserved?

The scope of the research was the under and unbanked in SA and excludes the excluded and fully banked.

The scope is also limited to credit providers registered with the National Credit Regulator, this are namely; commercial banks, salary based lenders, micro-enterprise lenders, Postbank and other credit providers.

Further details on these providers are given in Chapter 2.

#### **1.4. Research Assumptions**

In carrying out the research, it was assumed that most of the under and unbanked would like to be fully banked. It is was also assumed,

- The information required will be readily available on the internet or through telephone conversation. This is especially the case for the informal service providers e.g. cash loans and pawn shops.
- The products offered by the sample will be representative of the products available in a given province.

#### **1.5. Research Ethics**

The research relied on secondary data predominantly and where primary data was gathered the researcher posed as a member of the public shopping for a credit product as any customer would. In some instances, it was not possible to pose as a customer so the researcher introduced themselves telephonically and requested the required information.

## Chapter 2: Literature review

### 2.1 Introduction

The review highlights the definitions given by various scholars on Financial Inclusion, its effects and who the underbanked and unbanked are. It then focuses on various works done to understand the macro and micro enablers of financial inclusion whilst considering the different attempts in SA; both macro and micro, through banks or alternative financial service providers (AFSPs), and how they have succeeded at promoting financial inclusion or fostering exclusion.

### 2.2 Financial inclusion

Bhanot, Bapat & Bera (2012, p.1) defined financial inclusion as the process of ensuring access to financial services - e.g. savings, insurance, remittance, payments, etc. - and affordable, timely and adequate credit where needed by vulnerable groups such as low-income groups. AFI (2012) defined such 'access to financial services' as people's ability to reach and use available financial services and products from formal institutions. Access being measured not only by the number of access points per 10,000 adults at a national level, but also account opening requirements, transport costs to reach the access point and possible opportunity costs when travelling or queuing to receive service. However, Rangarajan (2012) was not content with just access or having a bank account as the sole or key determinant of financial inclusion. He said 'comprehensive' inclusion should entail among other things 'basic no frills banking accounts for making and receiving payments, a savings product suited to the pattern of cash flows for a poor household, remittances, small loans and overdrafts'.

Other research works have defined the lack of financial inclusion as a market failure. Jeffries (2007) noted 'while it is important to get all markets to work efficiently to improve economic growth, financial markets are somewhat different to other markets, as financial markets are more prone to market failure, and in particular are more prone to the type of market failure that excludes the poor.' Mehtrotra *et al.* (2009 in

Rajani, Bhama & Deepa, 2012) observed that banking services are increasingly viewed as a public good that needs to be made available to the entire population without discrimination. The degree of 'publicness' in financial inclusion may be different from a typical public good like 'defence' but as with any market failure; the lack of or poor financial inclusion has been seen to directly, or indirectly, result in adverse economic and social consequences.

***i. Effects of financial exclusion***

Demirgüç-Kunt & Klapper(2012) noted the effects of financial exclusion on economic growth and inequality highlighting how non-inclusive financial systems, forced the poor to rely on their own limited savings to invest in their education or start and grow a business.

Jeffries (2007) outlined these interrelationships between financial inclusion, economic growth and social development well. He noted; 'The lack of efficient financial service provision means that poor people are either forced to use inefficient provisions, often at high cost (for instance, with high transactions costs, excessively high interest rates on loans, or poor returns on savings) – thereby entrenching poverty – or they do not have access to certain financial products, either because of an absolute absence of suitable products or because available products are too expensive. This in turn tends to restrict the economic opportunities open to the poor. This is most obviously the case with credit, as almost all entrepreneurship activities need capital upfront, even if in small amounts, to fund investment. It makes the poor vulnerable to adverse events and financial loss (due to lack of insurance and secure savings products) and the absence of savings products makes it difficult to build up capital;

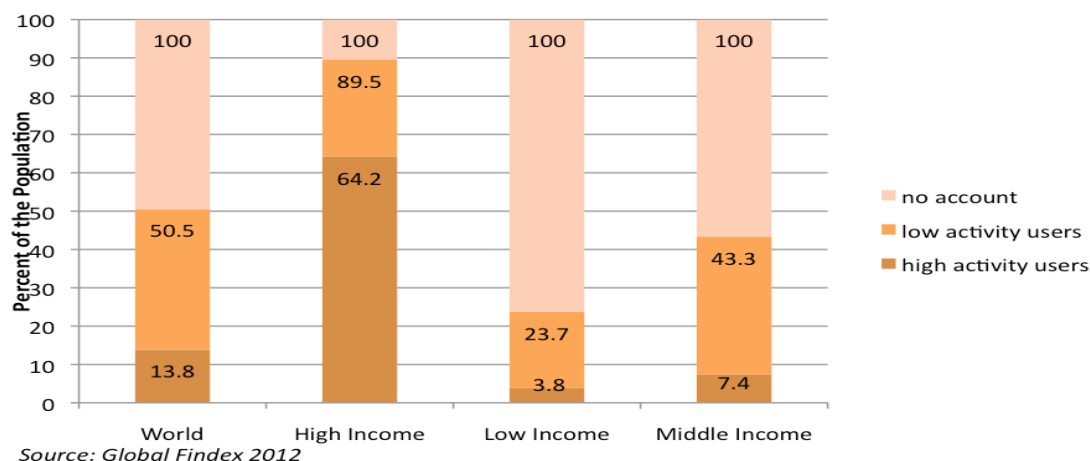
As a result poverty is entrenched, as the poor are faced with the high costs of accessing financial services, and are denied entrepreneurship opportunities that might provide them with a chance to earn an income and in the long term economic growth of a country is below potential, as the level of investment is reduced.

### 2.3. Unbanked and Underbanked

Financial inclusion then is targeted at; the unbanked who have no interaction with the banking sector or formal financial system i.e. they do not have a basic transaction or savings account (Moloi, 2009) and are prone to using the services of cash loan providers or pawn shops; and the underbanked whom Elisabeth Rhyne (2012) defined as typically having at least one product with the bank but also relying on alternative financial institutions for some of their banking needs.

In addition, accounts held by the underbanked are relatively inactive i.e. having less than two withdrawals a month implying such accounts are used to get paid or receive money. The Global Findex (2012 in Elisabeth Rhyne, 2012) also highlighted such inactivity was dependent on a countries income levels. In SA approximately 28% i.e. 6million of the banked withdraw all their money from the account once they receive any (Finscope, 2012).

**Fig 1: Bank Account Ownership and Activity, by Country Income Groupings**

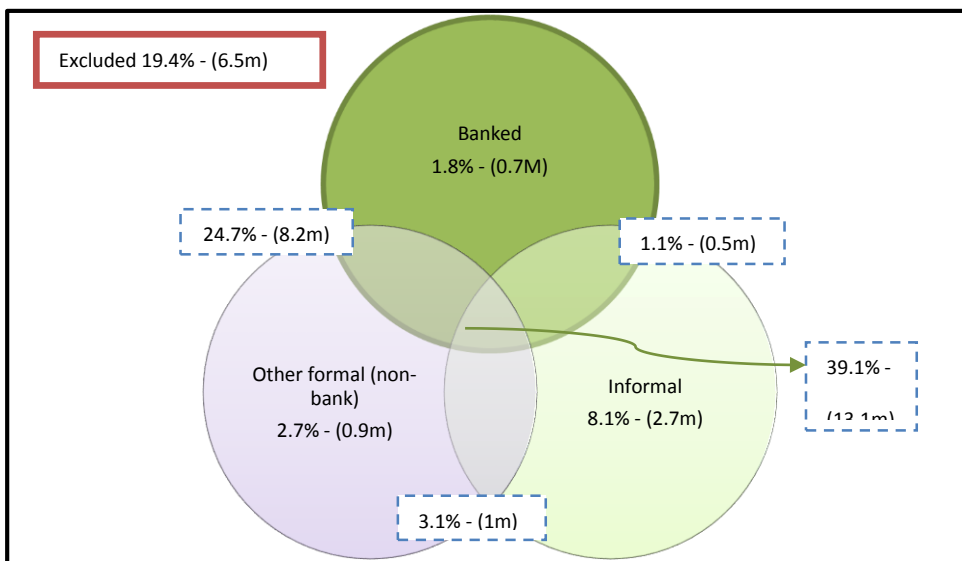


‘No account’ holders would be the unbanked and excluded; ‘low activity users’ the underbanked; and ‘high activity users’ the fully banked or financially included.

Figure 2, below, highlights the proportions of the unbanked and underbanked in SA. Approximately 51.4% i.e. 17.2million South Africans use informal service providers or buy informal products to meet some of

their financial needs and 65% i.e. 21.8million, are underserved by the banking sector i.e. although banked they utilise informal or formal non-bank products or services (Finscope, 2012). And although the statistics have changed much from 2004 (46% banked) it remains to be seen if such inclusion is active or merely having a bank account (Finscope, 2012).

**Diagram 2: Overlap in Financial Product usage in South Africa**



Source: Finscope, 2012

#### 2.4. Macro and micro enablers of financial inclusions

What then facilitates financial inclusion and how does South Africa compare against these enablers based on previous research?

The journey to achieving financial inclusion has its fair share of barriers and constraints. Demirgüç-Kunt & Klapper(2012) identified four barriers to formal banking in Africa – lack of money to use one, insufficient documentation amongst the young mainly, fixed fees and high costs of maintaining accounts. Rajani, Bhamu & Deepa (2012) identified individual or personal constraints such as low literacy levels, low levels of income, psychological and cultural barriers, place of living and a lack of awareness.

Rajani, Bhama & Deepa (2012) also observed institutional and macro barriers; such as inadequacies and/or shortcomings of the system, could be effectively overcome by making available legal identity cards, simplifying complicated procedures, relaxing stringent terms and conditions attached to financial products and services and making them available at affordable costs. They acknowledged the work of governments in exploring innovative methods to help overcome these barriers, but noted the process of transformation was generally long and also dependent on the individual's level of motivation to overcome these barriers.

This section of the literature review seeks to answer this question but with a focus on institutional and environmental enablers only i.e. excluding personal or individual enablers to financial inclusion.

