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BANKING SECTOR REFORM AND FINANCIAL REGULATION: IT'S EFFECTS ON ACCESS TO FINANCIAL SERVICES BY LOW INCOME HOUSEHOLDS IN ZAMBIA

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Banking Sector Reform and Financial Regulation: It's Effects on Access to Financial Services by low Income Households in Zambia

Abstract

The change in government in 1991 brought about radical economic reform, from state control to an economy led by private sector development. The reforms included decentralisation, privatisation and liberalisation of the financial sector. Liberalisation initially led to the proliferation of financial institutions in the financial sector. However, it also led to a number of bank failures, resulting in the closure of nine commercial banks since 1995. Access to financial services by the majority of Zambian's was further constrained by the closure of unprofitable rural branches by commercial banks, the raising of minimum account balances and the introduction of bank charges, as well as the closure of a number of Government owned financial institutions specifically set up to address the needs of low income households and the rural poor. These developments have resulted in a financial system that focuses on meeting the needs of the corporate sector and working class elite. This paper traces how the Government's liberalisation policy for the financial sector has resulted in decreased access to financial services by low income households and the rural poor.

Abbreviations and acronyms

AMIZ	Association of Microfinance Institutions of Zambia
BBZ	Barclays Bank Zambia Plc
BFSA	Banking and Financial Services Act
BOZ	Bank of Zambia
CGAP	Consultative Group to Assist the Poorest
CSO	Central Statistics Office
FB	Finance Bank Zambia Limited
IMF	International Monetary Fund
MFIs	Microfinance institutions
MOF	Ministry of Finance
Natsave	National Savings and Credit Bank
NGOs	Non-governmental organisations
PRSP	Poverty Reduction Strategy Paper
SADC	Southern African Development Community
SCB	Standard Chartered Bank Plc
SCC	Swedish Cooperative Centre
ZCCM	Zambia Consolidated Copper Mines
ZNCB	Zambia National Commercial Bank

INTRODUCTION

Zambia, which until two decades ago was one of the most prosperous countries in sub-Saharan Africa, now ranks as one of the least developed countries in the world. It has a total population of approximately 10.3 million people (CSO, 2003). According to the 2000 Census, 64 per cent of the population is below the age of sixteen. The average population density ranges from 64 persons per square kilometre in the capital, Lusaka to 5 persons in the North Western Province. Overall, the population density in Zambia is relatively low with the national average at 13.1 persons per square kilometre (CSO, 2003).

The poor performance of Zambia's economy over the past thirty years as evidenced by the declining per capita GDP that is now only a fraction of the level it was at independence, has had a significant impact on the level of poverty in the country. Poverty has increased not only in income terms but in all major non-income dimensions as well (MOF, 2002). An estimated 86 per cent of the population is living in poverty, of which approximately 72 per cent is living on less than a dollar a day (World Bank, 2001).

The situation has been exacerbated by the combined effects of stabilisation, subsidy removal and paratastatal restructuring undertaken as part of the radical economic reforms that the Government initiated in the early 1990s. The reforms resulted in the shrinking of the formal employment sector. Many formal sector jobs have been lost (MOF, 2002). Although some new jobs have been created, they have not kept pace with the rate of job losses. Formal sector employment, which has not exceeded 20 per cent of the labour force for a number of years, declined to 11 per cent from 12 per cent between 1996 and 1999. However, unemployment also came down from 18.2 per cent to 9.5 per cent of the labour force implying an increase in informal sector employment. This growth however has not contributed to a reduction in poverty which has continued to increase. This is because the average wage in informal sector employment does not cover livelihood demands (MOF, 2002, p.19).

The informal sector in Zambia, as in many other developing countries, remains the most dynamic in terms of employment generation and currently accounts for more than 70 per cent of the Zambian labour force (MOF, 2002, p.43). It is likely, therefore, that the majority of the population will continue to depend on the informal sector for their livelihood in the foreseeable future. Thus polices to support this sector, including amongst other things, the

development of specialised financial institutions such as microfinance institutions (MFIs), need to be put in place (Brownbridge, 1997).

The reforms undertaken included the liberalisation of the financial sector and banking sector reform, principally through the introduction of prudential regulation and supervision. The changes initially led to the proliferation of financial institutions in the financial sector. However, it also led to a number of bank failures. The restructuring of parastatals undertaken as part of the reforms resulted in the closure of Government owned financial institutions that had been specifically set up to cater for the needs of small, medium and micro enterprises as well as low income households and the rural poor.

This paper traces the impact that the Government's liberalisation policies and banking sector reforms have had on access to financial services and is organised as follows: The next section looks at Zambia's economic performance since the early 1990s and financial liberalisation. In section 3, the paper provides an overview of the Zambian financial sector, followed by a description of Government led initiatives in the provision of financial services in section 4. Section 5 outlines the structure of the financial sector. The banking sector reform measures undertaken are then discussed in section 6, followed by an assessment of the impact reforms have had on the provision of financial services in section 7. The analysis focuses on subsequent developments in the financial sector and more specifically the impact it has had on the number of branches in operation, especially in the rural areas. Lastly, the paper concludes by noting that without a more proactive stance by Government to provide financial services to low income households and the rural poor, the private sector is unlikely to take up the challenge and where it has, the impact to date has been negligible.

