



Cooperative Financial Institutions as a Source of Development Finance - a Case Study on Sub-Saharan Africa

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By

Michelo M. Nzila
(NZLMIC001)

Supervised by: Professor Joshua Yindenaba Abor

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II. ABBREVIATIONS

BOZ	Bank of Zambia
CEO	Chief Executive Officer
CFI	Cooperative Financial Institution
CGAP	Consultative Group to Assist the Poor
CUSA	Credit Union and Savings Association
FDI	Foreign Direct Investment
ICURN	International Credit Union Regulators' Network
IFC	International Finance Corporation
ILO	International Labour Organization
GDP	Gross Domestic Product
MDGs	Millennium Development Goals
MSMEs	Micro, Small and Medium Enterprises
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
SACCO	Savings and Credit Cooperative
SSA	Sub-Saharan Africa
UN	United Nations

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Research Title

Cooperative Financial Institutions (CFIs) as a source of Development Finance - a Case Study on Sub-Saharan Africa.

Research Problem Statement and Objectives

Statement of the Problem

The lack of access to finance is cited as one of the major barriers preventing developing countries from attaining economic development. While traditional sources of financing such as Official Development Assistance (ODA), Foreign Direct Investment (FDI) and Remittances have done much to alleviate the problem, they have left what is termed the missing middle; a financing gap created by failure to provide financing particularly for Micro, Small and Medium Enterprises (MSMEs) and for the poor in the subject countries. The major impediments have included lack of collateral, inadequate training and business knowledge and risk aversion on the part of traditional financial institutions such as banks.

Further, domestic resource mobilization endeavors have concentrated on tax reforms to improve governments' revenue collection and administration, leaving personal savings aggregation unattended. This financing gap is in spite of knowledge that MSMEs possess the most potential for employment creation, thus poverty alleviation for the masses.

Cooperative Financial Institutions have been in existence for a long time and have the potential to provide innovative solutions in addressing the problem at hand. They have however, received little attention and recognition and the historical association with agriculture and the older generation has limited their outreach and impact.

This study is thus intended to explore whether CFIs can bridge the financing gap for MSMEs in Sub-Saharan Africa.

Research Objectives

The broad objective of this research is to establish whether CFIs can bridge the financing gap for economic development in Sub-Saharan Africa by improving access to finance for otherwise underserved sections of society. More specifically, the study will endeavor to address the following research objectives;

Research objective 1: To obtain an understanding of the nature of the CFI sector in Sub-Saharan Africa.

For a thorough analysis of the potential role of the CFI sector as a source of development finance, it is important to understand the extent and impact of the sector. This is especially important given the diverse nature and forms that CFIs assume, as well as the scarcity of material on the sector in the region. The research question to be answered in addressing this research objective is;

¿ *What is the nature of the CFI sector in Sub-Saharan Africa?*

Research Objective 2: To examine the role and importance of CFIs as a source of Development Finance and to investigate hindrances (if any), that restrict CFIs from providing finance for economic development.

It is necessary to identify obstacles and challenges faced by the CFI sector in the SAA region which hinder them from playing a more significant role as a source of development finance. This research objective can be refined into the following research question:

¿ *What are the obstacles that hinder CFIs from playing a more significant role as a source of development finance?*

Research Objective 3: To explore and identify innovative ways through which CFIs can sustainably provide financing for development while serving their own members.

Identification of obstacles facilitates the process of exploring and recommending innovative ways through which CFIs can sustainably provide financing for development while serving their own members. The research question to be asked when addressing this objective is;

¿ *What are the ways in which these obstacles can be addressed or circumvented?*

Background of the study

A plethora of studies and an enormous amount of academic literature have cited inadequate or lack of access to finance as a major impediment to economic growth, particularly in developing countries such as those that constitute the Sub-Saharan African (SSA) region. The region is particularly reputed for having the lowest levels of investment owing to several reasons, not least of which are the underdeveloped capital and financial markets. Other impediments include low or lack of sovereign credit ratings stemming from political and economic uncertainty which constrains Foreign Direct Investment (FDI) as well as inadequate financial policies and systems.

This predicament has led to a dire shortage of resources to finance developmental projects, both public and private. To meet the region's financing requirements, the major sources of development finance have traditionally included;

Official Development Assistance (ODA),
Foreign Direct Investment (FDI),
Domestic Revenues – mainly taxes, and
Remittances from those in the diaspora.

Although the sources of financing listed above have played a significant role in alleviating the funds shortfall, they have been found to leave what is referred to as the financing gap constituted by the unbanked section of the population perceived to be high risk clients for traditional capital markets. Interventions have been devised to cater to this segment including new policies and reforms to make the financial systems more inclusive. Significant progress has been made to this end, including the development of the Microfinance sector (see discussion on Box 1), yet a lot more remains to be done.

Cooperatives financial institutions can help fill this financing gap. They have been in existence for a very long time in one form or another. However, the idea of cooperative associations came up following the famine of 1846/47 in Germany when many lost their property and livelihood to moneylenders (Oluyombo, 2012). These associations were premised on principles of self-help and self-reliance through savings mobilization, self-determination and self-governance. In the present day, these principles still form the basis for cooperative financing and the importance of this sub sector has become even more apparent. This is demonstrated by the United Nations General Assembly passing of a resolution in December 2009 declaring the year 2012 as the International Year of Cooperatives. The resolution was aimed at, among other reasons, highlighting the contribution and impact of cooperatives to the social economic welfare of participants.

Some of the demonstrated positive contributions of cooperatives include enhanced savings, access to investment income, improved income levels and employment creation among others. Further, cooperatives have demonstrated resilience during economic crises due to their more stable and sustainable business model that mainly relies on members' contributions and savings, while avoiding excessive risk through adoption of a longer-term outlook in their strategies. However, several impediments prevent this sub sector from having full impact on economic development and poverty alleviation. These challenges include poor governance, limited management skills, inadequate or limited access to investment credit and limited application of technology in developing new products.

Although CFIs or their derivative forms have been in existence for many years, even predating other forms of financing, their potential as a source of development finance has neither been fully explored nor exploited. This is exemplified by the scarcity of information on the sector. In the Southern African country of Zambia for example, one is hard pressed to gather meaningful and adequate statistics to determine the number of CFIs operating in the country, let alone the size of portfolios they manage and the range of financial products they offer.

This research thesis undertook to establish whether CFIs can bridge the financing gap for economic development in the region.

For reasons of time and resources constraints, the scope of this thesis is restricted to financial services cooperatives as contrasted with other forms such as agricultural commodity and retail cooperatives. This approach is supported by the fact that the Continent has witnessed a surge in the rate of urbanisation, with 40% of its one billion people currently living in cities, compared to 28% in 1980. This number is projected to rise to 50% by the year 2030, (Wilson, 2013).

The paper uses various secondary data sources. It is organised into five chapters. It begins with an introduction, which covers the background to the study as well as a historical perspective. The introduction also incorporates the research title followed by the statement of the research problem and objectives. The literature review forms the second chapter and discusses relevant academic and practitioners' material with regard to the research problem. Research design and methodology make up chapter three, in which assumptions and limitations are also considered. Chapter four then follows with findings and discussion thereof before winding up in chapter five with a consideration of policy implications and research conclusion. References and appendices wrap up the paper.

Introduction

Many theories have been developed offering ways in which to raise and apply financial resources in order to attain economic development. The sources of finance are broadly covered under Official Development Assistance (ODA), Foreign Direct Investment (FDI), Domestic Resources and more recently Remittances from those in the diaspora, (OECD, 2007 – *Development Finance in Africa: from Monterrey to Doha*). This research focuses on domestically mobilized resources through Cooperative Financial Institutions (CFIs). The bulk of literature on the subject of domestic resource mobilization has concentrated on tax reforms, dealing with tax revenue collection and administration. Little attention is given to the mobilization of private savings as a way to finance economic activity despite the demonstrable potential applications of aggregated private savings. This is particularly topical in developing countries as many studies and discussions by scholars and industry practitioners alike have cited the lack of access to finance as a major impediment to attainment of meaningful economic development (IFC, World Bank, 2010; *InfoDev.org*, June 2008; Dalberg, November 2011).