#### **2.4.1. Macro enablers**

Arora & Leach, (2005) in Moloi,( 2009) identified three critical components in the environment that surrounds financial markets – institutional, organisational and support infrastructure. They noted if any of these were dysfunctional, financial markets were then expected to be ineffective.

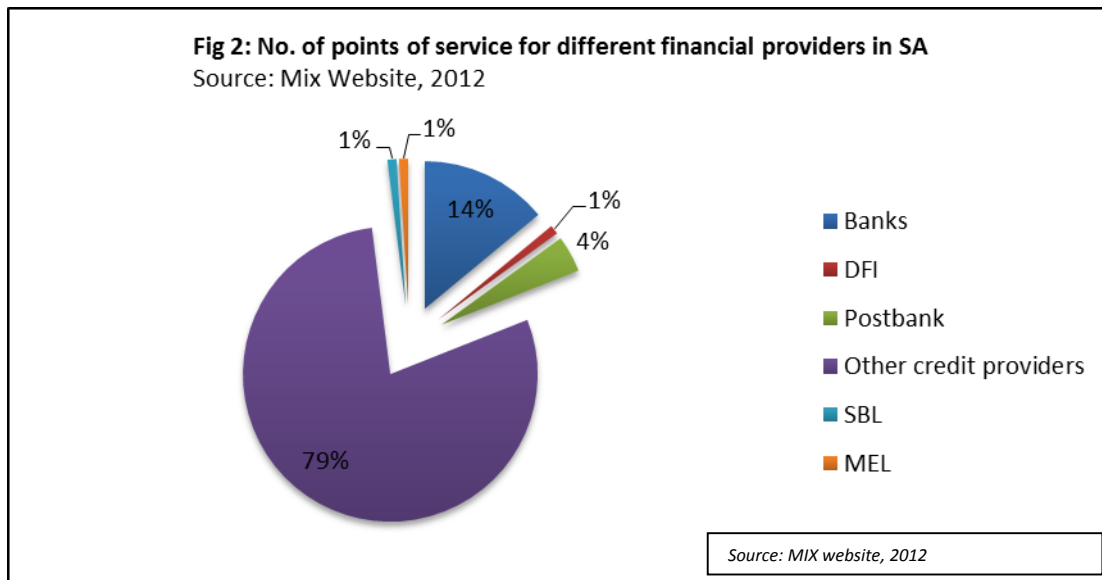
***Institutional infrastructure*** – i.e. policies, laws and regulations (Arora & Leach, 2005 in Moloi, 2009). AFI (2012) echoed the same in when they noted - regulation has been found to play a key role in creating an enabling environment for financial inclusion; in particular, government policy plays a role in determining the supply side of financial inclusion and plays an integral role in protecting consumers. In their work in 2011, Hougaard, Smith, deVos & Chamberlain also found institutional infrastructure could be driven by changes in local legislation or changes in global policies, especially thorough global membership's e.g. SA passed the Financial Intelligence Centre Act (FICA) between 2001 and 2003, after which all financial institutions were required to amongst other things; identify the identity of account users.

Duflos & Imboden (2004) highlighted that for governments to support financial inclusion they should consider; maintaining macroeconomic stability, involving the private sector in formulating poverty reduction strategies, adjusting regulatory frameworks to permit different providers to offer service to the

poor and investing in supervisory capacity. In addition Stuhldreher & Tescher (2005) noted governments could also increase sponsorship on research efforts that yield more information on the unbanked and underbanked markets and promote financial literacy education for children to avoid adult financial illiteracy.

**Organisational infrastructure** – focuses on the diverse providers of financial services, their capacity and ability to compete amongst themselves in a healthy manner (Arora & Leach, 2005 in Moloji, 2009). According to MIX (2012) SA's infrastructure is fairly robust; it has approximately 43,000 point of service spread across the country including ATMs and branches. These service points belong to four main service or product providers' i.e.

1. **Banks** – These are registered under the Banking Act and authorised to take deposits from the public. N Matoti (2010) found 'South Africa had 19 registered banks, 2 mutual banks, 13 local branches of foreign banks, and 43 foreign banks with approved local representative offices. The Big 4 banks are FNB, Standard Bank, ABSA and Nedbank'. While these numbers have changed the MIX, Financial Inclusion Map (2012) documented SA big 4 banks – FNB, ABSA, Standard Bank and Nedbank – and a few foreign banks as having approximately 9,500 points of service nationwide.
2. **Post bank** a state-owned entity offering saving and basic transaction account services and is currently seeking amendment to the SA Postbank Ltd Act 2010, to allow it to offer full banking services (Postbank, 2012). The Post office has more than 1,800 points of service nationally and accounts for 4% of all points of service nationally.



3. Development Finance Institutions (DFIs), micro enterprise lenders (MEL) and salary based micro lenders (SBL) account for only 3% of the points of service nationally and include co-operative societies (Mix, 2012).
4. The most points of service, approximately 30,900, are offered by **other credit providers**. These are mainly licensed service providers which are semi supervised; the regulator has limited oversight of their activities and they have limited or no reporting requirements. Such entities include retail store card providers e.g. Mr Price or Woolworths, pawn shops, repossession agents, cash loan points and several private or single branch loan providers. Of these points of service approximately 1,100 have pawn shops, cash loan and repo as their trading name and are more than DFIs, micro enterprise lenders and salary based micro lenders combined. Except the store cards other credit providers are assumed to predominantly service the informal banking market (Mix, 2012).

Other than the banks these other financial institutions are alternative financial service providers (AFSPs). They may operate in the same market segment as commercial banks and can be considered direct competitors as noted by Moh'd, Karim & Mohammed (2012) and Paradigm Shift (2010).

In their work van Rooyen, Stewart and De Wet (2012) found these institutions; particularly MFIs, have been noted to alleviate poverty, foster economic development, help the poor to save, accumulate assets and better manage their money. However they have also been criticised for not helping the poorest of the poor and even for causing more harm than good. In markets where financial exclusion is prevalent they appear to meet the needs of the poor while commercial banks addressed those of higher income markets. The same findings were echoed by Annabel & Bert, (2009) in their conclusion that MFIs respond to a need that banks do not fulfil and flourish where the formal banking sector fails.

Excluded from the 'point of service' summary by MIX (2012) are the informal financial service providers such as stokvels; voluntary membership groups, family and friends etc that are not formerly regulated but rely on trust as the mechanism to ensure the safety of funds and the operations and pursuits of the groups is purely member driven. In 2006, the SA Reserve Bank introduced legislation for stokvels which allowed them to be viewed as legal, self-governing entities operating outside the banking regulations (Barbara & Gerhard, 2010).

**Support infrastructure** provides support to the institutional and organisational infrastructure and includes professional service providers involved in the financial sector (Arora & Leach, 2005 in Moloji, 2009).

In addition to the mentioned macro enablers Jeffries (2007) highlighted the importance of quality and timely information to fostering financial inclusion. He noted, information plays a critical role in financial markets, and is crucial to making efficient decisions, especially regarding loans. A lack of information tends to restrict the availability of credit, even to viable borrowers and although insufficient (imperfect) information is a general problem in the financial sector, there is a particular problem with a lack of information about low-income household market needs and use, leading to a lack of appropriate financial products and services for this group'.

### 2.4.2. Micro enablers

In addition to the macro enablers are the micro enablers at an institutional and environmental level that enable financial inclusion. For many banks the risk versus return of serving the underserved barely makes business sense, more so because the business of the poor is principally one of high volume low margins. Albeit banks such as Grameen and Citibank have shown that it can be done if a different approach to the poor is taken.

**Grameen Bank** – In their work Dean & Johnathan (2007), found ‘Yunus’s fundamental insight was to show that the poor are bankable if the right lending mechanism is used. The earliest mechanism to gain attention is the “group lending” contract, mitigating problems imposed by information asymmetries and costly external contract enforcement. The bank reports loan repayment rates above 98% despite lending to poor households, most of whom lack collateral and experience with banks’. Grameen Bank and Yunus are used synonymously.

**Citibank** – In trying to understand what it took to succeed in underserved markets, Wessie (2007) highlighted how Citibank’s different approach to the poor paid-off. In 2001, Banamex, Mexican bank merged with Citigroup and begun to explore ways to make a profit in the approximately USD24Bn annual remittance market for fund transferred from the USA to Mexico. To avoid large capital outlays they introduced a ‘checkless check account’ with attractive features for immigrants to open an account. They also introduced the a card which enabled recipients in Mexico to access the funds through branches, ATM’s or debit card channels nationally. By using already existing networks they lowered the price of remittances from 4% of funds to 1% of funds.

## 2.5. But what does it take to succeed in underserved markets?

In conclusion of his work Wessie (2007) proposed five strategies for any company; based on research on companies that had excelled in serving the underserved. They are;

***Mine and translate local market information*** – He observed, underserved communities tended to be more heterogeneous, diverse in need and taste and national information sources on them were often inaccurate or incomplete. Gathering information on them through e.g. surveys etc, also proves difficult or unreliable as participants may not be legally documented, have permanent homes or they could be suspicious of the exercise. As such to obtain reliable information companies have to find alternative ways to collect information on the market e.g. local information brokers, learning labs etc. (Wessie, 2007)

***Adapt the business model to community realities*** – In this regard Wessie (2007) observed, customers in these communities have preferences that differ significantly from consumers in mainstream markets. They tend to prefer products with the lowest initial costs, even if the life cycle costs are higher. This can dramatically change how companies package and deliver product. Another key challenge is created by the fact that the social networks in these communities are often disconnected from the social networks in which the company and its employees are embedded. As such to reach the people with new and innovative products different marketing and sales channels may have to be adopted.

***Change internal incentives and challenge cultural assumptions*** – ‘Most companies have developed a set of financial and social incentives that work to align the behaviour of its employees with strategic goals and objectives. But incentives that work well to focus the behaviours of employees in mainstream markets can often be counterproductive when it comes to providing incentives for working with underserved communities. Incentives might have to shift, for example, from a focus on margins to a focus on total profits in order to encourage managers to spend time and energy building business in these markets that might be lower margin.

