Socio-economic impacts of microfinance and repayment performance under imperfect information.
A case study of the small enterprise foundation, South Africa

Hietalahti, Johanna
Linden, Mikael
Socio-economic Impacts of Microfinance and Repayment Performance under Imperfect Information
A case study of the Small Enterprise Foundation, South Africa

Johanna Hietalahti¹ and Mikael Linden²

Abstract

The socio-economic impacts of microcredits on women’s welfare were studied in North Eastern South Africa using qualitative semi-structured interviewing method. The study especially focuses on the benefits, disadvantages and challenges obtained from the Small Enterprise Foundation (SEF) microcredit programmes (MCP and TCP) in sustainable livelihoods framework. In two case villages, impacts of microcredits and comparison of two programmes were analysed on household level. The nature of credit allocation and SEF clients’ repayment performance was analyzed with the credit rationing model.

The results reveal that a number of poorest women have been released out of deepest poverty through the opportunities provided by SEF. The MCP clients, who tend to have a better starting point, seemed to be more educated, able to diversify and improve their businesses as well as more capable to protect against vulnerability than the poorer TCP clients. Many repayment problems were caused by group heterogeneity. Especially in the MCP the phenomenon of moral hazard (in the presence of joint liability) seemed to be a problem. These drawbacks reflect that there are still some unsettled disadvantages in programmes.

Key words: microcredits, the Small Enterprise Foundation (SEF), repayment performance, credit market imperfections, moral hazard.

1) University of Joensuu, Department of Business and Economics, Box 111, Yliopistokatu 7, FIN-80101. E-mail: johanna.hietalahti@joensuu.fi
2) University of Joensuu, Department of Business and Economics, Box 111, Yliopistokatu 7, FIN-80101. E-mail: mika.linden@joensuu.fi
I. INTRODUCTION

In many countries traditional financial institutions are concentrating on large-scale loans removing from the area of aid to small enterprises (Woller and Woodworth 2001ab, Todaro 2000, Jabbar et al. 2002). Access to credit is especially restricted for the poor, owing to their inability to provide collateral and thus credit risks are excessive. Potential clients live in remote rural villages behind the reach of the commercial banking system, where monitoring and enforcement costs are high, and returns on investments low (Snow et al. 2001). If some sort of local private banking system exists it is characterized by high interest rates, by connections with other local markets, such as land, labor and crop, and by significant credit rationing. Because of credit rationing the borrowers are unable to borrow all they want, or some loan applicants are unable to borrow at all (Ma and Smith 1996).

The theory of credit rationing originates with the paper by Stiglitz and Weiss (1981). Credit rationing is outcome of fact that lenders cannot distinguish between borrowers of different degrees of risk, and that loan contracts are subject to limited liability. Since lender’s preferences over project risk run counter to these of borrowers, they may hold interest rates at levels below market-clearing rates and ratio borrowers in order to achieve a better composition and lower risk in their portfolio. Although lenders possess in traditional rural societies a great deal of information about relevant borrower characteristics the returns of investment are still greatly affected by local conditions and the borrower’s actions. When loanable funds and collateral actions are limited credit rationing appears with high interest rates. As long as the borrower does not have enough wealth to guarantee the full value of the loan, higher interest rates cause the problem of debt overhang since the investor captures only a small fraction of returns. Subsequently, the level of borrower’s effort avoiding low yield states may be depressed. Thus an increase in the size of collateral leads to fall in interest rate and debt and an increase in effort. (Ghosh et al. 2000). Without collateral the social norms and close social networks can be useful in mitigating the credit rationing problems.

On partial solution is the system of microfinance based on the peer monitoring: having co-investors, neighbours or relatives who are in a good position to monitor the borrower and required to pay a penalty if the borrower goes bankrupt. The local banking system can provide larger loans as it is able to exploit the local knowledge of the members of social responsibilities. It has devised an incentive structure whereby others with in the village do the
monitoring for it. They have been induced to bear more risks than they otherwise would (Stiglitz 1990, Arnott & Stiglitz 1991).

Thus microfinance is expanding as a grass-roots instrument for alleviating poverty and improving the poor’s access to financial services especially in developing countries\(^1\). The loan is intended especially for poor women to buy the initial goods that are needed to start or improve a small business. The objective is to break the vicious circle of poverty consisting of low capital, productivity, income, and savings (Evans et al 1999, Woller and Woodworth 2001ab, Anderson et al. 2001).