Studies have also shown that commercial banks, which dominate the formal financial sector in developing countries, have largely failed to provide access to finance for the so-called missing middle, an under-banked populace perceived to be of high risk. Cooperative Financial Institutions can help bridge this gap by serving individuals whose needs are not met by the free enterprise system. Cooperative organizations have a significant economic footprint in our modern economy – a presence that may be poised to expand due to a growing dissatisfaction with the short-term orientation of traditional financial institutions, (McKinsey & Company, 2012). Cooperative Finance falls within the broader sphere of Development Finance, which is still an evolving subject and was previously covered under the auspices of Development Economics. As Professor Rao rightly points out, while a considerable amount of literature has been written on Development Economics, hardly any textbooks address the specific topic of development finance (P.K. Rao, 2003 – *Development Finance*). An exploration of this field of finance will reveal that mutual or cooperative financial intermediaries can play a significant role in bridging the financing gap and meeting the funding needs of this missing middle, particularly for poor and middle income people.

Although cooperative businesses have been responsible for many market innovations and

corrections of market imperfections, little is known about their impact as an economic sector (Deller, Hoyt, Hueth and Stukel, 2009). There is a lack of comprehensive statistics on the impact of the sector on economies across the region. Perhaps the most comprehensive and contemporary piece of writing on the subject of CFIs is one titled “*Cooperative Finance in Developing Economies*”, a compilation, by Onafowokan Oluyombo, of several contributors in commemoration of 2012, the International Year of Cooperatives as declared by the United Nations General Assembly. Although the compilation has a bias to the West African experience, particularly Nigeria owing to the editor’s background, its content cannot be dismissed on this premise as it points out universal truths from which parallels can be drawn for other sub regions and countries. Another publication by the consultancy and advisory firm McKinsey & Company titled “*McKinsey on Cooperatives*” offers a more commercially-oriented perspective on the subjects and provides very useful insights. This dissertation thus makes extensive reference to these publications as well as other relevant literature on the subject.

Box 1: Discussion of Other Sources of Development Finance

- **Official Development Assistance (ODA)** – in the form of aid through multinational and donor agencies who have given enormous amounts through direct budget support to governments and indirectly through project support to specific sectors. This source has not been without its challenges, with questions about aid effectiveness being prominent. The recent financial and economic crisis has entailed dwindling levels of ODA.
- **Foreign Direct Investment (FDI)** – from large pools of international investors seeking new sources of financial return. This has tended to benefit the investors more than economically developing and empowering citizens of host countries, particularly in extractive economies where raw natural resources are exported in shiploads for processing elsewhere. Further, Sub-Saharan Countries were among the worst hit by capital flight as the economic crisis unfolded despite these countries showing more resilience in financial returns (Maimbo, 2008).
- **Domestic Revenues** – These have generally increased as a proportion of GDP following extensive tax reforms embarked by developing countries in early to mid 1990s (*Jonathan DiJohn, 2010*). These reforms have focused on the public sector by concentrating on tax revenue collection and administration.
- **Remittances** – these have recently gained prominence with the increase of Africans in the Diaspora. Remittances remain largely uncoordinated however, and are aimed at financing consumption more than investment.
- **Micro Finance Institutions (MFIs)** - The proliferation of Microfinance Institutions (MFIs) has gone a long way in addressing the lack of access to finance problem. However, MFIs have their own shortcomings including questions regarding their impact in poverty reduction. Concerns have been raised about ‘mission drift’ brought about by commercialisation of the sector which is said to go against the very reason why microfinance was set up; that of providing financial services to the poorest (Niels Hermes et al, 2009). It is further contended that microfinance increases consumption expenditure which does not necessarily translate in betterment of the economic situation of the recipients. In some cases, microfinance is said to have increased recipients’ indebtedness, worsening their situation. The MFIs set up by NGOs have a significant subsidy component and it is argued that subsidies may perpetuate inefficiency in these institutions, rendering them unsustainable in the long run. Another significant criticism of microfinance is the short term nature of its products and services, characterised by short loan repayment periods. This discourages embarking on long term projects, thus constraining the ability of microfinance to contribute significantly to economic growth and development. Also the regular loan repayment model does not lend itself very useful to the majority of microfinance users who are mainly in the informal sector with irregular streams of income.

Definition of Cooperative Financial Institution

Defining what constitutes a Cooperative Financial Institution (CFI) can be a challenging undertaking given the numerous forms which they may assume, including Cooperative Society, Cooperative Bank and Credit Union. This multiplicity of terms is understandable given the fact that such organizations are commonplace in most countries and have existed for a long time, resulting in them assuming a variety of forms in differing communities. However, the defining characteristics of the cooperative model remain universal; that control is in the hands of members, who democratically elect the board of directors and that the primary source of equity capital is members' shares and savings and net earnings are either reinvested or distributed to members as prorated to the level of savings (CGAP, 2005).

Box 2: Definition of CFI and Credit Union

"CFIs include diverse member-owned financial intermediaries referred to as credit unions, savings and credit cooperatives, and cooperative banks and other terms that differ across regions of the world." - World Bank Working Paper No. 82, 2006.

"A cooperative is defined as an "autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise." - ILO Recommendation 193

What is a Credit Union?

"A Credit Union is a cooperative financial institution that is owned and controlled by its members and operated for the purpose of promoting thrift, providing credit at competitive rates, and providing other financial services to its members. Many credit unions exist to further community development or sustainable international development on a local level." – www.cusa.co.zm

An example of a cooperative intermediary is a Savings and Credit Cooperative or a SACCO as it is popularly referred to in most east and southern African countries (Ahimbisibwe, 2007). While CFIs vary widely in their structure and legal status, their basic business model is the same; that of collecting deposits from, and giving loans to their members at competitive interest rates. Most CFIs also distribute excess profits to their members in the form of dividends, with the option of retaining the profits while crediting a member's savings. The characteristics of cooperatives are summarized below.

Characteristics of Cooperatives

- Democratic structure representing members and target groups
- Ownership and management by members
- Open and voluntary membership
- A one door service providing as per members' need including savings, credits, insurance, remittances, trainings and marketing
- Low administrative cost
- Undertakes social mobilization and community development programs to raise the living standard of the poor

Source: Simkhada, 2013

Cooperative Principals and Values

Cooperative Financial Institutions are guided by seven widely accepted principles as prescribed by the International Cooperative Alliance. These articulate the common characteristics of cooperatives. The principles present best practice and promote good corporate governance within the sector. The seven principles include voluntary and open membership, democratic member control, member economic participation, autonomy and independence. Others are education, training and information, cooperation among cooperatives and concern for the community.

Box 3: Cooperative Principles

The cooperative principles are guidelines by which cooperatives put their values into practice.

Voluntary and open membership

Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

Democratic member control

Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary cooperatives members have equal voting rights (one member, one vote) and cooperatives at other levels are also organized in a democratic manner.

Member economic participation

Members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative.

Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.

Autonomy and independence

Cooperatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

Education, training and information

Cooperatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their cooperatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of cooperation.

Cooperation among cooperatives

Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.

Concern for community

Cooperatives work for the sustainable development of their communities through policies approved by their members.

The Roles of Cooperative Financial Institutions

The economic role played by CFIs has been the subject of many studies. CFIs have a dual-role,

that of providing not only economic development but social progression as well. As demonstrated by the limited success of donor-funded Micro Finance Institutions (MFIs) and government intervention programs, economic development requires more than just provision of funds. There needs to be a sense of ownership as well as a consideration of the social aspects for development financing schemes to be effective. Cooperative Financial Institutions have the advantages of identifying economic opportunities for the less privileged, empowering the disadvantaged in defending their interests and providing security to the poor by allowing them to convert individual risks into collective risks (Wanyama, Develtere and Pollet, 2006).

Economic development is more than just economic growth; the former takes into account the welfare and quality of life of a given society while the latter is confined to the metrics of measuring sustained increase in the level of real gross domestic product (GDP) of an economy (Ighomereho, Dauda and Olabisi, 2012). Well-run cooperatives are capable of contributing towards attainment of both these goals; economic growth and social development through the benefits they offer their members as well as other positive externalities they confer on their communities. By providing finance to the underserved, so-called unbanked population, CFIs can thus contribute to the economy and help increase GDP in the developing economies. (Franklin Allen et al, 2011). This in turn can help to substantially reduce poverty. The following is a discussion on the roles played by CFIs in economic development.

