

**FINANCIAL CO-OPERATIVES:  
REGULATORY AND SUPERVISORY ANSWERS FOR  
SOUTH AFRICA AND MALAWI**

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## DECLARATION

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**Date:** 26/10/2021

## DEDICATION

*For my mother*

*When I look up from the playing field, my eyes still find yours.*

*Thank you for always being there.*

## ACKNOWLEDGEMENTS

When I embarked on this PhD journey, I did not know what it would take to get to the end. Now that I am at the end of this journey, I find myself at a loss for words. The journey has been both long and tough. It has stretched my capacities and demanded a lot from me.

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## **ABSTRACT**

The regulatory and supervisory framework of financial co-operatives in South Africa consists of the Co-operatives Act (No. 14 of 2005), the Co-operatives Bank Act (No. 40 of 2007), Banks Act Exemption (Notice 620 of 2014) and the Financial Sector Regulation Act (No. 9 of 2017). In Malawi, the regulatory and supervisory framework of financial co-operatives consists of the Financial Services Act (No. 26 of 2010) and the Financial Co-operatives Act (No. 8 of 2011). This thesis proposes that the regulatory and supervisory frameworks provided by these pieces of legislation in both South Africa and Malawi do not adequately regulate the sector and that this in turn, one of the main contributing factors to the slow growth of financial co-operatives in the respective countries.

On the one hand, the frameworks over-regulate some aspects of the financial co-operatives sector. This overregulation has created a harsh regulatory environment for some financial co-operatives. On the other hand, some aspects of the financial co-operatives sector are underregulated. Under-regulation has resulted in regulatory arbitrage and oversight of the fact that financial co-operatives have economic objectives, ownership structures, risks, and challenges unique to them.

Interestingly, although such gaps and overcompensations in the frameworks have hindered the growth of formal and semi-formal financial co-operatives, they have fostered the growth of informal financial co-operatives. Accordingly, in both countries, there is an overwhelmingly large sector of informal financial co-operatives. Informal financial co-operatives are not governed by formal pieces of legislation. Rather, they are governed by indigenous law, or as otherwise termed, the law of the people.

This thesis postulates that the overregulation and under-regulation embedded in the current regulatory and supervisory frameworks have been birthed from a misunderstanding of what financial co-operatives are and how they ought to function; an infusion of unfavourable historical and political influences and practices into the current regulatory and supervisory frameworks; overdependence of external aid; and lastly, an underestimation of the competencies of the citizens in both countries.

The aim of this thesis is not to suggest supplanting of the current formal frameworks in South Africa and Malawi, or an adoption of informal governance structures. Instead, this thesis aims to provide recommendations for legal reform within the current framework. It aims to propose how, if possible, or required, the relevant laws in South Africa and Malawi might be changed, reformed or developed within their existing frame of reference.

## TABLE OF ABBREVIATIONS

AFRACA	African Rural and Agricultural Credit Association
ALDSAP	Agriculture and Livestock Development Strategies and Action Plan
ASCA	Accumulating Savings and Credit Associations
ASCRA	Accumulating Savings and Credit Rotating Associations
ATM	Auto Teller Machines
CAU	Catholic African Union
CBDA	Co-operative Banks Development Agency
CCUL	Cape Credit Union League
CFI	Co-operative Financial Institutions
CIPC	Companies and Intellectual Property Commission
CSA	Co-operative Savings Associations
DTIC	Department of Trade Industry and Competition
FCA	Financial Co-operatives Act
FSA	Financial Services Authority
FINCA	Foundation for International Community Assistance
FSC	Financial Services Co-operative
FSRA	Financial Sector Regulation Act
ICA	International Co-operative Alliance
IFAD	International Fund for Agricultural Development
MoFEPD	Ministry of Finance, Economic Planning and Development
MoIT	Ministry of Industry and Trade
MUSCCO	Malawi Union of Savings and Credit Co-operatives
NACFISA	National Association of Co-operative Financial Institution of South Africa
NBFI	Non-Bank Financial Institutions
NGO	Non-Governmental Organisations
PA	Prudential Authority
RBM	Reserve Bank of Malawi
ROSCA	Rotating Savings and Credit Associations
SACCO	Savings and Credit Co-operatives

SACCOL	Savings and Credit Co-operative League of South Africa
SARB	South African Reserve Bank
SCA	Savings and Credit Associations
USAID	United States Agency for International Development
VSLA	Village Savings and Loans Association
WOCCU	World Council of Credit Unions

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# PART ONE

Understanding Financial Co-operatives

# CHAPTER ONE

## INTRODUCTION

*“If someone had told me a few years ago what progress cooperation was about to make, I should have said that he was talking of a vision of Utopia.” – Rt. Hon. W. E. Gladstone<sup>1</sup>*

### 1.1 CONTEXTUAL BACKGROUND

#### 1.1.1 CO-OPERATION – THE PREMISE UPON WHICH CO-OPERATIVES REST

Co-operation, as a way of life, is as old as human civilisation itself.<sup>2</sup> It can be traced back to our prehistoric predecessors who recognised, quite early on, the benefits of individuals working together as a group.<sup>3</sup> By working co-operatively to hunt animals and gather food, our predecessors discovered that in unity, varied individual talents, resources and skills could be pooled together to achieve more economic benefit for all.<sup>4</sup>

Our predecessors also found that co-operation had social benefits.<sup>5</sup> Much comfort was found in the coming together to mourn the death of loved ones in a community; much joy was found in the gathering to celebrate achievements; or where problems arose, in the coming together of minds to formulate solutions.<sup>6</sup>

Today, in both South Africa and Malawi, as elsewhere in the world, people continue to work co-operatively in the pursuit of common goals.<sup>7</sup> For South Africans, this is encapsulated in the concept of *ubuntu*, translated *umunthu*, in the Malawian vernacular. *Ubuntu* is the principle of caring for each other’s well-being and of encouraging a spirit of mutual support.<sup>8</sup> It is the acknowledgement of the rights and the responsibilities of every person in collaborating or cooperating to promote individual and societal well-being.<sup>9</sup> Co-operatives are institutions based on the idea that there is strength in numbers; and that through co-operative action, more can be achieved.<sup>10</sup>

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<sup>1</sup> Hampton Negro Conference *Ninth Annual Report of the Hampton Negro Conference* Forgotten Books (2017) 5.

<sup>2</sup> J M Mwangi *The Role of Savings and Credit Co-operative Societies (SACCOS) in Financial Intermediation in Nairobi County* (unpublished Master’s thesis, University of Nairobi, 2011) 10–11.

<sup>3</sup> A Kimario *Marketing Co-operatives in Tanzania: Problems and Prospects* (1992) 3.

<sup>4</sup> *Ibid.*

<sup>5</sup> K Zeuli & R Cropp *Co-operatives: Principles and Practices in the 21st Century* 4 ed (2004) 1.

<sup>6</sup> K Zeuli & J Radel *Co-operatives as a Community Development Strategy: Linking Theory and Practice* (2005) 5.

<sup>7</sup> Zeuli & Cropp op cit note 5 at 1.

<sup>8</sup> D Nabudere ‘Ubuntu philosophy. Memory and reconciliation’ (2005) *Human Rights Internet Resources Archive* 2–3. available at <https://repositories.lib.utexas.edu/handle/2152/4521?show=full> accessed on 10 May 2019.

<sup>9</sup> South Africa Department of Social Welfare *The White Paper for Social Welfare* (1997) 5.

<sup>10</sup> B Dogarawa ‘The role of co-operative societies in economic development’ (MPRA Paper, University Library of Munich, 2005) 1.

### 1.1.2 DEFINING CO-OPERATIVES

It is difficult to establish a globally accepted definition of co-operatives because their diversity is kaleidoscopic, and their variability is infinite.<sup>11</sup> By some, co-operatives have been defined as voluntary organisations in which the decisions and the control and risk-bearing functions reside in the members; and in which the decision-management resides in the managers who represent the members' interests.<sup>12</sup> This definition points out that

- co-operatives are voluntary associations of persons;
- co-operatives are controlled by their members; and
- members bear the risks of co-operatives.

Notwithstanding, such a definition is not a holistic representation of co-operatives because it only focuses on their organisational structure.<sup>13</sup> It fails to clearly state what co-operatives do. The value of any definition of co-operatives lies in highlighting the distinctness of co-operatives in what they do as well as the reasons for which the nature of the association is sought.<sup>14</sup> Thus, to get a full picture of what is meant by a co-operative, it is important to become acquainted with its functions and reasons for establishment rather than to rely wholly on abstractions.<sup>15</sup>

Accordingly, to highlight their functions, co-operatives have also been defined as social movements of independent farmers seeking to advance and safeguard their place in the economic organisation of agriculture.<sup>16</sup> This definition has not been well received because it limits the scope of what co-operatives do by suggesting that the overriding goal of co-operatives is to protect the interests of members against exploitation in the agricultural supply chain.<sup>17</sup>

Granted, such a definition is unsurprising because most co-operatives, especially in developing countries, function in the agricultural sector.<sup>18</sup> Moreover, there are also conceptualisations of co-operatives as

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<sup>11</sup> Zeuli & Cropp op cit note 5 at 1.

<sup>12</sup> A E Okem 'The meaning and defining characteristics of co-operatives' in A E Okem (ed) *Theoretical and Empirical Studies on Co-operatives: Lessons for Co-operatives in South Africa* (2016) 2.

<sup>13</sup> A Fici 'The essential role of co-operative law' (2014) *The Dovenschmidt Quarterly* 148–9.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

<sup>16</sup> R E Torgerson et al Evolution of Co-operative Thought: Theory and Purpose (1998) *Journal of Co-operatives* 11.

<sup>17</sup> D Baker & K Graber-Lüzthøft 'Concentration in agribusiness and marketing: A case of study of Arla foods' in P Pinststrup-Andersen & F Cheng (eds) *Food Policy for Developing Countries: The Role of Government in the Global Food System* (2007) 1–15 at 5.

<sup>18</sup> R Taylor 'Credit unions and co-operative banking in developed and developing countries' (1974) 45 *Annals of Public and Co-operative Economics* 106; G F Ortmann & R P King 'Agricultural co-operatives II: Can they facilitate access of small-scale farmers in South Africa to input and product markets?' (2007) 46 *Agrekon*

agricultural organisations ideal for rural peasants.<sup>19</sup> Nonetheless, conceptualising co-operatives in this manner is misleading; co-operatives are neither restricted to the agricultural sector nor are they only suitable for the rural poor.<sup>20</sup> Co-operatives aim to benefit society as a whole by providing goods and services to their members; eliminating unnecessary profits of intermediary advantages in trade and commerce; protecting the rights of individuals both as producers and consumers; and preventing exploitation of weaker members of society.<sup>21</sup>

One definition that portrays these benefits has been provided by the United States Department of Agriculture (USDA).<sup>22</sup> The USDA defines co-operatives as user-owned, user-controlled businesses that distribute benefits based on use.<sup>23</sup> The 'user-owner' principle implies that the people who use co-operatives (members), also assist in financing the co-operatives and, therefore, own the co-operatives.<sup>24</sup> The 'user-control' concept means that the members govern the co-operatives; they approve and amend the co-operatives' governing principles.<sup>25</sup> 'Distribution of benefits based on use' provides for the aim of co-operatives, which is, to share benefits among members, as well as all costs, and risks of doing business in equal proportion to the patronage of the members.<sup>26</sup> This definition, makes clear that co-operative members derive benefit from their membership as a function of the extent to which they patronise the organisation.<sup>27</sup>

Another similar definition, and perhaps the most common, has been that provided by the International Co-operative Alliance (ICA).<sup>28</sup> The ICA defines co-operatives as "*autonomous associations of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through jointly owned and democratically controlled enterprises.*"<sup>29</sup> The advantages of this definition are that it is broad and synthesises the multi-faceted functions of co-operatives and the reasons for which individuals would opt for co-operatives.

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<sup>19</sup> Okem op cit note 12 at 2.

<sup>20</sup> Ibid.

<sup>21</sup> I Packel 'What is a co-operative' (1939) 14 *Temp LQ* 61.

<sup>22</sup> The United States Department of Agriculture is the US federal executive department responsible for developing and executing federal laws related to farming, forestry, rural economic development, and food; K Zeuli 'What is a co-operative' in P Jakes (Compiler) *Forestry Co-operatives: What Today's Resource Professionals Need to Know* (2003) 13–14.

<sup>23</sup> Ibid.

<sup>24</sup> Arcadia International *Study of The Best Ways for Producer Organisations to be Formed, Carry Out Their Activities and be Supported* (Report prepared by Arcadia International E.E.I.G., EY and independent experts, 2019) 15.

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

<sup>27</sup> L Evans & R Meade *The Role and Significance of Co-operatives in New Zealand Agriculture: A Comparative Institutional Analysis* (Report Prepared for the New Zealand Ministry of Agriculture and Forestry, 2006) 11.

<sup>28</sup> The ICA is the international umbrella for the global co-operative movement.

<sup>29</sup> International Co-operative Alliance *Global 300 Report 2010 International Co-operative Alliance: The World's Major Co-operatives and Mutual Businesses* (2010) 1.

While it places little apparent emphasis on the fact that co-operative owners are also patrons of the organisations, it recognises the critical elements of voluntary membership and ownership.<sup>30</sup> True co-operation cannot be forced; people should be able to join voluntarily and have the freedom to leave the co-operatives at will.<sup>31</sup> The definition also clearly emphasises that co-operatives are independent from the government and are owned by their members.<sup>32</sup> It further highlights that co-operatives are associations of persons, which can mean individuals, but also legal persons (organisations that can have members themselves).<sup>33</sup>

Beyond that, the ICA definition not only focuses on the economic benefits of co-operatives but also on their social and cultural benefits; making it clear that co-operatives can infiltrate and integrate themselves into the threads that intertwine society. Of importance to note as well is that, unlike companies or other business ventures where welfare gains from trade are shared between buyers and sellers, with co-operatives, the buyers and sellers are the same economic actors (members), and so welfare gains remain with the members of the co-operatives themselves.<sup>34</sup>

### 1.1.3 FOCUSING ON FINANCIAL CO-OPERATIVES

Financial co-operatives are one of the variations of co-operatives. Very broadly defined, financial co-operatives are co-operatives that offer financial services to their members and the local communities in which they are located.<sup>35</sup> Initially, their principal purpose was to assist individuals experiencing hardships resulting from economic challenges.<sup>36</sup> Financial co-operatives accomplished this by pooling resources of the members together and distributing the resources among themselves; not as charitable donations, but as loans to be repaid.<sup>37</sup> Over the years, although they have grown and, in some respects, veered away from their initial structure and methods of achieving their purpose, they have nevertheless maintained their uniqueness among financial institutions; being financial institutions that function based on the following co-operative principles:<sup>38</sup>

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<sup>30</sup> Evans & Meade op cit note 27 at 11.

<sup>31</sup> Zeuli & Radel op cit note 6 at 5.

<sup>32</sup> J Nannyonjo 'Enabling agricultural co-operatives through public policy and the state: The case of Uganda' Draft paper prepared for the UNRISD Conference on Potential and Limits of Social and Solidarity Economy, 6–8 May 2013, Geneva, Switzerland at 6, available at

[http://www.unrisd.org/80256B42004CCC77/\(httpInfoFiles\)/FA3911B9091BF39BC1257B7200356723/\\$file/Justine%20Nannyonjo.pdf](http://www.unrisd.org/80256B42004CCC77/(httpInfoFiles)/FA3911B9091BF39BC1257B7200356723/$file/Justine%20Nannyonjo.pdf) accessed on 16 January 2019.

<sup>33</sup> Okem op cit note 12 at 2.

<sup>34</sup> C Colvin et al *The Origins of the (Co-operative) Species: Raiffeisen Banking in the Netherlands, 1898–1909* (2018) EHES Working Papers in Economic History No 126 at 11.

<sup>35</sup> J Forker et al 'Management models and priorities in member associations: Is credit unions community involvement crowded-out?' (2014) 43 *Non-profit and Voluntary Sector Quarterly* 105.

<sup>36</sup> D McKillop 'Financial co-operatives: Structure, conduct and performance' (2005) 76 *Annals of Public and Co-operative Economics* 301.

<sup>37</sup> Ibid.

<sup>38</sup> Taylor op cit note 18 at 106.

- **Voluntary and open membership/ownership** – Financial co-operatives are associations owned by their members.<sup>39</sup> They accept anyone who intends to use their services or opportunities. However, these people must commit to their values and accept the responsibilities that membership brings.<sup>40</sup>
- **Democratic member control** – This principle is at the heart of financial co-operatives. Financial co-operatives practice the “one member one vote” rule which means that irrespective of the number of shares held by a member, they only have one vote, that is, all members have equal rights.<sup>41</sup> This ensures that financial co-operatives are committed to fulfilling the needs and aspirations of their members, thereby safeguarding financial co-operatives against hijacking, either by their members with higher investments, or non-co-operative institutions (such as the government and development organisations).<sup>42</sup>
- **Member economic participation** – The members of financial co-operatives are required to contribute to their growth. The nature of contribution may be in form of buying shares or paying memberships fees, for instance.<sup>43</sup>
- **External autonomy and independence** – Financial co-operatives must be free from the influence of external entities such as the government, non-governmental organisations (NGOs), and development agencies.<sup>44</sup> Instead, the role of the government in relation to financial co-operatives must be to create enabling environments that foster their growth as autonomous associations.<sup>45</sup>
- **Education, training and information** – As a general principle, financial co-operatives ought to provide relevant education and training to members.<sup>46</sup> Education and training empower and encourage members to participate in decision-making and guarantees that leaders of the financial co-operatives have the requisite skills to oversee the day-to-day running of the associations.<sup>47</sup>
- **Co-operation among financial co-operatives** – Co-operation among financial co-operatives facilitates the formation of networks of financial co-operatives at local, regional, national, and international levels.<sup>48</sup> Where such networks are formed, financial co-operatives become strategically positioned to take advantage of the benefits of economies of scale and scope.<sup>49</sup>

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<sup>39</sup> J Birchill *Co-operatives and the Millennium Development Goals* (2004) 6.

<sup>40</sup> Ibid.

<sup>41</sup> International Co-operative Banking Association *Regulation and Sustainability of Co-operative Banks: A Cross Country Study* (2020) 12.

<sup>42</sup> Ibid.

<sup>43</sup> T Bernard & D J Spielman ‘Reaching the rural poor through rural producer organizations? A study of agricultural marketing co-operatives in Ethiopia’ (2009) 34 *Food Policy* 63.

<sup>44</sup> R Hannan ‘The institution of co-operation: A pathway from governance to spill over and poverty reduction’ (2014) 2 *Journal of Co-operative Organization and Management* 34–35.

<sup>45</sup> Ibid.

<sup>46</sup> D A Frederick *Co-ops 101 An Introduction to Co-operatives* Co-operative Information Reports (CIR) 280597 (2016) 4; F Wanyama et al ‘Reinventing the wheel? African co-operatives in a liberalized economic environment’ (2009) 80 *Annals of Public and Co-operative Economics* 361–392

<sup>47</sup> Ibid.

<sup>48</sup> Birchill op cit note 39 at 2; S Novkovic ‘Defining the co-operative difference’ (2008) 37 *The Journal of Socio – Economics* 2170.

<sup>49</sup> Ibid; D Dredge ‘Policy network and the local organization of tourism’ (2006) 27 *Tourism Management* 277.

- **Concern for the community** – Financial co-operatives must have strong concern for the immediate area in which they exist.<sup>50</sup> Thus, although their primary focus is on member needs and desires, financial co-operatives must also work for the substantial growth of their members.<sup>51</sup>

## 1.2 THE SOCIO-ECONOMIC IMPORTANCE OF FINANCIAL CO-OPERATIVES

Zeuli et al state that co-operatives have more potential to generate substantial social and economic benefits within a community than other non-co-operative associations.<sup>52</sup> The seven principles outlined above enable financial co-operatives to disregard profit maximisation and instead focus on the promotion of the social and economic welfare of members and local communities in which they are located in.<sup>53</sup> Financial co-operatives provide a platform that promotes the inclusion of marginalised sections of society, economic development, and financial resilience.<sup>54</sup>

### 1.2.1 FINANCIAL CO-OPERATIVES AND FINANCIAL INCLUSION/ FINANCIAL EXCLUSION

Most of the population today consists of individuals that are less visible and vulnerable in society. These individuals include small retailers, smallholder farmers, industrial labourers, people involved in unstructured sectors, the unemployed, children, women, senior citizens and the physically challenged of the population.<sup>55</sup> Collectively, these individuals make up what has been termed as the informal economy.<sup>56</sup> The informal economy refers to all economic activities, enterprises, jobs and workers that are – in law or practice – not covered or sufficiently covered by formal arrangements.<sup>57</sup> It is characterised by zero to minimal social protection, written contracts, payslips, and so forth, making it hard for individuals in the informal economy to access sustainable financial services like credit, insurance and savings.<sup>58</sup>

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<sup>50</sup> International Co-operative Banking Association op cit note 41 at 12.

<sup>51</sup> Ibid; LTY Bertulfo 'Women, co-op and peace work' in J Emmanuel & I Macpherson (eds) *Co-operatives and the Pursuit of Peace* (2007) 105.

<sup>52</sup> K Zeuli et al 'Co-operatives in rural community development: A new framework for analysis' (2004) 35 *Journal of the Community Development Society* 18.

<sup>53</sup> Frederick op cit note 46 at 4

<sup>54</sup> X Qin & B O Ndiege 'Role of financial development in economic growth: Evidence from savings and credits co-operative societies in Tanzania' (2013) *International Journal of Financial Research* 4.

<sup>55</sup> R K Nayak 'Financial Inclusion through co-operative banks: A feasible option for inclusive growth' (2012) 4 *GIMJ* 11.

<sup>56</sup> E Etim & O Daramola 'The informal sector and economic growth of South Africa and Nigeria: A comparative systematic review' (2020) 6 *Journal of Open Innovation: Technology, Market, and Complexity* 136.

<sup>57</sup> International Labour Organisation 'Resolution concerning decent work and the informal economy' paper presented at the 2002 General Conference of the International Labour Organization, meeting in its 90th Session available at [https://www.ilo.org/wcmsp5/groups/public/---ed\\_norm/---relconf/--relconf/documents/meetingdocument/wcms\\_080105.pdf](https://www.ilo.org/wcmsp5/groups/public/---ed_norm/---relconf/--relconf/documents/meetingdocument/wcms_080105.pdf) accessed on 20 January 2019.

<sup>58</sup> Kofi Annan Keynote Address at the United Nations General Assembly 2 December 2003 available at <https://www.un.org/press/en/2003/sgsm9088.doc.htm> accessed 17 August 2021.

On a global level, more than 60 per cent of the world today is employed or functions within the informal economy.<sup>59</sup> Full integration of this section of the population into the formal financial market system despite different initiatives discussed and implemented by global economies remains a struggle.<sup>60</sup> Many products designed by commercial and investment banks seemingly do not satisfy or encourage members of the informal economy to participate in mainstream financial services.<sup>61</sup>

Some scholars have described this challenge as one of financial exclusion where there is a difficulty, inability, or reluctance by the poor, to access suitable and conventional financial services.<sup>62</sup> Other scholars have described the challenge as one of financial inclusion where there is an incapacity of the poor to access financial services because of the failure of mainstream financial institutions to deliver financial services to disadvantaged groups of people at affordable prices.<sup>63</sup>

Whatever description one opts to take, the failure of financial mainstream services to reach these sections of the economy with affordable financial services has led to a search for other arrangements. Financial co-operatives have been shown to be popular alternatives.<sup>64</sup> Their economic and social focus on local communities enables their branches to extend to every nook and cranny of society.<sup>65</sup> The pooling of collective financial resources at the community level helps make financial co-operatives a cost-effective local institution that can provide credit to the low-income segments of communities.<sup>66</sup> Moreover, financial co-operatives have shown to be highly capable of motivating self-help energy and excitement, equity and solidarity, and democracy and local development, which in turn draws the less visible sections of society.<sup>67</sup>

### 1.2.2 FINANCIAL CO-OPERATIVES AND ECONOMIC DEVELOPMENT

Economic growth ought to be distinguished from the development of an economy. In theorising economic growth, many authors have conceptualised an economy as a machine that produces economic

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<sup>59</sup> International Labour Organisation 'More than 60 per cent of the world's employed population are in the informal economy' *International Labour Organisation* 30 April 2018 available at [https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS\\_627189/langen/index.htm#:~:text=employed%20population%20...,More%20than%2060%20per%20cent%20of%20the%20world's%20employed%20population,work%20and%20decent%20working%20conditions](https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_627189/langen/index.htm#:~:text=employed%20population%20...,More%20than%2060%20per%20cent%20of%20the%20world's%20employed%20population,work%20and%20decent%20working%20conditions) accessed at 20 September 2018.

<sup>60</sup> L Louis & F Chartier 'Financial inclusion in South Africa' (2017) 1 *JCULP* 172.

<sup>61</sup> World Bank 'Developing trends reports' (2013) available at [www.worldbank.org/topic/developingtrends/](http://www.worldbank.org/topic/developingtrends/) accessed on 24 December 2020.

<sup>62</sup> L Mitton 'Financial inclusion in the UK: Review of policy and practice' (2008) available at <http://www.jrf.org.uk.com> accessed on 18 December 2018.

<sup>63</sup> S M Dev 'Financial inclusion issues and challenges' (2006) *Economic and Political Weekly* 41.

<sup>64</sup> *Ibid.*

<sup>65</sup> P S King *People's Banks* (1896) 90.

<sup>66</sup> C Feather & C K Meme 'Consolidating inclusive housing finance development in Africa: Lessons from Kenyan savings and credit co-operatives' (2018) 10 *African Review of Economics and Finance* 84.

<sup>67</sup> A Périlleux et al 'Are financial co-operatives crowded out by commercial banks in the process of financial sector development?' (2016) 69 *Kyklos* 108–9.

output based on inputs such as labour, land, equipment, and entrepreneurship.<sup>68</sup> Growth occurs when output rises. Output can rise either as more inputs are added (for example, an increase in skilled labour), or technology or innovation is utilised to increase the efficiency with which inputs are converted into outputs.<sup>69</sup>

On the contrary, economic development is the development of capabilities that expand the capacities of economic actors; these actors can be people, companies, or industries.<sup>70</sup> Economic development is about the strengthening of autonomy and substantive freedoms to allow people to participate fully in economic life.<sup>71</sup> Therefore, one can speak of economic development when individual actors have opportunities to develop capacities that allow them to actively participate and make a contribution to the economy.<sup>72</sup>

To this end, financing and banking are instrumental in economic development. Finance and banking contribute to the extent that, through the dispersion of credit, the ability of individuals to participate within an economy, is increased.<sup>73</sup> Even better, if the supply of credit is diversified through different channels, economic activity, and in turn, development, increases at a faster rate.<sup>74</sup>

Financial co-operatives provide another channel, in addition to mainstream financial services, through which credit may be dispersed into different parts and groupings of an economy.<sup>75</sup> As organisations are biased towards supporting their members, they mobilise local financial resources for the benefit of their members and strengthen the political bargaining power of their members.<sup>76</sup> Additionally, financial co-operatives mobilise credit to small businesses.<sup>77</sup>

Small business or entrepreneurship is the backbone of many economies. However, many of these businesses face significant restrictions in accessing financial services; which in turn affects the livelihood of many budding entrepreneurs.<sup>78</sup> Such financial restrictions exist because by nature small

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<sup>68</sup> M Feldman et al 'The logic of economic development: A definition and model for investment' (2014) *Environment and Planning C Government and Policy* 3.

<sup>69</sup> Ibid.

<sup>70</sup> Ibid.

<sup>71</sup> A Sen *Commodities and Capabilities* (2009) 4.

<sup>72</sup> Ibid.

<sup>73</sup> A Khafagy *The Economics of Financial Co-operatives: Income Distribution, Political Economy and Regulation* (2019) 2.

<sup>74</sup> Ibid.

<sup>75</sup> K C Bezboruah & V Pillai 'Exploring the participation of women in financial co-operatives and credit unions in developing countries' (2015) 26 *Voluntas* 919.

<sup>76</sup> S Goglio & P Kalmi 'Credit unions and co-operative banks across the world' in J Michie et al (eds) *The Oxford Handbook of Mutual, Co-operative, and Co-owned Business* (2017) 2.

<sup>77</sup> I Hasan et al *Bank ownership, SME lending and local credit markets* Bank of Finland Discussion Paper 22 (2014) 5.

<sup>78</sup> H Kraemer-Eis & F Lang 'The importance of leasing for SME financing' In *Euromoney World Leasing Yearbook* (2014) available at [http://www.eif.org/news\\_centre/research/eif\\_euromoney\\_importance-of-leasing-for-smes\\_fv.pdf](http://www.eif.org/news_centre/research/eif_euromoney_importance-of-leasing-for-smes_fv.pdf) accessed on 10 January 2020.

businesses pose more financial risks to the mainstream financial institutions than their larger peers.<sup>79</sup> Notwithstanding, financial co-operatives, because of their not-for-profit orientation and focus on maximising benefits to members, can continue to extend credit to small businesses even in circumstances where profit-orientated commercial banks would restrict credit.<sup>80</sup>

Thus, Hasan et al found that financial co-operatives in Poland lent more to small businesses than large domestic and foreign-owned banks.<sup>81</sup> A detailed analysis also revealed that financial co-operatives did continue to smooth the impact of tighter monetary policy on their lending during crisis periods (for example, the financial crisis of 2008–2011), whereas commercial banks do not.<sup>82</sup>

### 1.2.3 FINANCIAL CO-OPERATIVES AND FINANCIAL RESILIENCE

As an overall subject, the literature on resilience is dispersed. However, resilience is important today because the economic crises of the last two decades has shown how, in the face of economic crises and shocks, the global economy and its organisations face difficulties in providing sufficient and equitable standards of living for many people.<sup>83</sup>

Having resilient institutions means having institutions with a set of dynamic capabilities to adapt to shocks as they occur, mitigate their impacts and deal with their consequences while simultaneously taking advantage of opportunities that arise from shocks or crises.<sup>84</sup> Several case studies have shown that agricultural co-operatives have protected the bargaining power of members in times of high commodity prices where intermediaries have entered the market and tried to take advantage of farmers by buying cheaply and selling at high prices, thereby acquiring most of the profits for themselves.<sup>85</sup> Similarly, several United Nations agencies have stated that co-operatives have empowered their members socially and economically and created sustainable rural employment through business models that are resilient to economic and environmental shocks.<sup>86</sup>

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<sup>79</sup> Ibid.

<sup>80</sup> A Botsari *European Small Business Finance Outlook* EIF Working Paper 2019/57 (2019) 57.

<sup>81</sup> Hasan et al op cit note 77 at 5.

<sup>82</sup> McKillop et al op cit note 36 at 17.

<sup>83</sup> A Borda-Rodriguez & S Vicari 'Rural co-operative resilience: The case of Malawi' (2014) 2 *Journal of Co-operative Organization and Management* 43

<sup>83</sup> Ibid at 5.

<sup>84</sup> Ibid.

<sup>85</sup> FAO, IFAD, WFP 'Agricultural co-operatives: Paving the way for food security and rural development factsheet: Rome' (2011) at 1, available at <http://www.fao.org/docrep/016/ap088e/ap088e00.pdf> accessed on 10 January 2020.

<sup>86</sup> Ibid.

More relevant to this thesis though, research by Birchall has shown the resilience of financial co-operatives in economic crises occurring in developed countries.<sup>87</sup> Data from United States, Canada, Netherlands, United Kingdom and Taiwan reflect a pattern of financial co-operatives increasing their deposits and loan portfolios amid banking crises and lending freezes that occurred in the global financial crisis of 2008.<sup>88</sup> Further, not a single financial co-operative received government recapitalisation following the crisis.<sup>89</sup>

### 1.3 THE RELEVANCE OF FINANCIAL CO-OPERATIVES IN SOUTH AFRICA AND MALAWI

#### 1.3.1 FINANCIAL INCLUSION/EXCLUSION

South Africa is one of the powerful emerging economies in the world.<sup>90</sup> By the end of 2019, the South African banking sector was comprised of 42 banking institutions and 30 foreign banks with approved representative offices in South Africa.<sup>91</sup> Of these banking institutions, five main South African commercial banks (Standard Bank, ABSA Bank, First National Bank, Nedbank, and Investec) hold more than 90.5 per cent of the banking sector's total assets; having a network of over 6 000 branches and approximately 31 000 Auto Teller Machines (ATMs).<sup>92</sup>

However, there is competition brewing in the sector. Recently, these commercial banks have begun to face increasing pressure from technology-based banks like Capitec, and other digital banks like Discovery Bank, Bank Zero and TymeBank that are taking over traditional financial services and offering the services more efficiently and affordably.<sup>93</sup> Standard Bank, Absa Bank, First National Bank, Nedbank, and Investec are consequently undergoing branch closures or downsizing to control operating costs that are on the rise and in response to the increasing use technology-based banking services by customers.<sup>94</sup>

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<sup>87</sup> J Birchall *Resilience in a Downturn: The Power of Financial Co-Operatives* (2013) 11.

<sup>88</sup> S Smith *Co-operatives in a Global Economy: Key Economic Issues, Recent Trends, and Potential for Development* IZA Policy Paper No 68 (2013) 7.

<sup>89</sup> Ibid.

<sup>90</sup> International Monetary Fund 'World economic outlook database' (2016) available at <https://www.imf.org/external/pubs/ft/weo/2016/02/weodata/index.aspx> accessed September 2018.

<sup>91</sup> SARB 'Banks: Registered banks, mutual banks, branches, co-operative banks and representative offices' <https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/sa-registered-banks-and-representative-offices> accessed on 5 January 2020.

<sup>92</sup> The Banking Association of South Africa 'The banking sector review' (2014) available at <http://www.banking.org.za/docs/default-source/publication/banking-sector-overview.pdf?sfvrsn=6>. accessed on 5 September 2108; updated figures as at December 2019.

<sup>93</sup> P Calvey & P Romagny 'New banking sector entrants challenge the status quo' *Business Day* 11 September 2019 available at <https://www.businesslive.co.za/bd/opinion/2019-09-11-new-banking-sector-entrants-challenge-the-status-quo/> accessed on 24 December 2019.

<sup>94</sup> Ibid.

Notwithstanding, one would think that with such an extensive network of banks and increasing competition amongst them, only a minimal portion of South Africa's population would be unbanked.<sup>95</sup> Unfortunately, though, the presence of such an extensive network masks a high degree of socio-economic disparity that is characteristic of South Africa.<sup>96</sup> On the one hand, South Africa has a formal economy that is strong and attractive to foreign investors and global partners.<sup>97</sup> On the other hand, there lies an informal economy that commercial banks fail to serve effectively.<sup>98</sup> Consequently, there exists in South Africa, a very wide and obvious socio-economic demarcation that separates the wealthy and gainfully employed merchants from the domestic, under-employed, poor, less visible, and vulnerable people of the country.<sup>99</sup>

FinMarkTrust, in 2014, estimated that of the 36.8 million South Africans above 16 years of age who were eligible to open bank accounts, approximately 9.3 million did not subscribe to any banking product.<sup>100</sup> Of these 9.3 million South Africans, just over 7.3 million had never opened bank accounts.<sup>101</sup> However, later in 2016, Finmark reported a decline in the number of South Africans who were not financially included in the mainstream financial services, from 9.3 million to nearly 8.5 million (representing 23 per cent of the population).<sup>102</sup> By the close of 2019, the percentage had increased to an estimated 24 per cent.<sup>103</sup>

Reports further showed that many South Africans (46 per cent), preferred to borrow from Non-bank financial institutions (NBFIs) to supplement their limited resources.<sup>104</sup> Only 15 per cent of South Africans were recorded to be saving with banking institutions, with 14 per cent saving with NBFIs, 8 per cent with informal institutions and 11 per cent saving at home.<sup>105</sup> Consequently, by the close of 2019, approximately R12 billion (\$1.04billion) in cash was believed to be held outside of banks.<sup>106</sup>

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<sup>95</sup> Louis & Chartier op cit note 60 at 179.

<sup>96</sup> Ibid.

<sup>97</sup> Ibid.

<sup>98</sup> G Coetzee & C Cross *The Role Of Community Banks In South Africa: Can It Contribute To Improve Access To Financial Services For The Poor?* (2002-2003) Working Paper 2.

<sup>99</sup> T Phadu 'Establishing more co-operative banks will change the exclusionary financial sector' *Sowetan Live* 28 July 2017 available at <https://www.sowetanlive.co.za/news/2017-07-28-establishing-more-co-operative-banks-will-change-the-exclusionary-financial-sector/> accessed on 2 March 2019.

<sup>100</sup> FinMark Trust *Finscope South Africa 2014 Survey* (2014) 7.

<sup>101</sup> Ibid

<sup>102</sup> FinMark Trust *Finscope South Africa 2016 Survey* (2016) 3.

<sup>103</sup> FinMark Trust *Finscope South Africa 2019 Annual Report* (2019) 15.

<sup>104</sup> M Mushonga et al 'Drivers, inhibitors and the future of co-operative financial institutions: A Delphi study on South African perspective' (2018) 133 (C) *Technological Forecasting and Social Change* 256.

<sup>105</sup> Ibid.

<sup>106</sup> Ibid.

An attempt was made to boost the involvement of South Africans in the more formal mainstream financial services through Mzansi accounts (entry-level national bank accounts).<sup>107</sup> However, this attempt failed because of an absence of quality access to finance, among other reasons.<sup>108</sup> It is not a stretch but rather an evidential conclusion therefore to state that the harsh reality in South Africa is that the formal banking sector is somewhat unsuited for the needs of the individuals that characterise the informal economy.

Like South Africa, Malawi too has commercial banks controlling the mainstream financial services. Malawi has eight commercial banks, four being domestic privately-owned and four being foreign.<sup>109</sup> The domestic privately-owned banks comprised 54.9 per cent of total net assets and the remaining four foreign-owned banks comprised 45.1 per cent of total net assets by the end of 2020.<sup>110</sup> Two banks dominate the sector with a combined market share of 96.2 per cent for both total assets and deposits.<sup>111</sup> With regard to the branch network, the banking system has 106 branches, 112 agencies, kiosks and vans across the country and 494 ATMs.<sup>112</sup>

Meanwhile, the Malawi diagnostic report published in 2015 stated that only 34 per cent of adults reported using at least one financial service from formal financial service providers; 63 per cent of them being urban adults compared with 28 per cent of rural adults.<sup>113</sup> Further, as of 2015, 64 per cent of adults had never heard of an ATM, 58 per cent had never heard of a savings account, and 99.7 per cent of all payments were being made in cash.<sup>114</sup>

What this report showed, therefore, is that whatever progress is being made on the mainstream financial services front, a bigger part of the country remains severely unserved by the mainstream formal

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<sup>107</sup> P Kostov et al 'Access to financial services: the case of the 'Mzansi' account in South Africa' (2015) 5 *Review of Development Finance* 36-7.

<sup>108</sup> Ibid.

<sup>109</sup> The Registrar of Financial Institutions *Annual Report* (2020) 13.

<sup>110</sup> Ibid.

<sup>111</sup> Ibid.

<sup>112</sup> Ibid.

<sup>113</sup> Finmark Trust 'Malawi demand, supply, policy and regulation diagnostic report' (2015) *Making Access Possible* 44. 1 MAP Malawi relied on demand side data from three FinScope surveys (FinScope Malawi Consumer Surveys 2008 and 2014, and FinScope Malawi MSME Survey 2012) and 46 qualitative immersive interviews, and supply side data from 75 stakeholder interviews with financial service providers, regulators and policymakers, published annual or interim financial statements and reports and data collected by supervisors. 2 Five target markets were selected based on income source: salaried employees, MSMEs, farmers, dependents and ganyu. Analysis of the different demographics and needs of adults based on geographical area (rural or urban) and gender was also conducted.

<sup>114</sup> Ibid 14.

institutions.<sup>115</sup> This is unsurprising because Malawi is one of the poorest countries in the world with an estimated 85 per cent of the people living in the rural areas of Malawi.<sup>116</sup>

With such numbers of financially excluded individuals in both countries, financial co-operatives become important to the economies as agents that incorporate the less visible members of these societies.<sup>117</sup>

### 1.3.2 ECONOMIC DEVELOPMENT

It is quite often the story in sub-Saharan Africa that economic growth occurs without economic development; that is, there is economic growth but with little broad-based improvement in people's quality of life and ability to realise human potential.<sup>118</sup> The World Bank reported for Malawi, for instance, an increase in economic growth in 2019.<sup>119</sup> Regardless, the average Malawians continue to live in poverty with little progress being made on their daily ability to access good health services, sufficient nutrition, education or engage in economic activity.<sup>120</sup>

Similarly, although South Africa is far more advanced than its sub-Saharan peers, economic growth still occurs amid vast inequalities that have literally split the nation into two economies.<sup>121</sup> Thus, there is still 25 per cent of the population that is unemployed, 39 per cent that lives in poverty, and 21.7 per cent that live in extreme poverty.<sup>122</sup>

For both South Africa and Malawi, the positive effects of having a prosperous network of financial service providers that extends services to individuals and small businesses that fall outside the scope of mainstream financial services are incalculable. As stated, small businesses are the backbone of many economies because of their extensive contribution to economic development and economic growth.<sup>123</sup> Extending credit to such a grouping would therefore facilitate economic development for South Africa and Malawi.

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<sup>115</sup> C Chipeta & E Kanyumbu *Determinants of Access to Banking Services in Malawi* AERC Research Paper 351 (August 2018).

<sup>116</sup> O Nkuna 'The Role of Commercial Banks on Financial Inclusion in Malawi' (2018) 6 *Open Journal of Business and Management* 93.

<sup>117</sup> Louis & Chartier op cit note 60 at 179.

<sup>118</sup> Feldman et al op cit note 68 at 7.

<sup>119</sup> The World Bank 'The World Bank in Malawi' 18 March 2021 available at <https://www.worldbank.org/en/country/malawi/overview> accessed on 5 February 2019.

<sup>120</sup> D Acemoglu et al 'Reversal of fortune: geography and institutions in the making of the modern world income distribution' (2002) 117 *The Quarterly Journal of Economics* 1235.

<sup>121</sup> Louis & Chartier op cit note 60 at 179.

<sup>122</sup> The World Bank *Overcoming poverty and inequality in South Africa: An assessment of drivers, constraints and opportunities* (2018) available at <http://documents1.worldbank.org/curated/en/530481521735906534/pdf/124521-REV-OUO-South-Africa-Poverty-and-Inequality-Assessment-Report-2018-FINAL-WEB.pdf> accessed on 12 November 2018.

<sup>123</sup> For example, in the European Union's non-financial sector, more than 22.3 million small businesses made for 99.8 per cent of all non-financial enterprises, employed 90 million people (66.9 per cent of total employment), and generated EUR 3.7 trillion in value added (57.8 per cent of total value added); Kraemer-Eis & Lang op cit note 78.

Further, international donors have recognised the capacity of financial co-operatives to be the biggest contributors to overcoming dependency on external capital financing in many African countries today.<sup>124</sup> For South Africa and Malawi, this translates into a better standard of living for lower-income individuals and a reduction of governmental financing.

### 1.3.3 FINANCIAL RESILIENCE

As resilient associations, financial co-operatives are a type of financial intermediary that can survive, adapt, and grow in a difficult economic environment.<sup>125</sup> South Africa and Malawi are largely more exposed to political, economic and climate crises than their counterparts in the developed countries.<sup>126</sup> In Malawi for example, macroeconomic instability and high inflation rates contribute to a very high cost of living for people living below the poverty line.<sup>127</sup> Shortage of foreign exchange, shortage of electricity, lack of properly qualified workers in some sectors, dilapidation of natural resources such as land and forests, are among the main obstacles.<sup>128</sup> In addition, Malawi has progressively witnessed several natural disasters such as floods and droughts, severe famines and the HIV/AIDS pandemic since the 1990s. The combined effect of these factors has plunged the country into a complex poverty trap.<sup>129</sup> The stability that financial co-operatives would bring to such an economy would therefore be a haven for many people.

## 1.4 RESEARCH CONSIDERATIONS AND QUESTIONS

Unfortunately, even though there are possible benefits to a thriving sector of financial co-operatives in South Africa and Malawi, the reality on the ground is that the imprint of financial co-operatives has been more evident in developed economies than in developing and emerging economies.<sup>130</sup> Financial co-operatives hold a significant market share in Europe and Latin America, as well as a few countries in Africa.<sup>131</sup> They also have a strong presence in Asia, Australia, and the United States of America (USA).

According to the World Council of Credit Unions (WOCCU), in 2016, there were 68 882 financial co-operatives in 109 countries with more than 235 million members and total assets of more than 1.7 trillion

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<sup>124</sup> FAO, IFAD, WFP op cit note 85.

<sup>125</sup> H Johnson et al 'What makes rural co-operatives resilient in developing countries?' (2016) 28 *Journal of International Development* 91.

<sup>126</sup> Ibid.

<sup>127</sup> Borda-Rodriguez & Vicari op cit note 83 at 43

<sup>128</sup> Ibid.

<sup>129</sup> Ibid.

<sup>130</sup> Khafagy op cit note 73 at 2.

<sup>131</sup> World Council of Credit Unions Annual Statistical Report (2020) available at [https://www.woccu.org/our\\_network/statreport](https://www.woccu.org/our_network/statreport) accessed on 25 August 2020.

dollars.<sup>132</sup> Of the 235 million members, the United States served more than 104 million members, which was estimated to be 45.4 per cent of the economically active population.<sup>133</sup> Likewise, in Europe, financial co-operatives served more than 80 million people.<sup>134</sup> However, this data did not include some major financial co-operatives' networks in Europe, such as Germany, Finland, France, Denmark, and Italy; where they also have significant market shares of the banking sector.<sup>135</sup>

In contrast, financial co-operatives in all developing economies only serve approximately 81 million people.<sup>136</sup> Of these, it is reported that only a modest 20 million Africans are estimated to be members of formal financial co-operatives. Remarkably, Kenyans constitute 27.9 per cent of these 20 million members, distinguishing Kenya as having one of the highest rates of market penetration at 13.3 per cent.<sup>137</sup> Conversely, South Africa, has the lowest financial co-operatives' penetration rate in the world, at 0.06 per cent.<sup>138</sup> Even worse, South Africa's financial co-operatives and membership have steadily decreased over the years from 121 and 59 394 in 2011 to 30 and 29 818 respectively in 2017.<sup>139</sup>

Similarly, Malawi too, has not had much development on the financial co-operatives front. In fact, the development of the whole co-operative sector has been challenging.<sup>140</sup> As of 2020, it was reported that there were 40 licensed financial co-operatives with a member base of an estimated 151 221 individuals.<sup>141</sup> Undoubtedly this is better than South Africa and the numbers have been steadily increasing over the past years, with more people preferring financial co-operatives to commercial banks.<sup>142</sup> Still, the progress in Malawi could be improved.

#### **1.4.1 UNDERSTANDING THE GROWTH STAGNATION OF FINANCIAL CO-OPERATIVES IN SOUTH AFRICA AND MALAWI**

There are several reasons for the status of financial co-operatives in South Africa and Malawi. For South Africa, many of the reasons relate to the history and administration of financial co-operatives; the progress of which has been short and troubled.<sup>143</sup> This has led to drastic effects on the level of people's

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<sup>132</sup> Ibid.

<sup>133</sup> Ibid.

<sup>134</sup> Khafagy op cit note 73 at 2.

<sup>135</sup> Ibid.

<sup>136</sup> Feather & Meme op cit note 66 at [insert page number].

<sup>137</sup> Ibid.

<sup>138</sup> Ibid.

<sup>139</sup> M Mushonga *The Efficiency and Sustainability of Co-Operative Financial Institutions in South Africa* (unpublished doctoral thesis, Stellenbosch University 2018) 54.

<sup>140</sup> Genesis Analytics *Understanding financial co-operatives: South Africa, Malawi and Swaziland* Final Report submitted to FinMark Trust (21 February 2013) 18.

<sup>141</sup> The Registrar of Financial Institutions *Annual Report* (2019) 50.

<sup>142</sup> Ibid; Genesis op cit note 140 at 21.

<sup>143</sup> Genesis op cit note 140 at v.

trust in financial co-operatives as safe and reputable financial institutions.<sup>144</sup> In Malawi, one of the main reasons for the slow development has been the social and economic environment. A 2008 study by FinScope of Malawi found that the top reasons adults do not have bank accounts or use other financial services are related to income.<sup>145</sup> In the study, 98 per cent of adults without bank accounts said they had insufficient money either before or after expenses.<sup>146</sup> There are also high levels of corruption and mismanagement of funds that have created distrust among Malawians for financial institutions.<sup>147</sup>

Further reasons, especially in developing and emerging economies as a whole, have been the political influence in the sector. Financial co-operatives were naturally politicised from their inception; possibly because they were founded by politicians during the revolutionary period in Germany in the mid-nineteenth century.<sup>148</sup> Since then, they have been extremely vulnerable to both government harassment and support. This has varied from being overcontrolled by the state in many authoritarian regimes to being aggressively involved – even indirectly – in local politics in other countries.<sup>149</sup> In fact, Khafagy argues that some economies deliberately oppose the expansion of a highly operative financial co-operatives sector. This is done by influential and dominating parties who wish to maintain their political influence and prevent the formation of powerful pressure groups that could threaten the political status quo and decrease the economic benefits that such an elite acquires from an underdeveloped and exclusive financial sector.<sup>150</sup>

Even more, and for the purposes of the thesis, the impact of regulation on financial co-operatives cannot be undermined. In both the United States of America and the European Union, financial co-operatives grew in an environment that protected them from market globalisation, international competition and stringent legislation.<sup>151</sup> Both the circumstances and laws in these economies created a suitable environment that resulted in the growth of financial co-operatives and the sustainability of a comparatively large market share that has in modern day, evolved from the informal economy to the mainstream financial services.<sup>152</sup>

In contrast, for both South Africa and Malawi, from their inception, financial co-operatives have progressively faced competition from both national commercial banks and multinational financial

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<sup>144</sup> K Mndawe 'Co-operative banks ease access to capital' *Fin24* 19 Nov 2017 available at <https://m.fin24.com/Companies/Financial-Services/co-operative-banks-ease-access-to-capital-20171119> accessed on 19 June 2018.

<sup>145</sup> FinMark Trust 'Finscope South Africa 2008 Survey' *FinMark Trust* 35.

<sup>146</sup> *Ibid.*

<sup>147</sup> *Ibid.*

<sup>148</sup> Khafagy op cit note 148 at 8; F Poli *Co-operative Banking Networks in Europe* (2019) 2.

<sup>149</sup> E Gutiérrez *The Reform of Italian Co-operative Banks: Discussion of Proposals* (2008) Working Paper No 08/74 at 13.

<sup>150</sup> Khafagy op cit note 148 at 73.

<sup>151</sup> Périlleux et al op cit note 67 at 109.

<sup>152</sup> *Ibid.*

institutions.<sup>153</sup> As was noted above, in South Africa, the last three decades of financial liberalisation have amplified the existence and expansion of foreign banks in the country.<sup>154</sup>

Notwithstanding, the development of financial co-operatives should easily occur in developing countries because, in contrast to developed countries that have already cemented their structures, institutions in developing countries still possess the flexibility to restructure and incentivise the growth of financial co-operatives.<sup>155</sup> Moreover, unlike developed countries that founded financial co-operatives, developing and emerging economies have the history and success of financial co-operatives in multiple jurisdictions that provide examples or best practices that can act as a guide to countries struggling to achieve growth.<sup>156</sup>

Further, right within many developing and emerging economies is a thriving financial co-operatives sector embedded in their informal economy.<sup>157</sup> In South Africa, 11.4 million South Africans belong to 811 130 financial co-operatives within the informal economy, which have a collective value of R49 billion a year.<sup>158</sup> By studying these economies therefore, recommendations on how to create a growth enabling regulatory and supervisory environment for financial co-operatives could be developed.

#### **1.4.2 THE CURRENT REGULATORY FRAMEWORK IN SOUTH AFRICA AND MALAWI**

The current regulatory and supervisory framework of financial co-operatives in South Africa consists of the Bank Act Exemption Notices,<sup>159</sup> the Co-operatives Act 14 of 2005, the Co-operatives Bank Act 40 of 2007 and the Financial Sector Regulation Act 9 of 2017. In Malawi, the regulatory and supervisory framework of financial co-operatives consists of the Co-operative Societies Act 21 of 2010, Financial Services Act 26 of 2010 and the Financial Co-operatives Act 8 of 2011. In both countries, these frameworks have been established as responses to political influences, economic needs, and the global growth of the financial co-operatives sector.

While I acknowledge that the frameworks have indeed developed extensively and incorporated many international best practices for financial co-operatives, I propose that in some respects, the current regulatory and supervisory frameworks do not accurately regulate the financial co-operatives sector and that this, in turn, hinders growth.

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<sup>153</sup> Louis & Chartier op cit note 60 at 192.

<sup>154</sup> F Balmaceda et al 'Financial Liberalisation, Market Structure and Credit Penetration' (2014) 23 *Journal of Financial Intermediation* 65.

<sup>155</sup> Khafagy op cit note 148 at 73.

<sup>156</sup> Ibid.

<sup>157</sup> J K M Bophela & N Khumalo 'The role of stokvels in South Africa: A case of economic transformation of a municipality' (2019) 17 *Problems and Perspectives in Management* 27.

<sup>158</sup> J Lappeman et al 'Exploring retail orientated rotating savings and credit associations: festive season 'stokvels' in South Africa' (2019) *The International Review of Retail, Distribution and Consumer Research* 2.

<sup>159</sup> Banks Act 94 of 1990.

On the one hand, the frameworks over-regulate some aspects of the financial co-operatives sector. This overregulation has created a harsh regulatory environment for some financial co-operatives.<sup>160</sup> On the other hand, some aspects of the financial co-operatives sector are underregulated.<sup>161</sup> Under-regulation has resulted in regulatory arbitrage and oversight of the fact that financial co-operatives have economic objectives, ownership structures, risks, and challenges unique to them.<sup>162</sup>

Interestingly, although such gaps and overcompensations in the frameworks have hindered the growth of formal and semi-formal financial co-operatives, they have fostered the growth of informal financial co-operatives.<sup>163</sup> Accordingly, in both countries, there is an overwhelmingly large sector of informal financial co-operatives. Informal financial co-operatives are not governed by formal pieces of legislation. Rather, they are governed by indigenous law, or as otherwise termed, the law of the people.<sup>164</sup>

This thesis postulates that the overregulation and under-regulation embedded in the current regulatory and supervisory frameworks have been birthed from a misunderstanding of what financial co-operatives are and how they ought to function; an infusion of unfavourable historical and political influences and practices into the current regulatory and supervisory frameworks; overdependence of external aid; and lastly, an underestimation of the competencies of the citizens in both countries.<sup>165</sup> To this end, this thesis aims to provide recommendations for legal reform within the current regulatory and supervisory frameworks.

In order to do so, this thesis will address the following questions:

- What are financial co-operatives?
- How did financial co-operatives develop?
- What are the financial co-operatives in South Africa and Malawi; and how do they function?
- What are the current regulatory and supervisory frameworks in South Africa and Malawi?
- What are the gaps or overcompensations in the law in both jurisdictions?
- How do these gaps or overcompensation in the law influence, shape, and constrain the activities of financial co-operatives in South Africa and Malawi?

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<sup>160</sup> M Mushonga *Co-operative Financial Institutions in South Africa at Crossroads: Facing Reality and the Future* (unpublished thesis, University of Stellenbosch Business School, 2017) 4.

<sup>161</sup> *Ibid.*

<sup>162</sup> Khafagy op cit note 148 at 90.

<sup>163</sup> Mushonga op cit note 139 at 6.

<sup>164</sup> *Ibid.*

<sup>165</sup> Ortmann & King op cit note 18 at 230.

- What lessons can be drawn from history and other jurisdictions that have influenced the growth of financial co-operatives?
- What recommendations can be made for regulatory reform?

The aim of this thesis is not to suggest supplanting the current formal frameworks in South Africa and Malawi or adopting informal governance structures. Instead, it aims to propose how, if possible or required, the relevant laws in South Africa and Malawi might be changed, reformed, or developed within their existing frame of reference.

## **1.5 OBJECTIVES OF THIS THESIS**

To provide recommendations for legal reform, this thesis will need to acquire regulatory and supervisory solutions for the current challenges embedded in the frameworks of both South Africa and Malawi. To accomplish this, the thesis must:

- Thoroughly understand financial co-operatives and how they function currently in South Africa and Malawi.
- Outline the current regulatory and supervisory frameworks in South Africa and Malawi.
- Identify the gaps or overcompensations in the law in both jurisdictions.
- Analyse the regulatory and supervisory frameworks governing financial co-operatives and how they influence, shape, and constrain their activities.
- Draw lessons from multiple sources (historical and geographical) that have contributed to the global growth of the sector.
- Make recommendations for regulatory reform.

## **1.6 CREATING A GROWTH ENABLING REGULATORY AND SUPERVISORY ENVIRONMENT FOR FINANCIAL CO-OPERATIVES IN SOUTH AFRICA AND MALAWI**

It ought to be emphasised that recommendations for regulatory reform that supports a growth enabling regulatory and supervisory environment for financial co-operatives in South Africa and Malawi means creating an environment that supports the growth of financial co-operatives that are currently governed by the frameworks and those that are not governed by the frameworks but by indigenous law. In this thesis, I submit that instead of advancing the divisions currently in place between the 'formal' frameworks and the 'informal' frameworks (that is, indigenous law), a holistic view of the informal and formal sectors should rather be encouraged.<sup>166</sup> That is, where possible the best of both frameworks should be considered to create an inclusive environment for financial co-operatives in South Africa and Malawi.

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<sup>166</sup> W G Schulze 'The origin and legal nature of the stokvel (Part 1)' (1997) 9 SA Merc LJ 18.

Unfortunately, creating such an environment is still a paradox. There is no mutual understanding over which legal approaches work better to support growth and sustainability of the sector.<sup>167</sup> Globally, financial co-operatives are formally regulated in three ways; first, they can be fully regulated by a general co-operative law that governs all types of co-operative organisations, including non-financial co-operatives (for example, housing, or agricultural co-operatives, and so forth).<sup>168</sup> A case in point is South Africa, where until the Co-operatives Banks Act, financial co-operatives were regulated by the Co-operatives Societies Act which regulated all co-operatives; both financial and non-financial.<sup>169</sup>

Secondly, financial co-operatives can completely be regulated by the central bank or the bank superintendence with separate and detailed provisions regulating financial co-operatives.<sup>170</sup> Such is the case in Malawi, where in 2011 the government passed the Financial Co-operatives Act which technically provides for regulation by the Reserve Bank of Malawi (RBM).<sup>171</sup>

Lastly, in some countries, financial co-operatives are regulated under legislation intended to govern the banking sector and all microfinance institutions (MFIs).<sup>172</sup> This framework is usually applied to the entire banking sector, including financial co-operatives.<sup>173</sup> Alternatively, the framework is applied as a dual approach where the banking sector laws are only applicable to large co-operatives while the smaller co-operatives are left to a dedicated co-operative society's law.<sup>174</sup> Such an approach is very popular in Latin America.<sup>175</sup>

In terms of supervision, currently, there are four types of supervisory approaches implemented to oversee the financial co-operatives sector.<sup>176</sup> The first approach is the direct supervision of the entire sector by a prudential regulator. This is prevalent in Latin America and some parts of East Africa.<sup>177</sup>

The second approach, practised in countries such as India, entails direct supervision over large financial co-operatives only; all smaller financial co-operatives are monitored by another governmental agency (like

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<sup>167</sup> Khafagy op cit note 148 at 109.

<sup>168</sup> C E Cuevas & K P Fischer *Co-operative Financial Institutions: Issues in Governance, Regulation, and Supervision* (2006) 30.

<sup>169</sup> Genesis op cit note 140 at 10.

<sup>170</sup> Cuevas & Fischer op cit note 168 at 30.

<sup>171</sup> Financial Co-operatives Act 8 of 2011, s 1.

<sup>172</sup> Cuevas & Fischer op cit note 168 at 30.

<sup>173</sup> Ibid.

<sup>174</sup> Khafagy op cit note 148 at 91–92.

<sup>175</sup> Cuevas & Fischer op cit note 168 at 45.

<sup>176</sup> Ibid.

<sup>177</sup> A Poprawa *Regulation and Legislation of Co-operative Banks and Credit Union* (Paper prepared for the United Nations Expert Group Meeting on Co-operatives, 2009) 28–30.

ministries of co-operatives with limited non-prudential monitoring).<sup>178</sup> This is done to encourage smaller and more remote financial co-operatives that would not thrive inside of the scope of mandatory supervision.<sup>179</sup>

The third approach is delegated or auxiliary supervision. This approach gives the supervisory duty to a third party, who is usually, the national federation of financial co-operatives.<sup>180</sup> In Malawi for instance, supervision of some financial co-operatives is delegated to Malawi Union of Savings and Credit Co-operatives (MUSCCO), a member-based apex organisation of savings and credit co-operatives (SACCOS).<sup>181</sup> Similarly, this used to be the case in South Africa, where the regulatory and supervisory power for SACCOs was delegated to the self-regulated Savings and Credit Co-operative League of South Africa (SACCOL) before it was dismantled in 2011.<sup>182</sup> The current South African approach will be discussed later within the thesis.

The last and most popular approach practised around the world, is supervision by ministries of co-operatives that oversee the entire co-operative sector, including housing and agricultural co-operatives, and any other non-financial co-operatives.<sup>183</sup>

On the other side of these formal types of regulatory and supervisory frameworks, especially for African countries, indigenous law regulates financial co-operatives.<sup>184</sup> Indigenous law may be viewed as a body of customary law that is, in certain cases, applied instead of the 'formal' law.<sup>185</sup> In this set-up, it is the people themselves who regulate the financial co-operatives and supervise the implementation.<sup>186</sup> Thus for example, in both South Africa and Malawi, the informal sector has associations that are governed by regulations agreed by the people themselves.

There is no mutual agreement over which of these different regulatory and supervisory approaches work better to encourage the development of financial co-operatives.<sup>187</sup> On the one hand, having a general law for all forms of co-operatives disregards the peculiarity of financial co-operatives and therefore hinders the growth of financial co-operatives.<sup>188</sup> On the other hand, having a specific law potentially leads to

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<sup>178</sup> J Poyo 'Regulation and supervision of credit unions' in G Westley & B Branch (eds) *Safe Money: Building Effective Credit Unions in Latin America* (2000) 32.

<sup>179</sup> *Ibid.*

<sup>180</sup> Cuevas & Fischer op cit note 168 at 45.

<sup>181</sup> Genesis op cit note 140 at 10.

<sup>182</sup> *Ibid.*

<sup>183</sup> Khafagy op cit note 148 at 91–2.

<sup>184</sup> Schulze op cit note 166 at 18.

<sup>185</sup> *Ibid.*

<sup>186</sup> *Ibid.*

<sup>187</sup> Khafagy op cit note 148 at 109.

<sup>188</sup> Mushonga et al op cit note 160 at 4.

growth of the financial co-operatives but supervisory challenges still hamper more growth.<sup>189</sup> Moreover, having indigenous laws does not advance other types of financial co-operatives that are governed by the formal regulatory and supervisory frameworks; in fact, having informal co-operatives exacerbates the disregard of the formal and semi-formal financial co-operatives.<sup>190</sup>

Regardless, for both South Africa and Malawi, more laws and supervisory structures continue to be constructed in this sector, and in as much as this prudential regulation is necessary to bring market confidence and stability, overregulation of the sector is just as harmful.<sup>191</sup> Besides, even when adequate legislation has been enacted, there is another key challenge that rises; how to ensure effective supervision and guarantee compliance.<sup>192</sup>

## 1.7 THE SIGNIFICANCE OF THIS THESIS

The world as we know it today is wrought with natural disasters that affect every country. More than ever, the spirit of co-operation (*ubuntu* or *umunthu*) has become important to effectively formulate innovative ideas that can enhance inclusion, development, and resilience.<sup>193</sup> Improving the status of financial co-operatives through regulatory and supervisory amendments would mean improvements in financial inclusion challenges and economic development despite harsh economic environments and social instability.