It is argued that microfinance may improve women’s empowerment and general welfare by expanding their social and economic opportunities and reducing vulnerability (Newaz 2001, 2003) and even contribute to reduced fertility (Anderson et al. 2002). Moreover, women spend a large proportion of what they earn on household expenses that serve to benefit the family as a whole (Kabeer 2000).

Despite these impressive benefits recent studies have pointed out several social and economic problems in some of the programmes. These are the high interest rate (Hossain 2002), the risk to end up in a circle of debt (Snow et al. 2001), the fragility of credit-financed household (Floro and Dymski 2000), the risk of free-riding and conflicts between villagers and gender (Hossain 2002). Moreover, in practice, microfinance may still not reach the very poorest, since some borrowers experience still credit rationing in microcredit programmes including inequality in terms of benefits and loan sizes as well as limited access to services (Stix 1997, Baydas et al 1994, de Meza and Webb 2000).

The present study aimed at gaining a better understanding of how microcredit projects impact on rural women’s livelihood structures, and how they can strengthen women’s welfare. It was focusing on the operations of the Small Enterprise Foundation (SEF) that is serving the residents in former homelands in South Africa. Specifically, the study aimed at:

1) Assessing the impacts of women’s group loans in the sustainable livelihoods framework, particularly when livelihood outcomes to be achieved are more income, increased well-being, reduced vulnerability and improved food security on household level;

---

\(^1\) In the early 1980’s, the Grameen bank of Bangladesh initiated the microfinance movement, currently the world’s best-known provider of microcredit. Recent statistics on the global outreach of microfinance institutions (MFIs) report that over 30 million families have access to microfinance services, of which more than 19 million qualified as the poorest who are particularly women.
2) Studying the influence of other activities than loans (e.g. motivation and on-going support) of the microcredit projects on the maintenance of local people’s livelihood structures;
3) Additionally investigating the nature of microcredit allocation under credit market imperfections and its consequences for repayment behaviour in general, and further relating these issues to the operations of the Small Enterprise Foundation (SEF) in its aim to reach to the poorest of the poor.

II. MATERIAL AND METHODS

II.1 Study area and the basic livelihood structure
The research was carried out in the Northern Province of South Africa, where the Small Enterprise Foundation (SEF) has been serving the residents in the three former homeland areas, Lebowa, Gazankulu and Venda, since its launch in 1991. South Africa’s northernmost province borders on Botswana, Zimbabwe and Mozambique, and is one of the poorest areas of the country. Most of its economic activity is focused on farming. Industrial activity is limited to small mining operations. The province has the highest rates of unemployment, illiteracy and birth in all of the country, unemployment reaching even the level of 80%. Tzaneen is one of the largest commercial centres in the province, with a population of 80,000. Bungeni and Mankweng villages are situated in the surrounding area. The number of people inhabiting the villages is uncertain. They represent mainly Venda, Sotho and Tsonga languages.

In the Northern Province, African people comprise 97% of the population. Because of separation of rural homelands by the nation’s former apartheid regime inequality still exists with a poor infrastructure, limited access to resources, and poor economic opportunities. Rural black women are the bottoms of the heap because of the discrimination on grounds of race, class and gender (Deegan 1999). High population density and poor land quality provide only minor income opportunities. Limitation of final services is gradually changing with the advent of the micro-lending industry and since the establishment of the Micro Finance Regulatory Council (MFRC) in 1999. MFRC has now registered more than 1,247 micro-lenders represented through more than 6,775 branches.

The SEF is a non-profit, non-governmental organisation, and applying the methods of Grameen Bank that extends loans to groups of five in joint liability basis. SEF’s Head Office
is located in the town of Tzaneen working with a target population of about 65,000 rural villagers around the town. The SEF has two separate programmes, the original Micro Credit Programme (MCP) consisting of 8,163 active clients\(^2\) and the Tšhomisano\(^3\) Credit Programme (TCP), a poverty targeted programme which was started in 1996 and consists nowadays of 5,224 members (SEF 2002a). In 2000, there were 5 MCP branches employing 33 field workers and the TCP had 4 branches employing 17 field workers. Approximately 98 % of the SEF’s clients are female. TCP clients are the poorest of the poor based on a targeting methodology, Participatory Wealth Ranking, using the “household subsistence” level as the poverty line. In 2001 this stood at R920\(^4\) (100 EUR) per family of five per month. 40 % of households in the Northern Province live below half of this line.

