The role of community banks in South Africa: Can it contribute to improve access to financial services for the poor?

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Abstract

Community banking initiatives are defined in this paper as membership based decentralised and self-help financial institutions. Under this broad definition we discuss the informal variants of community banks, the rotating savings and credit association (or in South Africa better known as the stokvel), the more formalised village banks spreading throughout the country and the very formalised (defined in terms of legislation and registration requirements) institutions registered under the Mutual Banks Act of 1993. We show that the informal financial groups are changing in profile and mode of operation and we look at factors contributing to success and failure (CC - please expand here). The village banks started slowly since 1994 and then the concept received support after which the formation of new village banks mushroomed. At first this phenomena was handled as an "exemption" by the financial regulators and recently more serious consideration of the more formal inclusion of the concept in financial legislation was evident with its inclusion in the draft co-operatives legislation. The danger exists of too fast growth as these institutions are by nature savings-first institutions and experience shows that quick growth could lead to the formation of a weak institutional and collective base. Lastly we turn to the highly formalised structures; thus those registered under the Mutual Banks Act. We discuss the rise and demise of the Community Bank (the first bank to be registered under the Mutual Banks Act) and other registrations and their experiences. We conclude by highlighting the risks that must be attended to in supporting community banking, the vast potential of community banking and support measures that could help the growth of these institutions without distracting them from their essential focus and strength, self-help and self-organised.

1. Introduction

Until recently, an area of relative neglect in the formal conception of the supply of financial services is the concept of decentralised financial services. The decentralised concept refers to financial services that are organised by the local community. This is the essence and origin of financial intermediation. It normally emphases a savings first approach. Slow growth and social capital are implied in starting and organising such a system. It further implies local control, or member control over the activities of these institutions. Member control also includes mutual monitoring of activities by members. Activities refer not only to the handling of cash, but also to the management of investments by borrowers. In essence these systems address the core of all issues in financial transactions and markets; it improves information flows, thus improving the quality of decisions. It therefore decreases adverse selection and moral hazard problems (Graham & Von Pischke, 1995).

As formal financial services contract in the rural areas of South Africa more emphasis is placed on self-help endeavours. Attention is slowly turning to financial intermediation at the local level. Several forces contribute to this renewed emphasis.

[1] By Gerhard Coetzee (University of Pretoria and ECI (Pty) Ltd) and Catherine Cross (Rural Urban Research Associates). The usual disclaimers apply. Paper read at the XXth meeting of the Commonwealth xxx in Durban, South Africa, 8 March 2001.

The most success in the micro finance sector in South Africa is of private sector origin and is based on the urban employed. The extension of financial services to the self-employed is severely lacking and once again it is the private sector that is taking the lead in the provision of services. However albeit estimated that the penetration of this market is less than one percent. The provision of credit facilities is, however, emphasised. Further the decrease in presence of commercial bank branches in rural areas contributes to the finding that between 1995 and 1998 the number of people in South Africa in close proximity of a commercial bank branch contracted from just over 50 percent to 34 percent (Eskom, 1998). This is ,inter alia, a function of the pressures on the agricultural sector resulting mostly in declining productivity of farming, the pressure on the margins of commercial banks due to, inter alia, international competition and the high levels of poverty and lack of formal employment in rural areas.

In this paper the current status of community banking in South Africa is discussed. We define community banking as initiatives ranging from informal self-help financial services right to formalised membership based institutions. The common denominator is assumed to be member based institutions and self-help initiatives. In section two we reflect on the informal initiatives and discuss the results of recent surveys of informal financial groups and the trends we observe in their make up and function. In section two we turn to more formalised endeavours, in South Africa referred to as the village bank initiatives. Section three looks at our experience with formalised membership based financial institutions. We conclude with a few general remarks about the potential of community banks in South Africa.

2. Membership based informal financial structures

2.1 Introduction

A wide range of credit and savings associations operating in disadvantaged communities are spoken of loosely as *stokvels*, based on an Afrikaans terms for cooperative savings groups. Most of these groups are on a very small scale. They provide a range of services depending on how the group is structured and its rules of operation, from more or less pure savings mobilization to profit-directed commercial lending operations. One of the purposes of the qualitative research is to give some indication of the range of group types operating in the study localities, and to reflect their goals, how they work, how they recruit and hold members, and some of the factors involved in success or failure.

These groups are the informal version of the community bank. This is the start of the continuum of formalisation, and many more formalised structures capitalise on the social fabric and experience with these informal variants of the community bank.