Aside from this, a study of the regulatory and supervisory frameworks contributes to the literature in the sector which is currently minimal.<sup>194</sup> Packel observed in 1939 of the legal profession and co-operatives that rings true today for financial co-operatives.<sup>195</sup> He noted that:

Thousands of co-operatives, millions of members, billions of dollars of trade, and yet to hosts of lawyers the co-operative movement is nothing more than a subject of unsatisfied intellectual curiosity. To enable the movement to have a healthy growth and to give it a fair opportunity to assert itself, the lawyer should not lag behind the economist or other specialist in his knowledge and analysis of the subject.

The legal profession has done comparatively little in the way of research and legislative work on co-operatives. In recent years, however, there has been an increased demand for the furnishing of legal services to co-operatives, to business enterprises dealing with co-operatives and to public

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<sup>189</sup> Genesis op cit note 140 at 31.

<sup>190</sup> Lappeman et al op cit note 158 at 2.

<sup>191</sup> S O Ighomereho et al Making co-operatives effective for poverty alleviation and economic development in Nigeria in O Olujobo (ed) *Co-operative Finance in Developing Countries* (2012) 34.

<sup>192</sup> Ibid.

<sup>193</sup> Nabudere op cit note 8.

<sup>194</sup> D Cracogna *International Handbook of Co-operative Law* (2013) 8.

<sup>195</sup> Packel op cit note 21 at 60.

bodies concerned with organizing, financing, regulating or taxing co-operatives. The past growth and the potential growth of the co-operative movement, coupled with the valuable assistance which the profession can render, makes it of the utmost importance that the lawyer should not be in a position where he must ask, 'What is a co-operative?'<sup>196</sup>

Truthfully, lawyers all around the world today have done little in researching the regulatory and supervisory frameworks of financial co-operatives.<sup>197</sup> In South Africa, while there are several papers written on the topic, they are mostly written by economists and business specialists.<sup>198</sup> For Malawi, outside the regulatory and supervisory framework created by the government, there has been no specific legal research done on the regulation on financial co-operatives to analyse the effectiveness of the law in regulating the sector. This begs the question: how can the sector be effectively regulated without a comprehensive understanding of the financial co-operative institution?

Notwithstanding, financial co-operatives should be understood and studied, particularly by legal scholars, simply as one of the possible legal types of private organisations provided for by legislatures, aside from companies and partnerships.<sup>199</sup> Financial co-operatives should also be studied from a legal perspective because of the detrimental effect of corruptive regulatory frameworks on any country.

Accordingly, this thesis would be useful to governments in both countries, the central banks, other financial institutions, the legal fraternity, as well as to academia. Even if the proposed recommendations were not to be adopted entirely, I hope that this thesis would serve as a valuable addition to the financial co-operatives sector regulation in South Africa and Malawi. I also hope that this study can provide a strong ground and basis for further research in this field.

## **1.8 LIMITATIONS OF THIS THESIS**

The main limitation of this thesis is the lack of prior comprehensive research on regulatory frameworks of financial co-operatives in South Africa and Malawi. The sector in both jurisdictions is under-theorised and under-researched.

Especially for Malawi, most of the literature used on financial co-operatives was written over 20 years ago.<sup>200</sup> The more recent literature was the primary and secondary sources of law themselves and several presentations by employees of the central bank and other government institutions that enabled me to

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<sup>196</sup> Ibid.

<sup>197</sup> Cracogna op cit note 194 at 8.

<sup>198</sup> Ibid.

<sup>199</sup> Packel op cit note 21 at 60.

<sup>200</sup> Chipeta writes extensively on the topic, but his work was published in 1992.

extract issues to expound on. Moreover, both government and financial co-operatives' websites contained outdated information.

Fortunately for South Africa, several economists have written on the various pieces of legislation from an economical perspective.<sup>201</sup> Granted, legal research would have been preferable, but the economic research coupled with primary and secondary sources of law, and updated websites have enriched the research of financial co-operatives in South Africa.

However, as an overall assessment for both jurisdictions, there is no consolidated body of legal literature on financial co-operatives, rather a set of scattered literature, across multiple sources and written over the past decades. For this thesis, I, therefore, gleaned information from the various sources outlined above and compiled the information into this study that I hope will light a match for further research within the sector.

The secondary limitation of this study is the deliberate omission of any in-depth comparative study between South Africa and Malawi and other jurisdictions. Undoubtedly, such a study would have enriched this thesis. However, one argument that this thesis presents is that one of the reasons for the ineffectiveness of the current regulatory and supervisory frameworks is the wholesale transplantation of co-operative law and practices from advanced jurisdictions whose financial co-operatives sectors are mature and tailor-made to suit their economies into economies like South Africa and Malawi, whose financial co-operatives sectors are still in the nascent stages.<sup>202</sup> This thesis therefore rather focuses on the extraction of historical lessons from advanced jurisdictions that empowered financial co-operatives to transition to the position that they are now in.

## **1.9 NOTES ON RESEARCH METHODOLOGY**

The first part of the thesis will delve into a historical and cultural study of the development of financial co-operatives; the word 'cultural' here being broadly conceived as the philosophical, social, economic, and ethical environment or context which gave rise to financial co-operatives, and which profoundly influenced their progress.<sup>203</sup> The historical perspective will provide context for the development and current status of financial co-operatives and the legislation that governs them.<sup>204</sup> Scrutiny of past developments and the study of seams of doctrine that did not survive to the current day may expose

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<sup>201</sup> Mushonga is an example of one such author.

<sup>202</sup> M Nath 'Do institutional transplants succeed? Regulating Raiffeisen co-operatives in South India, 1930–1960' (2021) *Business History Review* 61–2.

<sup>203</sup> D Watkins & M Burton (eds) *Research Methods in Law* (2018) 99.

<sup>204</sup> *Ibid.*

errors in the current thinking and practices pertaining to financial co-operatives in South Africa and Malawi or provide cause to question current practices relating to financial co-operatives.<sup>205</sup>

Once the context has been established, the second part of the thesis will use the doctrinal research methodology to assemble the relevant laws of financial co-operatives in South Africa and Malawi. It is not the intention of this paper to conduct a comparative analysis of the law in these countries, although that may be unavoidable to some degree.<sup>206</sup> Rather it is the expectation of this thesis that by studying one of the biggest economies in Africa, and one of the poorest economies on the continent and in the world, the answers achieved in the research would be able to apply to all the countries on the continent, albeit with minor changes adapted to the individual countries.<sup>207</sup>

Thereafter, a brief critical analysis of the law will be conducted to uncover any difficulties that have been encountered in applying the law. For instance, parts of the implementation of the law have resulted in the formulation of supervisory bodies in both South Africa and Malawi. A critical analysis will aid in assessing the effectiveness of these bodies and in identifying those aspects of the law that need to be changed to achieve different (and more effective) outcomes for South Africa and Malawi.<sup>208</sup>

Following this, the thesis will provide recommendations on how South Africa and Malawi can improve their regulatory and supervisory frameworks. This will be done by extracting valuable observations from various jurisdictions including South Africa, and Malawi itself whose indigenous regulatory and supervisory framework provide reservoirs of information that this thesis can draw from and use to provide reform recommendations. The aim of this analysis is not to supplant the South African and Malawian legal framework, but to propose recommendations, if any, that will improve the current frameworks and foster the growth of financial co-operatives in the respective countries.

Lastly, where appropriate the thesis will be punctuated with economic explanations. These parts are merely descriptive and literature-based and have been incorporated to deepen the legal and comparative analyses where appropriate.<sup>209</sup> It should be noted however that the thesis will not directly engage with economic methods and theories as a core component, but will rather incorporate the research resulting from the previous economic analysis of financial co-operatives.<sup>210</sup> This will be done to ensure that the

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<sup>205</sup> Ibid.

<sup>206</sup> T Tyler 'Methodology in Legal Research' (2017) 13 *Utrecht Law Review* 130.

<sup>207</sup> Nkuna op cit note 116 at 93.

<sup>208</sup> M Walter *Social Research Methods* (2010) 485.

<sup>209</sup> Watkins & Burton op cit note 203 at 192.

<sup>210</sup> Ibid.

recommendations provided in this thesis are economically congruous and that the insights can be related to economic reality in South Africa and Malawi.

## **1.10 REASONS FOR OPTING TO STUDY FINANCIAL CO-OPERATIVES IN SOUTH AFRICA AND MALAWI**

### **1.10.1 MALAWI**

I am originally from Malawi. As a Malawian, I have observed the aspirations of the country and its citizens to create a financial environment that fosters financial inclusion. To foster this growth, over the past years, there has been an influx of financial co-operatives that have mushroomed in many parts of the country. However, the development of frameworks that provide for the supervision and regulation of these co-operatives has been slow and is still in infant stages. Through this thesis, I would like to contribute to the development of these frameworks.

### **1.10.2 SOUTH AFRICA**

As a student at the University of Cape Town, I enjoy South Africa and find it quite impressive for an African country. In the last twenty years, South Africa's financial sector has developed rapidly and extensively. However, financial co-operatives are recorded to play a miniscule role in that sector. I would like to explore why this is so and whether legal reformation of the sector would foster the further development of financial co-operatives in South Africa.

## **1.11 CONCLUSION AND THESIS OVERVIEW**

This thesis does not intend to idealise financial co-operatives. Financial co-operatives have witnessed several failures and challenges, like other financial institutions. It is the purpose of this thesis, however, to acknowledge the importance of financial co-operatives and to enable their growth in these economies. To that end, the thesis will be structured as follows:

### **PART ONE (CHAPTER TWO – CHAPTER FIVE): UNDERSTANDING FINANCIAL CO-OPERATIVES**

**Chapter Two – Origins of financial co-operatives and co-operative law.** This chapter explores the origin of financial co-operatives and co-operative law, their evolution and development towards their modern-day existence. This chapter aims to provide a contextual background to this study and to highlight any observations from their development that triggered growth.

**Chapter Three – Modern financial co-operatives.** This chapter considers a holistic view of the present-day structure of financial co-operatives in the world. It outlines the types of financial co-operatives, being

formal, semi-formal and informal financial co-operatives; and delves into a comprehensive discussion that creates a definite understanding of financial co-operatives.

**Chapter Four – The evolution of formal financial co-operatives and co-operative law in South Africa.**

This chapter discusses financial co-operatives in South Africa from a historical perspective to provide context for the status of financial co-operatives and the legislation that governs them. A historical study is essential as it provides an understanding of how history has shaped current practices in relation to the development of financial co-operatives. In addition, it provides lessons from the various developmental paths about factors that facilitate or inhibit growth of financial co-operatives. Such lessons could be invaluable in providing recommendations for the supervisory and regulatory framework of financial co-operatives in South Africa.

**Chapter Five – The evolution of formal financial co-operatives and co-operative law in Malawi.**

This chapter discusses financial co-operatives in Malawi from a historical perspective to provide context for the status of financial co-operatives and the legislation that governs them. A historical study is essential as it provides an understanding of how history has shaped current practices in relation to the development of financial co-operatives. Additionally, it provides lessons from the various developmental paths about factors that facilitate or inhibit growth of financial co-operatives. Such lessons could be invaluable in providing recommendations for the supervisory and regulatory framework of financial co-operatives in Malawi.

**PART TWO (CHAPTER SIX – CHAPTER EIGHT): REGULATING AND SUPERVISING FINANCIAL CO-OPERATIVES**

**Chapter Six – Regulation and Supervision of Financial Institutions.** This chapter will delve into a discussion on the forces that drive financial regulation and supervision; one force being the objectives of financial regulation, and another being the underlying philosophical theories of regulation.<sup>211</sup>

**Chapter Seven – Regulation of formal financial co-operatives in South Africa and Malawi.** This chapter will assemble the law that governs formal financial co-operatives in South Africa and Malawi. Such an assembly will include an outline of the current regulatory and supervisory framework and how it operates. The chapter will also critically analyse the framework to assess the impact that the current regulatory and supervisory framework has had on the growth of financial co-operatives in Malawi. It is the aim of this

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<sup>211</sup> C Buttigieg et al 'A Critical Analysis of the Rationale for Financial Regulation Part I: Theories of Regulation' *European Company and Financial Law Review*, vol. 17, no. 5, 2020, pp. 419-436. <https://doi.org/10.1515/ecfr-2020-0020> p. 435.

chapter to both commend the current structure and to also expose the weaknesses in the current legal structure that need to be addressed.

**Chapter Eight – Supervision of formal financial co-operatives in South Africa and Malawi.** This chapter discusses supervision of financial co-operatives and the challenges that this entails in both South Africa and Malawi. It is the aim of this chapter to both commend the current structure and to also expose the weaknesses that need to be addressed.

**Chapter Nine – Regulation and Supervision of Semi – Formal and Informal Financial Co-operatives in South Africa and Malawi.** This chapter aims to discuss how the semi-formal and informal financial co-operatives may be regulated or managed to encourage growth. Specific actions will be proposed that can be taken to improve the sector.

**Chapter Ten – Conclusions, Observations and Recommendations for Legal Reform of Financial Co-operatives in South Africa and Malawi.** This chapter will conclude the thesis by providing a summary of the thesis. Thereafter, it will outline the strengths of the current regulatory and supervisory structure that should be maintained because they promote the development of financial co-operatives. However, its focus will be to recommend changes (if any) to the current structure.

## CHAPTER TWO

### ORIGINS OF FINANCIAL CO-OPERATIVES

*“Money is so plentiful that you can hardly get money for it; it is overflowing in the coffers of capitalists and the bankers.”<sup>1</sup>*

#### 2.1 CONTEXT

To give a robust understanding of financial co-operatives as they are today, a historical account is necessary.<sup>2</sup> A historical account of the origins of financial co-operatives will provide an understanding of how history has shaped current practices in relation to the development of financial co-operatives.<sup>3</sup> A historical account will bring out clearly the importance of financial co-operatives; the effects of a changing environment on financial co-operatives; and lessons about factors that facilitate or inhibit the growth of financial co-operatives.<sup>4</sup>

#### 2.2 BRIEF HISTORY OF FINANCIAL CO-OPERATIVES

The history of financial co-operatives as is recorded begins with the appearance of the friendly society birthed in France during the sixteenth century.<sup>5</sup> The friendly society, also known as the benefit society and box club was a kind of fraternity or fellowship that collected a small subscription from its typically poor members and in return guaranteed certain benefits such as, sick pay, insurance, a respectable burial, distress grants, widows and orphans’ pension and free medical treatment.<sup>6</sup>

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<sup>1</sup> R W Barnett & H W Wolff ‘People’s Banks: A record of social and economic success’ (1984) 4 *The Economic Journal* 73.

<sup>2</sup> A E Okem ‘The meaning and defining characteristics of co-operatives’ in A E Okem (ed) *Theoretical and Empirical Studies on Co-operatives: Lessons for Co-operatives in South Africa* (2016) 16.

<sup>3</sup> Okem op cit note 2 at 16.

<sup>4</sup> Ibid.

<sup>5</sup> N E Key *Britain in the Hanoverian Age, 1714–1837: An encyclopaedia* (1999) 27 *History: Reviews of New Books* 51–2.

<sup>6</sup> Ibid.

Notwithstanding, the friendly society is not the institution that is heralded as the origin of the modern-day co-operative movement. The Rochdale Society of Equitable Pioneers founded in 1844, England, is instead the predecessor of the modern-day co-operative movement.<sup>7</sup> The society was the first successful co-operative association of a group of workers that provided to its members, benefits based on use and was one of the first co-operatives to establish co-operatives' governing principles.<sup>8</sup> It was therefore a form of prototype for future co-operatives.<sup>9</sup> However, beyond this, the English did not do much else in developing financial co-operatives.<sup>10</sup>

Rather, the origins of financial co-operatives shifted back to France where, in 1848, Pierre Joseph Proudhon launched a grandiloquent scheme for a friendly association the structure of which was by no means co-operative.<sup>11</sup> The association collapsed within a few months and by its failure prevented the development within France of any genuine financial co-operative.<sup>12</sup>

Nevertheless, the associations proved resilient and in the same year, they popped up again, this time in Belgium. Belgium became the birthing place of the first true credit union.<sup>13</sup> M. Francois Haeck induced several men to join, each subscribing for shares in the union.<sup>14</sup> The union was very successful; so successful in fact that wealthy men were pleased to join. However, it soon became a rich men's club and consequently lost its popularity.<sup>15</sup> These two occurrences provide two lessons that are essential for the development and sustainability of co-operatives. Firstly, financial co-operatives thrive best when they function as co-operative entities and should therefore be structured as co-operatives and not other types of legal entities. Secondly, financial co-operatives should not be structured to primarily serve the rich as doing so excludes the poor.

### **2.3 THE BIRTH OF FINANCIAL CO-OPERATIVES' MODELS IN GERMANY**

After the failed experiments in many parts of Europe towards the development of financial co-operatives, the Germans took on the reins and became the practical founders of modern financial co-operatives.<sup>16</sup>

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<sup>7</sup> D Tucker *The Evolution of Peoples Banks* (1922) 14.

<sup>8</sup> International Co-operative 'Our history: Establishing the international co-operative alliance' (2020) available at <https://www.ica.coop/en/co-operatives/history-co-operative-movement>, accessed on 12 January 2020.

<sup>9</sup> *Ibid.*

<sup>10</sup> Tucker *op cit* note 7 at 14.

<sup>11</sup> *Ibid.*

<sup>12</sup> *Ibid.*

<sup>13</sup> T Bickerstaffe *The Significance of the Common Bond in Credit Unions* (unpublished PhD thesis, University of Leeds, 2001) 82; Tucker *op cit* note 7 at 17.

<sup>14</sup> *Ibid.*

<sup>15</sup> *Ibid.*

<sup>16</sup> H W Wolff *People's Banks: A Record of Social and Economic Success* (2012) 286; P S King *People's Banks* (1896) 4.

Many favouring circumstances made Germany the cradle of the financial co-operatives' movement.<sup>17</sup> First, unlike the more industrialised Britain, Germany took its first steps towards industrial growth through the creation of a new internal rail network and a customs system, designed to facilitate free trade between the various aristocratic German states.<sup>18</sup> This, combined with Germany's large population, ensured that cooperation could spread within it to a large extent without facing the barriers of diverse languages and ideals.<sup>19</sup>

In addition, especially in north Germany, there were certain definite establishments, the operation of which had extensively familiarised the population with some forms of co-operative organisation.<sup>20</sup> These included the joint-stock corporation, charitable loan societies and some institutions like the English friendly societies.<sup>21</sup> Furthermore, the famine that had affected Germany and the whole of Europe from 1846 to 1847 highlighted the problem of lack of capital in both urban and rural areas which was not only a cause of the slow German economic growth but was also a cause of the disappearance of small businesses, artisans, and farmers.<sup>22</sup> This urban and rural distress associated with the industrial revolution led to the birth of two distinguishable financial co-operative models from 1848 onwards; one served the needs of urban dwellers and the other those in rural agriculture.<sup>23</sup>

It is important at this stage to study these two models because it is from these models that financial co-operatives as we know them today, developed. Moreover, a study of these models will show important lessons about factors that further influence the development and advancement of financial co-operatives. For example, it will be observed that strong ambassadors of financial co-operatives are a requirement in the development of financial co-operatives. Both models succeeded mainly because they had strong ambassadors at the forefront of development.<sup>24</sup> These models are discussed in turn below:

### **2.3.1 PEOPLES BANK (VOLKSBANKEN) – URBAN DWELLERS' BANK**

The establishment of the Peoples Bank was strictly associated with the urbanisation process and the economic growth of urban classes.<sup>25</sup> It was created to financially assist emerging classes of craftsmen,

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<sup>17</sup> Ibid. Tucker op cit note 7 at 18.

<sup>18</sup> F Poli *Co-operative Banking Networks in Europe* (2019) 2.

<sup>19</sup> Tucker op cit note 7 at 18.

<sup>20</sup> Wolff op cit note 16 at 287.

<sup>21</sup> Ibid.

<sup>22</sup> Poli op cit note 18 at 2.

<sup>23</sup> E Allen & S Maghimbi *African Co-operatives and the Financial Crisis* (2009) CoopAFRICA Working Paper No 3 International Labour Organisation 2.

<sup>24</sup> Prinz op cit note 120 at 15–16.

<sup>25</sup> V Boscia *Co-operative Banking: Innovations and Developments* (2009) 21.

traders, small and medium-sized firm owners, and professionals who could not raise enough resources from traditional commercial banks.<sup>26</sup>

Peoples Bank was formed by Hermann Schulze-Delitzsch. Schulze-Delitzsch first started to experiment with co-operative associations in 1846 when he held the post of Patrimonial-Richter.<sup>27</sup> As Patrimonial-Richter he tried both civil and criminal cases and supervised the village administration, the police, the schools, the church, the roads, and the preservation of public order.<sup>28</sup> This role gave him an excellent opportunity to observe the economic life of his neighbourhood and form a large circle of friends.<sup>29</sup> It was with this circle of friends, somewhat similarly educated, that he organised a chorus with the most wealthy members, and through this chorus also formed a committee to help those who began to suffer during the crop failure of 1846.<sup>30</sup> This gesture, while entrepreneurial was one of charity and not of reform, but it was in this manner that Schulze-Delitzsch made his first move away from an attitude of benevolent passiveness and into co-operation.<sup>31</sup>

Schulze-Delitzsch founded his first co-operative society in 1849.<sup>32</sup> He observed that without a mandatory disablement and benefit fund, members of lower-income classes suffered if the breadwinners in families fell ill or died.<sup>33</sup> Consequently, Schulze-Delitzsch drew on the English friendly societies and established an insurance association of a type like the friendly societies. The benefits paid out covered free medicine, free medical treatment and where necessary, sickness pay.<sup>34</sup> The fund was financed through entry fees and consistent contributions from members.<sup>35</sup>

Towards the end of the same year, Schulze-Delitzsch founded two other co-operative purchasing societies; one for cabinet makers and another for master shoemakers in his village.<sup>36</sup> These were the first true co-operative societies in Germany that existed not for profit on capital invested but to only further the economic life of their members. The members comprised mainly labourers and small businessmen.<sup>37</sup>

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<sup>26</sup> Ibid

<sup>27</sup> Bickerstaffe op cit note 13 at 78.

<sup>28</sup> Ibid.

<sup>29</sup> Tucker op cit note 7 at 33.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

<sup>32</sup> G Alexopoulos *Financial Co-operatives and Rural Development in Greece* (unpublished PhD thesis, University of Leicester, 2004) 54.

<sup>33</sup> R Gibbons 'German Yearbook on Business History 1982' (2012) 57 *Business History Review* 20.

<sup>34</sup> Ibid.

<sup>35</sup> Ibid.

<sup>36</sup> Tucker op cit note 7 at 43.

<sup>37</sup> Ibid.

The shoemakers' co-operative purchasing society sold leather to its members at a price lower than the market price.<sup>38</sup> However, Schulze-Delitzsch discovered that even at this low price, the members of the co-operative purchasing society lacked the financial resources necessary for purchasing the cheap raw materials from their own society. Credit in some form was therefore required.<sup>39</sup> The co-operative purchasing society might perhaps have given the credit itself, but Schulze-Delitzsch decided on a strategy that became basic in the development of co-operative societies: the separation of credit from sales.<sup>40</sup>

Unsurprisingly, in 1850, he founded a loan association. This loan association consisted of honorary members as well as beneficiaries.<sup>41</sup> It was different from many other co-operatives that had been established at that time because, for the first time, borrowers were required to make regular contributions towards the association.<sup>42</sup> These contributions gradually replaced any funds that had been sourced externally, either from creditors or charitable donations from honorary members.<sup>43</sup> As a result, the co-operative became truly independent, consisting only of small borrowers of the lower social class and growing to become the Peoples Banks.<sup>44</sup>

### **2.3.2 SOCIAL CREDIT BANK (DARLEHENS KasSENVEREINE) – RURAL BANK**

Almost simultaneously, in Weyerbusch, a rural area in another part of Germany, shortage of capital was making farmers susceptible to takeovers and input costs.<sup>45</sup> Friedrich Wilhelm Raiffeisen, motivated by this agricultural distress and the indebtedness of smallholder agriculturalists began to develop his own model of financial co-operatives parallel to Schulze-Delitzsch.<sup>46</sup>

Raiffeisen was the son of a farmer and mayor of a small rural town, who became a mayor himself and later a wine merchant and a manufacturer of cigars.<sup>47</sup> He was an ardent Lutheran who was actively involved in works of charitable and social activities to help and develop the impoverished local community in which he served as a public servant.<sup>48</sup> Accordingly, when the bad harvest of 1846 struck the people of Weyerbusch as severely as it did the residents of Schulze-Delitzsch, Raiffeisen distributed flour

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<sup>38</sup> Poli op cit note 18 at 6.

<sup>39</sup> W van Opstal 'Schulze-Delitzsch, Franz Hermann' in H K Anheier & S Toepler (eds) *International Encyclopaedia of Civil Society* (2010) 1351.

<sup>40</sup> Tucker op cit note 7 at 44.

<sup>41</sup> Ibid.

<sup>42</sup> Alexopoulos op cit note 32 at 54; Tucker op cit note 7 at 44.

<sup>43</sup> Ibid.

<sup>44</sup> Poli op cit note 18 at 6.

<sup>45</sup> D G McKillop & J Wilson 'Credit unions: A theoretical and empirical overview' (2011) *Financial Markets, Institutions and Instruments* 20, 81.

<sup>46</sup> Allen & Maghimbi op cit note 23 at 2.

<sup>47</sup> Poli op cit note 18 at 5.

<sup>48</sup> Ibid.

to the poor and formed a "Relief Commission" to organise additional aid.<sup>49</sup> Loans were granted, seed and seed potatoes purchased and finally, a bakery was opened where subsidised bread could be bought.<sup>50</sup> The Commission called itself "The Bread Association" and later changed its name to "The Consumers Association".<sup>51</sup> This was an example of a spontaneous charitable initiative, but it marked the first of his initiative in the creation of rural financial associations.<sup>52</sup>

After this association, Raiffeisen founded the Flammersfeld Association for the Support of Needy Farmers in 1849 and the Heddesdorf Charitable Association of 1854.<sup>53</sup> Initially the association in Flammersfeld Association was still closely tailored to Raiffeisen's earlier charitable associations.<sup>54</sup> However, the main difference was that Flammersfeld Association was not, as in the initial cases, created to cope with emergency distress. Flammersfeld Association was formed to offset extortionate practices in the cattle trade.<sup>55</sup> The association began by buying cattle for its members but later extended services to the provision of loans for the purchasing of livestock and any other arising purposes. Instead of supplementing the capital, the association depended on the solidarity between the members, who even in this early association took on liability for each other.<sup>56</sup> The association also had a board of directors and an administrative council who acted in an honorary capacity.<sup>57</sup>

Notwithstanding, the evolution into a strictly financial association only began with the Heddesdorf Charitable Association.<sup>58</sup> Originally, this association had a wide range of goals organised in a comparable way to its predecessor in Flammersfeld.<sup>59</sup> For example, it also granted loans for the purchase of livestock and provided guarantees issued by their wealthier members. In addition, it also had charitable functions.<sup>60</sup> For instance, it educated children, helped the unemployed to acquire jobs, promoted the furtherance of education for community members through the creation of an open-access libraries, assisted poor farmers to buy cattle and grain, and organised a system of mutual credit.<sup>61</sup>

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<sup>49</sup> Ibid.

<sup>50</sup> Gibbons op cit note 33 at 21.

<sup>51</sup> Ibid.

<sup>52</sup> Poli op cit note 18 at 5.

<sup>53</sup> Gibbons op cit note 33 at 21.

<sup>54</sup> S Goglio & A Leonardi 'The roots of co-operative credit from a theoretical and historical perspective' (2012) *SSRN Electronic Journal* 15.

<sup>55</sup> Gibbons op cit note 33 at 22.

<sup>56</sup> Ibid.

<sup>57</sup> Goglio & Leonardi op cit note 54 at 15.

<sup>58</sup> Ibid.

<sup>59</sup> Gibbons op cit note 33 at 22.

<sup>60</sup> Ibid.

<sup>61</sup> Poli op cit note 18 at 7.

However, over time, the association seemed to be in danger of dissolving when its volume of loans rose to more than 20,000 thalers.<sup>62</sup> Gradually, through his observations and experience, Raiffeisen realised that small farm businesses could not be liberated from the vicious cycle in which they were trapped by relying on help from outsiders.<sup>63</sup> Like Schulze-Delitzsch, he began to see that co-operative solutions were the best route to take. He therefore advocated for the principle of *Selbsthilfe* (self-help), leading to the reorganisation of the Heddesdorf Charitable Association, from a charitable organisation to one based on the principle of self-help.<sup>64</sup>

By 1862, the association had limited itself entirely to granting loans, primarily to farmers, and became the first rural Social Credit Bank (*Darlehenskassenvereine*).<sup>65</sup> The Social Credit Bank aimed at the social, economic, and moral rejuvenation of rural society in an environment of strong evangelical solidarity. For Raiffeisen, besides economic motivations, ethical motivations were essential.<sup>66</sup>

Both banks proved to be successful. This success was mainly because, as stated earlier in the chapter, the banking models each had ambassadors that promoted their growth. Further, they were versatile. Both banks continually adapted to their local environment. This may be because they were self-help groups that needed to help people and people by form are also evolutionary creatures.<sup>67</sup> In addition, the banks were successful because in both the Peoples Bank and the Social Credit Bank, efforts were made to wean the associations of their dependency on external factors.<sup>68</sup> Strongly embedded in the development of financial co-operatives therefore was the principle of autonomy and self-help. However, it is important to note that this autonomy was evolutionary and not abrupt. There was a transitional period that permitted the financial co-operatives to build enough stamina to exist on their own. Below is a summary of the similarities and differences between the functionalities of the banks:

### **2.3.2.1 Membership**

In Peoples Banks, members were required to pay an entry fee.<sup>69</sup> This fee served to limit access of the bank to people who were able to help themselves and discourage the poor from trying to join.<sup>70</sup> It was supposed that people who were not able to pay such fees either lacked moral qualities such as thrift or diligence or were in a state of such poverty that they would not be able to repay loans extended by the

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<sup>62</sup> Gibbons op cit note 33 at 22.

<sup>63</sup> Goglio & Leonardi op cit note 54 at 17.

<sup>64</sup> Ibid.

<sup>65</sup> Goglio & Leonardi op cit note 54 at 15.

<sup>66</sup> Ibid.

<sup>67</sup> Allen & Maghimbi op cit note 23 at 2.

<sup>68</sup> Tucker op cit note 7 at 65.

<sup>69</sup> T W Guinnane 'The early German credit co-operatives and microfinance organisations today: Similarities and differences' in B Armendariz & M Labie (eds) *The Handbook of Finance* (2011) 84.

<sup>70</sup> Ibid.

bank.<sup>71</sup> On the other hand, the task of Social Credit Banks was to gain credit on the best conditions and to provide it to its members at the lowest cost.<sup>72</sup> Therefore, admission was permissible to all without regard to their economic status, unless their behaviour showed that they were not worthy of admission.<sup>73</sup> The selection was based less on entry fees than on shared knowledge and solidarity among members.<sup>74</sup>

As will be shown in the next chapters, both types of membership and entry requirements still exist today. High entry fees while beneficial in that they offer required capital to the financial co-operatives still offer an entry barrier to people wishing to gain membership. Accordingly, more people prefer the modern versions of Social Credit Banks that do not require a significant amount of entry fees, if any at all.

### **2.3.2.2 Governance**

Democratic self-government was a fundamental principle in Peoples Bank.<sup>75</sup> It meant that each member only had one vote in decision-making.<sup>76</sup> Originally therefore, decisions were made by a meeting of all the members.<sup>77</sup> In such an assembly, wealthy members and those without a similar standing sat side by side, with the same rights and duties.<sup>78</sup> Elections and decision making followed the “one man, one vote” principle.<sup>79</sup> Like Peoples Banks, Social Credit Banks was operated by a democratic administration whose main governance body was the general assembly.<sup>80</sup> Members were obligated to attend these meetings to prevent entry into the bank of individuals who were only interested in the management of the bank when they needed a loan.<sup>81</sup> This characteristic is still prevalent in financial co-operatives today.

### **2.3.2.3 Capital and reserve funds**

In Peoples Banks, the operating capital necessary for the lending business of the bank primarily came from the membership entry fees. The entry fee was not payable in one lump sum but was spread over several monthly instalments. In addition, the members also made monthly contributions to the bank. These small monthly sums were payable up to the amount of a shareholding within the bank. Such a structure was set up to make the members both customers and investors (borrowers and savers).

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<sup>71</sup> Goglio & Leonardi op cit note 54 at 13.

<sup>72</sup> Ibid.

<sup>73</sup> F W Raiffeisen *The Loan Fund Associations as a Means to Remedy The Hardship of the Rural Population, as Well as the Urban Craftsmen and Workers: Practical Instructions for the Formation of Such Associations, Based on Sixteen Years of Experience, as the Founder of the Same* (1866) 41–42.

<sup>74</sup> Ibid.

<sup>75</sup> Tucker op cit note 7 at 180.

<sup>76</sup> Ibid.

<sup>77</sup> Ibid.

<sup>78</sup> Goglio & Leonardi op cit note 54 at 18.

<sup>79</sup> Goglio & Kalmi op cit note 92 at 73.

<sup>80</sup> Ibid.

<sup>81</sup> Ibid.

Schulze-Delitzsch did not determine how large this contribution was. He only referred to two limits: “Regarding the amount of the monthly contribution, this must not be fixed too high, so that persons without extensive means would be prevented from joining. On the other hand, too great a restriction will limit the desired growth of the savings stock.”

In contrast, Social Credit Banks had no share capital and, in addition to their own resources, only had access to excess savings. Raiffeisen welcomed savings deposits and relied on them as the main source of financing. The main business goal of these banks was therefore to finance the growth of their loan portfolio to liable members, and the most affordable way of doing this was by attracting new savings deposits from both existing and new members. Indeed, in practice, the managers of these banks aimed to attract and hold savings deposits wherever they could, and borrowed externally only where necessary, which in most cases only occurred when establishing a new bank. Raiffeisen believed that “[i]f, as is urgently necessary, the union is to help the rural areas, borrowed funds are essential and considerable loans must be taken up at the start.”

#### **2.3.2.4 Loans to members**

Only short-term loans were given to members of Peoples Banks. The loans were commonly issued for a three months’ duration, though renewable in some cases.<sup>82</sup> Schulze-Delitzsch believed that long-term loans stimulated disorder, negligence, and slackness among debtors.<sup>83</sup> The security for the loans was the members themselves. Schulze-Delitzsch stated that “*among the craftsmen and workers, nothing is held in lower esteem than to harm a fellow-citizen, a close friend and companion, after he has proved willing to share the risk. They would rather sacrifice their last penny ...*”.<sup>84</sup> The interests on the loans were deliberately set very low to create attractive conditions for the members.<sup>85</sup>

Social Credit Banks operated differently. Unlike urban producers, small farmers made their profits once a year when harvest was completed, or livestock was sold.<sup>86</sup> Consequently, loans could not be easily repaid on a short term or lump-sum basis.<sup>87</sup> Therefore, Social Credit Banks needed to have long periods of repayment (up to ten years) with the possibility of instalment amortisation.<sup>88</sup> From Raiffeisen’s point of view, only long-term financing could encourage impoverished borrowers to plan and bear the costs of investments aimed at improving activities and the quality of life.<sup>89</sup> It will be show in the chapters below

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<sup>82</sup> T W Guinnane ‘Diversification, liquidity, and supervision for small financial institutions: Nineteenth-century German credit co-operatives’ (1995) Centre Discussion Paper, No 733 at 11, available at <https://www.econstor.eu/bitstream/10419/160650/1/cdp733.pdf>, accessed on 19 June 2019.

<sup>83</sup> Goglio & Leonardi op cit note 54 at 14.

<sup>84</sup> Aschhoff op cit note **Error! Bookmark not defined.** at 30.

<sup>85</sup> Ibid.

<sup>86</sup> Goglio & Leonardi op cit note 54 at 17.

<sup>87</sup> Ibid.

<sup>88</sup> Aschhoff op cit note **Error! Bookmark not defined.** at 32.

<sup>89</sup> Ibid.

that to date, long term loans are more popular among financial co-operatives in Africa where short term repayment may not be ideal for the majority of borrowers.

### **2.3.2.5 Joint and several liability and unlimited liability**

Peoples Banks were opposed to savings deposits. Therefore, at times when the banks required an influx of liquidity, the banks borrowed funds from the non-bank sector and other creditors. The principle of joint and several liability was established for the insurance of these creditors. This means upon joining, all the members of the association were jointly and personally liable for the amount contributed by the external creditors. This generated solidarity among the members and encouraged them to deal with the bank's administration, to attend the general assemblies, to feel part of a collective organisation.

Similarly, the unlimited and joint liability of members was fiercely defended by Raiffeisen. Making the members responsible for each other's financial losses was believed to be an effective mechanism that encouraged mutual trust between members and everyone's involvement in paying each member's debt. This commitment to repay loans was reinforced by two factors: the homogeneity of the members and their limited numbers, being part of small communities. Such conditions allow members to develop mutual knowledge of one another, placing them in a better position to exercise social control over each other's behaviour.

### **2.3.2.6 Profits and dividends**

For Peoples Banks, members were paid dividends deriving from operating profits. The dividends were paid in sole proportion to the work undertaken by co-operative members. Dividends encouraged members to invest their savings, and for the poorer members, dividends encouraged them to increase their capital contributions.

Notwithstanding, for Social Credit Banks, profits were not distributed among members (as there were no shares), but were held as reserves to meet future losses, reducing borrowing costs and increase deposit yields. In the event of the dissolution, cumulated reserves, therefore, would not be distributed among members, as was the case with Peoples Banks. Instead, it was agreed that profits would be devolved to community-based charitable activities. In this way, the strong mutualistic character of the Social Credit Banks could be fully maintained.

### **2.3.2.7 Geographical area**

Small short-term loans payments plus dividend payments to members required individual Peoples Banks to carry out many operations involving relatively small amounts. Consequently, the geographical area in which Peoples Banks operated to generate profits, could not be small. Furthermore, the interest rate

applied to the loans had to be such that they generated sufficient operating profits to allow the distribution of dividends among members. Therefore, the banks functioned better across broad areas and not only that, but they also had to acquire qualified personnel, both as administrators and as employees to manage transactions in such large areas. In contrast to Peoples Banks, an important rule in the operational practice of Social Credit Banks was the limitation of the geographical area in which the banks functioned. All such banks restricted their market to one locality, or even to members of a religious denomination within that area. This restriction permitted members to have perfect knowledge of the moral and economic situations of other members so that when members requested loans, they could assess solvency without risk of loss.

### **2.3.2.8 Remuneration**

Qualified personnel came at a cost. One distinctive feature of Peoples Banks was that the role of directors was not on a volunteer basis which was typical of co-operative movements at the time.<sup>90</sup> The directors of these banks were paid wages and commissions as compensation for their efforts in conducting sound banking operations and enabling them to grow. To further reinforce the application of prudent lending practices, Raiffeisen, unlike Schulze Delitzsch, did not allow remuneration for the management of Social Credit Banks. There were no salaries, or commissions for activities generated by management, or bonuses for performance achieved. Social Credit Bank management activities were carried out on a purely voluntary basis with the full spirit of charitable principles for the good of the community. Only accountants and cashiers received remuneration for their work.

Notwithstanding the success of both banks, critics of the Schulze-Delitzsch's emphasised that Peoples Banks were inadequate for poor people in rural areas.<sup>91</sup> Some aspects of the bank like entry requirements, short-term loans and credit services, and capital reserves were not conducive to people in the rural areas because they assumed that members possessed a reasonable level of available funds, which for rural areas was not always the case.<sup>92</sup> It was consequently necessary to re-interpret the Schulze-Delitzsch model of banking so that it matched rural realities and persuasively promote itself to the most vulnerable workers in those rural areas.<sup>93</sup> In other words, Peoples Banks only succeeded in urban areas, while the Social Credit Banks succeeded in rural areas.

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<sup>90</sup> Schulze-Delitzsch op cit note **Error! Bookmark not defined.** at 112.

<sup>91</sup> Poli op cit note 18 at 4.

<sup>92</sup> S Goglio & P Kalmi 'Credit unions and co-operative banks across the world' in M J Blasi & C Borzaga (eds) *The Oxford Handbook of Mutual, Co-operative, and Co-owned Business* (2017) 3.

<sup>93</sup> Ibid.

## 2.4 THE EMERGENCE OF CO-OPERATIVE LAW

In time, these financial co-operatives gained a reputation of meeting the needs of ordinary men and therefore spread rapidly.<sup>94</sup> Their growth attracted the attention of the German government, and not all the attention was positive.<sup>95</sup> The close connection between the co-operatives and the founding politicians made some officials to utilise the law for the harassment or even prohibition the co-operatives.<sup>96</sup>

For example, the government tried to subject the general assemblies of co-operative members to conduct supervision on the grounds that they were public meetings.<sup>97</sup> Moreover, in 1855 an order was made requiring all new co-operatives of a financial nature to secure permits or licenses from authorities and to consent to give these authorities the power to revise their governance structures, supervise their management, and dissolve the co-operatives if they chose to.<sup>98</sup>

However, even after applications for licences were made, the authorities refused some licenses because there was no need for such associations, and in some other cases, on the grounds that the interest rates were usurious.<sup>99</sup> When the courts took up the matter, a judicial decision was secured which classified financial co-operatives with private partnerships rather than with friendly societies requiring licences.<sup>100</sup> While this gave financial co-operatives momentary relief from governmental pressure, being classified with private partnerships was also not entirely favourable to them.<sup>101</sup>

The General State Laws for the Prussian state while acknowledging them as somewhat similar to private partnerships in that they were groups of people working together, only permitted financial co-operatives to have an internal governance mechanism, but externally, gave them no right to act in their own name.<sup>102</sup> This was not an initial problem, but some features of financial co-operatives later made this a legal problem.<sup>103</sup>

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<sup>94</sup> McKillop & Wilson op cit note 45 at 83.

<sup>95</sup> R Brooks & T W Guinnane 'The right to associate and the rights of associations: Civil-society organizations in Prussia, 1794-1900' in N Lamoreaux & J Wallis (eds) *Organizations, Civil Society, and the Roots of Development* (2017) 291–93.

<sup>96</sup> Ibid.

<sup>97</sup> Tucker op cit note 7 at 65.

<sup>98</sup> R Fink *The Schuh-Delitzsch Co-operative* (1854) 83; This demand was based on a statute of 1851 which subjected friendly societies to such supervision.

<sup>99</sup> Tucker op cit note 7 at 65.

<sup>100</sup> Ibid.

<sup>101</sup> T W Guinnane 'Co-operatives before co-operative law: Business law and co-operatives in Spain, 1869-1931' (2001) *Journal of Iberian and Latin American Economic History* 70.

<sup>102</sup> Ibid.

<sup>103</sup> Ibid.

Financial co-operatives had a large membership, often comprising of 100 members or more.<sup>104</sup> In contrast, private partnerships seldom had more than three or four members and the partnership parties seldom changed while co-operatives experienced steady turnover in membership.<sup>105</sup> A legal consequence of this was that financial co-operatives incurred extra costs for basic decisions. For instance, where the financial co-operative wanted to exercise the right to act in its name, the co-operative members would have to give their power of attorney for the relevant business to the co-operative's leadership.<sup>106</sup>

The creation of the power of attorney required either a notarised document or personal appearance before an official, both of which fees were .<sup>107</sup> However, financial co-operatives incurred extra costs because every time someone joined or left a co-operative, the institution had to incur legal costs of changing the list of members that the power of attorney represented, and every change in membership raised the possibility of defective documents.<sup>108</sup> Co-operative leaders insisted that this basic issue impeded co-operative development. In contrast, partnerships did not encounter this because their membership was much smaller and steady. <sup>109</sup>

#### 2.4.1 THE 1867 CO-OPERATIVES ACT

These struggles convinced Schulze-Delitzsch that specific legislation was required for his co-operatives to thrive.<sup>110</sup> He sought two things from legislation: recognition that co-operatives should not be subjected to police oversight, and the right for co-operatives to act as legal entities.<sup>111</sup> These two factors reflected the co-operative movement's history to that point. The 1867 Co-operatives Act drew heavily on the provisions for partnerships; most notably, co-operatives were given something approaching legal personality by strict analogy to the rights of commercial partnerships under the commercial code.<sup>112</sup> The 1867 Act also freed co-operatives from police harassment that related to the lack recognition of co-operatives as legal entities.<sup>113</sup>

One important and favourable feature about the Act is that it did not create a new institution; but rather, it was tailor-made to regulate an existing institution, being the co-operatives pioneered by Schulze-Delitzsch.<sup>114</sup> However, this was also not a fully commendable approach since the 1867 Act was

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<sup>104</sup> Fonteyne op cit note **Error! Bookmark not defined.** at 8–9.

<sup>105</sup> Guinnane op cit note 101 at 70.

<sup>106</sup> Ibid.

<sup>107</sup> T W Guinnane 'New law for new enterprises: Co-operative law in Germany, 1867–1889' (2020) 61 *Economic History Year* 380–81

<sup>108</sup> Ibid.

<sup>109</sup> Ibid.

<sup>110</sup> D Cracogna et al *International Handbook of Co-operative Law* (2013) 4.

<sup>111</sup> Ibid.

<sup>112</sup> L Seeberger 'History of the evolution of co-operative law from its origins to the present day' (2014) 333 *Recma* 66–67.

<sup>113</sup> Ibid.

<sup>114</sup> A Khafagy *The Economics of Financial Co-operatives : Income Distribution, Political Economy and Regulation* (2020) 67.

structured with only his co-operatives in mind making some practices in Raiffeisen co-operatives illegal.<sup>115</sup> Unsurprisingly therefore, Raiffeisen drove a debate for a new legal framework.<sup>116</sup> Fortunately, Schulze-Delitzsch also started to see flaws in the new co-operatives law and sought modifications.<sup>117</sup>

Notwithstanding, Schulze-Delitzsch was still sceptical about the Raiffeisen co-operatives. He did not support the excessive reliance of Raiffeisen co-operatives on borrowed money.<sup>118</sup> As stated previously, Raiffeisen's co-operatives tended to have no capital other than a reserve fund that was built up slowly out of profits which his co-operatives did not distribute to members.<sup>119</sup>

Schulze-Delitzsch also opposed the way the Raiffeisen group created co-operative centrals.<sup>120</sup> As Raiffeisen's co-operatives had expanded into rural areas, Raiffeisen had established specialised regional organisations to serve the requirements of co-operatives.<sup>121</sup> Raiffeisen's centrals were co-operatives whose only members were other co-operatives.<sup>122</sup> In the absence of any natural persons as members, these centrals had non-members in leadership roles, which violated the law as set out by Schulze-Delitzsch. Schulze-Delitzsch had an essential point against these centrals: an unlimited-liability co-operative with only unlimited-liability co-operatives as members pyramided liabilities.<sup>123</sup> However, Raiffeisen defended their methods as suitable to their place of operation and at that stage, Raiffeisen's influence, and success began to disturb the balance of power sufficiently.<sup>124</sup>

Accordingly, when proposals for reform were lodged in 1881, they included submissions from Schulze-Delitzsch, Raiffeisen and some interested parties.<sup>125</sup> Schulze-Delitzsch's draft law included several changes, like reform to the bankruptcy rules to reduce the role of direct liability.<sup>126</sup> For its part, the Raiffeisen group focused on changes aimed at legalising the practices criticised by Schulze-Delitzsch.<sup>127</sup> Von Mirbach proposed the introduction of co-operatives with limited liability alongside those with

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<sup>115</sup> T W Guinnane & S Martínez Rodríguez *Did the co-operative start life as a joint-stock company? Business law and co-operatives in Spain, 1869-1931* (2010) Centre Discussion Paper No 987 at 8.

<sup>116</sup> *Ibid.*

<sup>117</sup> *Ibid.*

<sup>118</sup> S Cornée, L Fattobene & M Migliorelli 'An overview of co-operative banking in Europe' (2018) *New Co-operative Banking in Europe* 3.

<sup>119</sup> *Ibid.*

<sup>120</sup> M Prinz 'German rural co-operatives, Friedrich Wilhelm Raiffeisen and the organization of trust' (2002) 54 *8th International Economic History Association Congress, Buenos Aires* 18–19.

<sup>121</sup> *Ibid.*

<sup>122</sup> *Ibid.*

<sup>123</sup> T Guinnane et al 'The history of the DZ Bank. The co-operative central banking system from the 19th century to today, 2013' (2014) 3 *Sehepunkte* 70–4.

<sup>124</sup> *Ibid.*

<sup>125</sup> Guinnane op cit note 394.

<sup>126</sup> *Ibid.*

<sup>127</sup> *Ibid.*

unlimited liability.<sup>128</sup> His proposal to place the co-operatives under the supervision of local authorities was less welcome.<sup>129</sup> In 1887, the government assembled a committee of experts to advise on the draft. The experts recommended more changes that were incorporated in the 1889 Co-operatives Act.<sup>130</sup>

## 2.4.2 THE 1889 CO-OPERATIVES ACT

The Co-operatives Act of 1889 introduced three important changes.<sup>131</sup> First, it introduced mandatory external audits for all registered co-operatives.<sup>132</sup> Co-operatives could meet the audit requirements in one of two ways. They could ask the local courts to appoint an auditor for the period requiring an auditor, or instead, have the audit conducted by a regional co-operative association acting as a specialised audit association.<sup>133</sup> Secondly, the Act of 1889 allowed co-operatives whose only members were other co-operatives, thus legalising the Raiffeisen centrals.<sup>134</sup> Thirdly, the new law changed the rules for unlimited-liability co-operatives and, more famously, allowed co-operatives to form with either limited or unlimited liability.<sup>135</sup> Under the Act of 1889, disgruntled creditors could still sue individual members to recover the debts of the co-operative.<sup>136</sup> This Act was one of the foundational pieces of legislation that evolved into other countries and was used to establish the primary laws for co-operatives in those countries.<sup>137</sup> This discussion will be picked up later in thesis when I delve into regulatory and supervisory frameworks.

## 2.5 CONCLUSION AND OBSERVATIONS

I conducted a study of the origins of financial co-operatives to provide a robust understanding of financial co-operatives. This study was essential because it provided an understanding of the foundation of financial co-operatives and how different factors either encouraged their growth or ensured their failure. This chapter revealed that financial co-operatives had a rough start, leading to several failed experiments. For some, this was because their structure was by no means co-operative. For others, they collapsed because they developed into rich men's club and consequently lost popularity.<sup>138</sup>

Notwithstanding, financial co-operatives flourished in Germany because there was an enabling environment and the German citizens themselves were desperate for a solution to their socio-economic

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<sup>128</sup> Ibid.

<sup>129</sup> Guinnane op cit note 101 at 90.

<sup>130</sup> Ibid.

<sup>131</sup> T W Guinnane 'A "friend and advisor": external auditing and confidence in Germany's credit co-operatives, 1889–1914' (2003) 77 *Business History Review* 236–7.

<sup>132</sup> Ibid.

<sup>133</sup> Ibid.

<sup>134</sup> Ibid.

<sup>135</sup> Guinnane op cit note 107 at 394–6.

<sup>136</sup> Ibid.

<sup>137</sup> Cracogna op cit note 110 at 416–7.

<sup>138</sup> Bickerstaffe op cit note 13 at 82; Tucker op cit note 7 at 17.

challenges.<sup>139</sup> Some of the factors that enabled the growth of financial co-operatives were a large population and economic distress among its citizens. As a result, little self-help credit and savings associations comprising of financially handicapped individuals began to pop up, often around kitchen tables or church basements.<sup>140</sup> These credit and savings associations pooled together financial resources from their members and used the pooled resources to offer financial services to their members.<sup>141</sup>

The chapter showed that of these, it was mainly two predominant models of financial co-operatives that successfully developed to cater for the urban dwellers on the one hand, and the rural inhabitants on the other. These financial co-operatives had distinct characteristics that were tailor made for their environments. It was shown therefore that a one-size fits all approach to financial co-operatives was not successful. Thus, Raiffeisen co-operatives were different to People Banks not by preference or competition, but by necessity.<sup>142</sup>

Other observations that were made in this chapter were that financial co-operatives did not develop in a vacuum. Some accounts of their developments often portray them in a vacuum: as debates by and about co-operatives.<sup>143</sup> This perspective is at variance with the way the participants saw themselves and risks ignoring broader influences.<sup>144</sup> The ideas and questions facing the co-operative reform reflected events and debates relevant to financial distress.<sup>145</sup> An appreciation of this key helps to understand why they were continually evolving and did not remain stagnant. Financial co-operatives were changing in response to the problems that they were trying to solve.

Further, strongly embedded in the development of financial co-operatives was the principle of autonomy and self-help. Raiffeisen for example observed that small farm businesses could not be freed from the vicious cycle in which they were trapped by relying on help from outsiders.<sup>146</sup> External interference whether from government, political bodies, donations, or charities continually hindered the development of financial co-operatives.<sup>147</sup> In both the Peoples Bank and the Social Credit Bank, efforts were made to wean the associations of this dependency and later by the introduction of the law, to discourage police oversight.<sup>148</sup>

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<sup>139</sup> Tucker op cit note 7 at 18.

<sup>140</sup> P A Dunae *Common Bonds: A History of Greater Vancouver Community Credit Union* (2015) 63.

<sup>141</sup> *Ibid.*

<sup>142</sup> Allen & Maghimbi op cit note 23 at 2.

<sup>143</sup> Guinnane op cit note 107 at 394–6.

<sup>144</sup> Guinnane op cit note 107 at 379.

<sup>145</sup> *Ibid.*

<sup>146</sup> Goglio & Leonardi op cit note 54 at 17.

<sup>147</sup> *Ibid.*

<sup>148</sup> Tucker op cit note 7 at 65.

Moreover, pioneers were an essential requirement for advancement. Both movements had strong ambassadors at the forefront of development, inspiring a dedication to growth. Heated debates and exchanges are recorded as part of the evolution of these associations.<sup>149</sup> In addition, Germany's co-operatives and co-operative law began under a hostile legal structure. The law allowed political adversaries to harass financial co-operatives, and even where this was not the case, the private law failed to acknowledge the features of co-operatives that distinguished them from partnerships.<sup>150</sup> Schulze-Delitzsch's greatest contribution to German co-operation might be his appreciation of these challenges and his acknowledgement that the co-operatives required a specialised law.<sup>151</sup>

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<sup>149</sup> Prinz op cit note 120 at 15–16.

<sup>150</sup> Tucker op cit note 7 at 65.

<sup>151</sup> Guinnane op cit note 107 at 399.

## CHAPTER THREE

### MODERN FINANCIAL CO-OPERATIVES

#### 3.1 INTRODUCTION

Today, variations of the Peoples Banks and the Social Credit Banks can be found in most parts of the world, albeit with slight modifications to their structure, either to adapt to local law or local business needs.<sup>1</sup> These modifications have attracted assorted names to them such as co-operative banks, credit unions, village banks, savings and credit co-operatives (SACCOs), rotating savings and credit associations (ROSCAs), accumulating savings and credit associations (ASCAs), and many more.<sup>2</sup> Collectively, this thesis refers to them as financial co-operatives.<sup>3</sup>

Unfortunately, I found that the term financial co-operatives, or indeed the names referring to the individual financial co-operatives are often used interchangeably.<sup>4</sup> For example, credit unions will be referred to as SACCOs and *vice versa*; financial co-operatives may be used to only mean one type of financial co-operative to the exclusion of all others, and village banks may refer to co-operative banks and *vice versa*.<sup>5</sup> This has resulted in a web of confusion that has made it difficult to understand financial co-operatives.<sup>6</sup>

Researchers, practitioners, and policymakers have not put much effort into untangling this web.<sup>7</sup> On the contrary, there seems an apparent consensus among them to use these names interchangeably when referring to financial co-operatives.<sup>8</sup> Such an approach has been promoted because it is believed that all financial co-operatives, except for a few organisational structure differences, are identical and therefore need not be distinguished from each other.<sup>9</sup>

In contrast, some researchers have argued that not all financial co-operatives are the same; financial co-operatives differ in legal and regulatory statuses, institutional structures and governance, and scale and

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<sup>1</sup> C E Cuevas & K P Fischer *Co-operative Financial Institutions: Issues in Governance, Regulation, and Supervision* (2006) 1–2.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Ibid.*

<sup>4</sup> Amongst others Tucker in D Tucker *The Evolution of Peoples Banks* (1922) refers to Raiffeisen's and Schultze-Delitzsch's initiatives under various names that include credit co-operatives, loan associations etc. This terminology is also present in researchers that focus on the historical evolution of the movement like T Guinnane. In the World Bank's 'Microfinance Handbook', the term 'financial co-operative' encompasses all relevant co-operative initiatives as parts of a formal, semiformal or informal sector of the economy [J Ledgerwood *Sustainable Banking with the Poor. Microfinance Handbook. An Institutional and financial Perspective* (1998) 101–3].

<sup>5</sup> *Ibid.*; S Enarsson & K Wiren 'CGAP Working Group on Microinsurance Good and Bad Practices' MUSCCO, Case Study No 8, 2005 at 4, available at [https://www.ilo.org/wcmsp5/groups/public/---ed\\_emp/documents/publication/wcms\\_122463.pdf](https://www.ilo.org/wcmsp5/groups/public/---ed_emp/documents/publication/wcms_122463.pdf) accessed on 12 November 2020.

<sup>6</sup> Cuevas & Fischer op cit note 1 at 1–2.

<sup>7</sup> G Alexopoulos *Financial Co-operatives and Rural Development in Greece* (unpublished PhD Thesis, University of Leicester, 2004) 51.

<sup>8</sup> *Ibid.*

<sup>9</sup> Cuevas & Fischer op cit note 1 at 1.

services portfolio.<sup>10</sup> In addition, they seem to differ largely across regions, and particularly between developed countries and developing countries.<sup>11</sup> Consequently, they reason that financial co-operatives should be referred to with definite terms that are not interchangeable.<sup>12</sup> I concur with this approach. By illustration, the Peoples Bank and Social Credit Bank discussed above may have been similar in several ways; however, the slight modifications made by Raiffeisen sufficiently distinguished them to warrant the distinction.<sup>13</sup> It would have been incorrect to refer to these two financial co-operatives interchangeably.

To this end, I acknowledge that the institutions that comprise financial co-operatives today are extensive. However, for this chapter, only those that are most prominent around the world presently will be outlined. These include ROSCAs, co-operative banks, credit unions, SACCOs, village banks and or alternatively referred to as ASCAs in some cases.<sup>14</sup>

Overall, the main objective of this chapter is to present some of the most current research on these types of financial co-operatives to build, step by step, a nuanced understanding of them. By outlining the varied institutions that are captured within the umbrella term of financial co-operatives, and establishing their differences, if any, this chapter will provide a holistic understanding of modern financial co-operatives in a manner that is meaningful. As a by-product, such a study will reveal further lessons about factors that facilitate or inhibit the growth of financial co-operatives thereby contributing to the overarching objective of this thesis.

### **3.2 AN OVERVIEW OF FINANCIAL CO-OPERATIVES TODAY**

In a broader sense, financial co-operatives today are informal financial institutions, formal financial institutions, or semi-formal financial institutions. Informal financial institutions include all associations that provide financial services outside the sphere of formal financial sectors.<sup>15</sup>

Informal financial institutions are built on socially shared rules, typically unwritten, and operate primarily outside officially sanctioned routes where it is almost impossible to use any financial or monetary policy instruments to supervise or regulate their activities.<sup>16</sup> ROSCAs, which will be discussed in this thesis especially in reference to South Africa and Malawi, fall under this category and are perhaps the oldest of

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<sup>10</sup> Alexopoulos op cit note 7 at 51.

<sup>11</sup> Rabobank Group *Co-operatives and Rural Financial Development: Great Opportunities and Surmountable Difficulties* (2012) 43.

<sup>12</sup> Cuevas & Fischer op cit note 1 at 2.

<sup>13</sup> See page...above on the contrasts of both institutions.

<sup>14</sup> R Coelho et al 'Regulation and supervision of financial co-operatives' (2019) 15 *FSI Insights on Implementation* at 4, available at <https://www.bis.org/fsi/publ/insights15.htm> accessed on 10 July 2021.

<sup>15</sup> A Pedzinski & F Odoemenam 'The role of informal microfinance and co-operatives in poverty alleviation and economic development' in O Oluyombo (ed) *Co-operative Finance in Developing Countries* (2012) 43.

<sup>16</sup> R Tengeh & L Nkem Sustaining Immigrant Entrepreneurship in South Africa: The Role of Informal Financial Associations (2017) 9 *Sustainability* 4.

the financial co-operatives, predating even Peoples Banks and Social Credit Banks.<sup>17</sup> They could possibly be the oldest form because they are a type of financial structure that spontaneously arises based on human behaviour and the logic of co-operation as explained in section 1.1.<sup>18</sup> Unfortunately, the origins of ROSCAs are a controversial topic of scholarly debate that lies out of the ambit of this thesis.<sup>19</sup> The controversy lies at the point of their universality. That is, in different countries, they originated differently. In some countries, their origination coincided with the introduction of money. In other countries, their origins were rooted in the need for community. It is hard to say that they were introduced. It would be more accurate to say they were borne out of the needs of people.<sup>20</sup>

Formal financial institutions refer to financial intermediaries that are recognised by the government and, act under the monetary authorities' supervision or are at least connected with some public function.<sup>21</sup> Co-operative banks, credit unions and in some economies especially in Africa, SACCOs can be classified as formal financial institutions.<sup>22</sup> In Malawi, for example, SACCOs can be categorised as formal financial institutions. These institutions are the direct descendants of Peoples Banks and Social Credit Banks.<sup>23</sup> As Peoples Banks and Social Credit Banks spread after their inception, it became opportune – and soon necessary – to aggregate the banks for coordination and promotion.<sup>24</sup>

Accordingly, they underwent processes of systemisation, professionalisation and concentration where many of their practices became structures that guided their operation.<sup>25</sup> Especially in the 30 to 40 years after World War II, both banks experienced processes of having to reduce the number of local institutions to less than one half over time and of intensifying co-operation in their corresponding networks.<sup>26</sup> The objective was to form a common and uniform regulatory regime that would assist them consolidate and multiply; and also to govern the resources and requirements of individual co-operatives.<sup>27</sup>

Semi-informal financial institutions are organisations that are not subjected to governmental registration or supervision, although their rules of operation may be laid down by law.<sup>28</sup> All their financial transactions

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<sup>17</sup> S Ardener 'Credit unions and money clubs (ROSCAs)' (2014) 30 *Anthropology Today* 4.

<sup>18</sup> F Bouman 'Rosca: On the origin of the species' (1995) 19 *Savings and Development* 22.

<sup>19</sup> B Fairbairn 'History of co-operatives' in C Merrett & N Walzer (eds) *Co-operatives and Local Development* (2004) 10.

<sup>20</sup> Ibid.

<sup>21</sup> Pedzinski & Odoemenam op cit note 15 at 43.

<sup>22</sup> See evaluation of the regulatory frameworks of these organisations in Coelho et al op cit note 14 at 15.

<sup>23</sup> S Goglio & A Leonardi 'The Roots of Co-operative Credit from a Theoretical and Historical Perspective' (2012) *SSRN Electronic Journal* 18.

<sup>24</sup> Goglio & Leonardi op cit note 23 at 19.

<sup>25</sup> D Bülbül, R H Schmidt, U Schüwer Savings banks and co-operative banks in Europe (2013) SAFE White Paper No 5, Goethe University Frankfurt, SAFE – Sustainable Architecture for Finance in Europe, Frankfurt at 6.