FINANCIAL LIBERALISATION

From 1980 to 1990 the country's economic growth rate was the second lowest in the Southern African Development Community (SADC) after Mozambique. From 1990 to 1999, it had the lowest average annual growth rate in the SADC region at 1 per cent. This was also below the sub-Saharan Africa rate of 2.4 per cent. As a result, per capita GNP has declined over the years since independence (MOF, 2002)[1]. Zambia is predominantly dependent on copper and cobalt mining with copper accounting for approximately 80 per cent of the country's export earnings. However, export earnings have declined over the years with the fall in copper prices.

The change in government in 1991 brought about radical economic reform, from state control to an economy led by private sector development[2]. The reforms included decentralisation, privatisation and liberalisation of the financial market (Brownbridge, 1996a). Financial sector reforms had two main components. The first component included the liberalisation of interest rates and foreign exchange markets in 1992 and 1993. The second component involved reforms to the system of prudential regulation and supervision of financial institutions, and included the enactment of new banking laws in 1994 (Brownbridge, 1996a).

Borrowing and lending rates were decontrolled in October 1992 and the Treasury Bill was introduced as a less inflationary form of deficit financing (McCulloch, et al., 2000; Maimbo, 2001; Chiumya, 1999; Brownbridge, 1996b). Through various measures taken, such as the introduction of a "cash-budgeting system" in which government payments could only be made if cash was available, the liberalisation of commercial banking loan rates, and an increase in the reserve ratio inflation was reduced substantially. Real interest rates rose dramatically, from largely negative rates at the end of 1992 to substantial positive rates by the end of 1993. Prior to this, interest rates had been negative for most of the time since independence (Kani, 1998). Though not as high as in the early 1990s in which inflation was in excess of 190 per cent, inflation is still relatively high at 22.6 per cent (BOZ, 2003) and remains a problem in attaining macroeconomic stability. This has been compounded by the high real rates of interest which make borrowing unaffordable (Mbanacele, 2000; MOF, 2002).

Foreign exchange controls were also removed around the same time. The exchange rate and the allocation of foreign exchange were permitted to be market determined. By March 1993 most foreign exchange controls on current transactions had been removed and in February 1994 the capital account of the foreign payment systems was liberalised (McCulloch, et al., 2000; Maimbo 2001). In 1995, the Bank of Zambia allowed commercial banks to hold foreign currency deposits. In 1996 the final phase of liberalisation of the foreign exchange market was implemented with Zambia Consolidated Copper Mines (ZCCM) being allowed to retain all its foreign currency earnings and supply foreign exchange to the market directly (Kani, 1996)[3].

Figure 1: Inflation, interest rates and real exchange rates over the 1990s
Source: IMF (1999)

