Understanding Financial Cooperatives South Africa, Malawi and Swaziland

FINMARK TRUST

Making financial markets work for the poor

FinMark Trust commissioned research to better understand the role and use of co-operative financial institutions (CFIs) as viable alternatives to the commercial banking sector for accessing financial services for lower income individuals in South Africa, Malawi and Swaziland, as well as best practices in the sector. The study was undertaken by Genesis Analytics on behalf of FinMark Trust.

Interpretation of the Terms of Reference

Based on the research, and in the context of the CFI sector, financial inclusion is understood to mean financial empowerment, through the promotion of improved financial capability and financial freedom. Having the skills, knowledge and confidence required to make sound financial decisions, partnered with the appropriate opportunities and access to financial services, is an integral component of responsible, inclusive and sustainable financial systems. This is particularly relevant to the fundamental principles of CFIs, which enable communities to create self-managed financial services and provide education to members, elected representatives and employees.

Therefore CFIs are viewed not as an alternative to commercial banking, but as one option or opportunity out of what should be an inclusive mix of financial institutions that provide appropriate financial tools based on people's needs.

The focus of this study is therefore to better understand the role the CFI sector can play in achieving the objective of financial and economic empowerment in southern Africa, with the principles that underlie and guide co-operatives forming the heart of the sector's value proposition.

Methodology

An initial desktop review was completed at the inception of the study. Following the development of research tools, research teams of one senior researcher and one junior researcher were deployed to South Africa, Malawi and Swaziland to conduct field research. This included key informant interviews with regulators, policy makers, apex bodies and CFI leadership, as well as focus group discussions with CFI members.

Country case studies

Detailed descriptions of the CFI sectors in South Africa, Malawi and Swaziland are provided according to:

- The history of the co-operative and CFI movements;
- An overview of the CFI sector today, in terms of the number and types of CFIs, products, challenges and roles in the financial system; and,
- An assessment of the legislative and regulatory environment.

The CFI sector in South Africa today is small and plays a minor role in the country's overall financial system relative to other African countries. This has been attributed to a number of reasons, many of which relate to the sector's history in the country, the development of which has been short and troubled. Challenges include grant-based programmes that did not operate for long enough to ensure that managers and communities were equipped to run CFIs, resulting in misaligned incentives and rent-seeking in some cases; poor management; insufficient capacity and top-down approaches to development. The failure of many of the smaller CFIs, and a lack of publication of the few clear success stories, has also affected the level of people's trust in CFIs as safe and reputable financial institutions. The majority of CFI members in South Africa also have bank accounts.

Table 1: Drivers of success and challenges in South Africa

Drivers of success	■ South Africa has a SACCO specific legislation which has assisted in ensuring that CFIs are regulated based on activities in the sector. ■ The Reserve Bank is highly involved in the regulation of co-operative banks. This will go a long way in ensuring that large CFIs are not a risk to the financial system of the country. ■ The CBDA assists in ensuring compliance to legislation. ■ The establishment of the apex body, NACFISA, will go a long way in promoting CFIs in South Africa. However it will be critical that it is well capacitated and coordinated. ■ The establishment of capacity building within the CBDA goes a long way in attending to training needs of the CFI sector. With a bit more funding, this department could offer these services to those CFIs that are aspiring to register as CFIs. ■ The collaboration of the CBDA and other entities like BANKSETA and the establishment of a CFI management training programme at the University of Pretoria could also assist the sector in capacity building.

Table 1: Drivers of success and challenges in South Africa continued

Current challenges	■ Legacy challenges of grant-based programmes that did not operate for long enough to ensure that managers and communities were equipped to run CFIs, resulting in misaligned incentives and rent-seeking in some cases; poor management; insufficient capacity and a lack of coordination of the different stakeholders. The resulting failure of many CFIs has also affected the level of people's trust in CFIs. ■ The majority of CFIs in South Africa use manual accounting and management information systems. ■ There is a lack of development programmes for CFI start-ups that have not achieved the thresholds for registration. ■ There is a widely held view that not enough government resources are dedicated to CFIs. ■ Financial literacy levels amongst CFI members are low and people do not fully understand the benefits of being a CFI member. South Africans are also naturally distrustful of unknown and untested financial institutions. ■ Public sector payroll deductions have been disallowed. ■ There is currently nothing in place to cover members' deposits should a CFI fail.

