State of the Microfinance Industry in South Africa and the Regulation Thereof

By **Chisala Tembo**
Managing Director
Lime Credit Group: South Africa

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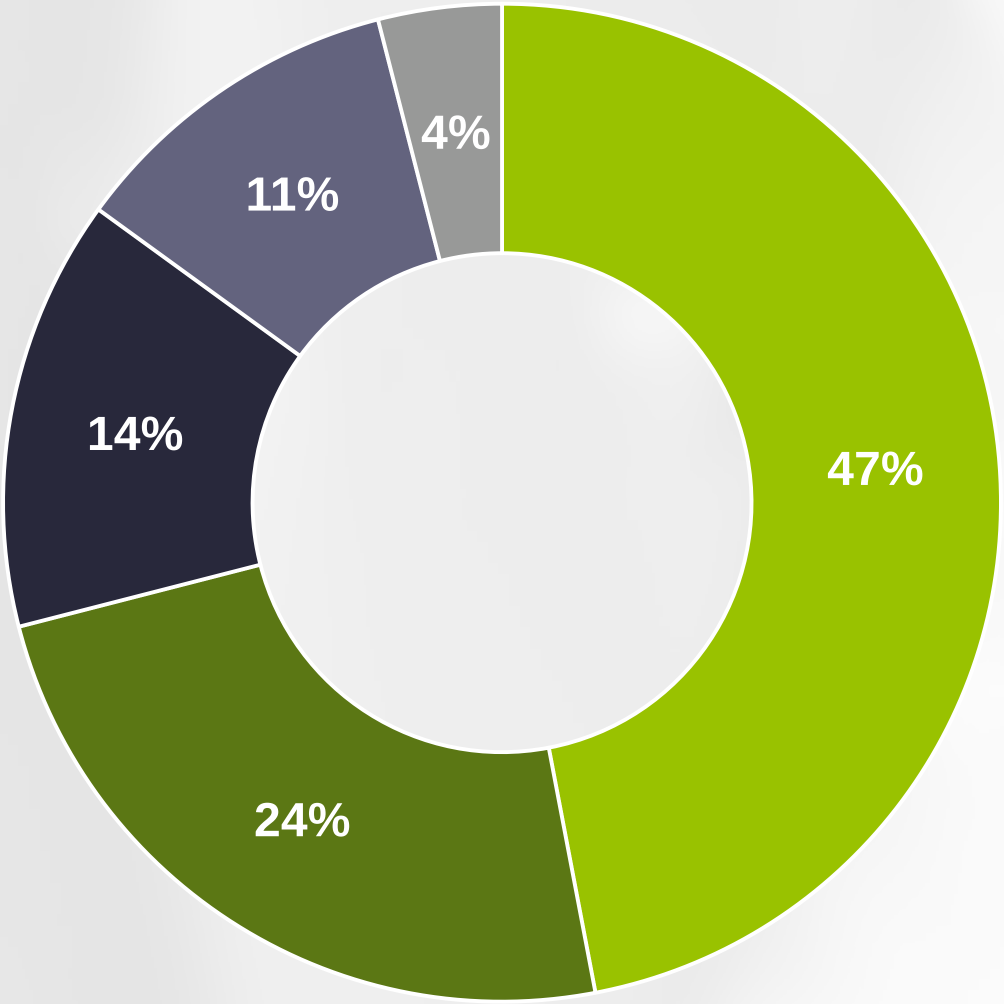
The South African Microfinance Structure



The most prominent feature is that the largest proportion of microfinance in South Africa is towards consumption lending (47%) and only 4% is towards small business. A paradigm shift is required in the industry in order to have more micro loans towards developmental purposes.

- Consumption
- Housing
- Durable Goods
- Small Business
- Education

Source: National Credit Regulator

The South African Microfinance Structure

South African microloans, due to the costs and size, **lead to outcomes that differ from the intentions of inclusive microcredit.**

Microcredit	SA Micro Loans
Small loans	Large loans
Short-term loans	Long-term loans
Granted to unemployed people	Targeted exclusively at employed people
Intended for creation of income-generating activities	Marketed & used for consumption purposes
Low cost	Exorbitant costs
Developmental focus	Profit motive

High Demand and Easily accessible

Lenders compete on size not cost

Fixed regulated fees and interest regardless of size of lender

As per National Credit Regulator (NCR), Q1 and Q2 of 2019

Euro 16 025 100 000 was issued in total loans in South Africa, of which **Euro 642 675 000** went towards micro loans. This is only **4%** of total loan portfolio.