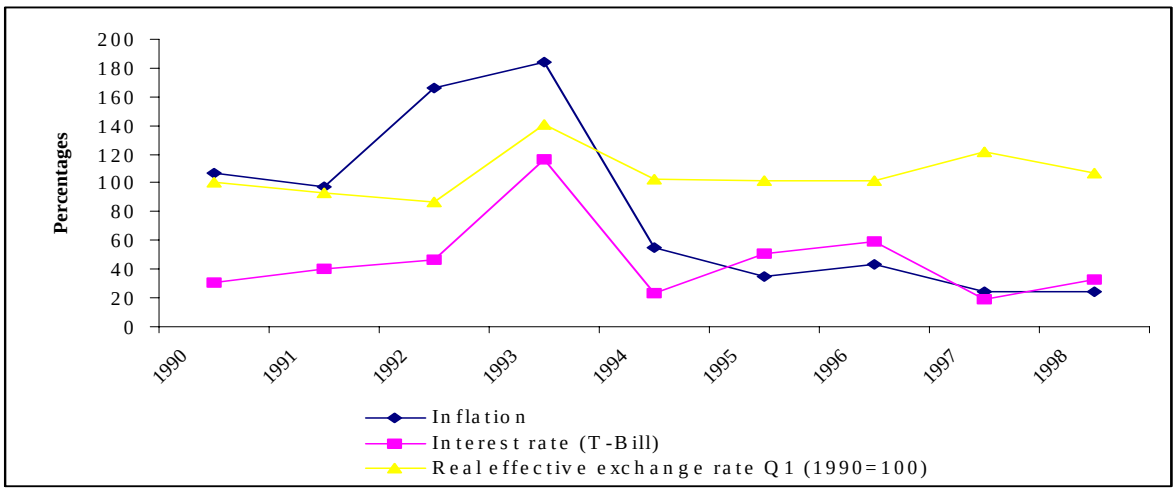
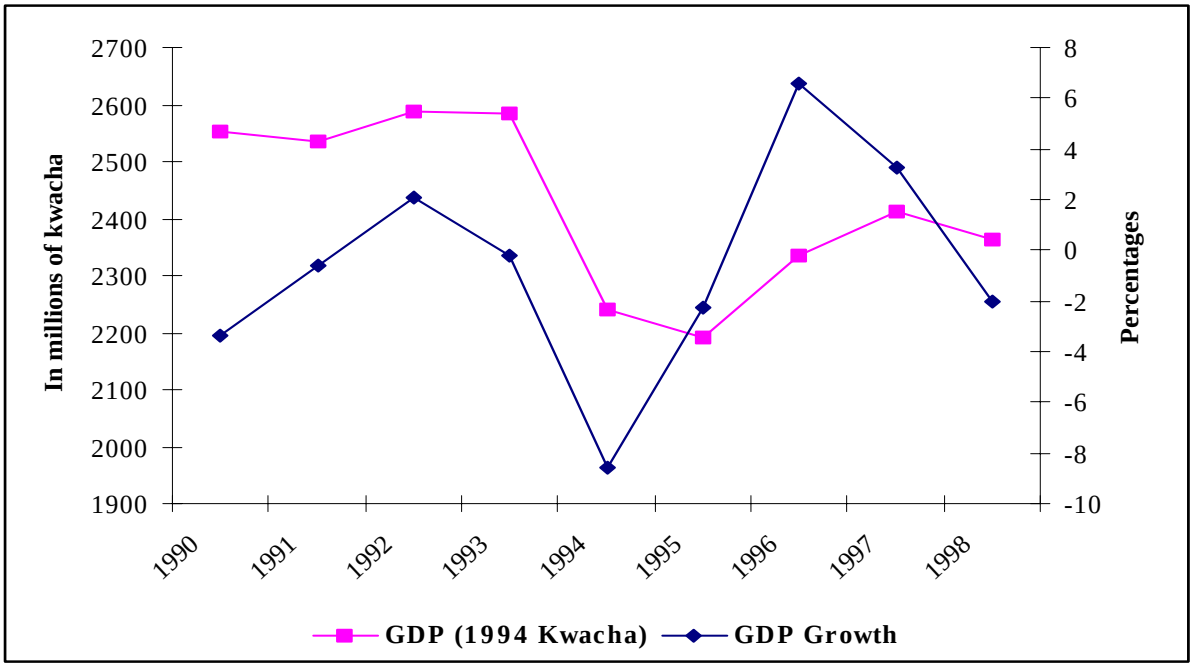


Figure 2: GDP and GDP growth over the 1990s



Source: IMF (1999)

In addition to the stabilisation program described above, the government implemented reforms in agricultural marketing, a large privatisation program, sweeping trade policy reforms and public sector reform (McCulloch, et al., 2000). The public sector reform program was aimed at reducing the civil service and improving its competence and professionalism (Kani, 1996). Public enterprises that contributed to the fiscal drain on state

revenue were closed or privatised (MOF, 2002). Price controls were lifted and agricultural input and output markets opened up to private sector entry. Capital controls were totally removed. Import controls were also abolished with a few exceptions mainly for dangerous materials (MOF, 2002; Maimbo, 2001). However, the debt stock of over US$6.5 billion remains a major constraint to growth (MOF, 2003, p. 4). Zambia's annual expenditure on debt servicing still exceeds its total expenditure on social services (MOF, 2002).

OVERVIEW OF THE ZAMBIAN FINANCIAL SECTOR

Prior to the economic reforms undertaken in the early 1990s, the financial sector was dominated by foreign owned banks and state owned financial institutions set up by the Government for various purposes, including the provision of concessional and long term finance to priority sectors. Three of the major banks, Barclays Bank, Standard Chartered Bank and ANZ Grindlays Bank (now Stanbic Bank), were established in the colonial era and primarily served the interests of foreign corporate entities (Brownbridge, 1996b). To redress this perceived imbalance the government established a number of financial institutions to serve the interests of the local population in need of small and medium scale financial services (Maimbo, 2001).

This it did through the nationalisation of foreign owned financial institutions, the establishment of Government owned banks and development financial institutions, administrative controls over interest rates and to a limited extent, credit allocation (Brownbridge, 1996b, p.2). However, Government attempts to nationalise the foreign banks failed as the banks threatened to withdraw their expatriate management and Government did not have the expertise to manage without them (Brownbridge, 1996b). Consequently, Government intervention was more prevalent in the non-bank financial sector of the economy.