After its launch in 1991, the SEF has distributed some 100 000 loans valued more than 100 million rand (11 million EUR). In June 2002 the SEF served 13,387 clients in the value of R8.0 million (890 000 EUR), and was forced to write-off R38,695 (4,340 EUR) (SEF 2002a). Ten years after launching its program of lending, 68% of the SEF’s clients were financially sustainable. The SEF is attempting to combine targeting the poorest, poverty alleviation and financial self-sustainability aiming for financial self-sustainability by June 2005. Sustainability has been managed to achieve through several donors, most importantly with the ongoing support of The United States Agency for International Development, The Ford Foundation, Hivos and ImpAct – A Ford Foundation/Institute of Development Studies project (SEF 2002a).

II.2 Data collection and analysis

The empirical fieldwork was done in February-March 2003 with assistance of the Small Enterprise Foundation (SEF). The research involved semi-structured interviews with 21 entrepreneurs from participants in the SEF microenterprise programmes, consisting of 10 clients in the Micro Credit Programme (MCP) and 11 clients in the Tšhomisano Credit Programme (TCP). The fieldwork was implemented by attending six different centre meetings in the villages of Mankweng and Bungeni.

The questionnaire schedule comprised both closed-question and open-ended narrative sections. The closed section collected background information about the identity of the respondent. It covered basic livelihood information, loan history and performance, experience

\(^2\) In June 2002
\(^3\) Tšhomisano is the Northern Sotho word meaning “Working together”
and level of education. The open section dealt in turn with changes in household and business activities, experience as a group member, income and expenditure, impact on social welfare and livelihood structure, and perceptions for the future. Villagers were also asked to list suggestions on what the SEF should do to improve its microcredit operations. Open-ended questions were designed to encourage respondents to describe their experience in their own words. It was also paid careful attention to question design to gaining rich and useful information on impacts (Wright 2002).

All questions were printed in English but interpreted to local languages, Venda, Sotho and Tsonga. Short summaries were typed up of the narrative sections, drawing upon memory and field notes (Table 2). For a wider qualitative analysis the table was read systematically column by column. Comparing clients from the two different programmes were done additionally through cross-tabulations and means tests. The results were scored, and then entered onto a single database along with pre-coded data from the closed section of the interview schedule. The impact scores could then be analysed (through cross-tabulation) against pre-coded variables.

### Table 2. Illustration of qualitative analysis of narrative summaries.

<table>
<thead>
<tr>
<th>Topic/level</th>
<th>Respondent 1</th>
<th>Respondent 2</th>
<th>Respondent 3</th>
<th>Respondent 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business activity</strong></td>
<td>Selling ice cream, lemonade, blankets, chicken, old clothes</td>
<td>Selling drinks, fish, cakes</td>
<td>Selling fruits, juice</td>
<td>Knitting and sewing clothes</td>
</tr>
<tr>
<td><strong>Material impact on business</strong></td>
<td>Able to buy stock and to improve business</td>
<td>Able to run business</td>
<td>Able to run business</td>
<td>Able to improve business, to buy new knitting and sewing machines and material. Bought a car. Built a workshop.</td>
</tr>
<tr>
<td><strong>Material impact on household</strong></td>
<td>Able to buy more food fruits</td>
<td>Able to buy meat, fruits</td>
<td>Started to build a house</td>
<td>Has built a house</td>
</tr>
<tr>
<td><strong>Material impact on individual</strong></td>
<td>Able to buy more needed items</td>
<td>Able to buy clothes and needed items</td>
<td>Able buy more needed items</td>
<td>Able to buy needed items</td>
</tr>
<tr>
<td><strong>Material impact on children</strong></td>
<td>Able to pay school fees and to buy clothes for children</td>
<td>Able to buy more food and sometimes Goodies</td>
<td>Able to pay school fees and to buy clothes for children</td>
<td>Able to buy needed items for children</td>
</tr>
<tr>
<td><strong>Financial impact</strong></td>
<td>Can take care of the costs</td>
<td>Financial situation has improved</td>
<td>Not enough money to buy all the needed items</td>
<td>Money covers all the costs and solves financial problems</td>
</tr>
</tbody>
</table>

---

4 Calculated in March 2003 when the EUR/Rand exchange rate stood close to EUR = R8.9
III. RESULTS

III.1 Socio-economic impacts of SEF microcredits

The interviewed clients volunteered mostly positive comments expressing their opinions of the importance of SEF operations. Motivation and business training supported by the company were appreciated especially within the Tšhomisano Credit Programme (TCP). When they join microfinance programme, the women are usually unemployed with minimal opportunities and experience in business running. Most women in the Micro Credit Programme (MCP) in turn only lack of finance but have most basic business skills in advance.