<sup>26</sup> Ibid.

<sup>27</sup> Ibid.

<sup>28</sup> A Dejene *The informal and semi-formal financial sectors in Ethiopia: a study of the iqqub, iddir, and savings and credit co-operatives* (1993) Working Papers, African Economic Research Consortium, Research Department at 21.

are offered by institutions that are not regulated by banking authorities but that are supervised and licensed by other government agencies.<sup>29</sup> Semi-informal financial institutions are not a spontaneous result of local and/or traditional structures like informal financial institutions.<sup>30</sup> They rather have a “foreign” or external origin, mostly in the form of a non-governmental body that facilitates their initial establishment and growth. Still, they mostly embed themselves in the communities in which they are born, commonly in the form of self-help groups that are member owned.<sup>31</sup> An example of this type of financial co-operative is the village bank which in many instances has been introduced within communities by different types of non-governmental organisations. Semi-formal financial institutions in most cases have been formed to improve on the failures of both the formal and informal financial institutions.<sup>32</sup> These institutions will be discussed in turn below.

### 3.2.1 ROTATING SAVINGS AND CREDIT ASSOCIATIONS

ROSCAs, in their most basic form, are best defined by way of illustration. Thus, if a group of ten people with common economic or social goals agreed to pool \$1 000 for a cycle of 10 months, each member, in such a setting, would equally have to contribute \$100 to the pool.<sup>33</sup> Once the total amounted to \$1 000, the contributed amount would be given as credit to one member who is nominated by a predetermined criterion.<sup>34</sup>

The recipient of the credit is excluded from receiving credit in future meetings, while still being obliged to repay the money to the pool in instalments (\$100 in this case) through the entire cycle.<sup>35</sup> This continues until all members have received the money in the pool, in whole, or in part, at some point during the cycle.<sup>36</sup> Accordingly, the members save until they receive credit, after which the receiver starts to repay the loan in instalments. In this way, not only does the receiving of the pool rotate, but the savings positions rotate too, thereby justifying the term ROSCA.<sup>37</sup> A cycle of a ROSCA is completed when all members receive their payments; after which the ROSCA is either disassembled or a new cycle begins.<sup>38</sup>

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<sup>29</sup> Ibid.

<sup>30</sup> C Chipeta & M Mkandawire ‘The informal financial sector in Malawi’ (1992) 2 *African Review of Money Finance and Banking* 124–6.

<sup>31</sup> Ibid.

<sup>32</sup> M Beck *Impact of Accumulating Savings and Credit Associations on Child Well-Being Evidence from World Vision Groups in Mozambique* (unpublished master’s thesis, Marburg, 2012) 16.

<sup>33</sup> R van den Brink & R J Chavas ‘The microeconomics of an indigenous African institution: The rotating savings and credit association’ (1997) 45 *Economic Development and Cultural Change* 747. Note that the dollar is the preferred currency in this example. Neither the ZAR nor the Malawi Kwacha was used as the thesis addresses both countries. I Resolved to picking the dollar as a commonly used currency.

<sup>34</sup> Ibid.

<sup>35</sup> Ibid.

<sup>36</sup> J Owusu et al ‘An assessment of the operations of rotational savings and credit association in the Kumasi Metropolis, Ghana’ (2013) 3 *International Journal of Business and Social Research* 152.

<sup>37</sup> Ibid.

<sup>38</sup> R Mbizi & E Gwangwava ‘Rotating savings and credit associations: an alternative funding for sustainable micro enterprise – case of Chinhoyi, Zimbabwe’ (2013) 15 *Journal of Sustainable Development in Africa* 158.

Thus, in defined terms, a ROSCA is a type of informal financial co-operative in which a group of individuals enter into an agreement to rotate credit to each other, whose money is issued from a common pool that each individual contributes to on a weekly or monthly basis or as frequently as the individuals may decide upon.<sup>39</sup>

ROSCAs are estimated to have started as early as 200BC or much earlier among subgroups experiencing economic and social hardships.<sup>40</sup> However, today, ROSCAs seem to have captured all strata of society; the rich, the poor; farmers, traders, teachers and even bank employees.<sup>41</sup>

ROSCAs are particularly prolific in Africa, where they have remarkably high membership rates (between 50 per cent and 95 per cent of the adult population in many countries).<sup>42</sup> Their annual sums are estimated to be more than 25 per cent of the national credit in Africa and South and East Asia.<sup>43</sup> Nonetheless, while predominantly found in developing economies, ROSCAs are also persistent in economies that have developed formal financial services. This suggests that there is still a place for them alongside formal financial services.<sup>44</sup> A study in Indonesia for example showed that even among households with steady access to financial services provided by formal banks, roughly 40 per cent still participate in ROSCAs.<sup>45</sup>

### **3.2.1.1 The functionality of ROSCAs**

While not all ROSCAs share the exact functionality, the differences are very much variations on discernible characteristics present in all forms of ROSCAs. These characteristics are discussed below.

#### **(a) Structure and governance**

ROSCAs do not rely on legal and state governance except when registered, for example, as a company, closed corporation, or friendly society.<sup>46</sup> ROSCAs are self-governing institutions; members formulate their own informal rules or constitutions that are flexible and simple, and often unwritten.<sup>47</sup> Adherence to such

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<sup>39</sup> F Bouman 'Rotating savings and credit organised world' (1995) 23 *A Development Perspective World Development* 182.

<sup>40</sup> A Mushuku & J Mayisa 'Unlocking the door from poverty through rotating savings and credit associations: A study of group based savings in Ward 14 of Gutu District, Zimbabwe' (2014) 11 *Bangladesh e-Journal of Sociology* 119.

<sup>41</sup> Bouman op cit note 39 at 183.

<sup>42</sup> Mushuku & Mayisa op cit note 40 at 119.

<sup>43</sup> Ibid.

<sup>44</sup> Ardener op cit note 17 at 4-5.

<sup>45</sup> Bouman op cit note 18 at 120; Mushuku & Mayisa op cit note 40 at 119.

<sup>46</sup> WG Schulze 'The origin and legal nature of the Stokvel (Part 1)' (1997) 9 *South African Mercantile Law Journal* 22.

<sup>47</sup> P Mashigo & C Schoeman 'Stokvels as an instrument and channel to extend credit to poor households in South Africa' (2012) 5 *Journal of Economic and Financial Sciences* 55.

rules effectively reduces uncertainty and implies member control and mutual monitoring of the activities.<sup>48</sup>

In terms of their structure, ROSCAs have officials elected by members to take care of records, bank the funds generated, and perform other administrative functions.<sup>49</sup> They choose the persons in charge and determine the modes of benefits for themselves according to their suitability.<sup>50</sup> All officials work voluntarily.<sup>51</sup>

The simplicity of this structure is one of the reasons that ROSCAs are preferred to formal financial institutions; members easily understand their organisation.<sup>52</sup> In contrast, formal financial institutions are perceived as complex, often implementing methods whose mechanisms escape them.<sup>53</sup>

Nonetheless, there are still disadvantages to this simplicity such as a risk of mismanagement fraud or bankruptcy by officials.<sup>54</sup> Further, since there is no legal paperwork that governs ROSCAs, default by members cannot result in legal action against such members.<sup>55</sup>

#### **(b) Membership – Geographical area and common bond**

Membership in ROSCAs is voluntary.<sup>56</sup> The number of members may vary but it is a requirement that all members must share a common bond based on ethnic background, employment, friendships, biological relationships, or residence.<sup>57</sup> This makes ROSCAs highly accessible financial co-operatives because every family compound, hamlet, village, and farm can form its own association, extending saving and credit services straight down to the most simple level.<sup>58</sup> In contrast, formal financial institutions, are geographically isolated, often requiring individuals to visit a branch that is, in most cases, not near the

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<sup>48</sup> Ibid.

<sup>49</sup> E Thomas 'Rotating credit associations in Cape Town' in E Preston-Whyte & C Rogerson (eds) *South Africa's Informal Economy* (1991) 295.

<sup>50</sup> Schulze op cit note 46 at 22.

<sup>51</sup> Van Den Brink & Chavas op cit note 33 at 747.

<sup>52</sup> L Tchuindjo 'The evolution of an informal financial institution: The rotating savings and credit association in Cameroon' (1999) *African Review of Money Finance and Banking* 14.

<sup>53</sup> Ibid.

<sup>54</sup> Mushuku & Mayisa op cit note 40 at 125.

<sup>55</sup> Ibid.

<sup>56</sup> A K Lukhele 'Stokvels Milestone, 1988-1998.' NASASA document. Johannesburg at 47.

<sup>57</sup> G Verhoef 'Informal financial service institutions for survival: African women and stokvels in urban South Africa, 1930–1988' (2001) 2 *Enterprise & Society* 263.

<sup>58</sup> F J A Bouman 'Indigenous savings and credit societies in the third world. A message (1977) 1 *Savings and Development* 183.

people.<sup>59</sup> In Malawi for example, access to formal financial institutions may require people to walk a distance that can be an equivalent to a half day's work.<sup>60</sup>

Although membership often appears open and to cut across age, status and occupation, peer selection is characteristic of ROSCAs.<sup>61</sup> Individuals wishing to join ROSCAs are selected by the leader or, in some ROSCAs, at the recommendation of an existing member.<sup>62</sup> New members must first demonstrate their credit worthiness and good moral to the community.<sup>63</sup>

### (c) Services

There are several services offered by ROSCAs. These include:

- **Loans:** The fund that members contribute to, is used to extend loans to members. Loans are granted much faster and easier because ROSCAs do not need to assess borrowers' credit history, current income, and available collateral to arrive at credit decisions.<sup>64</sup> ROSCA members are individually familiar with each other and are usually a part of the same community.<sup>65</sup> Accordingly, members' current, and previous economic status, as well as commitments to meet financial obligations, is information that is easily attained. This makes ROSCA loans more affordable since costs associated with bank lending are avoided.<sup>66</sup>
- **Savings:** Members save until they receive the loan, after which they can then begin to repay the loan.<sup>67</sup> The lifetime of a ROSCA and, concurrently, the duration of a savings or loan period, is contingent on the length of intervals and the number of players.<sup>68</sup>
- **Insurance:** In many developing economies, formal insurance markets are virtually non-existent.<sup>69</sup> ROSCAs provide insurance to their members by providing an additional instrument for members to share shocks among themselves.<sup>70</sup> They insure members against the effects of accidents, illness, or death.<sup>71</sup>

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<sup>59</sup> Ibid.

<sup>60</sup> A Borda-Rodriguez 'Case Study 3: The Malawian Union of Savings and Credit Co-Operatives (MUSCCO)' (2013) at 5–6, available at <http://www.open.edu/openlearnworks/course/view.php?id=1598> accessed on 18 May 2021.

<sup>61</sup> Mashigo & Schoeman op cit note 47 at 57.

<sup>62</sup> Ibid.

<sup>63</sup> Bouman op cit note 39 at 123.

<sup>64</sup> Ibid.

<sup>65</sup> Mushuku & Mayisa op cit note 40 at 122.

<sup>66</sup> A Bisrat *Are there Financial Benefits to Join RoSCAs? Empirical evidence from Equb in Ethiopia Agegnehu Bisrata, Karantininis Kostasab* International Conference on Applied Economics (ICOAE) (2012) Li Fenga Department of Economics, SLU, Sweden bFØI, LIFE, KU, Denmark at 230.

<sup>67</sup> Bouman op cit note 58 at 185.

<sup>68</sup> Ibid.

<sup>69</sup> Mushuku & Mayisa op cit note 40 at 123.

<sup>70</sup> Ibid.

<sup>71</sup> Tchuindjo op cit note 52 at 13.

- **Social networking and information exchange:** Many ROSCA meetings include ritualistic practices and social customs.<sup>72</sup> ROSCAs offer members opportunities to support each other in their financial and social activities and to congratulate each other on the achievement of financial goals.<sup>73</sup> It is not uncommon for participants to discuss what they want to do with their money and other participants to offer financial guidance.<sup>74</sup>

In essence, ROSCAs offer most of the services provided by formal financial institutions.<sup>75</sup>

Notwithstanding, in addition to some disadvantages highlighted above, more disadvantages include a fixed monthly contribution which may be a hinderance for people without any consistent income; largely unresponsive and inflexible to emergency needs because all the money that is pooled together is also loaned out to the members in rotation; ROSCAs make extremely poor long-term savings instruments because ROSCAs with lengthier cycles are unlikely to complete cycles; and credit advances are short term.<sup>76</sup> Furthermore, their success is highly dependent on the participation of the members.<sup>77</sup> Therefore, if people cannot depend on each other and regularly default, ROSCAs tend to be unsuccessful.<sup>78</sup> Regardless, ROSCAs are still preferred because primarily many individuals prefer simple banks governed by their peers.<sup>79</sup>

### 3.2.2 CO-OPERATIVE BANKS

Co-operative banks are formal financial institutions that are predominantly found in Europe.<sup>80</sup> They can be defined as licensed and supervised banks created and run as co-operative enterprises.<sup>81</sup> Co-operative banks are a direct descendant of Schulze-Delitzsch's Peoples Banks discussed in Chapter 2.<sup>82</sup> However, due to adaptations and systemisations that have occurred over the last decades, co-operative banks, especially in Europe, have only retained the skeleton structure and values of their predecessor.<sup>83</sup> In many ways, they have evolved and their function has changed. Notably though, co-operative banks have been successful in Europe but struggle to develop substantially in many parts of the world.<sup>84</sup>

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<sup>72</sup> S Arderner & S Boutran *Money go Rounds. The Importance of Rotating Savings and Savings Credit Associations for Women* (1995) 231.

<sup>73</sup> M Aliber 'Rotating savings and credit associations and the pursuit of self-discipline: A case study in South Africa' (2001) *African Review of Money Finance and Banking* 60–61.

<sup>74</sup> Ibid.

<sup>75</sup> Mushuku & Mayisa op cit note 40 at 122.

<sup>76</sup> D Kurtz 'The rotating credit association: An adaptation to poverty' (1973) 32 *Human Organization* 49–58.

<sup>77</sup> Beck op cit note 32 at 16.

<sup>78</sup> Mushuku & Mayisa op cit note 40 at 124.

<sup>79</sup> Ibid.

<sup>80</sup> F Poli *Co-operative Banking Networks in Europe* (2019) 10.

<sup>81</sup> Ibid.

<sup>82</sup> Bülbül et al op cit note 25 at 5.

<sup>83</sup> Ibid.

<sup>84</sup> Ibid.

### 3.2.2.1 Membership

#### (a) Ownership and clientele

Co-operative banks require membership entry fees.<sup>85</sup> This principle has been retained from Peoples Banks. However, co-operative banks today have deviated from Peoples Banks in that their customer base is not exclusive to their members.<sup>86</sup> This deviation is due to economic and stability benefits.<sup>87</sup> The provision of co-operative services to a larger population of users, other than members increases the economic sustainability of the banks (via higher exploitation of economies of scale), favours the diversification of risks borne, and encourages non-members to the banks.<sup>88</sup> Notwithstanding, the disadvantage of this has been an erosion of the primary focus of co-operative banks on their members.<sup>89</sup>

#### (b) Geographical area

In 1972, Peoples Banks and Social Credit Banks in Europe merged to operate on one primary local level.<sup>90</sup> The result was local co-operative banks that operated within broad geographical areas and served both urban and rural dwellers.<sup>91</sup> As a result, co-operative banks established a relatively high number of branches and employees, requiring a high level of expertise in administration.<sup>92</sup> By 2013, it was recorded that there were 3 874 co-operative banks in Europe with 181 million customers.<sup>93</sup>

### 3.2.2.2 Structure and services

Co-operative banks may consist of small local co-operative banks focused on the retail market; possibly regional banks or associations that fulfil certain oversight functions and provide more specialised services; and a central 'apex' organisation that coordinates across regions and is typically engaged in international business.<sup>94</sup> Apex bodies for the banks were created to ensure that co-operative banks were able to service their customers and also have the necessary administrative and technical support.<sup>95</sup> Apex regional and national co-operative organisations play an important role in offering advice and managerial

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<sup>85</sup> F Lang et al 'The role of co-operative banks and smaller institutions for the financing of SMEs and small midcaps in Europe' (2016) EIF Working Paper, No 2016/36, European Investment Fund (EIF), Luxembourg at 11, available at [http://www.eif.org/news\\_centre/publications/EIF\\_Working\\_Paper\\_2016\\_36.htm](http://www.eif.org/news_centre/publications/EIF_Working_Paper_2016_36.htm) accessed on 11 May 2021.

<sup>86</sup> Poli op cit note 80 at 12.

<sup>87</sup> Poli op cit note 80 at 13.

<sup>88</sup> Ibid.

<sup>89</sup> W Fonteyne & D Hardy 'Co-operative Banking and Ethics: Past, Present and Future' (2011) 18 *Ethical Perspectives* 510.

<sup>90</sup> Bülbül et al op cit note 25 at 6.

<sup>91</sup> Ibid.

<sup>92</sup> R Mitra 'Co-operatives: A democratic instrument of human empowerment' (2014) 42 *Social Scientist* 53.

<sup>93</sup> Ibid.

<sup>94</sup> Fonteyne & Hardy op cit note 89 at 494.

<sup>95</sup> Ibid.

training to co-operative banks on how to prevent and/or manage the risks to the autonomy and independence of member co-operative banks.<sup>96</sup>

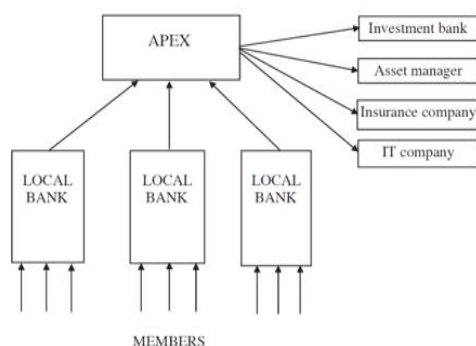


Figure 1 Structure of Modern-Day Co-operative Bank (2007)<sup>97</sup>

As the figure above shows, several apexes today act as delegated providers of a varied range of services. They provide individual co-operatives with affordable access to various specialised functions (such as training, auditing, advertising). They also provide more sophisticated financial services and products (for example, risk management, liquidity management) which aim to strengthen the competitiveness of co-operative banks to compete with investment-based companies while simultaneously protecting their independence and survival.<sup>98</sup> In some cases, apex organisations consist of or control limited-liability companies, which may be listed on a stock exchange.<sup>99</sup> This enables co-operative banks to not only provide banking services such as savings, but also to participate in the wholesale markets for bonds, money, equities, and trade on public stock markets.<sup>100</sup>

However, growth can be dangerous for the autonomy of financial co-operatives. It encourages an excessive reliance on financing from external investors.<sup>101</sup> Accordingly, co-operatives, for example, seek to raise capital from financial markets and other financial institutions, or because of the burden of financial covenants and compliance obligations, gradually grant more control to investors, they potentially weaken their autonomy.<sup>102</sup>

<sup>96</sup> Poli op cit note 80 at 19.

<sup>97</sup> Fonteyne & Hardy op cit note 89 at 495.

<sup>98</sup> N Yamori et al 'Corporate governance structure and efficiencies of co-operative banks' (2017) 22 *International Journal of Finance and Economics* 370.

<sup>99</sup> Ibid.

<sup>100</sup> J Marqués & R Martín 'Co-operative and savings banks in Europe: Nature, challenges and perspectives' (2011) 6 *SSRN Electronic Journal* 127; Fonteyne & Hardy op cit note 89 at 507.

<sup>101</sup> Ibid.

<sup>102</sup> M Migliorelli *New Co-operative Banking in Europe. Strategies to Adapt the Business Model Post-Crisis* (2018) 6.

In addition, in such a structure, co-operative banks are dominated from the top.<sup>103</sup> Although local branches of co-operative banks manage their own operations and appoint their own boards of directors, the highly strategic decisions entail endorsement from a central office.<sup>104</sup> This means that they operate much like commercial banks, thus undermining the dominant self-help principle of co-operatives.<sup>105</sup>

Regardless, the co-operation between co-operatives through the formation of apex bodies is a tactical mechanism that has allowed the self-preservation of the financial co-operatives, strengthening the central idea that has guided the founding of co-operatives: making the weak, strong.<sup>106</sup> In this case, the apex organisations have had the task of ensuring member co-operatives safe and strengthening their capability to serve their communities.<sup>107</sup>

### 3.2.2.3 Governance

Through regulatory restrictions, national legislation has played a critical role in ensuring co-operative banks they do not differ significantly from their foundational elements.<sup>108</sup> Thus, the principle of democratic participation of members still applies today; one vote per person.<sup>109</sup> Regardless of the condition of the members – employees or customers – they have the same voice in the administration of the banks and participate in the surplus.<sup>110</sup> This has been valuable in ensuring that members continue to control the banks and preserve their autonomy.

However, democratic participation has proven to be detrimental when members lack the skills necessary to keep banks healthy.<sup>111</sup> In many cases, the failure of co-operative banks has been attributed to the lack of managerial and supervisory skills of elected members, who have proven incapable of safely managing such social organisations over time and due to changes in the economic environment.<sup>112</sup>

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<sup>103</sup> Fonteyne & Hardy op cit note 89 at 494.

<sup>104</sup> Migliorelli op cit note 102 at 6.

<sup>105</sup> Ibid.

<sup>106</sup> Ibid; Poli op cit note 80 at 19.

<sup>107</sup> Fonteyne & Hardy op cit note 89 at 494; V Boscia *Co-operative Banking: Innovations and Developments* (2009) 139.

Such a structure of co-operative banks, with variations, can be seen in the large co-operatives' groups, the German Volksbanken and Raiffeisenbanken (with DZ Bank as their apex organisation, except in Rheinland and Westfalen where a separate apex bank – WGZ Bank – is active), the Rabobank Group in the Netherlands, and the separate Volksbanken and Raiffeisenbanken groups in Austria, to name just a few examples.

<sup>108</sup> Poli op cit note 80 at 18.

<sup>109</sup> Fonteyne & Hardy op cit note 89 at 494.

<sup>110</sup> Ibid.

<sup>111</sup> Poli op cit note 80 at 18.

<sup>112</sup> Ibid.

The alternative is to appoint directors outside of co-operative banks with the right skills and knowledge to run businesses in the modern economy.<sup>113</sup> However, this leads to management incentives that are not aligned with co-operative values and ultimately leads banks to a process of demutualisation.<sup>114</sup> Reconciling the contradictory needs that arise from these phenomena is not always easy and is one of the most important tasks of the co-operative banks.<sup>115</sup>

#### **3.2.2.4 Limited liability**

Nowadays, most co-operative banks are recognised as limited-liability institutions whose members are not liable for more than the amount they have subscribed for.<sup>116</sup> This approach was adopted by Luzzati in 1886 when he started the Peoples Bank in Italy.<sup>117</sup> Despite the suitability of unlimited liability as a mechanism for self-responsibility and participation in the early days, its value was primarily challenged by the competence of members to exercise effective hands-on supervision of the co-operatives' operations over a broad sphere of people.<sup>118</sup> Besides, unlimited responsibility of members reduced the attractiveness of participating in co-operative banks because of the increased risk of seeing invested wealth being undermined by the co-operative banks' losses.<sup>119</sup>

#### **3.2.2.5 Capital, profits and reserve funds**

Usually, in addition to membership contributions and the deposits of customers, an almost exclusive source of capital for co-operative banks is retained profits, a characteristic preserved from the Social Credit Banks.<sup>120</sup> A significant proportion of profits are allocated as reserves.<sup>121</sup> The reserve is essential not only for capital regulatory reasons, but also because dependence on external financing can increase the risk appetite of the banks and compromise the banks' independence through financial and compliance covenants imposed on them by non-member lenders or financiers.<sup>122</sup> For these reasons, the collection of membership fees and the predominant retention of profits are essential safeguards for the autonomy of co-operative banks.<sup>123</sup>

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<sup>113</sup> Ibid.

<sup>114</sup> Migliorelli op cit note 102 at 6.

<sup>115</sup> Ibid.

<sup>116</sup> Alexopoulos op cit note 7 at 55.

<sup>117</sup> Ibid.

<sup>118</sup> F R Chaddad & M L Cook 'Understanding new co-operative models: An ownership-control rights typology' (2004) 26 *Applied Economic Perspectives and Policies* 349; Poli op cit note 80 at 15.

<sup>119</sup> Ibid.

<sup>120</sup> F Lang et al 'The role of co-operative banks and smaller institutions for the financing of SMEs and small midcaps in Europe' (2016) EIF Working Paper, No 2016/36, European Investment Fund (EIF), Luxembourg at 3, available at [http://www.eif.org/news\\_centre/publications/EIF\\_Working\\_Paper\\_2016\\_36.htm](http://www.eif.org/news_centre/publications/EIF_Working_Paper_2016_36.htm) accessed on 11 May 2021.

<sup>121</sup> Ibid.

<sup>122</sup> E Clark et al 'Co-operative banks: What do we know about competition and risk preferences?' (2018) 52 *Journal of International Financial Markets, Institutions and Money* 99.

<sup>123</sup> Poli op cit note 80 at 14.

### 3.2.3 CREDIT UNIONS / SACCOS

Credit unions are an extension of Social Credit Banks and another example of formal financial institutions.<sup>124</sup> After Social Credit Banks initially spread in Germany, the bank expanded into Canada. In Canada, they were known as credit unions and it is Alphonse Desjardins who organised the first Canadian credit union in 1901, bringing the financial co-operative experience to North America.<sup>125</sup> Desjardins' motivation was a unique combination of Catholic aversion to usury and the Quebec political and religious philosophy.<sup>126</sup>

From Canada, the credit union ideal entered the USA, with Desjardins helping to organise a credit union in Manchester, New Hampshire.<sup>127</sup> By the end of 2018, the World Council of Credit Unions (WOCCU) estimated that 85 400 credit unions were operating in 113 countries. They had total assets of \$2.19 trillion and a membership of 274.2 million representing 9.38 per cent of the global population.<sup>128</sup> However, there is a large variety within the credit union movement across these countries, reflecting the various historic, economic, and cultural contexts within which credit unions' function.<sup>129</sup>

On the one hand, there are credit unions with only a handful of members, offering basic savings and loans products.<sup>130</sup> On the other hand, there are credit unions that are full-service financial providers, working with paid employees, having thousands of members, and managing billions of dollars in assets.<sup>131</sup> What unifies or distinguishes credit unions today are their features. These features are discussed next.

#### 3.2.3.1 Membership

When credit unions spread to Canada and the USA, they offered services among rural farmers who were facing difficulties in obtaining financing during the Great Depression of the 1930s.<sup>132</sup> Gradually, however, they began to serve small businesses and other sections of society that were also experiencing hardships.<sup>133</sup> Today, credit unions serve both rural and urban areas.

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<sup>124</sup> D G McKillop & J Wilson 'Credit Unions as Co-operative Institutions: Distinctiveness, Performance and Prospects' (2015) 35 *Social and Environmental Accountability Journal* 97.

<sup>125</sup> *Ibid.*

<sup>126</sup> McKillop & Wilson *op cit* note 124 at 83.

<sup>127</sup> *Ibid.*

<sup>128</sup> WOCCU World Council of Credit Unions Annual Statistical Report (2020) available at [https://www.woccu.org/our\\_network/statreport](https://www.woccu.org/our_network/statreport) accessed on 25 August 2021.

<sup>129</sup> McKillop & Wilson *op cit* note 124 at 80.

<sup>130</sup> *Ibid.*

<sup>131</sup> *Ibid.*

<sup>132</sup> F Mavenga & R M Olfert 'The role of credit unions in rural communities in Canada' (2012) 40 *Journal of Rural Cooperation* 6.

<sup>133</sup> B Fairbairn et al *Credit Unions and Community Economic Development* (Center for the Study of Co-operatives: University of Saskatchewan, 1997).

However, credit unions tend to be relatively small when compared to co-operative banks because unlike co-operative banks; their members are identical to their customers.<sup>134</sup> Credit unions do not do business with the public because they limit membership by common bonds.<sup>135</sup> Common bonds are effectively the social glue that binds credit union members together.<sup>136</sup> It can include being a member of the same trade union, industry, community or club, religious or ethnic background, or being a resident of a defined geographic area.<sup>137</sup>

A common bond guarantees a certain level of similarity among members and restricts the size of the credit union to a manageable size, thereby increasing the likelihood of members knowing each other.<sup>138</sup> This, in turn, alleviates information deficiencies characteristic of financial transactions and enables credit unions to offer banking and credit facilities to financially excluded members that conventional financial institutions would consider too risky.<sup>139</sup> The common bond also reduces the cost of loan collection and credit investigation.<sup>140</sup> A negative consequence of the common bond, however, is that credit unions cannot raise secondary capital. Secondary capital is capital that is not given by their members in the form of deposits and capital obtained from interest payments on loans.<sup>141</sup>

### 3.2.3.2 Ownership and governance

To become a member of a credit union, a member must own one share in the credit union.<sup>142</sup> Members' shares or share accounts are savings accounts that signify ownership in the credit union.<sup>143</sup> In terms of governance, credit unions operate under national law and are therefore subject to government supervision and regulation.<sup>144</sup> In addition, they are member owned and member governed with each member having one vote.<sup>145</sup> The board of directors is drawn from the membership for the governance of the credit union and functions on a voluntary basis.<sup>146</sup>

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<sup>134</sup> H Black & R Dugger 'Credit union structure, growth and regulatory problems' (1981) 36 *The Journal of Finance* 529.

<sup>135</sup> Ibid.

<sup>136</sup> D G McKillop & J Wilson 'Credit unions: A theoretical and empirical overview' (2011) 20 *Financial Markets, Institutions, and Instruments* 102.

<sup>137</sup> Mavenga & Olfert op cit note 132 at 4.

<sup>138</sup> McKillop & Wilson op cit note 124 at 97.

<sup>139</sup> Ibid.

<sup>140</sup> D J Smith 'A Theoretic framework for the analysis of credit union decision making' (1984) 39 *The Journal of Finance* 1155.

<sup>141</sup> L Mook et al 'Credit unions: Market niche or market accommodation' (2015) 44 *Nonprofit & Voluntary Sector Q* 814 at 827.

<sup>142</sup> AICPA *Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies: Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies* (2017) 36.

<sup>143</sup> Ibid.

<sup>144</sup> AICPA op cit note 142 at 38.

<sup>145</sup> D McKillop, A M Ward & J Wilson 'The development of credit unions and their role in tackling financial exclusion' (2007) 27 *Public Money & Management* 37–44.

<sup>146</sup> D J Smith et al 'Credit unions: An economic theory of a credit union' (1981) 34 *Journal of Finance* 557.

Notwithstanding, effective credit union governance, depends largely on the willingness of members to exercise their rights of ownership by communicating their views to the board of directors and by holding the board accountable for the advancement of credit unions.<sup>147</sup> Presently, there is indication that this is a challenge for some credit unions that have evolved into expertly managed multi-product financial organisations.<sup>148</sup>

### 3.2.3.3 Capital, profits and reserve funds

Credit unions do not issue capital stock.<sup>149</sup> Largely, they start with minimal capital and generate capital over a period of time by maintaining some of their net income; therefore, the founding members or organisations usually begin by providing start-up amenities in the form of office space and equipment.<sup>150</sup> However, once credit unions are established, funds from members' savings are the capital utilised to make investments and loans to members.<sup>151</sup> Predominantly, credit union assets consist of member loans make.<sup>152</sup>

Credit unions are not created for profit.<sup>153</sup> Any net income is therefore distributed to members in the form of lower loan interest rates, higher savings rates, better quality of service, or contributions to reserves.<sup>154</sup> As non-profit organisations, credit unions are not required to meet shareholder earnings expectations and diverse customer needs.<sup>155</sup> As a result, credit unions are not likely to engage in risky investments and risky lending practices to maximise short-term returns.<sup>156</sup>

However, although credit unions are constituted as non-profit institutions, they are still obliged to behave as profit maximisers when subjected to extreme competition from other financial institutions.<sup>157</sup> Especially as they grow, credit unions are increasingly faced with the struggle to retain a balance between economic realities, on the one hand, and social and philosophical goals on the other.<sup>158</sup>

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<sup>147</sup> Smith op cit note 140 at 1155.

<sup>148</sup> McKillop & Wilson op cit note 124 at 103.

<sup>149</sup> Ibid.

<sup>150</sup> Ibid.

<sup>151</sup> R A Taylor 'The credit union as a co-operative institution' (1971) 29 *Review of Social Economy* 111-112.

<sup>152</sup> AICPA op cit note 142 at 36.

<sup>153</sup> McKillop & Wilson op cit note 124 at 102.

<sup>154</sup> C M Gambs 'Discussion [on Smith et al (1981); Black and Dugger (1981); and Navratil (1981)]' (1981) *Journal of Finance* 36, 553.

<sup>155</sup> McKillop & Wilson op cit note 124 at 97.

<sup>156</sup> Ibid.

<sup>157</sup> M J Flannery 'Discussion [on Smith et al op cit note 146; Black & Dugger op cit note 134 and Navratil (1981)]' (1981) 36 *Journal of Finance* 555-556.

<sup>158</sup> McKillop & Wilson op cit note 124 at 97.

Indeed, in some parts of the world, credit unions have succumbed to the pressure. Worthington notes, for example, that in Australia prudential regulation aimed at ensuring a level playing field for financial institutions has forced credit unions to maximise profits.<sup>159</sup>

### 3.2.3.4 Structure and services

Credit unions' structure and services offered are determined by which phase of growth they are in.<sup>160</sup> According to Ferguson and McKillop, credit unions can be divided into three different growth phases consisting of nascent (formative), transition and mature.<sup>161</sup> Credit unions that are within each of these growth phases can be characterised by different financial and organisational attributes.<sup>162</sup>

- **Nascent credit unions:** In the formative stages, the structure of credit unions is very similar to Social Credit Banks. Generally, they are mostly wholly run by volunteers and receive financial aid and other forms of help from the wealthy, local government agencies and charitable organisations.<sup>163</sup> They tend to be missionary in nature, with zealous leadership.<sup>164</sup> Furthermore, they have a tight common bond, a small assets size, high levels of structural and conduct regulation, and offer standard savings and loans products.<sup>165</sup> Currently, nascent credit unions can be found mainly in developing Asia, Africa, and the former Soviet bloc countries.<sup>166</sup> In Africa especially, they are famously referred to as SACCOs.<sup>167</sup> They are a large network with 39,447 SACCOs and 35,783,426 members recorded in Africa alone by 2018.<sup>168</sup> SACCOs will be discussed in more detail in Chapters 4 and 5, in reference to both South Africa and Malawi.
- **Transition credit unions:** When credit unions are in the transition phase, efficiency gains which can be realised through the use of economies of scale can be forgone to conserve the original objective of smallness.<sup>169</sup> Nevertheless, credit unions begin to provide a broader range of products and have larger asset sizes and evolving regulatory and supervisory structures.<sup>170</sup> Many employ paid employees, either as full time or part-time employees, although volunteer directors are

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<sup>159</sup> A C Worthington 'Determinants of merger and acquisition activity in Australian co-operative deposit-taking institutions' (2004) 57 *Journal of Business Research* 55.

<sup>160</sup> C Ferguson & D G Mckillop 'Classifying credit union development in terms of mature, transition and nascent industry types' (2000) 20 *The Service Industries Journal* 103–4.

<sup>161</sup> Ibid.

<sup>162</sup> Ibid.

<sup>163</sup> J Goddard et al 'Scale and life cycle effects on credit union growth: an empirical investigation' (undated) at 7 available at <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.196.872&rep=rep1&type=pdf> accessed on 10 May 2021.

<sup>164</sup> Ibid.

<sup>165</sup> Ibid.

<sup>166</sup> McKillop & Wilson op cit note 124 at 85.

<sup>167</sup> S Vicari 'A report on the credit union movement in Malawi' (2014) *The Co-Operative College* 1 available at <http://coop-web-assets.s3-eu-west-1.amazonaws.com/uploads/2013/12/SARA-VICARI-REPORT-5-11-13.pdf> accessed on 10 January 2021.

<sup>168</sup> WOCCU op cit note 128.

<sup>169</sup> Goddard et al op cit note 163 at 7.

<sup>170</sup> Ferguson & Mckillop op cit note 124 at 111.

retained.<sup>171</sup> The restrictions of the common bond are lessened resulting in membership becoming more diversified. Much emphasis is placed on growth and efficiency.<sup>172</sup>

- **Mature credit unions:** As credit unions develop and expand their product offering, the common bond can act as a constraint on operational efficiency gains.<sup>173</sup> Consequently, in mature movements, such as those in the United States, Australia and Canada, the definition of what the common bond entails has evolved to a more permissive interpretation of the activities and membership scope.<sup>174</sup> The legal environment under which credit unions operate has been significantly relaxed to encourage competition with other financial institutions.<sup>175</sup>

Post-maturity, there is a tendency for credit union distinctiveness to be sacrificed and for them to function in a similar way to market-driven financial competitors.<sup>176</sup> Such an important transformation requires a huge shift in governing values.<sup>177</sup> The seeds of such a transformation exist in the United States credit union sector.<sup>178</sup>

The fact that credit unions are at different levels of growth complicates any overview of credit unions because issues pertaining to mature credit unions may not have any bearing on credit unions in the nascent stages.<sup>179</sup> As has been observed, credit unions in these varying stages differ significantly. However, what is of importance is that the focus of credit unions at whatever stage is the same: credit unions are co-operative enterprises, owned and controlled by their members, that offer financial services to their members only, most times, in a manner that maximises their benefits.<sup>180</sup> They can be distinguished from co-operative banks in that credit unions only do business with their members, whereas co-operative banks typically also allow non-member customers.<sup>181</sup> Moreover, credit unions are smaller than co-operative banks, focusing primarily on the common bond and empowering their customers (who are also members) and the local community in which they are based.<sup>182</sup>

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<sup>171</sup> Ibid.

<sup>172</sup> McKillop & Wilson op cit note 160 at 86.

<sup>173</sup> McKillop et al 'The development of credit unions and their role in tackling financial exclusion' (2007) 27 *Public Money & Management* 8.

<sup>174</sup> Mavenga & Olfert op cit note 132 at 5.

<sup>175</sup> Ibid.

<sup>176</sup> Goddard et al op cit note 163 at 8.

<sup>177</sup> Ibid.

<sup>178</sup> Coelho et op cit note 14 at 73.

<sup>179</sup> Goddard et al op cit note 163 at 8.

<sup>180</sup> Black & Dugger op cit note 134 at 529.

<sup>181</sup> Ibid.

<sup>182</sup> Smith et al op cit note 146 at 557.

### 3.2.4 VILLAGE BANKS

Village banks are semi-formal financial co-operatives.<sup>183</sup> By this is meant that they are not a spontaneous result of local and/or traditional structures like ROSCAs.<sup>184</sup> Village banks are not formally registered with the government and are not regulated by formal law.<sup>185</sup> Rather, they have a “foreign” or external body, mostly in the form of a non-governmental body that facilitates their initial establishment and growth.<sup>186</sup>

Unfortunately, the initial foreign intervention of these implementing agencies and the adherence to their structures can sometimes deter rural people.<sup>187</sup> Thus, many still prefer the more traditional institutions of ROSCAs.<sup>188</sup> Notwithstanding, the benefits that village banks provide are undeniable. They aimed to improve on ROSCAs by:

- making informal financial co-operative groups more sustainable through a series of accountability features that prevent the theft of funds and elite capture;<sup>189</sup>
- making informal financial co-operative groups that are more flexible by enabling members to borrow any amount that they want which is up to three times their own level of savings if funds are available;<sup>190</sup> and
- encouraging savings and investments among low-income community members. Unlike ROSCAs, borrowers in village banks pay interest on group loans, which encourages more savings by those with larger means while simultaneously discouraging borrowing for less productive purposes.<sup>191</sup>

Village banks are a type of ASCA, where members deposit their savings and take out loans when required.<sup>192</sup> They are intended to be an improvement on ROSCAs, offering alternative finance methodologies that provide members with the means to cope with emergencies, build capital and recreate social dynamics that support genuine self-reliance.<sup>193</sup> Efforts to rectify ROSCAs shortcomings continue to prompt many innovations and have given birth to a hybrid that preserves the best of both

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<sup>183</sup> G Coetzee & C Cross *The Role of Community Banks in South Africa: Can it Contribute to Improve Access to Financial Services for the Poor?* (2002-2003) Working Paper 16.

<sup>184</sup> Chipeta & Mkandawire op cit note 30 at 124–6.

<sup>185</sup> Coetzee & Cross op cit note 13.

<sup>186</sup> Chipeta & Mkandawire op cit note 30 at 124–6.

<sup>187</sup> Mwansakilwa et al 'Village savings and loan associations and household welfare: Evidence from Eastern and Western Zambia' (2017) 12 *African Journal of Agricultural and Resource Economics* 88.

<sup>188</sup> *Ibid.*

<sup>189</sup> Beck op cit note 32 at 16.

<sup>190</sup> *Ibid.*

<sup>191</sup> *Ibid.*

<sup>192</sup> T Mulenga et al 'State of financial co-operatives in Zambia: A viable option for increasing financial inclusion?' (2019) Zambia Institute for Policy Analysis and Research (ZIPAR) at 2, available at <https://www.africaportal.org/publications/state-financial-co-operatives-zambia-viable-option-increasing-financial-inclusion-no-35/> accessed on 10 January 2021; Beck op cit note 32 at 16.

<sup>193</sup> *Ibid.*

associations.<sup>194</sup> The hybrid is accumulating savings and credit rotating associations (ASCRAAs). In ASCRAAs, funds are not immediately withdrawn but are left to grow for loan making.<sup>195</sup>

### **3.2.4.1 The history of village banks**

Frederick Nicholson, in his report to the Indian government in 1896, first used the term village bank.<sup>196</sup> Nicholson had, before this, visited Germany and studied the European financial co-operatives. In his report, he recommended that the Indian government adopt the Raiffeisen banking model in villages that had been struck with famine and had many indebted farmers.<sup>197</sup>

Unlike the European methodology, however, that had started as charitable organisations funded by the wealthy in society, Nicholson advised that the government should be the benefactor of the village banks; providing supervision and granting moderate loans.<sup>198</sup> Notwithstanding, the government showed no support for these proposals, clearly stating that such a concept would not function in India. Regardless, Nicholson's report triggered the beginnings of small experiments in some parts of India.<sup>199</sup>

However, the experiments were minimal, resulting in India losing the opportunity of being the pioneers of modern-day village banking.<sup>200</sup> As known today, most village banks originated from a less stringent microfinance model termed the Foundation for International Community Assistance (FINCA) model of village banking.<sup>201</sup>

### **3.2.4.2 The characteristics of FINCA village banks**

#### **(a) Membership**

FINCA village banks work with groups of 10 to 50 members.<sup>202</sup> The original organisational structure worked with groups of 30-60 members, usually all women.<sup>203</sup> Unfortunately, because this model tended to

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<sup>194</sup> Bouman op cit note 18 at 119.

<sup>195</sup> Ibid.

<sup>196</sup> M Tiwari & S Ahirwar 'Origin and development of co-operatives in India' (2017) 2 *International Journal of Academic Research and Development* 878–79.

<sup>197</sup> Ibid.

<sup>198</sup> P I Bhat 'Revitalizing the co-operative societies through constitutional means' (2010) 8 *Int'l J Civ Soc'y L* 14.

<sup>199</sup> Ibid.

<sup>200</sup> G Westley 'A tale of four village banking programs: Towards effective village banking' (Inter-American Development Bank Washington, D. C. Sustainable Development Department Best Practices Series, 2004) 1.

<sup>201</sup> Ibid.

<sup>202</sup> Finca 'FINCA: Banking on the poor' available at <http://www.gdrc.org/icm/finca/finca-1.html> accessed on 10 June 2020.

<sup>203</sup> J Paxton 'Sustainable banking with the POOR case studies in microfinance' *A World Bank Report* (1998) 4.

have a large membership, free riding was more likely, and monitoring was correspondingly weaker.<sup>204</sup> Gradually, therefore, FINCA decreased the numbers.

## **(b) Ownership and governance**

FINCA village banks are owned by the members. Once the membership is formed, the banks undergo induction by a local branch of FINCA or its affiliates.<sup>205</sup> Thereafter, the village banks receive start-up loans from FINCA for on-lending to the individual members of the village banks.<sup>206</sup>

Representatives of FINCA spend one to three months setting up each bank and training members. During this period, FINCA sets up group visits and scheduled weekly meetings aimed at assisting the banks.<sup>207</sup> The members themselves, with the assistance of FINCA representatives, develop constitutions that describe areas of potential conflict and the solutions that would be available to resolve the matters arising.<sup>208</sup> Areas of potential conflicts mainly include election procedures, non-attendance, exclusion of members, and fines for delays.<sup>209</sup>

The members elect a president, treasurer, and perhaps other officers who preside over meetings, collect and pay money, and generally administer the affairs of the village banks in accepting and rendering services.<sup>210</sup> FINCA's role in managing the village banks is to support leadership and facilitate decision-making among members of the village banks. However, their participation decreases as the bank's management capacity increases.<sup>211</sup>

## **(c) Financial services**

FINCA village banks have two main products – loans and savings.<sup>212</sup> The savings are linked to the loan system within the banks. FINCA village banks are initially granted start-up loans.<sup>213</sup> Once the loans are granted, a loan cycle begins.<sup>214</sup> The banks consist of nine loan cycles. During each of the cycles, 20 per

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<sup>204</sup> K Ouattara, C Gonzalez-Vega & D Graham 'Village banks, caisses villageoises, and credit unions: Lessons from client-owned microfinance organizations in West Africa' (1999) *Economics and Sociology Occasional Paper No 2523* at 69.

<sup>205</sup> C Ksoll et al 'Impact of village savings and loan associations: Evidence from a cluster randomized trial' (2016) 120 *Journal of Development Economics* 72-3.

<sup>206</sup> *Ibid.*

<sup>207</sup> C Brannen *An Impact Study of the Village Savings and Loan Association (VSLA) Program in Zanzibar, Tanzania. Honors Theses – All* (2010) 27.

<sup>208</sup> Ouattara et al op cit note 204 at 42.

<sup>209</sup> *Ibid.*

<sup>210</sup> Westley op cit note 200 at 2.

<sup>211</sup> *Ibid.*

<sup>212</sup> Ouattara et al op cit note 204 at 85.

<sup>213</sup> *Ibid.*

<sup>214</sup> Paxton op cit note 203 at 10.

cent of the initial loan is deducted from compulsory savings (saved in an internal reserve fund) that the village banks impose on members, as well as a 5 per cent monthly interest rate.<sup>215</sup>

At the end of the first loan cycle, the village banks repay the initial loan to FINCA, plus interest and within an agreed period.<sup>216</sup> This repayment gives the bank access to a second loan cycle, which will be the amount loaned in the first cycle plus accumulated savings.<sup>217</sup> If the village banks fail to repay the initial loan, they typically face termination of all provided services.<sup>218</sup> Therefore, this model requires each village bank member to save.<sup>219</sup>

The mandatory savings serve at least two main purposes. First, they serve as cash collateral, to deter the complete failure of village banks and reduce the impact of such failures on FINCA.<sup>220</sup> Secondly, mandatory savings are used to cover the more routine instances of individual loan delinquency and to provide additional loans to village bank members, including loans for emergencies, consumer goods, and additional business needs.<sup>221</sup> This feature differentiates them from ROSCAs, which tend to borrow out to members, all funds that have been pooled together. This feature also allows the village banks to be more flexible in their provision of credit.<sup>222</sup>

The designers of the FINCA village banking model projected that, at the end of three years, the internal reserve funds would be enough to meet all members' needs, resulting in the graduation of the village banks.<sup>223</sup> At that point, FINCA would withdraw the funds and utilise them in starting a new village bank.<sup>224</sup> However, graduation results in an unfavourable structure of incentives.<sup>225</sup> It implies an absence of permanency with access to the external source of funds, thereby decreasing incentives to repay as the graduation approaches.<sup>226</sup> For this reason, many programs do not implement the graduation rules.<sup>227</sup>

Members meet regularly (generally weekly or bi-weekly, occasionally monthly) to collect each member's loan payments, take out savings or deposits, pay out savings withdrawal requests, and manage other

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<sup>215</sup> Westley op cit note 200 at iv.

<sup>216</sup> Ksoll et al op cit note 205 at 72–3.

<sup>217</sup> F Perez et al 'Village banking development model: FINCA Costa Rica' (2011) 64 *Journal of Business Research* 321.

<sup>218</sup> Ouattara et al op cit note 204 at 53.

<sup>219</sup> *Ibid.*

<sup>220</sup> Ksoll et al op cit note 205 at 72–3.

<sup>221</sup> *Ibid.*

<sup>222</sup> Beck op cit note 32 at 16.

<sup>223</sup> M Zeller & R Meyer *The Triangle of Microfinance* (2002) 139.

<sup>224</sup> Ouattara et al op cit note 204 at 67.

<sup>225</sup> *Ibid.*

<sup>226</sup> Zeller & Meyer op cit note 223 at 139.

<sup>227</sup> *Ibid.*

business.<sup>228</sup> While these meetings keep members away from their own businesses for a significant period of time (meetings usually last between one and a half to two hours), they are the means through which village bank credit and savings services are provided.<sup>229</sup>

#### **(d) Non-financial services**

The frequent meetings among members of the banks provide them with many other benefits which include what might be termed informal non-financial services.<sup>230</sup> These services include networking, empowerment, informal technical assistance, a sense of belonging and enjoyment from socialising.<sup>231</sup>

#### **3.2.4.3 The transformation of FINCA Village Banks**

The key features of the FINCA banking model are standardisation, collective liability, and loans linked to savings.<sup>232</sup> This model however has been subjected to several transformations, to respond to member's demand and to adapt it to local circumstances.<sup>233</sup> The various new models have been organised by FINCA itself and other implementing agencies.<sup>234</sup>

Although the models of village banking can be structured differently and adapt to the country in which they are based, the ultimate essence of village banks remains to provide community-based credit and savings services that allow people in rural areas to overcome capital shortcomings.<sup>235</sup> For the purposes of this thesis, only village banks initiated by the International Fund for Agricultural Development and CARE International will be discussed (in Chapters 4 and 5, respectively) because these are the models available predominantly in South Africa and Malawi, respectively.<sup>236</sup>

### **3.2.5 MODERN FINANCIAL CO-OPERATIVES AND CO-OPERATIVES LAW**

The regulation of financial co-operatives around the world today also reflects their diversity in size, scope, and complexity.<sup>237</sup> There are three main regulatory approaches and four supervisory approaches adopted to ensure regulation and compliance of financial co-operatives.<sup>238</sup>

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<sup>228</sup> GIZ GIZ *Handbook Operating Village Banks Microfinance in Rural Areas – Access to Finance for the Poor* (2014) 17.

<sup>229</sup> Westley op cit note 200 at 42.

<sup>230</sup> Ibid.

<sup>231</sup> Ibid.

<sup>232</sup> Hatch 'A brief primer on FINCA' available at [http://www.haas.berkeley.edu/haasglobal/events\\_microfinanceos.html](http://www.haas.berkeley.edu/haasglobal/events_microfinanceos.html), accessed on 20 April 2019.

<sup>233</sup> Perez et al op cit note 217 at 321.

<sup>234</sup> Zeller & Meyer op cit note 223 at 139.

<sup>235</sup> B Verhan et al 'Mushrooming Village Community Banks in Tanzania: Is it really making a difference?' (2014) 6 *International Journal of Innovation and Scientific Research* 133.

<sup>236</sup> Hatch op cit note 232.

<sup>237</sup> Coelho et op cit note 14 at 53.

### 3.2.6 CURRENT REGULATORY MODELS FOR FINANCIAL CO-OPERATIVES

The first regulatory model is where financial co-operatives are regulated by the individual country's banking law - the European co-operative banking sector is an example. Alternatively, it is also where the banking law can only be applied to larger co-operatives, while smaller co-operatives are regulated by the general co-operative law applicable to all co-operatives.<sup>239</sup>

However, banking laws without specific provisions for financial co-operatives are usually insufficient. The regulation of financial co-operatives within a broader legal framework directed at other non-financial co-operatives, banks or micro-finance institutions (MFIs) fails to recognise the governance structure of financial co-operatives and their deposit-taking function, as well as their small size, limited scope and the specific risks they face.<sup>240</sup> For example, high initial capital requirements that apply to banks may be unreasonable for financial co-operatives because low- and middle-income groups would be unlikely to raise start-up capital.<sup>241</sup> In addition, financial co-operatives are non-profit organisations whose members (shareholders) are more concerned with obtaining adequate financial services than with annual profits.<sup>242</sup>

Accordingly, other jurisdictions opt for co-operative society regulations that governs the entire co-operatives sector, without specific provisions for financial co-operatives.<sup>243</sup> This, it is assumed is more relevant and less stringent for co-operatives. Notwithstanding, these have also been argued as ineffective, as financial co-operatives mobilise deposits from their members and therefore require deposit protection measures, such regulations that impose a minimum capital base to absorb and cover unforeseen losses.<sup>244</sup>

Co-operative society regulations neglect such specificity and broadly, other regulations pertaining to financial intermediation services such as stipulation of supervision and prudential financial standards, organisation of access to liquidity facilities, money transfer, payment networks, settlement and clearing, all of which must be regulated in order to have financial co-operative sector that functions properly.<sup>245</sup>

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<sup>238</sup> A Poprawa *Regulation and Legislation of Co-operative Banks and Credit Union* (Paper prepared for the United Nations Expert Group Meeting on Co-operatives, 2009) 2–3.

<sup>239</sup> A Khafagy *The Economics of Financial Co-operatives: Income Distribution, Political Economy and Regulation* (2020) 153.

<sup>240</sup> *Ibid.*

<sup>241</sup> Khafagy op cit note 239 at 161.

<sup>242</sup> Khafagy op cit note 239 at 92.

<sup>243</sup> Cuevas & Fischer op cit note 1 at 33.

<sup>244</sup> B Branch & D Grace *Technical Guide: Credit Union Regulation and Supervision. Wisconsin: World Council of Credit Unions* (2008) 4.

<sup>245</sup> *Ibid.*

Hence, there are increasing arguments in favour of a third model, which is the regulation of financial co-operatives through specialised regulation.<sup>246</sup> Specialised regulation ensures the adaptation of appropriate rules for financial management and governance controls, as well as the facilitation of capital formation and distribution and the establishment of a potentially well-functioning supervisory framework for many small financial co-operatives.<sup>247</sup>

### 3.2.7 CURRENT SUPERVISORY MODELS FOR FINANCIAL CO-OPERATIVES

The regulatory instrument in place also feeds into the supervisory model that is adopted. The main models of supervision applied around the world are as follows:

- **Direct supervision of all financial co-operatives:** Direct supervision of all financial co-operatives by a supervisory authority with a legal obligation to supervise financial co-operatives ensures uniform standards of competition in the market, eliminates the possibility of regulatory arbitrage, and promotes consumer confidence.<sup>248</sup> The main obstacle to implementing this framework is the real and perceived costs in countries where many financial co-operatives have limited public funds to supervise.<sup>249</sup>
- **Direct supervision of the largest financial co-operatives:** In some countries, the financial sector regulator only directly supervises the largest financial co-operatives in the country based on asset size or deposit base.<sup>250</sup> This model was created in Latin America in the mid-1990s and is now used in Chile, Bolivia, Ecuador, Colombia, and El Salvador.<sup>251</sup> Direct supervision of these large financial co-operatives broadens the technical expertise of central banks to financial co-operatives and concentrates resources on larger institutions that could cause systemic problems in the event of failure.<sup>252</sup> Positively, this framework requires fewer supervisory resources. However, it can lead to regulatory arbitrage as it divides the financial co-operative sector into two sections with different compliance, interests, and service offerings.<sup>253</sup> The effect of this two-part supervisory framework is confusion among depositors as to which financial co-operatives are supervised and which ones are not.<sup>254</sup> This confusion can lead to a loss of trust in all financial co-operatives.<sup>255</sup>

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<sup>246</sup> T Jansson et al *Principles and Practices for Regulating and Supervising Microfinance* (2004) 50.

<sup>247</sup> *Ibid.*

<sup>248</sup> Poprawa op cit note 238 at 2–3.

<sup>249</sup> *Ibid.*

<sup>250</sup> C Cuevas *Financial Co-operatives Issues in Regulation, Supervision, and Institutional Strengthening* (2018) 23.

<sup>251</sup> *Ibid.*

<sup>252</sup> Branch & Grace op cit note 244 at 4.

<sup>253</sup> *Ibid.*

<sup>254</sup> Poprawa op cit note 238 at 4.

<sup>255</sup> *Ibid.*

- **Delegated supervision:** Delegated supervision exists when the government formally transfers the supervisory authority by law or regulation to a third party, usually to the national association of financial co-operatives or a branch of the association.<sup>256</sup> This model is typical of financial co-operative movements in the early stages of development and, if well managed, can be extended to more sophisticated systems.<sup>257</sup> When delegated to the national association, this model helps to guarantee closer feedback between financial co-operatives and their supervisory authority compared to direct supervision from the government supervisory authority.<sup>258</sup> Such an arrangement benefits the government in the short term since as it allows it to avoid the financial costs of supervision. It also benefits the national association by providing an additional source of income from the supervisory fees.<sup>259</sup> In addition, financial co-operatives benefit from a more collegial relationship with a supervisor whose task it is to promote the expansion and development of the sector.<sup>260</sup> However, successful delegated supervision requires:
  - strong conflict of interest management where the supervisor is the primary advocate for financial co-operatives and is led by the organisations they supervise;<sup>261</sup> and
  - the development of strong technical capacities in the delegated body. Some jurisdictions that use this approach are Mexico, Korea, Poland, and Peru.<sup>262</sup>
- **Supervision by restructured co-operative ministries:** Based on experience in many countries over the past 50 years, this approach has several financial and technical weaknesses.<sup>263</sup> Most co-operative ministries focus on promoting co-operatives of many types and purposes (for instance, agriculture, housing, manufacturing, and others) rather than just financial co-operatives.<sup>264</sup> They are also generally underfunded, especially compared to central banks and / or banking regulators.<sup>265</sup> This shortage of funding and focus makes it difficult to attract and retain individuals with the necessary financial and technical expertise.<sup>266</sup> And finally, through international training and exchanges, banking sector supervisors generally have greater access to newer supervision techniques and technologies.<sup>267</sup> This is the predominant form of supervision in Africa and many parts of Asia and Central America.<sup>268</sup>

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<sup>256</sup> B Branch & C Baker 'Overcoming governance problems' in G Westley & B Branch (eds) *Safe Money: Building Effective Credit Unions in Latin America* (2000) 210–11.

<sup>257</sup> Ibid.

<sup>258</sup> J Poyo 'Regulation and supervision of credit unions' in G Westley & B Branch (eds) *Safe Money: Building Effective Credit Unions in Latin America* (2000) 140.

<sup>259</sup> Ibid.

<sup>260</sup> Jansson et al op cit note 246 at 51.

<sup>261</sup> Ibid.

<sup>262</sup> Cuevas & Fischer op cit note 1 at 41.

<sup>263</sup> Ibid.

<sup>264</sup> Cuevas op cit note 250 at 23.

<sup>265</sup> Khafagy op cit note 239 at 144.

<sup>266</sup> Ibid.

<sup>267</sup> Poyo op cit note 258 at 140.

<sup>268</sup> Cuevas op cit note 250 at 23.

These models have been adopted and adapted to suit different countries around the world. Most relevant to this thesis, some of these approaches are applicable in Malawi and South Africa today. These will be discussed in Chapter 8. However, it is important to note that not all regulatory supervisory efforts have had positive effects on the growth of financial co-operatives.<sup>269</sup> In Africa particularly, the introduction of a regulatory framework has transformed the organisational nature of co-operatives from instruments aimed at creating alternative contractual arrangements that govern the relationship between the members and the market, and between the members themselves, to instruments of governmental that transfer credit and subsidies to mass populations and follow government policies.<sup>270</sup> Co-operatives are subsequently engulfed in state politics to the extent that the failures of state policies find expression in the co-operative movement.<sup>271</sup>

### 3.3 OBSERVATIONS AND LESSONS

There are some key observations and learnings that can be extracted from this chapter as a contribution to the overall objective of this thesis to recommend regulatory and supervisory changes in South Africa and Malawi. Firstly, it can be observed from this chapter that institutional confidence is vital for the growth of financial co-operatives. Aside from the simplicity of the structures in ROSCAs that attracts many members, members of ROSCAs are also attracted to the institution because it is governed by their peers or people whom they know. Having people that one knows running the institutions communicates trustworthiness of the institution.<sup>272</sup>

Secondly, in reforming the informal sector, and therefore ROSCAs, it can be observed that long-term loans may be more useful for ROSCA members. This chapter showed that ROSCAs have several disadvantages that village banks have sought to resolve.<sup>273</sup> However, one disadvantage that should be highlighted is that they offer short-term loans.<sup>274</sup> This is a digression from what Raiffeisen found to be effective of beneficial for rural members in Germany.<sup>275</sup> In Raiffeisen's view, only long-term financing could empower impoverished borrowers to plan and meet the costs of the investments which were designed to improve their activities and the quality of their lives.<sup>276</sup>

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<sup>269</sup> Khafagy op cit note 239 at 144.

<sup>270</sup> R Cull et al 'Does regulatory supervision curtail microfinance profitability and outreach?' (2011) 39 *World Dev* 960.

<sup>271</sup> Khafagy op cit note 239 at 144.

<sup>272</sup> Mushuku & Mayisa op cit note 40 at 124.

<sup>273</sup> Beck op cit note 32 at 16.

<sup>274</sup> *Ibid.*

<sup>275</sup> *Ibid.*

<sup>276</sup> *Ibid.*

Thirdly, it can be observed that the evolution and growth of financial co-operatives have come at a cost of the initial ethos of financial co-operatives. This is especially clear as they grow. It has been shown that the struggle that financial co-operatives face is to maintain a balance between the social and philosophical objectives on the one hand, and the economic realities on the other is increasingly grappled with.<sup>277</sup> For example, for co-operative banks, appointing directors that are not members of the co-operative banks has led to decision-making that does not completely align with the ethos of co-operatives but has been considered an important decision to be made to ensure the competitiveness of co-operative banks on the financial market.<sup>278</sup> Accordingly, it is very important that in recommending regulatory and supervisory frameworks that foster the growth of financial co-operatives, care is taken to maintain the ethos of financial co-operatives.

Fourthly, this chapter has shown that apex organisations for financial co-operatives have important benefits. The co-operation between co-operatives through the creation of apex bodies is a strategic mechanism that makes smaller co-operatives stronger and protects them from the harshness of economic pressure.<sup>279</sup> However, apex bodies should be properly managed because growth can be perilous to the autonomy of co-operatives leading to governance from the top down like commercial banks and conflicts of interest where the apex body is also the delegated supervisor of smaller co-operatives.<sup>280</sup>

Another important observation is that the governance of financial co-operatives is a difficult task in every country, but regulation plays an important role in ensuring that financial co-operatives do not deviate from their principles.<sup>281</sup> It is therefore important to ensure that there are sufficient regulatory restrictions, to ensure that financial co-operatives do not differ significantly from their foundational elements.

Further, it was observed that external financing should still be discouraged in modern financial co-operatives as they were in the German banking models. Reliance on external financing may encourage higher risk-taking and compromise the autonomy of the banks through the financial and compliance covenants imposed on them by lenders or non-member capital investors.<sup>282</sup> Moreover, for organisations that rely on funding in their initial stages like SACCOs in the nascent stage or village banks, it is important for mechanisms of weaning to be put in place that encourage autonomy of the financial co-operative to develop.<sup>283</sup>

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<sup>277</sup> McKillop & Wilson op cit note 124 at 97.

<sup>278</sup> Ibid.

<sup>279</sup> Fonteyne & Hardy op cit note 89 at 494.