Employees may have a tacit set of cultural assumptions or biases that need to be challenged if they include inaccuracies or biases concerning underserved individuals and communities. Companies that have successfully entered underserved markets often work to identify and change cultural and racial biases within the organization that prevent their managers from understanding and developing opportunities in

those markets. The core of their strategies often involves making these assumptions explicit so that they can be addressed and managed' (Wessie, 2007).

**Create partnerships and strategic alliances** – These are important to overcome barriers of entry in such markets. Such barriers could be trust related, cost structures that make it impossible to sell a product profitably, difficulties in aggregating demand, political or bureaucratic obstacles (Wessie 2007). Such partnerships and alliances take the shape of community bankers who live and work in the communities or networking with retail shops to distribute or disseminate information.

**Improve the enabling environment** – The suggestions made are similar to the macro enablers noted earlier. Financial institutions need to play an active role in infrastructure development by making their voice heard and getting their hands dirty when required.

Several others have echoed some of the sentiments by Wessie (2007). Prahalad, (2010) in his book *Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits* identified three key success factors; the need to create capacity among the poor to consume. This did not entail free hand-outs but rather the breaking down of products into small and affordable chunks. Secondly, these customers wanted to be treated with dignity and have variety to choose from and finally trust was a major prerequisite i.e. no hidden charges or small text.

Anderson & Billou (2007) also demonstrated by research on companies successfully serving the underserved in Asia, that by leveraging the 4As - availability, affordability, acceptability and awareness - companies could achieve growth and profit. They explained each 'A' as

1. **Availability** - distribution channels to the poor can be fragmented or non-existent and the task of simply providing service to people can be a major hurdle to overcome due to population dispersion and poor transport infrastructure.

2. **Affordability** – Underserved consumers have low disposable incomes, and products may also need to match the cash-flows of customers who frequently receive their income on a daily rather than weekly or monthly basis.
3. **Acceptable** – The target market must accept the product or service offered for it to be successful. In their work they demonstrated companies that designed their products or tailored their services to existing market behaviour and trends were likely to be successful.
4. **Awareness** – Most poor communities do not have access to conventional advertising media e.g. TV, Internet or smart phones. To create awareness on their products financial institutions have to rely on alternative advertising media e.g. billboards for urban and rural communities some of which may have to be in vernacular, marketing material at points of access but more importantly material held by strategic alliance partners, advertising through transport vehicles e.g. taxi in SA, among others medias.

## 2.6. Conclusion

Both macro and micro enablers are essential in addressing financial exclusion. This research has added to this knowledge by comparing how the institutional and organisational infrastructure in SA has supported or failed to support financial inclusion. The research also looked at the credit products to the underserved through commercial banks and AFSPs to identify areas of weakness or strength in serving or aspiring to serve the underserved. The assessment of products was against four factors i.e. availability, acceptability, affordability and awareness of the end users.

## **Chapter 3: Research design and methodology**

### **3.1 Introduction**

This chapter outlines the final approach, design, sampling and data analysis techniques used and limitations encountered during the research.

### **3.2 Research approach and strategy**

The research was done using a deductive approach and qualitative strategy. A deductive approach was considered better than an inductive approach because the research commenced with a broad theory and hypothesis that:

Theory – The macro and micro enablers identified in the literature review are essential in creating a conducive environment for financial inclusion.

Hypothesis - some of the identified macro and micro enablers required when seeking to serve the underserved are missing in SA.

In carrying out the research information was gathered on the macro environment in SA, the credit products offered by AFSPs' and commercial banks and an analysis done to compare the products. The results of the research then enabled us to 'Accept' or 'Fail to accept' our hypothesis and make recommendations as need be (Aquil, 2008).

The research relied on the collection of qualitative data so it used a qualitative and not a quantitative strategy.

### **3.3. Research Design, Data Collection Methods and Research Instruments**

To answer the research questions, the data collected was mostly factual so it was unlikely to be manipulated by both investigator and provider of data. It was also collected from various sources and

analysed to provide further insight into financial inclusion in SA. For these reasons the case study design was preferred and considered more suitable.

The research used both primary and secondary data. The primary data was collected from the regulators, players in the financial services space, commercial banks and AFSPs' websites or thorough telephone interview. Secondary data was collected from books, articles, websites and journals on the macro and micro environment of SA, India, commercial banks and AFSPs' population. The data was collected using two methods i.e.

*Browsing the internet* and specifically

- Websites of various providers of credit products to understand the products provided.
- Websites with articles, publications, journals and books on regulatory environment for financial inclusion in India and SA.
- The SA map of Financial Inclusion for distribution of providers across the country and demographics of SA (Mix, 2012).

This approach was preferred because it was considered cheap and allowed the research to be done at any time of day. However, not all entities sampled had websites and some were obviously out-dated. Such entities were contacted telephonically.

*Unstructured telephone interviews* were conducted where the information was unavailable on the internet or websites were considered outdated. Although the interviews were unstructured a questionnaire was designed to guide the interview, see Appendix 1. This method was preferred as it is quick, more flexible and it allowed the interviewer to explain the questions if need be, skip or probe more on others and it allowed for greater sample control (UCT, 2012). However to manage costs calls were only made where websites were unavailable or outdated.

### **3.4. Sampling**

The SA map of Financial Inclusion (Mix, 2012) was used to give the population of banks and AFSPs' registered with the NCR. It provided;

- demographic details of the overall SA population and distribution of the unbanked and financially excluded country-wide
- a distribution map of financial providers in SA and their contact details

The researcher noted, while the map is a big step towards understanding the layout of points of service nationally it is considered incomplete meaning there could be more points of service albeit likely to be concentrated in major towns.

The data on service providers was then stratified by province and further by nature of financial service provided i.e. banking or AFSPs'. Samples were then selected for each province for the different service providers using stratified random sampling and the sample sizes were determined by;

- Poverty ratio of a province i.e. the poorer a province the larger the sample selected;
- Type of service provider; at least one bank and other formal entity was sampled from each province.
- Geographic distribution of an entity i.e. if an entity has points of service nationally only one point of service was selected for sampling and the results were assumed to be the same nationally.

In summary 38 entities were selected most of which were other service providers. The sample details are outlined in Appendix 2.

### **3.5. Research Criteria**

Based on (UCT, 2012) the approach selected for the research was

- Reliable – The information collected was mainly factual and by stratifying the data into provinces and selecting a larger sample for areas with higher populations of the under and unbanked the sample was fairly representative of the SA's under and unbanked.
- Valid – All data was considered fairly valid as information gathered was based on actual product offering at the time of gathering the data.

### **3.6. Data Analysis Methods**

Excel was used to analyse the data collected. The questionnaire and sampled service providers were uploaded into Excel and the findings were documented for transaction and credit offerings. Once data collection had been completed, Excel was used to analyse the data and deduce findings report. Tabulation in Excel was preferred as it allowed for easy comparison and identification of errors or omissions; and easy classification and stratification of data.

### **3.7. Limitations**

Firstly, most entities classified as 'Other service providers' did not have a website or contact number registered with Telekom. These entities were replaced with other alternative entities. In replacing sampled entities every effort was made to choose an entity as similar to the entity being replaced. A replacement approach was considered most suitable as the research question is mainly one of product type not accessibility of provider. Where a replacement was not made either due to lack of alternative entities or contact details the findings in other provinces were used. Such instances included; no co-operative could be contacted in KZN nor could any sampled cash loan providers in Limpopo.

The SA map of Financial Inclusion (Mix, 2012) may not be complete and as such may not be reflective of the total population of banks and AFSPs'. To manage this, a small assessment was done to establish who the major banks and AFSPs' are in SA and where need be they were added to the population. This was

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necessary for the co-operative sample which excluded Orania Co-operative Bank; which is one of only two co-operative banks.

Most of the entities shown as other service providers on the map were predominantly asset financiers. These entities were excluded from the sampling process because providing credit or taking deposits is not their core business.

## **Chapter 4: Research findings, analysis and discussion**

### **4.1 Introduction**

The research findings detailed in this section are collated from the instruments detailed in Chapter 3 and comparisons between the literature and findings are detailed in the respective summary sections in this chapter.

The chapter commences with our findings on the regulatory infrastructure of South Africa, followed by findings on the organizational infrastructure. In discussing the organizational infrastructure, a brief summary of findings on the products offered per organization is provided. The research then discusses findings on the products offered and some innovative solutions from India.

### **4.2 Institutional enablers of financial inclusion in SA**

Regulation and supervision of the financial sector or industry requires establishment of rules, policies and laws to govern the industry and subsequent monitoring and enforcement of the same.

Different theories, for example the Body of Knowledge on Infrastructure Regulation – explain that regulation happens because of either of the following scenarios: the government would like to minimize information asymmetries and to align an operator's interest with its interest; consumers would like protection from monopoly power where competition does not exist or is not effective; market operators would like protection from rivals; and operators themselves would like protection from government opportunism.

Falkena, 2001, also noted the need to mitigate systemic risk, regulate the conduct of business in the financial market, protect the consumer and maintain economic efficiency as the main rationale for regulating markets.

In the document '*A safer Financial Sector to Serve South Africa, 2011*' the Minister for Finance - Parvin Gordon highlighted the objectives of regulating the financial sector as

- i. Maintaining confidence in the financial system and sustaining systemic stability;
- ii. Ensuring providers of financial services are appropriately licensed;
- iii. Promoting appropriate market conduct and prosecuting cases of market misconduct, thereby protecting the consumer;
- iv. Maintaining the safety and soundness of financial institutions; and
- v. Enforcing applicable laws.

### THE SOUTH AFRICAN FINANCIAL REGULATORY SYSTEM

The Financial Services sector is highly valuable to the economy of South Africa and is best understood using Table 1 below which expresses the sector in proportion to the country's GDP.

**Table 1: Snapshot of the Financial Services Sector of South Africa in 2010**

*Source: National Treasury, 2011*

	<b>Share of GDP</b>
Size (gross value added)	10.5%
Assets	252%
Of which:	
- Banks	127%
- Long term insurers	60%
- Short term insurers	4%
- Pension funds (public and private)	62%
	<b>Share of formal employment</b>
Employment	3.9%
	<b>Share of corporate taxes</b>
Tax contribution	15.3%

The assets of the sector, particularly banks are over 100% of GDP and the contribution to the economy through employment and tax is immense not to mention its indirect contributions e.g. providing a spring board for international and South African companies venturing into Africa.