Membership in SEF programmes seemed to increase the women’s self-confidence and willingness to participate in activities in their communities. Eight of all ten MCP clients indicated higher self-confidence than before. They also said to be particularly proud of their businesses and financial contribution. This empowerment dynamic is undoubtedly one of the major non-financial benefits of the programmes. Running a business contributes to women’s improved welfare. Although women’s problems were not entirely resolved, most clients considered life was easier than before. The study showed that through the SEF’s loans TCP clients who used to be unemployed were able to employ themselves by running their businesses.

Respondent 1 (TCP): "Since I started in the program I realised a big change in financial matter. Now I’m able to buy bricks for a house and different things for my family. ...In future I hope that the loan sizes will grow so that I would be able to buy bigger stock and improve my business. ...I also hope that SEF could help children to go to school."

Especially in the MCP some women were able to diversify into more profitable product lines due to increased capital after joining the programme, but there were success stories within the TCP as well (Respondent 4).

Respondent 4 (TCP): “There is an extremely serious unemployment problem in this area. People lack incomes struggling permanently in the poverty. I have been lucky....After joining SEF credit programme, I have been able to buy stock and new materials, and improve my sewing business. Now I have one knitting and three sewing machines, and I can run my own clothing business successfully....I have built a new house and my own workshop.”
Two of the ten MCP clients believed to be able to grow their businesses so that they will finally reach self-sustainability. Six MCP clients and three TCP clients said that their financial situation had improved significantly since joining the programme. The influence could be seen in the form of ability to buy more of needed items and improved food security, among others.

All the women interviewed in both programmes said their husbands and/or families supported their joining the programme. In the TCP it was common that households were headed by the women who alone provided for the family when the husbands were either unemployed or passed away, or they did not have husbands at all. To decrease the likelihood of opposition to their participation by family elders, the SEF encourages clients to discuss the programme and the loan with their families. The SEF’s drop-out studies indicate that the number of clients dropping out due to spouse’s opposition is deminimus. In regard to the question of whether microfinance reinforces traditional gender roles, in the SEF programmes, there is no correlation of increased loan size between female and male clients.

While credits are essential for the poor to ensure their financial well-being, it is critical that savings are encouraged to increase clients’ assets. The SEF does not require deposit or proportion of loan as a savings component to cover possible economical losses, or ever directly handle clients’ repayments. However, clients are encouraged to save a small amount of money on a fortnightly basis as part of the membership criteria. Before the disbursement of the first loan, the group has to open a group savings account and demonstrate their ability to save. These savings along the repayment performance will impact whether clients are considered good members and on the next loan size. However, despite the pressure the SEF brings to clients regarding the savings, it became evident in the centre meetings that either clients were unable to save or the significance of savings was not completely internalised. Relatively few clients per meeting seemed to be able to contribute to the savings account, and the average size of deposits was relatively low.

Microcredits undoubtedly contribute to the survival of families who are living on the margins of absolute poverty. However, the SEF has not been able to eliminate vulnerability among TCP clients through microcredits. The most serious problems among the TCP clients were unemployment and income insufficiency in regard to meeting their basic needs. Although most found their financial situation improved and life become easier, all the financial problems can hardly be seen as entirely resolved. Credit and possible economic returns
dwindle for both new stock supplement and daily household costs. Some of the women may
too be able to afford more diversified commodities, but still others face serious problems with
finance having difficulties to provide for sufficient food security and education of children.
Besides these, the women were concerned about health care and untrustworthy clients.

Their problems notwithstanding all ten of the MCP clients said that their lives had become
easier due to credits. For five of them, the financial situation had improved crucially. The
most remarkable improvements were seen in improved food security and opportunity to meet
responsibilities and household needs. Six of the interviewed were able to pay children’s
school fees. However, it was exposed that while paying school fees, the family did not always
have enough money for food. Yet all the needs could not be supplied. Half of the women
complained about inadequate and irregular income, deceitful clients, and loan repayment
problems. The clients did not complain about too high interest rates. No one accused rules of
being too strict or hard to follow, but yet sometimes unstable.