<sup>280</sup> Ibid.

<sup>281</sup> Poli op cit note 80 at 18.

<sup>282</sup> Migliorelli op cit note 102 at 6.

<sup>283</sup> Zeller & Meyer op cit note 223 at 139.

Lastly, financial co-operatives are not the same in every country and it is important to adjust them to the country in which they function.<sup>284</sup> Moreover, financial co-operatives are at different levels of maturity and therefore may not be treated generally.<sup>285</sup>

### 3.4 CONCLUSION

Generally, financial co-operatives should be understood as a broad range of financial intermediaries that function based on co-operative principles. They are member-owned and member-controlled financial institutions, the ownership and membership of which may vary, but at their core are focused on the provision of benefits to their members as opposed to profit maximisation.

Financial co-operatives have evolved over the years, from the two banks discussed in Chapter 2 to different types and sizes, spread across many countries. My intention in this chapter was to dissect the different institutions that reside under the umbrella term of financial co-operatives to establish an accurate and inclusive understanding of financial co-operatives. For the purposes of this study, only ROSCAs, co-operative banks, credit unions/SACCOs, and village banks were discussed.

Below is a summary of their distinct characteristics:

CHARACTER	ROCSA	CO-OPERATIVE BANK	CREDIT UNION/SACCO	VILLAGE BANK
<b>Regulatory framework</b>	Informal	Formal	Formal/Semi - Formal	Semi-Formal
<b>Governance</b>	Written or non-written constitution; voluntary staff to handle administrative tasks; one-man-one-vote principle	Applicable legislation; voluntary board of directors; one-man-one-vote principle	Applicable legislation; voluntary board of directors; one-man-one-vote principle	Applicable Non-governmental Organisation structures; Written constitution; voluntary board of directors; one-man-one-vote principle
<b>Membership</b>	Open to all members that have a common bond	Open to all members with or without a common bond	Open to all members that have a common bond	Low-income clients and farmers that have a common bond
<b>Products and services</b>	Credit; savings; insurance	Credit; savings; insurance; investment; as well as more sophisticated financial products and services (e.g., liquidity)	Credit; savings; insurance; investment; as well as more sophisticated financial products	Credit; savings; insurance

<sup>284</sup> McKillop & Wilson op cit note 160 at 103–4.

<sup>285</sup> Ibid.

		management, risk management)	and services (e.g., liquidity management, risk management)	
<b>Geographical location</b>	Urban and rural, predominantly in Africa	Urban and rural, predominantly in Europe	Urban and rural, predominantly in the United States of America, Canada, and Africa	Urban and rural, predominantly in Africa

The chapter also included some key observations and learnings that can be extracted as a contribution to the overall objective of this thesis to recommend regulatory and supervisory changes in South Africa and Malawi. It also showed that co-operative law has also evolved and spread into different jurisdictions over the years. There are now various regulatory and supervisory approaches adopted in different countries. It is therefore important to ensure that financial co-operatives are effectively regulated and supervised.<sup>286</sup> However, before I delve into discussions on regulatory and supervisory framework, the next two chapters discuss financial co-operatives in South Africa and Malawi.

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<sup>286</sup> Khafagy op cit note 239 at 123.

## CHAPTER FOUR

### FINANCIAL CO-OPERATIVES IN SOUTH AFRICA

#### 4.1 INTRODUCTION

There are three tiers of banking financial institutions in South Africa.<sup>1</sup> The first tier includes commercial or retail banks. The second tier includes mutual and co-operative banks, and the third tier includes a wide range of formal and informal institutions. This chapter focuses on the second and third tiers which are composed of member-based financial institutions across a spectrum that includes stokvels, savings and credit unions, village banks, co-operative banks, and mutual banks.<sup>2</sup> While not all of these would consider themselves as financial co-operatives, many in fact, meet the critical criterion of member ownership and control.<sup>3</sup> The exception being, mutual banks. Mutual banks are registered as companies (not co-operatives) and are not necessarily based on the principle of 'one person, one vote' which underpins co-operatives.<sup>4</sup> The discussion in this chapter will therefore exclude mutual banks.

The Co-operatives Banks Act 40 of 2007 as amended by the Financial Sector Regulation Act 7 of 2017 (FSRA), provides for financial co-operatives as being co-operative banks and Co-operative Financial Institutions (CFIs).<sup>5</sup> CFIs have been defined as co-operatives that take deposits and choose to identify with the following names:

- financial co-operative
- credit union
- financial services co-operative (FSC)
- savings and credit co-operative (SACCO)<sup>6</sup>

This means that legally recognised CFIs include SACCOs or credit unions and village banks (which identify themselves as FSCs).<sup>7</sup> There is no clear reason why co-operative banks have been distinguished from CFIs given that co-operative banks are also a type of CFI. Even more, ROSCAs have also been excluded.

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<sup>1</sup> ECI Africa *Third-Tier Banking Report: A review of the capacity, lessons learned and way forward for member-based financial institutions in South Africa* (23 July 2003) i available at <https://finmark.org.za/system/documents/files/000/000/289/original/ThirdTierBanking.pdf?1613657073> accessed on 14 February 2021.

<sup>2</sup> Ibid.

<sup>3</sup> K Philip 'Co-operatives in South Africa: Their role in job creation and poverty reduction' (2003) at 15, available at [http://www.sarpn.org/documents/d0000786/P872-Co-ops\\_October2003.pdf](http://www.sarpn.org/documents/d0000786/P872-Co-ops_October2003.pdf) accessed on 14 March 2020.

<sup>4</sup> Ibid. Finbond Mutual is 51 per cent mutual bank owned by Finbond Group Ltd. Members do not have control of this entity.

<sup>5</sup> Co-operative Banks Act 2007, s 3(1).

<sup>6</sup> As outlined in the 'Definitions' clause of the Co-operative Banks Act 2007.

<sup>7</sup> Ibid; P Mashigo et al 'Village banks: a financial strategy for developing the South African poor households' (2016) 11 *Banks and Bank Systems* 9.

This exclusion is not surprising given the historical background of financial co-operatives. Financial co-operatives were introduced into the South African environment by European settlers during the apartheid regime.<sup>8</sup> To a large extent then, South Africans, whether knowingly or unknowingly, viewed financial co-operatives as external European concepts to be adopted.<sup>9</sup> In contrast, ROSCAs in South Africa originally grew organically within communities.<sup>10</sup> Their growth was rooted in normal everyday practices, and at times, out of the necessity of individuals to help themselves in economically and socially difficult environments; much like the credit co-operatives in Germany.<sup>11</sup>

Despite this exclusion, ROSCAs do fall within the ambit of financial co-operatives, albeit informal.<sup>12</sup> They may not view themselves as financial co-operatives, but they meet the essential criterion of member ownership and control.<sup>13</sup> Accordingly, ROSCAs are incorporated in this chapter as the informal financial co-operatives of South Africa. Especially for South Africa, it is critical to include ROSCAs, because ROSCAs are by far the most visibly known form of member-based financial intermediary schemes in South Africa.<sup>14</sup> A study by African Response Research indicates that stokvels alone, have a membership of approximately 11 400 400 registered individuals, belonging to 811 830 stokvels; and collectively saving R44 billion a year.<sup>15</sup>

In contrast, the formal and semi-formal financial co-operatives in South Africa are minuscule in comparison.<sup>16</sup> The sector has the lowest penetration rate in Africa at 0.1 per cent compared with Africa's average of 6.8 per cent.<sup>17</sup> There are only five registered co-operative banks, nine SACCOs, and 15 FSCs; marking a grave disparity between the growth of the formal versus informal financial co-operatives in

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<sup>8</sup> M Mushonga et al 'The co-operative movement in South Africa: Can financial co-operatives become sustainable enterprises?' (2019) 28 *Strategic Change* 260.

<sup>9</sup> R P Walsh 'Cooperation in native South Africa' (1940) 21 *Blackfriars* 241 at 244.

<sup>10</sup> F Bouman 'Rosca: On the origin of the species' (1995) 19 *Savings and Development* 121.

<sup>11</sup> W G Schulze 'The origin and legal nature of the Stokvel (Part 1)' (1997) 9 *South African Mercantile Law Journal* 20; M W Magro *Examining the Federal Credit Union Model in the 21st Century* (unpublished PhD Dissertation, University of Southern California, 2016) 126.

<sup>12</sup> G Verhoef 'Informal financial service institutions for survival: African women and stokvels in urban South Africa, 1930–1988' (2001) 2 *Enterprise & Society* 263.

<sup>13</sup> *Ibid.*

<sup>14</sup> D de Jong & M Kuhlengisa 'Co-operative Banking in South Africa' in V Satgar (ed) *Co-operatives in South Africa: Advancing Solidarity Economy Pathways from Below* (2019) 56–7.

<sup>15</sup> M J K Bophela & N Khumalo 'The Role of Stokvels in South Africa: A Case of Economic Transformation of a Municipality' (2019) 17 *Problems and Perspectives in Management* 27.

<sup>16</sup> De Jong & Kuhlengisa op cit note 14 at 56–7.

<sup>17</sup> *Ibid.*; C Feather & C K Meme 'Consolidating inclusive housing finance development in Africa: Lessons from Kenyan savings and credit co-operatives' (2018) 10 *African Review of Economics and Finance* 84.

South Africa.<sup>18</sup> A wholesome discussion of the sector is therefore incomplete without delving into the informal sector.

This chapter will consider financial co-operatives in South Africa from a historical perspective to provide context for the status of financial co-operatives and the legislation that governs them. It will trace the evolution of financial co-operatives in South Africa and show that the co-operative movement emerged along three distinct paths, namely white-owned co-operatives operating in the formal economy (formal financial co-operatives), financial co-operatives facilitated by missionaries (semi-formal financial co-operatives) and informal financial co-operatives (stokvels).<sup>19</sup>

## 4.2 THE HISTORY OF FORMAL AND SEMI-FORMAL FINANCIAL CO-OPERATIVES IN SOUTH AFRICA

Financial co-operatives in South Africa, like on the whole African continent, originate from co-operatives in general.<sup>20</sup> However, there is no consensus as to when these co-operatives themselves began in South Africa.<sup>21</sup> As Walsh puts it, before the white man arrived, the black African lived in a way that can be called collective or co-operative. African society was bound together by a common bond, the tribe, of remarkable strength.<sup>22</sup> Co-operatives, therefore, may have already been existent at this time, albeit informally.

Nonetheless, the history of formal co-operatives begins, following the influx of European settlers into South Africa in the 19<sup>th</sup> century.<sup>23</sup> The influx resulted in the reorganisation of societal structures and the incorporation of European ideals into the African framework.<sup>24</sup> Some of the effects of this societal reconstruction were co-operatives advanced by the apartheid government; others were co-operatives advanced by missionaries and the civil society, and still others were co-operatives progressed within the black communities.<sup>25</sup> All these structures have evolved into financial co-operatives as are known today and in this section, each structure is discussed in turn.

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<sup>18</sup> South African Reserve Bank Prudential Authority available at [https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/SA\\_registered\\_financial\\_institutions](https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/SA_registered_financial_institutions), accessed 2 August 2021.

<sup>19</sup> De Jong & Kuhlengisa op cit note 14 at 76–77.

<sup>20</sup> Ibid.

<sup>21</sup> Walsh op cit note 9 at 242.

<sup>22</sup> Ibid.

<sup>23</sup> Department of Trade and Industry op cit note 23 at 36.

<sup>24</sup> Ibid.

<sup>25</sup> M A Okbandrias & A E Okem 'Co-operatives in Vogue: A case study of co-operatives in South Africa' in A E Okem (ed) *Theoretical and Empirical Studies on Co-operatives: Lessons for Co-operatives in South Africa* (2016) 73.

## 4.2.1 CO-OPERATIVES ADVANCED BY THE APARTHEID GOVERNMENT

### 4.2.1.1 Introduction of agricultural co-operatives

Co-operatives in South Africa are fundamentally linked to and have been moulded by the history of colonial and apartheid regimes.<sup>26</sup> The 1886 discovery of gold brought into South Africa, thousands of British and other prospectors and settlers from around the world.<sup>27</sup> Nearly overnight, the city of Johannesburg sprang up as a shanty town, as foreigners surged in and settled around the mines.<sup>28</sup>

This prompted a huge market for agricultural produce leading to the first formally established co-operative in South Africa, being the Pietermaritzburg Consumers Co-operative.<sup>29</sup> The Pietermaritzburg Consumers Co-operative was registered in 1892 under the then Companies Act,<sup>30</sup> for the purchase and sale of agricultural produce.<sup>31</sup> The co-operative was registered under the Companies Act because, at that time, there was no legal framework dedicated to co-operatives and no co-operatives exclusively dedicated to the provision of financial services.<sup>32</sup>

Further development of co-operatives in the aftermath of this registration was derailed by the Anglo-Boer War from 1899 to 1902 which affected some parts of South Africa.<sup>33</sup> It only resumed after the war in 1902 when white settlers once again began to establish co-operatives to develop their farming communities.<sup>34</sup> To assist with the establishments, co-operative experts were brought in from Denmark and Ireland.<sup>35</sup>

Following the regrowth in the agricultural sector, Agricultural Development Acts were passed in 1904 and 1907.<sup>36</sup> The Acts included provisions for co-operatives; allowing government loans to be paid to farmers who formed co-operatives or joint-stock companies with co-operative principles.<sup>37</sup> Many of these co-operatives, however, subsequently failed due to a lack of supervision and the failure to understand the

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<sup>26</sup> M Jara & V Satgar *Co-operative International Co-operative Experiences and Lessons for the Eastern Cape Co-operative Development Strategy: A Literature Review* (2008) ECSECC Working Paper Series No 5, Part 1 at 5.

<sup>27</sup> Ibid.

<sup>28</sup> R Mears Historical Development of Informal Township Settlements in Johannesburg since 1886, Paper presented at the Economic History Society of Southern Africa, Conference, 10 – 12 September 2007, Indaba Hotel, Fourways, Johannesburg and at ERSA Research Workshop, 2 – 4 November 2011, Kopanong, Johannesburg at 1.

<sup>29</sup> V Satgar 'The state of the South African co-operative sector' (undated) at 2, available at <http://www.copac.org.za/files/State%20of%20Coop%20Sector.pdf>, accessed 2 August 2021.

<sup>30</sup> Companies Act 1892.

<sup>31</sup> J A S Van Niekerk *Co-operative Theory and Practice* (1988) 19.

<sup>32</sup> Jara & Satgar op cit note 9 at 5.

<sup>33</sup> N Tshishonga & E Bandyambona 'The development and sustainability of agricultural co-operatives at Inanda Township: An Analysis of Inanda Farmers' Association (IFA)' in A E Okem (ed) *Theoretical and Empirical Studies on Co-operatives: Lessons for Co-operatives in South Africa* (2016) 82.

<sup>34</sup> Ibid.

<sup>35</sup> C F Strickland 'The co-operative movement in South Africa' (1937) 36 *Journal of the Royal African Society* 461.

<sup>36</sup> Agricultural Development Act 44 of 1904; Agricultural Development Act 28 of 1907.

<sup>37</sup> R P King & GF Ortmann 'Agricultural Co-operatives I: History, Theory and Problems' (2007) 46 *Agrekon* 46.

distinction between co-operatives and joint-stock companies.<sup>38</sup> This was somewhat corrected in 1908 and 1910 when specific Co-operative Acts for Agricultural co-operatives were passed that provided for the setting up of co-operatives with unlimited liability. These co-operatives were also eligible for government loans.<sup>39</sup>

The introduction of the agricultural co-operatives' laws fostered the growth of co-operatives and led to the introduction of various other laws in support of white commercial farming and agricultural co-operatives.<sup>40</sup> For example, the Land Acts 27 of 1913 and 18 of 1936 were enacted to remove the African-black population from designated white areas and to consolidate black homelands; the Co-operatives Societies Acts 28 of 1922 and 29 of 1939 were introduced to secure input supply and output marketing services, and the Marketing Act 26 of 1937 aimed at controlling the marketing of agricultural products.<sup>41</sup>

In addition, financial institutions to support these co-operatives, like the Land and Agricultural Bank (Land Bank) were established in 1912.<sup>42</sup> Once introduced, the Land Bank began to use co-operatives as agents that provided short-and medium-term credit to commercial farmers at subsidised interest rates.<sup>43</sup> Simultaneously, the government used co-operatives to channel assistance for disasters to farmers, usually in the form of debt consolidation.<sup>44</sup> In this way, agricultural co-operatives themselves became financial intermediaries.<sup>45</sup>

This environment nurtured agricultural co-operatives. Granted, there were still incidents where co-operatives failed, but these incidents were often failures due to excessive credit.<sup>46</sup> Largely though, the recognition of co-operatives as organisations that were not to be designed as joint-stock companies and the consequent introduction of a regulatory framework, supervised by a Registrar and the Co-operative Office in the Department of Agriculture, worked advantageously to propagate the growth of the co-operatives.<sup>47</sup> Notwithstanding, these laws also served negatively in empowering co-operatives as instruments for syphoning public funds as well as creating a white monopoly in the agricultural sector.<sup>48</sup>

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<sup>38</sup> G Patmore & N Balnave *A Global History of Co-operative Business* (2018) 1867.

<sup>39</sup> Ibid

<sup>40</sup> Van Niekerk op cit note 31 at 22.

<sup>41</sup> R Rena 'Co-operatives in South Africa: A Review' (2017) 10 *Indian Journal of Science and Technology* 3.

<sup>42</sup> Z G Gotyi *A Critical Analysis Of The Role Of Co-operatives In Enhancing The Socio-Economic Development Of Chris Hani District Municipality* (unpublished PhD dissertation, Stellenbosch University, 2019) 18.

<sup>43</sup> S R Gundani *The Laws Regulating Co-operative Banks and the Contribution to Economic Growth and Poverty Alleviation in South Africa* (unpublished LLM thesis, University of Limpopo, 2017) 1

<sup>44</sup> Ibid; Rena op cit note 41 at 3.

<sup>45</sup> Strickland op cit note 35 at 464–5.

<sup>46</sup> Ibid.

<sup>47</sup> Gotyi op cit note 42 at 18.

<sup>48</sup> M Mushonga et al *Co-operative Financial Institutions in South Africa at Crossroads: Facing Reality and the Future* (PhD Thesis, University of Stellenbosch Business School, 2017) 40.

#### **4.2.1.2 Transitioning to financial co-operatives: Co-operatives Act, 1981**

South Africa began to formally acknowledge co-operatives beyond agricultural co-operatives in 1981, through the Co-operatives Act 91 of 1981.<sup>49</sup> The Act essentially provided for three kinds of co-operatives. These were special farmers' co-operatives, agricultural co-operatives, and trading co-operatives.<sup>50</sup> Agricultural co-operatives were extensively defined in the Act and any co-operative that did not qualify in terms of the agricultural co-operatives' definition was regarded as a trading co-operative.<sup>51</sup> Financial (or, alternatively, credit co-operatives) were included in the trading co-operatives. However, the Act did not permit the receipt of members' deposits as is expected for financial co-operatives.<sup>52</sup>

#### **4.2.1.3 The decline of co-operatives advanced by the apartheid government**

Over time, the substantial costs of supporting commercial farmers incurred by government and the legal framework – in terms of price support, subsidies, tax concessions and the misallocation of resources caused by distorted prices – became unsustainable.<sup>53</sup> With political and financial change also happening in South Africa, a series of changes began in the 1980s, including the removal of subsidies and tax concessions and deregulation of agricultural financing and marketing.<sup>54</sup> This reduced the role of agricultural co-operatives and made them less reliant on governmental support.<sup>55</sup> Without governmental support, many of these co-operatives were demutualised in the late 1980s and early 1990s.<sup>56</sup> Fortunately, there continued to exist other forms of co-operatives, though small, that had been developing simultaneously to the co-operatives advanced by the apartheid government. These were the co-operatives that missionaries introduced.<sup>57</sup>

### **4.2.2 INTRODUCTION OF CREDIT CO-OPERATIVES BY MISSIONARIES**

In the later part of the 1800s, other European settlers had begun to advocate for the development of co-operatives among the black communities.<sup>58</sup> This suggestion was at once adopted. However, very few

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<sup>49</sup> Gotyi op cit note 42 at 86.

<sup>50</sup> Jara & Satgar op cit note 9 at 6.

<sup>51</sup> Ibid.

<sup>52</sup> Department of Trade and Industry op cit note 23 at 25–26.

<sup>53</sup> King & Ortmann op cit note 37 at 46.

<sup>54</sup> Ibid.

<sup>55</sup> Okbandrias & Okem op cit note 25 at 73.

<sup>56</sup> C van Wyk 'East Africa terror hazards tied to poverty: Africa-wide-featured analysis' (2014) *Africa Conflict Monthly Monitor* 14.

<sup>57</sup> Ibid.

<sup>58</sup> S C Thaba & C Mbohwa 'The Nature, Role and Status of Co-operatives in South African Context' Proceedings of the World Congress on Engineering and Computer Science 2015 Vol II WCECS 2015, October 21-23, 2015, San Francisco, USA at 1.

black communities utilised the co-operatives. Notwithstanding, the seed had been sown and advocacy initiated.<sup>59</sup>

In 1926, Catholic missionaries took on the establishment of co-operatives as part of their Christian mission.<sup>60</sup> Father Bernard Huss led co-operatives advocacy by giving lectures and writing extensively on the establishment of credit co-operatives, especially as a means of encouraging economic thrift and financial prudence among black African farmers.<sup>61</sup> He frequently cited examples of previous experiments in co-operative credit societies, particularly those of Raiffeisen.<sup>62</sup> He saw the societies as an essential tool for black Africans to develop 'on their own lines' under the supervision of missionaries.<sup>63</sup> He was convinced that co-operatives would be more likely to succeed in South Africa because South African communities had a greater racial homogeneity and closer settlements in locations; much like the environment that had been provided in Germany in the 1800s.<sup>64</sup>

To facilitate the growth of the credit co-operatives, Huss established the Catholic African Union (CAU) in Transkei, and what is currently part of Eastern Cape and Kwazulu Natal provinces.<sup>65</sup> CAU aimed at empowering black communities through self-help projects.<sup>66</sup> The union consisted of ten men, each contributing not less than an equivalent of £600.<sup>67</sup> The CAU meetings dealt with savings, co-operatives, farming, accounting, elementary bookkeeping, and business methods.<sup>68</sup> From such meetings emerged practical organisations like the farmers' unions, thrift associations, savings banks, peoples' banks, credit co-operatives and agricultural unions for the natives.<sup>69</sup> The CAU promoted Catholic social principles and natives were trained for leadership positions. In essence, it was a nondenominational savings scheme organisation.<sup>70</sup>

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<sup>59</sup> Walsh op cit note 9 at 245.

<sup>60</sup> Ibid.

<sup>61</sup> P B Rich 'Bernard Huss and the experiment in African co-operatives in South Africa, 1926-1948' (1993) 26 *International Journal of African Historical Studies* 301.

<sup>62</sup> Rich op cit note 61 at 298.

<sup>63</sup> Ibid.

<sup>64</sup> B Huss *Agricultural Economics Among American Negroes* (1931), 16; *Rural Organization Among Transkeian Natives* (Umtata, 1932), 5-6

<sup>65</sup> Ibid.

<sup>66</sup> A Ngidi 'A. Ngidi, Autobiography of Mdontswa Andreas Ngidi' (undated) *Inkamana Monastery Archives, Vryheid: Andreas Ngidi: Clergy File #1* available at <https://dacb.org/stories/southafrica/ngidi-andreas/> accessed on 10 November 2020.

<sup>67</sup> Ibid.

<sup>68</sup> G Sibanda *'Better Homes, Better Fields, Better Hearts': A Contextual Interpretation of Bernard Huss' Model of Social Transformation and its Implications for the Missionaries of Mariannahill Today* (unpublished Master of Theology and Development dissertation, University of Kwazulu Natal 2008) 22.

<sup>69</sup> Ibid.

<sup>70</sup> Ngidi op cit note 66.

#### 4.2.2.1 Credit co-operatives' growth inhibitors

Huss's work was viewed quite favourably by the Transkei administration. However, many of these credit co-operatives remained weak and underdeveloped, with the consequent slowness in their progress.<sup>71</sup> In fact, by 1929, only two had over £1 500 circulating as loans and only one had made an actual profit of £50.<sup>72</sup> This derailment was because first, the black Africans and the European settlers could not trust each other.<sup>73</sup> On the one hand, black Africans thought credit co-operatives were a white man's trick to get their money.<sup>74</sup> On the other hand, white traders viewed credit co-operatives as a threat to their businesses because they encouraged economic independence among black Africans and discouraged the black Africans from depending on unfavourable financial loans from the white traders.<sup>75</sup>

Not only this but in 1936, the Transkei administration lost interest in the credit co-operatives, partly because of the pressure of the white commercial farmers and traders and partly because of a desire to consolidate control over the black Africans.<sup>76</sup> Thus, the administration began to use the absence of a clearly defined legal status of the co-operatives to intimidate organisers who were trying to establish credit co-operatives.<sup>77</sup>

To combat the antagonism by black Africans, and to enable co-operatives to appear as an 'entirely spontaneous' movement independent from European settlers, Huss tried to distance himself, as far as possible, from the activities of the Transkei administration.<sup>78</sup> However, the distrust only grew and, in many instances, the black Africans fought foreign influence; often pushing away advisors and disregarding the proper adoption of co-operatives' principles or administration.<sup>79</sup> This unsurprisingly led to the continued failure of credit co-operatives.<sup>80</sup>

In increasing persistency, however, from the early 1980s onwards, the Catholic Church tried to resurrect the work pioneered by the Christian missionaries.<sup>81</sup> Following a study tour of Ireland, Catholic parishes decided to form credit co-operatives in what is now the Western Cape.<sup>82</sup> The Cape Credit Union League

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<sup>71</sup> Rich op cit note 61 at 300.

<sup>72</sup> Ibid.

<sup>73</sup> Walsh op cit note 9 at 244.

<sup>74</sup> Ibid.

<sup>75</sup> Ibid.

<sup>76</sup> Rich op cit note 61 at 300.

<sup>77</sup> Ibid.

<sup>78</sup> P Walshe *The Rise of African Nationalism in South Africa* (1970) 399–400.

<sup>79</sup> Ibid.

<sup>80</sup> Rich op cit note 61 at 315.

<sup>80</sup> Ibid.

<sup>81</sup> Department of Trade and Industry op cit note 23 at 32.

<sup>82</sup> De Jong & Kuhlengisa op cit note 14 at 56–57.

<sup>82</sup> Ibid.

(CCUL) was established to help in the coordination of the activities of credit co-operatives and standardisation of their operations.<sup>83</sup> Notwithstanding, credit co-operatives continued to fail, this time because of low funding and an overdependence on the missionaries as the leaders of the movement.<sup>84</sup>

#### **4.2.2.2 Growth and expansion of credit co-operatives**

A positive consequence of the persistence of the missionaries in advancing the growth of credit co-operatives, however, is that credit co-operatives began to be recognised by civil society as a tool for alleviating economic and social deprivation among the poor in South Africa.<sup>85</sup> Thus, trade unions started developing SACCOS as vehicles to address retrenched and redundant workers' economic needs.<sup>86</sup> Such SACCOS unfortunately, were often established without much critical examination of the success or failure record of co-operatives in developing countries, or of the real capacity of co-operatives to deliver fundamental changes in the lives of members.<sup>87</sup> Therefore, the likelihood of their failure was mostly high.

Regardless, the impact of SACCOS continued to increase. SACCOS grew from a handful in the Western Cape to approximately 50, scattered around both urban and rural areas, as well as some located within workplaces.<sup>88</sup> In 1987, SACCOS extended their activities outside of the Western Cape Region.<sup>89</sup> However, the problems within the institution persisted and consequently, in 1991, non-governmental international bodies began to be involved in their development.<sup>90</sup>

The World Council of Credit Unions (WOCCU) intervened to assess the viability of SACCOS in South Africa. They discovered that only three of the existing 47 SACCOS were viable.<sup>91</sup> To make them more viable, a decision was made to change the entire orientation of SACCOS toward a business orientation.<sup>92</sup> Thus, in 1993, after discussions with the Canadian Co-operative Association and the African Confederation of Savings and Credit Associations, the self-regulated Savings and Credit Co-operative League of South Africa (SACCOL) was born.<sup>93</sup>

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<sup>83</sup> Ibid.

<sup>84</sup> Mushonga op cit note 52 at 44.

<sup>85</sup> U S Henama 'Trade unions saving and credit co-operative: The case of NEHAWU SACCO' (2012) 1 *International Journal of Co-operative Studies* 26 at 30.

<sup>86</sup> Ibid.

<sup>87</sup> Jara & Satgar op cit note 9 at 6.

<sup>88</sup> Ibid.

<sup>89</sup> De Jong & Kuhlengisa op cit note 14 at 56–57.

<sup>90</sup> Ibid.

<sup>91</sup> Genesis Analytics 'Understanding financial co-operatives: South Africa, Malawi and Swaziland' (2013) *Final Report submitted to FinMark Trust* at 10 available at <http://finmark.org.za/understanding-financial-co-operatives-in-south-africa-malawi-and-swaziland-full-report/> accessed on 12 May 2019.

<sup>92</sup> Ibid.

<sup>93</sup> Rena op cit note 41 at 4.

SACCOL replaced all prior apex bodies that had been formed since the CCUL.<sup>94</sup> SACCOL offered registration, education and training, assistance with management, and setting up of systems services to its member institutions.<sup>95</sup> The model of this apex body was strongly influenced by, a combination of the Irish model and the Canadian model, with the Canadian Co-operative Association having a full-time technical advisory section embedded in SACCOL.<sup>96</sup> The United States Agency for International Development (USAID) also came on the scene to provide a major grant to support the growth strategy in South Africa and the Irish Credit Union League was incorporated to provide funding for capacity building.<sup>97</sup>

#### **4.2.2.3 The first exemption to the Banks Act 94 of 1990**

The South African Reserve Bank (SARB) recognised the need for and benefits of these SACCOs and other credit co-operatives mushrooming at the time.<sup>98</sup> In recognising this importance, the first exemption to the Banks Act 94 of 1990 was made just before the post-apartheid era began in 1994 to permit common bond entities to mobilise deposits under certain conditions for on-lending to their members.<sup>99</sup> One such condition was that these entities must be affiliated to a self-regulatory body. For SACCOs, this was SACCOL.<sup>100</sup> Government Notice 1176 of 1 December 2006<sup>101</sup> recognised SACCOL as the regulator of all SACCOs.<sup>102</sup> Essentially, this transformed SACCOs into semi-formal financial co-operatives, acknowledged by the government but regulated by a self-regulated body.<sup>103</sup> The first exemption to the Banks Act also paved the way for the formation of village banks, commonly known as FSCs.<sup>104</sup> These developed predominantly within the rural areas.<sup>105</sup>

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<sup>94</sup> V Satgar *Comparative Study – Co-operative Banks and the Grameen Bank Model* 8.

<sup>95</sup> ECI Africa op cit note 1 at 18–19.

<sup>96</sup> Ibid.

<sup>97</sup> G K Coetzee & C Cross 'Group approaches to financial service provision in rural South Africa,' Working Papers 18042, University of Pretoria, Department of Agricultural Economics, Extension and Rural Development (2002) 22.

<sup>98</sup> ECI Africa op cit note 1 at 29.

<sup>99</sup> A E Okem *The Implementation of Co-operative Policy: Perceptions From Co-operatives in the Umgungundlovu District Municipality (Kwazulu-Natal, South Africa)* (unpublished PhD thesis University of KwaZulu Natal, 2016) 113.

<sup>100</sup> Ibid.

<sup>101</sup> published in Government Gazette No 21492

<sup>102</sup> CBDA 'Supervisory and Regulatory Rules for Co-operative Financial Institutions (CFI) Applying for Registration to the CBDA' (20 July 2012) 3 available at <http://www.treasury.gov.za/coopbank/supervisory%20CFIs/documents/CBDA%20Rules%201%20July%202015.pdf>

<sup>103</sup> Refer to the definition of semi-formal financial co-operatives.

<sup>104</sup> Mushonga op cit note 52 at 44.

<sup>105</sup> J Schoeman et al *Third Tier Banking Report: A Review of the Capacity, Lessons Learned and Way Forward for Member-based Financial Institutions in South Africa* (2003) 11.

#### 4.2.2.4 The introduction of village banks

Village banks in South Africa were introduced in 1994 by the International Fund for Agricultural Development (IFAD) and the African Rural and Agricultural Credit Association (AFRACA).<sup>106</sup> The launch was conducted with three pilot initiatives.<sup>107</sup> IFAD's involvement comprised of funding the work of national and international consultants during the first ten-month period after which the project was taken over by the Department of Agriculture.<sup>108</sup>

The concept of a village bank was a 'hybrid' financial institution that combined a co-operative with links to commercial banks that enabled village banks and their members to have access to a broader range of financial services such as loans and savings offered by commercial banks.<sup>109</sup> The links also helped to grant village banks access to assistance from the commercial banks in the form of capacity building and product development.<sup>110</sup> The village banks themselves, however, were still characterised by simple systems and procedures, and a limited range of products.<sup>111</sup>

The concept aimed to encourage the poor to save individually or in groups, with branches depositing funds in 'link banks' to protect the funds against theft and provide an audit trail. <sup>112</sup>The reasons for this structure were based on the high demand for secure savings structures in rural areas, on the need for reliable transmission facilities for people who depended on remittances (especially women), on the need for bailout loans to meet unforeseen consumption costs and inherent limitations of ROSCA (rigid systems, poor financial management, and so on). <sup>113</sup>

Initially, community members showed a high level of interest and support for the banks. The first three banks all had committed and trustworthy employees that were capable of generating adequate financial assets.<sup>114</sup> Their low operating costs and proximity to users made it possible for the village banks to offer competitive services with the alternative options (especially the local post office). <sup>115</sup> Furthermore, local

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<sup>106</sup> Ibid.

<sup>107</sup> Mushonga op cit note 8 at 263.

<sup>108</sup> Ibid

<sup>109</sup> G A Jones & A Dallimore Wither participatory banking? Experiences with village banks in South Africa (2009) 21 *European Journal of Development Research* 349.

<sup>110</sup> Mashigo et al op cit note 7 at 9.

<sup>111</sup> Ibid.

<sup>112</sup> W D Mbiakop *Determinants of Participation in Village Banks and Effects on the Welfare of Smallholder Farmers in Ngaka Modiri Molema District, North West Province, South Africa* (unpublished dissertation, North West University, 2017) 20.

<sup>113</sup> M Nigrini 'Empowering poor rural villages in South Africa: A preliminary investigation into financial service co-operatives' (2002) 70 *South African Journal of Economics* 377.

<sup>114</sup> J S Schoeman *Village Bank Project: Project evaluation and strategic plan* (Report on the Village Banks of the North-West Province, JHS Management Services, Pretoria, 1996) 8.

<sup>115</sup> Ibid.

control assisted in establishing a sense of ownership and personal responsibility.<sup>116</sup> However, upon a review, it was noted that although the banks evolved differently, the same strengths and weaknesses existed in all three banks.<sup>117</sup>

In all these three banks, the requirement for training was identified, especially for members to understand how they can be involved in the banks, and for accounting skills for administrators.<sup>118</sup> Further, the relationship with the link banks also needed to be clarified and it was noted that the banks were vulnerable to external influences.<sup>119</sup> This vulnerability encompassed interference from governments, NGOs and local authorities that were willing to assist in their expansion or control their actions, which would, in turn, cause a decreased sense of control and ownership by shareholders.<sup>120</sup>

The legal identity of the banks was also a concern, along with unsatisfactory internal controls. Even more, it had become evident that there was a need for a devoted support structure to ensure sustainability after IFAD had ended its engagement with the project.<sup>121</sup> Such a structure would offer institutional support when needed.

Accordingly, two initiatives were introduced to offer support to the stabilisation of the sector.<sup>122</sup> The first was the Financial Services Authority (FSA), and the second was the Financial Solutions (FinaSol).<sup>123</sup> The first task that the FSA undertook was to make a submission to the Registrar of Banks for a special exemption under the second exemption of the Banks Act.<sup>124</sup> The exemption provided for the registration and capitalisation requirements of institutions that accept deposits from the public.<sup>125</sup> Village banks were granted an exemption from requiring a banking licence to accept deposits on the condition that they were registered as FSCs with the FSA.<sup>126</sup> This meant that the FSA took on the responsibility for regulating its members, effectively becoming a form of a self-regulatory body.<sup>127</sup>

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<sup>116</sup> Schoeman op cit note 114 at 9.

<sup>117</sup> Genesis Analytics op cit note 95 at 9.

<sup>118</sup> Mushonga op cit note 52 at 45.

<sup>119</sup> Jones & Dallimore op cit note 109 at 349.

<sup>120</sup> Ibid.

<sup>121</sup> Mashigo et al op cit note 7 at 9.

<sup>122</sup> A Schoombee *South African Banks and the Unbanked: Progress and Prospects* (Stellenbosch Economic Working Papers 2/2004) 9.

<sup>123</sup> Ibid.

<sup>124</sup> ECI Africa op cit note 1 at 13.

<sup>125</sup> Genesis Analytics op cit note 95 at 9

<sup>126</sup> F Malan & R Willemse 'Banks, Village Banks and Deposit Insurance' (1996) *J S Afr L* 618.

<sup>127</sup> G Coetzee & C Cross *The Role of Community Banks in South Africa: Can it Contribute to Improve Access to Financial Services for the Poor?* (2002-2003) Working Paper 15.

Shortly after this, in 1999, the third exemption notice under the Banks Act was issued to enable FinaSol to regulate village banks when FSA began facing difficult operational challenges.<sup>128</sup> These exemptions, as with SACCOs, established the second form of semi-formal financial co-operatives in South Africa, being village banks.<sup>129</sup>

#### **4.2.2.5 The decline of SACCOs and village banks**

SACCOL's main source of funding is the Canadian Co-operative Association.<sup>130</sup> The funding had the primary social mission of offering low-cost financial services to members through various products.<sup>131</sup> In the period between 1994 and 2001, SACCOL received a USAID grant of approximately R4.3 million.<sup>132</sup> However, this high level of financial assistance created an over-reliance on donor funding which began to destroy the co-operative self-help ethos involving active membership contributions (savings) and loans.<sup>133</sup> Donor policies and objectives, on the other hand, took priority over sustainability.<sup>134</sup> It is not surprising, then, that as funds began to dry up and eventually dwindled, the number of functional SACCOs also decreased.<sup>135</sup>

Similarly for village banks, in 1999, the National Department of Welfare approved a grant for the FSCs project of R7 million to facilitate the establishment of appropriate FSA structures and capacities and for the training of 70 village banks in seven provinces.<sup>136</sup> This funding made it possible to formalise FSA activities. During the 30-month funding period, 29 village banks were founded in rural communities.<sup>137</sup> Further funding requests were submitted to the Department of Social Development for project extension.<sup>138</sup>

However, the Department commissioned a project review, which highlighted, among other things, the lack of adequate management and presence of poorly trained staff with no experience in microfinance.<sup>139</sup> As a result, funding applications were rejected and FSA subsequently closed operations in 2002, leaving 32

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<sup>128</sup> Ibid.

<sup>129</sup> Mushonga op cit note 52 at 45.

<sup>130</sup> Rena op cit note 41 at 4.

<sup>131</sup> Ibid.

<sup>132</sup> Mushonga op cit note 52 at 43.

<sup>133</sup> Ibid.

<sup>134</sup> Ibid.

<sup>135</sup> C Coetzee & C Cross *The Role of Community Banks in South Africa: Can it Contribute to Improve Access to Financial Services for the Poor?* (2002-2003) Working Paper 22.

<sup>136</sup> K Bolton *Formalising the Informal: The 'fate' of Village Banks* (unpublished LLM thesis University of Cape Town) 22.

<sup>137</sup> ECI Africa op cit note 1 at 14.

<sup>138</sup> D Porteus & E Hazelhurst *Banking on Change* (2004) 96.

<sup>139</sup> Ibid.

registered village banks.<sup>140</sup> These individual village banks were allowed to continue their operations, but without additional external funding or further training or product development assistance.<sup>141</sup>

### **4.2.3 RECONSTRUCTING FORMAL AND SEMI-FORMAL FINANCIAL CO-OPERATIVES**

The challenges discussed in the previous section were occurring amid a lot of pressure and lobbying to reform the co-operatives sector in South Africa.<sup>142</sup> Thus in 2001, the mandate for co-operatives development moved from the Department of Agriculture to the Department of Trade Industry and Competition (DTIC); effectively re-defining co-operatives as predominantly agricultural institutions.<sup>143</sup> Second, the first explicit Co-operative Policy was introduced in 2004 to address the fragile and fragmented regulations governing co-operatives and the lack of non-compliance of South African co-operatives to universally accepted principles and values of the co-operative movement.<sup>144</sup> This policy also formed the basis for progressive co-operative strategies, frameworks and the new Co-operatives Act.<sup>145</sup>

#### **4.2.3.1 The Co-operatives Act, 2005**

The Co-operatives Act came into force to provide for the formation and registration of all types of co-operatives; and any other forms of regulation that may have been required for co-operatives.<sup>146</sup> The Co-operatives Act widened the scope of its predecessor by incorporating different types of co-operatives such as agricultural co-operatives, insurance co-operatives, distribution co-operatives, worker-owned co-operatives, housing co-operatives, and finally financial services co-operatives.<sup>147</sup> The Act provided for the scope, definitions, membership, registration, management, general meetings, audits, capital structure, restructuring, administration, winding up, judicial management, and other matters relating to co-operatives.<sup>148</sup> It also contained specific provisions on housing co-operatives, worker co-operatives, agricultural co-operatives, and financial services co-operatives.<sup>149</sup>

It defined financial services co-operatives as a co-operative whose main objective is to provide financial services to its members, and included credit unions, co-operative banks, SACCOs or other financial

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<sup>140</sup> Genesis Analytics op cit note 95 at 9.

<sup>141</sup> Ibid

<sup>142</sup> Ibid.

<sup>143</sup> T Twalo *The State of Co-Operatives in South Africa The Need for Further Research* (2012) LMIP Working Paper 6.

<sup>144</sup> M M Kuhlengisa *An Evaluation of the Regulation and Supervision of Co-Operative Financial Institutions in South Africa* (unpublished master's dissertation, University of Stellenbosch 2011) 5.

<sup>145</sup> CIPC *Annual Report 2013/2014* (2014) 3.

<sup>146</sup> Co-Operatives Act, s 2.

<sup>147</sup> Co-Operatives Act, sched 1.

<sup>148</sup> J Sarkin 'The reshaping of the co-operatives legal architecture as a result of the 2013 amendments to the 2005 Co-Operatives Act: Promoting democratic governance and economic sustainability or control and overregulation' (2015) 27 *S Afr Mercantile LJ* 275 at 284.

<sup>149</sup> Ibid.

services.<sup>150</sup> Part 3 of the Act, concerning financial co-operatives provided a list of clauses that the constitution of a financial service institution must possess.<sup>151</sup> These were not mandatory provisions and included, for example, provision of insurance to the members, deposits, and loans.<sup>152</sup> The section also provided for the establishment of a self-regulatory body that would be a secondary co-operative that would regulate smaller financial co-operatives.<sup>153</sup> Lastly, the Act empowered the Minister in consultation with the Registrar of co-operatives to make regulations for the administration of the financial co-operatives.<sup>154</sup> While these provisions may not have been comprehensive in that they did not provide for detailed prudential regulation required for deposit-taking institutions, it paved the way for the introduction in 2007, of legislation specifically targeted to financial co-operatives; the Co-operative Bank Act.<sup>155</sup>

The Co-operatives Bank Act was aimed at improving access to financial services by creating a legislative framework that allowed for co-operative banks to develop and provide financial services to their members.<sup>156</sup> This Act is still in force today and will be further discussed in Chapter 6.

As for the semi-formal financial co-operatives, the National Treasury motivated for the appointment of another regulator for the sector, given limited capacity on the part of the central bank in the absence of FinaSol and FSA.<sup>157</sup> An existing government unit, the South African Microfinance Fund (SAMAF) was instructed to assume regulatory responsibility for FSCs on an interim basis, through Exemption Notice No 887 issued in 2008.<sup>158</sup> SACCOL proceeded with the regulation of SACCOs.<sup>159</sup>

#### **4.2.4 INFORMAL FINANCIAL CO-OPERATIVES**

Among the indigenous people of Africa, the tribe, with its chiefs, sub-chiefs, and head man, was by no means a collection of individuals or simply a group; it was a highly organised group where everyone had a specific place and duty.<sup>160</sup> The land was jointly held and sufficient for each family.<sup>161</sup> Under the tribe, the unit was the family, perhaps better called the clan. The head of the family was the patriarch of the

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<sup>150</sup> Co-operatives Act, s 1.

<sup>151</sup> Co-operatives Act, sched 1, Part 3.

<sup>152</sup> *Ibid.*

<sup>153</sup> Co-operatives Act, sched 1, Part 3, s 6(1).

<sup>154</sup> Co-operatives Act, sched 1, Part 3, s 7.

<sup>155</sup> De Jong & Kuhlengisa op cit note 14 at 56–7.

<sup>156</sup> *Ibid.*

<sup>157</sup> Mushonga op cit note 52 at 46.

<sup>158</sup> Banks Act Exemption Notice No 887 (2008); Genesis Analytics op cit note 95 at 14.

<sup>159</sup> *Ibid.*

<sup>160</sup> K Reese 'Agricultural Co-operatives as a Means to Economically Integrate the Rural Bantu in South Africa' (1975) 28 *Studia Diplomatica* 686.

<sup>161</sup> *Ibid.*

families of his children, and all of them were closely bound to each other.<sup>162</sup> The individual was little or nothing; the collective as a whole and the tribe counted for everything.<sup>163</sup>

Through such collectiveness, indigenous Africans shared scarce resources and were able to maintain some form of insurance for themselves.<sup>164</sup> This form, although different from co-operatives as defined today was supported by similar principles and values.<sup>165</sup> The emphasis however was not necessarily on the provision of financial services, but the communal living of life.<sup>166</sup>

#### **4.2.4.1 The emergence of stokvels**

No agreement exists concerning exactly when ROSCAs, or as popularly known in South Africa, stokvels arose.<sup>167</sup> It is highly unlikely that there would be a consensus because South Africa like other parts of Africa, and as shown above was also a very communal country and may have had these informal structures entwined into the fabric of the communities before they were acknowledged as formally existent.<sup>168</sup>

Regardless, there is some consensus that South Africa had a diverse cultural presence of various immigrant cultures who would have brought this concept with them.<sup>169</sup> In fact, the name 'stokvel' itself was derived from the nineteenth-century 'stock fairs' of English-speaking settlers who established farms in the Eastern Cape.<sup>170</sup> These were fairs or cattle markets where the English settlers would auction off cattle to labourers and farmers in the area.<sup>171</sup> In that context, labourers and farmers saw opportunities to socialise, exchange ideas, gamble, and often pool money together to purchase livestock.<sup>172</sup>

Over time, this phenomenon developed, and groups of individuals began to meet at the house of one of their members, where each person would contribute a modest amount of money into a rotating fund.<sup>173</sup>

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<sup>162</sup> Walsh op cit note 9 at 242.

<sup>163</sup> Ibid.

<sup>164</sup> A E Okem *The Implementation of Co-operative Policy: Perceptions From Co-operatives in the Umgungundlovu District Municipality (Kwazulu-Natal, South Africa)* (unpublished PhD Thesis University of Kwazulu Natal, 2016) 35.

<sup>165</sup> Ibid.

<sup>166</sup> Reese op cit note 160 at 686.

<sup>167</sup> Bouman op cit note 10 at 121.

<sup>168</sup> Ibid.

<sup>169</sup> A Hutchison 'Uncovering contracting norms in Khayelitsha stokvels' (2020) 52 *The Journal of Legal Pluralism and Unofficial Law* 6.

<sup>170</sup> J Lappeman et al 'Exploring retail orientated rotating savings and credit associations: festive season 'stokvels' in South Africa' (2019) *The International Review of Retail, Distribution and Consumer Research* 5.

<sup>171</sup> Ibid.

<sup>172</sup> M Irving *Informal savings groups in South Africa: investing in social capital* (2005) Working Paper Number 112. Centre for Social Science Research, University of Cape Town 10.

<sup>173</sup> Lappeman op cit note 170 at 5.

The host would receive the money and save it until the group's next purchase.<sup>174</sup> Later, the concept was also transferred to Johannesburg when thousands of black men migrated from the Eastern Cape to work in gold mines.<sup>175</sup>

These men would send money to their families to build up the homestead.<sup>176</sup> The money sent would be saved by women, often in the form of accumulated cash or at the post office. However, the desire for social interaction and mutual support gave rise to a ROSCA-type of saving through stokvels.<sup>177</sup> The women, who often met to drink tea, gradually transformed these casual meetings into savings organisations requiring a regular monetary contribution.<sup>178</sup> This evolution explains the description of some stokvels as 'Christian tea parties.'<sup>179</sup> By the late 1920s, stokvels were operating in black societies in Witwatersrand, Natal, the Orange Free State, and the Western and Eastern Cape, the.<sup>180</sup>

Today, four main types of stokvels can be identified: savings clubs, burial societies, investment and credit groups, and high budget stokvels.<sup>181</sup> The first two categories were prevalent during the early 1930s and later 1940s, while the latter two types were more recent advancements.<sup>182</sup>

#### **4.2.4.2 Types of stokvels**

##### **(a) Savings clubs**

These are the earliest form of stokvels.<sup>183</sup> They are general savings clubs that follow the ROSCA structure discussed in Chapter 3. Membership is usually relatively small, ranging from five to six to between 20 and 25 people, though instances of memberships of up to 80 people have been recorded.<sup>184</sup>

##### **(b) Burial societies**

Burial societies constitute the second type of stokvels. High worker mortality due to dietary changes, unsanitary living conditions, and disease outbreaks amplified the need for funeral services.<sup>185</sup> In the urban

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<sup>174</sup> Schulze op cit note 13 at 22.

<sup>175</sup> Ibid.

<sup>176</sup> A K Lukhele *Stokvels in South Africa: Informal Savings Schemes by Blacks for the Black Community* (1990) 6–7. A lot of men had migrated to urban centres like Johannesburg to perform wage labour.

<sup>177</sup> Verhoef op cit note 12 at 265.

<sup>178</sup> Ibid.

<sup>179</sup> Lukhele op cit note 176 at 6–7.

<sup>180</sup> Verhoef op cit note 12 at 265.

<sup>181</sup> Schulze op cit note 13 at 26.

<sup>182</sup> Verhoef op cit note 12 at 285.

<sup>183</sup> Verhoef op cit note 12 at 265.

<sup>184</sup> Ibid.

<sup>185</sup> Hutchison op cit note 169 at 7.

communities, burial societies were recognised as basically dedicated stokvels with the key objective of supporting urban Africans with funeral costs.<sup>186</sup>

### **(c) Investment stokvels**

The third type of stokvel is the investment stokvel, known as the ASCRA. This stokvel surfaced much later with the increasing influx of Africans in urban communities.<sup>187</sup> ASCRAs resemble ROSCAs, except that the total pool of savings is not paid out to members at the end meetings.<sup>188</sup> Instead, money collected in the pool is retained up to a specified maturity date, whereupon the total contribution of each member is paid out in a lump sum, possibly with accrued interest.<sup>189</sup> Accumulated funds are reserved (banked) with the common objective of purchasing expensive large commodities, investing in capital projects, or investing in business ventures, property, or equity.<sup>190</sup> The stokvel capital is sometimes also temporarily deposited in formal commercial banks.<sup>191</sup>

### **(d) High budget stokvels**

The last category of stokvels is a more modern development and symbolises the most explicit change in the organisational structure of modern stokvels from the earlier savings clubs.<sup>192</sup> High budget stokvels consist of a large number of members (100 members or more), all of whom have high social status and can be trusted in a society.<sup>193</sup> Contributions vary between R200 and R2 000 per month and pay-outs vary between R7 000 and R15 000 per month. Regular pay-outs are not made on a rotating basis but are subject to a date set for allocation by the board, which is the supreme decision-making body of the stokvel.<sup>194</sup> Given the large membership and somewhat arbitrary selection base, members can make their regular contributions, as determined by the board, but despite requesting opportunities to be recipients, may wait up to five years before the pool is allocated to them.<sup>195</sup>

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<sup>186</sup> Verhoef op cit note 12 at 267 and 285.

<sup>187</sup> Hutchison op cit note 169 at 7.

<sup>188</sup> African Response 'Stokvels – A hidden economy: Unpacking the potential of South African traditional savings schemes' (2012) at 11, available at <https://www.africanresponse.co.za/assets/press/2012StokvelHiddenEconomy.pdf>, accessed on 8 November 2020.

<sup>189</sup> Ibid.

<sup>190</sup> Verhoef op cit note 12 at 267 and 285.

<sup>191</sup> Ibid.

<sup>192</sup> Schulze op cit note 13 at 24.

<sup>193</sup> Ibid.

<sup>194</sup> Lappeman op cit note 170 at 5.

<sup>195</sup> Ibid.

#### 4.2.4.3 Launching supervisory institutional structures

As stated, stokvels are informal financial co-operatives. Therefore, the vast majority of South African stokvels are unincorporated and choose not to opt into the formal sector laws.<sup>196</sup> However, the sheer volume of funds within stokvels has made them a target market for financial intermediaries and their growth over the years has prompted the government to attempt some form of oversight of the sector.<sup>197</sup> Thus, like SACCOs and village banks, the Banks Act provided an exemption that permitted stokvels to function as deposit-taking institutions without a banking license if they register under a self-regulatory body.<sup>198</sup> For stokvels, this body was the National Stokvel Association of South Africa (NASASA) established in 1988.<sup>199</sup>

NASASA is approved as an association that stokvels need to register with to operate in the market.<sup>200</sup> Registration is free. NASASA aims to represent stokvel members on a corporate and governmental level and to try to create better conditions for the operation of stokvels.<sup>201</sup> NASASA was founded to represent and 'legalise' the existence of stokvels. As an over-arching self-regulatory body, NASASA set out to improve the operational efficiency of stokvels and to consolidate compound savings in order to negotiate bulk consumer concessions and services from financial institutions.<sup>202</sup> Accordingly, several savings and loan products were developed between NASASA, banks and building societies to encourage stokvel savings in formal financial institutions. In return NASASA members would earn privileged access to loan funds and privileged access to credit.<sup>203</sup>

Despite its efforts, NASASA has still not succeeded in national stokvel affiliation.<sup>204</sup> Recent research findings revealed that a large majority, being, 80.4 per cent of stokvels are not registered members or affiliated in any way to NASASA.<sup>205</sup> The findings could be revealing a gap in policy makers failing to enforce the exemption notices of the Banks Act.<sup>206</sup> Alternatively, it could be revealing the reluctance of stokvel members to be regulated using a top-down approach in an area that is self-regulated.

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<sup>196</sup> Schulze op cit note 13 at 26.

<sup>197</sup> Bophela & Khumalo op cit note 15 at 30.

<sup>198</sup> Ibid.

<sup>199</sup> M N Naong 'Stokvels: a possible panacea for fostering a savings culture?' (2009) 7 *Journal for New Generation Sciences* 255.

<sup>200</sup> Ibid.

<sup>201</sup> De Jong & Kuhlengisa op cit note 14 at 56–7.

<sup>202</sup> Lukhel

<sup>203</sup> Ibid.

<sup>204</sup> Naong op cit note 199 at 255.

<sup>205</sup> Bophela & Khumalo op cit note 15 at 30.

<sup>206</sup> Ibid.

### 4.3 OVERVIEW OF FINANCIAL CO-OPERATIVES – PRESENT DAY

Stokvels today continue to increase in number. It is well documented those contributions from stokvels run into billions of Rands.<sup>207</sup> Those registered by NASASA show that 11.4 million South Africans belong to 811 130 stokvels, which have a collective value of R49 billion a year.<sup>208</sup> Notwithstanding, recent research findings suggest that stokvels, though being robust institutions, face several characteristic problems.<sup>209</sup> Chief amongst these problems is financial management; and the disappearance and misappropriation of funds.<sup>210</sup> These opportunities for mismanagement have multiplied as more complex forms of savings and credit operations requiring a high level of literacy and numeracy have replaced the earlier types of stokvels.<sup>211</sup>

By the end of 2020, there were five registered co-operative banks, nine SACCOs and 15 village banks in South Africa. In terms of size, on average SACCOs have total assets amounting to R13.7 million and village banks have assets amounting to R2.5 million.<sup>212</sup> One reason for this minimal registration has been the Act itself, which will be discussed in Chapter 7. Beyond this, several other reasons can be extracted from the study of financial co-operatives in the previous chapters. For example, Chapter 2 shows that successful co-operatives began organically as part of solutions to socio-economic challenges within society.<sup>213</sup>

In Germany for instance, the arrival of the famine exposed the problem of lack of capital in both urban and rural areas.<sup>214</sup> In South Africa though, before South Africans could mature into a place where they would require co-operatives or identify the need for them, co-operatives had already been introduced within the country by European settlers to advance the agenda of white commercial farmers.<sup>215</sup> Along with this introduction, was presented laws that cemented this imposition.<sup>216</sup> Thus, inadvertently, the law was used as a tool to establish formal co-operatives where there may not have been a need for any, or where the country was not yet at appropriate developmental stages to adopt such infrastructure.<sup>217</sup>

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<sup>207</sup> Ibid.

<sup>208</sup> Lappeman op cit note 170 at 2.

<sup>209</sup> ECI Africa op cit note 1 at 5.

<sup>210</sup> Ibid.

<sup>211</sup> Ibid.

<sup>212</sup> South African Reserve Bank Prudential Authority available at [https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/SA\\_registered\\_financial\\_institutions](https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/SA_registered_financial_institutions), accessed on 8 November 2020.

<sup>213</sup> F Poli *Co-operative Banking Networks in Europe* (2019) 2.

<sup>214</sup> Ibid.

<sup>215</sup> Department of Trade and Industry op cit note 23 at 36.

<sup>216</sup> Co-operatives Societies Acts were introduced to secure input supply and output marketing services; and the Marketing Act aimed at controlling the marketing of agricultural products.

<sup>217</sup> Van Niekerk op cit note 31 at 22.

Accordingly, up to the present date, there might be no need for institutions designed as co-operative banks in South Africa, or if there is a need, then the actualisation of such a need is being stifled by advanced legal structures currently in place.

In addition, it is well understood that the growth of many financial co-operatives around the world has been promoted by benefactors to the cause who started off as sponsors of the institutions.<sup>218</sup> However, the differentiating factor between South Africa and the growth patterns in Germany for instance, is that benefactors of financial co-operatives in South Africa have consistently kept the grip tightly fitted on financial co-operatives.<sup>219</sup> Unlike Germany that weaned financial co-operatives off their sponsors at an early stage and therefore hastened their pace of growth, formal co-operatives have never in fact thrived independently in South Africa.<sup>220</sup> Accordingly, there is still excessive interference in the manner in which financial co-operatives function.

Further, formal co-operatives when introduced into South Africa were not introduced based on purely co-operative principles.<sup>221</sup> They were not strictly self-help organisations.<sup>222</sup> Instead, they were either governmental initiatives for development or companies.<sup>223</sup> In this way, they were much like the credit union established in Belgium by M Francois Haeck, being rich men's clubs.<sup>224</sup> Accordingly, for many South Africans today, formal co-operatives represent institutions that primarily serve the rich and therefore not surprisingly unpopular; or as government initiatives that can provide money, and therefore not self-help organisations.<sup>225</sup>

Relative to the financial sector in South Africa, financial co-operatives are minuscule in comparison.<sup>226</sup> To put the sector into context, for instance, Capitec Bank, one of the relatively smaller banks, reported 7.9 million clients in August 2016, with over R51 billion in total deposits.<sup>227</sup> In contrast, there is a noticeable

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<sup>218</sup> M Prinz 'German rural co-operatives, Friedrich Wilhelm Raiffeisen and the organization of trust' (2002) 54 *8th International Economic History Association Congress, Buenos Aires* 15–16.

<sup>219</sup> *Ibid.*

<sup>220</sup> ECI Africa op cit note 1 at 18–19.

<sup>221</sup> Walsh op cit note 9 at 244.

<sup>222</sup> *Ibid.*

<sup>223</sup> *Ibid.*

<sup>224</sup> T Bickerstaffe *The Significance of the Common Bond in Credit Unions* (unpublished PhD Thesis, University of Leeds, 2001) 82; D Tucker *The Evolution of Peoples Banks* (1922) 17.

<sup>225</sup> Department of Trade and Industry 'The DTI integrated strategy on the development and promotion of co-operatives: Promoting an integrated co-operative sector in South Africa 2012–2022' (2012) at 36, available at [http://www.dti.gov.za/economic\\_empowerment/docs/coops/legis\\_policy/coop-strategy.pdf](http://www.dti.gov.za/economic_empowerment/docs/coops/legis_policy/coop-strategy.pdf) accessed on 12 July 2021.

<sup>226</sup> De Jong & Kuhlengisa op cit note 14 at 56–57.

<sup>227</sup> *Ibid.*

decline in absolute numbers of financial co-operatives from 2010 to 2016, with figures not even coming close to those generated in the formal financial sector.<sup>228</sup>

Granted, there have been tiny bursts of increase over the years, with increases in average member savings rates and deposits.<sup>229</sup> However, the reality of these figures is that the sector is still a relatively small base and more needs to be done to be able to scale these figures and institutions. Notwithstanding, these occasional bursts do point to the possibility of the sector becoming a solid and a dynamic competitor to more conventional enterprises if sufficiently nurtured.<sup>230</sup>

#### 4.4 CONCLUSION AND OBSERVATIONS

This chapter focused on the third tier of banking which comprise member-based financial institutions across a spectrum that includes stokvels, savings and credit unions, village banks, and co-operative banks.<sup>231</sup> The chapter considered these financial co-operatives from a historical perspective to contextualise the status of financial co-operatives and the legislation that governs them. It traced the evolution of financial co-operatives showing that the co-operative movement emerged along three distinct paths that produced formal financial co-operatives, semi-formal financial co-operatives, and informal financial co-operatives.<sup>232</sup> A historical study was essential because it demonstrated how history shaped current practices within the sector.<sup>233</sup>

For example, for formal financial co-operatives, which in South Africa constitute co-operative banks, a historical study showed that their growth today may be retarded and their popularity minimal because they may have been introduced within the society prematurely; before South Africans could understand the institutions as self-help organisations that would empower them and their communities.<sup>234</sup> Further, it showed that semi-formal financial co-operatives were inclined to receive assistance in the form of either monetary or capacity support, without sufficient support mechanisms to ensure their self-sustainability.<sup>235</sup> When such assistance is withdrawn therefore, the financial co-operatives have also failed.<sup>236</sup>

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<sup>228</sup> Ibid; South African Reserve Bank Prudential Authority available at [https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/SA\\_registered\\_financial\\_institutions](https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/SA_registered_financial_institutions) accessed on 12 July 2021.

<sup>229</sup> De Jong & Kuhlengisa op cit note 14 at 56–57.

<sup>230</sup> Ibid.

<sup>231</sup> Ibid.

<sup>232</sup> Ibid.

<sup>233</sup> As outlined in Chapter 1.

<sup>234</sup> Walsh op cit note 9 at 244.

<sup>235</sup> Satgar op cit note 94 at 8.

<sup>236</sup> Ibid.

Lastly, the historical study revealed for informal financial co-operatives, self-help and communal practices have been entwined in the societal threads of the South African society for many years. Consequently, informal financial co-operatives would appeal more to the South African society because it is the norm.<sup>237</sup> Notwithstanding, it was shown that even after financial co-operatives have been in operation now for many years, the metrics in the sector, as measured by increased membership and savings growth, have not matched the quantum of interventions introduced by the government, funding, policy, and the law over this period.<sup>238</sup> While the numbers have generally increased, the scale and depth of the sector is still marginal relative to the broader South African financial sector and economy.<sup>239</sup>

These challenges are, however, symbolic of the early stages of co-operative development. The challenge for the sector and other stakeholders is therefore, to create the necessary enabling environment to drive the next wave of growth in the sector.