#### 4.2.1. Reputational

The sector can be considered well-developed and is highly regarded internationally because of its strong regulatory framework and having weathered the 2007 crisis very well. South Africa is a member of G-20 countries, the Bank of International Settlements and the Financial Stability Board that co-ordinates

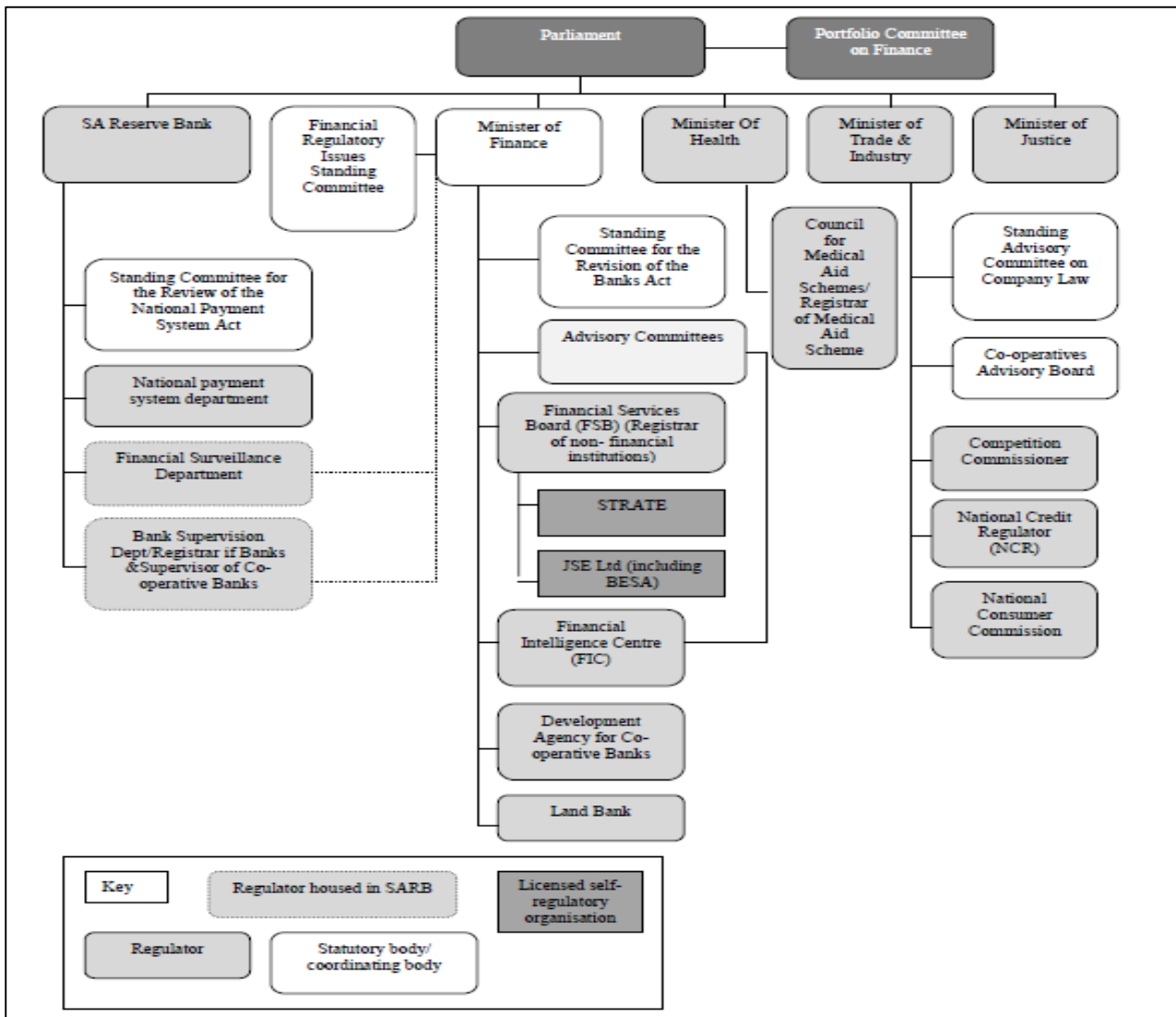
regulation at international levels. The country adheres to the Basel accords and several other international compliance or good practice recommendations e.g. Anti Money Laundering (AML), FICA etc. In addition the country is subject to regular assessment of the domestic financial sector by the IMF and the World Bank; one was done in March 2010 for adherence to international banking, insurance and securities markets' regulatory standards in terms of their Financial Sector Assessment Programme (FSAP); a positive assessment was given in the Report on Observance of Standards and Codes (ROSC).

#### **4.2.2. Functional organisation**

Functionally the sector has a disparate regulatory and supervisory system and doesn't have an overarching co-ordinating authority as shown in Diagram 2 on the next page. The various regulators in the current structure are micro-regulators focusing on their respective industries within the sector and no umbrella body is macro-regulating i.e. monitoring the whole. Following the financial crisis the management of systemic risks has become critical and one way to manage it is for regulators to have a holistic view or sense of the sector and not just industries within the sector.

#### **Diagram 2: Present regulatory structure of the South Africa Financial Sector**

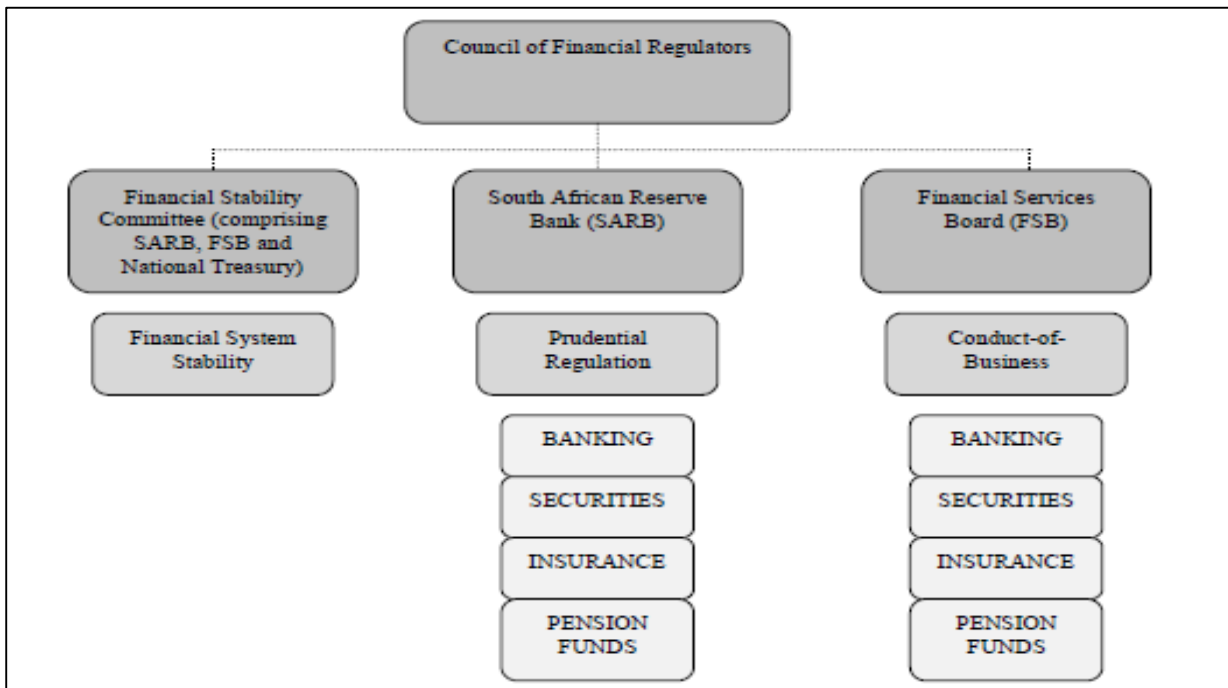
*Source: National Treasury, 2011*



To this end the government has proposed a financial sector reform using the ‘twin peaks’ approach. Using this approach the sector will have; a macro-prudential regulator who performs the prudential supervision function and a business conduct regulator who mainly focuses on customer protection. Using the proposed approach the Reserve Bank (SARB) will be the macro-prudential regulator and the Financial Service Board (FSB) the business conduct regulator. See Diagram 3 for details.

**Diagram 3: The proposed Twin – Peak Model for South Africa**

**Source:** Erika Botha & Daniel Makina, 2011



The model is structured under four main policy objectives with various parties assigned responsibility. The objectives and responsible parties are: financial stability – SARB; consumer protection and market conduct - FSB and National Credit Regulator (NCR); access to financial services – Treasury supported by co-operatives and dedicated banks e.g. Postbank, Land Bank; and combating financial crime – enforcement agencies.

The Council of Financial Regulators will consist of heads of key financial regulators, non-financial regulators and other stakeholders and will ensure the overall coordination of financial regulation. The Council will also serve as a formal channel for resolving conflicts that inevitably arise from separating prudential and business conduct regulation.

These structural changes are widely welcomed and are expected to foster financial inclusion with the FSB and Treasury playing critical roles. In the document '*A safer Financial Sector to Serve South Africa, 2011*' the Minister noted the new would model would foster financial inclusion through;

- i. Improved transparency and comparability of rates and fee disclosures for easy comparison of banks by consumers;

- ii. The FSB implementation of its own 'Treating Customers Fairly' initiative aimed at significantly improving the consumer experience with financial institutions. This initiative was piloted by the FSB in 2011 and is intended to have regulated institutions demonstrate to the FSB they treat customers fairly through all stages of the lifecycle.
- iii. Ensuring all financial service providers are formally and rigorously regulated; and
- iv. Introduction of various financial inclusion initiatives e.g. creating an enabling framework for co-operative banks, introducing more and strengthening existing dedicated banks.