The description given here is based on 63 qualitative case studies spread across six provinces. Provinces included were those with large rural African populations. Gauteng, Western Cape and Northern Cape were left out due to the fact that their African population was either highly urbanized or very small in total. Field areas included both dense peri-urban populations in relative mobilized rural areas in close touch with the cities, and outlying rural districts, which remained relatively, isolated. Where possible both types of area were included. However, the samples for Northern

Province, Free State and the Eastern Cape were drawn from peri-urban areas mainly, and that for Mpumalanga was entirely rural.

Agricultural activity was fairly strong in KwaZulu Natal and was one of the uses for credit in that sample in both the peri-urban and rural areas studied. Agricultural activity also figured in North West, where stock raising was important. However, agriculture was not strong in the villagized settlements in Mpumalanga or in peri-urban Free State, and the status of cultivation was not clear in Northern Province. The Eastern Cape sample was based on sponsored credit groups tied specifically to small business activity, and did not note household farming as a purpose for credit activity.

Addressing small-scale finance in rural communities is a task with technical difficulties. There are no official statistics, national or provincial studies able to delimit the universe of community savings and credit groups, making it impossible to structure a formal random sample. Household finance in general is known to be protected by elaborate privacy conventions in most parts of the developing world, raising the risk that survey data will be inaccurate (cf Hill 1970, Connell & Lipton 1977). The methodology for the primary data collection for this study[2] therefore focussed on qualitative work and adopted the fastest reliable method available, in the form of key informant interviews.

Interviewees were chosen on a quota sample basis developed from the interviewers' networks of contacts. The sampling effort focussed first on KwaZulu Natal as the lead province for agricultural activity, with fewer interviews in later-visited provinces. It was important that interviewers speak the local language, know local customs and culture, and have local connections. The interviews were informal and open-ended, using a semi-structured questionnaire and interview guide. Interviewers were encouraged to allow respondents to develop an argument and a point of view as they told their stories.

Based on the written questions and texts, a comparative analysis was developed. Interpretation focussed on the themes of *social capital* and *recruitment processes*, perceived *objectives of group participation*, contextual differences, and factors associated with *success or failure.*

2.2 What kinds of credit and savings groups are operating?

The development of informal credit and savings groups in rural South Africa, as in most parts of the developing world, probably starts out with *rotating savings associations*. These groups seem to be dominated by women. They provide perhaps the simplest form of savings mobilization, in which members save specified amounts on a fixed rotation into a lump sum payout, awarded to each member of the group in turn. These groups do not involve interest or generate income in their most classical form, but only help members to save. In their pure form, they do not hold any assets, but collect and pay out the amounts involved in a complete transaction taking place afresh at each meeting.

[2] This study was financed by the German Co-operative Federation (DGRV) and took place in 2000.

From the ancestral rotating savings associations have differentiated a number of other forms of group, which have gradually extended their operations into the sphere of income generation. Today, the most common type of group turned up by the provincial samples is the *accumulating savings and lending group* that collects monthly, pays out annually and lends out its accumulated assets during the year cycle. These groups do not follow a rotation, but have all members on the same payout cycle and often bank their assets since they are not distributed immediately. Otherwise, the assets taken in go out again as loans, and are saved in the form of debt obligations which come back with interest.

Pure rotating savings and credit groups (ROSCAs)

The four rotating savings groups represented in the KwaNyuswa case histories practice perhaps the most basic and straightforward kind of savings and credit enterprise. Each member receives the payout once in a rotation, and there are no additional loans or interest involved. Most of these groups report that they do not have or need written constitutions, since the rules are well understood by everyone. These groups usually reconstitute themselves at the end of each full set of rotations, to ensure that all members remain fully committed to make the necessary payments. Among the poor in KwaZulu Natal and Mpumalanga, amounts paid in monthly might be R 50-100, though teachers and others who were well off sometimes aimed at amounts as high as R 500 per month. Their main weakness is a risk that members who have received early payouts may drop out of the rotation before they have made all the expected contributions for other members with later positions to receive their payouts in turn. Members who receive early payouts in effect borrow from the other members and repay by making monthly contributions while members who receive the payouts later in the cycle in effect are saving.