Among the mostly positive comments of the SEF operations, the villagers volunteered also
some criticism granting some wishes for future. In the TCP most of the clients requested
bigger loan sizes that would be essential to grow and improve their businesses. Especially in
the MCP, besides the bigger loan sizes, the SEF was requested to admit individual loans so
that every member should guarantee solely their own loans. The most negative comments
were connected to repayment problems. Half of the interviewed in the MCP complained about
unreliable group members. Further, two of them had considered leaving off due to these
problems.

Respondent 8 (MCP): “Some women want their money immediately, and use it for everything
else but their businesses. ...To improve their businesses they should invest. Some women do
not invest rationally, and they do not work. How could they manage? ...These group loans
favour the poorest. Why should I suffer, work hard and repay their loans, if they could not or
did not want to do anything?”

It was also mentioned that sometimes loan sizes were too big for members to control, and that
way caused difficulties for other members who had to guarantee the loan. Although TCP
clients who were interviewed did not mention unreliable group members as a big problem, it
revealed in the meeting discussions (concerning their successes or defaults) that there were
some problems in regard to group relations, as demonstrated below.
Client in TCP meeting, Bungeni: “We joined the group because we are extremely poor. Those who do not repay their loans should leave the group. They should at least show up in these meetings and explain why they are not able to pay up, and not to leave other members to take responsibility of their defaults. It seems that people have not internalised the principles and rules. SEF has to do something for this issue.”

Both the TCP and the MCP have high drop out rates (i.e. percentage of clients who complete their loans and do not return for a further loan) reaching the level of 33 percent (SEF 2002a). In drive to attain self-sufficiency quickly the SEF introduced a new incentive scheme in 2000. However, the intention to provide strongest clients with larger loans failed, when a major part of the field staff pushed loan sizes with all their clients. Too big loan sizes lead to repayment problems, dissatisfaction, and clients preferring to leave their program, resulting increase in drop-out rates. Loan policies that allowed the pushing of loan sizes have now been revised. Increase in loan sizes has linked to the growth of clients’ businesses, and to bring the drop-out rates down interest rates have been increased (SEF 2001, 2002a). The SEF has been trying to resolve the repayment and drop-out problems also by creating strict rules for group establishment. Women are provided with learning process divided into three sections: (i) motivation, (ii) business planning, and (iii) continuous support. To prevent getting into overdebt, informal loans are forbidden.

III.2 Comparison between two microcredit programmes TCP and MCP

The wealthier borrowers seemed to have a significantly better starting point than the poorer ones. Mankweng, the village in which the Micro Credit Programme (MCP) was founded, provided a more urban setting and quality of services than the poorer Bungeni for Tšhomisano Credit Programme (TCP) clients. While all the interviewed TCP clients said there were no other incomes in the household besides the loan, in the MCP five of ten women said they were providing for the family together with their husbands. Business activities in both programmes consisted mostly of fruit, juice, beer, tobacco, textiles and vegetable hawking, and thus concentrated on the sectors with a low level of profitability. The biggest problem in trading lie upon a narrow profit margin, wide competition and poor customers, which are a serious problem especially among TCP clients.

In addition to the qualitative analysis, comparing clients from the two different programmes was done through cross-tabulations and means tests. In obtaining a Pearson’s correlation
coefficient as well as the associated significance level for two variables it was used the SPSS-programme. Statistically significant differences were revealed with relation to level of education, size of the first loan, and furthermore profits (Table 3). Most of the TCP clients were inexperienced and very poor with no or minor education. One interesting result was the positive correlation between education and children’s well-being ($p<0.05$). Data also shows that MCP clients were provided with bigger loan sizes in the beginning. The most common loan size in both programmes was R500. However, one third part of TCP clients had R300 or less as their first loan in contrast to wealthier MCP clients of whom one third part reached the level of R600-800. These results indicate that MCP clients appear to be more educated, and have access to bigger loan sizes when joining the microcredit programme. These characteristics connected with more business experience provide MCP clients with better fundaments for business management and diversification.

A great proportion of TCP clients were able to make profits of an amount of R50 per month at most, while in contrast only one of MCP client stayed at this level. Additionally, half of MCP clients made profits more than R500 per month. These comparisons are fairly analogous to the qualitative analysis, and indicate TCP clients to be very vulnerable against financial shocks. MCP clients, in turn, seem to be less vulnerable, but are still subjected to a great risk to be driven back into deep poverty.