#### **4.2.3. Other regulatory achievements**

**The Financial Sector Charter:** It is a transformation charter in terms of the Broad-based Black Economic Empowerment [BBBEE] Act [Act 53 of 2003]; that came into effect in 2004. Various financial institutions adopted the charter whose objectives included among other things financial inclusion. Although voluntary, the charter brought financial inclusion into the banking sectors agenda, it forced them to do something as they were required to report on their activities and targets were set for the same. Compliance to the commitments is monitored by the Banking Association of SA (BASA). (CGAP, 2012)

The amendment of KYC regulations was also a major achievement as it allowed banks to open accounts without requiring a proof of address or evidence of income, popularly known as an Exemption 17 account (CGAP, 2012). The restrictions on such an account include; one can only have one card account, total transactions per day are limited to R5,000, total monthly transactions are limited to R25,000, the account must never have more than R25,000 at any given point and to access the account abroad one would have to provide a proof of residence.

#### **4.3. Organisational enablers of financial inclusion in SA**

Organisational infrastructure focuses on the diverse providers of financial services, their capacity and ability to compete amongst themselves in a healthy manner and safely for the consumers. As mentioned in Chapter 2 SA's organisational infrastructure is fairly robust with approximately 43,000 points of service

including ATM's and Branches. This section summarises our findings on the capacity of service providers mentioned in section 2.4, to support government's agenda through their networks and services.

It also highlights the effects of other factors affecting inclusion but specific to market players e.g. competition and effects of Basel III on banks; the changing regulatory environment for co-operatives; and corporatisation of Postbank.

#### **4.3.1. Banks**

Commercial banks are the main players in the credit provision space in South Africa. They have assets amounting to more than 120% of GDP, account for approximately 4% of formal employment and provide consumers with a national network of approximately 26,000 branches and ATM's excluding other points of sale. As at 2012, there were 17 registered banks, 2 mutual banks and 12 local branches of foreign banks not to mention 41 foreign bank branches with local representative. The top four banks; Standard Bank, First National Bank, ABSA and Nedbank, account for more than 70% of the industry assets suggesting the industry is concentrated.

Alternative banks with a national footprint include African Bank, UBank and Capitec Bank. African Bank is not deposit taking and sources its funds from wholesale sources e.g. the bond market, DFI's etc. UBank has its history in the mining sector and is still predominantly focused on providing services to miners and blue collar workers in the mining sector. It received its banking license in 2007 and has approximately 98 branches, 48 agencies and 77 ATM's most of them in mining regions. Capitec bank has grown rapidly over the last few years and is now a nationwide bank and a favourite with low income earners as its fees are fairly low.

##### ***a. Research findings***

The study examined the services provided by the four main banks and two alternative banks i.e. UBank and African Bank. The findings are summarised below.

Account opening requires one to have identification cards and despite Exemption 17 not all banks are offering personal accounts for people without a proof of residence. An account opening fee and minimum deposit is not required for most banks and similarly most transaction accounts were activated for mobile banking and use of ATM's. The average monthly transaction costs i.e. monthly fees and making one withdrawal and deposit at the ATM ranges between R10-34.

The banks offer credit facilities of as little as R250, but the documentation requirements are much more onerous than those of opening an account e.g. proof of address, minimum income requirements and some requiring evidence the salary is deposited into a bank account. Interest rates on the loans range from as little as 8.5% to as much as 32% implying interest charged was dependent on one's credit rating. There are several alternatives for making loan applications e.g. online, at the branch or via telephone banking.

From these findings it is inferred commercial banks are willing to handle deposits for the underbanked and unbanked but are hesitant to offer credit in the absence of certain documentation.

### ***b. Other factors***

These are additional findings on factors unique to banks that influence financial inclusion.

#### **Competition**

As mentioned earlier the South African commercial banking space has more than 60% of assets managed by four banks although the market has more than 15 players.

Okeahalam (2001) concluded the South Africa banking sector was highly concentrated and with such high concentration there was a likelihood of collusive oligopoly i.e. entities colluding to the disadvantage of consumers. Falkena *et al* (2004) as part of a Task Group report to the National Treasury and SARB concluded there was indeed high concentration in the banking sector.

More recently in their paper '*Testing for Competition in the South African banking sector – 2012 pg 23*' Witness *et al* concluded '*The results ..... strongly suggest monopolistic competition in the South African banking sector.*' They tested competition during 1992 – 2008.

Monopolies or oligopolies lead to great returns for banks and reduces their appetite to enter markets that are considered difficult e.g. the poor, low income earners that are unsalaried, those without proof of residence, the unbanked or underbanked. Such absence does not have to be an absence of products but could include a lack of initiatives or channels to reach difficult markets.

In South Africa; the Mzansi initiative was introduced following an amendment of KYC regulations. As at 2011, 3.2M Mzansi accounts remained active and approximately 42% of accounts opened under Mzansi are dormant or have had no owner initiated transactions for more than a year (CGAP, 2012). In addition, there is barely any advertising through mainstream media e.g. TV, radio or newspapers of Exemption 17 accounts or the encouragement of the unbanked or underbanked to consider banking.

### Basel III

Following the crisis the global market responded with the introduction of Basel III which South Africa adopted 1 Jan 2013. Its objective is to strengthen bank balance sheets, enhance liquidity management and enhance on the quality and quantity of capital held by banks. As a result it has amongst other things increased capital requirements for banks and introduced two liquidity ratios to address short and long term liquidity needs.

Whilst the intention is to strengthen the banking sector and reduce the likelihood of another credit crunch like that of 2008, implementing Basel III could also mean; weaker and smaller banks are forced to merge, get acquired or close down as they are unable to raise the required capital, which in turn reduces players in the market. It could also mean reduced lending capacity as banks focus on increasing their capital base.

This would in turn increase the cost of credit and reduce the benefits of saving with banks for new entrants into banking.

### **4.3.2. Postbank**

Postbank; a division of the South African Post Office, is currently being corporatized to become the South African Post Bank. This is following a parliamentary approval of the SA Postbank Limited bill which created a SA Post Bank Limited Act. This provides a legislative framework to not only establish the bank but also improve and expand its role to retail banking dedicated to serving the rural and lower income markets. It is therefore expected to compete with other retail banks once it receives its banking license sometime in 2014.

In an interview with Moneyweb on 18 Sept 2013, the Post Office CEO noted the bank had two strengths; its national network through the Post Office and its dedicated role to financial inclusion which it considers an extension of government services to its people.

Currently the bank offers only saving and transactional accounts at competitive rates i.e. not subsidised; average monthly transaction costs i.e. monthly fees and making one withdrawal and deposit at the ATM, is R12. They are not the cheapest but are cheaper than most banks.

They currently do not offer personal credit but are expected to once they become a retail bank. If run effectively and with minimal government interference, SA Post Bank may go a long way in offering the under banked a national bank focused on their needs.

### **4.3.3. Co-operatives**

#### ***a. Co-operatives***

The co-operative community is made up of worker, agricultural, financial service, housing and consumer co-operatives, which can be further classified into worker or user co-operatives.

In worker co-operatives, the workers and owners each hold an equal vote on the basis of 'one member one vote'. In user co-operatives the members are users or direct beneficiaries of the co-operative services and

more often than not, members are not dependent on the co-operative for their livelihood rather for economies of scale e.g. wine co-operatives in Western Cape used to negotiate better prices for farmers who are members. This study focuses on financial co-operatives only which are also member owned and is limited to those registered with the National Credit Regulator (NCR) as a minimum.

***b. South African co-operative landscape***

In South Africa the Co-operative Banks Act was passed by Parliament in 2007 creating a regulatory framework that provides for the registration of Co-operative Financial Institutions (CFI's) as Co-operative banks. CFI's being; financial services co-operatives (FSC), saving and credit co-operatives (SACCO's), community banks, credit unions and village banks. Currently there are only two co-operative banks in the country i.e. Ditsobotla Primary SACCO Bank Ltd and OSK Co-operative Bank. As at Feb 2013 the two banks had 1,830 members, share capital of R487,320, assets worth R69M and liabilities of R62.6M.

As at Feb 2013, there were 16 eligible CFI's with 30,069 members, R8.7M in share capital, assets worth R145M and liabilities of R95M. This number had reduced from 19 in 2012 following the liquidation of one and winding down of two.

***c. Research findings and observations***

This study examined the services provided by 4 co-operatives one of which is a co-operative bank. The OSK co-operative bank shows a lot of potential but is restricted to operating and providing services only to residents of Orania and similarly Mathabatha SACCO is restricted to residents within a 50Km radius of the co-operative.

The interest rates offered vary between the various co-operatives some being flexible and others fixed. It is not clear if external credit checks are done to determine a members' credit worthiness and they usually require borrowers to provide collateral in addition to their savings.

They generally offer small loans with the exception of Orania Co-op Bank that offers home loans of up to ZAR 1.5M and repayment periods are generally not greater than 3 years. They require members to apply for loans through the branch.

Unfortunately most co-operative do not have a national network; they are mostly based in a province and with only one branch. They offer very basic co-operative services i.e. regular savings that are then used as collateral when borrowing.

#### ***d. Other factors***

These are additional findings on factors unique to co-operatives that influence financial inclusion.

#### Regulatory developments

Co-operative banks and CFI's are currently regulated by the Co-operative Banks Development Agency (CBDA); which sits under the Ministry of Finance, following the replacement of Exemption Notice Numbers 887 and 1176 which previously authorised SAMAF and SACCOL to regulate CFIs not registered as co-operative banks.

Should a pending amendment to the 2007 Act be passed, the co-operative banks will be handed over to the SARB allowing CBDA to concentrate on the registration, regulation and development of only CFI's. This centralisation of regulation of the CFI's is critical to 'minimise regulatory arbitrage; optimise the use of supervisory expertise and resources; minimising regulatory burden; alleviate confusion in the sector; and achieve the development objectives of the Act' (CBDA *et al* 2013).

#### Registration requirements and developments

To register as a CFI an entity must have at least 200 members, R1M in deposits, R100,000 in share capital and be solvent at the time of application. In the year 2012/13; 50 applications were received, 14 met the criteria and were registered to start operation as a CFI in FY 2013/14. Registered CFI's are subject to on-site

inspections and are required to maintain the criteria noted and submit quarterly returns to retain their annually renewed license.