Savings Mobilization and Intermediation

Cooperatives help cultivate a culture of saving among their members, making it possible to accumulate significant sums through small, regular contributions. These collections are then loaned out within the membership to those with financing needs. Cooperatives thus serve two purposes; encouraging savings while enabling members to access the much needed finance for development. Magill states that “they perform an active financial intermediation function, particularly mediating from urban and semi-urban to rural areas and between net savers and net borrowers while ensuring that loan resources remain in the communities from which the savings were mobilized” (Magill, 1994). He points out an important aspect of CFIs; that of retaining resources within the communities in which such resources are raised thus creating a revolving fund in which funds can be turned over several times. Cooperatives also have the advantage of lending at competitive interest rates, particularly in jurisdictions where they are tax exempt. Members also earn significantly higher returns on their savings through the distribution of dividends, relative to saving with commercial banks that offer virtually no return. Ahimbisibwe summarizes the roles played by CFIs to include provision of financial services to the poor through the provision of savings, credit

and investment opportunities to individuals, institutions and group members, (Ahimbisibwe, 2007). Other roles included are teaching members about financial management, provision of institutional development as well as promotion of stronger family ties.

Further, Cooperatives provide credit to their members without the stringent requirements for collateral demanded by formal banking institutions. Cooperatives are also more responsive to member's needs due to their proximity to the general membership; directors and management are usually members of the cooperatives they serve.

Employment Creation and decent work

According to a study of 2008 authored by Hertig and Elena, ILO estimates that 100 million jobs are provided by cooperatives – 20% more than Multi-National Companies. The study further states that cooperatives provide not only direct employment, but also self-employment, indirect and induced employment. Evidence from developed and developing countries also demonstrates how cooperatives can provide decent work for otherwise vulnerable or transitional individuals, especially women, youth, the aged and the physically challenged. Cooperatives can also endow members with valuable work experience, organizational capacities, and entrepreneurial skills to further diversify their own livelihood prospects (UN, September 2012).

Fairbairn, Kitilson and Krebs point to the role of CFIs in resisting certain ills such as dehumanization of the poor and depopulation of rural areas (Fairbairn et al, 1997). They also highlight other roles such as creation of new businesses and employment opportunities as well as new markets.

In a broader sense, proponents of CFIs point to the success of the sector in providing access to finance to sections of society that would not otherwise be served with financial services such as MSMEs. The importance of the role played by the MSME sector in both national and global economies cannot be underestimated. MSMEs are widely considered the engine of growth to almost all economies in the world due to their role as primary driver of employment creation and economic growth; they create entrepreneurial spirit and innovation and are thus crucial for fostering competitiveness and employment. In Africa for example, MSMEs make up over 90% of all businesses. They also contribute more to job creation than large established corporations to the tune of about 80% and 61% in Ghana and South Africa respectively. The MSME sector's contribution to GDP also asserts its economic importance, as much as 70% to Ghana's GDP and between 52-72% to South Africa's GDP (Abor, 2012).

Promotion of Social Change

Other than the demonstrated positive financial impacts of CFIs including those of job creation through income generating activities, facilitating the accumulation of assets and savings which help smooth consumption, CFIs perform other non-financial roles such as improved health, food security, women empowerment and education through improved financial literacy. These non-financial outcomes provide impetus and credence to the Millennium Development Goals (MDGs) of poverty reduction and deepening of financial markets.

Despite the foregoing positive aspects, one gets the sense that the CFI sector has not been fully exploited nor given the prominence due to it as an important source of finance for development. This is partly due to the lack of research and information on the importance of the sector; hence this case study is aimed at shedding more light on the sector in the region as well as proposing innovative ways of employing the CFI model as a financing source for which the demand is clearly there.

Advantages of CFIs over other finance providers

CFIs have an advantage over MFIs in that they offer both loans and savings services as opposed to just lending. Relative to traditional commercial banks, their edge stems from their ability to provide both financial and non-financial services in a cost effective manner. The cooperative sector in most SSA countries is largely unencumbered by onerous regulations, taxation and reserve requirements; hence they enjoy favorable terms such as low or no tax on income as well as less burdensome compliance requirements such as filling audited financial statements. According to McKinsey, the drag on ROE (Return on Equity) from compliance costs of regulations imposed on commercial banks can be as high as 4%. These conditions offer cooperatives incentives to generate comparatively better returns which they can pass onto their members through payment of dividends, or reinvested to obtain a better return on capital than would otherwise be obtained from commercial banks. A core advantage of cooperatives is their proximity to customers – they have a closer relationship with customers and a deeper understanding of their expectations and needs, (McKinsey, 2012). This relationship stems from the unique cooperative ownership model in which customers are also owners on the entity.

The CGAP Donor Brief No. 25 (August 2005) lists the following as advantages that CFIs offer for increasing outreach;

CFIs reach clients and areas that are unattractive to banks,

They provide savings services to their members unlike most MFIs,

CFIs are often started locally without major external support, enabling them to retain capital within their communities while insulating them from external shocks and crises, Their solid base of small savings accounts constitutes a stable, relatively low-cost funding source, and, Well-run CFIs have low administrative costs and are able to make loans at interest rates that are lower than those charged by other finance providers.

In the wake of the recent financial crisis and the subsequent economic meltdown that ensued, cooperative financial institutions have demonstrated resilience to the crisis. This view is supported by an ILO report authored by Birchall and Ketilson in which they contend that cooperatives succeed not only in crisis but also in crisis. This, they argue, is down to the virtues of customer-owned cooperative banking system that is more risk-averse and less driven by the need to make profits for investors and bonuses for managers (Birchall and Ketilson, 2009). Further, cooperatives generally tend to have a more long term, community-oriented focus that often result in less risk taking and more measured approach to growth. The more stable ownership of cooperatives places less emphasis on short term results.

“Whereas the primary purpose of a public company is to maximize profits for the benefit of its Shareholders, a cooperative’s priority is to provide goods and services to its members over the long term and at the lowest cost possible.” – McKinsey & Company, 2012

Criticisms of CFIs

While the majority of literature on the subject of cooperative financial institutions paints a positive outlook, the sector is not without its critics. In his 2006 background and discussion paper titled *“Current Issues in Cooperative Finance and Governance”*, James R. Baarda highlights some of these limitations and criticisms. Although his writing has an inclination towards agricultural cooperatives, parallels can be drawn in CFIs as follows;

- **Size and Scale** – Cooperatives are limited in size and scale due to their heavy reliance on their membership for loan products and savings. This over-reliance on the membership results in reduced market power and ability to respond to market demands on the entities and members’ needs, hence impacting on their operational efficiency. The low capitalization levels in the sector make economies of scale difficult to attain, rendering cooperatives unable to compete with other larger players in the financial services industry. While external capital is proposed as a way to increase cooperatives loanable funds, this has the effect of

diluting ownership and control of the entity and threatens the very principle of cooperatives as member-owned organizations.

- **Scope** – In this instance, scope refers to the range of products cooperative financial institutions are able to offer to their membership. A cooperative's scope of operation is limited to traditional loan products that its largely volunteer-board and management can comprehend. The only alterations have usually been the size of the loan or the repayment period. CFIs portfolios are therefore, narrow and undiversified, unlike commercial retail banks, for example who are able to offer a wider range of products such as personal life and general insurance, annuities, share trading etc.
- **The Horizon problem** – this describes the situation where the termination period of a member's investment in the cooperative does not correspond to the period of time the member uses and benefits from the cooperative. To elaborate, if a member wanted to leave the cooperative for example, he or she will would be compensated an amount equal to his initial capital contribution in the form of shares as well as any accumulated savings and dividends due. The share capital does not reflect the market value as it does not incorporate capital gains of the cooperative as an entity. However, in order to grow, the cooperative may need to make longer term investments, such as investing in an office block to serve as offices for the entity and to rent out excess space as a revenue generation exercise. The horizon problem makes the general membership averse to such projects as such investments will continue to generate income for the cooperative long after a member has left.
- **Lack of agility** – As a result of their governance and ownership structure which favors consensus through participatory and democratic over executive decision making, cooperatives tend to be slow in responding to emerging challenges and opportunities. Members may advocate differing political views and competing business ideas that may be at a tangent with interests of the cooperatives, thus delaying or even derailing progress. The concern for lack of agility within the cooperative sector is cemented by the view that it appeals more to the older generation and is less well known among the youths. This limitation however, can partially be addressed through inclusion of the subject of the cooperative model in school financial and commercial curricula alongside other business models.