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<sup>237</sup> Ibid.

<sup>238</sup> De Jong & Kuhlengisa op cit note 14 at 56–57.

<sup>239</sup> Ibid.

## CHAPTER FIVE

### FINANCIAL CO-OPERATIVES IN MALAWI

*"In the British colonies, which are not all in a highly developed state, the movement has grown slowly and there are at the present time some 8,000 societies with a total membership of only 900,000 persons. More than a third of these societies are credit societies and ... Kenya and the Gold Coast together account for well over half the turnover in the colonial movement. By comparison, the movement in Great Britain has over 12 million members, mainly in consumers' societies with 30,000 shops."*<sup>1</sup>

#### 5.1 INTRODUCTION

##### 5.1.1 CONTEXTUAL BACKGROUND

Malawi has an approximate population of 18.6 million people of which 89 per cent live in rural areas. This makes Malawi a rural-based economy.<sup>2</sup> The problem that such a rural-based economy faces is that most of the population has no access to commercial banks and other formal financial service providers because formal financial service providers do not typically extend their services to the rural population and the small enterprises found predominantly among them.<sup>3</sup> Accordingly, the formal financial sector is small and limited in scope.<sup>4</sup>

Access to formal financial service providers is also limited because of a history of repressive financial policies which include government control over the volume and direction of credit as well as over interest rates.<sup>5</sup> However, this absence of formal financial services in rural areas; personal collateral guarantees that are consistent with the capacity of borrowers; and the absence of controls on how loans can be used, has facilitated the growth of informal financial institutions in these areas.<sup>6</sup> Therefore, there is an overwhelmingly large presence of informal financial co-operatives in Malawi.<sup>7</sup> These informal financial co-operatives include savings and credit associations (SCAs), co-operative savings associations (CSAs)

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<sup>1</sup> J West *The Co-operative Movement in the Federation of Rhodesia and Nyasaland* (Paper presents at the Rhodesian Society, 21 August 1956) 42.

<sup>2</sup> O Nkuna et al 'The role of commercial banks on financial inclusion in Malawi' (2018) 6 *Open Journal of Business and Management* 813.

<sup>3</sup> A Kalanda 'Development of Malawi's microfinance regulation and supervision' (2006) 16 *Essays on Regulation and Supervision* 5-6.

<sup>4</sup> Nkuna et al op cit note 2 at 814.

<sup>5</sup> E Aryeetey et al 'Financial Market Fragmentation and Reforms in Ghana, Malawi, Nigeria, and Tanzania' (1997) 11 *The World Bank Economic Review* 197.

<sup>6</sup> C Chipeta & M Mkandawire 'The informal financial sector in Malawi' (1992) 2 *African Review of Money Finance and Banking* 129.

<sup>7</sup> Finmark Trust 'Malawi demand, supply, policy and regulation diagnostic report' (2015) *Making Access Possible* 44.

and credit clubs<sup>8</sup> The existence of these financial co-operatives and their impact shows that there is a thriving financial sector beyond the bounds of formality.<sup>9</sup> Aside from these co-operatives, there are formal savings and credit co-operatives (SACCOS), and semi-informal village savings and loans associations (VSLAs), locally termed *banki n'khonde*, which literally means veranda banks.<sup>10</sup>

It should be noted however that from a legal and historical perspective, there is little to no consolidated body of literature on financial co-operatives in Malawi. There are rather a set of scattered studies that are not recent. This chapter consolidates these studies and focuses on each of the different types of financial co-operatives in turn.

## 5.2 FORMAL FINANCIAL CO-OPERATIVES

### 5.2.1 THE RISING NEED FOR THE INTRODUCTION OF CO-OPERATIVES

As stated earlier, ideally, a co-operative movement should grow organically, springing from the needs of the people and their determination to improve themselves through the principle of mutuality.<sup>11</sup> However, for many African countries, and especially for the British colonies, this was not the case.<sup>12</sup> For the British colonies, after scattered attempts to start co-operatives had been made by individuals and groups for many years since the 1920s, the British government felt that the growth of the movement was slow in many of their colonies and so they purposefully set out to introduce co-operatives.<sup>13</sup>

One of the reasons that the British wanted to introduce co-operatives in their colonies was to retain control of Africans. Colonialists had very small administrative units working to govern large populations.<sup>14</sup> If they wanted to retain their authority, they had to ensure that any trace of concentration of power among the Africans was neutralised.<sup>15</sup> Co-operatives were well-suited to the preferred discourse of communal African organisation. The co-operative idea was regarded as a less elitist form of organisation where the concentration of power would be in few African traditional leaders.<sup>16</sup>

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<sup>8</sup> E McGuinness *Malawi's Financial Landscape: Where Does Opportunity International Bank of Malawi Fit? Assessing the Impact of Innovation Grants in Financial Services* (2008) 23-7.

<sup>9</sup> *Ibid.*

<sup>10</sup> This the lateral or contextual translation but the contextual translation would be your local bank (in or around your veranda - but in the sense of physical access).

<sup>11</sup> F Poli *Co-operative Banking Networks in Europe* (2019) 2.

<sup>12</sup> A E Okem & A Stanton 'Contextualising the Co-operative Movement in Africa' in A E Okem (ed) *Theoretical and Empirical Studies on Co-operatives: Lessons for Co-operatives in South Africa* (2016) 18.

<sup>13</sup> West op cit note 1 at 42.

<sup>14</sup> J Värlander A genealogy of governing economic behaviour: Small-scale credit in Malawi 1930 -2010 (2013) 97 *Uppsala Studies in Economic History* 54.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

Further, co-operatives were seen as a way to manage the advancement of Africans. Colonialists had to ensure that the advancement of Africans was regulated by conserving African societies according to the colonial image of “tradition”.<sup>17</sup> The idea of protecting “the native” way of life was so strong that Africans who started trading activities were considered as a threat to the colonial image of African societies.<sup>18</sup> Co-operatives were seen as an institutional framework where a “progressive” African community could advance within a regulated communal and egalitarian system.<sup>19</sup> Lastly, the British saw co-operatives as a tool for the regulation of labour migration. British officials hoped that producer, credit, and marketing co-operatives would function as economic alternatives to migration as they would offer a structure for pooling African savings and promoting productive investment within the individual colonies.<sup>20</sup>

Accordingly, serious deliberations for the introduction of the co-operative movement commenced. In 1936, the Governor of Nyasaland (as Malawi was termed in the colonial era) wrote to the Colonial Office in London seeking advice on the introduction of co-operatives.<sup>21</sup> In 1938 the Colonial Office recommended that Captain Bingham, a district commissioner, and member of the Native Welfare Committee in Nyasaland, should be sent on a study trip to Europe, Nigeria, and the Gold Coast. Bingham’s task was to collect relevant information for the introduction of co-operatives in Nyasaland.<sup>22</sup> It was believed that such a trip and dedicated officer would be a fundamental factor in the success of co-operatives in Nyasaland because Nyasaland would have its own expert who was well informed about local needs and difficulties and who would stay in the country (it was estimated that it would require at least ten years to build up a co-operative movement).<sup>23</sup>

Bingham returned to Malawi after the six-month study trip and presented what he had learnt.<sup>24</sup> He described that the origins of the co-operative movement were in Europe, where co-operatives had been set up to deal with the problem of the indebtedness of the peasantry at the hands of moneylenders.<sup>25</sup> The essence was to promote a specific behaviour of thriftiness, entrepreneurship and a work ethic that was more communal than individualistic.<sup>26</sup>

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<sup>17</sup> J Power ‘Individualism is the antithesis of indirect rule’: Co-operative development and indirect rule in colonial Malawi’ (1992) 18 *Journal of Southern African Studies* 331.

<sup>18</sup> Ibid.

<sup>19</sup> Power op cit note 17 at 318-19.

<sup>20</sup> L Vail ‘The making of an imperial slum: Nyasaland and its railways, 1895–1935’ (1975) 16 *The Journal of African History* 109–12.

<sup>21</sup> Co-operative movement introduction in Nyasaland, May 1936, CO 525/164/7; West op cit note 1 at 42.

<sup>22</sup> Minutes of a Special meeting of the Native Welfare Committee held at Zomba, 11th April 1938, MNA S11/1/2/1; Värlander op cit note 14 at 59.

<sup>23</sup> Värlander op cit note 14 at 59; K C Matupa, Secretary of the Nyasaland African Milling Company to Registrar of Co-operatives, 24 November 1948 and Bingham’s marginal notes; Co-operative movement introduction in Nyasaland, Ormsby-Gore (Secretary of State for the Colonies), Colonial Office, July 1936, CO 525/164/7.

<sup>24</sup> Report on a tour undertaken to study cooperation in Europe, West Africa and Ceylon, MNA S11/1/2/1.

<sup>25</sup> E Green ‘A lasting story: Conservation and agricultural extension services in colonial Malawi (2009) 50 *The Journal of African History* 257; Minutes of a Special meeting of the Native Welfare Committee held at Zomba, 11th April 1938, MNA S11/1/2/1.

<sup>26</sup> Ibid

After initial discussions, the Native Welfare Committee decided that Bingham could continue to conduct a preliminary examination in some parts of Nyasaland to explore the possibility of co-operatives and to see whether the establishment of credit co-operatives would help to improve the economic lives of the people.<sup>27</sup> The Committee especially referred to the indebtedness of the people in Nyasaland and the responsibility people with incomes had, for extended families.<sup>28</sup> There was however no proof of indebtedness mentioned in the files of colonial officers nor was a deeper study made on what type of debt it was.<sup>29</sup> This shows that the colonial administration may not have been fully aware of local circumstances at the time.<sup>30</sup>

Bingham's investigations confirmed that people were indeed in debt.<sup>31</sup> Much of the debt that was owed at the time was owed locally, which meant that there must have been rural creditors with funds available for local investments.<sup>32</sup> However, these rural creditors comprised of local businessmen that had high interest rates on the credit issued.<sup>33</sup> Articulated as a problem, indebtedness demanded alternative solutions such as the co-operatives. This issue and its solution legitimated Bingham's position and work.<sup>34</sup>

## **5.2.2 THE BIRTH OF CREDIT CO-OPERATIVES: LOAN AND THRIFT CO-OPERATIVES**

### **5.2.2.1 Establishing loan and thrift co-operatives**

After consideration of Bingham's findings, the Native Welfare Committee had the required proof to confirm that people in Nyasaland were indeed indebted, and thrift co-operatives were desirable in principle. Bingham was therefore permitted to set up model thrift co-operatives.<sup>35</sup> Bingham set up three thrift and loan co-operatives, one co-operative for members of the Native Civil Service in Zomba, one co-operative for members in the Native Civil Service in Blantyre and one for clerks employed in banks and commercial companies in Blantyre.<sup>36</sup>

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<sup>27</sup> Värlander op cit note 14 at 60.

<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

<sup>30</sup> D Meredith 'The British government and colonial economic policy, 1919-39' (1975) 28 *The Economic History Review* 487.

<sup>31</sup> Cooperation, Interim Report, 1938, MNA S11/1/2/1; B Ingham 'Household savings & credit: A long View of policy' in J H Frimpong-Ansah & B Ingham (eds) *Saving for Economic Recovery in Africa* (1992) 62.

<sup>32</sup> Ibid

<sup>33</sup> Power op cit note 17 at 336.

<sup>34</sup> Värlander op cit note 14 at 61.

<sup>35</sup> Extract from Minutes of Native Welfare Committee, May 1938, MNA S11/1/2/1.

<sup>36</sup> Zomba and Blantyre were administrative (capital city) and commercial centres, respectively during colonial times. The Original memberships of the co-operatives stood at fifteen, twelve and fifteen respectively. (MNA, S 1/1/2/4, F23d, Minute, Bingham, 24 June 1939).

Notably, the members were not farmers as had been learnt from Europe or discussed initially.<sup>37</sup> Bingham preferred the educated Malawian groups because he believed that the colonial officers could indirectly rule the larger groups of Malawians if they had few Malawians that could be seen as examples for the masses, defined as the progressive Africans.<sup>38</sup> Bingham also preferred the educated groups because he found that clerks were in debt and in serious need of education on how to handle money.<sup>39</sup>

### 5.2.2.2 Challenges to loan and thrift co-operatives

Initial challenges to the co-operative movement were illiteracy, lack of business, and the fact that building co-operatives required a lot of time.<sup>40</sup> An additional challenge that arose was the lack of legislation.<sup>41</sup> Bingham enquired into the question of introducing legislation to govern co-operatives for the first time in 1938.<sup>42</sup> He argued that if legislation was not introduced, it would handicap the movement: the co-operatives would not have any statutory legal protection, and it would not be possible to force the members to obey the bylaws set out.<sup>43</sup> His request was dealt with, and a draft ordinance was prepared in 1939.<sup>44</sup> The bill was discussed in the Native Welfare Committee, but no legislation was ratified because the governor thought the moment was not right.<sup>45</sup>

There are no minutes or notes that can show why the governor was so hesitant to ratify legislation. Still, the reason was possibly the governor's fear of responsibility, since legislation could lead to the growth of the co-operatives, which could in turn increase demand for credit that could not be handled at that time.<sup>46</sup> What was made evident, however, was that the colonial government did not want to risk creating unwanted state institutions and was unwilling to introduce legislation, which would have formalised the workings of the thrift and loan co-operatives.<sup>47</sup>

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<sup>37</sup> Annual Report Co-operative movement in 1938, written by Bingham 1939, MNA PCC1/9/1.

<sup>38</sup> M Vaughan *Better, Happier and Healthier Citizens: The Domasi Community Development Scheme, 1949-54* (1983) 15.

<sup>39</sup> M Vaughan *The Story of an African Famine – Gender and Famine in the Twentieth-century Malawi* (1987) 79.

<sup>40</sup> Minutes of a Special meeting of the Native Welfare Committee held at Zomba, 11th April 1938, MNA S11/1/2/1.

<sup>41</sup> C Ng'ong'ola 'The state, settlers, and indigenes in the evolution of land law and policy in colonial Malawi' (1990) 1 *The International Journal of African Historical Studies* 55.

<sup>42</sup> Letter from Bingham, 6th July 1938, MNA S11/1/2/4; Värlander op cit note 14 at 65.

<sup>43</sup> Ibid.

<sup>44</sup> Letter from co-operative officer to the chief secretary Zomba, 13th January 1940, MNA PCC1/9/1.

<sup>45</sup> Värlander op cit note 14 at 65.

<sup>46</sup> Ibid.

<sup>47</sup> Ibid.

### 5.2.2.3 The failure of loan and thrift co-operatives

Loan and thrift co-operatives did not exist for long.<sup>48</sup> By the 1940s many of them had been shut down. There were a number of reasons that contributed to their downfall. One such reason was the lack of organisational structures. In the 1940s, supervisors of co-operatives were people in the local administration.<sup>49</sup> Thus, organisational practices were connected to a few seemingly randomly chosen people in the administration.<sup>50</sup> When Bingham was given other duties during the second world war, no one replaced him as responsible for the co-operatives.<sup>51</sup>

Another reason was a lack of support from the local people. In August 1942, when Nyasaland acquired a new governor, he requested an update on the thrift and loan co-operatives.<sup>52</sup> An intense discussion broke out within the administration, and it was apparent that no one really knew what had happened to the co-operatives, or co-operative legislation.<sup>53</sup> The district commissioners were requested to locate the co-operatives and write reports. The reports showed that several of the co-operatives had died.<sup>54</sup> The fact that the colonial administration lost track of the co-operatives shows that co-operatives may have been weak at the time.<sup>55</sup> Further, the administrators reported that the need for credit among the local people had not yet become apparent and that therefore there was little scope for loan and thrift co-operatives.<sup>56</sup>

Further reasons included embezzlement of funds and high levels of illiteracy. The local population were not well-educated on bookkeeping and recording, and in some instances embezzled the funds.<sup>57</sup> In addition, it might have been the case that the environment was not conducive for them. Credit co-operatives flourished in countries where there were innumerable small landowners, as in Germany or the British colony of India, but in most of Africa, where Africans held land mainly on a communal basis, it was unlikely that they would develop.<sup>58</sup> Consequently, as depicted in the introductory quote, advancement of these co-operatives was slow.

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<sup>48</sup> F Cooper 'Modernizing Bureaucrats, backward Africans, and the development concept' in F Cooper & R M Packard (eds) *International Development and the Social Sciences. Essays on the History and Politics of Knowledge* (1997) 66.

<sup>49</sup> M M van Beusekom & D Hodgson 'Lessons learned? Development experiences in the late colonial period' (2000) 41 *Journal of African History* 655.

<sup>50</sup> *Ibid.*

<sup>51</sup> Värlander op cit note 14 at 65.

<sup>52</sup> *Ibid.*

<sup>53</sup> A C Ross *Colonialism to Cabinet Crisis. A Political History of Malawi* (2009) 43.

<sup>54</sup> Despatch, May 1942 at 23 MNA S11/1/2/5; Report written by K H Garvey on Blantyre commercial clerks co-operative Thrift and Loan Society, 3rd February 1943 MNA S11/1/2/5. See also a letter from the district commissioner in Blantyre, 3rd February 1943. MNA S11/1/2/5.

<sup>55</sup> Värlander op cit note 14 at 66.

<sup>56</sup> *Ibid.*

<sup>57</sup> Cooper op cit note 48 at 66.

<sup>58</sup> C Joon-Hai Lee 'The 'Native' Undefined: Colonial categories, Anglo-African status and the politics of kinship in British Central Africa, 1929–38' (2005) 46 *Journal of African History*.

In direct contrast though, both Malawians and the colonial administration preferred consumer and producer co-operatives because they were related to agriculture production and long-term development, rather than to short-term goals of individual and family security.<sup>59</sup> On the part of the Malawians, it may also have been because they already had informal societies that catered to their credit needs.<sup>60</sup>

Accordingly, the colonial administration continued to advance the co-operative agenda, this time with an emphasis on consumer and producer co-operatives.<sup>61</sup> A dispatch circulated by the Colonial Office noted that there were two requirements essential for the healthy development and maintenance of the co-operative movement.<sup>62</sup> One was a proper legal framework, and another was an officer of the government (usually called the Registrar of Co-operative Societies) assisted by a staff of the necessary quality and strength, to guide and assist the movement.<sup>63</sup>

### 5.2.3 THE LEGAL FRAMEWORK OF CO-OPERATIVES

The British introduced the Nyasaland Co-operative Societies Ordinance that became law in 1946.<sup>64</sup> The Ordinance was founded on the Co-operative Model Law of 1946; an interpretation by the British of the German co-operative law model – or rather misinterpretation of the German co-operative law - which they applied in all colonies under British rule.<sup>65</sup> The formulation of such a co-operative law was initiated without the involvement of co-operatives and co-operators, as was the case in Germany. Consequently, instead of considering the benefits of the co-operatives and its members, the main consideration was the benefits of the rulers or in this case, the colonisers. Accordingly, the co-operatives looked towards government departments and not to their members for guidance and working procedures.<sup>66</sup>

Thus, the Ordinance provided *inter alia*, that co-operative societies would be supervised by a Registrar of Co-operative Societies.<sup>67</sup> The Registrar would handle most affairs concerning the organisation of the co-operative societies. The societies would draft their own laws, but these would be submitted to the Registrar, as well as the list of members, and annual returns.<sup>68</sup> The duties of the Registrar included

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<sup>59</sup> Interim general report on co-operative development in the Northern province, 1951. MNA PCN 1/8/5.

<sup>60</sup> *Ibid.*

<sup>61</sup> Chipeta & Mkandawire *op cit* note 6 at 153.

<sup>62</sup> Värlander *op cit* note 14 at 66.

<sup>63</sup> *Ibid.*

<sup>64</sup> *Ibid.*

<sup>65</sup> D Cracogna *International Handbook of Co-operative Law* (2013) 806.

<sup>66</sup> *Ibid.* Henry H (2005) Co-operative Credit Societies Act, India, 1904. A model for development lawyers? In: Muñkner H-H (ed) 100 years co-operative Credit Societies Act, India 1904. A worldwide applied model of co-operative legislation. Institute for Co-operation in Developing Countries, Marburg, pp 135ff.

<sup>67</sup> Power *op cit* note 17 at 327.

<sup>68</sup> *Ibid.*

approving the auditor of societies, prescribing books to be kept, and when deemed necessary, holding enquiries into the societies.<sup>69</sup>

The Ordinance also set out several provisions regarding the organisation of co-operative societies. Co-operative societies would have a minimum of ten members, would be corporate bodies and would be registered with limited liability.<sup>70</sup> Members had to be at least 18 years of age, and no member would have more than one vote. Mandatory regular meetings would be conducted, and the management committee would be elected by most of the members present.<sup>71</sup> The financial end of the co-operative societies would be controlled by legislation, and societies would only offer loans to their members or invest their funds in securities, approved by the Registrar.<sup>72</sup>

Any society which made a profit would maintain a reserve fund and a maximum of ten per cent was set upon dividends. When the dissolution of a society occurred, the surpluses after meeting all liabilities would be distributed amongst its members in proportion to their share capital.<sup>73</sup> The legal framework to support the development of these co-operatives fostered the rise and growth of co-operatives in areas of agricultural production, processing, marketing, and general merchandise trading.<sup>74</sup>

However, ensuing co-operative legislation also had detrimental effects on the ethos of co-operatives in Malawi.<sup>75</sup> The co-operatives originated from government developmental policy and directives rather than people's common interests and own motivation.<sup>76</sup> The co-operative societies were conditioned to emerge as dependent agents and/or clients of the state and other semi-public agencies.<sup>77</sup> Accordingly, the co-operative societies were engulfed in state politics to the magnitude that the failures of state policies found expression in the co-operative movement.<sup>78</sup> Their development was therefore arrested from the beginning.

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<sup>69</sup> West op cit note 1 at 44.

<sup>70</sup> Ibid.

<sup>71</sup> Ibid.

<sup>72</sup> Ibid.

<sup>73</sup> Värlander op cit note 14 at 66.

<sup>74</sup> R Kachule 'Rural Producer Organisations and Policy Formulation in Malawi' (Working Paper 2004:127) 15.

<sup>75</sup> Ibid.

<sup>76</sup> O E Magambo *The Effect of Regulations on the Financial Performance of Deposit Taking Savings and Credit Co-operative Societies In Kenya* (unpublished thesis, University of Nairobi, October 2014) 3.

<sup>77</sup> Ibid.

<sup>78</sup> Ibid.

## 5.2.4 THE GROWTH AND IMPACT OF CO-OPERATIVES

By the end of 1947, 12 consumers' societies, and one society of small farmers had been registered under the new legislation.<sup>79</sup> Development was rapid in 1948 with an additional 16 new consumer societies, 11 producer societies, one federal society with ten primary societies, and one combined mutual aid and thrift and loan society being registered; all these societies were small, with the total membership of no more than 1 800.<sup>80</sup> By the end of 1950, there were 70 societies in existence with a total membership of 2 600.<sup>81</sup>

In 1952 many of the difficulties affecting consumer societies came to a climax, and 14 societies were liquidated.<sup>82</sup> The producer societies and the federal society however performed much better, so that by the end of the year there were 71 societies in all, with 3 200 members.<sup>83</sup> The loans and thrift co-operatives had all closed down.<sup>84</sup>

In 1962, there was introduced a Co-operatives' College to address the education and training needs of co-operatives.<sup>85</sup> Notwithstanding, co-operatives did not become a popular form of economic organisation in colonial Malawi.<sup>86</sup> This was especially among the educated government clerical workers, company employees and private businesspeople, where Bingham had first launched co-operatives.<sup>87</sup> As employees, proprietors of their own shops, consumers, or taxpayers, they were sound business people who recognised that co-operatives undercut the economic autonomy of individuals, depriving them of a crucial edge in a market overshadowed by foreign capital and characterised by competition.<sup>88</sup>

Similarly, in rural areas, because the colonial administration encouraged Malawians to join co-operatives to pool materials and resources into a fund that primarily boosted agricultural production and exported cash crops (and therefore the colonial agenda), Malawians did not regard co-operatives as belonging to them but rather saw the co-operatives as instruments of the colonial regime, introduced to control them.<sup>89</sup> Malawians mostly joined co-operatives either to avert problems with colonial authorities or to acquire access to certain services like marketing of their produce.<sup>90</sup>

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<sup>79</sup> West op cit note 1 at 48-49.

<sup>80</sup> Ibid.

<sup>81</sup> Ibid.

<sup>82</sup> Green op cit note 25 at 261.

<sup>83</sup> C Baker *Development Governor. A Biography of Sir Geoffrey Colby* (1994) 83.

<sup>84</sup> West op cit note 1 at 48-9

<sup>85</sup> A Borda-Rodriguez & S Vicari 'Rural co-operative resilience: The case of Malawi' (2014) 2 *Journal of Co-operative Organization and Management* 3.

<sup>86</sup> Ibid.

<sup>87</sup> Power op cit note 17 at 318.

<sup>88</sup> Ibid.

<sup>89</sup> Green op cit note 25 at 248.

<sup>90</sup> M J M Ochieno *Analysis of Institutional and Governance Factors and Their Impact on Smallholder Agricultural Co-operatives' Performance in Malawi: A case of rice-orientated co-operatives in Zomba, Saaima and Nkhatabay Districts of Malawi* (unpublished)

## 5.2.5 REBUILDING CREDIT (LOAN AND THRIFT) CO-OPERATIVES: SAVINGS AND CREDIT CO-OPERATIVES

In 1964, Malawi attained independence from colonial rule.<sup>91</sup> The regime that superseded the colonial rule was dictatorial in nature. In its disapproval of what the colonial rule had built, the dictatorial administration restructured the whole co-operatives sector, closing many small co-operatives and the Co-operatives College in 1966.<sup>92</sup> However, the dictatorial approach was not very different from the colonial approach. Like the government under colonial rule, the new government carried on with the manipulation of the co-operatives' model to advance economic, political, and private interests.<sup>93</sup>

The main difference with the regimes however was that while the colonial government had used individuals to advance the co-operative agendas, the dictatorial regime established itself as the dominant player, deregistering small co-operatives and replacing them with estates, large private industries and parastatals that acted as government-controlled co-operatives.<sup>94</sup> Their focus was on agricultural co-operatives.<sup>95</sup>

However, in time, the government realised that individuals and small co-operatives were still vital for the development of the country.<sup>96</sup> Therefore, credit was especially given to smallholder farmers and farmer-credit clubs to ensure that the smallholder sector kept up with the expansion in the estate sector and in turn increased agricultural production.<sup>97</sup> Credit was administered by the Government Loans Board from 1972.<sup>98</sup> The agricultural credit sector evolved over the years into what is now the microfinance sector in Malawi, heavily populated by the government, donors, and micro-credit institutions.<sup>99</sup>

### 5.2.5.1 Establishment of SACCOs

Credit co-operatives were successfully re-established in 1960s by Canadian Catholic priests.<sup>100</sup> Through the assistance of the church, 1973 saw the formation of the first SACCO known as Munjili in Mzimba.<sup>101</sup>

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dissertation, Exports University, 2012) 23; F Wanyama, P Develtere & P Pollet Cooperating out of poverty: The renaissance of the African Co-operative Movement, International Labour Office, World Bank Institute, Geneva, Switzerland (2008) 11.

<sup>91</sup> S Vicari *A Report On The Credit Union Movement In Malawi* (2014) *The Co-Operative College* 1.

<sup>92</sup> Kachule op cit note 74 at 16.

<sup>93</sup> Ibid.

<sup>94</sup> Ibid.

<sup>95</sup> M Mapila et al 'Elitism in the farmer organization movement in postcolonial Malawi' (2010) 2 *Journal of Agricultural Extension and Rural Development* 145.

<sup>96</sup> Värlander op cit note 14 at 264.

<sup>97</sup> Ibid.

<sup>98</sup> World Bank *Malawi Poverty Reduction Strategy Paper* (2002) 36.

<sup>99</sup> Värlander op cit note 14 at 264.

<sup>100</sup> Genesis Analytics *Understanding financial co-operatives: South Africa, Malawi and Swaziland* (2013) 18.

SACCOs were a good form of microfinance in Malawi. Independent from government intervention and donors, they grew slowly; and only began to rapidly expand when they received financial support from the USAID in 1980, and technical assistance from the World Council of Credit Unions (WOCCU) and CUNA Mutual, an American insurance group.<sup>102</sup>

With extensive experience in the emerging credit union movements in Africa, WOCCU built systems and procedures for savings and credit services.<sup>103</sup> CUNA Mutual, which at that time had a presence in many Africa countries, created simple insurance products that were constructed as a complementary services to the SACCOs' core business of savings and credit.<sup>104</sup> The organisations helped the co-operatives that were in existence by 1980, being 26 credit co-operatives, to come together to form the first secondary level co-operative organisation in the country, named MUSCCO.<sup>105</sup>

### 5.2.5.2 The growth of SACCOs

When the political dispensation in Malawi changed yet again in 1994 from a dictatorship to democratic rule, the democratic government, coupled with the advocates for the liberalisation of the economy began to introduce political and legal frameworks that would enable co-operatives to play a more prominent role in national development.<sup>106</sup> Accordingly, in 1995, the government formulated the Agriculture and Livestock Development Strategies and Action Plan (ALDSAP).<sup>107</sup> ALDSAP advocated for local initiatives and the participation of people in their development which entailed an increase in self-reliance and the use of local resources to meet local needs.<sup>108</sup>

ALDSAP eventually led to the launch of the Co-operative Development Policy in 1997 by the Ministry of Industry, Trade and Enterprise Development (MoIT).<sup>109</sup> This policy aimed to create an enabling atmosphere for the sustainable development of co-operatives with the overarching goal of enhancing the lives of Malawians.<sup>110</sup> The policy affirmed the new government's recognition of co-operatives as private enterprises that play a very important role in achieving national development objectives.<sup>111</sup>

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<sup>101</sup> Ibid.

<sup>102</sup> A Borda-Rodriguez 'Case study 3: The Malawian Union of Savings and Credit Co-Operatives (MUSCCO)' (2013) at 8, available at <http://www.open.edu/openlearnworks/course/view.php?id=1598> accessed on 18 May 2021.

<sup>103</sup> Ibid.

<sup>104</sup> S Enarsson & K Wirén 'MUSCCO – Malawi Union of Savings and Credit Co-operatives', CGAP Working Group on Microinsurance Good and Bad Practices, Case Study No 8. (2005) 4.

<sup>105</sup> Ibid.

<sup>106</sup> Kachule op cit note 74 at 16.

<sup>107</sup> Ochieno op cit note 90 at 26.

<sup>108</sup> Ibid.

<sup>109</sup> Genesis Analytics op cit note 100 at 18.

<sup>110</sup> Ibid

<sup>111</sup> Kachule op cit note 74 at 16.

The policy was superseded by the introduction of the Co-operatives Societies Act of 1998, which amended the Co-operative Ordinance Act of 1946.<sup>112</sup> The policy and legislative framework adopted together, for the first time recognised co-operatives as having principles and values that had to be encouraged.<sup>113</sup> The Act governed all co-operatives and endeavoured to reduce the powers of government and offered greater autonomy to co-operatives.<sup>114</sup> It was only in 2011 when Malawi passed the sector-specific Financial Co-operatives Act aimed at regulating and supervising SACCOs.<sup>115</sup>

### **5.2.5.3 SACCOs – The present day**

By 2012, there were only 192 SACCOs registered with the Department of Co-operatives; of these, only 50 SACCOs were reported to be active.<sup>116</sup> Further still, of the 50, only 39 are SACCOs are affiliated with MUSCCO.<sup>117</sup> They have a member base of approximately 155 632 individuals.<sup>118</sup> Members buy shares and deposit savings in their SACCO. They can also get loans.<sup>119</sup>

While SACCOs have developed over the years, in many ways they have remained stagnant. One of the reasons for this stagnation is the failed adaptation of SACCOs to suit the Malawian environment. Financial co-operatives were transplanted from the ideologies of co-operatives and individuals in Europe and therefore have little sympathy for the needs and means of the average depositor or borrower in a developing country.<sup>120</sup> The average Malawian for example is not able to read and write. It is difficult therefore to subscribe and understand the fundamental principles and workings of these financial co-operatives.<sup>121</sup> Another reason is the controls, inflexibility, repression, and high administrative costs that formal financial institutions suffer from.<sup>122</sup> Such controls include entry fees, increased prudential requirements and regulatory costs that will be discussed in Part 2 of this thesis.

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<sup>112</sup> M Nankhonya *An Assesment of the Factors Affecting the Growth of Savings and Credit Co-operatives in Malawi* (unpublished dissertation, Exploits University, 2013) 5.

<sup>113</sup> Genesis Analytics Genesis Analytics op cit note 100 at 18.

<sup>114</sup> Ibid.

<sup>115</sup> Financial Co-operatives Act 2011, s 1.

<sup>116</sup> Borda-Rodriguez & Vicari op cit note 85 at 6.

<sup>117</sup> Reserve Bank of Malawi Financial Institutions Annual Report for 2020 (July 2021) 99.

<sup>118</sup> Ibid.

<sup>119</sup> Genesis Analytics Genesis Analytics op cit note 100 at 18.

<sup>120</sup> S Madise *The Regulation of Mobile Money: Law and Practice in Sub-Saharan Africa* (2019) 220.

<sup>121</sup> Ibid.

<sup>122</sup> Chipeta & Mkandawire op cit note 6 at 154.

## 5.3 SEMI-FORMAL FINANCIAL CO-OPERATIVES

### 5.3.1 BANKI N'KHONDE (VILLAGE SAVINGS AND LOAN ASSOCIATIONS – VSLA)

While it was IFAD that led the development of village banks in South Africa, it was CARE International (CARE), that pioneered and still dominates the concept in Malawi.<sup>123</sup> CARE launched village banking in Malawi in 1998.<sup>124</sup> It is popularly known as VSLA or locally as *banki n'khonde*, literally translated to veranda bank.<sup>125</sup>

VSLAs offer a secure way to access loans and save money. No outside capital is required – just a safe, three locks and keys and some basic financial training, which CARE itself offers.<sup>126</sup> Typically, CARE representatives meet with village leaders, conduct promotional activities, and facilitate the formation of VSLAs.<sup>127</sup> Interested participants form groups of 19 to 30 members, pool money to create a fund from which they can take out loans.<sup>128</sup> With rates predetermined at the group's founding, members repay loans with interest, thus enabling them to also earn a return on their savings.<sup>129</sup>

This concept incorporates many elements of rotating savings and credit associations (ROSCAs) but adds more flexibility to savings and loans, standardises the governance structures and strengthens elements of accountability.<sup>130</sup> VSLAs rely on their members' savings for the provision of credit (as well as small contributions to a limited fund which can be accessed in times of funerals or illnesses of household members).<sup>131</sup> A minimum level of savings is compulsory at the weekly meetings and usually, loans are made available to members once a month.<sup>132</sup>

#### 5.3.3.1 Challenges encountered by the VSLA

A mapping exercise conducted in 2015 by the Ministry of Finance, Economic Planning and Development (MoFEPD) and CARE found that in total, there are 67 NGOs currently implementing VSLA programmes with a total of 37 461 savings groups and 610 596 members.<sup>133</sup>

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<sup>123</sup> J Agar et al Status of Agricultural and Rural Finance in Malawi FinMark Trust (July 2012) 40.

<sup>124</sup> Ibid.

<sup>125</sup> J Kumdana *The Role of Social networks in Supporting Micro and Small Entrepreneurship in Malawi* (unpublished thesis, Swedish University of Agricultural Sciences) 21. This the lateral or contextual translation but the contextual translation would be your local bank (in or around your veranda - but in the sense of physical access).

<sup>126</sup> CARE Village Savings and Loans (VSLA) available at <https://www.care.org.au/village-savings-loans/> accessed on 10 March 2020.

<sup>127</sup> Ibid.

<sup>128</sup> Ibid.

<sup>129</sup> Kumdana op cit note 125 at 21.

<sup>130</sup> Refer to Chapter 3 on Village banks vs ROSCAs.

<sup>131</sup> P Dupas 'Banking the unbanked? Evidence from three countries' (2018) 10 *American Economic Journal: Applied Economics* 266.

<sup>132</sup> Ibid.

<sup>133</sup> A van der Meerendonk *Extracts from the Full Report: Assessment of Social Protection Programmes and Costing of Policy Options Programme Specific Report: Village Savings and Loans* (2016) 3 available at

However, they observed that the NGOs had many implementation challenges. One prominent challenge was the lack of a legal framework for VSLAs.<sup>134</sup> More challenges included poor coordination and lack of collaboration of VSLA stakeholders and MFIs exploiting VSLAs through linkages especially after projects that enabled the establishment of these groups phase out.<sup>135</sup>

#### 5.4 INFORMAL FINANCIAL CO-OPERATIVES

In Malawi, there is generally a lack of sufficient literature concerning informal financial co-operatives.<sup>136</sup> They hardly feature in policies for promoting savings, efficient allocation of loanable funds or financial intermediation goals.<sup>137</sup> It is also rarely a thought that the existence of informal financial co-operatives might impair the effectiveness of monetary control if borrowers were to switch from formal and semi-formal financial institutions to informal financial co-operatives.<sup>138</sup> However, this is quite unfortunate because informal financial co-operatives play an important financial intermediation role.<sup>139</sup>

Malawians predominantly affiliate themselves to informal financial co-operatives because they have simplistic structures, governance of their peers and conduct business in the vernacular language.<sup>140</sup> Accordingly, Malawians feel that they can understand and trust these institutions.<sup>141</sup> Of course, those that are slightly less risk averse keep their money in a local SACCO or farmer's club.<sup>142</sup> However, for many Malawians, depositing money in a commercial bank or trusting a distant third party, requires a change of mindset that is not currently there.<sup>143</sup> There is something about keeping one's money within the local area with people one relates to, that they find self-assuring.<sup>144</sup>

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<https://socialprotection.org/discover/publications/programme-specific-report-village-savings-and-loans-malawi> accessed on 24 June 2021.

<sup>134</sup> Ibid.

<sup>135</sup> Ibid.

<sup>136</sup> H Ngalawa A Portrait of Informal Sector Credit and Interest Rates in Malawi: Interpolated Monthly Time Series (ERSA working paper 446) (2014) 1.

<sup>137</sup> Ibid.

<sup>138</sup> Chipeta & Mkandawire op cit note 6 at 121.

<sup>139</sup> Ibid.

<sup>140</sup> F N Ngwu 'Promoting formal financial inclusion in Africa: As institutional re-examination of the policies with a case study of Nigeria' (2015) 16 *Journal of Banking Regulation* 306 at 316.

<sup>141</sup> Ibid.

<sup>142</sup> Madise op cit note 120 at 220.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

## 5.4.1 TYPES OF INFORMAL FINANCIAL CO-OPERATIVES

There are different types of informal financial co-operatives in Malawi. Most of them mimic the banking system but are modelled on the concept of SACCOs.<sup>145</sup> These co-operatives will be discussed in turn:

### 5.4.1.1 Co-operative savings associations (CSAs) / chiperegani

CSAs, or natively, *chiperegani* (which literally means eating together) stem from indigenous co-operative behaviour that includes the mobilisation of labour, capital, land, food and other resources.<sup>146</sup> CSAs can grow into large groups but they often start as two-person societies formed by mutual agreement between co-workers, relatives, friends or neighbours who trust each other, and who are in frequent contact.<sup>147</sup> The common bond can also extend to geographic or blood ties.<sup>148</sup> For this reason, there is little friction between the members and the groups seem to operate relatively smoothly.<sup>149</sup>

CSAs function like the traditional ROSCA or the South African savings clubs except that the pooling of money can be regular or periodic because each member contributes an amount of money at the end of every month, or whenever money is earned.<sup>150</sup> The pool is in turn given to members one at a time. No interest is charged, and the receiver pays back exactly what they received from other members.<sup>151</sup> CSAs tend to be short-lived as they only exist for as long as the members are willing and able to contribute money.<sup>152</sup> If the members do not desire to form further associations, the groups easily become dissolved.<sup>153</sup> Thus, to most members the benefits from CSAs are short-term.<sup>154</sup> CSAs were initially popular only among low-income earners who considered them a convenient means of supplementing their incomes.<sup>155</sup> Currently, higher income groups also subscribe to them as an alternative stream of income.<sup>156</sup>

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<sup>145</sup> C Chipeta & E Kanyumbu *Determinants of Access to Banking Services in Malawi* AERC Research Paper 351 (August 2018) 3; Borda-Rodriguez & Vicari op cit note 85 at 4.

<sup>146</sup> Ibid.

<sup>147</sup> C Chipeta *The Informal Sector and Macroeconomic adjustment in Malawi* (AERC Research Paper 4, May 1991) 27.

<sup>148</sup> Ibid.

<sup>149</sup> Kumdana op cit note 125 at 48.

<sup>150</sup> Chipeta op cit note 147 at 27.

<sup>151</sup> Kumdana op cit note 125 at 48.

<sup>152</sup> Ibid.

<sup>153</sup> Aryeetey op cit note 5 at 13.

<sup>154</sup> Ibid.

<sup>155</sup> Ibid; Kumdana op cit note 125 at 48.

<sup>156</sup> Chipeta & Kanyumbu op cit note 125 at 3.

#### 5.4.2 SAVINGS AND CREDIT ASSOCIATIONS (SCAS)

SCAs work as follows: each member contributes a fixed amount of money at the opening of a cycle.<sup>157</sup> If a member does not contribute the full amount, the deficit is deducted from the portion that will be distributed to members at the end of the cycle.<sup>158</sup>

Most of the SCAs comprise of work colleagues and neighbours. This makes it simpler to establish and retain contact; there are only a few among friends, relatives, and business colleagues.<sup>159</sup> The amount of money that a member is permitted to borrow per month is estimated to not be more than the member's monthly salary, which sets an upper limit on the member's known debt-servicing capacity.<sup>160</sup> Loans are repaid with interest as soon as borrowers receive their monthly salaries, and the treasurer disburses new loans a day or more after payday to have sufficient time to accept repayments of maturing loans and interest charges on them, out of which new loans are made in the following month.<sup>161</sup>

Money is lent out to members and little or nothing is kept by the treasurer. The main aim of SCAs is to build up as many reserves as possible through interest payments so that the amount of money paid out to members at the end of the cycle is high.<sup>162</sup> Accordingly, there are occasions when members who do not need loans are required to take involuntary loans.<sup>163</sup> Moreover, loans can even be issued to non-members.<sup>164</sup> Once, the cycle is complete, all money is distributed to members.<sup>165</sup>

#### 5.4.3 CREDIT CLUBS

In this thesis, credit clubs refer to all informal financial co-operatives that do not fit within the defined framework of the CSAs and SCAs. These include *banki m'nkhonde* or veranda banks used loosely by Malawians to describe the phenomenon of people with a common bond coming together to pool resources.<sup>166</sup> They also include community savings and family savings.<sup>167</sup> These clubs are based on existing social networks with much emphasis on regular social interaction.<sup>168</sup> They exist in both rural and urban areas.<sup>169</sup>

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<sup>157</sup> Ibid

<sup>158</sup> Chipeta & Mkandawire op cit note 6 at 141.

<sup>159</sup> Ibid.

<sup>160</sup> Kumdana op cit note 125 at 48.

<sup>161</sup> G Mwalwanda 'Katapila' (usury), *This is Malawi* (1986) 16 *Reserve Bank of Malawi, Financial and Economic Review* 57.

<sup>162</sup> Chipeta & Mkandawire op cit note 6 at 141.

<sup>163</sup> Ibid.

<sup>164</sup> Chipeta op cit note 147 at 27.

<sup>165</sup> Ibid.

<sup>166</sup> Kumdana op cit note 125 at 46-9.

<sup>167</sup> Ibid.

<sup>168</sup> Chipeta & Mkandawire op cit note 6 at 141.

<sup>169</sup> Ibid.

In urban areas, credit clubs usually start at workplaces, religious gatherings, or family gatherings. In rural areas, these are normally developed among friends and relatives.<sup>170</sup> The following is representative functionality of the typical credit club:

The club has a treasurer who stores records of transactions. To become a treasurer, one must be literate and possess numeracy skills.<sup>171</sup> The committee operates voluntarily. At every weekly meeting, members contribute towards “buying of shares”. Each share is valued at a fixed rate, and members must acquire at least one share.<sup>172</sup> Members take loans from the treasury in proportion to their shares up to a maximum of 100 per cent of the shares held.<sup>173</sup> Every 6 to 12 months, all the club’s records are shared, and a new cycle is started again.<sup>174</sup> The interest earned is not shared under a common pool. In a rather strange but interesting structure, everyone earns their own interest that is issued to them.<sup>175</sup> In other clubs, interest accrues to the whole group and is divided equitably to the shares. It is common to have people with several memberships of these clubs.<sup>176</sup>

## 5.5 OVERVIEW OF THE FINANCIAL CO-OPERATIVES SECTOR IN MALAWI

While it is acknowledged that the financial co-operatives sector plays a significant role in the economy of Malawi, there is no adequate documentation of the history of financial co-operatives and more especially the status of financial co-operatives presently.<sup>177</sup> However, difficult as it is to ascertain their impact, the scattered information found shows that most of the population is actively involved in organising themselves into financial co-operatives.<sup>178</sup>

For the informal sector, a survey conducted in 2018 recorded that of 4.2 million Malawians that have some sort of savings, 54 per cent use village banks (used loosely to mean credit clubs).<sup>179</sup> In contrast,

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<sup>170</sup> Madise op cit note 120 at 220-2.

<sup>171</sup> Ibid.

<sup>172</sup> Ibid.

<sup>173</sup> T Linde & M Spencer *Access to Financial Services and Women’s Empowerment: An Evaluation of a Village Savings and Loans Association in Rural Malawi* (unpublished thesis, University of Gothenburg, August 2015) 9.

<sup>174</sup> Ibid.

<sup>175</sup> Chipeta & Mkandawire op cit note 6 at 141; S Madise *The Regulation of Mobile Money: Law and Practice in Sub-Saharan Africa* (2019) 220.

<sup>175</sup> Ibid.

<sup>176</sup> Ibid.

<sup>177</sup> Ngalawa op cit note 6 at 141 at 1.

<sup>178</sup> Ibid.

<sup>179</sup> C Ngulube ‘Malawians prefer to save, borrow from village banks – 2018 Census’ available at <https://www.kulinji.com/article/news/business/2019/malawians-prefer-save-borrow-village-banks-2018-census> accessed on 10 May 2020.

only 7.4 per cent saved with commercial banks.<sup>180</sup> For the semi-formal sector, the table below shows findings of a 2015 survey on the VSLA programme in Malawi:

Selected village savings and loans programme overview		
	COMSIP	Care Malawi
<b>Donors</b>	World Bank	DfID, Norway and Irish Aid
<b>Implementers</b>	COMSIP Cooperative Union	Various NGOs
<b>Time-frame</b>	2014-18 (current phase)	
<b>Benefit</b>	Financing of grants to increase household incomes and assets	Training in group dynamics, financial governance and money management
<b>Districts</b>	Nationwide	
<b>Targeting</b>	Self-selection	Self-selection
<b>Groups</b>	6,008	3,958
<b>Cooperatives</b>	133	
<b>Group Members</b>	106,371	118,064
<b>Cooperatives Members</b>	4,308	

Figure 2 Survey on VLSA Programme in Malawi<sup>181</sup>

Unfortunately, the same progress is not evident in SACCOs. Bingham started three loan and thrift (credit) co-operatives in the 1930s.<sup>182</sup> Malawi is currently only at 39 SACCOs after approximately 90 years.<sup>183</sup> In addition, there has been no marked increase since the introduction of the current regulatory framework showing that the current regulatory framework may not have been the solution.<sup>184</sup>

Granted, some reports have recorded that SACCOs are doing well in Malawi and that Malawi demonstrates that developing a new regulatory framework for financial co-operatives, after analysing and understanding the sector, is a more prudent way to formulate appropriate and accepted regulatory regimes that work.<sup>185</sup> However, I question this proposition. As early as the 1930s, Bingham is said to have extensively investigated what the preferred approach to the introduction of financial co-operatives in Malawi would be.<sup>186</sup> The failure of the co-operatives in the aftermath shows that the developmental strategies that were adopted still failed. Similarly, the results of the current regulatory framework show that what was adopted may still not be the answer.

<sup>180</sup> Ibid.

<sup>181</sup> Van Der Meerendonk op cit note 133.

<sup>182</sup> MNA, S 1/1/2/4, F23d, Minute, Bingham, 24 June 1939.

<sup>183</sup> Reserve Bank of Malawi Financial Institutions Annual Report for 2020 (July 2021) 99.

<sup>184</sup> Statement made in reference to the development observed in this chapter.

<sup>185</sup> Genesis Analytics op cit note 100 at 24.

<sup>186</sup> Cooperation, Interim Report, 1938, MNA S11/1/2/1; Ingham op cit note 31 at 62.

## 5.6 CONCLUSION AND OBSERVATIONS

Like the previous chapter, this chapter considered financial co-operatives in Malawi from a historical perspective to provide context for the status of financial co-operatives and the legislation that governs them. This was a difficult task because there is limited documentation on the history of financial co-operatives in Malawi and more especially informal financial co-operatives that developed among Malawians.<sup>187</sup>

What is sparsely recorded is the development of formal financial co-operatives introduced in Malawi within the colonial era and democratic era, namely SACCOs.<sup>188</sup> From a historic study of SACCOs, this thesis noted that foreign introduction of these associations as opposed to their organic development negatively impacted their growth and continues to do so. In addition, this thesis noted that political and governmental manipulations were a hindrance to growth.<sup>189</sup>

Semi-formal financial co-operatives have not been sufficiently recorded by the financial sector even though there are many established by CARE and other NGOs.<sup>190</sup> These financial co-operatives operate in rural areas and are independent of external financial aid.<sup>191</sup> What CARE and other NGOs offer to these co-operatives is institutional capacity, training, and monitoring services. However, their main weakness is the lack of a regulatory framework that governs them.<sup>192</sup>

Informal financial co-operatives are varied in their nature but there is no record of the numbers or their current impact. What is evident however is that a lot of Malawians are gravitating towards them because of their simplicity and accessibility.<sup>193</sup> Malawi is a rural-based economy and informal financial co-operatives are predominantly rural-based infrastructures although they are now also in urban areas.<sup>194</sup>

In addition to some observations that can be extracted from this chapter like the negative impact of political interference on financial co-operatives, another key observation that can be extracted from this chapter is the importance of having an expert to guide the development of co-operatives especially in the nascent stages is important for the effective implementation of co-operatives. However, such expert knowledge should not be invested in one person but rather in an institution or organisation.<sup>195</sup>

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<sup>187</sup> Ngalawa op cit note 136 at 1.

<sup>188</sup> Kachule op cit note 74 at 16.

<sup>189</sup> Ibid.

<sup>190</sup> Agar et al op cit note 123 at 40.

<sup>191</sup> CARE Village Savings and Loans op cit note 126.

<sup>192</sup> Van der Meerendonk op cit note 133.

<sup>193</sup> Chipeta & Kanyumbu op cit note 125 at 3.

<sup>194</sup> Ibid.

<sup>195</sup> Matupa op cit note 23.

Additionally, this chapter has shown that regulation is not enough. There is need for effective supervision if the success of co-operatives is to be ensured.<sup>196</sup> Regulation and supervision of financial co-operatives will be discussed in the second part of this thesis.

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<sup>196</sup> Ibid; This learning may be extracted from the requirement of having Bingham as the initiator and overseer of financial co-operatives at their inception.

# PART TWO

Regulating and Supervising Financial Co-operatives

## CHAPTER SIX

### REGULATION AND SUPERVISION OF FINANCIAL INSTITUTIONS

#### 6.1 OVERVIEW

The aim of this second part of the paper is to discuss the regulatory and supervisory frameworks of financial co-operatives in South Africa and Malawi, to analyse those frameworks and to provide recommendations that would enable the current frameworks to foster the growth of financial co-operatives in both countries. However, to understand these frameworks and make recommendations, it is important to comprehend the forces that drive financial regulation and supervision; one force being the objectives of financial regulation, and another being the underlying philosophical theories of regulation.<sup>1</sup>

The main position of this thesis as shown in Part 1, is that the current regulatory and supervisory frameworks in both South Africa and Malawi may be explained as a result of a combination of factors that surface from past political and economic factors. Part 2 of this thesis goes beyond that to show that the objectives and theories of regulation are also an influencing factor in the growth of financial co-operatives.<sup>2</sup> Chapter 7 and 8 especially, will show that regulatory and supervisory action to realise specific objectives of financial regulation could, at times, generate tensions with and weaken the realisation of other regulatory and economic objectives.<sup>3</sup>

They will also demonstrate the difficulties that could surface in finding the right balance between achieving the objectives of financial regulation, while avoiding instances of over-regulation.<sup>4</sup> As stated however, before this practical demonstration and analysis, it is important to understand the theoretical aspects of the regulation of financial institutions in their entirety. This chapter aims to do that.

#### 6.2 DISTINGUISHING FINANCIAL REGULATION AND FINANCIAL SUPERVISION

##### 6.2.1 REGULATION

In the context of this thesis, it is important at this stage to comment on the distinction between regulation and supervision. Whilst some literature makes use of the terms 'regulation' and 'supervision' interchangeably, these are distinct and serve different functions.<sup>5</sup> Regulation may be defined as the act of making laws and rules, including soft law, by a private or public body.<sup>6</sup> Alternatively, it has been defined as the sustained and focused control exercised by a public agency over activities that are valued by a

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<sup>1</sup> C Buttigieg et al 'A Critical Analysis of the Rationale for Financial Regulation Part I: Theories of Regulation' *European Company and Financial Law Review*, vol. 17, no. 5, 2020, pp. 419-436. <https://doi.org/10.1515/ecfr-2020-0020> p. 435.

<sup>2</sup> *Ibid.*

<sup>3</sup> For example, over-regulation may stifle innovation.

<sup>4</sup> C Buttigieg et al *op cit* note 1 at 435.

<sup>5</sup> *Ibid.*

<sup>6</sup> S Madise, 'Different Types of Regulation' in S Madise *The Regulation of Mobile Money* (2019) 111.

community.<sup>7</sup> Financial regulation includes entry, conduct, information and prudential regulation, governance of financial institutions, insurance and resolution measures.

### **6.2.1.1 Entry regulation**

Entry regulation affects the ability of potential participants in the financial sector to engage in financial transactions with other participants. From the customers perspective, this means participation restrictions inhibiting the ability of market players to engage in particular financial transactions.<sup>8</sup> Entry of financial institutions may be restricted for instance, to licensing requirements that empower regulators to grant approval to institutions prior to starting business. Initial and continuing compliance is made a condition of the grant of a licence, with the consequence that the sanction for non-compliance could be the cessation of the institution's business.<sup>9</sup> Licensing, among other things, seeks to weed out those with a history of having committed fraud or other serious violations of financial regulations.<sup>10</sup> However, the next chapter will show that excessive entry regulations can cause stagnation in the financial sector as institutions may fail to qualify for entry or indeed endeavour to enter. This is particularly visible in South Africa.

### **6.2.1.2 Conduct regulation**

Conduct regulation dictates appropriate standards of conduct to customers in the financial system. From the perspective of both customers and financial institutions, there are restrictions, which affect the way in which transactions may be conducted.<sup>11</sup> Specifically, actions taken to manipulate market prices are restricted. These restrictions are geared towards promoting market liquidity.<sup>12</sup> Moreover, regulators are also concerned with financial institutions' conduct from the perspective of competition. In particular, collusion between institutions to support prices or restrict supply is universally prohibited as a matter of law.<sup>13</sup> This aspect is also monitored in financial co-operatives. Interestingly however, integration is encouraged among financial co-operatives to foster growth and establish a support system that is able to strengthen weaker or smaller financial co-operatives.

### **6.2.1.3 Information regulation**

Information regulation comprises of rules intended to secure the comprehension and dissemination of information about financial institutions and products. From the customers perspective, an important

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<sup>7</sup> A I Ogus *Regulation: Legal Form and Economic Theory* vol 152 (1994) 1.

<sup>8</sup> R Romano, 'For Diversity in International Regulation of Financial Institutions: Critiquing and recalibrating the Basel Architecture' (2014) 31 *Yale Journal on Regulation* 1.

<sup>9</sup> *Ibid.*

<sup>10</sup> *Ibid.*

<sup>11</sup> J Armour et al *Principles of Financial Regulation* available at <https://oxford.universitypressscholarship.com/view/10.1093/acprof:oso/9780198786474.001.0001/acprof-9780198786474>> accessed on 17 April 2022

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid.*

technique is education.<sup>14</sup> Stringently speaking, this does not impose any legal obligation on customers—rather, legal obligations for the provision of education are imposed on public bodies. However, if education is provided, the onus is upon customers to make use of it to improve their understanding.<sup>15</sup> Consequently, customers of the financial system who do not make use of educational provision are likely to find themselves at a disadvantage.<sup>16</sup>

From the standpoint of financial institutions however, the principal technique of information regulation is disclosure. Disclosure seeks to enhance the informational efficiency of financial markets, and reporting of financial institutions to regulators assists in maintaining financial stability.<sup>17</sup> The regulatory frameworks of both South Africa and Malawi provide these elements. However, the next chapter will show that even where education is offered, the compliance to the information is still problematic. Accordingly, dissemination of information should be closely attached to supervision. Further, for a country like Malawi that has the majority of its population in rural areas, it matters what form the information is presented. The cost effectiveness of translating the information to locals may not be realistic.

#### **6.2.1.4 Prudential regulation**

The fourth form of regulation comprises rules that direct how financial institutions should manage their assets and liabilities.<sup>18</sup> It includes rules on capital adequacy that require banks and other financial institutions to maintain minimum levels of net assets and to ensure certain proportions of their liabilities are subordinated. It also includes rules on assets requiring a certain proportion of asset holdings to be of a liquid character. Further, it includes rules restricting the risks associated with investment and insurance.<sup>19</sup> Prudential requirements for financial co-operatives in South Africa and Malawi will also be discussed in the next chapter. It is important to understand at this point however, that minimum prudential requirements in both countries are important because they set standards which must be adhered to not only to maintain their registration but also to monitor their own sustainability.<sup>20</sup>

#### **6.2.1.5 Governance**

Governance relates to the way in which institutions are organised and managed. Most obviously, this strategy includes rules about board structure, executive compensation, and directors' duties for certain financial institutions.<sup>21</sup> Governance requirements have customarily been understood as investor

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<sup>14</sup> J Armour et al op cit note 11.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

<sup>17</sup> R Romano, 'For Diversity in International Regulation of Financial Institutions: Critiquing and recalibrating the Basel Architecture' (2014) 31 *Yale Journal on Regulation* 1.

<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

<sup>20</sup> Kuhlengisa op cit note 22 at 52.

<sup>21</sup> J Armour et al op cit note 11.

protection measures.<sup>22</sup> However, the negative externalities associated with risk-taking by large financial institutions means that their governance has implications for the stability of the financial system as a whole.<sup>23</sup> Even though financial co-operatives in South Africa and Malawi may not be categorised as large financial institutions when compared to the mainstream banks, the nature of ownership in financial co-operatives and their primary principles still possess governance risks.<sup>24</sup> For example, the internal ownership in financial co-operatives provides no external pressure on management or the board of directors to carry out their duties.<sup>25</sup>

#### **6.2.1.6 Insurance**

Insurance is prompted by the failure, or financial distress, of a financial institution. Insurance operates to provide a backup provision of liquidity at that point.<sup>26</sup> The most obvious example of insurance for financial institutions is deposit insurance schemes, which offer depositors in banks that have failed with compensation. However, there are other insurance schemes. Most known of these is the lender of last resort function played by a country's central bank.<sup>27</sup> In both South Africa and Malawi, the next chapter will show that there is need to implement insurance for customers of financial co-operatives.

#### **6.2.1.7 Resolution/ exit mechanisms**

Resolution mechanisms are designed to operate more quickly and effectively than ordinary insolvency law to avoid the destructive implications related with bank failure.<sup>28</sup> These seek to introduce private capital to distressed financial institutions, rather than rely on state support. One form involves the sale of the troubled entities to competitors; another anticipates an automatic reduction of its liabilities.<sup>29</sup>

Each of these examples of insurance and resolution strategies in financial regulation is generally understood in terms of promoting financial stability: reducing the probability of bank failure, or the severity of the outcomes of bank failure.<sup>30</sup> However, they could also be understood in terms of user protection, as they have the effect of protecting customers against loss.<sup>31</sup> Unfortunately, the next chapter will show that for both South Africa and Malawi, there are no systematic processes for resolution targeted at protecting depositors.<sup>32</sup>

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<sup>22</sup> Ibid.

<sup>23</sup> Ibid.

<sup>24</sup> R Spear et al 'For love and money: governance and social enterprise' (2007) *Governance Hub, National Council for Voluntary Organizations* at 6 available at <http://oro.open.ac.uk/view/person/cjc9.html> accessed on 23 June 2020.

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

<sup>27</sup> J Armour et al op cit note 11.

<sup>28</sup> J Armour, 'Making Bank Resolution Credible', in N Moloney, E Ferran, and J Payne, *The Oxford Handbook of Financial Regulation* (Oxford: OUP, 2015), 453, 466 (characterizing transfer procedures as 'first generation' resolution mechanisms).

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

<sup>32</sup> C Cuevas & J Buchenau *Financial Co-operatives: Issues in Regulation, Supervision, and Institutional Strengthening* (2018) 8.

## 6.2.2 SUPERVISION

Prudential rules are highly important because of the role those financial institutions have in any economy. Notwithstanding, a crucial aspect of prudential rules regards the enforcement powers given to financial supervisors to intervene to prevent losses from magnifying.<sup>33</sup> Supervision therefore refers to day-to-day action of supervisors monitoring the implementation and application of the rules. Supervision, the oversight of financial institutions, includes the functions of authorisation, supervision *stricto sensu*, the management of crises, and taking enforcement action where specific breaches have been committed.<sup>34</sup> The carrying out of supervision may be further categorised into micro and macro prudential supervision, conduct supervision and supervision of market integrity.<sup>35</sup>

### 6.2.2.1 Micro-prudential and macro-prudential supervision

Micro-prudential supervision deals with the stability of individual financial institutions and is largely conducted through oversight of the levels of capital structures, governance, quality of compliance and risk management in financial institutions.<sup>36</sup> On the other hand, macro-prudential supervision is interested in the safety and stability of a financial system as a whole and it seeks to identify threats to systemic stability by analysing trends and imbalances in the financial system.<sup>37</sup> Prudential supervision however only protects the solvency of financial institutions without being able to guarantee it.<sup>38</sup> The prudential instruments are rather complex and are currently outlined in the Basel III principles.<sup>39</sup>

### 6.2.2.3 Conduct of business supervision

Conduct of business supervision is aimed at ensuring honest dealing both in markets and in individual contacts with investors.<sup>40</sup> This is pursued by requiring adequate disclosures about products or transactions, by prescribing protective contract clauses and, increasingly, by imposing specific conduct.<sup>41</sup> Conduct of business rules with the monitoring of various types of conduct that can be detrimental to investors and the functioning of markets.<sup>42</sup> In this regard, the rules on conflicts of interest often attract a lot of attention.<sup>43</sup>

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<sup>33</sup> C Buttigieg et al op cit note 1 at 420.

<sup>34</sup> R Lastra, *Central Banking and Banking Regulation* (1996) 110.

<sup>35</sup> *Ibid.*

<sup>36</sup> E Wymeersch, 'The Future of Financial Regulation and Supervision in Europe', *Common Market Law Review* (2005), 987.

<sup>37</sup> *Ibid.*

<sup>38</sup> *Ibid.*

<sup>39</sup> See Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), *OJ* 2006 L 177/1.