Accumulating savings and lending groups paying annually

The accumulating savings and lending groups which now seem to dominate informal finance in both localities do not limit themselves to savings mobilization, but often try to increase their payouts on savings by adding in both bank interest on their regular deposits and interest on their own informal lending. Loan amounts may have a relatively low ceiling of R 200 in smaller and less ambitious groups, but the modal amount appears to be about R 100-500, and the larger and more commercially oriented groups allow loans of up to R 1000 or more. High rates of interest are charged, and in reported cases members may receive as much as R 550 as an interest payout on R 660 of savings. Loan periods vary from two months to a year, with most concentrating around four or five months before the principal is expected to be repaid. Longer loan periods are said to have the advantage of accumulating more interest in the common pool, but also carry some increased risk of default. Some groups accept variable rather than fixed contributions, and there are clear signs that record keeping is a problem, and a possible source of friction and corruption.

Commercial lending operations

In addition to the different kinds of savings groups, another kind of informal credit association has appeared in KwaZulu Natal. Three of the groups contacted reported that they were cash loan operations without a savings component. However, one of these, a group of less educated people related to the founder, actually does appear to have a savings function in the form of monthly subscriptions of R 50 per member, which are then returned to the members at the annual payout. The other two groups include one informal lending company organized on a shares basis around a core group of three brothers, and a church-based lending operation to fund church running expenses.

Intermediate and other types

Other intermediate forms have also developed as part of this wide-scale mobilization of savings and credit groups in South Africa's rural districts. It is not rare to find rotating savings groups also running a capital-generating operation which is based on holding parties and selling food and drink to group members: this is done in order to generate assets separate from the core rotating payout, so that this separate fund can then be lent out. ~~These groups that both rotate and also lend are perhaps the truest form of what is called ROSCAs, rotating savings and credit associations (cf Ardener~~ & Burman 1995, Cross 1986, 1987).(My view is that the first one is the true ROSCA ~~where members save or borrow or do both depending on their position in the schedule of who recives the pot at the end of each period)~~ Some of the classical burial societies which take in payments in order to insure member families against funeral costs also lend out their assets. When they do this, they operate as accumulating savings and lending groups. There are also sponsored programmes modelled on informal savings and credit groups which actually provide bank or NGO funds to group participants, though these programmes are few in relation to the need. In this study, the Uvimba programme in the Eastern Cape represents sponsored credit groups. In addition, KwaZulu Natal turned up three lending groups which declared that their main objective was lending out at a profit, though one of these also had a de facto savings component.

The DGRV study results suggest that the balance of savings and income generation may be changing among groups operating in the rural sector, with possible implications for cooperative savings and credit schemes assisting small farming or other economic activities (Cross 1986, 1987). New types of groups are appearing, and there are signs that the overall distribution of savings and credit groups may be shifting in favour of accumulating groups, which concentrate on annual expenses, and for which interest-bearing loans were a major part of the motivation for participation (Table 1).

For the easterly provinces, the modal group type was the accumulating savings and lending structure, with monthly payments accumulating for an annual shareout and loans bringing in interest. These groups were clearly dominant in KwaZulu Natal and Mpumalanga, the provinces where larger samples were collected. This held true even though the KwaZulu Natal samples were from relatively sophisticated and mobilized districts that were demographically fairly unstable, while the Mpumalanga samples were from unsophisticated, solid and long-established communities in the remote former homeland district of Nkomazi.

However, for the westerly interior provinces relatively small samples were collected, and this kind of trend – to move away from simple savings mobilization and go toward interest-bearing lending – was not evident as it was in the coastal districts.

Case studies mentioned fear of loan funds not being repaid, perhaps implying weak social bases of compliance in these districts which could make loan repayment unpredictable. One reason for this expressed fear of becoming involved in lending at interest may be severe poverty under conditions of high mobility and weak social capital. A larger formal sample would be needed to confirm trends and identify reasons.

However, it seems clear that the income-yielding accumulating savings and lending model answers a need particularly in areas where education levels are high enough and other conditions are present to sustain it. There was pressure reported in several of the coastal provinces case histories for simple rotating savings groups to convert to the accumulating savings and lending model. Several groups did this, and drew more interest and more members as an immediate result.

The simple rotating savings-only model is often used by the well-off to save for larger outlays, but in essence it seems to be seen as the safe model for the poor. That is, the simple rotating savings model can be successfully operated by anyone. It does not require either record-keeping or office-bearers to take responsibility for assets. The expanded rotating savings model, in which there is some additional source of accumulating funds such as monthly parties with food and drink sold, allows this kind of group to deliver a loan facility as well. However, it also increases the demands on both management and members. Commercial lending operations based on share subscriptions now also appear to be coming into operation, and what share of the informal financial market they will represent in these localities in the future is not clear.