Besides the differences between different programmes, there seemed to be differences between clients within the same programme in relation to professional skills, business management and returns. In the TCP, women whose source of income was in textiles and sewing were on average admitted bigger loan sizes in the beginning, and they were able to grow their loan sizes more compared to those who were in basic grocery business. The size of dressmakers’ last loan ranges from R1,700 to R4,500, while for example fruit and drink sellers had to content them with a maximum loan size of R1,000. Furthermore, it was found a strong positive correlation between the loan size and both profits ($p<0.01$), savings, food security, and business and financial improvement ($p<0.05$). These skilled women were more easily able to pay children’s school fees, save money for building a house or obtain new machines, and solve their financial problems. One interesting observation was the positive correlation between profits and years of participation ($p<0.05$), which implies that positive impacts might sometimes be distinguishable only in the long term.
Within the MCP differences were not quite that obvious. However, there seemed to be some differences in relation to professional skills, loan sizes and economic returns. A greater proportion (80 %) of fruit and juice sellers made profits less than R400 per month as opposed to dressmakers and tailors who all reached the level of a minimum of R500 per month. Positive correlation was found between profits and size of the first \( (p<0.01) \) and the last loan \( (p<0.05) \), savings \( (p<0.01) \), and business and financial improvements \( (p<0.05) \). In terms of business or financial impacts, however, cross-tabulation proves that disparities between different job characteristics were not as strong as in the TCP. This may result from the fact that since the family is not extremely poor in the beginning, the financial or business impacts may not be so considerable, although things might be more secure. In the TCP, in turn, changes in income appeared to have a great impact on food security, and both on business and financial improvement.

Table 3. Characteristics of the sample.

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Mean in TCP</th>
<th>Mean in MCP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sample Size</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>Female headed households</td>
<td>60 %</td>
<td>20%</td>
</tr>
<tr>
<td>Education</td>
<td>1.6 years</td>
<td>5.1 years</td>
</tr>
<tr>
<td>Size of first loan</td>
<td>R395</td>
<td>R570</td>
</tr>
<tr>
<td>Size of last loan</td>
<td>R1390</td>
<td>R1330</td>
</tr>
<tr>
<td>Profits</td>
<td>R452 (per month)</td>
<td>R745 (per month)</td>
</tr>
<tr>
<td>Savings</td>
<td>R63 (per month)</td>
<td>R52 (per month)</td>
</tr>
</tbody>
</table>

Table 3 demonstrates that there are no significant differences in regard to savings between these two groups, and even that the accumulation has been stronger in the TCP. This result is inconsistent with the evidence revealed in the qualitative analysis that suggests that MCP clients are more capable to protect themselves against vulnerability through savings and assets than the women in the TCP. It is justified to note that most of TCP clients were able to deposit savings of a maximum of R50 per month. Two of eleven members were able to save R200-300 per month, which has a strong effect on mean value. The setting is analogous to the MCP where only one member reached the level of R300. In regard to profits and savings, the standard deviation is remarkable in both programmes. Besides the distortion in mean value, disagreement will be explained by the fact that qualitative analysis is strongly affected by the general feature experienced in centre meetings. Moreover, it was exposed in the interviews that women in the TCP had no assets or savings to protect themselves against sudden costs, and were instead still unable to meet even their basic needs, since all incomes went to a new
stock or household expenditures. In summary, it is apparent that clients in both programmes do have difficulties to deposit remarkable savings.

In conclusion, it can be argued that there are distinct differences between clients in the poorer TCP and the wealthier MCP (Table 4). Wealthier borrowers tend to have a better starting point than the poorer ones, and they are more likely to be able to diversify and improve their businesses. MCP clients are less vulnerable against financial shocks and can solve many financial problems, while TCP clients still have difficulties to meet their basic needs.