<sup>40</sup> A Alcock Are financial services over-regulated? (2003) *Company Lawyer* 24(5) 133.

<sup>41</sup> *Ibid.*

<sup>42</sup> D Llewellyn 'Institutional Structure of Financial Regulation and Supervision: The Basic Issues World Bank Seminar', 6-7 June 2006, available at: [http://info.worldbank.org/etools/docs/library/232743/Llewellyn\\_OverviewPaper2006\\_final.doc](http://info.worldbank.org/etools/docs/library/232743/Llewellyn_OverviewPaper2006_final.doc)

<sup>43</sup> *Ibid.*

The typology described above is somewhat artificial. Conduct of business supervision is not just about protection of the consumer and should not be viewed in isolation.<sup>44</sup> It also serves to protect the reputation of financial institutions and therefore has direct prudential importance and can sometimes even give rise to systemic concerns.<sup>45</sup> Conversely, prudential supervision aims not only to protect the institution, but also the financial consumer.<sup>46</sup> In practice, therefore, prudential supervision and conduct of business supervision can be linked in what is known as the Twin Peaks form of supervision implemented in South Africa, for example.

#### **6.2.2.4 Market integrity supervision**

Lastly, supervision of market integrity focuses on the fairness, efficiency and transparency of capital markets and trading platforms.<sup>8</sup> It relates to the oversight function of central banks.<sup>47</sup> Depending on the approach taken, it deals mainly with the supervision (often referred to as oversight) of payments and securities settlement systems, while a broader definition includes the stability of the entire financial system and not of individual institutions.<sup>48</sup>

### **6.2.3 APPROACHES OF FINANCIAL SUPERVISION**

In practice, the modes of supervision above are implemented primarily by an authorised entity within a country. Although there are still exemptions, supervision of financial institutions is normally the responsibility of specialised public authorities, which in most cases experience an independent status.<sup>49</sup> In some jurisdictions, part of supervisory function is still in the hands of a government department.<sup>50</sup> In most modern economic systems, however, supervision is the task of specialised public bodies, sometimes referred to as government 'agencies'.<sup>51</sup> The creation of separate agencies ensures a high level of expertise, specialisation and independence.<sup>52</sup> It also prevents supervision from becoming subservient to government.<sup>53</sup> The current oversight approaches implemented worldwide can be divided into four main categories namely, the institutional approach, functional approach, integrated approach, and twin peaks approach.

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<sup>44</sup> Wymeersch, op cit note 36 at 245.

<sup>45</sup> Ibid.

<sup>46</sup> Ibid.

<sup>47</sup> Llewellyn op cit note 42.

<sup>48</sup> Wymeersch, op cit note 36 at 245.

<sup>49</sup> BIS Core Principles for Effective Supervision: "each authority should have operational independence...". New version according to the consultative document of April 2006, available at: <<http://www.bis.org/publ/bcbs123.pdf>>.

<sup>50</sup> Ibid.

<sup>51</sup> Ibid.

<sup>52</sup> IOSCO Principle A.2, stating that the "regulator should be operationally independent...". IOSCO Objectives and Principles of Securities Regulation (February 2002), available at: <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf#search=Objectivesandprinciplesofsecuritiesregulation%2Cfebruary2002%22>>.

<sup>53</sup> Ibid.

### 6.2.3.1 The institutional approach

The institutional approach is one of the conventional forms of financial supervision. It is a legal-entity-driven approach where the financial institutions' legal status (for instance, an institution registered as a bank, an insurer, or microfinance institution) basically determines which regulator has been entrusted with monitoring its activities both from a business conduct and a safety and soundness perspective.<sup>54</sup> The main advantage of this approach is that it centralises power to supervise in once institution which specialises in that form of institution. However, this approach is under some stress due to significant changes in financial services business models as it is based on a business model that, to a large extent, no longer exists.<sup>55</sup>

### 6.2.3.2 The functional approach

In the functional approach, supervision is determined by the business carried out by the institution, regardless of its legal status. Each type of business can have its own functional regulator.<sup>56</sup> For example, if an institution has multiple lines of business that include banking, insurance activities, and securities, each of those different lines of business would be supervised by a separate, 'functional' regulator.<sup>57</sup> The challenge for the functional approach is that activities must be distinct enough to fall into categories that each regulator can oversee.<sup>58</sup> However, there are clear benefits to this approach. For instance, at least in theory, a single, technically expert regulator is able to apply consistent rules to the same activity regardless of the entity in which it is conducted. Accordingly, regulatory arbitrage, which can occur when multiple regulators interpret and enforce the same, or perhaps even inconsistent, rules in different ways, is avoided under this approach.<sup>59</sup>

Notwithstanding, one of the major challenges of functional regulation is that it can be extremely difficult to distinguish which activity comes within the jurisdiction of a particular regulator. As regulators expand the scope of permissible activities of the entities under their watch, there is a general reluctance to cede to another agency authority for overseeing those new activities.<sup>60</sup> Further, this approach forces financial institutions to deal with multiple regulators, which is often more costly in terms of time and effort. Moreover, there is a tendency for multiple regulators to duplicate efforts.

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<sup>54</sup> T Jansson et al *Principles and Practices for Regulating and Supervising Microfinance* (2004) 81.

<sup>55</sup> Group of Thirty *The structure of Financial Supervision Approaches and Challenges in a Global Marketplace* (2007) 36

<sup>56</sup> *Ibid*, 24

<sup>57</sup> *Ibid*.

<sup>58</sup> T Jansson et al. *op cit* note 54.

<sup>59</sup> Group of Thirty *op cit* note 55 at 34.

<sup>60</sup> T Jansson et al. *op cit* note 54.

#### **6.2.3.4 The integrated approach**

Under the integrated approach, there is a single regulator that carries out both the soundness oversight and safety and conduct of business regulation for all the sectors of the financial services.<sup>61</sup> This approach has the advantage of a streamlined focus on the supervision of financial institutions without confusion or conflict over jurisdiction lines.<sup>62</sup> This clarity of focus potentially leads to higher-quality regulatory outcomes. Certainly, with one regulator, an institution is more likely to experience consistent application of rules and is less apt to be caught in jurisdictional disputes between regulators.

Notwithstanding, there are also potential downsides to this approach. For example, there are concerns related to having a single point of failure. If an integrated regulator fails to spot an issue, there is no other agency to potentially fill the void.<sup>63</sup> Moreover, in a very large market, there may be concern that an integrated regulator might simply be too large and thus too cumbersome to be managed effectively. A large integrated supervisor that regulates across all business sectors will likely have to divide its workflows into manageable functional or other business units.<sup>64</sup> Regardless, this approach has acquired increased popularity over the past decade and is currently used in Malawi where the RBM supervises all financial institutions.<sup>65</sup> The effectiveness of this approach in Malawi is analysed in Chapter 8.

#### **6.2.3.5 The twin peaks approach**

The twin peaks approach is based on the principle of regulation by objective and refers to a separation of regulatory functions between two regulators; one regulator performs the safety and soundness supervision function and the other focuses on conduct-of-business regulation.<sup>66</sup> The twin peaks model has multiple advantages. First of all, a two headed regulation system is seen as having more dedication towards achieving respective objectives and specific rules that regulators are bound with.<sup>67</sup> The second advantage is that it is less likely for the regulatory system to surpass the general regulatory authorities.<sup>68</sup>

Moreover, the regulatory culture applied to achieve certain objectives can be amended according to the cultural features and regulator's functions.<sup>69</sup> This flexibility prevents the concern of containing several different cultures within one system which can occur in situations where there is one regulator at the top

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<sup>61</sup> Ibid.

<sup>62</sup> Group of Thirty op cit note 55 at 34.

<sup>63</sup> Ibid.

<sup>64</sup> Ibid.

<sup>65</sup> Ibid.

<sup>66</sup> D Calvo et al Financial supervisory architecture: what has changed after the crisis? (2018) *FSI Insights* 5 available at <https://www.bis.org/fsi/publ/insights8.pdf> accessed on 10 September 2021

<sup>67</sup> D Llewellyn, "Institutional Structure of Financial Regulation and Supervision: The Basic Rules", Paper presented at a World Bank seminar Aligning Supervisory Structures with Country Needs, Washington DC, 6 and 7 June 2006, 26 (2006). 27-28

<sup>68</sup> Ibid.

<sup>69</sup> Ibid.

with different cultures from diversified regulatory purposes.<sup>70</sup> This also in turn prevents the complications arising from a system with a super-regulator.<sup>71</sup>

Notwithstanding, there are also several perceived disadvantages of the twin peaks model.<sup>72</sup> First, twin peaks can potentially create a regulatory overlap with dual-regulated entities. The model means that it is 'inevitable that two separate regulators would have two separate rule books and two separate systems.'<sup>73</sup> This in turn places 'considerable burdens' on regulated entities and leads to poor information-sharing and coordination.<sup>74</sup> Secondly, there is a general risk that cooperation and coordination between the regulators is not sufficient.<sup>75</sup> While these risks can be managed through robust coordination and liaison channels, it nevertheless remains a key concern for jurisdictions implementing this model. For example, in South Africa where the Prudential Authority (PA) supervises the safety and soundness of all financial institutions, and the Financial Sector Conduct Authority (FSCA) supervises how financial institutions conduct their business and treat customers.<sup>76</sup>

### 6.3 OBJECTIVES OF FINANCIAL REGULATION

Both financial regulation and financial supervision feed into the high-level objectives of financial regulation. While debates on what the high-level objectives of financial regulation should be have ranged far and wide, it is generally accepted that financial regulation has a crucial role to play in achieving consumer policy objectives and in curbing financial crime. Financial regulation endeavours to protect the vulnerable users of the financial system from possible market misconduct or the fraudulent conduct of business by financial institutions.<sup>77</sup>

Apart from the consumer policy aspect, financial regulation is designed to regulate the economic market. However, one pinnacle tenet of the economic market is that it should be left to regulate itself and find its own equilibrium.<sup>78</sup> The economic rules prevalent in market itself, which, to a large extent are based on capitalist ideology, are characterised by market freedom, where individuals and in particular the industry, are subject to very simple controls and are otherwise uninhibited from pursuing their own welfare objectives.<sup>79</sup> Regardless, there are many instances where the market will fail to regulate itself. Financial market failures, especially those of a systemic nature, often have grave consequences on a country's

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<sup>70</sup> Hengel et al 'Experiences with the Dutch Twin Peaks Model: Lessons for Europe' in K Haan & Vries (eds), *Financial Supervision in the 21st Century* (2013) 186-7.

<sup>71</sup> *Ibid.*

<sup>72</sup> A Godwin 'Introduction to special issue – the twin peaks model of financial regulation and reform in South Africa' (2017) *Law and Financial Markets Review*, 11:4, 151-153, DOI: 10.1080/17521440.2017.1447777.

<sup>73</sup> *Ibid.* para 286

<sup>74</sup> Joint Committee on the draft Financial Services Bill (JCFSB), Draft Financial Services Bill – Report, together with formal minutes and appendices (HL 2010-12, 236, HC 2010-12, 1447) 73 [83].

<sup>75</sup> *Ibid.*

<sup>76</sup> *Ibid.* Also available at

[http://www.treasury.gov.za/twinpeaks/Press%20release%20Twin%20Peaks%20implementation%20March2018\\_FINAL.pdf](http://www.treasury.gov.za/twinpeaks/Press%20release%20Twin%20Peaks%20implementation%20March2018_FINAL.pdf)

<sup>77</sup> R Lastra, *Central Banking and Banking Regulation* (1996) 110.

<sup>78</sup> *Ibid.*

<sup>79</sup> A Ogus *Regulation: Legal Form and Economic Theory* (2004) 5.

economic stability and its potential for growth. Accordingly, the regulation kicks in to provide legal order to stabilise the economy and grow economic output.<sup>80</sup>

Financial market failures also have an impact on the confidence which the public has in a financial system.<sup>81</sup> Public confidence in a financial system is fundamental for the system to be able to function properly and continue to exist.<sup>82</sup> Therefore, from an economic perspective, the one of the other aims of financial regulation is to safeguard economic integrity and build public confidence in the financial system.<sup>83</sup>

## 6.4 THEORIES OF FINANCIAL REGULATION

There are several reasons why financial regulation originally materialised. From a historical perspective two broad categories of theories of regulation can be identified: the 'public interest' or 'helping hand' theories of regulation and the 'private interest' theories of regulation.<sup>84</sup>

### 6.4.1 PUBLIC INTEREST THEORY

Public interest theory explains regulation as a result of public demand to correct the probable failures of some of the assumptions prevalent in the market system.<sup>85</sup> An implicit conclusion of public interest theory is that regulation aims primarily to protect the interests of the general public and thereby achieve the common good, that is the socio-economic wellbeing of society as a whole.<sup>86</sup> Public interest theorists see economic markets as extremely fragile and tend to function very inefficiently if left to their own devices.<sup>87</sup> These theorists see regulation as a means to achieve the best allocation of scarce resources for individual and collective benefits.<sup>88</sup> Regulation, in this context, takes the form of an indispensable application of communal power through government, with the purpose of disabling potential failures of the market system.<sup>89</sup>

Potential market failures can take many forms. Monopoly is considered as a fundamental market failure since monopolist practices impair the competition needed for market efficiency and proper allocation of scarce resources.<sup>90</sup> Moreover, the unregulated market's failure to generate optimal information related to

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<sup>80</sup> C Buttigieg et al op cit note 1 at 420.

<sup>81</sup> Ibid.

<sup>82</sup> Ibid.

<sup>83</sup> Ibid.

<sup>84</sup> M Hantke-Domas, "The Public Interest Theory of Regulation: Non-Existence or Misinterpretation?", *European Journal of Law and Economics*, (2003) 165; and F S. McChesney, *Money for Nothing: Politicians, Rent Extraction, and Political Extortion* (1997) 2.

<sup>85</sup> R Posner, "Theories of Economic Regulation", *The Bell Journal of Economics and Management Science* (1974) 23.

<sup>86</sup> C Ugochukwu Uche, "The theory of regulation: A review article", *Journal of Financial Regulation and Compliance* (2000) 68.

<sup>87</sup> R Posner op cit note 86.

<sup>88</sup> J den Hertog, *General Theories of Regulation* (1999) 225.

<sup>89</sup> Ibid.

<sup>90</sup> M E Levine and J L Forrence, "Regulatory Capture, Public Interest and Public Agenda: Toward Synthesis", *Journal of Law, Economics and Organisation (Special Issue)* (1990) 167.

a particular area of decision-making leads to uninformed and inefficient consumer decisions.<sup>91</sup> Regulation is therefore necessary to correct market failures and as a means to maximise general welfare and society's common economic interests. However, the common good is not defined solely in terms of efficient resource use and allocation.<sup>92</sup> The public interest theory also proposes that regulatory intervention by the State is aimed at the socially efficient use of scarce resources. Accordingly, regulation protects the vulnerable members of society who, without regulation, would be exposed to social injustice.<sup>93</sup>

This theory was formulated by academics with the aim of proposing what governments and regulators should do. Since its inception, it has become the cornerstone of regulatory philosophies that attempt to justify regulation as applied in modern democratic states. However, certain features of this theory are criticised.<sup>94</sup> One major criticism is that the theory assumes that government regulation is effective and that it can be implemented without cost.

Regardless, regulation might sometimes prove unsuccessful in reaching its objective because regulators responsible for overseeing compliance with regulation are requested to fulfil impossible and sometimes contradictory functions. In their attempt to succeed, they distort the efficient functioning of financial markets.<sup>95</sup> Furthermore, effective regulation is expensive and is an area where an increase in output leads to a sharp increase in the cost of production.<sup>96</sup> Also, the theory ignores the "linkage or mechanism by which a perception of the public interest is translated into legislative action". That is, what is perceived to be in the public interest may not be what is on the mind of government. In fact, it begs the question, how is the public interest measured, and who decides that regulation is in the public interest?

Notwithstanding the criticism, it is reasonable to argue that the rationale behind regulation as proposed by the public interest theory could, even today, contribute a valid academic basis for the understanding of certain objectives which the regulation of financial services aims to achieve in practice.<sup>97</sup>

#### **6.4.2 PRIVATE INTEREST THEORY**

This theory holds that regulation is a response to the demands of interest groups seeking to increase members' revenues.<sup>98</sup> Private interest theorists usually question the public interestedness of policymakers and regulators.<sup>99</sup> They argue that regulation could often be a tool that benefits specific interest-groups rather than members of society. They argue that regulation intended to serve the

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<sup>91</sup> A Ogus, *Regulation: Legal Form and Economic Theory* (2004) 339.

<sup>92</sup> A Ogus, "W(h)ither the economic theory of regulation? What economic theory of regulation?", in J Jordana and D Levi-Faur (eds) *The Politics of Regulation* (2004) 35.

<sup>93</sup> Ibid.

<sup>94</sup> C Buttigieg et al op cit note 1 at 430.

<sup>95</sup> R Posner op cit note 86 at 339.

<sup>96</sup> I Erlich and R. Posner, "An Economic Analysis of Legal Rule-making", *Journal of Legal Studies* (1974) 257.

<sup>97</sup> S Madise op cit note 6 at 115.

<sup>98</sup> R Posner op cit note 86 at 339.

<sup>99</sup> R Baldwin et al *Understanding Regulation: Theory, Strategy, and Practice* (2012) 42.

common good, is actually designed to protect the interests of the industry.<sup>100</sup> These theories are based on the assumption that as a result of the high stakes and the interests in the outcome of policy or regulatory decisions, interest groups affected by regulation concentrate their resources and energies to support policy outcomes that they prefer.<sup>101</sup> As a result, the positive objectives of regulation are weakened and regulatory effectiveness is hampered, with the benefits of regulatory reform being shared unequally to a few players at the expense of society as a whole.<sup>102</sup>

### 6.4.3 CAPTURE THEORY

Capture theory argues that regulation occurs initially in service of the general public but given the efforts made over time, interest groups may capture the influence of policymakers and regulators and influence decisions to serve their interests.<sup>103</sup> Three main levels of regulatory capture may be identified. The first stage is where as a result of the pressure from the regulated, the regulators allow the regulated to breach applicable regulations.<sup>104</sup> At a second stage, the regulators assist the regulated to avert regulatory enforcement after a breach has occurred. Finally, capture becomes so deep that regulators opt to even assist and guide the regulated to overcome the regulatory system before a breach is committed.<sup>105</sup> The capture theory has been criticised on the basis that it mistakenly assumes that the regulator and the regulated should be at polar ends of the regulatory spectrum, with power concentrated in the regulator.

### 6.4.4 THE ECONOMIC THEORY

A more notable and refined adaptation of the private interest theory of regulation originates from economic theorists. This adaptation is based on the economic assumption that members of society assert their self-interest and do so in a rational manner.<sup>106</sup> Regulation is thus explained as a result of the forces of demand and supply, while the creation and nature of regulation may be expected as a response by politicians to the requests of interest groups which could benefit from the regulation.<sup>107</sup> Thus, the main proposition of the economic theory of regulation is that, regulation predominantly functions to benefit interest groups not society.<sup>108</sup>

Financial regulation may therefore become a method to curtail competition through the introduction of excessive regulatory obligations that can only be complied by big players within the market.<sup>109</sup> This theory

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<sup>100</sup> Ibid 21.

<sup>101</sup> C Buttigieg et al op cit note 1 at 431.

<sup>102</sup> A Estache and D Martimor, "Politics, Transaction Costs, and Design of Regulatory Institutions", (World Bank, 1999) 10.

<sup>103</sup> C Buttigieg et al op cit note 1 at 431.

<sup>104</sup> Ibid 432.

<sup>105</sup> Ibid.

<sup>106</sup> Ibid.

<sup>107</sup> Ibid.

<sup>108</sup> D Gowland, "The Regulation of Financial Markets in the 1990's" in *Economic theory of regulation* (1991) 33.

<sup>109</sup> J M Hendrickson, "Regulation and Instability in US Commercial Banking" in *Theories of Bank Regulation* (2011) 12.

is has however criticised on several counts including the fact that it is based on the assumptions that interest groups control regulators.<sup>110</sup>

## 6.5 CONCLUSION

This chapter sought to understand the theoretical aspects of the regulation of financial institutions in their entirety. Accordingly, it distinguished regulation from supervision as different terminology that feed into the broader financial regulation. Regulation was defined as the act of making laws and rules, including soft law, by a private or public body.<sup>111</sup> It was shown to include entry, conduct, information and prudential regulation, governance of financial institutions, insurance and resolution measures. These different aspects are practically included in the regulatory frameworks of South Africa and Malawi and will be the discussion of chapter seven.

Supervision was defined as the day-to-day action of supervisors monitoring the implementation and application of the rules. Supervision, the oversight of financial institutions, includes the functions of authorisation, supervision *stricto sensu*, the management of crises, and taking enforcement action where specific breaches have been committed.<sup>112</sup> In South Africa, this chapter showed that the approach of supervision implemented is the twin peak approach where there is the separation of regulatory functions between two regulators: one that performs the safety and soundness supervision function and the other that focuses on conduct-of-business regulation. In Malawi, it is the integrated approach in play. Under the integrated approach, there is a single regulator that carries out both the soundness oversight and safety and conduct of business regulation for all the sectors of the financial services.<sup>113</sup>

This chapter also outlined the main reasons for regulation. Broadly put, regulation of the financial sector occurs to protect consumers and to maintain financial stability. These objectives are underpinned by the theories of financial regulation. Unfortunately, both the public and private interest theories have been heavily criticised. The public interest theory which explains regulation as a means to achieve the general wellbeing of society, may be considered as excessively naïve because it assumes that the regulator regulates for the interests of the public. On the other hand, the private interest theory, which relates the regulatory process totally to individual interests, is exceptionally cynical because it assumes that regulators only regulate for specific members of society. Other theories discussed were the capture theory and the economic theory.

Whatever the criticisms instituted against these theories however, I submit that they are still validated in the financial sector today as the reasons for regulation remain the protection of consumers (private individuals) and protection of the public in its entirety (financial stability). The next chapters show the

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<sup>110</sup> S Peltzman, "Toward a more general theory of regulation" *Journal of Law and Economics* (1976) 230.

<sup>111</sup> S Madise op cit note 6 at 111.

<sup>112</sup> R Lastra op cit note 34.

<sup>113</sup> T Jansson et al. op cit note 54.

extent to which these theoretical aspects and approaches discussed in this chapter are implemented in the financial co-operatives sector in South Africa and Malawi.

## CHAPTER SEVEN

### REGULATION OF FORMAL FINANCIAL CO-OPERATIVES IN SOUTH AFRICA AND MALAWI

#### 7.1 INTRODUCTION

The historical view outlined in Chapter 2 shows that the regulatory framework for financial co-operatives in Germany evolved together with the financial co-operatives, adapting to their changes and encouraging their development while ensuring stability.<sup>1</sup> Chapter 3 showed that for modern financial co-operatives in advanced economies or where formal financial co-operatives play a significant role, the regulator did not attempt to straitjacket financial co-operatives.<sup>2</sup> Instead, the law in these countries developed and evolved as the context dictated.<sup>3</sup> Consequently, financial co-operatives grew into large memberships in Europe, Canada and Australia.<sup>4</sup>

In contrast, for many developing countries, including South Africa and Malawi, Chapters 4 and 5 showed that during the government- and colonisation-led subsidised agricultural credit era, the majority of co-operatives' policies and regulations were created through parliamentary legislation that was independent of the financial sector legislation and heavily influenced by politics.<sup>5</sup> Such governance proved unsustainable in the long run and most of the co-operatives closed down after financial and governmental aid was terminated.<sup>6</sup>

Following this era, the aim in both countries was to foster the growth of all co-operatives and to bring co-operatives in line with international best practices.<sup>7</sup> Accordingly, new regulatory frameworks were adopted in both countries. The regulatory frameworks governed all co-operatives and were foundational,

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<sup>1</sup> E Cuevas & K P Fischer *Co-operative Financial Institutions: Issues in Governance, Regulation, and Supervision* (2006) 38.

<sup>2</sup> *Ibid.*

<sup>3</sup> T W Guinnane 'Co-operatives before co-operative law: Business law and co-operatives in Spain, 1869-1931' (2001) *Journal of Iberian and Latin American Economic History* 70.

<sup>4</sup> E Cuevas & K P Fischer op cit note 1 at 38.

<sup>5</sup> Refer to Chapters 4 and 5; R Rena 'Co-operatives in South Africa: A Review' (2017) 10 *Indian Journal of Science and Technology* 3; Genesis Analytics 'Understanding financial co-operatives: South Africa, Malawi and Swaziland' (2013) *Final Report submitted to FinMark Trust* at 9 available at <http://finmark.org.za/understanding-financial-co-operatives-in-south-africa-malawi-and-swaziland-full-report/> accessed on 12 May 2019.

<sup>6</sup> Refer to Chapters 4 and 5; M Mushonga et al *Co-operative Financial Institutions in South Africa at Crossroads: Facing Reality and the Future* (PhD Thesis, University of Stellenbosch Business School, 2017) 44.

<sup>7</sup> Genesis Analytics op cit note 5 at 18.

containing provisions for the fundamentals of co-operatives like definitions of co-operatives, co-operative principles, memberships, registration, and licensing.<sup>8</sup>

These frameworks, however, did not provide specifically for financial co-operatives' and this meant that there was regulatory neglect of financial co-operatives;<sup>9</sup> there was no consideration of the peculiarities of financial co-operatives including the provision of prudential regulation;<sup>10</sup> and the regulatory authorities had a broad range of responsibilities including registration, supervision, and inspections.<sup>11</sup> Given the growing number of co-operatives, there were insufficient resources to supervise all co-operatives.<sup>12</sup> Accordingly, some co-operatives escaped registration and therefore supervision.<sup>13</sup>

As discussed in Chapter 3, other countries have taken several routes to address these discrepancies. For South Africa and Malawi, however, both countries adopted sector-specific regulations to regulate their formal financial co-operatives.<sup>14</sup> Notwithstanding, for both jurisdictions, sector-specific regulation and supervision is a relatively new phenomenon and in nascent stages, albeit slightly more advanced in South Africa. The advantages of such specificity have included focused regulation and consumer protection for the members.<sup>15</sup> However, more than a decade after these introductions, progress in this sector is still slow. While there may be multiple reasons for this as alluded to in the earlier part of this thesis, one important reason for this slow growth are the gaps in the regulatory infrastructure.<sup>16</sup> This chapter discusses these gaps and aims to effectively provide recommendations for future reforms.

## **7.2 OVERVIEW OF THE REGULATORY FRAMEWORK OF FORMAL FINANCIAL CO-OPERATIVES IN SOUTH AFRICA AND MALAWI**

Before I delve into an analysis of the regulatory framework in South Africa and Malawi, it is important to firstly outline the pieces of legislation that govern financial co-operatives in both sectors. In South Africa, formal financial co-operatives refer to co-operative banks and registered CFIs.<sup>17</sup> In Malawi, formal financial co-operatives refer to Savings and Credit Co-operatives (SACCOs).<sup>18</sup> The main piece of national legislation governing financial co-operatives in South Africa is the Co-operatives Banks Act of 2007 and

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<sup>8</sup> Co-operatives Act 14 of 2005 in South Africa; Co-operative Societies Act 36 of 1998.

<sup>9</sup> A Khafagy *The Economics of Financial Co-operatives: Income Distribution, Political Economy and Regulation* (2019) 91-92.

<sup>10</sup> B Branch & D Grace *Technical Guide: Credit Union Regulation and Supervision*, Wisconsin: World Council of Credit Unions (2008) 3-4.

<sup>11</sup> Co-operatives Act 14 of 2005; Co-operative Societies Act 36 of 1998; Branch & Grace op cit note 10 at 3-4.

<sup>12</sup> Khafagy op cit note 9 at 92.

<sup>13</sup> Ibid.

<sup>14</sup> Co-operatives Banks Act 14 of 2005 at 1; Financial Co-operatives Act 8 of 2011 at 3.

<sup>15</sup> I Buendía-Martínez & B Tremblay 'Financial services co-operatives, public policy and financial inclusion: A perspective from Latin-America' in O Oluoyombo (ed) *Co-operative Finance in Developing Countries* (2012) 137.

<sup>16</sup> K Mndawe 'Co-operative banks ease access to capital' *Fin24* 19 Nov 2017 available at <https://m.fin24.com/Companies/Financial-Services/co-operative-banks-ease-access-to-capital-20171119> accessed on 19 June 2021.

<sup>17</sup> Co-operative Banks Act 2007, s 4(1).

<sup>18</sup> Financial Co-operatives Act 2011, s 3.

the subsequent amendments issued thereof.<sup>19</sup> It builds on the Co-operatives Act of 2005 and continues to function concurrently with it to regulate formal financial co-operatives in South Africa.<sup>20</sup> Similarly, the Financial Co-operatives Act of 2011, primarily governs SACCOs in Malawi. The Act also builds on the Co-operatives Societies Act of 1998.<sup>21</sup> Both these pieces of legislation are governed by the Financial Services Act of 2010 which is the over-arching law of the financial services sector.

In South Africa, introducing the Co-operative Banks Act provided a sector-specific supportive regulatory and supervisory environment to address the deficiencies of the general laws and to protect members of formal financial co-operatives.<sup>22</sup> The Co-operative Banks Act recognised the importance of viable, autonomous, self-reliant, and self-sustaining formal financial co-operatives in the economic and social development of South Africa.<sup>23</sup>

The Act provided for the definitions, scope, registration, administration, supervision, prudential requirements, restructuring, winding up, and other matters relating to co-operatives banks.<sup>24</sup> By these provisions, the Act sought to provide a uniform framework that applied to all formal financial co-operatives.<sup>25</sup> However, just a year post its introduction, amendments began to be made to the Act in the form of the Financial Services Laws General Amendment Act 22 of 2008 to clarify the application of the Act; and to effect technical amendments to the Act.<sup>26</sup> Secondary amendments were made in the Financial Services Laws General Amendment Act 45 of 2013 to close regulatory gaps, to effect improvements to several provisions, to provide for increased supervisory capabilities, and to rationalise and to align the supervisory functions afforded to the Registrar.<sup>27</sup> The last amendments have been made recently by the Financial Sector Regulation Act 9 of 2017 (FSRA).<sup>28</sup>

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<sup>19</sup> Co-operative Banks Act 2007, s 4(2).

<sup>20</sup> Co-operative Banks Act 2007, s 4(1) stipulates that the Co-operatives Act still applies unless the Act expressly says that it does not apply.

<sup>21</sup> Financial Co-operatives Act 2011, s 3.

<sup>22</sup> M Kuhlengisa *An Evaluation of the regulation and Supervision of Co-operative Financial Institutions in South Africa* (unpublished Master's thesis, Stellenbosch University, 2011) 47.

<sup>23</sup> S R Gundani *The Laws Regulating Co-operative Banks and the Contribution to Economic Growth and Poverty Alleviation in South Africa* (unpublished LLM thesis, University of Limpopo, 2017) 9.

<sup>24</sup> Table of Contents provided in Co-operative Banks Act 2007.

<sup>25</sup> Gundani op cit note 20 at 15–16.

<sup>26</sup> SARB Publications General Amendments to the Co-operative Banks Act 2007, ss 76 and 77 available at

<https://www.resbank.co.za/en/home/publications/prudential-authority/legislation/co-operative-banks-act-no-40-of-2007> accessed on 12 March 2021.

<sup>27</sup> SARB Publications Amendment Act 45 of 2013, ss 240 and 256 available at

<https://www.resbank.co.za/en/home/publications/prudential-authority/legislation/co-operative-banks-act-no-40-of-2007> accessed on 12 March 2021.

<sup>28</sup> Financial Sector Regulation Act 9 of 2017, Schedule 4 at 388.

Likewise, Malawi's Financial Co-operatives Act was introduced to apply specifically to financial co-operatives, which by the Act have been limited to SACCOs.<sup>29</sup> The Act provides for their registration and licensing; prudential requirements; governance, amalgamations, divisions, and liquidations; deposit insurance fund and other matters relating to SACCOs.<sup>30</sup> In this way, this Act also seeks to provide a uniform framework that is applied to all SACCOs.<sup>31</sup> However, there have not been any further amendments following the inception of the Acts.<sup>32</sup>

### 7.3 AN ANALYSIS OF THE REGULATORY FRAMEWORK OF FORMAL FINANCIAL CO-OPERATIVES

The regulatory frameworks in South Africa and Malawi regulate formal financial co-operatives using prudential and non-prudential regulation. As stated in the previous chapter, prudential regulation controls systemic risk by focusing on the safety and soundness of the financial system, as well as idiosyncratic risks associated with individual institutions.<sup>33</sup> Its objective is to protect depositors' savings and maintain stability through extensive regulation, control and enforcement tools.<sup>34</sup> Non-prudential regulation refers to the additional aspects of regulation like information regulation that has other diverse objectives, such as consumer protection and prevention of fraud, and is based on disclosure and non-bank authorities.<sup>35</sup>

As shown earlier as well, generally, the regulatory framework for financial institutions distinguishes between provisions that apply to entry (licensing and registration), operational or functional regulation (governance, administration, financial and operational standards), and exit or resolution of failing institutions.<sup>36</sup> An important fundamental issue in the regulation of financial co-operatives is the degree to which these components exist and align in different jurisdictions.<sup>37</sup> Unfortunately, it is often the case that these have been misaligned in developing countries, with mechanisms implemented either being minimal, non-existent or too stringent.<sup>38</sup> This section analyses these components (referred to as types of

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<sup>29</sup> Financial Co-operatives Act 2011 at 3; 'Definitions' provided in Financial Co-operatives Act 2011.

<sup>30</sup> Table of contents provided in Financial Co-operatives Act 2011.

<sup>31</sup> The FSA governs all financial institutions in Malawi; Financial Services Act 2010, s 3.

<sup>32</sup> RBM Publications Financial Co-operatives Regulations available at <https://www.rbm.mw/FinancialSectorRegulation/CaptialMarketsRegulation/?activeTab=MCSUFinancialCo-operatives> accessed on 20 September 2021.

<sup>33</sup> E Macchiavello 'Microfinance regulation and supervision: A multi-faced prism of structures, levels and issues' (2012) *NYU Journal of Law & Business* 145-6.

<sup>34</sup> Ibid; International Monetary Fund, Monetary and Capital Markets Department 'Lessons of the financial crisis for future regulation of financial institutions and markets and for liquidity management' (4 February 2021) 4, available at <http://www.imf.org/external/np/pp/eng/2009/020409.pdf> accessed 2 August 2021.

<sup>35</sup> Ibid; A Crockett 'Marrying the micro- and macro-prudential dimensions of financial stability' (21 September 2020) (unpublished presentation at the Bank for International Settlements autumn meeting in 2000) 2, available at <http://www.bis.org/review/rr000921b.pdf> accessed 2 August 2021.

<sup>36</sup> C Cuevas & J Buchenau *Financial Co-operatives: Issues in Regulation, Supervision, and Institutional Strengthening* (2018) 6.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

regulation in Chapter 6) in regards to South Africa and Malawi. Before I delve into this discussion however, it is important to identify who regulates the sector in the respective countries. Such clarity is important because the theories discussed in the previous chapter shows that regulating authorities have an important role to play in the economic party. That is, they may either regulate to advance the economy or inadvertently harm it.

### 7.3.1 REGULATORY AUTHORITIES

#### 7.3.1.1 South Africa

The regulatory authority of co-operative banks in South Africa is the Prudential Authority (PA) established under the FRSA.<sup>39</sup> This is a recent development. The initial mandate under the Co-operatives Bank Act of 2007 was for co-operative banks that hold deposits of more than R20 million to be regulated by the South African Reserve Bank (SARB), while co-operative banks and registered CFIs that hold deposits of between R1 million and R20 million and had a membership of at least 200 people were regulated by the Co-operative Banks Development Agency (CBDA).<sup>40</sup> This changed in April 2012 by an exemption from the Banks Act 2013 with the CBDA also taking on the regulation of CFIs previously regulated by SACCOL and SAMAF that met the registration requirements of R100,000 in shares and 200 members in the aftermath of their closures.<sup>41</sup> The SARB took over the responsibility for regulating all co-operative banks.<sup>42</sup>

There were several disadvantages to this arrangement, including regulatory arbitrage which will be discussed later in the thesis. However, of relevance in this section is that the CBDA was also the developmental and supervisory body for co-operative banks and the registered CFIs.<sup>43</sup> Combining regulatory and development roles in one entity is not a recommended practice for financial institutions.<sup>44</sup> The conflicts of interest are evident as the developer finds itself in the position to judge, as the regulator, the outcome of its own promotion exertions.<sup>45</sup> Notwithstanding, the FSRA has altered this landscape, transferring all regulatory oversight of both co-operative banks and CFIs to the PA.<sup>46</sup> This is a welcome

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<sup>39</sup> Financial Sector Regulation Act 2017, s 32; The FSR Act gives effect to three significant changes to the regulation of the financial sector. First, it gives the SARB an explicit mandate to maintain and enhance financial stability. Second, it creates a prudential regulator (PA) within the administration of the SARB. The PA is responsible for regulating banks (commercial, mutual and co-operative banks), insurers, co-operative financial institutions, financial conglomerates and certain market infrastructures. Thirdly, the FSR Act establishes a market conduct regulator – the Financial Sector Conduct Authority (FSCA) – which is a national public entity.

<sup>40</sup> Co-operative Banks Act 2007, s 54(1); K Mabule *CBDA CFI Start up Guide* (2014) 6.

<sup>41</sup> D de Jong & M Kuhlengisa 'Co-operative Banking in South Africa' in V Satgar (ed) *Co-operatives in South Africa: Advancing Solidarity Economy Pathways from Below* (2019) 68.

<sup>42</sup> *Ibid.*

<sup>43</sup> *Ibid.*; Gundani op cit note 20 at 20.

<sup>44</sup> Cuevas & Buchenau op cit note 36 at 11.

<sup>45</sup> *Ibid.*

<sup>46</sup> Financial Sector Regulation Act 2017, s 32; SARB 'Prudential Regulation' available at <https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation> accessed on 30 June 2021.

development for co-operative banks and registered CFIs because it removes the conflict of interest that the CBDA had as both regulator and developer of co-operative banks and registered CFIs.<sup>47</sup> Moreover, in theory, the advantage of having one regulator for both institutions is to minimise duplicity of responsibilities and to foster uniformity in the sector.<sup>48</sup>

However, the PA is also the regulator of other financial institutions like commercial and mutual banks, insurers, financial conglomerates and certain market infrastructures.<sup>49</sup> The consequence of such a structure is that the co-operative banks and CFIs are likely to compete for regulatory attention not only with the established commercial banks, but often with a large number of financial institutions serving similar customers.<sup>50</sup> Such competition may result in inadequate regulatory powers effected over different types of financial co-operatives.

### 7.3.1.2 Malawi

Prior to the introduction of the Financial Co-operatives Act of 2011, the Co-operatives Societies Act bestowed the role of the regulator to the Ministry of Industry and Trade (MoIT), giving the MoIT the responsibility for the auditing, the arbitration and the liquidation of co-operatives.<sup>51</sup> The Act also called for the promotion of co-operatives by MoIT, the provision of education and training, the facilitation of linkages (for example, linking financial co-operatives with commercial financial institutions) and product development.<sup>52</sup> Given the limited resources of the government, MoIT worked closely with industry stakeholders, particularly MUSCCO, to achieve adequate regulation.<sup>53</sup>

Accordingly, tasks such as auditing, promotion and the provision of education and training of SACCOs were delegated to the MUSCCO.<sup>54</sup> However, the main challenge of such a set-up was that the main regulator for SACCOs was a non-financial institution, being MoIT.<sup>55</sup> Moreover, there was a concentration of responsibilities in MoIT that resulted in the same disadvantages as those highlighted with the Co-operative Banks Act 40 of 2007, being a conflict of interest.<sup>56</sup>

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<sup>47</sup> G M Llanto *Financial Inclusion, Education, and Regulation in the Philippines*. Asian Development Bank Institute, Working Paper Series No 541 (2015) 7-8.

<sup>48</sup> Kuhlengisa op cit note 22 at 47; Co-operative Banks Act 2007, s 54(1); CBDA Co-operative Banks Development Agency Strategic Plan for the Fiscal Years of 2019/20-2021/22 at 20, available at [https://static.pmg.org.za/CBDA\\_Strategic\\_Plan\\_2019\\_2020.pdf](https://static.pmg.org.za/CBDA_Strategic_Plan_2019_2020.pdf) accessed on 10 May 2021.

<sup>49</sup> SARB Publications Prudential Regulations available at <https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation> accessed on 12 March 2021.

<sup>50</sup> C Cuevas & J Buchenau op cit 37 at 8.

<sup>51</sup> Genesis Analytics op cit note 5 at 19.

<sup>52</sup> Genesis Analytics op cit note 5 at 23.

<sup>53</sup> Ibid.

<sup>54</sup> S Enarsson & K Wirén 'MUSCCO –Malawi Union of Savings and Credit Co-operatives', CGAP Working Group on Microinsurance Good and Bad Practices, Case Study No 8. (2005) 5.

<sup>55</sup> Ibid.

<sup>56</sup> Cuevas & Buchenau op cit note 36 at 11.

Under the Financial Services Act, the regulator of SACCOs is the Reserve Bank of Malawi (RBM), under the Registrar (who is the Governor of Reserve Bank).<sup>57</sup> The Governor also regulates the whole financial sector.<sup>58</sup> Positively, this now brings the regulation of SACCOs into the purview of a financial regulator. However, having the regulatory office sitting in an individual, albeit within an institution, means that there is often inadequate personnel because of limited resources being allocated within the whole sector.<sup>59</sup> SACCOs are also neglected because they are competing for resources with the whole financial sector that comprise bigger financial institutions as is the case in South Africa.<sup>60</sup>

For both South Africa and Malawi, while having one regulator may have its disadvantages like a lack of specialisation on the part of the PA and the RBM, the advantages of a single regulator within the overall financial sector gives formal financial co-operatives authenticity and clarity that was lacking in the history of these institutions in both countries.<sup>61</sup> Moreover, the sector is not sufficiently large to warrant its own regulator.<sup>62</sup> What is more important in this regard therefore is institutional strengthening and supervision which would be provided by development agencies as the CDBA in South Africa. Setting up an institutional strengthening arm for the regulatory function would offer the necessary support to the authorities.<sup>63</sup>

## 7.3.2 REGISTRATION AND LICENSING

### 7.3.2.1 South Africa

To register as a co-operative bank, an application must be submitted to the PA and meet the requirements of:<sup>64</sup>

#### (a) Membership

A group of 200 members with a common bond. The definition of a common bond was broadened by the Financial Services Laws General Amendment Act 45 of 2013 from members who are employed by a common employer to those of a similar occupation or profession.<sup>65</sup> The reason for this amendment may

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<sup>57</sup> Financial Services Act 2010, s 8.

<sup>58</sup> Ibid.

<sup>59</sup> M Chintengo 'Regulation of financial co-operatives: The case of Malawi' available at <http://www.treasury.gov.za/coopbank/Conferences/CFI%20Indaba%20and%2014th%20SACCA%20Congress%2028%20Oct%20-%201%20Nov%202013/Regulation%20of%20financial%20co-operatives.pdf> accessed on 10 September 2020.

<sup>60</sup> K Mutua *Recommendations on Policy and Regulatory Framework for Inclusive Finance: A COMESA Region Country Representatives Initiative* (2016) 26.

<sup>61</sup> S Subramanyan 'Why the Financial Sector Needs a Single Regulator' (2002) *Economic and Political Weekly* 37(2) 169–72.

<sup>62</sup> Ibid.

<sup>63</sup> Cuevas & Buchenau op cit note 36 at 11.

<sup>64</sup> This is a list of requirements set out by the CBDA; T Tshabalala 'CBDA CFI start up guide' (2019) 6, available at <http://www.treasury.gov.za/coopbank/CFI%20start%20up%20guide.pdf> accessed on 11 February 2021.

<sup>65</sup> Financial Services Laws General Amendment Act 2013, s 240.

have been to enable more financial institutions to register as co-operative banks or allow people in a similar profession, but across companies to pool resources together.<sup>66</sup> The Ditsobotla Co-operative Bank Limited, for example, emerged from the combination of three worker based SACCOs.<sup>67</sup> In addition, the Co-operative Banks Act requires that they have common membership in an association or organisation, including a business, religious, social, co-operative, labour, or educational group; or live within the same defined community or geographic area.<sup>68</sup>

### **(b) Minimum capital and liquidity**

To be considered for registration as a CFI, the applicant must have a minimum of 200 members and a share capital of at least R100 000.<sup>69</sup> To be considered for registration as a co-operative bank, the applicant must have a minimum of 200 members and total deposits of at least R5 million.<sup>70</sup> A CFI must, once it has maintained at least R5 million in members' deposits for a period of at least six consecutive months, apply for registration as a co-operative bank in terms of the Act.<sup>71</sup> In terms of section 40B(2)(d)(ii) of the Act, the general maximum limit for holdings of deposits by any CFI is prescribed at R50 million.<sup>72</sup>

### **(c) Requirements of the Co-operatives Act of 2005 and Co-operatives Banks Act.**

The requirements of the Co-operatives Act include a constitution, a list of founding members and a list of directors of the association intending to register as a co-operative.<sup>73</sup> Such requirements must be submitted to the Companies and Intellectual Property Commission (CIPC) Registrar of Co-operatives for registration as a co-operative.<sup>74</sup>

The requirements of the Co-operative Banks Act include a prescribed form, certified copies of the constitution, certified copies of registration under the Co-operatives Act 2005, a full and abbreviated name, a lending policy (if applicable), a saving policy, a business plan, certified copies of registers, a

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<sup>66</sup> Ibid.

<sup>67</sup> D de Jong & M Kuhlengisa op cit note 42 at 74.

<sup>68</sup> Financial Services Laws General Amendment Act 2013, s 240.

<sup>69</sup> CBDA 'Guidance Note on Application for registration as a Co-operative Financial Institution' available at <http://www.treasury.gov.za/coopbank/supervisory%20CFIs/guidancenotes/Application%20as%20a%20CFI%20Guideline.pdf> accessed on 10 May 2021.

<sup>70</sup> Ibid.

<sup>71</sup> Co-operatives Banks Act 2007, s 40B(2)(d)(i).

<sup>72</sup> Co-operatives Banks Act 2007, s 40B(2)(d)(ii).

<sup>73</sup> Co-operatives Act 2005, s 6.

<sup>74</sup> CBDA 'Guidance Note on Application for registration as a Co-operative Financial Institution' available at <http://www.treasury.gov.za/coopbank/supervisory%20CFIs/guidancenotes/Application%20as%20a%20CFI%20Guideline.pdf> accessed on 10 May 2021.

postal and physical address and statements describing the suitability of the premises selected.<sup>75</sup> Further, the PA may request any other additional information as required.<sup>76</sup>

The applying co-operative must also demonstrate that the business that it wants to engage in fits within the type of co-operative bank that it is applying for.<sup>77</sup> In other words, a co-operative wishing to apply as a bank must show that its business plan is in line with the services that co-operatives are allowed to provide.<sup>78</sup> Further, a co-operative must demonstrate that it has sufficient human, financial and operational capacity to function efficiently and competently as a co-operative bank; and that the appointed officers of the bank have the necessary knowledge and qualification to operate the bank.<sup>79</sup>

#### **(d) Prudential and operating standards**

This is an additional requirement that has been introduced by the FSRA. The standards set out the principles and requirements for registration and operation of a CFI or co-operative bank registered in terms of the Co-operative Banks Act, 2007.<sup>80</sup> This standard covers matters concerning co-operative values and principles, the registration of CFIs and co-operative banks, certificate of registration, application for conversion of primary savings co-operative bank, application for approval of amalgamation, division of or transfer by co-operative bank; governance structures, constitution of a CFI or co-operative bank, board composition, the supervisory/audit committee, strategy and business plans, policy and procedures, financial management, and reporting.<sup>81</sup> These prudential and operating standards were released as a draft on 8 July 2021, for comments by the public.<sup>82</sup> It is not clear how these standards will work in practice and it is difficult to assess or predict in the absence of evidence.

Notwithstanding, these are quite comprehensive requirements when compared to the list of requirements provided prior to the introduction of both the Co-operative Banks Act 2007 and the FRSA.<sup>83</sup> Granted, financial co-operatives require a higher level of transparency given the nature of their business.<sup>84</sup> Admittedly though, the introduction of such an extensive list shortly after the introduction of the Co-

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<sup>75</sup> Co-operative Banks Act 2007, ss 6 and 7 provides for requirements for registration.

<sup>76</sup> Ibid.

<sup>77</sup> Co-operative Banks Act 2007, s 7(a) provides for requirements for registration.

<sup>78</sup> Ibid.

<sup>79</sup> Co-operative Banks Act 2007, s 7(b) provides for requirements for registration.

<sup>80</sup> Draft Standards made under section 46(1) of the Co-operative Banks Act, 2007 (Act No. 40 of 2007) (Act) read with section 105 and 108 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act) available at <https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-deposit-takers/co-operative-banks-prudential-standards/2021/Draft-Prudential-Standards-CFIs-and-Co-operative-banks-July-2021> accessed on 22 September 2021.

<sup>81</sup> Ibid.

<sup>82</sup> Ibid.

<sup>83</sup> See Co-operatives Act 2005, ss 6 and 7.

<sup>84</sup> Macchiavello op cit note 33 at 145-6.

operatives Act in 2005 may have discouraged applicants who sought to apply as co-operative banks. The sector may not have been ready for such a drastic change between requirements.<sup>85</sup>

Regardless, once the PA has assessed the application, and is satisfied that the applying co-operative meets the requirements, the PA requests concurrence from the Financial Sector Conduct Authority.<sup>86</sup> A licence will only be issued once the PA is satisfied that all procedural requirements set in the Act have been addressed and upon the establishment that the applying co-operative will be for the public interest.<sup>87</sup> How the co-operative's benefit for the public is assessed is not expressed. Here, therefore, one can note the vagueness of the public interest theory and the questions raised in the previous chapter. Who determines what public interest is? Notwithstanding, it may be redundant in reference to financial co-operatives considering that one of the principles of co-operatives is community development.<sup>88</sup> It would follow then that once institutions register as co-operatives, this extra requirement has already been established.

Further, registration with both the CIPC and PA creates a duplication of regulatory responsibility as the applying co-operatives must undergo checks with both institutions. This could potentially create confusion and lead to incomprehensive strategies, with policies overlapping and lacking cohesiveness.<sup>89</sup> Preferably, considering that the list of requirements in the Co-operatives Act is not as extensive, the involvement of the CIPC should be removed and passed on to the PA so that applicants only deal with the PA.

### **7.3.2.2 Malawi**

Like South Africa, all co-operatives in Malawi are firstly registered under the general Co-operatives Act, being the Co-operatives Societies Act of 1998.<sup>90</sup> The registration authority is MoIT and the Registrar of Co-operatives.<sup>91</sup> However, the point of deviation between the jurisdictions is that in Malawi, MoIT also registers co-operatives as SACCOs, unlike in South Africa where the PA (which is a financial regulator)

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<sup>85</sup> De Jong & Kuhlengisa op cit note 67 at 56-7.

<sup>86</sup> The FSCA is The FSCA is the market conduct regulator of financial institutions, that provide financial products and financial services, financial institutions that are licensed in terms of a financial sector law, including banks, insurers, retirement funds and administrators, and market infrastructures. This is a list of requirements set out by the CBDA; Tshabalala op cit note 64 at 6.

<sup>87</sup> Co-operative Banks Act 2007, s 8 provides for requirements for registration.

<sup>88</sup> LTY Bertulfo 'Women, co-op and peace work' in J Emmanuel & I Macpherson (eds) *Co-operatives and the Pursuit of Peace* (2007) 105.

<sup>89</sup> FinMark Trust 'Third tier banking report: A review of the capacity, lessons learned and way forward for member-based financial institutions in South Africa' (2003) at 31, available at <http://www.finmark.org.za/wpcontent/uploads/2016/01/ThirdTierBanking.pdf>, accessed on 25 April 2021.

<sup>90</sup> Financial Co-operatives Act, s 4(1)(a).

<sup>91</sup> Financial Co-operatives Act, s 3(1); Genesis Analytics op cit note 5 at 23.

registers the financial co-operatives.<sup>92</sup> The implication of this is that a non-financial authority that still assesses the viability of an association to become a financial co-operative.<sup>93</sup>

What has changed with the introduction of the Financial Co-operatives Act is an additional step that has been introduced, namely licensing by the Registrar of SACCOs.<sup>94</sup> This is unlike South Africa where the licensing and registration authority sits in one office, the PA.<sup>95</sup> In Malawi, MoIT is responsible for assessing whether an institution is fit to be registered as a SACCO and once it considers that it is, the process is escalated to the Registrar to issue the licence.<sup>96</sup>

According to section 4 of the Financial Co-operatives Act, registration and licensing of SACCOs is a two-step process. First, the applying institution must apply for registration as a SACCO under the provisions of the Co-operative Societies Act.<sup>97</sup> The requirements for incorporation under the Co-operative Societies Act include membership of at least ten people and three copies of the bylaws in English or the local language.<sup>98</sup>

Once this is established, the registered SACCO must apply for licensing to the Registrar, under the Financial Services Act.<sup>99</sup> The Financial Services Act provides general requirements for all types of financial institutions in Malawi. They include insurance institutions, MFIs, banks and so forth.<sup>100</sup> The list of requirements includes valid and unquestionable application documents, integrity, prudence, and professionalism when running the business, and public good and good financial prospects of the applying SACCO.<sup>101</sup> In addition, the Financial Co-operatives Act provides for the prudent governance, in accordance with co-operative principles, that is incorporated in the SACCO bylaws;<sup>102</sup> board of directors elected from within SACCO membership; and membership in the national association of financial co-operatives; and any other matter that the Registrar may consider necessary.<sup>103</sup>

The Registrar may only grant a licence, within, 60 days from the date of receipt of a completed application, once satisfied that the proposed business is financially viable.<sup>104</sup> In a case where the

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<sup>92</sup> Ibid; Enarsson & Wirén op cit note 54 at 5.

<sup>93</sup> Ibid.

<sup>94</sup> Financial Co-operatives Act 2011, s 4.

<sup>95</sup> Co-operative Banks Act 2007, s 8.

<sup>96</sup> Genesis Analytics op cit note 5 at 23.

<sup>97</sup> Financial Co-operatives Act 2011, s 4.

<sup>98</sup> Co-operative Societies Act 1998, s 5.

<sup>99</sup> Financial Co-operatives Act 2011, s 4(1)(b).

<sup>100</sup> Financial Services Act 2010, s 2.

<sup>101</sup> Ibid.

<sup>102</sup> Financial Co-operatives Act 2011, s 6.

<sup>103</sup> Ibid.

<sup>104</sup> Financial Co-operatives Act 2011, s (7)(1).

Registrar refuses to grant a licence, reasons for refusal must be provided. A person aggrieved by the decision of the Registrar may appeal to the Appeals Committee.<sup>105</sup> The Appeals Committee may reverse the decision of the Registrar where, among other things, the Registrar abused his or her discretion.<sup>106</sup>

As highlighted earlier, registration of SACCOs by a non-financial body omits the consideration of peculiar financial requirements that distinguish SACCOs from being considered at an early stage.<sup>107</sup> The Registrar only consider this when the SACCO applies for a licence, which might be confusing and add another barrier for applicants.<sup>108</sup> Further, as with the South African Co-operative Banks Act, the additional requirements for registration that SACCOs must ensure they have, present a hindrance to their registration.<sup>109</sup> Of note is that there is no minimum financial requirement for registration. This is omitted and left to the discretion of the Registrar who would assess the financial condition of the SACCO applying for a licence.<sup>110</sup>

Unfortunately, however, such a method of assessment for financial viability leaves room for subjectivity and abuse of power by the Registrar.<sup>111</sup> Without an evident promotion of transparency and accountability in these processes, it is hard to foster public confidence in the sector, thereby deterring other groups from entering the sector by registering as SACCOs.<sup>112</sup> What would assist is more transparency in the process of registration and licensing which also in turn increases predictability in the process.<sup>113</sup>

Considering these barriers to entry in both jurisdictions, it is subjective as to whether the requirements for registration and licensing were made following proper investigations of the sector. It may be possible that the sector was not ready for extensive lists of requirements introduced by the sector specific regulations. As shown in Part 1 of this a proper understanding of the sector is necessary to provide context and increases success in the implementation of the regulation.

### 7.3.3 TYPES OF FORMAL FINANCIAL CO-OPERATIVES

In both South Africa and Malawi, financial co-operatives can register as different types. Normally, laws and regulations determine whether they apply equally to all financial co-operatives, or whether they

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<sup>105</sup> Financial Co-operatives Act 2011, s (7)(3).

<sup>106</sup> Financial Co-operatives Act 2011, s (7)(4).

<sup>107</sup> Branch & Grace op cit note 10 at 3-4.

<sup>108</sup> FinMark Trust op cit note 89 at 31.

<sup>109</sup> De Jong & Kuhlengisa op cit note 67 at 56-7.

<sup>110</sup> Financial Co-operatives Act 2011, s 6(3).

<sup>111</sup> Ibid.

<sup>112</sup> M K Biwott *Impact of Prudential Regulations on Technical Efficiency of Deposit-Taking Co-operative Societies in Kenya* (unpublished thesis, Jomo Kenyatta University of Agriculture and Technology, 2020) 8.

<sup>113</sup> The following are guideline as set out in the WOCCU op cite note **Error! Bookmark not defined.** at 3.

recognise multiple tiers, depending on their size.<sup>114</sup> Likewise, the law can distinguish between the provisions that apply to independent financial co-operatives and those that apply to second-tier (network) associations such as federations.<sup>115</sup> The existence of networks and apexes raises governance issues beyond those associated with that of independent financial co-operatives.<sup>116</sup> Depending on the nature of the network apexes, from purely representative and promotional functions to specialised business entities housing shared services, the justification for the regulatory framework in establishing these divisions and governance rules is to avoid dominance and abuse of power by the large entities within the network.<sup>117</sup> Accordingly, both Acts provide for different types of formal financial co-operatives that may be registered under them.

### **7.3.3.1 South Africa**

#### **(a) Types of co-operative banks**

Four types of co-operative banks that may be registered under the Co-operative Banks Act. These are:

- Primary savings co-operative banks that have a minimum of five people. They are limited to basic financial services, including opening savings accounts for members, requesting and receiving deposits from members and making such deposits on their behalf, providing trust or custodial services for members, and providing loans.<sup>118</sup>
- Primary savings and loans co-operative banks that function like the primary savings co-operative banks, but primary savings and loans co-operative banks have the additional ability of providing secured and unsecured loans to their members and of making additional investments and banking services in accordance with regulations.<sup>119</sup>
- Secondary co-operative banks that are co-operative banks established by two or more primary co-operatives to deliver the same services as those services delivered by primary savings and loans co-operative banks. However, they can also trade in financial instruments on behalf of members and open accounts with banks registered under the Banks Act to facilitate foreign currency transactions.<sup>120</sup>

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<sup>114</sup> Cuevas & Buchenau op cit note 36 at 7.

<sup>115</sup> Ibid.

<sup>116</sup> International Co-operative Banking Association *Regulation and Sustainability of Co-operative Bank: A Cross country Study* (2020) 14.

<sup>117</sup> Ibid; Cuevas & Buchenau op cit note 36 at 7.

<sup>118</sup> Co-operatives Act 2005, s 7; Co-operative Banks Act 2007, s 5 and 14(1).

<sup>119</sup> Co-operative Banks Act 2007, ss 5 and 14 (2).

<sup>120</sup> Co-operative Banks Act 2007, ss 5 and 14 (3).

- Tertiary co-operative banks are co-operative banks established by secondary co-operatives to provide services similar to other forms of co-operative banks but that are granted wider latitude to perform additional banking services and invest money.<sup>121</sup>

The Act does not clearly distinguish a tertiary co-operative bank from a secondary co-operative bank in terms of its functionality.<sup>122</sup> Thus, the intent may have been to simply align the Act with the Co-operative Act of 2005 which provides for tertiary co-operative banks as co-operative apexes. Aside from this relevance, there is no defined basis for this particular division.<sup>123</sup> Moreover, financial co-operatives have also not taken advantage of these divisions because they do not qualify.

Notwithstanding, aside from these specific functions attributed to each bank, the Act also sets out several general functions that are to be performed by every registered co-operative bank.<sup>124</sup> Co-operative banks may receive grants and donations, be a member of a representative body or support organisation, and enter into agreements with such, establish a dispute resolution scheme with other co-operative banks of the same type and these banks may act as agents for their members or in the interest of their members as an intermediary of a banking or other institution as listed.<sup>125</sup>

However, it is not clear which organisations or sources may extend grants or donations to the banks. Suffice it to say that such an open-ended provision creates loopholes that may be exploited and discourage the autonomy of the banks. For instance, where the bank receives a donation from the government or donors.<sup>126</sup> This also shows the reluctance of the sector to wean itself from benefactors. Ideally, this clause should have restrictions that show the willingness of the regulatory framework to grow towards further autonomy.<sup>127</sup>

## **(b) Co-operative financial institutions**

A new development introduced by the FSRA is that the Co-operative Banks Act now also provides for all registered CFIs.<sup>128</sup> Prior to their incorporation into the Act, Government Notice R887 published in Government Notice No 31342 (recognised the SAMAF as regulator of all FSCs) and Government Notice 1176 of 1 December 2006 published in Government Gazette No 21492 (recognised SACCOL as the

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<sup>121</sup> Ibid.

<sup>122</sup> Kuhlengisa op cit note 22 at 57-58.

<sup>123</sup> Ibid.

<sup>124</sup> Co-operative Banks Act 2007, s 15.

<sup>125</sup> Ibid.

<sup>126</sup> High dependency is a recurring theme in this sector that should be restricted.

<sup>127</sup> A restriction may include the guidance on the sources from which donations may be received.

<sup>128</sup> Co-operative Banks Act 2007, s 40A.

regulator of all SACCOs).<sup>129</sup> These were repealed in May 2012 and replaced with Government Gazette 35368 no. 404, of 25 May 2012.<sup>130</sup>

This Gazette transferred the regulation and supervision of CFIs to the CBDA, marking the beginning of the transition of the semi-formal sector of financial co-operatives in South Africa to a clearer divide between the formal and the informal financial co-operatives.<sup>131</sup> I have found no evidence that eliminating the semi-formal sector was a deliberate intention of the Gazette. It may be more accurate to assume that it was done to ensure that there was still regulatory oversight over CFIs after SAMAF and SACCOL failed in 2012 and left a vacuum in the regulation of registered CFIs.<sup>132</sup>

Notwithstanding this was a welcome development because it addressed the regulatory arbitrage that existed where some CFIs met the Co-operative Bank threshold and were regulated by the Act, whereas others were regulated under SAMAF or SACCOL.<sup>133</sup> Initially, this meant that the Act only regulated big financial co-operatives that either registered as co-operative banks or exceeded the prescribed threshold and registered as CFIs.<sup>134</sup> Regulation of large financial co-operatives alone is commendable because the increasing complexity and increasing volume of regulations that financial co-operatives must follow leads to higher regulatory compliance costs which are - at least relatively - greater for smaller financial co-operatives.<sup>135</sup>

For example, if compliance with a new regulatory standard involves the use of additional employees, the cost impact for a CFI with five employees will be relatively larger than the increased compliance costs for a larger co-operative bank.<sup>136</sup> On the part of the regulatory or supervisory bodies, this minimises regulatory and supervisory costs incurred by authorities.<sup>137</sup> Nevertheless, by excluding financial co-operatives that do not qualify, the financial co-operatives sector is divided into two camps, with differing compliance, service offerings and interests.<sup>138</sup> The result of this bifurcated framework is confusion among depositors as to which financial co-operatives are supervised and which are not. Such confusion can lead to a lack of trust in all financial co-operatives.<sup>139</sup>

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<sup>129</sup> CBDA 'Supervisory and Regulatory Rules for Co-operative Financial Institutions (CFI) Applying for Registration to the CBDA' (20 July 2012) 3 available at <http://www.treasury.gov.za/coopbank/supervisory%20CFIs/documents/CBDA%20Rules%201%20July%202015.pdf>

<sup>130</sup> Ibid

<sup>131</sup> Government Gazette No 21492.