***Table 1:T*types of savings and credit groups found in the provincial samples (Raw numbers of case histories collected per province, by category of group)**

	Rotating savings	Accumltg savings & lending	Burial	Lending only	Sponsored formal credit	Other	*Total cases*
KwaZulu Natal	6	14	N/A	2	-	1	23
Mpumalanga	5	8	-	-	-	-	13
North West	2	-	3	-	-	-	5
Northern Province	2	1	1	-	-	2	6
Free State	2	2	2	-	-	-	6
Eastern Cape	[3]	-	-	-	10	-	10
Total	17	25	6	2	10	3	N = 63

Overall, there were about a third again as many accumulating savings and lending groups in the total DGRV study sample as there were rotating savings associations. For KwaZulu Natal and Mpumalanga alone, the figure was about double. That is, for these areas pure savings mobilization remains a strong element of informal finance, but most groups were now profit-driven, and members expected to earn relatively high rates of interest on their savings as well as to accumulate funds on a savings basis.

2.3 Dynamics of informal credit groups: What are the risk factors?

The task of savings and credit groups is to deliver their services in relation to savings and perhaps making loans to their locality or community: this is an inherently difficult and stressful task because of the potential for conflict around issues of controlling and dividing scarce resources, so there is a central need for groups to cohere in the face of the disrupting forces they are containing within them. Social capital factors in the background of group members are a key concern here, but performance characteristics such as leadership and administrative competence represent the other side of the equation in relation to keeping control over centrifugal forces and enabling groups to continue delivering their services.

The key problem for savings and credit groups is how to guarantee reliable payment and reliable management, in the face of unpredictable cash shortfalls and competing demands for available income. It appears that in order to become as reliable as possible, successful groups first need to hold themselves together, and then also keep to their rules in terms of payments and due diligence. To do this, they need to meet a set of basic standards in relation to their composition, or *recruitment*, and also in relation to how they run themselves, or *performance* factors.

Social capital

The first requirement for any group to operate successfully appears to be social capital. This is the webbing of interpersonal connectivity that allows group members to trust each other, and to predict each others' behaviour. Connections of this kind include both personal connections by blood and marriage, friendship and identification with the neighbourhood locality, and common membership in different kinds of association, including church groups, recreational groups, study groups and others. Without social capital, groups would be comprised of strangers, and would be unable to count on each other to observe rules, to contribute payments and to repay loans. This kind of webbing of trust and expectation helps to absorb stress within groups, which could otherwise cause them to fall apart.

Social capital resources are characteristically deepest in old undisturbed neighbourhoods where people have grown up together. Areas near the cities, which have relatively high incomes are also likely to have a demographically turbulent, highly mobile population which has fewer interpersonal links and a higher share of relative strangers. In these areas, groups can still operate, but social capital stocks are low, and more than social capital alone may be needed to make them reliable and successful.

Leadership conditions

In this light, both the characteristics of the group as an institution and the characteristics and capability of the group leader as an individual are closely involved in maintaining group cohesion. In this vital respect, the leader whose role is most central is not necessarily the publicly designated chair of the savings and credit group.

It is widely understood that in addition to membership commitment, effective institutional leadership appears as a key factor. However, in defiance of the literature on how groups should choose leaders for greatest representation and effectiveness (cf Uphoff 1992, 1994), the groups in the DGRV study sample did not characteristically choose leaders at all. Instead, leadership roles were attributed more or less automatically to the group's founding members, who usually acted to start the group on their own, and were therefore identified before the group took shape. This held true even in situations where the group organizer declines to take on any formal office. The understood role of the original group founder – as distinct from the designated office-holders – seems to be a critical but largely unrecognized factor in the success or failure of rural informal savings and credit groups.

Groups continued to look to organizers to keep the groups they recruited operating smoothly, and responsibility defaulted to the organizer when the formal office bearers were not performing effectively. Organizers in many cases appeared to be less educated people with vision and strong motivation rather than educated and technically qualified people, and several organizers went out of their way to bring educated people into their groups and/or to put forward educated office-bearers. However, office-holders chosen for their education sometimes took advantage of their qualifications to skim off funds or award themselves interest-free loans, so that group decisions based on objective qualifications for office holders were not necessarily effective.

However, it also appears that most group organizers were motivated to a considerable extent by a genuine desire to be of service as well as by their own family and personal needs, and most appeared to take their service role seriously. From case material it looks as if most of the KwaZulu Natal group organizers did not expect personal benefits but were satisfied with a position of influence and respect. However, in Mpumalanga some organizers seem to have expected that money earned by the group as interest would go to them personally, raising the issue of management compensation.