Notwithstanding the CFI registration requirements entities previously registered with SAMAF and SACCOL were considered for registration with CBDA provided they were solvent at the time and not *stokvels* registered as co-operatives.

### Challenges facing the sector

In its 2012/13 annual report the CBDA identified capital adequacy; management and governance; weak operations and inadequate Management Information Systems as the biggest weaknesses facing CFI's looking to register as Co-operative banks.

#### *e. Observations*

In the researcher's observation, these entities offer a good saving alternative where the intention is to borrow against ones savings; they can be a good launch pad into mainstream banking for the unbanked; and provide a good opportunity for one to build a credit history which can be used later. However, the lack of transaction accounts would require members to either open an account or hold cash in their homes.

This is probably the next space; after Post Bank, that has great potential to offer service to the under and unbanked population. It is still in its infancy but is receiving good attention from regulators and government with the intention of grooming CFI's to become co-operative banks. Their potential is great because in their formative periods they are self-regulated e.g. *stokvels*, allowing members unable to provide bank statements or proof of residence to join them. As the group matures they then enter into a regulated environment and hopefully the members will have grown with them and therefore moved from being unbanked to being banked albeit underbanked.

The co-operatives also offer very basic facilities and hopefully as they grow they will catch up with other African counterparts who offer members; transaction accounts; modern banking solutions e.g. mobile banking and ATM's; and have national networks through branches or alliance partners.

#### **4.3.4. Other financial service providers**

##### ***a. Development Finance Institutions (DFIs)***

They mostly come into existence through an Act of government e.g. Industrial Development Corporation Act and have specific mandates aimed at assisting the government achieve key objectives.

In South Africa the main DFI's are public DFI's that receive subsidised funds from government and donors and then provide the funds to the public at subsidised rates through various channels. They principally seek to invest or participate in areas where the market fails to invest or participate sufficiently. In carrying out the research we sampled two entities i.e the National Youth Development Agency (NYDA) and Land Bank.

The NYDA has recently shifted focus from offering loans to the youth to focusing on education and skills development and providing of micro finance grants. This shift has been to avoid duplication of services as several other DFI's provide loans albeit not specifically focused on the youth.

Grants offered are between R1,000 – 100,000 to the youth between 18-35 years. The recipients are not expected to repay the grant but are required to participate in the affairs of NYDA for a minimum of two years. Youth co-operatives and businesses at the start-up or promising phase are eligible for the grant and this includes formal and informal businesses e.g. motor mechanics/panel beaters, electricians, plumbers, beauticians, hair dressers, cleaning companies, small scale recycling companies, street vendors, car washes etc. This is especially important as most private financial entities are unwilling to fund start-ups and the youth in general as they have not built up a credit history.

Land Bank is also a DFI and in some ways a specialist bank. It provides finance for commercial farming only to both established farmers and entrants into the sector. Its products include short, medium and long term loans which can be used for establishment or expansion. Loans are repayable over 18 months to 15 years with room to repay earlier for short term loans. The bank requires collateral which is usually the asset purchased or in case of plantation establishment loans alternative assets.

DFI's as mentioned are very specialised and target a specific market. Others such as Khula are discussed under Micro-enterprise lenders. In addition, a list of some DFI's in SA is attached in Appendix 3

#### ***4.1. Salary based micro lenders (SBL)***

As the name suggests they target low to middle income salaried people who are either underbanked or underserved. They are usually privately owned entities offering salary advances typically. Those with a national footprint are Blue Financial Services and Real People. Others in the space include Thuthukani Financial Services and Atlas Finance.

In carrying out the research three entities were sampled i.e. Blue Financial Services, Thuthukani and Real People. These entities typically only offer loans to salaried customers who generally have personal bank accounts with commercial banks. They perform credit checks on their customers and offer loans at approximately 30% which is quite high. However, customers are able to apply for loans online or through the branch. In some instances loan applications can only be finalised at the branch.

Unfortunately, Blue Financial Services is no longer providing loans and this is an indefinite decision. It also suspended its listing on the Johannesburg Stock Exchange earlier this year and is rumored to be in financial distress.

Thuthukani offers short term loans for approximately one week to six months, the maximum loan is for ZAR 7,000 and minimum loan is ZAR 500 only at approximately 30% per annum. This implies they are a salary advance lender.

Real people on the other hand only offer home improvement loans for a maximum amount of ZAR 100,000. The funds are paid to selected stores from which customers can purchase required materials to improve their homes.

If the entities mentioned are a reflection of the SBL sector in the country there is room for much growth and possibly more support is required for players in the sector in form of regulation and supervision.

#### **4.2. *Micro-enterprise lenders (MEL)***

These entities are predominantly registered under the Section 21 Act as Not for Profit organisations. They receive funding from wholesale lenders, donors and in some instances the government.

In South Africa the national players in this space include Khula Enterprise Finance which is also noted as a DFI in Appendix 3, Women Development Business, Marang Financial Services and Small Enterprise Foundation (SEF). They have wholly or partially adopted the Grameen Bank model and use a Centre Based Group Lending approach. With this approach each individual is part of a small group of typically five people and the group is in turn a member of a center. The various institutions have different rules governing the centers and groups e.g. family members cannot be part of the same group, group members must live within walking distance of each other, each group in a center must save a defined amount per month or have regular meetings. The group lending approach has several advantages for persons with low income or unable to meet typical bank requirements. These are; credit evaluation is done by group members saving people the hustle of having to identify themselves and evidence their ability to repay; credit monitoring is also done by the group which reduces the chances of default; and usually group members monitor each other which helps ensure the funds are put into productive use.

Their products are targeted at persons living below the poverty line as such they deal with micro loans of as little as R300 and with less than one year repayment periods typically. Most of the customers do not have personal bank accounts and the entities do not offer deposit taking services so they require

customers to open group accounts with Postbank or other commercial banks and make regular deposits. The MEL then disburses the funds using the account to members and savings can be used for emergencies. Loan applications are done at the group and centres and presented to branch offices through regional coordinators. Group members must all be present for group application in most cases.

Requiring groups to open accounts is often seen as the first introduction to banking for most of these members and enables them to build relationships and grow with the banks.

The selected sample included SEF, Akanani Finance and Khula. Khula Enterprise Fund provides retail and wholesale lending services at subsidised rates. The wholesale arm enables them to extend their reach, create jobs and distribute the administration burden for small loans to micro lenders. Their retail loans are offered to both individuals and groups and are much larger than typical micro-finance loans at ZAR 50,000.

#### **4.3. *Other providers***

Despite the entities mentioned above South Africa has a wide array of other credit providers mostly asset based financiers e.g. auto credit, retail store credit cards amongst others. However amongst them are also cash loan providers and pawn shops. These entities are all registered with the National Credit Regulator (NCR) but for most giving credit is not their core business. This study focuses on the 'cash loans' and 'pawn shops'.

Cash loans offer micro loans and are most popular because although some consider ones credit rating they provide the loan and within a very short time – usually minutes. Pawn shops on the other hand require no credit check and once the goods are accepted for credit one need not pay the loan as the asset can be sold off. They are required to co-operate with law enforcement agencies to ensure they don't deal in stolen goods.

According to the NCR website, to register with the NCR entities need to meet the following requirements:

- Credit providers who have entered into at least 100 agreements or have a total outstanding book of credit of more than R500 000;
- Are juristic persons and individuals;
- Have a commitment to combating over-indebtedness.

Whilst the first requirement is most likely designed for administration purposes, it means the first 100 agreements and R500k are unregulated. Fraudsters may also register the entity and ditch it once it meets the requirements to avoid being regulated.

Cash loans and pawn shops mainly target people excluded from the formal financial sector for one reason or the other. It is a difficult market to regulate because of the minimal entry requirements, high number of players and the financial literacy levels of consumers. This was recently brought to the fore following the Marikana massacre where NCR found most micro-lenders operating near Lonmin offices were operating illegally and were guilty of charging excessive interest rates and illegal fees, retaining customers bank cards, ID cards and performing inadequate affordability tests. This is feared to be the case in many areas where the vulnerable are.

In carrying out the research, a total of 18 entities were sampled from all over the country. It was interesting to note the cash loans and pawn shops offer and require very similar documentation irrespective of province. Typically the cash loans would require three months bank statements, recent payslip and identification documents. All sampled cash loan providers issue loans to employed persons or pensioners only, require salaries or pensions to go through the provided bank statements and will place a debit order with the bank before disbursing the funds. Loan amounts vary from as little as ZAR 100 to 15,000, the amount one qualifies to receive is dependent on cash balance as shown on the payslip and also the relationship with the loan provider. Some cash loans have a maximum amount and repayment period

for first time borrowers and most did a credit check on the borrower; the results did not necessarily mean no credit would be granted rather the interest rate would be higher.

The pawn shops required only identification documents and the asset of value. They determined the worth of the asset and issued loans for one month after which if the loan was unpaid the asset was sold.

Alternatively, the borrower could pay interest and have the asset held for another month.

Both pawn shops and cash loans charge extremely prohibitive interest rates. Interest charged by the selected sample ranged from 5% per month to 31% per month.

#### **4.4. Overview of products offered by commercial banks versus AFSPs'**

This section aims to provide an overview of commercial banks versus AFSPs'. The details of each provider have been noted in the respective sections above and are not repeated below. The overview is provided under the 4 A's utilised by successful companies serving the underserved i.e. affordability, availability, acceptability and awareness.

##### **4.4.1. Availability**

Anderson & Billou (2007) noted distribution channels to the poor can be fragmented or non-existent and the task of simply providing service to people can be a major hurdle to overcome due to population dispersion and poor transport infrastructure. In carrying out the research, four main questions were asked to determine the availability of products offered by commercial banks and other providers; a summary of the findings is given below.

The commercial banks and Post Bank have the largest network of branches. The poorest province; Free State, is mainly serviced by Postbank, banks and other credit providers e.g. asset financiers, cash loans and pawn shops. Other players e.g. MEL's seem to only have one branch as they are mainly concentrated in wealthier provinces i.e. Mpumalanga, KZN, Eastern Cape and Limpopo.