Malawi is an example of a poor and predominantly rural country where CFIs provide an opportunity for people to use financial products and services they would not otherwise have had access to. Malawi has a strong apex body, the Malawi Union of Savings and Credit Co-operatives (MUSCCO), and donor support for the sector consisted mainly of capacity building, through the remuneration of staff, and education, training and development, rather than financial support. Given the limited resources of the state, the Ministry works closely with industry stakeholders, particularly MUSCCO, to achieve adequate regulation and supervision. The Malawian case demonstrates that developing a new regulatory framework with the Savings and Credit Co-operatives (SACCOs) and the apex body, after analysing and understanding the sector, is a more prudent way to formulate appropriate and accepted regulatory regimes.

Table 2: Drivers of success and challenges in Malawi

Drivers of success	■ Donor support has consisted mainly of capacity building, rather than financial support, which contributed to the establishment of a sustainable and resilient SACCO sector. MUSCCO has also operated on the principle that donor income should not be more than 33% of its income. ■ SACCOs have been able to reach a large number of economically active individuals who are situated in the informal sector and rural areas and are therefore not able to access financial services from commercial banks. ■ The CFI sector has grown through the formation of viable and sustainable partnerships and linkages amongst co-operatives that operate in different sections of the value chain, particularly agricultural and financial co-operatives. ■ MUSCCO is a strong apex body and the government recognises and continues to see MUSCCO as the guardian of a sound and safe SACCO movement. ■ Malawi has a financial co-operative-specific law and regulatory framework that was developed in collaboration with the sector.
Current challenges	■ There is a lack of appropriate skills amongst members of the governance structures of SACCOs, which is a symptom of a skills shortage nationally. SACCOs are also often not able to afford appropriately skilled staff. ■ Manual systems are still being used by many of the organisations as the cost of activation of computerised systems is too high for many SACCOs ■ The CFI sector is exposed to different types of agricultural activities and is thus vulnerable to changes in commodity prices and other market dynamics. ■ The non-remittance of payroll deductions by government departments to SACCOs and other microfinance institutions to date poses a risk to the financial stability of a number of SACCOs. ■ MUSCCO does not have a reinsurance mechanism in place, and in the event of a strike of an idiosyncratic risk, this could threaten MUSCCO's stability.

The CFI sector in **Swaziland** grew off the back of large, employer-based organisations and continues to play an important role in the country's economy. CFIs make use of non-withdrawable savings that members can borrow against and they remain competitive with commercial banks. Most CFI members also have bank accounts but are loyal to their CFIs and apex body, and use their CFIs for asset-building and large expenses, such as school fees and lobola[1]. Recent changes in the regulatory environment have raised concerns amongst some CFIs who have expressed the need for these to be resolved and adopted shortly.

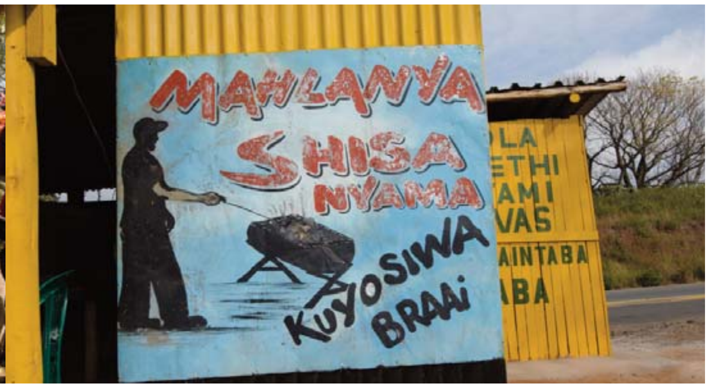
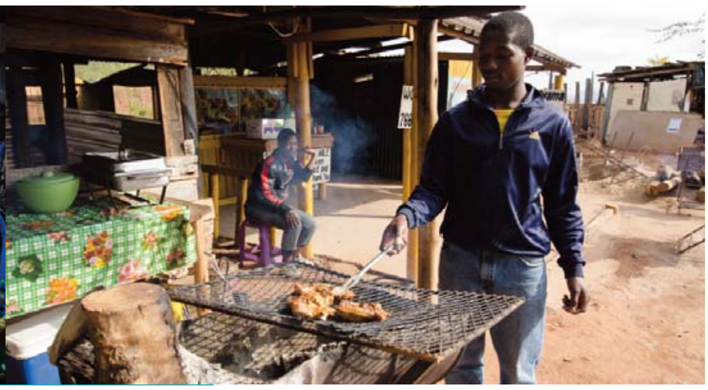