Putting these factors together, the case material suggests that successful groups can work in one of two ways, depending on the background of the area and the characteristics and goals of the participants:

1 *Groups based on social capital:* In a stable community or a stable institutional context, groups can often hold together by accumulating several layers of social capital linkages, which hold group members in a tight web of relations that is not easily broken even by severe stresses. The most effective connections appear to be extended kinship combined with close, long-term identification with the larger neighbourhood. These bases of association often seem to come together with co-membership in other groups that imply relations of mutualism and respect: either church groups or business associations appear in the data in this connection. In this kind of context groups may feel unable to drop misperforming members, and instead work to exert pressure on the members suspected of malpractices to change their behaviour and meet expectations. In a tightly knit community, both leaders and members may have too much tied up in their community standing to be able to defy public pressure and accept being looked down on.

2 *Groups based on performance and leadership:* In areas with an unstable and mobile population, where social capital linkages may be relatively shallow, groups

appear to depend closely on their leaderships and particularly on the role of the group organizer, whether or not the organizer holds an office. These groups appear to mobilize around specific individuals, drawing in a relatively indirect way on the personal networks as well as on the personal qualities and management ability of the key leaders. More stress then comes onto the leadership's executive responsibility to maintain the group in working order, to take tough action if necessary, and to ensure that potentially disruptive misunderstandings and failures to meet obligations do not develop into internal splits. Other linkages between group members then help to maintain group coherence but may not be the central mechanism for group continuation. Characteristically, these groups appear to be more willing to expel members who do not conform to rules and expectations, and seem to view membership in a more conditional, performance-related light. Their expectations around goals and objectives are also likely to be more individualistic and less closely tied to mutual aid and a contribution to the community, though these motivations seem to present in nearly all groups at a higher or lower level.

Depending on the characteristics of the area where the groups are operating, savings and credit groups will either rely mainly on social capital, or they will rely at least as heavily on individual leadership. It seems to be the latter type of group which has progressed further toward basing group cohesion on formal rules and procedures. However, it seems clear from the case material, as well as from the abundance of literature dealing with the problems of savings and credit groups, that rules are not enough to make groups work and that other kinds of connectivity are also necessary.

The dynamics of failure: what are the risk factors?

Case data suggests that rotating savings groups are likely to be easier to manage and control than accumulating savings and lending groups, assuming that the bases of cohesion are roughly equivalent. A central reason is the difficulties involved with bookkeeping for accumulating savings and lending groups, which are multiplied when the group begins to accept variable contributions as well as interest on continuing loans of different sizes. Results suggest that the problems with transparent administration of complicated interest transactions for savings and lending groups – which see interest as the key reason for their existence - is probably the central problem creating tensions within the newer kinds of income-generating lending groups.

The specific factors which put savings and credit groups at risk of non-compliance and break-up are usually thought to be *loan default and failure to repay,* and *risk of management malpractice or embezzlement.* Another important factor is group motivation to save. The results from the DGRV study suggest that loan default is not always as serious a problem as it is often thought to be. On the other hand, management malpractice is an increasingly serious risk as groups take on more complex functions, and motivation to save cannot simply be assumed.

Default risk

Although failure to repay loans is a serious problem and is mentioned in many of the case histories, it appears as a major threat to the group only in a small number of cases. None of the failed groups contacted fell apart because of loan defaults resulting in insolvency. Likewise, few of the existing groups seemed to be in danger from this side.

Nearly all groups now appear to require outside borrowers to receive loans only through group members, who serve as the borrowers of record and have to pay back the amount if the outside borrower fails to pay it. Many groups also limit loans to amounts smaller than the member's saved assets already invested with the group. These mechanisms appear to be fairly effective.

Interest revenue and record keeping

Very few accumulating savings and lending groups seem to have worked past the problem of making a transparent and mutually acceptable split of interest revenue. Most groups still adhere to the principle of an annual equal division, which works well in so far as groups maintain a set of rules that provide for equal amounts paid in and also borrowed out for on-lending. However, a number of groups are now yielding to the pressure from members to accept different amounts paid in, and also carry on their books a number of loans of different sizes and durations, and in a few cases even with different interest rates. That is, they are taking on a complicated caseload resembling that of a formal bank, which in itself creates a serious challenge to the group's and the members' bookkeeping capability, and builds in space for corrupt practice by group administration. The problem with interest division follows. Once differential pay-ins are established, pressure mounts for a proportional shareout, with individuals who have paid in more claiming a greater share of the payout.