Once again commercial banks offer the best alternatives to branch banking. Such services include card services, cell phone banking, online banking and ATM's. Post Bank has networked with banks for its card services allowing users to enjoy card and ATM services. Other providers that can be groomed to take advantage of such technology are the co-operative banks which offer only branch services currently.

For loan applications and disbursements, commercial banks offer the best channels i.e. online, cell phone or telephone for pre-qualification and branch banking. Approved funds are then accessible through ATM or card services in addition to the branch. Other providers especially SBL's and cash loans provide for online applications which once approved have funds disbursed to personal accounts.

In summary, commercial banks – especially the four main banks – are most available to the consumer and this will soon include Post Bank once it has its banking license. This is may be especially important for Free State which is currently underserved by other players.

#### **4.4.2. Affordability**

Anderson & Billou (2007) noted underserved consumers have low disposable incomes so products targeted to them may also need to match the cash-flows of customers who frequently receive their income on a daily rather than weekly or monthly basis. Four main questions were asked during the research; a summary of the findings is given below.

Transaction accounts were typically offered by commercial banks and Post Bank. It is possible to open an account for free with two of the sampled banks and Post Bank. Others required an account opening fees which could then be withdrawn or acted as the minimum deposit for the account. Most banks do not require a minimum deposit to be held those that did required between ZAR 20 – 25 minimum, Post Bank requires ZAR 35.

The co-operatives offered a regular saving account for members to accumulate shares against which to borrow in future. To open an account, members were required to pay between ZAR 100 – 250 which went towards purchasing the first share.

All entities provided loans; mostly personal loans but DFI's and MEL's provided specialized or group loans respectively. It was difficult to ascertain the cost of personal loans from commercial banks and DFI's as they are priced based on ones' credit scoring, relationship with the institution and loan amount. With the other entities no distinction was made rather the interest rate provided was all encompassing.

On average interest rates in South Africa are based on a persons' credit score, relationship with the entity and the entities appetite for risk. However from the information gathered: commercial banks offered loans at between 8.5% - 35% p.a; co-operatives at between 15-26%; SBL's at above 30% p.a; cash loans at approximately 5-31% p.m; and MEL and DFI's offered flexible rates some of which were subsidized.

Commercial banks emerge at the top once more because they appear to be the only ones providing loans between 8.5-15%. Other cheap alternatives for the under and unbanked include MEL's or DFI's which unfortunately are focused on group lending or financing of businesses. Once again, Post Bank could provide the much needed alternative for these low income earners.

#### **4.4.3. Acceptability**

Anderson & Billou (2007) suggested the target market must accept the product or service offered for it to be successful and demonstrated companies that designed their products or tailored their services to existing market behaviour and trends were likely to be successful. To determine the acceptability of credit products in the market seven main questions were asked; the findings are discussed below.

To obtain a loan in South Africa one is required to provide an identification card, some evidence that they can repay the loan and understandably proof of residence so in case the loan is in default the lender can find the borrower to lay claim on assets or otherwise. As such Mzansi transaction account holders are usually disqualified from obtaining loans. To evidence the ability to repay, consumers can provide 3

months bank statements or payslips; and as proof of residence water bill, electricity bill or lease agreement. Most providers prefer payslips to bank statements as they can lay charge through employers and have their monies deducted before it is banked. Alternatively they establish standing orders with banks to withdraw the funds.

Loan processing times vary significantly with short term loans provided by SBL's and cash loans taking as little as minutes for frequent customers. Other providers' process loans within a week or two typically once all required documentation is provided.

The market offers loans of as little as R100 and the sky is the limit and for as little as one week to several years. Typically ones' payslip provides the required security, however depending on ones' credit profile and nature of organisation additional collateral may be required e.g. pawn shops take assets as collateral and the co-operatives seem to require additional security despite the savings.

It appears there are no characteristics to distinguish the players except that MEL's rely on group dynamics instead of some of the mentioned documentation. However, their services are focused at those below the poverty line which is not the case with most of the under and unbanked people.

#### **4.4.4. Awareness**

Anderson & Billou (2007) noted most poor communities do not have access to conventional advertising media e.g. TV, Internet or smart phones, so to create awareness on their products financial institutions have to rely on alternative advertising media e.g. billboards for urban and rural communities some of which may have to be in vernacular, marketing material at points of access but more importantly material held by strategic alliance partners, advertising through transport vehicles e.g. taxi in SA, among others medias. Two main questions were asked during the research; the findings are provided below.

Needless to say, commercial banks and Post bank were best placed to raise awareness or advertise themselves due to their financial muscle. However, providers such as MEL's did not need to advertise

themselves through conventional means because they were heavily dependent on group dynamics. As such they relied mainly on Word of Mouth and people coming together by choice. Similarly co-operatives use different channels to advertise as they are restricted to members sharing a common bond. SBL's and other providers are increasingly available online but rely heavily on alternative channels e.g. word of mouth, radio, pamphlets and regional newspapers.

#### **4.4.5. Summary**

Based on the findings, it appears commercial banks are the major one stop for deposit taking and credit provision nationally but this will change once Post Bank becomes a fully operational retail bank. They also offer the best service in three categories except acceptability where there are barely any distinguishing factors.

The findings also highlight the glaring lack of good and competitive alternatives for persons excluded from formal banking. Hopefully, the corporatisation of Post Bank and increased government attention to co-operatives will help alleviate this in the future.

#### **4.5. Other financial inclusion solutions - India**

The work done above has focused purely on South Africa with minimal input on the happenings in other countries. This section of the research aims at highlighting initiatives being adopted by other countries – specifically India, to enhance financial inclusion.

The researcher noted, there are many similarities in approach between the two countries; e.g. the Mzansi account is the No frills account in India and relaxing of KYC rules to encompass those without addresses; but the detail below only highlights some approaches taken that do not seem to be in South Africa or if in place they are not fully exploited.

### 5.5.1. Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF)

According to National Bank for Agriculture and Rural Development (NABARD) website the objective of the funds is to support developmental and promotional activities that enhance financial inclusion and the FITF will be used to enhance investment in Information Communication Technology (ICT) aimed at promoting financial inclusion. The funds are funded by the Government, RBI and NABARD in a ratio of 40:40:20.

Eligible parties are financial institutions, NGOs, MFIs, SHGs, training and research organisations, academic institutions, universities, service providers e.g. Insurance Companies and other entities whose agenda is aligned to that of the fund. For FITF technology service providers are also eligible. It is not clear how much or to whom funds have been disbursed to date or what activities have been funded.

Other initiatives taken by government include

**Network mapping:** Using Geographical Information System the Department of Financial Services in India is mapping the various points of service i.e. branches, ATM's, business correspondents etc in a bid to identify deficient areas.

**Branch opening:** The Reserve Bank of India (RBI) has also taken aggressive steps towards strengthening the financial service infrastructure by requiring banks to extend their branch network into rural areas and allowing previously restricted entities to open networks in other areas.

### 5.5.2. Micro finance institutions (MFI) and Self-help groups (SHG) Bank linkages

According to Hema Bansal, 2003; India offers linkages to the poor through three channels

- i. Bank-SHG-Members: The bank itself acts as a self-help group promoting institution.
- ii. Bank-Facilitating Agency-SHG-Members: Facilitating agencies like NGOs, government agencies, or other community-based organizations form groups. The bank then offers loans directly to the groups.

- iii. Bank-NGO-MFI-SHG-Members: NGOs act both as facilitators and microfinance intermediaries. First they promote groups, nurture them, and train them, and then they approach banks for bulk loans for lending to the SHGs.

These approaches require for banks, MFI and other financial players in the respective markets to work closely to develop the groups and keep default levels low. E.g. NGO's provide financial literacy education and assist members with record keeping.

The Micro-enterprise lenders in South Africa currently utilise the hybrid version of the third model as they source their funds from various sources. The other two models can be explored and adopted in South Africa.

### **5.5.3. Business correspondents and business facilitators**

The Reserve Bank of India (RBI), as part of its Financial Inclusion mandate has permitted banks to engage companies registered under the Indian Companies Act amongst others and individuals as Business Correspondents (BCs) subject to guidelines for engaging BCs. The banks remain fully responsible for the actions of the BCs and their retail outlets / sub agents. Individual BC's are expected to be have defined minimum qualifications, be well known in their locality, reliable and have the ability to invest in the required point of sale and hand held device. Such persons are usually retired teachers, doctors, shop owners. Eligible entities include well run self-help groups, companies etc.

It has been the most successful approach as it requires minimal outlay of capital in form of branches or ATM's and is easily acceptable by the community as one of their own offers the service. Banks are also required to promote their agents to avoid any confusion in the market.

The BC's are mandated to carry defined amounts of cash with them and are expected to regularly report to the bank on their transactions. Account holders are issued with smartcards which they use to deposit and draw funds.

## **Chapter 5: Conclusion and recommendations**

### **5.1. Conclusion**

A long journey starts with one step. The journey to having an inclusive environment has only begun in South Africa. Changes in the overall regulatory structure will not only improve transparency and enhance customer protection; they will give some regulatory bodies e.g. CBDA a better platform to serve and empower others by focusing them on their core business e.g. FSB will focus on conduct of business only in the whole sector.

The corporatisation of Post Bank will probably be the most notable achievement on this journey. It has been long awaited and hopefully it will remain focused on financial inclusion in the long term. The focus on co-operatives and intention to increase the number of co-operative banks is yet to bear fruit but once it does it will be a good stepping stone for people aspiring to be banked.

As these changes and other organisational developments become entrenched, hopefully commercial banks will have strong competitors offering competitive alternatives to the unbanked and underbanked in the future.