<sup>132</sup> Genesis Analytics op cit note 95 at 14.

<sup>133</sup> Kuhlengisa op cit note 22 at 58.

<sup>134</sup> F Giovanni *Regulation and the Viability of Co-operative Banks* (2012) 330.

<sup>135</sup> C E Cuevas & K P Fischer *Co-operative Financial Institutions: Issues in Governance, Regulation, and Supervision* (2006) 31–32

<sup>136</sup> F Giovanni op cit note 135.

<sup>137</sup> Ibid; Kuhlengisa op cit note 22 at 58.

<sup>138</sup> WOCCU op cite note **Error! Bookmark not defined.** at 14.

<sup>139</sup> Ibid; Gundani op cit note 20 at 29.

With the introduction of FSRA, the first change that has been made to the regulation of CFIs was to expressly broaden the Co-operative Banks Act from co-operative banks and some qualifying CFIs to include all CFIs as defined in the Financial Services Laws General Amendment Act 45 of 2013.<sup>140</sup> This has been an important adjustment because it removes any vagueness.<sup>141</sup> Thus, the Act has formalised all CFIs and brought them within the purview of the law.<sup>142</sup> This has been an important change because it has theoretically demolished the semi-formal sector as defined and drawn a clear line between the formal and informal. The Act now regulates all co-operative banks, credit unions, financial services co-operatives, and SACCOs.<sup>143</sup> Such an incorporation though commendable might be overly ambitious for a sector that is in the infancy stage. Having a single regulator increases the probability of deficiencies in how financial co-operatives are regulated.

Sections 40A and 40B provides for requirements for registration as CFIs. These include a demonstration to the PA or CBDA on an ongoing basis that they have the experience, knowledge, qualifications, and competencies necessary to fulfil their obligations; they have sufficient human, financial, and operational capacity to work efficiently and competently; and meet all prescribed thresholds in terms of membership, member shares and deposits held; and meet all other applicable regulatory requirements.<sup>144</sup> The Act provides that where the responsibility for registering CFIs has been assigned or delegated to the CBDA, the CBDA must recommend to the PA whether the application for registration as a co-operative bank should be approved or declined.<sup>145</sup> Positively, the list of requirements for CFI is not as extensive as that of co-operative banks.<sup>146</sup>

Notwithstanding, there is still no obligation for registration which may not change the reality for CFIs.<sup>147</sup> The following important questions may therefore still be applicable in this case:<sup>148</sup>

- How would the CBDA treat CFIs that meet the qualifying criteria, but are not registered, considering that these institutions provide access to financial services in excluded areas?
- What powers would the CBDA have in cases where a legitimate applicant intentionally avoids applying, for whatever reason?

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<sup>140</sup> Co-operative Banks Act 2007, s 40.

<sup>141</sup> A E Okem *The Implementation of Co-operative Policy: Perceptions From Co-operatives in the Umgungundlovu District Municipality (Kwazulu-Natal, South Africa)* (unpublished PhD Thesis University of Kwazulu Natal, 2016) 35.

<sup>142</sup> Genesis Analytics op cit note 95 at 14.

<sup>143</sup> Co-operatives Banks Act 2007, s 3.

<sup>144</sup> Co-operative Banks Act 2007, ss 40A and 40B.

<sup>145</sup> Co-operative Banks Act, s 40B (1).

<sup>146</sup> Ibid.

<sup>147</sup> In reality, many financial co-operatives may still opt to remain as informal financial co-operatives.

<sup>148</sup> Kuhlengisa op cit note 22 at 58.

In addition, while it is the Financial Services Laws General Amendment Act 45 of 2013 that introduced the new terminology into the Act in the form of CFI, the continued endorsement of the distinction between CFIs and co-operative banks as though a co-operative bank is not a CFI has no justification.<sup>149</sup> CFI is an umbrella term for all member-owned deposit-taking institutions as introduced above. This is an oversight that South Africa made in its regulation and arguably one of the reasons for persistent divisions within the financial co-operatives.<sup>150</sup> This should not be the case; co-operative banks should be incorporated into this term and divisions or tiers within the sector established on this basis.<sup>151</sup> This would lead to a tiered network of banks which would enrich the apex and integration for the banks.<sup>152</sup>

### **(c) Integration and networks**

The most integrated type of co-operation among financial co-operatives leads to the formation of a centralised and diversified mutual banking group.<sup>153</sup> In such a model, like in Europe and America, small local financial co-operatives control regional mutual banks which in turn hold a majority stake in a company or corporations.<sup>154</sup> This company, usually licensed as a commercial bank, acts as the group's apex entity with risk management responsibilities across the group. In Africa, an example of this is the Kenyan Co-operative bank which is registered as a company.<sup>155</sup>

The CBDA has proposed setting up a National Co-operative Bank in South Africa which would function similarly.<sup>156</sup> However, such a bank would not be necessary in South Africa because the number of co-operative banks and CFIs is not yet numerous enough to require such a structure.<sup>157</sup> Further, for South Africa, it would validate the top to bottom structure that is currently in force now, and contrary to the nature of financial co-operatives that should ideally function from the bottom towards the top.<sup>158</sup> I recommend rather that focus is shifted to the smaller financial co-operatives, that would, in turn, strengthen the sector sufficiently to require a National Co-operatives Bank. This is contrary to what Khafagy suggests promotes growth.

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<sup>149</sup> Financial Services Laws General Amendment Act 2013, s 240(b); Financial Sector Laws Amendment Bill Comments Matrix (2020) at 4, available at [http://www.treasury.gov.za/comm\\_media/press/2020/20200611%20Comments%20Matrix.pdf](http://www.treasury.gov.za/comm_media/press/2020/20200611%20Comments%20Matrix.pdf) accessed on 1 May 2021.

<sup>150</sup> Cuevas & Fischer op cit note 135 at 30.

<sup>151</sup> Financial Sector Laws Amendment Bill Comments Matrix op cit note 149 at 4.

<sup>152</sup> Ibid.

<sup>153</sup> R Coelho et al 'Regulation and supervision of financial co-operatives' (2019) 15 *FSI Insights on Implementation* at 8, available at <https://www.bis.org/fsi/publ/insights15.htm> accessed on 10 July 2021.

<sup>154</sup> Ibid.

<sup>155</sup> Ibid; The Bank converted to become a fully-fledged commercial bank in 1994 offering the complete range of financial services beyond the captive Co-operative sector to include personal, corporate and institutional customers – see <https://www.co-opbank.co.ke/our-history> accessed on 10 June 2021.

<sup>156</sup> N Sauli et al The Role of the co-operative banks development agency on the co-operatives developmental Presentation to the Portfolio Committee on Small Businesses, 14 November 2018) 41.

<sup>157</sup> In Kenya and Europe where these structures have worked, there have been numerous small financial co-operatives.

<sup>158</sup> In South Africa, there is a lot of concentration of resources and supervision at the top with smaller CFI's being neglected.

As the Co-operative Banks Act currently is, Chapter 5 of the Act prohibits co-operative banks from converting into other forms of corporate or incorporate bodies, but they may amalgamate with other co-operative banks.<sup>159</sup> Mergers in South Africa have not yet developed at the co-operative bank level. The co-operative banks are stand-alone banks with a limited and clearly defined membership and franchise.<sup>160</sup> However, mergers have occurred to form co-operative banks.<sup>161</sup> This is a welcome development as it strengthens the smaller financial co-operatives and provides support.

The Act also makes provision for the establishment of support organisations to develop and support the banks, as well as representative bodies promoting and advocating the interests of co-operative banks.<sup>162</sup> An organisation may apply as a representative body for co-operative banks where it demonstrated that it represents two or more co-operative banks in interactions with organs of the state and has the requisite experience and human, financial and operational capital.<sup>163</sup> For support organisations, in addition to the above, they must show that they have two or more co-operative banks as members and have support agreements that provide for the support that they will offer.<sup>164</sup>

There is currently only one such institution, the National Association of Co-operative Financial Institutions of South Africa (NACFISA), which consists of 40 co-operatives. NACFISA is registered as a representative body within the meaning of the Co-operatives Bank Act.<sup>165</sup> It provides representation and advocacy to its members, and also provides some demand-driven support services such as capacity building and mentoring, technology and accounting support, advice, product development and marketing, management information systems, audit preparations and training for financial co-operative employees and counsellors.<sup>166</sup> The effectiveness of NACFISA is questionable however as many co-operatives opt to not register with it.

#### **7.4.4.2 Malawi**

For Malawi, the Financial Co-operatives Act provides for primary, secondary and apex co-operatives:

- Primary SACCO – whose membership consists of at least ten individual persons. In comparison to the South African co-operative banks, what qualifies as primary SACCO in Malawi requires more

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<sup>159</sup> Co-operative Banks Act 2007, s 27(1).

<sup>160</sup> Coelho et al op cit note 153 at 26.

<sup>161</sup> De Jong & Kuhlengisa op cit note 67 at 56–7.

<sup>162</sup> Co-operative Banks Act 2007, ss 31 and 36.

<sup>163</sup> Co-operative Banks Act 2007, s 32.

<sup>164</sup> Co-operative Banks Act 2007, s 37.

<sup>165</sup> See homepage of NACFISA available at [www.nacfisa.org](http://www.nacfisa.org) accessed on 23 March 2021.

<sup>166</sup> Ibid.

people.<sup>167</sup> This could be a barrier to entry as well where the right numbers are not available. Five people to form a primary SACCO as the South African primary co-operative bank might be more aligned to the needs of Malawi.<sup>168</sup> Primary SACCOs provide the following services:

- deposit, credit, financial services to its members; and investment of funds.
- credit facilities; shared branching among SACCOs; transfers; chequing; deposit-taking; insurance agency; leasing; bill payments; automated teller machines and debit cards; participatory loans among other SACCOs; and any other financial services as the Registrar may approve from time to time.<sup>169</sup>
- Secondary SACCO - whose membership is restricted to primary SACCOs and may consist of 15 licensed primary SACCOs or more.<sup>170</sup> Secondary SACCOs may provide all services permissible to primary SACCOs, in addition to:
  - liquidity management services, auditing services of primary SACCOs, clearing services and securitisation.
  - participation in any national payments, clearing and settlement system.
  - insurance services to a person that has a deposit with, or an investment in the ownership shares of a primary SACCO.<sup>171</sup>

Community Savings and Investment Promotion (COMSIP), chiefly funded by World Bank, is an example of a secondary SACCO in Malawi. It has 193 co-operatives and 2000 members belonging to those co-operatives.<sup>172</sup> COMSIP also has other members, being 5,564 that belong to village banks under the VSLA programme. Others are MFIs, and others are non-financial co-operatives.<sup>173</sup> COMSIP is therefore not a co-operative that is specifically for SACCOs or providing co-operative services. Such organisations that offer varied services under the umbrella term confuses members, thereby increasing distrust in the institutions among Malawians.

Malawi has a SACCO apex body termed, MUSCCO. MUSCCO is a national democratically controlled apex body.<sup>174</sup> Its objective is to facilitate and sustainably promote the growth and development of SACCOs by providing a diversified range of financial, technical, administrative, and other products and support

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<sup>167</sup> Co-operative Societies Act 1998, s 5(1)(a).

<sup>168</sup> *Ibid.*

<sup>169</sup> Financial Co-operatives Act 2011, s 19.

<sup>170</sup> Co-operative Societies Act 1998, s 5(1)(b).

<sup>171</sup> Financial Co-operatives Act 2011, s 20.

<sup>172</sup> Refer to the official website of COMSIP available at <http://www.comsip.org.mw/#> accessed on 10 June 2021.

<sup>173</sup> *Ibid.*

<sup>174</sup> Genesis Analytics op cit note 5 at 23.

services.<sup>175</sup> It has 39 members affiliated with it, which means there are 39 licensed SACCOs in Malawi.<sup>176</sup> Membership of MUSCCO is a pre-requisite for licensing.<sup>177</sup>

It is commendable that integration or affiliation of SACCOs to MUSCCO should be compulsory. Regulations should support and permit the institutional integration between financial co-operatives to help them address the risks of maturity mismatches and liquidity risks, to allow small primary co-operatives to benefit from external technical assistance from larger co-operatives or federations, and to increase public confidence in the sector.<sup>178</sup> However, voluntary integration is preferable because the ethos of co-operatives is autonomy and voluntary based.

#### **7.4.5 MINIMUM PRUDENTIAL REQUIREMENTS**

Co-operative banks and SACCOs enjoy the privilege of accepting deposits from the public and therefore need to be prudentially regulated.<sup>179</sup> Prudential requirements are more detailed than legislation and address specific administrative, financial, and operational issues.<sup>180</sup> Minimum prudential requirements are important because they set standards which regulated institutions must adhere to not only to maintain their registration but also to monitor their own sustainability.<sup>181</sup> This section will only provide an evaluation of some of the key prudential requirements of the Co-operative Banks Act and the Financial Co-operatives Act vis-a-viz international best practices:

##### **7.4.5.1 Capital requirements**

It is commonly accepted that regulatory capital refers to the broadest scope of capital that can be used to absorb losses and to expand an institution.<sup>182</sup> It includes both institutional capital and secondary capital. Institutional capital refers for the most part to non-distributable reserves related to retained earnings, as well as ownership shares.<sup>183</sup> Secondary capital comprises subordinated debt and general reserves.<sup>184</sup> Capital clauses in financial co-operatives laws define minimum capital requirements and

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<sup>175</sup> Refer to the MUSCCO home page available at <https://www.muscco.org/> accessed on 20 May 2021

<sup>176</sup> Reserve Bank of Malawi 'Financial Institutions Annual Report for 2020' (July 2021) 99.

<sup>177</sup> Financial Co-operatives Act, s 6.

<sup>178</sup> Cuevas & Buchenau op cit note 36 at 7.

<sup>179</sup> Mutua op cit note 60 at 48.

<sup>180</sup> A Poprawa Regulation and Legislation of Co-operative Banks and Credit Union (Paper prepared for the United Nations Expert Group Meeting on Co-operatives, 2009) 5.

<sup>181</sup> Kuhlengisa op cit note 22 at 52.

<sup>182</sup> World Council of Credit Unions *Model Law for Credit Unions* (2015) 12.

<sup>183</sup> Branch & Grace op cit note 10 at 6.

<sup>184</sup> Ibid.

establish a timeframe for new financial co-operatives to meet the requirements.<sup>185</sup> Minimum capital adequacy ratios are also indicated. The ratios are usually set in the range between 8 to 10 per cent.<sup>186</sup>

### **(a) Minimum capital**

Capital is the primary resource of an institution provided by members and acts as a buffer to absorb unforeseen losses, thereby enabling institutions to continue operating even in difficult times.<sup>187</sup> Capital also serves as the basis for credit operations and expansion, while offering support for reasonable growth and public confidence in the institution and system.<sup>188</sup> Moreover, setting a minimum capital requirement has the benefit of having non-volatile and non-withdrawable reserves that reassure members to generate surpluses over time.<sup>189</sup>

The Co-operative Banks Act as it was initially introduced did not have minimum capital requirements.<sup>190</sup> Kuhlegisha identified this as a key weakness of the Act.<sup>191</sup> At the time, this was an accurate assessment in that there was no provision for a buffer in times of instability.<sup>192</sup> This omission was amended and the minimum capital for registration is R100,000 for CFIs.<sup>193</sup> To be considered for registration as a co-operative bank, the applicant must have a minimum of 200 members and total deposits of at least R5 million.<sup>194</sup>

In Malawi, the minimum capital requirements are not specified in the Act but have been determined by the Registrar through a directive.<sup>195</sup> Minimum capital is described as being both share capital and institutional capital.<sup>196</sup> Each member of a primary SACCO is required to have at least K5,000 in share capital and the primary SACCO itself is required to have a minimum of K2 million.<sup>197</sup> The institutional minimum capital for secondary SACCOs is K30 million.<sup>198</sup>

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<sup>185</sup> Cuevas & Buchenau op cit note 36 at 8.

<sup>186</sup> Ibid.

<sup>187</sup> R Ahmad *Capital Requirement and Financial Regulations in Banking: Are they Effective?* (2006) 13.

<sup>188</sup> A Siddika & R Haron (5 June 2020) Capital Adequacy Regulation, Banking and Finance, <https://www.intechopen.com/chapters/72411> accessed on 10 June 2021.

<sup>189</sup> Kuhlengisa op cit note 22 at 56.

<sup>190</sup> Ibid.

<sup>191</sup> Ibid.

<sup>192</sup> Siddika & Haron op cit note 22 at 187.

<sup>193</sup> CBDA 'Guidance Note on Application for registration as a Co-operative Financial Institution' available at <http://www.treasury.gov.za/coopbank/supervisory%20CFIs/guidancenotes/Application%20as%20a%20CFI%20Guideline.pdf> accessed on 10 May 2021.

<sup>194</sup> Draft Standards made under section 46(1) of the Co-operative Banks Act, 2007 (Act No. 40 of 2007) (Act) read with section 105 and 108 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act) available at <https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-deposit-takers/co-operative-banks-prudential-standards/2021/Draft-Prudential-Standards-CFIs-and-Co-operative-banks-July-2021> accessed on 22 September 2021.

<sup>195</sup> Financial Co – operatives Act 2011, s 26.

<sup>196</sup> Financial Services Minimum Capital Requirements for Savings and Credit Co-operative Societies Directive 2013, s 2.

<sup>197</sup> Financial Services Minimum Capital Requirements for Savings and Credit Co-operative Societies Directive 2013, s 5(1).

<sup>198</sup> Financial Services Minimum Capital Requirements for Savings and Credit Co-operative Societies Directive 2013, s 5(2).

## **(b) Minimum capital adequacy**

While minimum capital comprises, reserves held by financial institutions to cover possible losses, capital adequacy is the minimum amount of capital that financial institutions must have to execute business, benefit from profitable growth opportunities, absorb losses, and maintain customer confidence.<sup>199</sup> At a minimum, regulatory frameworks must have significant capital adequacy requirements because without adequate capital, the potential for failure in financial institutions increases.<sup>200</sup>

The international minimum adequacy ratio is between 8 to 10 per cent.<sup>201</sup> Accordingly, the minimum capital adequacy ratio in Malawi is 10 per cent of total assets, with a possibility of it being increased by the Registrar where there is increased exposure to risk.<sup>202</sup> The minimum capital adequacy requirement for co-operative banks in South Africa is at 6 per cent of total assets which is considered high and stringent.<sup>203</sup> Moreover, the use of total assets for both countries, to determine capital adequacy does not arguably fully reflect the risk inherent in the institution and it penalises institutions for holding assets that have low risk, like buildings.<sup>204</sup>

### **6.4.5.2 Liquidity**

Financial co-operatives regulations typically define a minimum liquidity ratio, as a proportion of short-term liabilities.<sup>205</sup> Liquidity is measured by the cash and other liquid financial assets that formal financial co-operatives hold to meet their short-term commitments as and when they fall due.<sup>206</sup> Effective liquidity management, which includes both quantitative and qualitative elements, is crucial for the continued viability of financial co-operatives.<sup>207</sup> Especially for financial co-operatives, liquidity is crucial to their ongoing viability because they do not have access to a lender of last resort facility like commercial banks do with central banks.<sup>208</sup> The common standard is 10 per cent of total deposits because financial co-operatives tend to operate on the liquid side.<sup>209</sup> This standard operates in both South Africa and Malawi.<sup>210</sup>

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<sup>199</sup> Siddika & Haron op cit note 22.

<sup>200</sup> Kuhlengisa op cit note 22 at 52.

<sup>201</sup> Cuevas & Buchenau op cit note 36 at 8.

<sup>202</sup> Ibid.

<sup>203</sup> Co-operative Banks Act 2007: Regulations in Terms of Section 86, reg 4(1)(a)(i).

<sup>204</sup> Kuhlengisa op cit note 22 at 52.

<sup>205</sup> Cuevas & Buchenau op cit note 36 at 8.

<sup>206</sup> SARB 'Co-operative Banks Annual Report 2017/18' at 6 available at <https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-co-operative-banks-annual-reports/2018/8939> accessed on 16 June 2021.

<sup>207</sup> Gundani op cit note 20 at 31.

<sup>208</sup> Kuhlengisa op cit note 22 at 52.

<sup>209</sup> World Council of Credit Unions *Model Law for Credit Unions* (2012) 12.

<sup>210</sup> Co-operative Banks Act 2007: Regulations in Terms of Section 86, reg 4(1)(c); Financial Services Prudential Liquidity Requirements for Savings and Credit Co-operative Societies Directive 2013, s 5(1).

### 7.4.5.3 External borrowing

External borrowing refers to funds received in the form of a loan from non-members in respect of which a financial co-operative has entered into a repayment agreement.<sup>211</sup> Such external debt can promote the control of net borrowers and, in turn, have detrimental effects on co-operative governance.<sup>212</sup> Prudential requirements limiting external borrowings recognise that the sustainable success of financial co-operatives lies in their ability to grow organically through self-help principles rather than through external borrowing.<sup>213</sup> It is therefore advisable to limit the level of dependence on external borrowing.

In this regard, co-operative banks are prohibited from having external borrowings that exceed 15 per cent of total assets.<sup>214</sup> Additionally, the Act and relevant regulations limit the extent to which co-operative banks can depend on donations, which is set at a maximum of 15 per cent of total assets.<sup>215</sup> This is to ensure that a co-operative bank makes use of its members' for on-lending purposes and to stimulate a culture of savings.<sup>216</sup> Similarly, SACCOs in Malawi may borrow externally between 5 to 15 per cent of total assets.<sup>217</sup> Variation of limits depends on the written permission of the Registrar and the board of directors.<sup>218</sup> However, all external borrowing requires the prior approval of the board of directors.<sup>219</sup>

### 7.4.5.5 Asset classification and delinquent loans

Formal financial co-operatives need to manage assets and delinquent loans because problematic assets give rise to financial risk, especially for financial co-operatives that also lend funds to members.<sup>220</sup> Granting loans to members and its mismanagement can give rise to loan delinquency because of the unwillingness or inability of members to pay.<sup>221</sup> In addition, granting loans to members can also be a problem when board members and employees use their position and privileged information to issue loans to themselves or to their friends and family.<sup>222</sup> This is a common place especially in small communities where social ties can negate the professionalism of management.<sup>223</sup>

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<sup>211</sup> Financial Services External Borrowing Requirements for Savings and Credit Co-operative Societies Directive 2013, s 2(1); Co-operative Banks Act 2007: Regulations in Terms of Section 86, reg 1(c).

<sup>212</sup> Kuhlengisa op cit note 22 at 53.

<sup>213</sup> Ibid.

<sup>214</sup> Co-operative Banks Act 2007: Regulations in Terms of Section 86, reg 4(1).

<sup>215</sup> Co-operative Banks Act 2007, s 15(a); Co-operative Banks Act 2007: Regulations in Terms of Section 86, reg 3(1).

<sup>216</sup> Regulations s 3.1; Kuhlengisa op cit note 22 at 53.

<sup>217</sup> Financial Services External Borrowing Requirements for Savings and Credit Co-operative Societies Directive 2013, s 5.

<sup>218</sup> Financial Services External Borrowing Requirements for Savings and Credit Co-operative Societies Directive 2013, s 6.

<sup>219</sup> Financial Services External Borrowing Requirements for Savings and Credit Co-operative Societies Directive 2013, s 2.

<sup>220</sup> Co-operative Banks Act 2007: Regulations in Terms of Section 86, reg 3(1).

<sup>221</sup> Kuhlengisa op cit note 22 at 55.

<sup>222</sup> Ibid.

<sup>223</sup> R Levine, G Caprio G & J R Barth *The Regulation and Supervision of Banks Around the World: A New Database*. Policy Research Working Paper 2588. World Bank Publications (2001) 19.

In South Africa, delinquent loans must not exceed between 2 to 100 per cent per cent of all loans delinquent over a period ranging from 1 to 12 months.<sup>224</sup> In addition, all loans must be made in accordance with the loan policy, and for all loans to employees, officers and directors of the co-operative bank or their immediate family members or business associates, all loans must be declared in annual financial statements in a prescribed manner.<sup>225</sup>

For Malawi, provision for loan losses comprise of 35 per cent on the outstanding principal balances for loans classified as overdue and 100 per cent of loans classified as loss.<sup>226</sup> Loans may be made to employees and members of the board in an amount not exceeding a proportion of the total assets as prescribed by the Registrar.<sup>227</sup> While this may seem open-ended and subjective, the board of directors is required to adopt and implement a written policy regarding asset classification and insider lending.<sup>228</sup> In addition, no director or employee of a SACCO is permitted to receive any product or service on terms that are any more or less favourable than any other member of the SACCO with a similar credit history and capacity to repay.<sup>229</sup> All loans of a SACCO involving any related party of a SACCO must be disclosed to the board of directors and annually to the Registrar.<sup>230</sup>

#### **7.4.5.6 Inspection of SACCO premises**

This prudential requirement is not available in South Africa. However, it is a requirement for SACCOs in Malawi. At a minimum, SACCO premises are subject to inspection to ensure that they have adequate security arrangements and infrastructure to command the trust of the public and SACCO members.<sup>231</sup> Minimum requirements include windows with blinds, counters, security lights, a spacious banking area, a computer and so forth. While this is commendable, there are other requirements that a rural-based economy like Malawi is not ready for.<sup>232</sup>

Having a computer, for example, already restricts their reach because other sections of Malawi do not have electricity. It is therefore important to investigate such places to find commendable methods of what SACCO premises should have. One such way has been mobile banking to expand the reach of their

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<sup>224</sup> Co-operative Banks Act 2007: Regulations in Terms of Section 86, reg 4(1).

<sup>225</sup> Co-operative Banks Act 2007: Regulations in Terms of Section 86, reg 3(3).

<sup>226</sup> Financial Services Asset Classification Requirements for Savings and Credit Co-operative Societies Directive 2013, s 9(1 and s9(2).

<sup>227</sup> Financial Services Asset Classification Requirements for Savings and Credit Co-operative Societies Directive 2013, s 6(1).

<sup>228</sup> Financial Services Asset Classification Requirements for Savings and Credit Co-operative Societies Directive 2013, s 4.

<sup>229</sup> Financial Co-operatives Act 2011, s 30(1).

<sup>230</sup> Financial Co-operatives Act 2011, s 30(3).

<sup>231</sup> Financial Co-operatives Premises Inspection Directive 2013, s 3.

<sup>232</sup> Financial Co-operatives Premises Inspection Directive 2013, s 8(3).

services. Or, alternatively, village banks that only have a safe with three sets of keys.<sup>233</sup> As it currently stands, the requirements necessary to establish a SACCO premise may be a barrier to entry.

In both jurisdictions, there are complaints that the prudential requirements are strict and bar entry into the sector. Thus, given the plight of the poor and the low-income earners, it is necessary to review the current prudential requirements to relax them cautiously.<sup>234</sup> This could encourage poor and low-income earners to trust formal financial co-operatives. Financial co-operatives should cautiously relax their document requirements for the poor and low-income earners without necessarily exposing other financial customers to risks such as fraud.<sup>235</sup>

As an overview comment on the prudential requirements, the CBDA has rejected a number of applications by CFIs in South Africa as a result of their failure to meet some of the prudential requirements as well as being insolvent.<sup>236</sup> Likewise, for Malawi, as shown, some of the entry requirements are quite onerous within a rural -based economy. It would seem that formal financial co-operatives are subject to the higher standard of banking laid out in the Basel III.<sup>237</sup> Most formal financial co-operatives in these countries however are in the rapid growth phase and therefore lack the capital to sustain their business because of low member capital base and losses.<sup>238</sup>

#### **7.4.6 EXIT MECHANISMS AND DEPOSIT INSURANCE SCHEME**

Many regulatory systems do not provide exit mechanisms or create conditions for business termination, compensation of depositors and other creditors, and creation of resolution processes (mergers, acquisitions, interventions) that are adequately funded and staffed for financial co-operatives.<sup>239</sup> As a result, many financial co-operatives, particularly in developing countries have large numbers of inactive and failing financial co-operatives that have not been resolved.<sup>240</sup>

In South Africa, as well as Malawi, provision is made for deregistration. In South Africa, a co-operative bank may be deregistered where it has not started six months after the date of registration or has ceased to operations for a continuous period of three months.<sup>241</sup> Additionally, a co-operative bank may also be

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<sup>233</sup> CARE Village Savings and Loans (VSLA) available at <https://www.care.org.au/village-savings-loans/> accessed on 10 March 2020.

<sup>234</sup> E Botha & D Makina 'Financial regulation and supervision: Theory and practice in South Africa' (2011) 10 *International Business & Economics Research Journal* 31.

<sup>235</sup> H Chitimira & M Ncube 'Legislative and other selected challenges affecting financial inclusion for the poor and low-income earners in South Africa' (2020) *Journal of African Law* 18.

<sup>236</sup> De Jong & Kuhlengisa op cit note 67 at 74.

<sup>237</sup> This should not be the case

<sup>238</sup> Gundani op cit note 20 at 31.

<sup>239</sup> Cuevas & Buchenau op cit note 36 at 8.

<sup>240</sup> Ibid.

<sup>241</sup> Co-operative Banks Act 2007, s 11(1)(a).

de-registered if a co-operative bank has obtained the registration fraudulently and therefore, has violated the provisions of the Act.<sup>242</sup> Upon deregistration, the supervisor may direct the co-operative bank to repay any deposits.<sup>243</sup> For Malawi, deregistration may occur after suspension or revocation of a licence.<sup>244</sup>

Both also Acts provide for mergers, acquisitions and winding up of co-operative banks either voluntarily or upon recommendation of the PA or Registrar.<sup>245</sup> However, for both countries, there are no systematic processes for resolution targeted at protecting depositors.<sup>246</sup> Some jurisdictions generally have clear processes and principles for rehabilitation, rescue, or resolution, depending on the type of difficulty that the financial co-operative is facing.<sup>247</sup> These include for example, 'bridging' where another institution will take over a financial co-operative for a period to 'nurse' it back to health.<sup>248</sup> Another tool may be restructuring without a member's approval.<sup>249</sup> The main challenge with restructuring, however, is that this resolution tool can be contested in the courts unless it is clearly stipulated in law.<sup>250</sup> For financial co-operatives, whose members are owners, the lack of members' approval in restructuring could affect the business of financial co-operatives.<sup>251</sup> There are many tools available that could be considered for South Africa and Malawi. However, a deep investigation into this sphere is beyond the scope of this thesis.

Notwithstanding, I acknowledge that for both countries, their attempt to protecting members of financial co-operatives in the event of closure or crises has been through the provision of the deposit insurance fund.<sup>252</sup> A deposit insurance fund is generally recommended to protect depositors' money.<sup>253</sup> The idea is to allocate some of the deposits of the members to this fund for compensation and investment purposes.<sup>254</sup> However, although this provision has been made, no deposit insurance scheme has been implemented in both countries.<sup>255</sup> In the absence of an explicit deposit insurance, regulators resort to guaranteeing the stability of the institutions by providing for mergers and acquisitions as recourse to

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<sup>242</sup> Co-operative Banks Act 2007, s 11(1)(d).

<sup>243</sup> Co-operative Banks Act 2007, s 11(1)(e).

<sup>244</sup> Financial Co-operatives Act 2011, s 11.

<sup>245</sup> Financial Co-operatives Act 2011, s 49; Co-operative banks Act 2007, ch 5.

<sup>246</sup> Cuevas & Buchenau op cit note 36 at 8.

<sup>247</sup> R Coelho et al 'Regulation and supervision of financial co-operatives' (2019) 15 *FSI Insights on Implementation* at 24, available at <https://www.bis.org/fsi/publ/insights15.htm> accessed on 10 July 2021.

<sup>248</sup> Research and Guidance Technical Committee *Resolution Issues for Financial Co-operatives- Overview of Distinctive Features and Current Resolution Tools* (2018) Research Paper 27.

<sup>249</sup> *Ibid.*

<sup>250</sup> *Ibid.*

<sup>251</sup> Coelho et al op cit note 248 at 24.

<sup>252</sup> Co-operative banks Act 2007, s 24; Financial Co-operatives Act 2011, s 51

<sup>253</sup> Khafagy op cit note 9 at 17.

<sup>254</sup> *Ibid.*

<sup>255</sup> SARB 'Designing a deposit insurance scheme for South Africa - a discussion paper' (2017) available at <http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> accessed on 25 July 2021; Gundani op cit note 20 at 15.

individual financial co-operatives failure.<sup>256</sup> For depositors however, this means that there are currently no explicit arrangements in place to protect depositors in the event of an institutional failure. This is an omission that should be addressed. South Africa has started discussing such measures and Malawi should consider this as well.

#### 7.4.7 CO-OPERATIVE GOVERNANCE

Governance is important in all financial institutions. Internal governance rules establish internal control, management, and supervisory systems to address problems before external intervention is required.<sup>257</sup> Governance includes guidelines for board of directors, internal auditor, reporting, management and annual general meetings.<sup>258</sup> Especially in financial co-operatives, good governance is an essential component of success because the boards of directors are democratically elected from among the members.<sup>259</sup> The nature of ownership in financial co-operatives and their primary principles underlie governance risks that are quite different from those of commercial banks.<sup>260</sup> For example, unlike investor-owned banks, internal ownership in financial co-operatives provides no external pressure on management or the board of directors to carry out their duties.<sup>261</sup>

Furthermore, the effectiveness of co-operative governance is reduced by the political aspirations, collusion and personal agendas of the board of directors.<sup>262</sup> Stories abound of managers and board members fleeing with member deposits, while less extreme examples of entities weakened by poor and unanswered decisions are perhaps the most common situation leading to bankruptcy.<sup>263</sup> Finally, co-operative governance can also be weakened by the involvement of political parties, for example, in the direction and management of the financial co-operatives.<sup>264</sup> Addressing these conflicts should be a central issue in the prudential regulation of financial co-operatives.<sup>265</sup>

One mode of governance offered to financial co-operatives is in the form of annual general meetings because at least once a year, members exercise absolute control over the co-operatives in the form of control over management decisions, policies and other important issues.<sup>266</sup> The important aspects of

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<sup>256</sup> Cuevas & Buchenau op cit note 36 at 8.

<sup>257</sup> Poprawa op cit note 180 at 6.

<sup>258</sup> Ibid.

<sup>259</sup> R Spear et al 'For love and money: governance and social enterprise' (2007) *Governance Hub, National Council for Voluntary Organizations* at 6 available at <http://oro.open.ac.uk/view/person/cjc9.html> accessed on 23 June 2020.

<sup>260</sup> Ibid.

<sup>261</sup> Ibid.

<sup>262</sup> A S Kleanthous *Co-operatives, credit unions and principles: a post 2008 critique* (PhD thesis, University of Glasgow, 2017) 28-30.

<sup>263</sup> Ibid.

<sup>264</sup> N Yamori et al 'Corporate governance structure and efficiencies of co-operative banks' (2017) *Journal of Financial Economics* 369.

<sup>265</sup> Ibid.

<sup>266</sup> Kleanthous op cit 262 at 28-30.

the annual general meetings include the ability to make unanimous decisions, and the real participation of the majority of members in democratic procedures, making decisions and executing them.<sup>267</sup> Finally, other powers that are exercised include the selection of the board of directors and the committees, and the approval of annual financial statements.<sup>268</sup>

Another important mode of governance is the board of directors. The board is responsible for most of the decision-making process, as it has both real and formal authority and exercises the management and control of ex ante decisions (in addition to decisions that require the approval of members in the general assembly).<sup>269</sup> Some of the functions that are assigned to the board of directors are the assessment of the adequacy and efficiency of the internal control systems, accounting practices, information systems and auditing processes within the financial co-operatives.<sup>270</sup> In Malawi, the Financial Services Act states that a prudentially regulated financial institution must have a board of directors responsible for managing the institution's affairs.<sup>271</sup>

Unfortunately, however, the Financial Co-operatives Act itself does not explicitly list the responsibilities of the of directors but gives the Registrar the discretion to determine these responsibilities.<sup>272</sup> Further, the appointment of these directors, executive officers and managers is subject to the approval of the Registrar.<sup>273</sup> The frequency of meetings and the responsibilities and qualifications of the directors may also be determined by the Registrar.<sup>274</sup> This heavy reliance on the Registrar arguably creates arbitrary excesses that is detrimental to the growth of financial co-operatives.

An additional mode of governance is the management of the formal financial co-operatives which over time has consisted of professional members to order to complement their expertise (usually in finance, legal or marketing issues).<sup>275</sup> In many countries, this has occurred because of the lacking capacity of members within the financial co-operatives.<sup>276</sup> For Malawi, the Registrar may also, through directives, determine the responsibilities and qualifications of any officer in the management of SACCOs.<sup>277</sup> The management of SACCOs is responsible for prudently overseeing the operations of the SACCOs in

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<sup>267</sup> Spear et al op cit note 260 at 6-7.

<sup>268</sup> Ibid.

<sup>269</sup> Kleanthous op cit 262 at 25.

<sup>270</sup> Ibid.

<sup>271</sup> Financial Services Act 2011, s 30.

<sup>272</sup> Financial Co-operatives Act 2011, 21 (d).

<sup>273</sup> Financial Services Act 2011, s 30; Financial Co-operatives Act, s 22.

<sup>274</sup> Ibid.

<sup>275</sup> Kleanthous op cit 262 at 26.

<sup>276</sup> De Jong & Kuhlengisa op cit note 67 at 74.

<sup>277</sup> Financial Co-operatives Act 2011, s 22(2).

accordance with the Financial Co-operatives Act, the Financial Services Act and policies established by the board of directors of the SACCO.<sup>278</sup>

As noted, the Registrar exercises substantial control on the appointment of the leadership of SACCOs. The advantage of this is that the current framework ensures the appointment of leadership that is accountable and reliable leadership to SACCO members by encouraging best management practices.<sup>279</sup> This is supported by rotating director elections, annual reviews and general membership meetings each year. This provides an assurance that members evaluate and hold directors accountable.<sup>280</sup>

However, the disadvantage of such dependence on the Registrar is that the government plays a more dominant and central role in the management of co-operatives, thereby creating a climate of dependence within the sector which in turn slows development.<sup>281</sup> SACCOs should be able to develop their systems with relatively low government interference.<sup>282</sup> This can be counterbalanced by a broader regulatory framework that ensures the protection of members' interests.<sup>283</sup>

Consequently, there is a need for significant governance reforms, as government control still exists.<sup>284</sup> Government control should be limited to basic regulatory functions reflected in controls which focus on registration, supervision, sanctions and liquidation, without weakening the ability of co-operatives to function well and grow.<sup>285</sup> However, the unrestricted powers of government registries or authorities, such as the appointment or removal of co-operative or board directors, are harmful.<sup>286</sup> Furthermore, legislation should not facilitate the intervention of government authorities in day-to-day operations or allow for mandatory membership.<sup>287</sup>

Likewise, in South Africa, there are weaknesses in all modes of governance. The members of the supervisory and audit committees rarely meet.<sup>288</sup> Some of those committees that meet regularly do not provide effective oversight.<sup>289</sup> Furthermore, the active participation of members through the annual

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<sup>278</sup> Financial Co-operatives Act 2011, s 22(1).

<sup>279</sup> Gundani op cit note 20 at 54.

<sup>280</sup> Financial Co-operatives Act 2011, ss 21 and 22.

<sup>281</sup> Gundani op cit note 20 at 54.

<sup>282</sup> Ibid.

<sup>283</sup> Khafagy op cit note 9 at 96.

<sup>284</sup> Ibid.

<sup>285</sup> C Musumal 'Summary of the Discussions. In the Relationship between the State and Co-operatives in Co-operative Legislation' (1994) 157-58.

<sup>286</sup> Ibid.

<sup>287</sup> Khafagy op cit note 9 at 96.

<sup>288</sup> De Jong & Kuhlengisa op cit note 67 at 74.

<sup>289</sup> Ibid.

general meetings is generally inadequate.<sup>290</sup> Also, although policies and plans are available, they are often outdated or not implemented.<sup>291</sup> Evidence suggests that policy templates and training manuals are adopted without the experience required to successfully implement relevant policy proposals.<sup>292</sup>

Further, the Co-operative Banks Act does not go into much detail about the specifications of directors' education or experience. However, it does provide that the constitution of co-operative banks (which are the internal rules) must stipulate these requirements.<sup>293</sup> Notwithstanding, the Act explicitly states that a director should be a fit and proper person.<sup>294</sup> What a fit and proper person means, is assessed by the PA.<sup>295</sup> In making this assessment, the PA considers the competence and soundness of the person's judgment, the care with which the person in question can fulfil these responsibilities, and the person's behaviour to date.<sup>296</sup>

The main concerns in this context are the capabilities and qualifications of the members of the board of directors, the executive committee, and the members of the supervisory board.<sup>297</sup> The pool from which the board of directors is selected from is often limited because it must be from members of the co-operative bank.<sup>298</sup> In rural areas in particular, there are hardly any members with the necessary experience and qualifications.<sup>299</sup> Further, the term fit and proper is loosely defined or sufficiently unclear as it depends on the PA. Admittedly, it would be hard to set a standard but while in many contexts it may be unrealistic to expect qualification requirements to be met, mandatory training and certification can be stipulated or the recruitment of qualified individuals for managerial roles can be made possible.<sup>300</sup>

Proper training can guarantee that management should at least have academic and professional qualifications and competencies.<sup>301</sup> It can also ensure that the board of directors must have the necessary skills and knowledge.<sup>302</sup> Thus, the law can come in place in this instance to establish appropriate criteria for board members that include specific training or managerial experience.<sup>303</sup>

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<sup>290</sup> Gundani op cit note 20 at 54.

<sup>291</sup> Ibid.

<sup>292</sup> De Jong & Kuhlengisa op cit note 67 at 74.

<sup>293</sup> Co-operatives Banks Act 2007, s 7(c).

<sup>294</sup> Ibid.

<sup>295</sup> Ibid.

<sup>296</sup> Co-operatives Banks Act, 2007 s 9 (1)(a).

<sup>297</sup> Gundani op cit note 20 at 33.

<sup>298</sup> Ibid.

<sup>299</sup> Ibid.

<sup>300</sup> Cuevas & Buchenau op cit note 36 at 7.

<sup>301</sup> Ibid.

<sup>302</sup> Ibid.

<sup>303</sup> Branch & Grace op cit note 10 at 10.

Alternatively, the law may stipulate that directors must attend formal training in the management and supervision of financial institutions in order to retain their positions on the board.<sup>304</sup>

However, globally, new, and innovative governance strategies are being developed to address these challenges including a movement towards launching basic qualifications for election to a board including requirements such as experience, skills, and independence to ensure that directors can oversee the operations of larger, more complex institutions.<sup>305</sup> Further there is greater use of technology (for example, online voting) and decentralised governance processes.<sup>306</sup>

Hopefully, these trends will also be effected in South Africa and Malawi. To achieve this, a clear description of the composition of governing bodies will be required. Fit and proper requirements for governance bodies, senior management and their succession will also be important, especially for Malawi.<sup>307</sup> This would address and prevent all potential conflicts of interest, for example, when board members decide on loans for themselves or close relatives.<sup>308</sup> In addition, as financial co-operatives grow in size and complexity, the rules of fitness and order will need to progressively adjust.<sup>309</sup>

#### **7.4.8 REPORTING AND AUDITING**

Reporting requires that supervisory authorities have the ability to collect, review and analyse annual or quarterly prudential reports and returns from regulated financial co-operatives.<sup>310</sup> It also requires that the authorities have a mechanism to independently review such reports, for example, through the use of external experts, such as auditors.<sup>311</sup> These reports are a form of information regulation and form an integral part of the regulation of financial co-operatives.

The Co-operative Banks Act only provides for the function of auditor, without the suitability and / or if an external or internal auditor is sufficient.<sup>312</sup> This focus on South Africa is largely motivated by the small size of the sector and therefore the desire to minimize audit costs for the sector.<sup>313</sup> However, co-operative banks must at least be able to produce reliable, timely, and transparent data on defaults, write-offs, and general financial developments.<sup>314</sup> Unfortunately, the efficiency of boards of directors and the

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<sup>304</sup> Ibid.

<sup>305</sup> Poprawa op cit note 180 at 6.

<sup>306</sup> Ibid.

<sup>307</sup> Cuevas & Buchenau op cit note 36 at 7.

<sup>308</sup> Cuevas & Buchenau op cit note 36 at 7.

<sup>309</sup> Ibid.

<sup>310</sup> Kuhlengisa op cit note 22 at 55.

<sup>311</sup> Ibid.

<sup>312</sup> Co-operative Banks Act, 2007, s 18.

<sup>313</sup> Ibid.

<sup>314</sup> Ibid.

way they manage their functions, financial statements, and management accounts are often perceived as unreliable. Therefore, this would be accomplished by a qualified and independent auditor. By contrast, Malawi provides for a qualified external auditor.<sup>315</sup> However, it is not clear to what extent such a requirement would be possible considering the costs to be borne in hiring an external auditor.<sup>316</sup> I would propose for Malawi that a more proportional approach would be to appoint an internal auditor who would provide reliable reports. This would be more aligned to the historical approach of voluntary administrators for co-operatives.

## 7.5 CONCLUSION AND OBSERVATIONS

This chapter started by laying out the pieces of legislation that govern financial co-operatives in both sectors. In South Africa, formal financial co-operatives refer to co-operative banks and registered CFIs.<sup>317</sup> In Malawi, formal financial co-operatives refer to Savings and Credit Co-operatives (SACCOs).<sup>318</sup> The main piece of national legislation governing financial co-operatives in South Africa is the Co-operatives Banks Act of 2007 and the subsequent amendments issued thereof.<sup>319</sup> Similarly, the Financial Co-operatives Act of 2011, primarily governs SACCOs in Malawi.

The introduction of the sector-specific legislation in both South Africa and Malawi were welcome changes in the financial co-operatives sector and positive steps towards providing sound legislative foundations in the respective countries.<sup>320</sup> Both Acts provide for prudential regulation to manage systemic risk and protect depositors' savings while still providing uniformity in the application of the law.<sup>321</sup> Both Acts have also gone to great length to ensure that entry into the sector is regulated, as it information and governance. However, this chapter also showed that these pieces of legislation require further amendments to plug the gaps that affect their effectiveness in fostering the growth of financial co-operatives sector.

By way of an example, the introduction of both Acts restricted entry into the sector by suddenly increasing the requirements for registering and licensing co-operatives intending to register as formal financial co-operatives.<sup>322</sup> This unexpected shift from the minimal requirements that the general co-operatives Acts provided required transitional time.<sup>323</sup> While this may have been a welcome approach, this chapter

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<sup>315</sup> Financial Co-operatives Act, 2011, s 44

<sup>316</sup> Financial Co-operatives Act, 2011, s 45.

<sup>317</sup> Co-operative Banks Act 2007, s 4(1).

<sup>318</sup> Financial Co-operatives Act 2011, s 3.

<sup>319</sup> Co-operative Banks Act 2007, s 4(2).

<sup>320</sup> Macchiavello op cit note 33 at 145-6.

<sup>321</sup> Ibid.

<sup>322</sup> As shown, these jumps were not welcome.

<sup>323</sup> Ibid.

stated that it is not clear whether the requirements were made following proper investigations of the sector. This thesis therefore recommended a further investigation of the sector. Further, the chapter showed that there is an institutional overlap and duplication between registration entities (for example in South Africa, registration with both the CIPC and PA and in Malawi, registration and licensing sitting in two different institutions). The chapter therefore recommended harmonising the institutional providers needed for registration.

Further, it was shown that both Acts give considerable discretion to regulators in key decision-making functions which leans into an overlap in the management the financial co-operatives.<sup>324</sup> Such unrestricted powers to state registrars or authorities are detrimental as they create arbitrary excess of power in one institution.<sup>325</sup> There is need to therefore put in place mechanisms or structures that disperse these powers. Additional gaps within the Acts included lack of clarity as regards co-operative governance and apparent state control or potential of state control; stringent requirements regarding the relevant documentation for the poor and low-income earners; and lack of deposit insurance schemes.<sup>326</sup> Further recommendations to create deposit insurance schemes and relax the information regulation requirements were therefore made.

The implementation of these recommendations will serve to establish an institutional framework that enables the registration of co-operatives in the fastest, easiest, cheapest, and most efficient way possible; facilitate joining co-operatives; and encourage the development of co-operatives as autonomous and self-managed business entities, particularly in areas where co-operatives have an important role to play or provide services that are not provided otherwise. This would in turn trickle down to the supervisory framework discussed in the next chapter of this thesis.

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<sup>324</sup> Branch & Grace op cit note 10 at 10.

<sup>325</sup> Gundani op cit note 20 at 54.

<sup>326</sup> Khafagy op cit note 9 at 96.

## CHAPTER EIGHT

### SUPERVISION OF FORMAL FINANCIAL CO-OPERATIVES IN SOUTH AFRICA AND MALAWI

*“The most carefully conceived regulations will be useless or worse, if they cannot be enforced by effective supervision.”<sup>1</sup>*

#### 8.1 INTRODUCTION

Even when adequate regulations have been enacted, enabling effective supervision, and ensuring compliance remains a challenge.<sup>2</sup> This brings us to the other critical dimension of the regulation of financial co-operatives: the challenge of supervision.

This chapter discusses the supervision of financial co-operatives in South Africa and Malawi as provided by the law in place and the effectiveness of the supervisory structures in place. Unfortunately, there is complexity associated with supervision of financial co-operatives because of the uniqueness of their structure and the cost of supervision.<sup>3</sup> Notwithstanding, countries must endeavour to supervise this sector effectively to ensure the viability of financial co-operatives, the financial stability of the sector and the protection of the members.<sup>4</sup>

#### 8.2 SUPERVISION OF FINANCIAL CO-OPERATIVES – IS IT NECESSARY?

The overall objectives of supervision of financial institutions are to monitor the solvency of financial institutions, to protect depositors, and to foster financial system stability.<sup>5</sup> This is particularly important when dealing with financial institutions whose business is motivated by profit because such motivation drives financial institutions to invest in high-risk assets and to speculate on risky positions to generate more profit.<sup>6</sup>

When the focus shifts to mutual financial institutions like financial co-operatives, a realignment occurs.<sup>7</sup> In contrast to profit-driven financial institutions, members of financial co-operatives have no incentive to expose the co-operative to risk or to speculate on risky positions for the sake of increasing profits.<sup>8</sup> The

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<sup>1</sup> C R Peck & R Rosenberg 'The rush to regulate' CGAP Occasional Paper No 4 (1999, April) at 4, available at <http://www.gdrc.org/icm/govern/regulation.pdf> accessed 2 August 2021.

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

<sup>4</sup> K Lackhoff 'Which credit institutions will be supervised by the single supervisory mechanism?' (2013) *Journal of International Banking Law and Regulation* 28(11), 457.

<sup>5</sup> Ibid.

<sup>6</sup> C E Cuevas & K P Fischer *Co-operative Financial Institutions: Issues in Governance, Regulation, and Supervision* (2006) 38.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

question therefore arises whether such supervisory measures are necessary when the subject of monitoring are financial co-operatives not driven by profit?<sup>9</sup>

There are strong justifications of putting financial co-operatives under supervision. Regulation does not sufficiently replace the need for specialised supervisory personnel and tailored practices and procedures for financial co-operatives.<sup>10</sup> In addition, there are large numbers of small financial co-operatives operating in geographically remote areas that require monitoring.<sup>11</sup> Moreover, especially for formal financial co-operatives, members' deposits need protection where self-supervision may be difficult because of a weak common bond.<sup>12</sup> Accordingly, the Basel Committee for Banking Supervisions (BCBS) has still issued guidance for the implementation of its core principles for institutions such as financial co-operatives, among other microfinance providers.<sup>13</sup> The core principles however, propose that these types of institutions may have to be supervised differently or proportionately, especially if they do not possess a significant percentage of the financial system's deposits.<sup>14</sup>

### **8.3 THE SUPERVISORY FRAMEWORK FOR FINANCIAL CO-OPERATIVES IN SOUTH AFRICA AND MALAWI**

Now that it is established that supervision of financial co-operatives is necessary, the important question is how to set up a system of supervision which, on one hand, respects the origins and aims of financial co-operatives and, on the other, protects the individual depositors of these financial co-operatives.<sup>15</sup> Many countries have extremely limited budgets, which constrain them in supervising financial co-operatives.<sup>16</sup> A major challenge therefore lies in finding supervisory structures and processes that are not overly costly but are effective in identifying and addressing the risks associated with financial co-operatives.<sup>17</sup>

Ideally, this responsibility should be taken on by the bank supervisory authority, given its technical capabilities and the structures it already has in place.<sup>18</sup> However, since there are oftentimes many financial co-operatives in a country, in many cases the bank supervisory authority considers it impossible

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<sup>9</sup> J Poyo "Regulation and supervision of credit unions" in Westley, G., Branch, B. (eds.) *Safe Money: Building Effective Credit Unions in Latin America* (2000) 140.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> A Khafagy *The Economics of Financial Co-operatives: Income Distribution, Political Economy and Regulation* (2019) 145.

<sup>13</sup> BCBS: Core Principles for Effective Banking Supervision. Basel: Basel Committee on Banking Supervision (2012) 13; BCBS: Range of Practice in the Regulation and Supervision of Institutions Relevant to Financial Inclusion. Basel: Basel Committee on Banking Supervision (2015a) 5-9.

<sup>14</sup> Ibid.

<sup>15</sup> Jansson et al op cit note 25 at 81-2.

<sup>16</sup> Cuevas & K P Fischer op cit note 34 at 38-9.

<sup>17</sup> Ibid.

<sup>18</sup> Jansson et al op cit note 25 at 81-2.

to oversee all of these financial co-operatives.<sup>19</sup> Moreover, since financial co-operatives are already accustomed to operating without any government oversight, they are typically opposed to this type of supervision, which they feel, in many respects, is unsuited to the intrinsic nature of a co-operative.<sup>20</sup>

For these reasons, bank supervisory authorities generally find themselves forced to limit their role in the supervision of financial co-operatives, either by keeping the number of regulated financial co-operatives low or by delegating some or all of the supervisory responsibility to a third party.<sup>21</sup> In the first case, depositors in unsupervised financial co-operatives do not enjoy the same protections as depositors in banks, which are supervised.<sup>22</sup> In the second case, the quality of supervision may suffer, as the delegated supervisor may not have the same level of skills and expertise as the bank supervisor.<sup>23</sup>

In South Africa, prior to 2017 and the introduction of the FSRA, the Co-operative Banks Act 40 of 2007 as initially introduced provided for two types of supervisors.<sup>24</sup> The SARB appointed the first supervisor with the authority to exercise a broad range of powers over the co-operative banks that hold deposits of R20 million or more, secondary, and tertiary co-operative banks.<sup>25</sup> In this way, the SARB was directly supervising the large co-operative banks.

The second supervisor was appointed by the CBDA to supervise co-operative banks that held deposits of R20 million or less.<sup>26</sup> These supervisors were required to cooperate and coordinate their approach with each other. This was the hybrid approach where the Act provided for both direct and indirect supervision. As noted above, this will generally happen because of a scarcity of resources.<sup>27</sup>

In the case of South Africa however, this may have just been an adopted methodology with no justification. The law was adopted before the establishment of co-operative banks and was therefore not tailored to context.<sup>28</sup> Further, when the co-operative banks were eventually registered, there were only three established over an extended period and to date only five.<sup>29</sup> While it is accurate that these institutions competed for attention with commercial banks, this is still not a large enough figure to warrant the delegation of authority.

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<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

<sup>21</sup> C Cuevas & J Buchenau *Financial Co-operatives: Issues in Regulation, Supervision, and Institutional Strengthening* (2018) 8.

<sup>22</sup> Ibid.

<sup>23</sup> Ibid.

<sup>24</sup> Co-operative Banks Act 2007, ss 41 and 42.

<sup>25</sup> Co-operative Banks Act 2007, s 41(1).

<sup>26</sup> Co-operative Banks Act 2007, s 43.

<sup>27</sup> Co-operative Banks Act 2007, s 42.

<sup>28</sup> J A S Van Niekerk *Co-operative Theory and Practice* (1988) 22.

<sup>29</sup> D de Jong & M Kuhlengisa 'Co-operative Banking in South Africa' in V Satgar (ed) *Co-operatives in South Africa: Advancing Solidarity Economy Pathways from Below* (2019) 74.

This changed however in 2014 because the CBDA had also taken over supervision of CFIs.<sup>30</sup> Accordingly, the Financial Services Laws General Amendment Act, 2013 (Act No. 45 of 2013) resulted in a number of amendments to the Co-operative Banks Act, 2007 (Act No. 40 of 2007), the most significant being the supervision of all registered co-operative banks coming under the sole remit of the SARB.<sup>31</sup> The supervision of co-operative financial institutions (CFIs) and their development into fully fledged co-operative banks remain with the Co-operative Banks Development Agency (CBDA). This amendment aligns the regulation of co-operative banks with the incoming twin peaks model of financial regulation in South Africa.

Section 54 of the Co-operative Banks Act had established the CBDA as a juristic person.<sup>32</sup> It was introduced to support, promote, and develop co-operative banking. Some of the functions designated to it were<sup>33</sup>:

- registration and regulation of representative bodies;<sup>34</sup>
- provision of financial support to co-operative banks through loans or grants;<sup>35</sup>
- assistance to co-operative banks with liquidity management;<sup>36</sup>
- facilitation, promotion and fund education, training and awareness in connection with, and research into, any matter affecting the effective, efficient and sustainable functioning of co-operative banks;<sup>37</sup>
- interaction with any regulatory authority to ensure appropriate regulation of co-operative banking and provision of assistance to co-operative banks in auditing their financial statements;<sup>38</sup> and
- to take any measures it considered necessary for the proper performance and exercise of its functions or duties or to achieve the objects of the Act.<sup>39</sup>

Thus, in addition to its developmental role, it was practically given the responsibility for the licensing, and supervision, including problem bank resolution of financial co-operatives above prescribed thresholds.<sup>40</sup> This was a conflict of interest as it became both regulator and promoter. Accordingly, such concentration of power in one body also posed the risk of reputational losses where the failures of the CBDA are more

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<sup>30</sup> Financial Services Laws General Amendment Act, 2013 (Act No. 45 of 2013).

<sup>31</sup> Financial Services Laws General Amendment Act, 2013 (Act No. 45 of 2013).

<sup>32</sup> Co-operative Banks Act 2007, s 54.

<sup>33</sup> Co-operative Banks Act 2007, s 55.

<sup>34</sup> Co-operative Banks Act 2007, s 55(d).

<sup>35</sup> Co-operative Banks Act 2007, s 55(f).

<sup>36</sup> Ibid.

<sup>37</sup> Co-operative Banks Act 2007, s 55(i).

<sup>38</sup> Co-operative Banks Act 2007, s 55(k).

<sup>39</sup> Co-operative Banks Act 2007, s 56.

<sup>40</sup> Co-operative Banks Act 2007, s 55(i).

visible than the successes.<sup>41</sup> There would have been no objectivity and enhancement of public trust in the sector where there was no such separation of powers.<sup>42</sup> With the introduction of the PA, the supervisory role of the bigger financial co-operatives remains with it and that of smaller CFIs with the CBDA.<sup>43</sup>

In Malawi, the Registrar of Financial Institutions regulates and supervises Savings and Credit Co-operatives (SACCOs).<sup>44</sup> It is not clear how this is to be construed as particular methods of supervision or what is to be supervised.<sup>45</sup> What is clear is that the supervisory function of all small SACCOs has been delegated to MUSCCO; not through law but through a memorandum of understanding.<sup>46</sup> MUSCCO however, aims to facilitate and promote, on a sustainable basis, the growth and development of SACCOs through the provision of a diversified range of financial, technical, administrative and other support services and products'.<sup>47</sup>

The Act therefore did not solve the problem that MUSCCO experienced since its foundation: the conflict between its role as co-operatives' developer and co-operatives' supervisor.<sup>48</sup> However, insufficient levels of financial and human resources at the Department of Co-operatives requires the union to perform these conflicting functions.<sup>49</sup> Thus, the independence of a financial sector supervisor is one of the major factors affecting the effectiveness of supervision in Malawi.

In addition, the sectors in Malawi and South Africa have multiple supervisors. Where multiple parties are involved in the supervisory process as in this case, they should ensure that there is sufficient coordination, co-operation and information sharing necessary for the discharge of their duties.<sup>50</sup> In both countries, there are Memorandums of Understanding (MOUs) that have been signed between the supervisors to ensure this. For South Africa, it is still too early to assess whether these will be effective. For Malawi, there have been duplication of roles and inconsistencies in the frameworks that need to be addressed as these potentially lead to supervisory arbitrage.

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<sup>41</sup> M Kuhlengisa *An Evaluation of the Regulation and Supervision of Co-operative Financial Institutions in South Africa* (unpublished research Master thesis, Stellenbosch University, 2011) 59.

<sup>42</sup> *Ibid.*

<sup>43</sup> Financial Sector Regulation Act 2017, s 32.

<sup>44</sup> Financial Co-operatives Act, 2011; Refer to Chapter 5.

<sup>45</sup> Financial Co-operatives Premises Inspection Directive 2013, s 3.

<sup>46</sup> Refer to Chapters 4 and 5; R Rena 'Co-operatives in South Africa: A review' (2017) 10 *Indian Journal of Science and Technology* 3; Genesis Analytics 'Understanding financial co-operatives: South Africa, Malawi and Swaziland' (2013) *Final Report submitted to FinMark Trust* 9, available at <http://finmark.org.za/understanding-financial-co-operatives-in-south-africa-malawi-and-swaziland-full-report/> accessed on 12 May 2019.

<sup>47</sup> *Ibid.*

<sup>48</sup> S Enarsson & K Wirén 'MUSCCO –Malawi Union of Savings and Credit Co-operatives', *CGAP Working Group on Microinsurance Good and Bad Practices*, Case Study No 8. (2005) 5.

<sup>49</sup> K Mutua *Recommendations on Policy and regulatory Framework for Inclusive Finance: A COMESA Region Country Representatives Initiative* (2016) 26.

<sup>50</sup> *Ibid.*

Nevertheless, the pressure to delegate supervisory responsibility is strong, particularly in cases where the bank supervisor is operating on a budget that does not permit it to collect supervision fees from the institutions it supervises.<sup>51</sup> In such cases, the licensing and supervision of a greater number of institutions creates additional costs but no additional revenue for the supervisor.<sup>52</sup> However, delegated supervision of financial co-operatives has not proven very successful. Supervisors of financial co-operatives often require the same clarity of mandate, accountability, independence, legal foundation, transparency, legal powers, and inter- ministry co-operation as supervisors of commercial banks.<sup>53</sup> The supervisor – or other authority with similar expertise, skills, credibility, and resources – is normally the most suitable resource for such a significant role because the financial co-operatives can leverage existing skills and infrastructure and ensure a levelled and coherent playing field.<sup>54</sup> When supervision is delegated, this is not the case.

In addition, there is a conflict of interest within the, for example, federation.<sup>55</sup> Federations are owned by the financial co-operatives that comprise them, and also are charged with promoting and supporting member financial co-operatives.<sup>56</sup> Understandably, federations find it hard to discipline and shut down the very financial co-operatives that own them.<sup>57</sup>

While some European and American countries have functioning delegate supervision systems, in developing countries the number of failures has clearly out-stripped the number of successes.<sup>58</sup> Consequently, supervisory authorities should approach this option with extreme caution.<sup>59</sup> Despite its problems, a delegated supervision system may be the only realistic alternative in situations in which the supervisory authority decides to or is tasked with overseeing a large number of credit unions, but is limited by a fixed budget (in which it has no ability to collect fees from the supervised institutions).<sup>60</sup> In such cases, the only way to defray the cost of supervision may be through delegated supervision.<sup>61</sup>

However, for delegated supervision to work, the duties and responsibilities of the bank supervisory agency and the delegated supervisor must be clearly defined; the delegated supervisor must have the requisite technical capacity and resources; and the delegated supervisor must be reasonably independent

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<sup>51</sup> Jansson et al op cit note 25 at 81-2.