One of the pure lending groups in KwaZulu Natal adopted the principle of membership through shares as a way of managing the problem. In a share system, individual members pay in and receive payouts in terms of the number of shares they have taken, allowing record keeping to work in terms of standard amounts. This fairly effective solution is not necessarily gaining ground, perhaps because - except for elite groups and groups aimed at commercial lending only - it conflicts with the principles of mutualism and equality which remain very central to how rural savings and credit groups think of their identity. That is, groups may look for ways to generate income, but do not want to be seen privileging the better off members or adopting an entirely profit-directed ethic. Conflicting expectations are created when groups try to simultaneously generate maximum income and also benefit all members equally. In order to compete for savings and lending business, groups are under pressure to depart from their mutualist ethic and customize their services.

Motivation to save

Several accounts draw attention to the importance of recruiting a group membership that is strongly motivated as well as strongly connected and well led. Results suggest that the prime motivating factor for determined saving is the need to provide for the welfare and education of young children. This factor appears to be confirmed by the age distribution of group members, which closely coincides with the child-rearing years for both men and women. However, some of the older group members in KwaZulu Natal were saving to buy tractors in the expectation of making a profit from providing tractor services, and some of the younger male group members were saving for their weddings.

It would appear that people approaching retirement, when they experience the shock of sharply reduced income while perhaps no longer having to channel a large part of their resources to their own children, may be likely to drop out of the category of highly motivated savers. People on pension face a more advanced stage of the same process, in which they may often need money for their own support, but do not need to accumulate resources for the major enterprise of child-raising and education unless they have responsibility for unsupported grandchildren, as many do.

Defining the risk factors

Overall, these cases of groups that failed draw attention to a series of risk factors, many of which connect bookkeeping problems with leadership issues. Although the main problems for informal finance groups are often thought to be embezzlement and loan defaults, the results suggest that these may not be the only or even the most important issues. Taking both recruitment and performance factors together, risk factors identified include:

- Weak group structure, with few internal connections between members
- High reliance on friendship connections alone in recruiting the group
- Becoming overextended through expanding group membership to unmanageable size
- Weak or ineffective leadership, leading to unresolved grievances and disputes

- High proportion of members without young children
- High proportion of members approaching retirement age
- High proportion of members on pension
- High proportion of illiterate members

- Unrealistically high contribution requirements against members' income levels
- Requirement for unequal pay-ins and equal payouts, OR
- Absence of mechanisms for equitable division of interest revenue

- Absence of written constitution
- Lack of access to group rules and/or constitutions
- Lack of access to records

- Complacency and trusting management to control funds on members' behalf
- Technical failures of record keeping, especially in relation to interest revenue
- Lack of transparency and resistance to questions on the part of management
- Culture of impunity, in accepting that leaders and managers have some right to enrich themselves
- Lack of participation and indifference on the part of members

2.3 Cases of group failure

This section focuses on the groups that failed, and tries to identify some of the factors and processes which raise a red flag and put groups at risk. Nearly all the failed groups recorded in North West, Free State and Northern Province collapsed when members were unable or unwilling to comply with the operating requirements of contributing and repaying on time. However, half the failed groups in KwaZulu Natal fell apart when their designated leaders were caught in deliberate mismanagement, in relation to having taken out substantial amounts of money to which they were not entitled. Two other KwaZulu Natal groups had managed to weather this kind of event, and had got their operations back on track when group pressure on the delinquent leaders was strong enough to force repayment. One of the 13 Mpumalanga groups failed when its organizer, a government official, disappeared suddenly after having seemingly been in a position to take out considerable amounts in unrecorded interest payments. The Mpumalanga case histories also seem to offer internal evidence that appropriation of unrecorded interest may have been fairly common. In the Mpumalanga cases, unlike those in KwaZulu Natal, there was no clear public assumption that interest revenues were to be divided up among group members, and the actual disposition of interest – as opposed to actual contributions and loan principal - often seems to have been mysterious. The problems experienced by these groups were procedural as well as structural, but also relate back to the dark side of social capital in contributing toward an unquestioning respect for group management, which allowed thefts to take place.

2.4 Discussion

The case study material confirms the rich fabric of informal arrangements in South Africa and the changes that occur in these groups. Groups are becoming more business orientated and definite changes in group objectives are observed, especially in KwaZulu Natal and Mpumalanga.