Financial institutions set up by the Government included the National Savings and Credit Bank (Natsave), Zambia National Commercial Bank (ZNCB), Zambia National Building Society (ZNBS), Lima Bank and the Cooperative Bank. As with other sectors of the economy, Government involvement in the financial sector resulted in an inefficient and non-competitive market. Like other developing countries at the time, the Government focused on protecting the real sector with the financial sector only playing a subsidiary role in the belief that the real sector could be supported by direct involvement in the financial sector (Maimbo, 2001).

GOVERNMENT LED INITIATIVES

Up till the 1990s, Government took the lead in providing micro, small and medium scale financial services (Maimbo and Mavrotas, 2003). Prior to independence in 1964, credit was provided to the small-scale farmers through the then Land Bank. At independence, the Land Bank was replaced with the Credit Organisation of Zambia (COZ). Due to poor repayment rates resulting in insolvency the COZ went under and was replaced by the Agricultural Finance Company Limited (AFC) and the Rural Development Corporation (RDC). This was followed by the formation of the Zambia Agricultural Development Bank (ZADB) which catered for the commercial farmers (Mbanacele, 2000).

In 1987, the two government institutions, the Agricultural Finance Company and the Zambia Agricultural Development Bank were merged to create Lima Bank (Brownbridge, 1996b). Like its predecessors, its main purpose was to provide small scale farmers with loans for the purchase of inputs as well as act as a buying agent for agricultural produce from the farmers. However, the bank experienced problems from the start. It had inherited a large non-performing loan portfolio and had a negative capital position. The absence of an efficient collection system, low recovery rates and erratic funding by the Government resulted in the bank's poor performance. Although it obtained cheap funds from the Ministry of Finance, it was forced to lend at rates which were too low to sustain its operations (Maimbo, 2000).

In 1991, the Cooperative Bank of Zambia was formed as a society under the Cooperatives Act and commenced operations in October 1991. However, the bank only operated for five years before it was closed in 1996 due to gross mismanagement and abuse of depositors' funds. Both Lima Bank and Cooperative Bank are now in liquidation (Maimbo and Mavrotas, 2003). All these government funded programs failed due to liquidity and sustainability problems resulting from poor loan recoveries, inadequate government funding and political interference (Mbanacele, 2000).

On the industrial side, the export guarantee scheme was set up in the early 1980s by the Government and administered through the Bank of Zambia, to encourage financial institutions to provide credit to medium, small and micro sectors of the economy. However, the scheme like many others before it did not succeed because one of the underlying reasons for commercial banks' reluctance to lend to this sector, namely the high transaction costs which could not be recovered due to the interest rate ceilings, had not been addressed

(Maimbo, 2000). Other initiatives targeted towards industrial development included the establishment of Small Industries Development Organisation (SIDO) which has since been transformed into the Small Enterprise Development Board (SEDB), Village Industry Service (VIS), and the Small Enterprise Unit (Mbanacele, 2000; Maimbo and Mavrotas, 2003).

To meet the financial service needs of the rural and poor communities on a broader scale, the Government established the National Savings and Credit Bank in 1972 through an Act of Parliament. The main objective of the bank was to mobilise savings in rural areas (Musona and Coetzee, 2001b). Conceived as a post office bank, it operated through the post office network under an agency agreement and served the interests of small savers well into the early 1990s. Due to various financial and operational problems, however, the agency agreement with the post office was terminated in 1999. It now provides services through its own branch network of 24 branches in various parts of the country.

To date, however, Natsave's performance has been dismal. Despite this, there are plans for the bank to be recapitalised and given a fresh mandate to help and develop small and medium sized enterprises and provide financial services in all districts in Zambia. The bank is expected to play an active role in stimulating economic activity among the poorer sections of the population (Maimbo, 2000). This it aims to do through the expansion in the number of its branches, sub-branches and money windows to 60 by the year 2010, expand its lending portfolio with particular emphasis on the rural community and increased levels of deposit mobilisation to support increased investment in earning assets and for the growth of small and medium scale businesses (NSCB, 2004).

The Government also set up Zambia National Commercial Bank (ZNCB) in 1969 to meet the credit needs of indigenous Zambians not being served by the foreign banks and to extend banking into the rural areas. Despite the fact that one of the objectives of ZNCB was to finance local business, the bank has been reluctant to extend credit to this sector, especially the small scale farmer which it regards as uneconomic. It has succeeded in not serving this sector as it enjoyed sufficient autonomy. In addition to establishing these financial institutions, commercial banks were required to set up a rural branch for each new urban branch established in line with the Government's policy of extending financial services into the rural areas (Brownbridge, 1996b).

