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THE EFFICIENCY AND OUT
INSTITUTIONS IN SOUTH AFRI

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The current literature on the provision of rural financial
financial institutions as a means of ensuring effective pro
various measures that have been used to measure both t
outreach of rural financial institutions, as two key areas
achieved. The results of some preliminary investigations i

1. INTRODUCTION

One important characteristic of rural financial markets in South Africa is that investment flows into rural areas are largely influenced by state institutions, while the mobilisation of the savings of rural people and the provision of transmission services is largely done by private sector institutions such as the commercial banks. In each of these cases there are important exceptions. With investment, private sector involvement is through substantial inflows of remittances to the rural poor, and the large investment by commercial banks and agricultural co-operatives in the commercial farming sector. However, remittances are seldom used for investment in farm production, although they are sometimes used for investment in rural non-farm enterprises. On the other side of the balance sheet, the state plays a substantial role in the mobilisation of savings and in providing transmission services to rural people through the Post Office and PostBank.

Despite these exceptions, the state remains an important actor in rural financial markets. However, state institutions have in the past largely concentrated on providing credit to farmers. This supply-driven approach leaves rural financial institutions vulnerable to failure, as they are unable to pool risk across sectors of the rural economy and they are able to provide credit only to farmers who can in any case borrow from commercial banks. In the former homelands this credit-first approach has had predictable consequences, as the rural poor have a greater need for savings and transmission facilities than for credit, which many are unable to service. In this way rural financial institutions have contributed to dualism in the agricultural economy. The net result is that rural financial institutions have either 'crowded-out' the private sector, or have become dependent on the state for subsidies.

A further weakness of the system is that these parastatal institutions are not subject to the same degree or level of regulation as are private sector financial institutions. This is worrying, as they represent a substantial portion of the financial sector in rural areas. It is this issue that is addressed in this paper, namely the dependence of such institutions on state subsidies in the absence of a sound regulatory framework. In the course of its investigations, the Strauss Commission was able to access international best-practice expertise on the monitoring and regulation of rural financial institutions. The purpose of this paper is to survey the work on

Table 1: Indicators for measuring ef

Outreach indicators	**Productivit**
Number of branches	% loans in a
First year of operation	Loans/staff
Non-financial services	Volume len
Deposit accounts	Loans/loan
Average deposit size	Volume len
Number loans outstanding	
Average loan size	
Agricultural loans outstanding	
Average agric. loan size	

Source: Strauss Commission report

account of the total cost of operating the ins including the actual value of all subsidies re Subsidies are calculated both in economic and f terms, making it a somewhat unique measuremer

The SDI assists in placing the total subsidies r by an institution in the context of its activity l represented by the subsidy received measured the interest earned on loans extended to the t clientele. It can also be used to measure dependence over time, therefore as a planni monitoring tool. A further application is to comp subsidy dependence of institutions providing services to the same clientele.

The SDI measures the percentage increase requ the average lending rate to compensate f elimination of all subsidies in a given year keeping return on equity equal to the market re deposit rate. The index is based on the assumpt an increase in the lending rate is the only chang made to compensate for the loss of subsidies.

The annual subsidy received by a development institution is defined as:

$$S = A (m-c) + \{(E \times m) - P\} + K$$

where:

S = the annual subsidy received t institution;

A = the concessional borrowed outstanding (annual average);

m = interest rate the institution would borrowed funds if access to conce funds were eliminated (generally, reference deposit interest rates, adju reserve requirements and the c mobilising and servicing these depo

c = weighted average annual concessior of interest actually paid by the ins on its average concessional borrowe outstanding;

E = average annual equity;

P = reported annual profit before tax (ad when necessary, for loan loss provis inflation, etc.); and

Table 2: Sensitivity of the SDI to critical parameters

Parameter changed ® → SDI component affected ↓	Concessional rate (C) ↑	Mar inte rate ↑
Numerator of the SDI (real subsidies, S)	↔	↑
Denominator of the SDI (interest earned on loans, LPi)	↔	←
A (m - c)	↓	↑
E * m	↔	↑
Gross subsidies	↓	↑
Profit (p)	↓	←
SDI	↔	↑

Notes: (*) ↑ = increase, ↓ = decrease, and ↔ = no c with respect to key variables do not reflec the E*m component of the SDI formula changes for some derivatives, but only relatively low.

(**) Subject to a situation in which the averag than the market rate (m), which indicates

Source: Yaron, 1995.

is determined through political decision making processes. The ratio can therefore not be relied on as a full measure of financial performance. When borrowing costs are determined by external forces, the 'real' return on assets is distorted.

The provision of non-financial services by state-supported financial institutions requires special attention when measuring the SDI. Non-financial services are often rendered free of charge as part of providing other financial services. Such institutions often lack cost accounting systems capable of reflecting the costs incurred. The inability to achieve financial viability is also often blamed on the need to provide services. The economic value of free services is difficult to assess. On the other hand, costs associated with non-financial services can be readily ascertained. This can also assist in improving efficiency, refocusing resources and improving the management of rural financial institutions.

The SDI method has the following advantages:

- It reveals whether or not an institution is financially self-sustaining.
- If not self-sustaining, the cost of keeping it afloat is quantified.
- Values for the SDI calculation can be compared across institutions, especially where they provide services to a similar clientele.
- Past trends and future projections can be calculated, providing management and policy makers with a valuable planning and evaluation indicator.

Table 3: The effectiveness of rural fina

	N b
Agricultural Credit Board	0
Land Bank	2
Agriwane	4
KwaZulu Finance Corporation	4
Ciskei Agricultural Bank	2
Transkei Agricultural Bank	5
Agribank (Northwest Province)	1
Gazankulu Development Corp.	2
KwaNdebele National Development Corp.	3
KwaNdebele Agricultural Company	1
KwaNdebele Utility Company	1
Northwest Development Corporation	1
Social Enterprise Fund	4
Get Ahead Foundation	1
Rural Finance Facility (Micro loans)	9
Village Banks	2
Financial Aid Fund	2

Notes:
* By number of loans. Remainin (i.e. missing one instalment) ov
** For the purpose of these calcul as: Average cost of funds for ba the administration and risk ma this rate has been increased to
*** Does not include other officers
**** When grant funds received by 28% becomes positive. To be income earned on the loan por included.
***** For micro loans only

commercial farmers. The latter is also true of the which in addition has a dismal SDI.

The remaining institutions supply loan services to mostly smallholder, farmers. Clearly the KFC, an lesser extent the Gazankulu Development Corpo (now part of the development corporation o Northern Province) differ from the other institu through the size of their branch networks.

- None of the state institutions, with the imp exception of KFC and the Ciskei Agricu Bank, mobilise savings. However, CA inaccessible to most rural people, as it has onl branches. Where other institutions (e.g. the Bank) have a savings portfolio, the size of acc is quite large, indicating a bias to institutional rather than individual accounts.

- Loans outstanding are quite worrisome for m the institutions. Default rates of more than 5- are unsustainable, and make savings mobili extremely risky.

- Outreach measures are worrisome except i case of KFC. These measures are linked wit profitability and thus sustainability of institution partly through the efficiency of staff, as measured by the loans/staff International experience shows that a loan o could be expected to handle approximately clients.

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