Challenges faced by CFIs

Notwithstanding the demonstrable strengths and roles played by cooperatives in economic development, the sector remains under explored and unexploited to derive maximum benefit and contribution. The cooperative form of enterprise, despite its significant and positive impact on economic and social development, continues to be underutilized and poorly understood (ILO, 2008). The major challenges inherent in the cooperative movement in developing countries such as those of SSA include lack of proper management, inadequate financing, poor cooperative integration, government unfavorable policies, resistance to change, illiteracy and lack of training facilities (DCFS, 2011); over-control and regulation by government, limited access to credit and inability to penetrate markets (GSDRC, 2011). These challenges are echoed by Nair and Kloeppinger-Todd, who state that CFIs in developing countries are typically beset with numerous constraints including anachronistic legal frameworks, low capacity, lack of appropriate regulatory framework, and poor supervision, (Nair and Kloeppinger-Todd, 2007). The issue of over-control and regulation can however be countered as the sector in most SAA countries is largely unregulated and enjoys favorable terms such as low or no tax on income as well as less onerous compliance requirements such as filing audited financial statements. The CGAP Donor Brief No. 25 (August 2005) identified similar challenges, including the ones discussed below;

- **Governance weaknesses and members participation**

Given that CFIs are usually run by a volunteer board of directors elected by and from within the membership, the result is that poorly skilled persons assume roles they do not even understand, let alone lack of vision and will to exploit potential ventures. Members' education levels regarding cooperative principles, values, ideas and practices have also tended to be very low, thus members are neither able to provide checks and balances for boards of directors nor suggest better ways to run the entities. Further, while members may be happy to receive benefits from services offered by their cooperatives, they may be reluctant to actively participate in the organizations' operations. Several national apex cooperative bodies have attempted to address this deficiency through workshops on corporate governance and entrepreneurship training. Much more remains to be done though, as most of these umbrella bodies are ill-equipped themselves to be able to deliver effective programs.

- **Inadequate regulation and supervision**

CFIs in most sub-Sahara are classified under the non-bank financial institutions. This is a very broad category that includes financial and non-financial cooperatives, micro finance institutions, among others. Most central banks are overstretched for resources both financial

and personnel to adequately regulate and supervise banks and non-bank institutions such as cooperatives. As such, the regulatory and supervisory responsibility for the cooperatives sector rests with ill-equipped and understaffed government agencies whose employees lack the necessary skills, experience and political independence needed to provide effective oversight on the sector.

- **Limited menu of products and inadequate marketing activities**

Products offered by cooperatives have historically been narrow and inflexible with no variation to take into account differing risk levels. As a result, cooperative organizations have lagged their publicly held counterparts in organic or portfolio growth because the former focus on their members' current needs than on developing innovative new products or actively searching for new markets to serve (McKinsey & Company, 2012). Further, due to their governance structure that tends to favour consensus over executive decision, cooperatives are unable to make decisions as quickly, hence lose out on opportunities.

- **Limited Access to Investment Capital and Damage done by external credit**

Cooperatives have traditionally relied on their members' savings and contributions as a source of loanable funds but these have, sometimes, been inadequate to meet the members' demand for funds. To exacerbate the problem, Cooperatives are usually unable to access external investment capital due to the high cost of such funds, making them unattractive for on-lending purposes. Further, internal management problems do not inspire confidence in would-be suppliers of such investment capital. Historically, indiscriminate channeling of large sums of donor and government funds to CFIs without developing their capacity created a culture of irresponsibility and lack of sense of ownership.

CFI Sector Regulatory Framework – A mini Case Study on Zambia

The following are the statutes and laws that govern the CFI sector in Zambia

Cooperative societies Act

Regulation of Cooperative Financial Institutions in Zambia largely falls under the **Cooperative societies Act of 1998 as amended**. The Act provides for the formation and registration of Cooperative Societies as corporate entities with perpetual succession and limited liability, (Meagher and Mwiinga, 1999). The Act also contains provisions that govern

membership and lending activities. Cooperative Societies incorporated for the promotion of savings and extensions of loans to their members are registered as credit unions. These institutions are however, not subject to the Banking and Financial Services Act and thus do not fall under the supervision of the Central Bank, the Bank of Zambia. The Act instead places such institutions under the supervision of the Registrar of Cooperatives, which lacks capacity and resources to carry out this function. This essentially entails a loosely regulated and sparsely supervised CFI sector, prompting numerous calls for reform to the regulatory framework by both law makers and industry practitioners who advocate for stricter laws (Meagher and Mwiinga, 1999).

Societies Act

This Act affects CFIs in that it provides for the registration and supervision of any club, company, partnership or other association of ten or more persons except for those registered under the Companies Act. This provision creates ambiguity with regard to regulatory authority.

Income Tax Act

CFIs are explicitly exempted from paying income tax and by virtue of the non-applicability of both the Companies Act and the Banking and Financial Serviced Act. This gives an advantage to such institutions in that they are able to retain all their profits for redistribution to members as either loans or dividends. This advantage creates a strong disincentive for CFIs to convert into cooperative banks, hence restricting their potential to grow further and develop more innovative products for both members and non-members who would like to access excess finance, (Meagher and Mwiinga, 1999). Further, this advantage given to CFIs has the potential to create resistance from these institutions to be included under the supervision of the Central Bank.

Size of the CFI sector

Because the cooperative sector is extraordinarily large, its size can only be estimated. The World Council of Credit Unions has 49,000 unions in membership with 177 million individual members in 96 countries while the International Raiffeisen Union estimates that 900,000 cooperatives with around 500 million members in over 100 countries are working according to the cooperative banking principles (Birchall and Ketilson, 2009). Cooperative organizations are present in nearly all economic sectors, from agriculture to retail, to financial services. In their publication titled "*McKinsey on Cooperatives*", McKinsey & Company estimate that cooperatives represent

approximately 3 to 5 percent of the world's GDP.

Due to the diverse forms that CFIs assume, it is difficult to measure the precise size and extent of influence carried by the sector. This is exacerbated the sometimes informal nature of cooperative arrangements and the scarcity of relevant and complete data on their operations. For example, the inadequate regulation and supervision of the CFI sector discussed above has the implication that there is uncertainty regarding the size and impact of the CFI industry in Zambia. The exclusion of CFIs from the regulation and supervision of the Bank of Zambia has not helped the situation. While the Bank of Zambia website lists all commercial banks and non-banking financial institutions including Micro Finance institutions (33) and foreign currency exchange bureaus, no such list is shown for CFIs. Only one entity is listed under the Savings and Credit Institutions category; the National Savings and Credit Bank, which is a semi-parastatal with little or no autonomy. The Cooperative Union Savings Association of Zambia (CUSA), lists its affiliated cooperatives (41 in total) on its website (www.cusa.co.zm) but affiliation is not mandatory meaning not all cooperatives are accounted for. Further, the listing does not indicate the sizes of the portfolios, neither paid up capital, savings nor outstanding loans of each entity. The Zambia scenario is repeated across most of the SSA region.

Box 4: Cooperative Union Savings Association (CUSA) of Zambia

CUSA is the cooperatives movement umbrella body registered under, and mandated, by the Cooperatives Act of 1998 and is tasked with making policy interventions in a variety of areas that regulate credit unions business, giving technical advice to members on taxation among other issues, and participate in national budget planning (www.cusa.co.zm).

CUSA was first founded in 1969 in Monze district of southern province, and established in 1970 as a federation of credit unions mainly to serve the urban salaried persons. The operations were extended to rural areas in the 1980s, during the 1970 to 1986 CUSA had been providing Central Finance facility to member credit unions that had pooled their financial resources together at credit union level in order to finance each other from the same resources.

CUSA's **objectives** are to promote the Co-operatives in Zambia by:

- Assisting the Organisations in promotion of Co-operative thrift, or Co-operative savings and Credits Societies, affiliate and liaise with the international Co-operatives and Credit Union Organisations, seek their financial and technical assistance for the good of the Credit Union movement in Zambia,
- Conducting or participating in educational and training courses and programmes, and to afford all possible assistance in the establishment and operation of a college or institute that will provide services to train and educate personnel in and members of Credit Unions, receive and administer any contributions, grants, donations, or subsidies that may be received by the Association and to improve, develop, mortgage.
- Making loans available to its members Credit Unions at interest rates that will be determined from time to time by the Board of Directors

It's **Mission:** Is to facilitate and promote the growth of efficient and quality service delivery to credit unions in Zambia

And it's **Vision:** To facilitate and promote the growth of efficient and quality service delivery of credit unions in Zambia.