Formal microfinance services in Zambia have also been provided by cooperative societies registered under the Cooperatives Societies Act (Meagher and Mwiinga, 1999). After independence, the Government embarked on the promotion of cooperatives, catering for all kinds of economic and social ventures. However, cooperatives were viewed by the Government as vehicles for general social and economic development in rural areas and not necessarily as economic institutions for fulfilling member needs. They were incorporated, therefore, in national development plans laid down by the Government and received a lot of Government and donor support. This undermined their cooperative identity and resulted in their being perceived as part of the government sector. It also resulted in a number of cooperatives being formed in many parts of the country principally to take advantage of the assistance that was available. With the change in Government in 1991, there was a change in policy with regards to cooperatives with the new Government stating that motivation and management of cooperatives stem from the needs of the community and not forced from Government. This was accompanied by the instant withdrawal of preferential treatment and the subsequent lack of Government support contributing to the collapse of the cooperative movement (SCC, 2002).

The poor performance and subsequent closure of financial institutions specifically set up by the Government to serve the interests of the population in need of small and medium scale financial services, and the failure of Government initiated projects meant that the portion of the population that was being targeted no longer had access to financial services.

STRUCTURE OF THE FINANCIAL SECTOR[4]

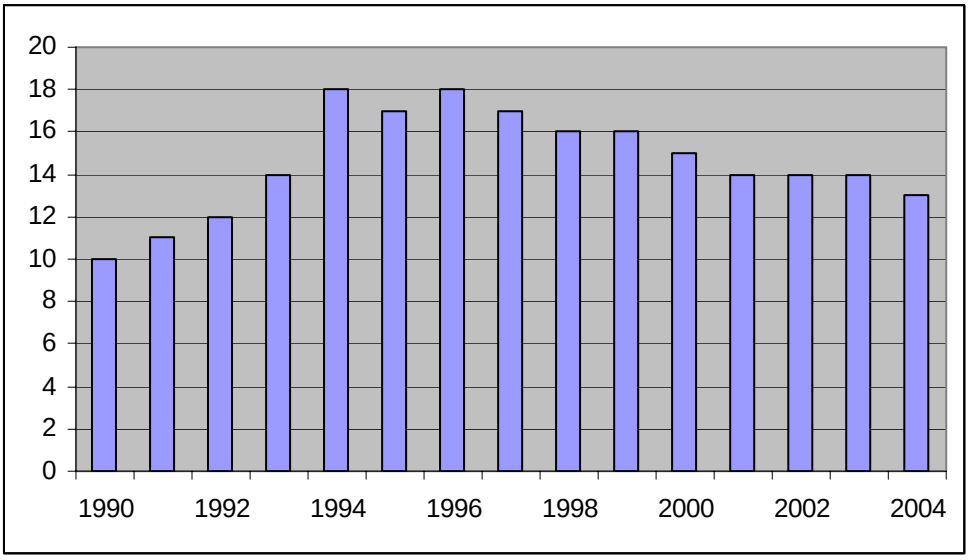
The Zambian financial system is currently made up of the central bank, the Bank of Zambia which is the regulatory and supervisory authority, thirteen commercial banks, and numerous non-bank financial institutions, including leasing companies, three building societies, microfinance institutions, bureaux de change, and those institutions established by Acts of Parliament.

The liberalisation policies outlined above were implemented before reforms were made to the system of prudential regulation and supervision of the financial system, which only began in 1994. This led to the proliferation of financial institutions in the financial sector (Chiumya, 1999). It became easier to obtain a financial institution license although prior restrictions may have been due more to political considerations than anything else. Additionally, capital requirements were low due to the depreciation of the kwacha

(Brownbridge, 1996b)[5]. Ten bank licences were issued between 1991 and 1994, with the number of commercial banks in operation increasing from ten in 1990 to thirteen in 2004, peaking at eighteen in 1994 and 1996. Figure 3 shows the growth in the number of banks from 1990 to 2004.

There are seven foreign banks, four local, one Government owned and a joint venture between the Governments of Zambia and India. It is worth noting that all banks are required to be incorporated in Zambia. Therefore, the banks that are classified as foreign are in most cases subsidiaries of foreign banks.

Figure 3: Growth in the number of banks from 1990 to 2004.



Source: Bank of Zambia

The banking sector is still dominated by foreign owned banks which account for 53 per cent of total banking sector assets. ZNCB, the state owned bank, accounts for a further 19 per cent. The four largest commercial banks, therefore, account for over 72 per cent of banking sector assets, 75 per cent of deposits and 80 per cent of loans (Bank of Zambia, 2004).

The number of non-bank financial institutions, including microfinance institutions, also increased dramatically. By 1996, there were 26 non-bank financial institutions registered with the BOZ, including twelve leasing companies, three building societies, two deposit taking financial institutions and one development bank. Deposits and deposit-like instruments amounted to K28.5 billion in 1996, almost half of which was accounted for by the state owned building society and was the equivalent of 4.5 per cent of the total deposits of the banking sector (Maimbo, 2001).