**Table 4.** Characteristics of SEF microcredit programmes.

<table>
<thead>
<tr>
<th></th>
<th>MCP</th>
<th>TCP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business opportunities and finance</strong></td>
<td>Better opportunities to diversify and improve incomes</td>
<td>Usually no opportunities to diversify or improve incomes</td>
</tr>
<tr>
<td><strong>Social impact and well-being</strong></td>
<td>Improved self-confidence. Able to make changes in life. Opportunity to health care. Life in general easier than before.</td>
<td>Low or somehow improved self-confidence. Still difficulties to get health services. Life in general easier than before.</td>
</tr>
<tr>
<td><strong>Food security and basic needs</strong></td>
<td>Improved food security. Able to meet most basic needs.</td>
<td>Food security difficult or somehow improved but still difficulties to meet basic needs.</td>
</tr>
<tr>
<td><strong>Vulnerability</strong></td>
<td>Less vulnerable being somewhat able to protect against financial shocks. Risk to be driven back to the poverty.</td>
<td>Very vulnerable having no savings or assets to protect against unexpected expenditures. Has to rely on neighbours help and loans.</td>
</tr>
<tr>
<td><strong>Training and motivating</strong></td>
<td>Usually have business skills. Money is the problem.</td>
<td>Appreciates training, learns how to run business</td>
</tr>
<tr>
<td><strong>Biggest problems</strong></td>
<td>Unreliable group members and joint liability</td>
<td>Meeting the basic needs. Vulnerability. Group members who don’t repay their loans. Income insufficiency.</td>
</tr>
</tbody>
</table>

**III.3 Credit rationing and credit market imperfections**

In this section it is tried to describe the standard practice that the Small Enterprise Foundation (SEF) applies in loan admittance and borrowers’ identification, and how the SEF handles the credit rationing and asymmetric information problems. Before launching microfinance activities both the staff and loan applicants have to go through a long training and recognition process. The SEF services are strictly targeted to a well-defined set of clients, the basic criterion used in the Micro Credit Programme (MCP) is the 6-month experience in entrepreneurship, and in the Tšhomisano Credit Programme (TCP) the position in the participatory Wealth Ranking (PWR). The aim is particularly to reach the poorest of the poor. The SEF first identifies areas where it is targeting the programmes based on population and
economic status. With the village elders’ consent the SEF will arrange for a PWR and meetings to promote the SEF in the community via motivations. The SEF resolves client information problems by identifying borrowers through special group recognition. If the necessary qualifications have been complied, the group is allowed to start training, which is a six-day process. Resource restraints and strict training may still limit access to SEF services. Applications that seem to be too risky will be rejected. Moreover, the meeting requirement and the pressure to repay a loan can be an additional burden on participants.

In order to evaluate the important factors used in credit rationing, the data is inadequate to verify the credit demand and supply equations. There are yet many interesting questions to consider related to credit rationing and SEF operations. The basic fact is that microcredit lenders grant larger loans at higher interest rates and for longer terms. In the SEF programmes all first loan clients’ repayments are based on a term of 8 fortights, with a higher effective interest rate than clients on subsequent cycles. Groups choose from the following terms: 4, 6, or 10 months of which four or six-month terms could be repaid monthly or fortnightly (Table 5). It can be seen that the straight interest rate is higher for the loans that can be repaid monthly than the loans that are to be repaid on fortnightly basis. The straight interest rate is higher at longer terms, too. However, the SEF does not grant larger loans at higher straight interest rates.

Table 5. Interest rates and Repayments of SEF loans (SEF 2002b).

<table>
<thead>
<tr>
<th>Loan Term</th>
<th>8FN</th>
<th>12FN</th>
<th>4Mo</th>
<th>6Mo</th>
<th>10Mo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instalment per R100 Loan</td>
<td>14.50</td>
<td>10</td>
<td>29</td>
<td>20.50</td>
<td>14</td>
</tr>
<tr>
<td>Total Interest Paid per R100 Loan</td>
<td>16</td>
<td>20</td>
<td>16</td>
<td>23</td>
<td>40</td>
</tr>
<tr>
<td>Effective Interest Rate</td>
<td>82.15%</td>
<td>70.1%</td>
<td>74.6%</td>
<td>75.1%</td>
<td>79.6%</td>
</tr>
<tr>
<td>Straight Interest Rate</td>
<td>16 %</td>
<td>20 %</td>
<td>16 %</td>
<td>23 %</td>
<td>40 %</td>
</tr>
</tbody>
</table>

As usual in microfinance, SEF contracts are self-enforcing so that subsequent loans are based on individual performance in regard to saving, attendance in the meetings and repayment, as well as existing business size (stock, savings, cash, debtors and capital expenditure). The SEF evaluates business type as a factor in determining first loan size giving holders of knitting, tailoring and clothing greater access to credit. To the question whether profitable business encourages borrowers to incur greater financial risk through increased borrowing, it can be remarked that (i) it was found a strong positive correlation between loan size and profits ($p<0.01$), (ii) the SEF pushes bigger loans for successful clients, and (iii) most clients
requested bigger loan sizes. These results do not conflict the implications of credit rationing model described in Section 1.