Methodology

This research on the role played by CFIs as a source of development finance has been conducted using a qualitative exploratory case study methodology based solely on secondary data. This involved review of previous studies on the subject including published report, papers, journal articles and other sources. This methodology was selected because of the relative ease of access to various literatures on CFIs both on public as well as private data bases and search engines. The choice of this methodology is also informed by time and resource constraints that otherwise prevent the undertaking of a long process of primary data collation and analysis. The lack of comprehensive set of statistics on the subject prevented employing a quantitative methodology. Further, CFIs have been a topical subject of late, resulting in proliferation of literature, albeit disjointed. Also, insights were drawn from the experiences of the researcher, who is a member of one of Zambia's most successful CFIs, Nkwazi Savings and Credit Cooperative. He has previously served as Treasurer on the Board of Directors of the Cooperative and is fairly knowledgeable and passionate about the sector.

Research Plan and data collection techniques

The case study research was conducted by employing purposive snowballing secondary data collection as guided by the research questions highlighted Chapter one above. The main providers of research material have included but not limited to the following, not least the researcher's own experience and observations;

- a. Publications by International Development organisations such as ILO
- b. Development Financial Institutions including IFC
- c. Academic Research Papers
- d. Internet journals and articles

Locality and Population

The scope of the study was initially restricted to be conducted in Zambia and particularly on CFIs operation in Lusaka, the country's capital city. However, this proved to be a very limiting scope both in terms of geographical reach and amount of data available for the initial scope. While Lusaka city

has a population of about three million people, only small fraction belong to CFIs, let alone successful ones. The population was thus inadequate for the purposes of this study. This was then expanded to cover the Sub-Saharan Africa region. The factors considered in the selection of location include limited time, concentration of CFIs as well as financial resource constraints.

Assumptions and Limitations

The topic of cooperative financial institutions is a very broad and varied subject where each country and organisation's experience is influenced by various and unique nuances. As a result, the findings on one CFI do not necessarily apply to the next. Further, there is a dearth of relevant literature on the subject matter. Due to the diverse nature and forms that cooperatives assume, there is also no comprehensive set of statistics and literature to demonstrate the sector's size, importance or economic impact across the region.

Other limitations that influenced the scope of this research project and the selection of methodology include limited time, financial resource constraints, as well as concentration of CFIs.

In undertaking this project, the researcher set out on the assumption that the subject research topic has not been exhaustively covered and that by embarking on this project, his work would contribute to the larger body of knowledge, and if nothing else, to consolidate the scattered knowledge on the topic. Based on the researcher's literature review, this was proved to be true.

Research question 1

In answering the research question “*What is the nature of the CFI sector in Sub-Saharan Africa?*” the researcher found it to be a formidable challenge owing to the diverse forms that CFIs assume. This was exacerbated by the informal nature that most CFIs operate across the region. Cooperative Financial Institutions in Sub-Saharan Africa have a long history, dating far back as the early 20th century. In light of this history, significant strides have been made to make the sector uniform and to encourage the adoption of best practices. Yet differences persist owing to differences in the level of development of cooperatives in the sub regions as well as varying political will to develop the sector.

Observation of the nature of these institutions yields mixed results; on the one hand, they have attained importance in furthering economic and social development for their members as well as other positive externalities. These positive aspects stem from development of new products that serve a multitude of members’ needs as well as the innovative application of technology such as Mobile Money Transfers and cell phone banking. Other innovations include online application and processing of loans as well as direct bank transfers to members. On the other hand however, in more recent times the reputation of CFIs has suffered, tarnished by poor administration and leadership, poor business practice and by corruption. So while certain CFIs are exhibiting signs of growth and advancement, others are held back by these poor business practices and failure to adapt to changing environments.

The CFI sector is loosely regulated and diverse, making it difficult to obtain a correct picture of the size and extent of the CFI sector. The sector is largely unexplored as shown by the scarcity of information and comprehensive statistics from which to make inferences. The CFI sector has not reached its potential role as a source of development finance due to historical government interference, inadequate regulation and supervision, inappropriate corporate structures and culture, weak financial positions, and lack of adequately skilled personnel (Chiumya, 2006). This is despite the huge potential for the development of the sector to particularly serve MSMEs and those who would not otherwise have access to finance.

Innovation can be applied to develop new products that are responsive to the rapidly changing business environment as well as the needs of finance seekers by exploiting and leveraging the

abundance of knowledge gained by CFIs in administering their entities. With training, including strategy formulation and implementation, financial and human resource management of boards of directors and management, the CFI sector can be propelled to higher levels in its quest to attain its potential to become a significant player in the financial sector.

Research question 2 - *What are the obstacles that hinder CFIs from playing a more significant role as a source of development finance?*

The Cooperative Reform and Modernization Program report of April 2005 by the Tanzanian Ministry of Cooperatives and Marketing identifies problems of poor management, inappropriate coop structures, corruption and embezzlement, lack of working capital, lack of cooperative democracy and education, weakness of supporting institutions and in general, an inability to compete in a liberalized market economy as the major problems facing the sector. The CGAP Donor Brief No. 25 (August 2005) identified similar challenges, including the following as discussed in the literature review of this paper;

- ***Governance weaknesses and members participation***

Given that CFIs are usually run by a volunteer board of directors elected by and from within the membership, the result is that poorly skilled persons assume roles they do not even understand, let alone the lack of vision and will to exploit potential ventures. Members' education levels regarding cooperative principles, values, ideas and practices have also tended to be very low, thus members are neither able to provide checks and balances for boards of directors nor suggest better ways to run the entities. Several national Cooperative bodies have attempted to address this deficiency through workshops on corporate governance and entrepreneurship training. Other ways to encourage participation include setting up focus groups, designing and offering loyalty incentives and other membership offers such as solicitation of investment ideas from the general membership and rewarding successful ones. Wider participation of members is crucial to prevent the dominance and imposition of a few powerful members' biases. Much remains to be done though, as most of these umbrella bodies are ill-equipped themselves to be able to deliver effective programs.

- ***Inadequate regulation and supervision***

CFIs in most sub-Saharan Africa are classified under the non-bank financial institutions. This is a very broad category that includes financial and non-financial cooperatives, micro finance institutions, among others. Most central banks are overstretched for resources both financial

and personnel to adequately regulate and supervise banks and non-bank institutions such as cooperatives. As such, the regulatory and supervisory responsibility for the cooperatives sector rests with ill-equipped and understaffed government agencies whose staff lack the necessary skills, experience and political independence needed to provide effective oversight on the sector. Regulating and supervising CFIs requires an understanding of their unique governance structure and risk profile.

- ***Limited menu of products and inadequate marketing activities***

Products offered by cooperatives have historically been narrow and inflexible with no variation according to risk levels. Loan products have traditionally been offered as a multiple of a member's savings, typically a 3:1 ratio, at fixed simple interest rates and fixed loan tenure of repayments. This inflexibility results in the CFIs' failure to meet their members' diverse financial needs. Many CFIs are however, introducing greater variety of products, particularly with the advent of new technologies such as mobile money transfer companies that have proliferated across the region. Examples of products include emergency, education, commodity and building loans, all with varying terms.

- ***Limited Access to Investment Capital and Damage done by external credit***

Cooperatives have traditionally relied on their members' savings and contributions as a source of loanable funds but these have, sometimes, been inadequate to meet the members' demand for funds. To exacerbate the problem, Cooperatives are usually unable to access external investment capital due to the high cost of such funds, making them unattractive for on-lending purposes. Further, internal management problems do not inspire confidence in would-be suppliers of such investment capital. Historically, indiscriminate channeling of large sums of donor and government funds to CFIs without developing their capacity created a culture of irresponsibility and lack of sense of ownership.

In addition to policy level constraints such as inappropriate regulatory environment, poor supervision and anachronistic legal framework, perhaps the biggest threat to the cooperatives sector has to do with behavioral aspects of participants; the low attitudes towards saving and apathy towards participation in cooperative affairs.

Research question 3 - *What are the ways in which these obstacles can be addressed or circumvented?*

The important role played by cannot be over-emphasised; neither can what they have achieved thus far be underestimated. These achievements have clearly demonstrated that the cooperative business model provides both social and economic development, through the provision of financial and non-financial services on a sustainable basis. However, it is also clear that the Cooperative sector has not attained its full potential in what it is capable of contributing. Several recommendations, if implemented, can further strengthen the sector. These are discussed below;

Board of Directors qualifications

Cooperative boards of directors are installed through elections at annual general meetings. This often results in the most popular and powerful persons assuming office even though they may not be appropriate for the roles. It is therefore imperative that an orientation program be put in place to educate directors of their responsibilities, management, governance as well as financial principles. Practices such setting minimum qualifications in terms of both experience and formal education and restriction on board tenure should also be encouraged whenever possible.