<sup>52</sup> Genesis Analytics op cit note 74.

<sup>53</sup> Cuevas & Buchenau op cit note 50 at 8.

<sup>54</sup> Ibid.

<sup>55</sup> Jansson et al op cit note 25 at 81-2.

<sup>56</sup> Ibid.

<sup>57</sup> Cuevas & Buchenau op cit note 50 at 8.

<sup>58</sup> Ibid.

<sup>59</sup> Cuevas & K P Fischer op cit note 34 at 43-4.

<sup>60</sup> Ibid.

<sup>61</sup> Khafagy op cit note 40 at 146-7.

of the institutions it supervises.<sup>62</sup> Notwithstanding, even assuming these conditions are met, it would still be advisable for the bank supervisory authority to directly supervise the large financial co-operatives, which could present systemic risk to the financial system as a whole.<sup>63</sup>

Once the supervisory agency and type of supervision have been decided upon, attention can be turned to a number of other important issues, such as supervisory processes and tools, accounting standards, disclosure requirements and credit bureaus.<sup>64</sup> In all of these areas, the supervisor must make adaptations to ensure the efficient and effective supervision of financial co-operatives.<sup>65</sup> The supervisory agency must ensure that its organisational structure allows for on-going, close supervision of financial co-operatives.<sup>66</sup>

In South Africa, the PA is one of the pillars and supervises co-operative banks and CFIs. In its supervisory role, the PA was given powers to make standards for the banks, conduct inspections, issue directives to ensure that the implementation and administration of the Act, impose administrative penalties for any failure to comply with the provisions of the Act, request reports, keep bank records, and build relationships with other supervisors in other jurisdictions.<sup>67</sup>

In addition to this, the PA has general powers to take steps to protect the public in their dealing with co-operative banks, issue guidelines to financial co-operatives, provide them with information on market practices, and take any other measures that were considered necessary for the proper performance and exercise of their roles.<sup>68</sup> The PA also assumed the central bank role of lender of last resort that could provide financial support to registered financial co-operatives as well as liquidity management for the sector.<sup>69</sup> The PA is also responsible for establishing and managing the deposit insurance fund making it responsible for the oversight of the financial safety nets necessary for the stability of the sector.<sup>70</sup>

Overall, the Co-operative Banks Act gives the PA wide-ranging powers to take the necessary steps to protect the public in their dealings with financial co-operatives<sup>71</sup> It allows the PA to issue directives to co-operative banks and CFIs to take specific courses of corrective action or to prohibit certain practices or

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<sup>62</sup> Jansson et al op cit note 25 at 81-2.

<sup>63</sup> Ibid.

<sup>64</sup> Cuevas & K P Fischer op cit note 34 at 43-4.

<sup>65</sup> A Poprawa *Regulation and Legislation of Co-operative Banks and Credit Union* (Paper prepared for the United Nations Expert Group Meeting on Co-operatives, 2009) 28–30.

<sup>66</sup> Jansson et al op cit note 25 at 81-2.

<sup>67</sup> Co-operatives Banks Act 2007, ss 45-52.

<sup>68</sup> Co-operatives Banks Act 2007, s 45.

<sup>69</sup> Co-operatives Banks Act 2007, s 55 (h).

<sup>70</sup> Co-operatives Banks Act 2007, ss 25-26.

<sup>71</sup> Co-operatives Banks Act 2007, s 45 (a)

processes.<sup>72</sup> The PA also has the power to force through an amendment of a co-operative banks constitution if it does not comply with the requirements of the legislation.<sup>73</sup> Furthermore, the PA can impose administrative penalties on any registered co-operative bank if it fails to comply with any of the prudential requirements. If none of the above corrective actions resolve the situation, the PA has the mandate to de-register or suspend a registered co-operative bank if the institution fails to comply with the requirements of the Act.<sup>74</sup>

I propose that this level of supervision is excessive because of the level of intervention into the internal governance of the financial co-operatives. Such a level of intervention directly affects the autonomy of the financial co-operatives.<sup>75</sup> The main role of a law for co-operatives, in general, is to reflect and protect internationally recognised co-operative principles, which must be adhered to by co-operative, by translating these principles into practical legal standards.<sup>76</sup> In line with co-operative principles, legislation must give individual co-operatives the autonomy to adjust their constitutions according to the needs of their members; especially since historical evidence shows how excessive government intervention is one of the main reasons for the failure of financial co-operatives.<sup>77</sup>

Notwithstanding, regulations among several underdeveloped economies strongly support this type of excessive regulation.<sup>78</sup> In these cases, co-operative regulations do not only emphasise statutory provisions such as membership, licensing, governance structure, and property and equity but also included several provisions concerning the powers and authority of the Registrar of co-operatives.<sup>79</sup> It is not unusual that the powers given to registrars can be extensive, going beyond supervision to incorporate a degree of managerial control over co-operatives, without appropriate channels for appealing their decisions.<sup>80</sup> However, excessive state control over co-operatives is usually costly and ineffective.<sup>81</sup>

In Malawi, supervision is minimal on the part of central bank and has been limited to premises inspection and disclosures. There is need to ensure that this is given much attention. To this end, it should at a minimum assign full-time, specialised staff to this task because if staff are not specifically assigned, there is a tendency for them to be drawn into the supervision of larger institutions and thereby neglect the

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<sup>72</sup> Co-operatives Banks Act 2007, s 48.

<sup>73</sup> Co-operatives Banks Act 2007, s 13(4)(a).

<sup>74</sup> Co-operatives Banks Act 2007, s 11.

<sup>75</sup> Refer to Chapter 2.

<sup>76</sup> H H Münkner *Ensuring supportive legal frameworks for co-operative growth* (paper presented at the ICA11th Regional Assembly, Nairobi, 2014) 3.

<sup>77</sup> *Ibid.*

<sup>78</sup> *Ibid.*

<sup>79</sup> A Khafagy *The Economics of Financial Co-operatives: Income Distribution, Political Economy and Regulation* (2019) 96.

<sup>80</sup> *Ibid.*

<sup>81</sup> *Ibid.*

smaller financial co-operatives.<sup>82</sup> If there are a significant number of financial co-operatives to be supervised, a specialised line unit should be formed in which expertise can be built and experience accumulated over time.<sup>83</sup> Further, proper oversight of financial co-operatives requires specialised supervision to identify and address the distinctive risks faced by financial co-operatives.<sup>84</sup> The development of such supervision requires a sustained investment in human resources on the part of the supervisory authorities.<sup>85</sup>

If there are not enough financial co-operatives to justify the formation of a specialised unit within the supervisory agency, it is preferable that supervision be done by the bank supervision department, rather than the department in charge of supervising non-deposit-taking institutions (such as bonded warehouses, currency exchange houses and state funds).<sup>86</sup> This is because the risks of financial co-operatives are more like the risks of commercial banks than they are like the risks of non-deposit-taking institutions.<sup>87</sup>

In this case, financial co-operatives should at least participate in the on-site evaluations of the lending methodologies used by financial co-operatives.<sup>88</sup> Moreover, in the case of financial co-operatives, specialists also should bring specific knowledge to bear in other key areas that often cause difficulties in financial co-operatives, including the issues of borrower domination, low salaries and lack of professionalisation, the proper role of volunteer credit committees, and under-or over-expenditure on fixed assets.<sup>89</sup> As argued earlier, delegated supervision of financial co-operatives is generally not recommended.

#### **8.4 CONCLUSION AND OBSERVATIONS**

Ultimately, supervisory solutions tend to be largely context-specific, where supervisors resort to different forms of risk-based approaches that attempt to optimise the use of scarce resources.<sup>90</sup> The type of financial co-operative supervisory model that would be effective within a given context may be affected by large numbers of small financial co-operatives operating in remote locations, posing both time and resource challenges for the supervisory authority to enforce new requirements and monitor compliance;

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<sup>82</sup> Cuevas & Buchenau op cit note 50 at 8.

<sup>83</sup> Jansson et al op cit note 25 at 83-4.

<sup>84</sup> Ibid.

<sup>85</sup> Ibid.

<sup>86</sup> Cuevas & K P Fischer op cit note 34 at 43-4.

<sup>87</sup> Ibid.

<sup>88</sup> A Poprawa *Regulation and Legislation of Co-operative Banks and Credit Union* (Paper prepared for the United Nations Expert Group Meeting on Co-operatives, 2009) 28–30.

<sup>89</sup> Ibid.

<sup>90</sup> Cuevas & Buchenau op cit note 50 at 8.

and low level of capacity/expertise of financial co-operatives' staff and management impacting their ability to effectively follow regulators/supervisors' requirements.<sup>91</sup>

Considering these complexities effective oversight of the sector represents tricky issues for regulators. The number and diversity of activities that comprise the sector and the high degree of decentralisation means that where financial resources are limited, policymakers must estimate supervision costs realistically and identify sustainable strategies that enable them to pay for them, before embarking on major regulatory initiatives or reforms.<sup>92</sup>

Unlike regulation, there is no clear consensus on what supervision arrangements are adequate.<sup>93</sup> Advocates of atomised free-standing systems favour direct supervision, yet supervisory capacity quickly becomes a limiting factor when there are many financial co-operatives to oversee.<sup>94</sup> The specific way in which supervision must be structured in each jurisdiction should ideally reflect, among other things, the unique history, culture, politics, economic development, size, and local business structure.<sup>95</sup> Therefore, no single model may be optimal on a "one size fits all" basis for all jurisdictions.

This chapter showed that for formal financial co-operatives, the level of supervision in the Co-operative Banks Act is excessive. Whether this translates practically is a question that may be answered with a qualitative study although there are observations made in some literature that the supervision currently in place has been ineffective. However, theoretically, the powers of supervision granted to the PA are excessive.<sup>96</sup> Notwithstanding, excessiveness in underdeveloped economies is recommended. Excessive supervision while detrimental to the autonomy of financial co-operatives is an important growth factor for financial co-operatives in the infancy developmental stages.<sup>97</sup>

History shows that the key is who provides the oversight.<sup>98</sup> The police and the state may not be the right parties to offer this oversight as members may interpret external intervention of this nature negatively.<sup>99</sup> However, oversight that aims to encourage development and growth is vital at this stage. The financial co-operatives in Germany had this offered by the founders and later the founders in other parts of the world, established successful predecessors after studying the initial models.<sup>100</sup> This shows that

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<sup>91</sup> Ibid.

<sup>92</sup> Ibid.

<sup>93</sup> Jansson et al op cit note 25 at 83-4.

<sup>94</sup> Ibid.

<sup>95</sup> Münkner op cit note 76 at 3.

<sup>96</sup> Ibid.

<sup>97</sup> Ibid.

<sup>98</sup> Refer to Chapter 2.

<sup>99</sup> Refer to Chapter 2.

<sup>100</sup> Refer to Chapter 2.

supervision geared at the promotion and development of financial co-operatives may be more beneficial for South Africa. The question that would assist therefore is whether the PA or CBDA offers such supervision, or whether they are perceived as external entities in which case their excessive supervision may prove to be more harmful than effective.

Conversely, the supervision in Malawi is minimal. While this thesis has alluded to the fact that the reasons for the minimal supervision may be human resources, it is hard to develop such an argument further given that there are only 43 SACCOs functional in Malawi.<sup>101</sup> The lack of oversight therefore may be attributed to the fact that there is not much emphasis placed on the importance of supervision to the growth of financial co-operatives. There is therefore need for a financial co-operatives ambassador in the sector to advocate for this provision.

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<sup>101</sup> Refer to Chapter 5.

## CHAPTER NINE

### REGULATION OF SEMI-FORMAL AND INFORMAL FINANCIAL CO-OPERATIVES

#### 9.1 INTRODUCTION

As mentioned in the previous chapter, South Africa does not have an acknowledged semi-formal financial co-operatives sector.<sup>1</sup> All financial co-operatives are either registered under the Co-operatives Bank Act, or not registered at all, in which case they land into the informal sector.<sup>2</sup> On the other hand, Malawi still has the semi-formal financial co-operatives sector that comprises of village savings and loans association (VSLA) programmes ran by non-governmental organisations (NGOs).<sup>3</sup>

In terms of the informal financial co-operatives, both South Africa and Malawi have a large network of informal financial co-operatives. An in-depth study of informal financial co-operatives is difficult not only because data is hard to obtain, but also because the phenomenon itself is to a degree elusive; there is an inherent paradox within it.<sup>4</sup> For example, informal financial co-operatives may be free from government regulation and oversight, but they themselves remain structured within informal institutional boundaries.<sup>5</sup> Thus, although stokvels in South Africa are exempted from regulation, they have National Stokvel Association of South Africa (NASASA), a self-regulatory body that oversees stokvels which are registered with it. Moreover, within the stokvels themselves, there are constitutions and structures for permitted behaviour.<sup>6</sup>

This chapter discusses the current regulatory structures within the semi-formal financial co-operatives in Malawi; the informal financial co-operatives in South Africa and Malawi; whether regulation should be considered for informal financial co-operatives; and recommendations for any further improvements within the sectors.

#### 9.2 THE REGULATORY FRAMEWORK OF SEMI-FORMAL FINANCIAL CO-OPERATIVES IN MALAWI

As mentioned, NGOs primarily run the VSLA programme in Malawi; CARE Malawi and World Bank being the key promoters.<sup>7</sup> The government has not done much in the form of regulating semi-formal financial

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<sup>1</sup> Refer to Chapter 7.

<sup>2</sup> Ibid.

<sup>3</sup> Refer to Chapter 5.

<sup>4</sup> P G Godfrey 'Toward a theory of the informal economy' (2011) 5 *The Academy of Management Annals* 231-33

<sup>5</sup> P C Mhando 'Managing in the Informal economy: The informal financial sector in Tanzania' (2018) *Africa Journal of Management* 2.

<sup>6</sup> M N Naong 'Stokvels: a possible panacea for fostering a savings culture?' (2009) 7 *Journal for New Generation Sciences* 255.

<sup>7</sup> J Agar et al Status of Agricultural and Rural Finance in Malawi' FinMark Trust (July 2012) 40; A van Der Meerendonk *Extracts from the Full Report: Assessment of Social Protection Programmes and Costing of Policy Options Programme Specific Report: Village*

co-operatives.<sup>8</sup> As of 2020, the Reserve Bank of Malawi (RBM) had confirmed that there was still no policy issued in respect of VSLAs despite the Registrar being aware that regulation would provide, among other things, consumer protection for the public.<sup>9</sup>

The regulatory framework that is in place currently only governs NGOs with no governance extending to the VSLAs.<sup>10</sup> NGOs in Malawi are required to be registered under the Trustees Incorporation Act 106 of 1962 or under the Companies Act 15 of 2013 as companies limited by guarantee.<sup>11</sup> NGOs are also required to register with the NGO Board, established under the Non-Governmental Organisations Act of 2000.<sup>12</sup> The NGO Board is empowered to issue directives on the structure and governance NGOs.<sup>13</sup> However, since the introduction of the NGO Board, there has been discomfort in the sector, with some feeling that the goal of the establishment of the NGO Board was to facilitate government control over NGO operations.<sup>14</sup> Beyond this, NGOs have an independent umbrella organisation with voluntary membership called the Council of NGOs in Malawi (CONGOMA), which is widely seen as the representative body of NGOs.<sup>15</sup>

There are two main challenges that haunt the semi-formal financial sector in Malawi. Firstly, there is no direct regulation or specialised body in place for VSLAs. The regulations govern the NGOs, which in turn help to provide a governance framework consisting of rules of operation for the VSLAs that are set up.<sup>16</sup> Therefore, from a practical perspective, VSLAs function as informal financial co-operatives would, except at their inception when they have the support of the initiating NGO<sup>17</sup> In Kenya, over time, commercial banks and other financial services providers reach out to these VSLAs to open group savings accounts and offer group loans.<sup>18</sup> This is the current case in Malawi. Various commercial banks have reached out to VSLAs with specialised services.<sup>19</sup>

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*Savings and Loans* (2016) 3 available at <https://socialprotection.org/discover/publications/programme-specific-report-village-savings-and-loans-malawi> accessed on 24 June 2020.

<sup>8</sup> Nation Online 'No policy yet for village banks – RBM' (29 August 2020) *Business News* available at <https://www.mwnation.com/no-policy-yet-for-village-banks-rbm/> accessed on 10 June 2021.

<sup>9</sup> *Ibid.*

<sup>10</sup> *Ibid.*

<sup>11</sup> A Kalanda 'Development of Malawi's Microfinance Regulation and Supervision' (2006) 16 *Essays on Regulation and Supervision* 3.

<sup>12</sup> Kalanda *op cit* note 11 at 7.

<sup>13</sup> *Ibid.*

<sup>14</sup> *Ibid.*

<sup>15</sup> V Luboyeski et al 'Microfinance Sector Assessment in the Republic of Malawi' 18, available at [https://pdf.usaid.gov/pdf\\_docs/Pnax006.pdf](https://pdf.usaid.gov/pdf_docs/Pnax006.pdf) accessed on 10 May 2021.

<sup>16</sup> Luboyeski et al *op cit* note 15 at 18.

<sup>17</sup> CARE Village Savings and Loans (VSLA) available at <https://www.care.org.au/village-savings-loans/> accessed on 10 March 2020.

<sup>18</sup> G Bostedt et al 'Saving and borrowing behaviour among agropastoralists in West Pokot County, Kenya' (2021) *J Int Dev* 1046.

<sup>19</sup> National Bank of Malawi 'NBM introduces village savings and loans account' published on 31 May 2021 available at <https://natbank.co.mw/media-centre/404-nbm-introduces-village-savings-and-loans-account> accessed on 15 June 2021.

This is a form of linkage to the formal sector that occurred in South Africa.<sup>20</sup> While it may be too early to state what such a development would lead to in Malawi, in Kenya, such linkage often tends to stop functioning due to default or fraud, which erode the asset base of the group and can often reflect dysfunctional group dynamics.<sup>21</sup> In South Africa too, VSLAs linked to commercial banks have not been successful in the long run.<sup>22</sup>

There are good reasons as to why this would be the case for Malawi too. Commercial banks are particularly ill-equipped to deal directly with groups, whether savings clubs or self-help groups, and whether pre-existing or not.<sup>23</sup> This is because the single most important factor contributing to the success of group financial performance is the ability to pool funds locally.<sup>24</sup> Where funds are sourced externally (or perceived as such), as in this case, a bank, then performance tends to be poor.<sup>25</sup> The underlying principle is the groups' sense of 'ownership', which means both identification with the financial service as well as "responsibility for its performance".<sup>26</sup> Where this sense of ownership is strong, then rules are taken seriously and are enforced, including those concerning repayment schedules and liability.<sup>27</sup>

However, these few paragraphs cannot substitute the need for a full analysis merited by an issue as complex as formal-informal linkages for Malawi. Nonetheless, what this discussion highlights, is that there is no direct oversight on VSLAs once the NGOs remove their initial support. This goes to the issue of inadequate supervision and compliance that also haunts the formal financial co-operatives.<sup>28</sup>

The second challenge in the regulation of the semi-formal financial sector is that NGOs also offer services to the rural areas which include micro-credit services and relate closely with micro-finance institutions (MFIs).<sup>29</sup> CARE Malawi for instance is also a member of the Malawi Microfinance Network.<sup>30</sup> The study of MFIs is beyond the scope of this study. However, linking financial co-operatives to MFIs

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<sup>20</sup> G A Jones & A Dallimore Wither participatory banking? Experiences with village banks in South Africa (2009) 21 *European Journal of Development Research* 349.

<sup>21</sup> Bostedt et al op cit note 18 at 1046.

<sup>22</sup> Ibid.

<sup>23</sup> M Aliber et al *The importance of Informal Finance in Promoting Decent Work Among Informal Operators: A Comparative Study of Uganda and India* (2015) Working Paper No 66 at 49.

<sup>24</sup> Ibid.

<sup>25</sup> L Bennett, M Goldberg & P Hunts 'Ownership and sustainability: Lessons on group-based financial services from South Asia' (1996) 8 *Journal of International Development* 146–7.

<sup>26</sup> Ibid.

<sup>27</sup> Aliber et al op cit note 23 at 49.

<sup>28</sup> Van der Meerendonk op cit note 7 at 3. NGOs provide funding to the central bank and other arms of government that undermine autonomy.

<sup>29</sup> Ibid.

<sup>30</sup> Mamn.org available at [https://www.mamn.mw/index.php?option=com\\_weblinksplus&view=category&id=39&Itemid=159](https://www.mamn.mw/index.php?option=com_weblinksplus&view=category&id=39&Itemid=159) accessed on 10 May 2021.

creates confusion within the sector and explains why MFIs tend to exploit VSLAs through linkages especially after projects that facilitated the formation of those groups phase-out.<sup>31</sup>

### 9.3 REGULATORY CONSIDERATIONS FOR SEMI-FORMAL FINANCIAL CO-OPERATIVES

As a start for Malawi, this thesis would recommend an apex self-regulatory or supervisory body established under the Financial Services Act 2010. Apex self-regulation refers to structures under which the main responsibility for monitoring and enforcing prudential norms lies within the membership itself.<sup>32</sup> Undoubtedly, self-regulation poses significant challenges and particularly in Africa, has been tried several times and has repeatedly proved ineffective, even in many cases where donors have supplied heavy technical assistance.<sup>33</sup> The reasons for the failure of the model are not difficult to find. The existence of supervised parties controlling the supervisor present a clear conflict of interest.<sup>34</sup> The immediate benefits to participating institutions are not so great as to encourage them to hold a rigorous line when challenges arise.<sup>35</sup>

However, apex self-regulation is often still being introduced because the use of indirect formalisation by empowering associations to provide formalised regulatory services to their members is much more effective and efficient than using formal government institutions.<sup>36</sup> The cost structure of government institutions and their capacities, does not correspond to the task of working with a large number of small and unstable co-operatives. At the same time, government support would create over-reliance among the associations.<sup>37</sup> Thus, having an apex self-regulatory body may allow the continued facilitation of services such as business development and skills training.<sup>38</sup>

The next question would then be how to make it successful in Malawi given the high failure rate. Apex self-regulation requires the existence of good governance and risk management systems in the financial co-operatives sector.<sup>39</sup> Unfortunately, the Malawian sector is still underdeveloped in this regard.<sup>40</sup> Perhaps what would work within the context of Malawi then, would be for the apex self-regulatory body

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<sup>31</sup> Kalanda op cit note 11 at 3.

<sup>32</sup> R P R Christen, R Rosenberg & V Jayadeval *Financial Institutions with a 'Double Bottom Line': Implications for the Future of Microfinance* (2004) 20.

<sup>33</sup> P R Christen & R Rosenberg *The Rush to Regulate* CGAP Occasional Paper No 4 at 35 (1999, April) available at <http://www.gdrc.org/icm/govern/regulation.pdf> accessed on 15 June 2021.

<sup>34</sup> Ibid.

<sup>35</sup> Ibid.

<sup>36</sup> D Olomi et al 'An inclusive approach to regulating the second economy: A tale of four Sub-Saharan African economies' (2018) 10 *Journal of Entrepreneurship in Emerging Economies* 463.

<sup>37</sup> Ibid.

<sup>38</sup> B Melese 'Small enterprise development as a strategy to promote entrepreneurship in Bahir Dar City, Ethiopia' (2018) 10 *Journal of Entrepreneurship in Emerging Economies* 46–47.

<sup>39</sup> Kalanda op cit note 11 at 10.

<sup>40</sup> Refer to Chapter 5.

to be composed of the membership itself (to foster the sense of ownership) and representatives of the NGOs to provide continuity of supervision once the initial 3 months of their direct supervision has elapsed.<sup>41</sup> Having such a structure would encourage regular and ongoing opportunities for the informal sector to participate in decision-making processes while encouraging an environment of development and training.<sup>42</sup> While this affects the autonomy of the village banks and gives rise to conflicts of interests, I believe that such intervention may be more advantageous to Malawi given the infancy stages of the village banks.

#### **9.4 CURRENT REGULATORY FRAMEWORK IN THE INFORMAL SECTOR IN SOUTH AFRICA AND MALAWI**

The informal financial sector in South Africa and Malawi is largely self-regulatory.<sup>43</sup> Informal financial co-operatives largely depend on their own social capital.<sup>44</sup> This is indigenous self-regulation which has evolved or can evolve from oral rules and regulations to written bylaws.<sup>45</sup> In South Africa, the self-regulation has also extended to efforts by the government to acknowledge stokvels with the exemptions to the Banks Act 94 of 1990. The Banks Act exempts stokvels that are registered with a self-regulatory body such as NASASA from formal regulation.<sup>46</sup> NASASA is an attempt to provide some form of regulation for the sector.<sup>47</sup>

The self-regulation prevalent in the sector is often construed as an anomaly requiring rectification. However, self-regulation is a form of regulation. It essentially combines a definition of two concepts being, “disciplining of one’s own conduct by oneself and regulation by a collective group of the conduct of its members”.<sup>48</sup> At the centre of self-regulation is the concept that the best way of regulating any industry is to have the industry participants themselves come up with their own rules to regulate their conduct. It assumes that “the only way of regulating complex organizations from the outside is to grant them a high degree of autonomy and to lay down only general structural guidelines to regulate the context of action”. Autonomy is, therefore, key to self-regulation.<sup>49</sup>

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<sup>41</sup> CARE Village Savings and Loans (VSLA) op cit note 17.

<sup>42</sup> M Clark *Towards Recommendations on the Regulation of Informal Trade at Local Government Level* (2018) Discussion Paper (2018) 22.

<sup>43</sup> Refer to Chapters 4 and 5.

<sup>44</sup> Mhando op cite note 5 at 7.

<sup>45</sup> Ibid.

<sup>46</sup> J K Mduduzi & N Khumalo ‘The role of stokvels in South Africa: A case of economic transformation of a municipality’ (2019) 17 *Problems and Perspectives in Management* 30.

<sup>47</sup> Ibid.

<sup>48</sup> S Madise *The Regulation of Mobile Money: Law and Practice in Sub-Saharan Africa* (2019) 220.

<sup>49</sup> Ibid.

Other attempts of regulating the sector, especially in South Africa have been attempts to integrate stokvels into the formal banking mainstream.<sup>50</sup> Nedbank and other registered banks in South Africa have created stokvel bank account products. These accounts administer rotational pay-outs in the manner stated in stokvel constitutions.<sup>51</sup> The products also offer zero transaction fees and require account holders to have constitutions and meeting minutes.<sup>52</sup> This is a recent example of how stokvels are becoming more formal.<sup>53</sup> These products are new, so there is uncertainty as to how they will perform in the market. However, through this interaction, to an extent, the informal financial sector can be seen and regulated.<sup>54</sup>

## 9.5 CONSIDERING REGULATION FOR THE INFORMAL SECTOR

Having minimal to no regulation in the informal sector has many advantages. In a nutshell, this thesis has shown that people prefer the informal sector because informal financial co-operatives are seen as easy and affordable ways to save; <sup>55</sup> formal requirements for licensing and registration are not necessary; loans are available for unexpected expenses; hidden costs and credit checks are non-existent; saving is 'forced' through social connections; and local knowledge – the beauty of these institutions lies in the closeness of their members to local affairs. <sup>56</sup>

However, some professionals believe that the informal financial sector is harmful to financial development and financial inclusion, and that efforts should be made to reduce or even eradicate it. <sup>57</sup> In fact, as the sector develops and matures, the arguments in favour of regulating and overseeing the sector are becoming progressively more substantial.<sup>58</sup> Academic literature provides important justifications for this such as consumer protection, sector supervision and fraud and crime prevention.<sup>59</sup>

### 9.5.1 SOME ISSUES AT STAKE

The critical question in considering regulation for the informal sector becomes what the best way would be to regulate the sector given the specific characteristics of the informal sector and the potential

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<sup>50</sup> M Gwamba *Why do South Africans use stokvels and what are the barriers that prevent participation in the formal financial sector?* (2019) (unpublished thesis, University of Cape Town) 32.

<sup>51</sup> Nedbank *Its easy to open a stokvel account* (2018).

<sup>52</sup> Ibid.

<sup>53</sup> Gwamba op cite note 50 at 32.

<sup>54</sup> Ibid.

<sup>55</sup> H Barry 'What financial services can learn from stokvels' (2015) *Moneyweb's Personal Finance* 15.

<sup>56</sup> J Visser 'Fewer rules and more enforcement – government regulation' (2020) *Finweek* available at <https://journals.co.za/doi/full/10.10520/EJC-1efcf85026> accessed on 10 May 2021.

<sup>57</sup> D Germidis 'Interlinking the formal and informal financial sectors in developing countries (1990) 14 *Savings and Development* 16.

<sup>58</sup> Ibid.

<sup>59</sup> Gwamba op cite note 50 at 32.

unintended consequences of regulation?<sup>60</sup> Alternatively, would the eradication of the sector by way of integration (that is, the formal sector expands and absorbs the informal sector) be a preferred approach to regulation of the sector? Even more, should efforts to promote interlinkages between formal and informal operators be undertaken on a greater and more systematic scale to enable regulation of both sectors?<sup>61</sup>

Proponents of integration advance that the informal sector is a response to the deficiencies and inefficiencies of the formal sector.<sup>62</sup> Accordingly, their focus is on in-depth institutional and operational reforms in the formal sector as a remedy for the adverse effects of the informal sector.<sup>63</sup> This involves removing some of the constraints imposed on the formal financial sector such as high interest rates or put differently, shifting from a policy of financial repression to one of financial liberalisation as well as deformalising or informalising the formal sector, that is, adopting some of the latter's own practices and competing it down.<sup>64</sup> This would gradually obviate the need for the informal sector itself, thereby enabling the formal sector to substitute the informal sector.<sup>65</sup>

By contrast, a less drastic approach is to focus on transforming the informal sector, by gradually organising or institutionalising it to some extent through linkage with the formal sector.<sup>66</sup> By giving informal financial co-operatives access to credit lines or other services, formal financial institutions can transmit, through them, to the rest of the population, the mechanics and mentality of formal financial practices.<sup>67</sup> Such linkages in the short term would also eventually, bring on integration in the long term.<sup>68</sup> However, some challenges of linkages have already been identified above and more so, is the challenge of promoting links between the formal and informal sectors in such a way as to maximise the positive and minimise the negative aspects of each.<sup>69</sup>

The bottom line, however, is that both routes would be dependent on policies and eventual regulatory frameworks that would enable such changes.<sup>70</sup> Further, integration and linkages suppose that informal financial co-operatives would be willing to be integrated or transition into the formal sector.<sup>71</sup> However, a

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<sup>60</sup> Ibid.

<sup>61</sup> Ibid.

<sup>62</sup> H D Seibel *Mainstreaming Informal Financial Institutions*, Working Paper, No 2001 (2001) 8.

<sup>63</sup> Ibid.

<sup>64</sup> Ibid.

<sup>65</sup> Germidis op cit note 57 at 16.

<sup>66</sup> Ibid.

<sup>67</sup> Ibid

<sup>68</sup> Olomi et al op cit note 36 at 448.

<sup>69</sup> Ibid

<sup>70</sup> Ibid.

<sup>71</sup> DCED 'What do we know about the effectiveness of business registration support and reforms? Key studies referenced in the DCED evidence framework. Donor committee on enterprise development' (2017) available at

growing body of research evidence suggests that this approach only works for a small part of the informal economy.<sup>72</sup> While the avoidance of regulation is a significant reason for informality, lowering regulatory requirements does not bring many informal associations into the formal sector or trigger economic growth.<sup>73</sup> Moreover, informal associations rarely transition to formal associations.<sup>74</sup>

The more practical question therefore is whether the sector should be regulated at all and if it can be regulated, how best it should be regulated.<sup>75</sup> Proponents of the 'no regulation' approach argue that the costs of designing, developing, and enforcing regulations outweigh the benefits of leaving the sector without a regulatory framework.<sup>76</sup> Furthermore, they believe that the operations of most financial co-operatives are too small to present a threat to the general stability of the financial system; something that is rapidly changing.<sup>77</sup>

Advocates opposed to this approach point to the risks of informal financial co-operatives and argue that they require some form of regulation – self-regulation, existing regulation, or special regulation – if the sector is to remain safe and thrive.<sup>78</sup> As far as self-regulation is concerned, there are two forms. The indigenous regulation which has been outlined above and the apex self – regulation, which has shown to be ineffective for this sector in developing countries.<sup>79</sup>

In the case of existing regulation, this would involve incorporating the informal financial sector into the existing regulatory framework for formal financial co-operatives to increase the likelihood that regulatory changes are adequately aligned with the existing regulatory landscape, including, where appropriate, international standards.<sup>80</sup> Furthermore, adapting existing rules or standards for incorporation would be technically simpler, cheaper, and may limit the risk of regulatory gaps and/or arbitrage.<sup>81</sup> Notwithstanding, given the gaps in the current regulatory frameworks in both South Africa and Malawi, it is doubtful that such an approach would drive the sector's growth. What is more likely to occur would be the potential unintended consequences of regulation.<sup>82</sup>

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[www.enterprisedevelopment.org/wpcontent/uploads/Effectiveness\\_of\\_business\\_registration\\_support\\_and\\_reforms.pdf](http://www.enterprisedevelopment.org/wpcontent/uploads/Effectiveness_of_business_registration_support_and_reforms.pdf) accessed on 15 July 2021.

<sup>72</sup> Ibid.

<sup>73</sup> R la Porta & A Shleifer 'Informality and development' (2014) 28 *The Journal of Economic Perspectives* 110.

<sup>74</sup> Ibid.

<sup>75</sup> C Kirkpatrick & S Maimbo 'The implications of the evolving microfinance agenda for regulatory and supervisory Policy' (2002) 2 *Development Policy Review* 298.

<sup>76</sup> Ibid.

<sup>77</sup> H Greuning et al *A Framework for Regulating Microfinance Institutions* (1999) 11.

<sup>78</sup> Ibid

<sup>79</sup> S Berenbach et al *Microfinance Institutions: To Regulate or Not?* (Paper presented to the Microfinance Practice and Policy Workshop for Southern and Eastern Africa, Harare, 2-5 February 1998) 10-14.

<sup>80</sup> Ibid

<sup>81</sup> S Staschen *Regulation and Supervision of Microfinance Institutions: State of Knowledge* (1999) 18-19.

<sup>82</sup> Ibid.

Nevertheless, considering specific regulations for the sector is complex. This is because the informal sector differs in many ways from the formal sector.<sup>83</sup> To begin with, its client base is predominantly made up of low-income earners, lacking in basic financial education and financial co-operatives that are typically widely scattered across the country.<sup>84</sup> Secondly, the average loan sizes are smaller and shorter-term than in mainstream financial services. Moreover, the loans are often unsecured (for example, no collateral is provided in exchange for a loan).<sup>85</sup> Thirdly, as shown above, informal financial co-operatives tend to be of different sizes, legal forms and have diverse lending practices.<sup>86</sup> Given the contextual, institutional, regulatory, operational and market risks associated with regulation of the sector versus mainstream financial regulation, it becomes difficult to recommend a particular regulatory and supervisory format that cuts across the specific characteristics of all informal financial co-operatives.<sup>87</sup>

In addition to the diversity of the sector, it should be noted that regulation and supervision are associated with considerable non-financial costs, such as the potential constricting of competition and/or the inhibition of innovation.<sup>88</sup> These are generally unintentional but can have a significant negative impact on informal financial sector activities.<sup>89</sup> Therefore, regulators would need to carefully weigh these potential impacts when considering the introduction of new regulatory measures.<sup>90</sup>

However, what is crucial for both South Africa and Malawi is that regulation of the sector, either through integration into the formal regulatory framework or through specific legislation would mean that informal financial co-operatives would be expected to obtain licenses, register with regulators, and pay taxes. To the informal financial co-operatives, these represent the costs of entry into the formal economy. In addition, for both South Africa and Malawi, this represents additional costs associated with processing the volumes of license applications and tax forms from all informal financial co-operatives. Moreover, it also represents additional supervisory costs.

## **9.6 PROPOSED WAY FORWARD FOR THE INFORMAL SECTOR**

This thesis proposes turning the formalisation debate towards recognising that it is unlikely that most informal financial co-operatives will be formalised or would want to be formalised – although efforts

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<sup>83</sup> Christen & Rosenberg op cit note 32 at 20-23.

<sup>84</sup> Ibid.

<sup>85</sup> A Pouchous The Regulation and supervision of microfinance: Main issues and progress (2012) *Trade Knowledge Report 6*.

<sup>86</sup> Ibid.

<sup>87</sup> Pouchous op cit note 85 at 7.

<sup>88</sup> Christen & Rosenberg op cit note 32 at 17.

<sup>89</sup> Ibid.

<sup>90</sup> Ibid.

should be made to do so.<sup>91</sup> Evidence in this thesis has shown that the sector has been in existence for a long time and continues to exist even in developed countries where there is a thriving formal sector.<sup>92</sup>

Rather than engaging in such a debate, efforts should instead be directed towards the management and supervision of the sector.<sup>93</sup> The informal sector should be empowered with the tools to encourage safety than to pull it into formality.<sup>94</sup> This can only be achieved by a more nuanced understanding of the nature, structure, and composition of the sector because of the inherent complexity of the informal financial co-operatives.<sup>95</sup> The sector requires policymakers to take a differentiated view of the informal economy and develop strategies tailored to different local needs.<sup>96</sup>

Thus, while it may be easy to propose an apex self-regulatory body for the informal financial co-operatives in Malawi because, for example, South Africa has National Stokvel Association of South Africa (NASASA), such an approach may not be successful in Malawi. Moreover, an investigation of South Africa's NASASA shows that its results have not been impactful within the sector.<sup>97</sup> NASASA has not been well integrated with the stokvels. Accordingly, before such a recommendation can be made, it is important to comprehensively study the informal financial co-operatives in Malawi at a local level.<sup>98</sup>

This can be done by first gaining an informed understanding of the economic environment and contribution of the informal financial co-operatives in both countries. Lack of recognition and understanding of these fundamental components of the informal economy often hampers the development of appropriate policies.<sup>99</sup> Moreover, institutional structures for supervising the sector need to be based on reliable knowledge of how the informal sector works and how the decision is likely to affect the livelihoods of existing financial co-operatives.<sup>100</sup> More localised research is therefore necessary to ensure that policymakers are equipped with the necessary information to enable evidence-

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<sup>91</sup> DCED 'What do we know about the effectiveness of business registration support and reforms? (2017) Key studies referenced in the DCED evidence framework. Donor committee on enterprise development' available at [www.enterprisedevelopment.org/wpcontent/uploads/Effectiveness\\_of\\_business\\_registration\\_support\\_and\\_reforms.pdf](http://www.enterprisedevelopment.org/wpcontent/uploads/Effectiveness_of_business_registration_support_and_reforms.pdf) accessed on 15 July 2021.

<sup>92</sup> Refer to Chapter 2.

<sup>93</sup> Ibid.

<sup>94</sup> Clark op cit note 42 at 2-5.

<sup>95</sup> Ibid.

<sup>96</sup> SALGA and LEDNA *Managing Informality* 89.

<sup>97</sup> Ibid.

<sup>98</sup> Mduduzi & Khumalo op cite note 46 at 30.

<sup>99</sup> Ibid.

<sup>99</sup> M Alter Chen *Rethinking the informal economy: linkages with the formal economy and the formal regulatory environment* WIDER Research Paper, No 2005/10, The United Nations University World Institute for Development Economics Research (UNU-WIDER) (2005) 25.

<sup>100</sup> Ibid.

based decision making.<sup>101</sup> Thereafter, context-specific solutions may be created based on the reality of different categories of the informal sector.

## 9.7 CONCLUSION AND OBSERVATIONS

The regulatory environment often overlooks semi-formal and informal financial co-operatives. However, as noted, a missing regulatory environment can be as costly to informal operators as an excessive regulatory environment.<sup>102</sup> The semi-financial sector seems to be either insufficiently regulated to encourage growth or possess the same problems as the formal financial sector, being inadequate supervision.<sup>103</sup> Similarly, while the informal sector continues to grow, the lack of regulation within the sector presents high risks to the consumers and the financial system as a whole.

Accordingly, the harmful activities in the informal sector that necessitate the need for formal regulation can also not be overlooked.<sup>104</sup> Formal financial regulation of the sector would protect consumer rights and ensure the stability of the financial market.<sup>105</sup> However, as this chapter shows, regulation and supervision are necessarily complex and challenging. It is also very contextual.<sup>106</sup> Therefore, regulators must weigh the potential costs of regulation and supervision, including the possible unintended consequences of regulation, particularly in terms of innovation and competition.<sup>107</sup> This is because blindly extending consumer protection and prudential laws to these sectors would not work.<sup>108</sup> Specific adjustments are needed to capture the specificities of semi-formal and informal financial co-operatives in both South Africa and Malawi.

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<sup>101</sup> Ibid.

<sup>102</sup> Ibid

<sup>103</sup> Ibid.

<sup>104</sup> Seibel op cit note 62 at 6.

<sup>105</sup> Refer to Chapter 6

<sup>106</sup> Alter Chen op cit note 99 at 25.

<sup>107</sup> Pouchous op cit note 85 at 6.

<sup>108</sup> Ibid.

## CHAPTER TEN

### CONCLUSION AND RECOMMENDATIONS

*"Progress is the constant replacing of the best there is with something that is better still"*<sup>1</sup>

#### 10.1 CONTEXTUAL BACKGROUND

To provide context, South Africa and Malawi both have large informal economies that mainstream financial services fail to serve effectively.<sup>2</sup> In addition, for both countries, there has been little broad-based improvement in people's quality of life and generally more exposure to economic, political and climate crises.<sup>3</sup> The topic of financial co-operatives is important in South Africa and Malawi because of the potential benefits that an effective financial co-operatives sector would have on these deficiencies.

Broadly, financial co-operatives are member-owned and member-controlled financial institutions, the ownership and membership of which may vary but that are, at their core, focused on the provision of benefits to their members.<sup>4</sup> The inherent characteristics or principles of financial co-operatives are beneficial because they enable financial co-operatives to offer financial services to less visible sections of society that formal financial services are unable to reach, thereby empowering these sections to participate within the economy and adjust to shocks that occur.<sup>5</sup>

Unfortunately, for both South Africa and Malawi, the financial co-operatives sector is small relative to their mainstream counterparts.<sup>6</sup> There are several reasons for this which include the history and administration of financial co-operatives, the excessive political influence, the lack of trust within the institution but most relevant for this thesis, the loopholes within the regulatory and supervisory frameworks governing the sector.<sup>7</sup>

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<sup>1</sup> J Wilcox *Credit Union Conversions to Banks: Facts, Incentives, Issues and Reforms* (2006) i.

<sup>2</sup> M Mushonga et al 'Drivers, inhibitors and the future of co-operative financial institutions: A Delphi study on South African perspective' (2018) 133 *Technological Forecasting and Social Change* 256; C Chipeta & E Kanyumbu *Determinants of Access to Banking Services in Malawi* AERC Research Paper 351 (August 2018).

<sup>3</sup> M Feldman et al 'The logic of economic development: A definition and model for investment' (2014) *Environment and Planning C Government and Policy* 3.

<sup>4</sup> A Botsari *European Small Business Finance Outlook* EIF Working Paper 2019/57 (2019) 57.

<sup>5</sup> R K Nayak 'Financial Inclusion through co-operative banks: A feasible option for inclusive growth' (2012) 4 *GIMJ* 11.

<sup>6</sup> M Mushonga *The Efficiency and Sustainability of Co-Operative Financial Institutions in South Africa* (unpublished doctoral thesis, Stellenbosch University 2018) 54.

<sup>7</sup> FinMark Trust 'Finscope South Africa 2008 Survey' *FinMark Trust* 35; Genesis Analytics *Understanding financial co-operatives: South Africa, Malawi and Swaziland* Final Report submitted to FinMark Trust (21 February 2013) 18.

On the one hand, the frameworks over-regulate some aspects of the financial co-operatives sector which creates a harsh regulatory environment for some financial co-operatives.<sup>8</sup> On the other hand, some aspects of the financial co-operatives sector are underregulated resulting in regulatory arbitrage.<sup>9</sup>

## 10.2 OVERVIEW OF THESIS

Against this backdrop, this thesis aimed to study financial co-operatives from the point of view of their history and evolution from Europe into both South Africa and Malawi, their modern-day structure, organisation, operations, and practices, as well as their current regulatory and supervisory environment to which they are subjected. Such a study was conducted to provide recommendations that would improve on the current regulatory and supervisory framework in South Africa and Malawi, to foster the growth of financial co-operatives in these economies.

Through a historical study, this thesis showed that the beginnings of financial co-operatives were modest and that after several attempts in Europe, Germany became the official birthing place of financial co-operatives as we know them today.<sup>10</sup> Germany produced two financial co-operatives models in the nineteenth century that were confirmed in contemporary studies as models to follow. Present-day scholarship endorses that view.<sup>11</sup>

Financial co-operatives in Germany provided credit to the poor and reported profits. Scholars explain their success by highlighting two key preconditions for successful financial co-operatives. First, co-operatives were self-funded within small membership groups.<sup>12</sup> Both rich and poor saved in local co-operatives.<sup>13</sup> Second, governments implemented regulatory and supervision structures that ensured co-operatives were well managed.<sup>14</sup>

However, when these models were transplanted to other parts of the world like South Africa and Malawi, such transplanted models did not perform well and failed to displace or become competitive against informal financial arrangements in these countries.<sup>15</sup>

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<sup>8</sup> Mushonga et al op cit note 6 at 4.

<sup>9</sup> A Khafagy *The Economics of Financial Co-operatives: Income Distribution, Political Economy and Regulation* (2020) 90.

<sup>10</sup> D Tucker *The Evolution of Peoples Banks* (1922) 18.

<sup>11</sup> M Nath 'Do Institutional Transplants Succeed? Regulating Raiffeisen Co-operatives in South India, 1930–1960' (2021) *Business History Review* 60.

<sup>12</sup> T W Guinnane 'A failed institutional transplant: Raiffeisen's credit co-operatives in Ireland, 1894–1914' (1994) 31 *Explorations in Economic History* 52-54.

<sup>13</sup> Ibid.

<sup>14</sup> Nath op cit note 11 at 61.

<sup>15</sup> This has been mentioned in Chapters 4 and 5 as one of the reasons that the formal financial co-operatives failed.

This thesis posited that some of the reasons for this failure were that the administrators in colonial and post-colonial South Africa and Malawi implemented the financial co-operative models in ways that differed from the European models like providing excessive financial aid over member savings, governmental interference versus autonomy from government, and adoption of a flawed regulatory framework versus a development of regulation that suited the context.<sup>16</sup>

To resolve the problems that arose from this unsuccessful transplantation, the governments of both South Africa and Malawi, established co-operatives laws, supervising unions and a top-down regulatory structure post-colonialism.<sup>17</sup> However, problems persisted as the interests of the government, regulatory authorities, supervisors, and members conflicted.

Although available sources do not fully capture the details of the problems, this thesis suggests that regulatory flaws lay in the design of the co-operatives and the laws. The co-operatives established in both South Africa and Malawi were not based on co-operative principles or international best practices. Large capital injections were made, and this government intervention altered the capital structure of the co-operative sector.<sup>18</sup> Further, even when the co-operatives were eventually founded on co-operative principles, the governing laws were designed not by the banking regulator but by the government; more specifically they were laws that regulated all co-operatives and not exclusively, financial co-operatives. There were therefore problems associated with the regulatory neglect of the financial co-operatives.<sup>19</sup>

More recently, with the introduction of the specialised financial co-operatives acts in both jurisdictions, the hope has been that the problems of the colonial and post-colonial eras will end. Notwithstanding, in both jurisdictions, it is still apparent that some of these problems are persisting and that the regulation and supervision of financial co-operatives still contain loopholes that can be further addressed.

### **10.3 CHALLENGES OF THE REGULATORY AND SUPERVISORY FRAMEWORKS IN SOUTH AFRICA AND MALAWI**

The current Acts have done considerably well in resolving some of the challenges that the financial co-operatives sectors were encountering. They have provided regulatory and supervisory specialised frameworks in both jurisdictions. The general legislative structures that had been in place before neglected to recognise the co-operative governance structure, deposit-taking function and/or scale and

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<sup>16</sup> M Prinz 'German rural co-operatives, Friedrich Wilhelm Raiffeisen and the organization of trust' (2002) 54 *8th International Economic History Association Congress, Buenos Aires* 15-16; R Kachule 'Rural producer organisations and policy formulation in Malawi' (Working Paper No 127) (2004) 16.

<sup>17</sup> Genesis Analytics op cit note 7 at 18.

<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

scope of financial co-operatives.<sup>20</sup> Conversely, the specific legislation in force now ensures an appropriate set of financial management disciplines, creates avenues for building and distributing capital, establishes governance controls and sets up a prudential supervisory framework.<sup>21</sup> However, there are still some gaps in the frameworks that should be addressed. In summary, they include challenges regarding entry (licensing and registration), operational or functional regulation (governance, financial and operational standards) of licensed entities, and exit (resolution of failing entities).<sup>22</sup>

As far as, for example, licensing and registration is concerned this thesis showed that as a result of the amended law, financial co-operatives have many more compliance requirements. As a result, there are new and additional expenses that financial co-operatives incur to comply with these provisions. Further, as regarding governance the thesis showed that the current legislation is still interventionist. It gives enormous powers to regulatory authorities and various of institutions. This does not mean that all the powers are used regularly. However, extending such broad powers to the governing institutions has consistently proved to be detrimental.<sup>23</sup>

While this thesis would have opted to provide a comprehensive set of prescribed and specific guidelines for improvements, Cuevas and Fischer highlight the shortcomings of setting a concrete model law.<sup>24</sup> They state that in all countries where the financial co-operatives sector is a significant player, the regulator has not attempted to put the institution into a straitjacket designed for another institutional form.<sup>25</sup>

### **10.3 FINDING THE RIGHT BALANCE IN SETTING THE REGULATORY APPROACH OF REGULATING AND SUPERVISING FINANCIAL CO-OPERATIVES**

When deciding on how to regulate and supervise financial co-operatives, several core principles underlie what approach should be considered. For example, financial co-operatives are private sector organisations and should therefore operate free of government interference with management.<sup>26</sup> Moreover, co-operatives should not be seen as the solution to all development problems, but as organisations that people choose to create.<sup>27</sup> In addition, financial co-operatives must be supervised by a

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<sup>20</sup> Khafagy op cit note 9 at 91-92.

<sup>21</sup> Ibid.

<sup>22</sup> C Cuevas & J Buchenau *Financial Co-operatives: Issues in Regulation, Supervision, and Institutional Strengthening* (2018) 6.

<sup>23</sup> Ibid.

<sup>24</sup> C E Cuevas & K P Fischer *Co-operative Financial Institutions: Issues in Governance, Regulation, and Supervision* (2006) 31–32; F Giovanni *Regulation and the Viability of Co-operative Banks* (2012) 330.

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

<sup>27</sup> M Jara & V Satgar *International Co-operative Experiences and Lessons for the Eastern Cape Co-operative Development Strategy: A Literature Review* (July 2009) ECSECC Working Paper Series No 5 at 31.

government agency responsible for the financial sector that has specific knowledge and training related to the sector.<sup>28</sup>

Furthermore, the appropriate role of the government vis-à-vis financial co-operatives is that of the legislature, the regulator, and the supervisory authority. In general, government intervention outside this range is detrimental to its success. Therefore, government and other supporters should focus on creating an environment in which the ability of participants to build their own organizations and do business in a normal business environment is enhanced.<sup>29</sup> A summary of what an enabling environment entails includes appropriate legal regulations and statutory provisions; facilities for information, education and training of members, board members, managers, and staff of financial co-operatives; facilities for auditor especially as regards managerial assistance; promotion of contextual as opposed to preferential treatment in favour of financial co-operatives; and provision of financial assistance to financial co-operatives in their infancy developmental stage in the form of credit and grants. Such assistance should be gradually withdrawn as the financial co-operatives grow. Accordingly, in addition to the specific lessons and recommendations made within the thesis, below is a list of general recommendations that would enhance an enabling environment.

## **10.4 RECOMMENDATIONS**

### **10.4.1 FORMAL FINANCIAL CO-OPERATIVES**

#### **Recommendation 1: Protection from government**

Financial co-operatives are consistently successful in countries where the role of the government is limited to strong ideological and institutional support and decisive action to ensure that the success of financial co-operatives is based on creating of an environment where success is possible despite various constraints.<sup>30</sup> In contrast, financial co-operatives are not successful in countries where government control of the sector is high.

Financial co-operative regulations in both jurisdictions have not been sufficient in empowering the financial co-operatives with enough autonomy to be independent of government control. This thesis has shown that some parts of the Acts give government registrars authority to intervene in the daily operations of the financial co-operatives and in some instances to receive donations from possibly, governmental entities.

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<sup>28</sup> Refer to Chapter 5.

<sup>29</sup> D Mayson 'Agrarian reform and agricultural co-operatives in Cuba – some lessons for South Africa' Research report for the Surplus People's Project (2002) available at [www.spp.org.za](http://www.spp.org.za).

<sup>30</sup> M Jara and V Satgar International Co-operative Experiences and Lessons for the Eastern Cape Co-operative Development Strategy: A Literature Review (July 2009) ECSECC Working Paper Series No 5 at 31.

Regulation for financial co-operatives must protect them from destructive government control. A supportive regulatory framework must focus on registration, liquidation monitoring, capital requirements, and other risk management mechanisms, without intervening and weakening the co-operatives' ability to function well and grow independently of government intervention.<sup>31</sup>

### **Recommendation 2: Incorporation of beneficial informal sector practices**

The formal sector must learn from informal savings clubs like stokvels and embrace the benefits they offer, such as easy access, transparency and simplicity. Good licensing rules and effective supervisory practices are key components in developing a strong regulatory and supervisory framework for the sector. Effective entry regulations isolate the sector from individuals and institutions that pose a risk to the stability and well-being of individual members.<sup>32</sup> However, entry requirements in both countries are considered high and appear to hinder entry. These should be amended appropriately to take into account the developmental stage of the growth of financial co-operatives in South Africa and Malawi. Regulators need to set reasonable entry standards that do not bar entry but instead promote professionalism in this growing segment of the financial services sector.

### **Recommendation 3: Separation of powers**

Governance is typically an area that policymakers should pay particular attention to when it comes to oversight of financial co-operatives. Ultimately, whether or not financial co-operatives can correctly manage their affairs and act responsibly towards members will highly depend on the quality of the overall governance and management, internal controls and auditing, and human resources.<sup>33</sup> Regulations governing financial co-operative regulations must pay particular attention to the two main conflicts which are inextricably linked to the ownership structure of financial co-operatives. Regulations should ensure that the decision oversight and decision-making roles of boards are clearly defined and not confused with the role of management in day-to-day operations.<sup>34</sup> Penalties and sanctions against boards or the management for failure to fulfil their responsibilities must be clearly defined. Further, regulation should ensure that there is a clear criterion for the required qualifications of board members and clear roles for

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<sup>31</sup> H H Munkner 'Ensuring Supportive Legal Frameworks for Co-operative Growth', Nairobi: International Co-operative Alliance. Paper presented at the ICA 11th Regional Assembly (2014) 3.

<sup>32</sup> C Kirkpatrick & S Maimbo 'The implications of the evolving microfinance agenda for regulatory and supervisory policy' (2002) 20 *Development Policy Review* 296.

<sup>33</sup> A Pouchous The regulation and supervision of microfinance: Main issues and progress (2012) *Trade Knowledge Report* 9.

<sup>34</sup> Ibid.

internal supervisory committees.<sup>35</sup> Controlling these factors would contribute to the prudential health of financial co-operatives.<sup>36</sup>

#### **Recommendation 4: Institutional integration and promotion of large financial co-operatives**

Regulations should support and allow voluntary institutional integration among financial co-operatives to help them manage maturity mismatches and liquidity risks, to allow small primary co-operatives to benefit from external technical assistance provided by larger co-operatives or federations, and to increase public trust in the sector.<sup>37</sup> This had not been sufficiently promoted, for example, in Malawi. While there is provision for mandatory registration of all SACCOs with MUSSCO, there is no further encouragement for smaller SACCOs to merge among themselves.

Promotion of integration can lead to the formation of large financial co-operatives. While the smaller size and homogenous composition of co-operatives can improve compliance and peer monitoring capabilities, the larger size and heterogeneous composition can provide members with strong financial capabilities and economic opportunities.<sup>38</sup> Larger sizes and coverage allow the financial co-operatives to develop strong institutional capacity and financial sustainability to mobilise domestic savings.<sup>39</sup>

#### **Recommendation 5: Clear exit mechanisms**

Regulations must provide for effective exit mechanisms, in particular effective deposit guarantee systems for financial co-operatives to protect member deposits and build trust and attract new members or encourage existing members to invest more.<sup>40</sup> While this has been provided for in both countries theoretically, it is important to strategise what this would entail practically and to implement it in the sector.

#### **Recommendation 6: Support for technology adoption and infrastructure**

Technological infrastructure would enhance the participation of members in meetings because they do not have to be in meetings physically. The problem of COVID-19 has also emphasised the need for increased adoption of web/mobile technology for business operations. This would enable them to reach a larger market and therefore increase profitability.<sup>41</sup>

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<sup>35</sup> Ibid. Khafagy op cit note 9 at 98.

<sup>36</sup> Ibid.

<sup>37</sup> R Coelho et al 'Regulation and supervision of financial co-operatives' (2019) 15 *FSI Insights on Implementation* at 8, available at <https://www.bis.org/fsi/publ/insights15.htm> accessed on 10 July 2019.

<sup>38</sup> Khafagy op cit note 9 at 98.

<sup>39</sup> Ibid.

<sup>40</sup> Cuevas & Buchenau op cit note 22 at 6.

<sup>41</sup> E Etim & O Daramola 'The Informal Sector and Economic Growth of South Africa and Nigeria: A Comparative Systematic Review' (2020) 6 *Journal of Open Innovation: Technology, Market and Complexity* 18.

## **Recommendation 7: Incorporation of historical lessons**

There are many historical lessons that this thesis has outlined in Chapters 2, 4 and 5 that may be beneficial in guiding changes to the financial co-operatives regulatory and supervisory framework. Right from the start for example, one disadvantage that can be highlighted is that the law preceded the formal financial co-operatives in both South Africa and Malawi. As a result, even though the sector is practically in the nascent stage with many co-operatives small and developing, the law prescribed for the financial co-operative is quite advanced. History shows however that financial co-operatives are more successful with a framework that grows organically and is tailored for their growth.<sup>42</sup> It is worth assessing in both countries therefore where the sector is and how the disproportional aspects of the law that are far more advanced than the sector could be amended to encourage growth.

### **10.4.2 SEMI-FORMAL AND INFORMAL FINANCIAL CO-OPERATIVES**

In many cases, the more positive characteristics of informal financial co-operatives reflect the weaknesses of formal financial institutions. These positive features include, to varying degrees, easy physical and social access to the rural and urban poor, provision of small loans and small deposits, low borrowing costs, flexibility in loan use, fast processing, locally adapted collateral requirements and high repayment rates.<sup>43</sup>

Likewise, the more negative the characteristics of informal financial co-operatives, the more positive the characteristics of formal financial institutions. The integration or linkage of the two sectors has the potential to take advantage of the positive characteristics of the two sectors. However, as with all proposals, there are arguments for and against linking formal and informal financial intermediaries.<sup>44</sup> Combining formal sector resources with informal sector knowledge and outreach is seen as a way to increase access to financial services for the people who are normally excluded from direct contact with formal financial institutions.<sup>45</sup>

At the same time, the persistent perception of the exploitative nature of some informal financial agents and transactions, on the one hand, and the risk of destroying the important informality of informal financial co-operatives, on the other, are good reasons to leave financial institutions in the informal sector alone.<sup>46</sup>

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<sup>42</sup> This was discussed in Chapter 2.

<sup>43</sup> H D Seibel *Mainstreaming Informal Financial Institutions*, Working Paper, No 2001 (2001) 8.

<sup>44</sup> Ibid.

<sup>45</sup> Ibid.

<sup>46</sup> Ibid.

Notwithstanding, this thesis suggests that instead of focusing on whether the formal and informal financial sectors should be integrated or linked, more attention should rather be paid to managing the sector. As such, the recommendations below refer to such:

### **Recommendation 1: Relaxation of entry requirements**

For the informal financial co-operatives wishing to join the formal sector or even formal financial co-operatives, stringent conditions and excessive documentation on entry requirements should be relaxed as highlighted above.

### **Recommendation 2: Information and research**

The fact that there is no formal regulation of the sector does not mean that both countries should be uninformed of the progress or growth of the sector. The governments should therefore consider establishing research facilities for the collection of reliable data as the basis of any development or progress in the sector, which may or may not include the development of policies.<sup>47</sup> The omission of informal financial sector activities from official statistics calls is of serious concern because the level of economic development in most developing countries depends on the size of the informal sector. The informal sector is large in both South Africa and Malawi, and it is therefore not appropriate to rely on data only collected from the activities of the formal sector.<sup>48</sup>

### **Recommendation 3: Contextual approach**

Strategic management and supervisory support of the informal financial sector should be focused, targeted, directed and adapted to the challenges faced by financial co-operatives. It should also be based on the level of development of individual financial co-operatives, financial co-operative sectors, and the financial co-operative movement as a whole. Finally, the challenges facing financial co-operatives as defined by financial co-operatives themselves should guide the development of the regulatory and supervisory frameworks.

## **10.5 CONCLUSION**

While there is more detail of specific regulatory and supervisory recommendations for reform within the thesis, this chapter sought to provide a summary or overview of recommendations for the changes that are required in the current regulatory and supervisory frameworks of financial co-operatives within South

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<sup>47</sup> P D Jeromi Regulation of Informal Financial Institutions: A Study of Money Lenders in Kerala (2007) 28 *Reserve Bank of India Occasional Papers* 27.

<sup>48</sup> Ibid.

Africa and Malawi. The recommendations were made for the formal sector, the semi-formal sector and the informal sector. Within the formal sector, the first recommendation made was for a supportive regulatory framework that focuses on registration, liquidation monitoring, capital requirements, and other risk management mechanisms, without intervening and weakening the co-operatives' ability to function well and grow independently of government intervention.<sup>49</sup>

The second recommendation was for the formal sector to incorporate learnings from the informal savings clubs like stokvels and embrace the benefits they offer, such as easy access, transparency and simplicity. The third recommendation was that regulations of the formal sector should ensure that the decision oversight and decision-making roles of boards are clearly defined and not confused with the role of management in day-to-day operations.<sup>50</sup> Additionally, regulations should support and allow voluntary institutional integration among financial co-operatives and provide for effective resolution mechanisms. Lastly, regulations should also incorporate historical lessons while also progressing with the current technological advancements withing the world today.

For semi-formal and informal financial co-operatives, the chapter recommended an informative and contextual response to regulation. In other words, the fact that there is no formal regulation of the sector does not mean that both countries should be uninformed of the progress or growth of the sector. Information and research of the sector is therefore paramount in guiding the development of the regulatory and supervisory frameworks within the sector.

It should be noted in conclusion however that these recommendations need not be implemented instantaneously. As this paper has shown, it is important for the developments of financial co-operatives to be responsive and reflective of what is happening within the jurisdiction that they are growing within. That is the only way that such changes can be effective and be sustained. If these recommendations are imposed upon the system in advance of their readiness, problems within the sector may inevitably occur.

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<sup>49</sup> H H Munkner 'Ensuring Supportive Legal Frameworks for Co-operative Growth', Nairobi: International Co-operative Alliance. Paper presented at the ICA 11th Regional Assembly (2014) 3.

<sup>50</sup> Ibid.

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