BANKING SECTOR REFORM

In line with the changes that were occurring in the financial sector vis-à-vis liberalisation, the regulatory framework governing this sector also underwent extensive review. A new banking law was enacted to replace the 1972 Banking Act which had now become outdated. The primary law governing the financial sector is the Banking and Financial Services Act of 1994 (BFSA) and subsidiary legislation. The Act was amended in 2000 to cover all institutions that provided financial services as defined in the Act, including microfinance institutions; strengthen the Bank of Zambia's regulatory and supervisory powers; incorporate best practices and internationally accepted standards for licensing and prudential regulation and supervision into the law; and establish higher standards of responsibility, accountability and professional competence and integrity for directors and senior officers of financial institutions. Provisions contained in subsidiary legislation were promulgated to cover the disclosure requirements of banks, capital adequacy, foreign exchange risk management and exposure, the classification and provisioning of loans, and exposure limits to single entities and parties connected to the financial institution in line with internationally accepted best practice in relation to bank supervision.

The Bank of Zambia was restructured to enable it to discharge its duties in line with its statutory duty to "formulate and implement monetary and supervisory policies that will ensure the maintenance of price and financial systems stability so as to promote macroeconomic development" as stipulated in section 4 of the Bank of Zambia Act of 1996 in the newly liberalised environment. During the 1970s and 1980s the primary responsibility

of the central bank was to ensure compliance to controls relating to foreign exchange, domestic credit and interest rates by financial institutions (Chiumya, 1999; Brownbridge, 1996b). Because banks in Zambia were either owned by well established foreign banks or the Government, it was felt that they required minimum prudential supervision. In addition, the controlled economy provided a relatively safe environment for banking business (Brownbridge, 1996b; Mwape, 1997).

Unfortunately, Zambia, like so many other countries around the world, has experienced financial sector distress resulting in the closure of nine banks since 1995[6]. The bank closures led to a loss of confidence and what has been termed "a flight to quality", i.e. the shift of deposits from the smaller, indigenous, locally owned institutions to foreign owned banks which are perceived to be "safer" as all the banks which have failed to date, with one exception, have been in the former group (Chiumya, 1999). The effect of the bank closures has also served to discourage people from placing deposits in financial institutions for fear of loss in the event of their failure (Kani, 1996).

The above developments have led to significant gaps in the provision of financial services to the un-banked population, especially those in the rural areas where a significant proportion of the poor reside. This has led to a significant growth in the number of MFIs (Maimbo, 2000). According to a survey conducted by the Bank of Zambia in 1999, there were over ninety MFIs operating in the country (BOZ, 1999). Despite this proliferation of MFIs, the majority operate in urban areas close to the line of rail (Wilkinson 2003, M and N Associates 2003) and their outreach remains low. The Association of Microfinance Institutions of Zambia (AMIZ) estimates that the industry's outreach is approximately 80,000 against estimated demand for microfinance services by two million people. Additionally, the majority of MFIs are involved in the provision of credit for small and micro enterprises already in operation. Very few offer other services such as savings. Those that do accept deposits, do so in the form of forced savings which are used as security.

EFFECTS ON ACCESS TO FINANCIAL SERVICES

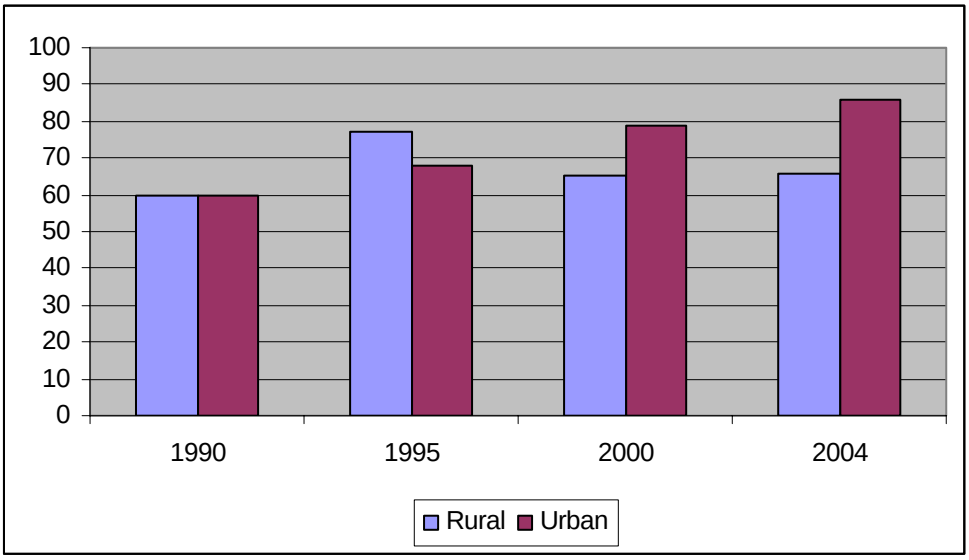
The above developments have resulted in a financial system that focuses on meeting the needs of the corporate sector with commercial banks not lending on average less than USD50,000 (Maimbo, 2000), and the working class elite. Historically, the banking sector has been unwilling to lend to the medium, small and micro sectors of the economy due to the high levels of risk associated with this sector. The harsh economic conditions that prevailed

in the country of high interest rates and volatile exchange rates meant borrowers found it difficult to repay their loans leading to poor repayment rates. The situation was exacerbated by the inefficient legal system which made it difficult to seek redress through the courts and the small value transactions made it uneconomical to do so (Maimbo, 2000; Mbanacele, 2000).