Strong corporate governance

Often CFIs are beset with poor leadership and bad management. To address this, By-laws and rules should be strengthened and disseminated to all members and adhered to consistently. These should be supplemented with policies, procedures and guidelines for day-to-day operations of the entity. Internal controls should be maintained including audits and the rotation of auditors where possible.

Education and Participation of Members

Most members are unable to effectively participate and contribute to the proper running of cooperatives due to inadequate knowledge and low levels of financial literacy. As a result, a lot of effort and time is wasted on non-issues that only detract from the cooperatives' ability to deliver economic benefit to the general membership. While education committees are formed as a sub-set of the board of directors, these generally tend to be inactive as they lack a clear mandate of what needs to be passed to members. Awareness programs targeted at communicating the vision and mission of the organisation as well as product types is one way of bridging the knowledge gap. The general membership also constitutes a vast resource for ideas, which will only come to the fore when members are engaged in the affairs of the cooperative.

Planning

The board of directors and management should develop strategic business plans for how they intend to attain their goals and monitor implementation of the same. Strategic plans are also a valuable tool for evaluating how well these goals are being achieved and should form part of the reporting process.

Innovative Product Development

Following the recent financial and subsequent economic crises, the general public lost trust in traditional financial institutions and publicly traded companies. This peaked interest in other organizational forms such as Cooperatives. Cooperatives should thus take advantage of this to attain growth and significance by playing to their natural strengths which entails adhering to their strong set of social values and delivering a unique member and customer experience. This then forms the foundation upon which to address the issue of limited range of products, one of the factors that hinder the development of CFIs. CFIs are thus encouraged to develop new products and services that cater to the needs of their membership, hence they will be able to attract new members and strengthen their capital base. CFIs are urged to utilise technological developments such as mobile money transfers and online banking services to be more effective in delivering and meeting members' needs. They therefore need to strike a better balance between democracy and executive agility. This can be achieved through undertaking three actions that have been found to be useful;

1. Clearly distinguish the respective roles and responsibilities of executive officers (management) and elected officials such as board members.
2. Create more efficient processes for involving members on strategic decisions.
3. Improve performance management systems better align employee incentives and members' needs.

Another area where CFIs can take advantage is in technological advancements such as finding new ways to engage their members through online and social media channels. This will make it easier to communicate with the membership, faster and on a larger scale. The use of modern technology can lower the costs of service delivery and facilitate the availability of financial services in lower to middle income groups.

Regulatory framework

Most supervisory institutions are either ill-equipped, lack funding or are inadequately staffed to deliver quality services to member CFIs and to cope with the sector's demands. Apex bodies that oversee the operations of CFIs need to be strengthened in order for them to render better service and guidance. Integration of other institutions such as credit reference bureau should also be considered as well as streamlining the registration processes and requisite documents. Other priorities for these umbrella bodies should include human resource development, better training, research, improved quality of audit and supervision, increased use of ICT and the creation of pools of cooperative specialists (Bibby, 2006).

Capital needs

CFIs have at times failed to meet the loan demands of their members due to reliance on internally generated funds. This not only constrains members' ability to borrow but also hinders cooperative from exploiting other profitable business opportunities which would strengthen the institutions' financial position and generate a higher return on capital for members. There is therefore, need for governments to facilitate an autonomous system of finance for cooperatives that will provide external loan capital. CFIs can also exploit their relationship with already existing members to encourage more deposits through offering investment products that offer competitive returns to members as well as recruiting new members to expand their capital base and in turn, reap economies of scale benefits. Additionally, CFIs can retain a higher proportion of their profits to be used for investment and further loan advances as opposed to distributing all earnings in the form of dividends.

Policy Implications

In trying to understand the nature of the CFI sector in the Sub-Saharan Africa region, it is apparent from this research that there is a lack of comprehensive knowledge and information on the subject. This lack of knowledge has been a recurrent obstacle in the sector, resulting in neglect of this important section of finance. The knowledge gap stems from limited well-structured research as well as political will to understand the sector better and highlight the important role that CFIs play. More recently, the sector has been catapulted into the spotlight following the declaration of 2012 as the International Year of Cooperatives by the United Nations General Assembly. There however, remains a huge informational gap in the form of accurate, complete and timely data. This makes understanding the size and impact of the sector difficult. This is despite the huge developmental potential of the sector.

It is imperative that further structured research be conducted on the subject of cooperatives including deliberate policy to develop the sector in order to bridge the knowledge gaps. Including the subject of the cooperative model in financial education curriculum should also be given serious consideration, in order to raise its profile especially among the younger generation. This will have the effect of correcting the notion that cooperatives are outdated as well as injecting the sector with fresh innovative ideas of how to retain its relevance.

Governments and cooperative apex bodies should encourage the adoption of sound governance policies and practices even before sector-specific regulations have been developed or required by law. These practices should include training directors in governance standards as well as monitoring and business planning tools. Further, CFIs should be encouraged to keep financial standards at the core of internal management in addition to supporting competent, independent external supervision of CFIs. More needs to be done to bring CFIs under efficient oversight that involves both external auditors and formal financial supervision, once they reach certain scale. A lot has been done in this regard by the International Credit Unions Regulators' Network (ICURN) which resulted in the development of Principles for Supervision of CFIs. This provides a good platform on which further work can be done to advance CFI regulation and supervision.

As discussed above, some of the main obstacles facing the Cooperatives sector have been

identified as weak governance, inadequate regulation and supervision, limited menu of products and inadequate marketing activities. Others include limited access to investment capital, members' illiteracy and low participation in cooperative affairs.

These challenges mentioned above are not insurmountable. CFIs should take it upon themselves to address these issues. In addition to recommendations previously suggested, other actions should include education programs for the board and general membership on cooperative business processes, application of technology to develop more innovative products that meet members' needs.

In order to grow investment capital, it may be necessary for regulating authorities to set minimum ratio requirements for CFIs to maintain as retained profits as opposed to paying out all profits as dividends to members. CFIs should also mobilise higher savings from the membership by offering incentives that encourage members to save more.

Further studies and research will be required to explore ways in which the CFI sector can be integrated into the wider financial infrastructure such as national payments and clearing systems, credit bureaus.

Conclusion

Cooperative Financial Institutions have demonstrated that they play an important role in attaining social and economic development goals through their provision of financial and non-financial services to their members and the communities in which they operate. CFIs help through increased income and savings of members, employment creation, improved health and overall development of society. Lower interest rates, more responsive products, non-collateralised loans, better return through payment of dividends and fewer administrative hurdles give CFIs a comparative advantage over other financial institutions. The importance of the sector became even more apparent in the recent financial and economic crisis in that while they may not hit the highest peaks during times of economic booms, they will also not hit the lowest troughs during periods of economic distress.

However, the cooperative sector is not without its challenges, including poor governance, limited management skills, inadequate or limited access to investment credit and limited application of technology in developing new products. These impediments have prevented the sector from attaining its full potential. Several measures can be instituted to circumvent these hurdles and make the sector's role in economic development even more significant.

If the constraints facing the cooperative sector are addressed and recommendations implemented, the sector has huge potential in providing access to finance to members of society who are otherwise not served by other financial institutions. This will result in enhanced economic and social development and poverty reduction. The cooperative sector in the Sub-Saharan Africa region is better poised to play an even more significant role as investment revenues and higher rates of economic growth are shifting to emerging markets. CFIs should therefore play to their unique strengths to ensure they remain relevant to their membership while continuously growing and adapting their institutions to new developments in the field of development finance.

CFIs are indeed an invaluable source of development finance.

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Appendix 1: Ethical Clearance Form

Graduate School of Business

Application for Ethical Clearance for Research

Any individual at the Graduate School of Business (GSB) undertaking any research that involves the use of human subjects, or research that may hold ethical consequences for the University of Cape Town, is required to complete this form. The completed form should be submitted for consideration to the GSB Ethics in Research Committee before the research is conducted.

All students conducting research projects are required to complete this form even if their research does not involve the use of human subjects. If the proposed research project does not include the use of human subjects then only the first section of this form needs to be completed.