Catherine just expand this a little bit

3. More formalised membership based financial institutions.

3.1 Introduction

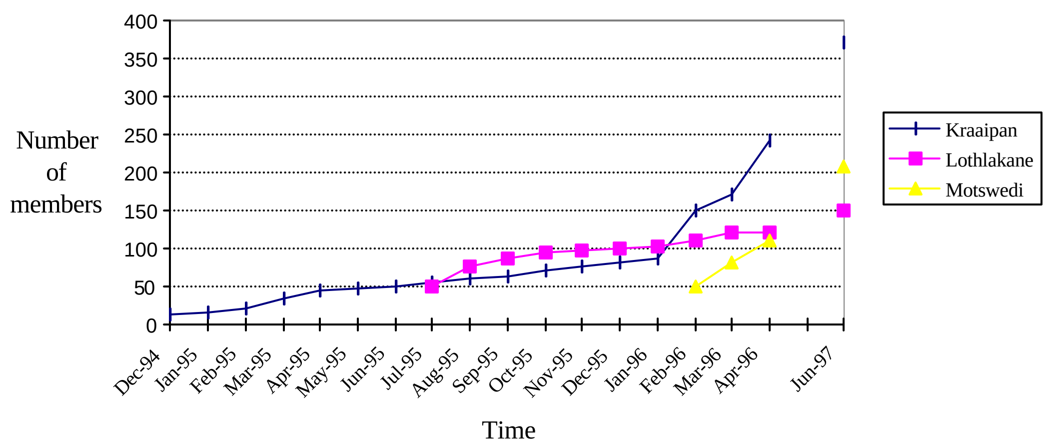
One example of a more formalised membership based financial institution is the so-called village bank. These are less formalised (in terms of legislated and registered) than commercial banks and more formalised than the ROSCA and its variants. One example in South Africa is the village banks (Jazayeri, 1995; Schoeman, 1996) started in the Northwest province of South Africa and now spreading across the country supported by several institutions. Village banks are organised and owned by members. Their objectives are to provide appropriate financial services at the village level, and to link this service with the commercial banking sector. This is a savings first approach that includes credit services only when the volume of savings allows it. It is further operated on the basis that the savings of each member come in two forms, shares and normal savings. During the period in which loans are not provided the only source of capital is the savings and depositing these savings at the nearest commercial bank branch generates income.

The village bank idea is now firmly entrenched in the South African financial landscape. In this section we discuss the first village banks and the more recent mushrooming of the concept across the country

3.2 The original village banks in South Africa

The Motswedi Village Bank in the NorthWest Province started in January 1996 and has accumulated deposits in excess of R200 000 from 200 members within a year from its inception (Coetzee, 1997). Today it has mobilised more than R1 million in savings (Doni, 2001). It is 75 metres from a Post Office branch that provides saving facilities. It is 35 kilometres (that is equal to R15 for a round trip by taxi and R10 per bus) from the nearest commercial bank branch. This village bank is situated in an area where a large proportion of the people lost their savings in a pyramid scheme in the same period in which the bank was formed. Against a range of odds it is succeeding. Its members cover all the economic sectors in the area, including farming (Coetzee, 1997). Unfortunately information could not be obtained with respect to the proportional savings in the bank according to member type. It is expected that the pensioners would have quite an influence on the bank due to their consistent access to cash funds. Since the start of the three functioning village banks in the NorthWest Province rapid growth in membership has been experienced. Figure 1 indicates growth in membership for the 30-month period since the inception of the first village bank.

Figure 1: Growth in membership at the three village banks in North-West Province (Schoeman, 1996; Coetzee, 1997; Vink et al, 1997)



After the initial success of the first few village banks the organisation that started them, the Financial Services Association (FSA) increased its focus and with funds obtained from the National Department of Welfare facilitated the creation of many more village banks. In addition, Finasol, an organisation supported by the sugar industry and a foreign donor also focused their attention of the facilitation of the creation of more village banks. In the period 1997 to 2001 nearly 56 additional village banks were registered with the Registrar of Co-ops.

Soon after the formation of the first few village banks the Registrar of Banks received applications to exempt village banks from the Banks Act. This exemption has to do with the registration and capitalisation requirements of institutions that accept deposits from the general public. After considering several submissions the registrar issued an exemption notice for village banks (or financial service associations). It requires a village bank to register as a co-operative and fulfil certain requirements.

Village banks mobilise savings of members and deposit these savings at a link bank (a commercial bank branch). They charge service fees for each transaction. Staff members who earn a basic salary and receive increases in relation to the growth in membership administrate them. A strong incentive therefore exists for a staff member to market the concept of the village bank. Once a village bank has mobilised savings for a while they may decide to provide credit to members.