Access to financial services by the majority of Zambians has been further constrained by the introduction of bank charges and the raising of minimum account balances that are too high even for the average middle class Zambian to maintain, let alone the poor. The situation has been compounded by the closure of unprofitable rural branches by commercial banks with the removal of the requirement for banks to open a rural branch for every urban branch opened as evidenced in figure 4.

As can be seen from the graph, in 1990 there were the same number of branches in rural areas as there were in the urban areas. This was obviously in line with Government policy at the time. However, with the removal of the requirement to open a rural branch for every urban branch opened, there was a reduction in the proportion of rural branches to urban branches, from 50 per cent in 1990 to 43 per cent in 2004. The change is most notable in the period 1995 to 2000 when the number of urban branches increased by 16 per cent from 68 to 79 compared to a drop of 15 per cent from 77 to 65 branches in rural areas.

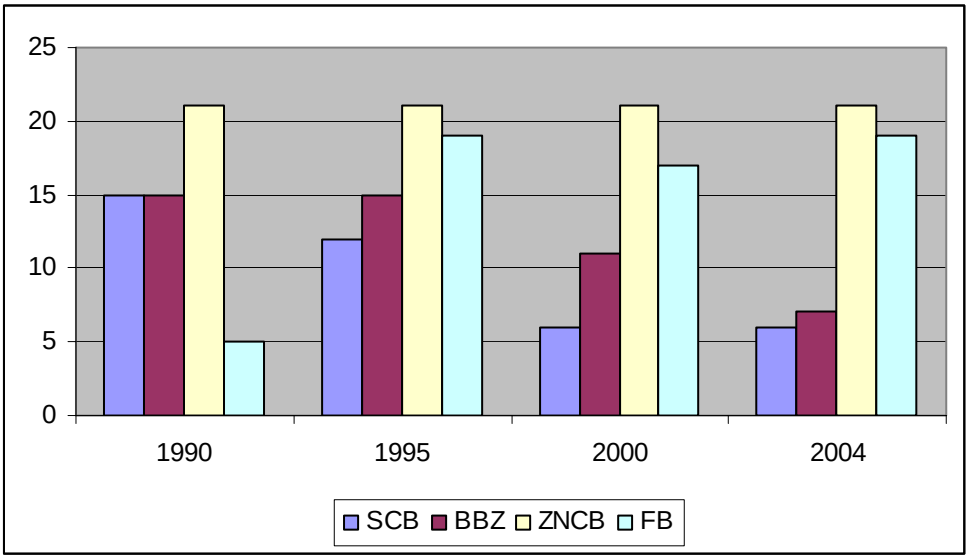
Figure 4: Number of rural and urban branches from 1990 to 2004



Source: Bank of Zambia, 2004

Figure 5 below shows the changes in the number of branches of the four banks with largest branch networks, namely Standard Chartered Bank (foreign), Barclays Bank (foreign), ZNCB (state owned) and Finance Bank (local).

Figure 5: Changes in the number of rural branches for SCB, BBZ, ZNCB and FB



The rise in the number of branches in rural areas is mainly attributable to Finance Bank, which is classified as a local bank. In the period 1990 to 1995, the number of its rural branches rose significantly from 5 to 19. One of the objectives of the bank is to be in as many centres as possible, subject to viability and profitability considerations, in order to serve the Zambian people with financial services. Hence it is pursuing a policy of expanding its branch network. In 2004 alone it opened three new branches. This is in contrast to the policy being pursued by the larger international banks, namely Standard Chartered and Barclays Bank. Both banks have reduced the number of their rural branches by over half. In the case of Barclays Bank it has even increased the number of branches it has in urban areas. ZNCB, which has the largest branch network in the country, is scheduled for privatisation. Therefore, it is uncertain at the moment what policy will be pursued with regards to its branch network by any new investors.

The concentration of financial institutions in urban areas has been attributed to the fact that Zambia's rural environment is not particularly conducive to the establishment of viable businesses. One of the main criteria used by banks in determining whether to establish a branch in a particular locality is the economic activity and level of business. The main form of economic activity in rural areas is peasant farming. Where there is commercial farming

on a significant scale, the banks may still be inclined to serve potential clients from already existing branches in the nearest urban centre, with visits to the client made when required.