Table 3: Drivers of success and challenges in Swaziland

Drivers of success	■ SACCO products are consciously not designed to cater for low income earners only. Members who benefit from SACCOs range from low income earners to middle- and upper-class class members of society. ■ The major savings made by the SACCO members are non-withdrawable. This has assisted in mobilising a lot of savings and these savings are used as collateral for loans. These savings also build wealth for members, and, in some cases, contribute to the good dividends they receive each year. ■ All members of the SACCOs are expected to make compulsory minimum savings to the SACCOs each month. These savings form part of the non-withdrawable savings. This drives the understanding from members that the success of a SACCO hinges on aggressive savings mobilisation. ■ Most SACCOs are formed within government departments, state owned enterprises and the private sector according to their professions. This allows for salary deductions for both savings and loans repayments. ■ The government allows for deductions of loans and savings to be made from source. ■ A number of the larger, more developed SACCOs in Swaziland are beginning to open their bonds, giving them the opportunity to increase membership and reducing the effect that job loss, employer losses, movement and retirement can have on membership numbers. ■ SACCOs have enjoyed success in keeping delinquency rates low by using a stop order or a debit order deduction from the banks. This is possible because almost all SACCO members have a bank account in addition to their SACCO membership.
Current challenges	■ The move to more financial sector-oriented and SACCO specific legislation for financial co-operatives should lead to more transparency and standards in the sector, but the direct regulation will most likely be a costly exercise. ■ There is a low level of financial reporting of primary CFIs, and including these in a standardised framework will be a complex task. ■ SACCOs have expressed concerns that they were not adequately involved in the legislative development process and that there was not enough consultation to create awareness of what the regulation will entail.

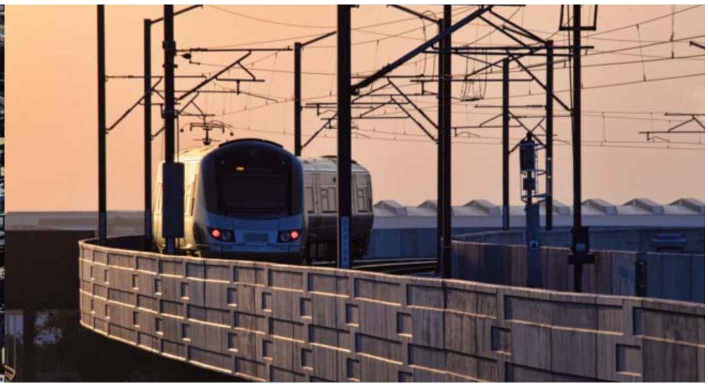


1 Lobola is a traditional southern African custom whereby the man pays the family of his fiancée for her hand in marriage

Building national CFI sectors

This section describes some of the better ways of promoting co-operatives, while at the same time enabling people to co-operate and build democratic structures. This includes:

1. Promoting the model and building the sector from the bottom up
2. Structures of CFIs, including a general assembly, board of directors, officers and employees
3. Integrity and financial integration of co-operatives, including internal controls and monitoring ratios
4. Structural needs at country level, including the role of apex bodies and educational institutions and programmes



Best practices

A number of best practices relating to CFI sectors have been identified and include:

- The value proposition of CFIs – this includes ownership and control, and the creation of self-managed savings-led financial services that provide education to members, elected representatives and employees. The main purpose of CFIs should be to benefit members rather than to maximise profit, while still operating as sound businesses.
- The role of major stakeholders, such as a self-sustaining apex body, the ability of governments to strengthen and regulate CFIs without overloading them, and the ability of the international development community to have patience and allow co-operative systems time to mature naturally. The state should also play a role in setting and maintaining standards, but should build sound, strong and strategic partnerships with the other relevant stakeholders in the sector that are responsible for capacity building, support and promotion of CFIs.
- CFIs should focus on savings-led, asset-building financial services offerings that are competitive with alternative financial institutions in terms of price, flexibility and security. Leveraging existing structures, such as employers and existing functional multi-purpose co-operatives, can be an effective way to build a critical mass of CFI membership.
- Systematic performance enhancement, training and monitoring at institutional and country levels, including CFI boards and staff members being trained and re-trained regularly, intra-sector knowledge transfer and education on personal financial management and the benefits of CFIs, as well as a transition from manual to computerised systems.
- Appropriate legislative, regulatory and supervisory framework that takes into account the unique nature of CFIs and empowers them, enables their development and encourages outreach, while protecting owners and depositors.