3.3 Conclusion

Spio (1995) illustrated the relatively high propensities to save of people in the rural areas of South Africa and his work confirmed the earlier findings by other researchers (Coetzee, 1988; Fenyes, 1982). The high savings propensity illustrates the potential for village bank approaches. The historic prototype, the stokvel, mobilises R83 million per month in the urban areas of South Africa (Markinor, 1993). The existence of these informal approaches and high propensities to save provide a fertile area for savings based decentralised approaches.

Cross (1997) shows how families cope when being turned away from commercial banks, how credit works to secure building loans without an employer guarantee, how households take part in savings and loan clubs and the risks they run when dealing with money lenders. The combination of these stories depicts an opportunity for intermediation between surplus households and deficit households in the form of a co-operative financial venture. The issue at stake is the facilitation needed to move from informal arrangements to more formalised relationships and possible links with the formal sector institutions. The commercial banks willing to forge these links with decentralised systems are called linkage banks. Numerous advantages exist for linkage banks. They mobilise savings at a very low transaction cost compared to interacting with each member of the village bank. If they provide funds for on-lending to members they make use of the information and monitoring arrangements within the village banks. However, a very careful approach should be followed not to provide on-lending funds at volumes that disturb the balance between member funds and external fund. This may have detrimental effects on control and management of the village bank.

4. Formalised approaches: The Mutual Banks Act in South Africa

The Mutual Banks Act of 1993 was an attempt to add depth to South Africa's financial system by creating a banking category that had less stringent capital adequacy prerequisites but similar risk management requirements. It also attempted to involve communities in banking by including a provision for local boards for branches of mutual banks, the organisation of which must be mutually based rather than equity-based. The primary share capital of mutual banks is in the form of permanent interest-bearing shares that are not redeemable but may be transferred at the discretion of the board of directors. It is expected that over time the members of the community in which a mutual bank operates will acquire shares in the financial institution. The Act provides that a mutual bank may accept deposits and grant loans, advances or other credit. The prudential requirements for mutual banks are similar to equity banks that fall under th

- meet capital adequacy requirements by maintaining unimpaired reserve funds in the amount of at least R10 million or up to eight percent of its risk exposures;
- maintain a minimum reserve balance with the reserve bank equal to five percent of its short-term liabilities;
- avoid portfolio concentrations in excess of a certain percentage without making a specific report to the Registrar; and
- give detailed monthly and quarterly returns, showing its various risk exposures and the manner in which it complies with capital adequacy and liquidity requirements.

The Act provides that the Registrar may require applicants for mutual banks to establish a relationship with an equity bank (referred to as a "guardian bank") to assist the applicant with technological infrastructure, management, and advice. A commercial bank can serve in a capacity similar to the guardian bank arrangement prescribed in the mutual bank legislation.

Mutual Banks have not effectively increased access to financial services in South Africa. Very few institutions opted for this rout. One of the first, the Community Bank, failed dismally after a very short period. The capital requirements effectively ensure that very few small membership based institutions can acquire a licence. The capital and reporting requirements are considered to be onerous. The most basic principle is that the benefits of formalisation should exceed the costs of reporting and supervising for practitioners, the Registrar, and the target market. It is also important that formalisation does not alienate the customer base. From the perspective of commercial banks, this category of financial institution may be an opportunity to improve their relationship with disadvantaged communities and consequently they may consider creating microbank subsidiaries.

The Mutual Bank concept is however sound. It emphasised membership based approaches that are so successfully applied in the more informal financial market. Earlier group based formalised institutions in South Africa, the erstwhile building societies, succeeded in mobilising savings and financing asset accumulation in the form of home ownership for thousands of South Africans. The challenge is to find the right mix of a system that answers to the requirements of development, the regulator and the constituency it serves. As the Mutal Banks Act stands at the moment, it does not answer to these requirements.

5. Concluding remarks

Community banks exist and are active on a continuum from informal to formal institutions. The informal institutions are evolving through several changes and the original ROSCA is merely one variant. The semi-formal institution in the format of the village bank is experiencing a growth spurt due to financed and focused support of the facilitation of the formation of new banks. One should however ensure that savings first institutions take their time towards maturity and the extension of credit. Formal community banks exist, however the legal structure is still not adequately adjusted to ensure a good uptake of registration of these institutions. It is clear that we still need the formal system in South Africa to finally accept the existence of membership based financial institutions in South Africa. They also need to be convinced that these institutions function well and make money!

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