The costs of operating in rural Zambia are relatively high. Like most other developing countries, Zambia suffers from a lack of basic infrastructure in the rural communities. Electricity supply in outlying areas is unreliable and in some areas non existent. The telecommunications system is poorly developed, making it difficult to communicate. Thus financial institutions have problems communicating effectively with head office and other branches. This also adversely affects the smooth and efficient operation of a payment system. Much of the country is covered by gravel roads. Away from the main line of rail, where roads are paved they are in bad need of repair. All these factors contribute to significantly raising the costs of operating in these areas. In most cases, they prove prohibitive even for investment into business ventures other than the provision of financial services. Cash transactions are minimal in outlying areas and barter is still the principle form of exchange. Combined with the low population density, retail banking in these areas is not a particularly attractive option. Zambia is divided into 73 districts, of which 32 do not have any banks or other financial institutions operating in the district. A few of these are lucky to be served by agencies, otherwise for some parts of the country, one has to travel long distances to the nearest financial institution.

Banking is no longer the lucrative business it once was. The fall in interest rates in the last couple of years, stabilisation of the exchange rate and reduction in domestic borrowing by Government has meant that banks are now forced to rely once again on their traditional source of revenue, namely the provision of credit. This has resulted in various initiatives including the introduction of unsecured lending to salaried employees and opening of branches in low income housing areas. Thus one of the local banks has opened a branch in one of the low cost housing areas and intends to open another shortly. However, both are located in the capital city, Lusaka. It has developed products specifically targeted to its client base and has opening times more suited to this segment of the market. Members of staff are encouraged to dress informally so as to identify with the clientele and account opening procedures and associated paperwork are kept to a minimum. Maximum use is made of community leaders who play a pivotal role as the link between the bank and those it wishes to serve and act as referees for potential clients.

CONCLUSION

Despite these developments a large proportion of the population is still excluded from the formal banking sector and still do not have access to financial services. The majority of the financial institutions' branches are concentrated in urban areas and even the relatively newly formed MFIs are concentrated along the line of rail. The outreach of MFIs despite their proliferation in the last few years has been very poor. Additionally, the range of services and products provided is very narrow and focuses on the provision of credit. In most cases they do not even provide savings facilities except where the facility serves as security.

The Institutional Development Plan proposed by Natsave can only be successful with strong support from the Government through substantial capital injection. The bank that has opened branches in low income housing areas highlighted above is test piloting its low income facilities in urbanised areas where the supporting infrastructure exists and population density is high compared to other parts of Zambia, e.g. in Lusaka. It is not clear whether it plans to extend this initiative to outlying area.

It is evident from the fall in the number of branches in rural areas that it is unlikely that the market on its own will step in to provide the services needed in rural areas or even in low income areas within the urbanised setting. Where the private sector has stepped in, the pace at which it has progressed has been very slow and may need Government impetus for it to make a significant impact. Even though tremendous progress has been made in the prudential regulation of financial institutions in line with internationally accepted principles, it is debateable whether legislation on its own, considering the constraints faced in terms of the lack of infrastructure, low population density, heavy reliance on agriculture, which is considered a relatively high risk venture, as the major economic activity in most parts of Zambia, can result in the satisfactory provision of financial services to low income households.

One of the objectives of the regulations for microfinance institutions under the Banking and Financial Services Act which will soon become law is to spur the development of the microfinance sector. However, the introduction of the regulations on their own will not address the underlying constraints that have been identified that are likely to hamper the development of the sector. This observation is applicable to the whole financial sector. Under the current liberalised environment, it will not be easy for Government to compel market participants, namely financial institutions, to operate in areas where they will not

earn adequate returns. Therefore, there is a case to be made for Government to adopt a more direct approach in the development of the financial sector in order to ensure increased access to financial services by low income households and the rural poor.

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Notes

[1] GNP per capita fell by 31 per cent from US$650 in 1980 to US$449 in 1990. It continued to decline, falling by 28 per cent to US$322 in 1999.

[2] Prior to 1991, the State controlled more than 80 per cent of the economy (Kani, 1998).

[3] Prior to this, ZCCM was required to sell an agreed percentage to the Bank of Zambia which then supplied foreign exchange to the commercial banks through the foreign exchange auctions.

[4] For the purpose of this paper, the financial system comprises all the financial institutions that fall under the ambit of the Bank of Zambia which is the regulatory authority for the banking sector. Therefore, insurance companies, those companies regulated by the Securities Act of 1993 such as brokerage firms and security houses, and other financial service providers regulated by separate regulatory authorities such as money lenders and hire purchase companies are not included, although they fall within the broader definition of the financial system (Mwape, 1997, p.2).

[5] In 1991, the minimum capital requirement for banks was K20 million (approximately US$0.3 million at the time and little more than US$50,000 by the end of the following year). This was revised to K2 billion in 1994 which was approximately the equivalent of US$2 million. However, with the depreciation of the kwacha over the years, it is now approximately the equivalent of only US$417,000 (at an exchange rate of approximately US$1/K4,800 as at 31 July 2004).

[6] 3 in 1995, 3 in 1997, 1 in 1998, 1 in 2000 and 1 in 2001.