As revealed in the interviews, too big loan sizes caused repayment problems and thus difficulties for other members who had to guarantee the loan. Although the SEF possesses lots of information about relevant characteristics of borrowers, it is impossible for the staff to flawlessly distinguish between the more and less successful clients which may lead to admitting too big loan sizes. Repayment problems seem to reflect that the problem of debt overhang is still evident. Free riding problems are also found since several clients complained about unreliable group members who did not want to work or feel like working, or did not show up in the meetings.

IV. DISCUSSION AND CONCLUSIONS

The Small Enterprise Foundation (SEF) plays an important role in strengthening women’s welfare in the study area. By providing financial services and in that way job opportunities, it may influence powerfully on rural women’s socio-economic situation and improve security. Targeting strictly women who live below half of the poverty line, the Tšhomisano Credit Programme (TCP) is able to reach the very poorest women., while the MCP in contrast is reaching people who are better off. Although SEF interest rates are higher than commercial rates, it must be noticed that while loan sizes are small and the repayment time is short, a small change in repayment terms might have an immense impact on the effective interest rate (based on a declining balance) but will be a nearly insignificant factor in the context of the borrower’s welfare.

It was found a positive correlation between education and turnover. The better-off MCP clients were more educated and literate than TCP clients. The lack of education compromises the ability to understand the benefits of credit. Moreover, the educated women would have additional benefits for their children. A strong positive correlation between loan size and profits was also found. However many clients especially in the TCP criticised the SEF for providing too low credit lines. The women were not able to grow stock, which would have been a necessity for business expansion. There is a good reason for taking a cautious attitude toward increased credit lines. It is vitally important that the loan size will take into account limited risk-bearing abilities and capacities of the poor. Therefore, in the presence of informational asymmetries and the moral hazard dilemma, increase in loan sizes should be
granted only after a careful investigation of risks, and also be made conditional upon previous repayment performance. Sharma and Zeller (1997) inquire about objective and realistic project evaluation, which they see to be necessary prior to loan approval.

Stiglitz (1990) suggests that there are more incentives for similar individuals to form groups, as information asymmetry between members is expected to be lower in homogeneous groups. In this study, it was noticed that a number of repayment problems in groups were caused by mixed income level and internal inequality. Especially in the MCP an incentive to free-ride seemed to be a problem, which reflects the need and importance of dynamic incentives. In heterogeneous groups the income gap between better- and worse-off clients may grow remarkably. Sharma and Zeller (1997) argue that a group member may choose to finance a riskier project than she would when liability is not shared with others. Their analysis also indicates that asset and enterprise diversity within groups significantly affect repayment rates. High drop-out rates indicate that there in turn are lots of membership changes in groups, which may have an influence on the effectiveness of the self-selection and enforcement factors of the joint-guarantee methodology. The strong correlation between profits, loan size and time of participation implies that new members will guarantee the larger loans taken by long-term clients, which may lead to difficulties to overcome the weaker borrowers’ incentive to free-ride. These problems are of critical point in the microfinance industry, and might never be entirely resolved. However, group members have better opportunity to obtain, at a lower cost, information regarding the reputation, indebtedness, and wealth of the loan applicant, and her effort performance, than the institutional borrower.

Reaching financial sustainability with targeting the poorest is a great challenge for the microfinance industry. Many microcredit institutes are financed partly by donors, since generating a sufficient cash flow from operations alone is usually difficult. It can be questioned, however, whether targeting self-sustainability is necessary if there is an opportunity for donor money. The key is increasing cost-effectiveness, which would presumably be at the expense of poverty targeting. Maximising institutional and field staff efficiency together with cutting costs might without doubt have a negative influence on the poorest, who request a great contribution in regard to monitoring and business training.

Although many important economic and social impacts of microcredits have been clarified in this study, it is still unable to provide a final answer to the question of the total effect of the microcredits on local livelihoods, even in this single case observed in Tzaneen area. The
results are still related only to a limited area, and the data has been gathered within only a limited period of time. It is, however, able to summarise cautiously the difficulties and opportunities that are directed towards microfinance in Southern Africa, in areas that share similar socio-economic setting. In this context it can be argued that, when properly designed, microfinance institutions like The Small Enterprise Foundation have an important contribution to make to women’s empowerment.

ACKNOWLEDGEMENTS

The travel scholarship of the Nordic Africa Institute, Sweden, facilitated the research trip to South Africa. The staff of the Small Enterprise Foundation in Northern Province South Africa provided important background information for the study and helped in organising the fieldwork.

References