1. PROJECT DETAILS	
Project title: COOPERATIVE FINANCIAL INSTITUTIONS AS A SOURCE OF DEVELOPMENT FINANCE	
Principal Researcher/s: Michelo Nzila	Research Supervisor / Co-researchers: Joshua Abor (Prof.)
E-Mail Address: michelonzila@gmail.com	
Brief description of the project: This is an exploratory case study of the Cooperative Financial institutions (CFI) sector in Zambia, including its size. Impact and potential as a source of Finance for economic development.	
Research methods and procedure: (please tick and explain procedure) <input checked="" type="checkbox"/> Interviews <input checked="" type="checkbox"/> Survey questionnaire <input type="checkbox"/> Experiment <input checked="" type="checkbox"/> Secondary data <input type="checkbox"/> Observation <input type="checkbox"/> Other* (please specify): *Select this option if you are not planning to conduct research using human subjects. You must outline your proposed research methodology to support this choice.	

2. PARTICIPANTS

Characteristics of participants:

Gender: Male and female
Race / Ethnicity: Various
Age range: Not specific
Location: Zambia
Other:

Affiliations of participants: (please tick)

X Company employees Hospital employees **X** General public Military staff Farm workers Students Other (specify)

If your sample includes children (aged 15 and below), mentally incompetent persons, or legally restricted groups please explain on a separate page why it is necessary to use these particular groups

3. ORGANISATIONAL PERMISSION

If your research is being conducted within a specific organisation, please state how organisational permission will be obtained:

The researcher currently serves as Treasurer on the board of directors of one of the more successful CFIs under study in Zambia and therefore has direct access to the rest of its directors and management of the organization. The researcher will seek written permission from the Board Chairperson to interview the entity's management and members as well as those of the other CFIs under consideration.

4. INFORMED CONSENT

What type of consent will be obtained from study participants?

- Oral consent
- Written consent
- Anonymous survey questionnaire (covering letter required, no consent form needed)
- Other (specify): _____

How and where will consent/permission be recorded?

Formal written correspondence as appendices to the research report

If subjects are minors or mentally incompetent, describe on a separate page how and by whom permission will be granted?

5. CONFIDENTIALITY OF DATA

What precautions will be taken to safeguard identifiable records of individuals? Please describe specific procedures to be used to provide confidentiality of data by you and others, in both the short and long run. This question also applies if you are using secondary sources of data.

Restricted physical access to records, signing a confidentiality pledge and adhering to ethical and copy write restrictions and parameters in addition to removing names from the data to protect the participants' privacy and identity.

6. RISK TO PARTICIPANTS

Does the proposed research pose any physical, psychological, social, legal, economic, or other risks to study participants you can foresee, both immediate and long range? (tick one)

Yes No

If yes, answer the following questions on a separate page:

1. Describe in detail the nature and extent of the risk and provide the rationale for the necessity of such risks
2. Outline any alternative approaches that were or will be considered and why alternatives may not be feasible in the study
3. Outline whether and why you feel that the value of information to be gained outweighs the risks

PLEASE ATTACH THE FOLLOWING DOCUMENTS TO YOUR APPLICATION

1. A full copy of the research proposal
2. Any consent form that will be signed by the participants or read to them (if any)
3. Any interview schedules, cover letters, forms, instruction sheets, survey questionnaires or other material that will be used in the study.

I certify that that the material contained herein is truthful and that all co-researchers and supervisors are aware of the contents there

Date: December 12, 2012

ETHICS COMMITTEE REPRESENTATIVE

Recommendation:

Signature:

Date:

ETHICS COMMITTEE CHAIRPERSON (FOR URGENT APPROVALS ONLY)

Recommendation:

Signature:

Date:

Appendix 2: Supervision Memorandum of Understanding

UNIVERSITY OF CAPE TOWN
Graduate School of Business
Memorandum of Understanding

Research Title: Cooperative Financial Institutions (CFIs) as a Source of Development Finance – A Case Study on Zambia

This memorandum of understanding between

MICHELO MITCHELL NZILA

..... (name of student)

And

PROFESSOR JOSHUA ABOR

..... (name of supervisor)

is designed to ensure that the supervision experience is as mutually productive as possible.

By signing this document, both parties acknowledge their understanding of and binding to the general and specific commitments it contains.

Student Details

Student number: NZLMIC001

Email: michelonzila@gmail.com

Telephone number(s): +27837806075

Supervisor Details

Email: joshabor@ug.edu.gh

Telephone number(s): +233-302-501594

General Commitment

Both the student and the supervisor bind themselves to the contents of the UCT GSB policy on research as set out in the "*UCT GSB Policies and Guidelines*", in particular the UCT and GSB policy on Authorship, Copyright, Ownership of Data and Plagiarism, as detailed therein.

Specific Commitments

The Student commits to:

- Honor all arranged meetings and agreed deliverable dates
- Keep the supervisor informed timeously of any unforeseen problems and/or changes to the research plan (and obtain acknowledgement that the supervisor has received such)
- apply the effort required at each stage of the research project to ensure compliance with and timely delivery of research requirements

The Supervisor commits to:

- Honor all arranged meetings
- Keep the student informed timeously of any unforeseen problems and/or changes that may impact on the supervisor's ability to adequately and timeously supervise the student's research
- Provide adequate, prompt comment and response on research progress and issues that the students present for discussion or that arise in response to written submissions. The

supervisor acknowledges that timely feedback to the student is crucial to their ability to deliver on research requirements

- Meeting at least 4 times with the student in accordance with the agreed timelines, and to make appropriate plans for electronic contact if away during the research project.

Supervision Session 1	Broad identification of research area, research topic, related research literature
Supervision Session 2	Specific research objectives, literature areas, methodologies appropriate to the objective
Supervision Session 3	Tactical research strategies and issues arising
Supervision Session 4	Progress review and problem solving
Supervision Session 5	Structuring analysis and discussion of key findings
Supervision Session 6	Feedback on draft report

Signed:.....J. Y. Abor..... (Supervisor)

Name: Professor Joshua Abor

Signed: (Student)

Name: Michelo Nzila

Date: December 7, 2012

Appendix 3: Notice of Intention to Submit

**COMMERCE FACULTY OFFICE
NOTICE OF INTENTION TO SUBMIT
MASTERS DISSERTATION**

TO BE COMPLETED AND RETURNED TO : Tel : (021) 406 1437

Candice Marais (email: Candice.marais@gsb.uct.ac.za)

Contact details : International Finance Corporation
(during examination/
graduation period) P. O. Box 41283, Craighall 2024
Johannesburg, South Africa
Telephone Number : +27837806075
Fax No & E-mail address : michelonzila@gmail.com

I hereby declare that I intend to submit my dissertation for the **June 2014 / ~~December 2014~~** graduation ceremony. (Please **delete** that which is not applicable).

Name and Student No : Michelo Nzila – NZLMIC001
Degree : Master of Commerce – Development Finance
Supervisor / s Name : Joshua Yindenaba Abor, PhD, FCCA
Dissertation Title : Cooperative Financial Institutions as a Source of Development Finance – a
Case Study on Sub-Saharan Africa.

Should I not be able to meet the deadlines for submission as set out in Rule FM6.4 of the Faculty of Commerce Handbook, I undertake to inform the Faculty Officer immediately.

Please note that if you submit your dissertation for examination at a time other than the Faculty submission dates, there may be a considerable delay before you receive the result. While every effort will be made to process the work for examination as soon as possible, the Faculty does not however undertake to reach a decision on the award of the degree by any specific date.

November 15, 2013

.....
Candidate's Signature

.....
Date

I acknowledge that the above-mentioned candidate has indicated an intention of submitting a dissertation for examination in fulfillment of the requirements for the above-mentioned degree.

J. Y. Abor

November 22, 2013

.....

.....

Supervisor's Signature

Date

Appendix 4: The International Credit Union Regulators' Network (ICURN)

Guiding Principles-

Guiding Principles

Effective Prudential Supervision of Cooperative Financial Institutions

The Guiding Principles incorporate 21 principles recommended by the International Credit Union Regulators' Network (ICURN) for effective supervision of cooperative financial institutions. The principles are categorized into six groups:

GROUP 1 – Objective, Independence, Powers, Transparency and Cooperation

GROUP 2 – Licensing and Ownership

GROUP 3 – Prudential Regulation and Requirements

GROUP 4 – Methods of Ongoing Supervision

GROUP 5 – Accounting and Disclosure

GROUP 6 – Enforcement

GROUP 1- OBJECTIVE, INDEPENDENCE, POWERS, TRANSPARENCY AND COOPERATION

Guiding Principle 1

OBJECTIVE, INDEPENDENCE, POWER, TRANSPARENCY AND COOPERATION

An effective system of supervision will have clear responsibilities and objectives defined for each authority involved in the supervision of the industry. It is essential for each authority to have operational independence, transparent processes, sound governance and adequate resources and for it to be accountable in its discharge of duties. An effective legal framework is also necessary, including the powers for authorization, supervision, powers to enforce compliance with relevant laws, safety and soundness and legal protection for supervisors. Where relevant, authorities must have the legal

capacity to share information while protecting the confidentiality of such information.