### **5.2. Recommendations**

Commercial banks are by a very large extent the principal deposit takers and lenders for all of South Africa. The case that there are only four with an extensive national reach naturally means the low income earners are not their primary concern. It could even be considered unrealistic to expect them to take the lead on the financial inclusion agenda considering they are expected to handle the local and international business and affairs of the middle and large income earners and businesses. Whilst the initiative for them to offer Mzansi products was successful in many ways, the Government has to seek alternative approaches to address financial inclusion. Such approaches could include;

- i. Proactive development of select alternative banks so they are able to play in the same space as the major four and increase competition. The increased competition would then force players to consider penetrating previously ignored markets.
- ii. The corporatisation of Post Bank and registering it under the Banking Act is a great move by the Government. It remains to be seen if it will remain primarily focused on financial inclusion and how it will balance the challenges of banking low income earners. Such challenges include; tendencies to have minimal bank transactions to save on costs, funds are quickly withdrawn upon deposit and costs of administrating several small accounts can be prohibitive. However, it has been done successfully in other countries e.g. Kenya, so there are plenty of peers to consult globally.
- iii. The re-organisation of supervision and regulation in the Co-operative sector into a centralised approach took long but has been accomplished, however, two provincial banks with less than 2,000 members is barely much. As mentioned earlier, there is plenty of room for growth in this space. Such growth could entail: development of the co-operative banks to have a national footprint; the development of front office services e.g. transaction accounts; offering of modern and convenient solutions to members e.g. mobile banking and ATM's. Such solutions have been implemented successfully in Kenya.

With alternative deposit taking institutions the underserved will be better placed to enjoy the benefits of the financial sector.

## Appendices

### 1. Research Questionnaire

#### Financial inclusion: Bank and AFSP's questionnaire

##### *Objective of questionnaire*

This questionnaire is designed to answer the following research question

*How do credit products offered by AFSPs' compare to those offered by commercial banks against the following characteristics; availability, acceptability, affordability and the target market awareness of the product (Anderson & Billou, 2007)?*

#### 4. General

1.1. Name of institution:

1.2. Nature of institution: **Bank / AFSP**

1.3. Province Branch or Office is located:

#### 2. Availability

2.1. Do you have a national branch network? **Yes / No**

2.2. Do you have branches in at least 3 provinces where most unbanked and underbanked people are found? **Yes / No.**

2.2.1. If yes, is it in **one / two / three / more than three** provinces

2.3. Does one have to come to the branch or office to access your services? **Yes / No**

2.3.1. If no, what alternatives are available e.g. Post Office, Cellphone? (list as many)

2.4. What channels are available to submit a personal loan application e.g. Post Office, internet, cellphone? (list as many)

#### 3. Affordability

3.1. Is there an initial charge for opening an account? **Yes / No**

3.1.1. If yes, how much is it?

3.2. How are the costs payable? **Monthly / Per transaction / Weekly / Other** (explain)

3.3. What are the average costs for a personal loan account?

3.4. What is the average interest rate of a personal loan currently?

**4. Acceptability**

4.1. What are the personal loan account opening requirements? (list all)

4.2. What alternative documents can be provided instead pay slips / bank statements? (list as many)

4.3. How long does it take to process the loan if all required documentation is provided?

4.4. What is the minimum loan amount one can take?

4.5. What is the maximum loan amount one can take?

4.6. What is the minimum and maximum personal loan repayment period?

4.7. Is collateral required? **Yes / No**

4.7.1. If yes, what kind of asset can one bring? (list as many)

**5. Awareness**

5.1. What advertising channels are used to inform the public about your new product or offering? (list as many)

5.2. Do you advertise and offer service in vernacular? **Yes / No**

## 2. Sample details

### Population

The population of 43,247 service provider offices or branches was obtained from 'South Africa Map of Financial Inclusion' (2012). It was stratified into the nine provinces using entity addresses and the provinces were further stratified by level of poverty with the poorest being Free State.

- Free State
- Limpopo, North West, North Cape and Eastern Cape
- KZN, Mpumalanga
- Gauteng, Cape Town

Once organized by province the data was further stratified into the seven service provider types.

### The service providers

The following is a brief summary of the service providers

- Bank – There are approximately 22 banks and the following have a national footprint; ABSA, Standard Bank, African Bank, Capitec, Surebank, Nedbank, FNB and African Miners Credit Bank. UBank, Sasfin and Bidvest Bank are found in at least five of the provinces.
- Postbank – Each province has a branch of Postbank, in total there are approximately 1,765 branches.
- Co-operatives – There are 29 co-operatives none of which have a national footprint, in addition Free State has no co-operative as per the data used. In carrying out further research on Co-operatives the researcher noted one of only two co-operative banks in the country was missing. As the sample had already been selected but no testing had been done the entity selected for North Cape Province – Orania SACCO, was replaced with OSK Co-op Bank which is also from North Cape. It was also subsequently noted, there is a SACCO with the national footprint SAMWU.
- Development Finance Institutions (DFI) - there are two main national DFI's i.e. Land Bank and National Youth Development Agency (NYDA). KZN also has Ithala Development Finance Corporation.

- Micro enterprise lenders (MEL's) – There are four national MEL's i.e. Khula / SEFA, Women Development, Marang and Small Enterprise Foundation (SEF).
- Salary based micro lenders (SBL) – There are approximately five salary-based micro-lenders nationally. Those with a national footprint are Blue Financial Services and Real People. Others include Thuthukani Financial Services and Atlas Finance.
- Other Providers – The population had to be sorted further as it contained details of other credit providers e.g. mortgage and car loan providers. The data was sorted by description of the entity i.e. entity names including 'cash', 'Loans', 'finance' or 'Pawn'. The entities containing the name 'Finance' have been further sorted to exclude asset financiers or financial advisors.

### **Sampling**

Once the data was stratified by province and type of service provider a random sample was selected for each type of service provider. Below is Table 1 providing a summary of the service providers by province, the actual entities identified e.g. there are only 22 banks in the population and the total samples selected.

**Table 2: Sample summary**

<b>Province By Poverty*</b>	<b>DFI's</b>	<b>Co-op</b>	<b>MEL</b>	<b>SBL</b>	<b>Postbank</b>	<b>Bank</b>	<b>Other Providers</b>
Free State	2**	-	2	5	161	14	227
Limpopo	2	3	6	4	168	11	234
North West	2	1	3	5	163	10	252
North Cape	2	1	2	2	82	8	99
E Cape	2	8	5	4	177	13	171
KZN	3	2	3	5	251	18	238
Mpumalanga	2	1	3	5	106	12	193
Gauteng	2	8	3	5	410	22	532
Cape Town	2	5	3	4	247	18	203
<b>Total entities</b>	<b>19</b>	<b>29</b>	<b>30</b>	<b>39</b>	<b>1,765</b>	<b>126</b>	<b>2,149</b>
<b>Actual entities in population</b>	3	29	6	5	1	22	2,149
<b>Entities sampled</b>	2	5	3	3	1	5	18
*The provinces are listed by poverty level with Free State being the poorest.							
** Highlighted in red is the province from which the sample was selected e.g. the DFI's sample was selected from Free State and N Cape provinces.							

### 3. Examples of DFI's in South Africa

<b>Institution</b>	<b>Mandate</b>
Industrial Development Corporation (IDC)	The IDC is a self-financing, state-owned national DFI that provides financing to entrepreneurs and businesses engaged in competitive industries.
Development Bank of Southern Africa (DBSA)	The purpose of the DBSA is to accelerate sustainable socio-economic development by funding physical, social and economic infrastructure. Its goal is to improve the quality of life of the people of the region. The bank plays a multiple role of financier, adviser, partner, implementer and integrator to mobilise finance and expertise for development projects.
National Housing Finance Corporation (NHFC)	The NHFC was set up with a mandate to ensure that every South African with a regular source of income is able to gain access to finance, to acquire and improve a home of his or her own.
Khula Enterprise Finance	Khula is dedicated to the development and sustainability of small businesses in South Africa. It provides finance, mentorship services and small business premises to small and medium enterprises (SMEs) through a network of partnerships and to encourage the sustainable development of SMEs while ensuring that Khula remains financially viable.
National Empowerment Fund (NEF)	The NEF promotes and facilitates Black Economic Empowerment (BEE) and transformation. Its mandate and mission is to be a catalyst of Broad-Based BEE through asset management, fund management and strategic projects.
Independent Development Trust (IDT)	The IDT has a mandate to support government in meeting its social mandate of alleviating poverty in improving the quality of life of poor rural communities. It has created a reputation for being a development programme-implementing agency focusing on development planning, implementation, and the coordination of government programmes.
Land and Agricultural Development Bank of South Africa	The Land Bank is a specialist agricultural bank guided by a mandate to provide financial services to the commercial farming sector and to agribusiness and to make available new, appropriately designed financial products that would facilitate access to finance by new entrants to agriculture from historically disadvantaged backgrounds.

Institution	Mandate
National Youth Development Agency (NYDA)	The NYDA's mandate is to: advance youth development through guidance and support to initiatives across sectors of society and spheres of government; embark on initiatives that seek to advance the economic development of young people; and develop and coordinate the implementation of the Integrated Youth Development Plan and Strategy for the country.
National Urban Reconstruction and Housing Agency (Nurcha)	Nurcha supports the national programme to house all South Africans in sustainable human settlements. Nurcha provides bridging finance to contractors and developers involved in the construction of subsidy and affordable housing, community facilities and infrastructure.
Rural Housing Loan Fund (RHLF)	The RHLF's core business is providing loans, through intermediaries, to low-income households for incremental housing purposes. Incremental housing is a people-driven process; and the RHLF's core business is to empower low-income families in rural areas to access credit that enables them to unleash the potential of their self-help, savings and local ingenuity to build and improve their shelter over time.
South African Microfinance Apex Fund (Samaf)	Samaf is tasked to facilitate the provision of affordable access to finance by micro, small and survivalist business for the purpose of growing their own income and asset base. The primary purpose of Samaf is to reduce poverty and unemployment and also to extend financial services to reach deeper and broader into the rural and peri-urban areas.
Micro Agriculture Finance Scheme of South Africa (Mafisa)	Mafisa was developed as a micro and retail agricultural financial scheme for economically active poor people. Mafisa allows access to financial services through selected institutions on an affordable and sustainable basis. It assists with loans to target groups, individuals, farmers and other groups as well as savings and banking facilities at approved financial institutions.

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