GROUP 2 - LICENSING AND OWNERSHIP

Guiding Principle 2

PERMISSIBLE ACTIVITIES

The permissible activities of institutions that are licensed and subject to supervision must be clearly defined, and terminology used to describe the institutions undertaking these activities, such as credit unions, *caisses populaires* and SACCOs, must be restricted and controlled by the supervisory authority. The supervisory authority must have the power to enforce against the use of the restricted terminology by unlicensed entities. Business powers and permissible activities may be proportional to the institution's size and ability to manage the risks inherent in such services and compatible with its business objectives.

Guiding Principle 3

LICENSING

The supervisory authority must have the power to establish and enforce the necessary criteria for licensing entrants. At a minimum, the licensing process should consider ownership (must be a cooperative structure), governance, fitness and propriety of board members and senior management, strategy, risk management and capital. This is not intended to be an exhaustive list, and supervisory authorities should consider additional criteria needed to facilitate effective supervision in their regimes.

Guiding Principle 4

OWNERSHIP

The supervisory authority should ensure the structure of any proposed institution complies with cooperative principles, recognizing that some second-tier organizations have proportional voting for members. It is not appropriate for any

individual or group of individuals to be in a position to exercise control from a minority position. Voting in credit union support organizations or associations may be proportional or representational.

GROUP 3 - PRUDENTIAL REGULATION AND REQUIREMENTS

Guiding Principle 5

CAPITAL ADEQUACY

The supervisory authority must establish and enforce the rules for an appropriate capital framework with which all regulated institutions must comply. The rules should balance cooperative principles and objectives with the need to protect depositors. Accordingly, supervisory authorities will need to carefully consider what meets the criteria for capital and to ensure that capital instruments are able to absorb losses in the event of failure.

When supervisors choose to align the capital requirements of credit unions to Basel standards, a simplified approach may be adopted for small or simple credit unions that are not allowed to hold complex financial instruments. For such institutions, compliance with the most advanced risk measurement techniques may be beyond their resources. Therefore, the regulator may require additional capital to support the limited information that may be available for supervisory authorities.

Guiding Principle 6

RISK MANAGEMENT

Regulated institutions must have appropriate and adequate risk management processes and systems in place. The risk management system must be able to identify, evaluate, monitor, manage and control the risks to which the regulated institution may be exposed. Policies and limits for risk undertakings must be clearly established and periodically reviewed. The risk management system should be commensurate with the size and complexity of the institution and its activities.

Guiding Principle 7

CREDIT RISK

Credit risk is generally the most significant risk for cooperative financial institutions. Accordingly, supervisory authorities should ensure that regulated institutions have appropriate policies in terms of their accepted risk in specific undertakings and adequate systems to manage such risks. It is essential that regulated institutions are able to manage their credit portfolios effectively in terms of monitoring the performance of the portfolio and the collection of distressed facilities. The supervisory authority should also focus on ensuring that regulated institutions focus on forms of lending they are capable of undertaking, while avoiding areas that require expertise they do not possess.

Guiding Principle 8

PROBLEM ASSETS, PROVISIONS AND RESERVES

Regulated institutions must have adequate policies and processes for managing problem assets and provision appropriately for such assets. It is essential for supervisory authorities to ensure that regulated institutions are adequately provisioned for troubled/problem loans and other impaired assets. Provisions should also be considered for untroubled loans to reflect historical loss experience and changes in economic conditions that may affect the quality of the loan portfolio as a whole. Some provision may be required for contingent liabilities, depending on the probability of a corresponding cash outflow.

Guiding Principle 9

LARGE EXPOSURES

Regulated institutions should have appropriate and adequate policies and processes around large exposures (concentration risk). The supervisory authority should set rules around the definition and limit of large exposures to which regulated institutions can be exposed and should have the power to intervene should these be breached.

Guiding Principle 10

**CONFLICTS OF INTEREST
AND RELATED PARTY EXPOSURES**

The supervisory authority should have the power to establish rules to control conflicts of interest and related party exposures. It should have in place powers that permit it to intervene where such rules are breached. Related party transactions should be required to be undertaken at arm's length, and there should be rules that require disclosure and reporting of such transactions.

Guiding Principle 11

INTEREST RATE RISK AND MARKET RISK

Regulated institutions must have policies and processes in place to manage interest rate risk to which regulated institutions may be exposed. In particular, supervisory authorities should be attuned to the interest rate risk of fixed rate lending portfolios.

Guiding Principle 12

LIQUIDITY AND FUNDING RISK

Regulated institutions must develop reasonable and prudent liquidity management strategies and contingency plans, including central bank borrowing, standby facilities and/or liquid reserves in a regulated central financial facility, which cover the funding of the institution and the ongoing monitoring of the regulated institution's liquidity/funding position. Supervisory authorities should have the ability to intervene when they believe a regulated institution has an excessively risky funding base or liquidity position. Liquidity risk should be addressed both on a per-institution and on a network-wide basis. Soundly managed network-wide liquidity and stability facilities are highly desirable.

Guiding Principle 13

INTERNAL CONTROLS

Regulated institutions should have in place an appropriate level of internal

controls commensurate with the size and complexity of the institution and its activities. This should include arrangements around delegations of responsibilities, authorizations, segregation of duties, reconciliations and accounting.

Guiding Principle 14

ABUSE OF FINANCIAL SERVICES

Regulated institutions should have policies and procedures in place that will prevent them from being used unintentionally for criminal activities, including money laundering. This should include having in place know-your-customer rules. Where the supervisory authority does not have responsibility for regulating such activities, it should ensure it has in place a process of regular liaison or a memorandum of understanding for working with the responsible authority.

Guiding Principle 15

OPERATIONAL RISK

Supervisors must be satisfied that credit unions have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the institution and its activities.

GROUP 4 - METHODS OF ONGOING SUPERVISION

Guiding Principle 16

INTERNAL AUDIT

The supervisory authority should consider the need for an appropriately qualified, independent and adequately resourced internal audit function. The internal audit function should focus on ensuring that the internal control function operates effectively. Where there is an internal audit function, it should report to an appropriate level within the regulated institution and must have direct access to the board where it considers this necessary. The scope of internal auditing within an organization may involve topics such as the efficacy of operations, the

reliability of financial reporting, deterring and investigating fraud, safeguarding assets and compliance with laws and regulations.

Guiding Principle 17

SUPERVISORY ACCESS

Regulated institutions and their subsidiaries should grant the supervisory authority complete and unfettered access to all aspects it considers necessary. The supervisory authority must have the ability to enforce access where this is not provided.

Guiding Principle 18

SUPERVISORY APPROACH, TECHNIQUES AND RESOURCES

The supervisory authority should develop and maintain a thorough understanding of the operations of individual regulated institutions and should deploy an effective and ongoing combination of offsite and onsite supervisory techniques. The supervisory authority should have appropriately qualified and independent staff and be adequately resourced to implement its supervisory approach.

Guiding Principle 19

SUPERVISORY REPORTING

The supervisory authority should have the ability to collect, review and analyze financial and/or statistical reports from regulated institutions in whatever form it requires. It should also have the ability to have such reports or forms independently verified where it considers this necessary.

GROUP 5 - ACCOUNTING AND DISCLOSURE

Guiding Principle 20

ACCOUNTING AND DISCLOSURE

Regulated institutions should maintain adequate records that have been prepared in accordance with the relevant accounting laws in its jurisdiction.

GROUP 6 - ENFORCEMENT

Guiding Principle 21

CORRECTIVE AND REMEDIAL POWERS OF THE SUPERVISORY AUTHORITY

An adequate range of enforcement tools to facilitate timely corrective action should be at the supervisory authority's disposal. This includes the ability to issue appropriate legal orders, to revoke licenses or to recommend revocation. This also includes the ability to impose restrictions on the activities and operations that institutions conduct.