Source: National Credit Regulator

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South African Microfinance Structure

Another prominent feature within the market is the existence of informal lenders within, commonly known as **“Mashonisas”.** Research conducted shows that approximately **40,000** informal lenders exist on the market with a ratio of 1:100 households.

Mashonisas		vs	Formal Lenders	
👍	👎		👍	👎
Local and easily accessible	Confiscation of personal I.D’s/cards		Discreteness	Tempted by bigger loan offers
Quick loan payout	Exorbitant interest rates		Bound by regulation	Long repayment
Not on credit record	Power dynamics		Low interest rates	Complicated fee structure
Easy to understand	Seizure of personal belongings		Payment arrangements	Too many documents required to be approved of a loan
No documents required to get a loan	Feel “watched”		Respect	Longer loan payout period
No affordability assessment or credit check	Humiliating			Travel often required to lender premises
	Limited recourse			

Market Entry and Regulation

Easy Market Entry but Increasing Market Exist

Registration with Companies and Intellectual Properties Commission → Register with National Credit Regulator (with various requirements) → Register with certified credit bureau → Fully registered and ready to trade.

Industry has been experiencing increased exit due to regulatory constraints in form of high cost of compliance. Micro Finance South Africa, the countries microfinance representing body has seen a reduction in membership of 50% in less than 8 years from 2200 membership to currently 1100 due to market exit.

Regulatory requirements are the same regardless of size of organisations eg the bank and a small microfinance organisation. This forces small microfinance organizations out of the market as they are unable to compete and afford to remain compliant and profitable at the same time. South Africa is said to be “a third world country with first world regulatory requirements” in the microfinance industry.

The rapid technological evolution in the industry is also a contributing factor to the increased exit from the market. Many MFI’s lack capacity and funding for technological advancement.

Opportunity

Opportunity exists by leveraging through digital technology in form of AI, Machine Learning which results in alternative credit scoring, quicker decisions and improved customer service, higher reach, integrated product life cycle and product agility. Companies that are transforming and taking advantage of technology are succeeding greatly in the industry. Eg Lime.

Costs and Profits

Despite the high-risk nature of the consumption lending related micro loans in South Africa, the industry remains profitable**.** This is due to the egregious charges levied on consumers to compensate for these risks**.** 60% first loan and 36% subsequent loan interest per annum, euro 3.7 service fees per month and euro 10 + 10% initiation fees. 347% APR on first loan and 323% APR on subsequent loans.

Estimation on the returns on equity (RoEs) for loans which do not default

2 – 6 months	534.00%
7 – 12 months	115.00%

Summarised Income Statement i.e. expressed as a % of Current Outstanding Balances

Income	11.76%
Other Income	0.22%
Total Income	11.97%
Expenses	6.01%
Net profit/Loss Before Tax	5.97%
Tax Expense	1.67%
Net profit/Loss After Tax	**4.30%**

Some Rule of Thumb Metrics based on above cost assumptions

Collect >=**111%** of total disbursement value

Overdue as % of Disbursements < **12.5%**

Defaults (3+ Arrears) as % of Disbursements < **6.75%**

Source: Compuscan Credit Bureau

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Collection Process

South Africa has one of the most **sophisticated payments and collection systems** in Africa.

Loan repayments collected through Debit order system.

Repayment of loans coincides with salary **payday** as consumers have money on their paydays.

This **increases collection** and allows for efficient cash flow **forecast.**

Most effective in conventional **brick and motor lending** as there is an opportunity to **lock with no ability to reverse collected transaction.**

Online transactions allows for reversing already collected repayment by the consumer. The solution to this is a recently introduced collection process by the Payments Association of South Africa called Debicheck which minimizes the risk of reversed successful collections.

Financial Literacy in South Africa

Part of **school curriculum,** adapted to the age and grade.

However the **high level of indebtedness in many households** shows that there is not much emphasis on **adult financial literacy.**

Household debt to income ratio at **all time high,** savings to income is **negative.** These levels indicate **poor financial management** as a result of little financial literacy.

Many **financial literacy programmes** not suited to **dualistic economies** like SA.

National average of adult financial literacy is at **48.42%.**

Gender

Male **49.02**

Female **47.87**

Race

Black **46.19**

Mixed race **49.19**

Indian **55.83**

White **60.86**

Education

Some primary school **42,4**

Primary school **44.33**

Some high school **45.2**

Matriculated **50.47**

Some university **57.46**

Any other post-matric qualification **58.73**

University **63.02**

Age (years)

18-29 **45.79**

45-59 **51.39**

30-44 **49.45**

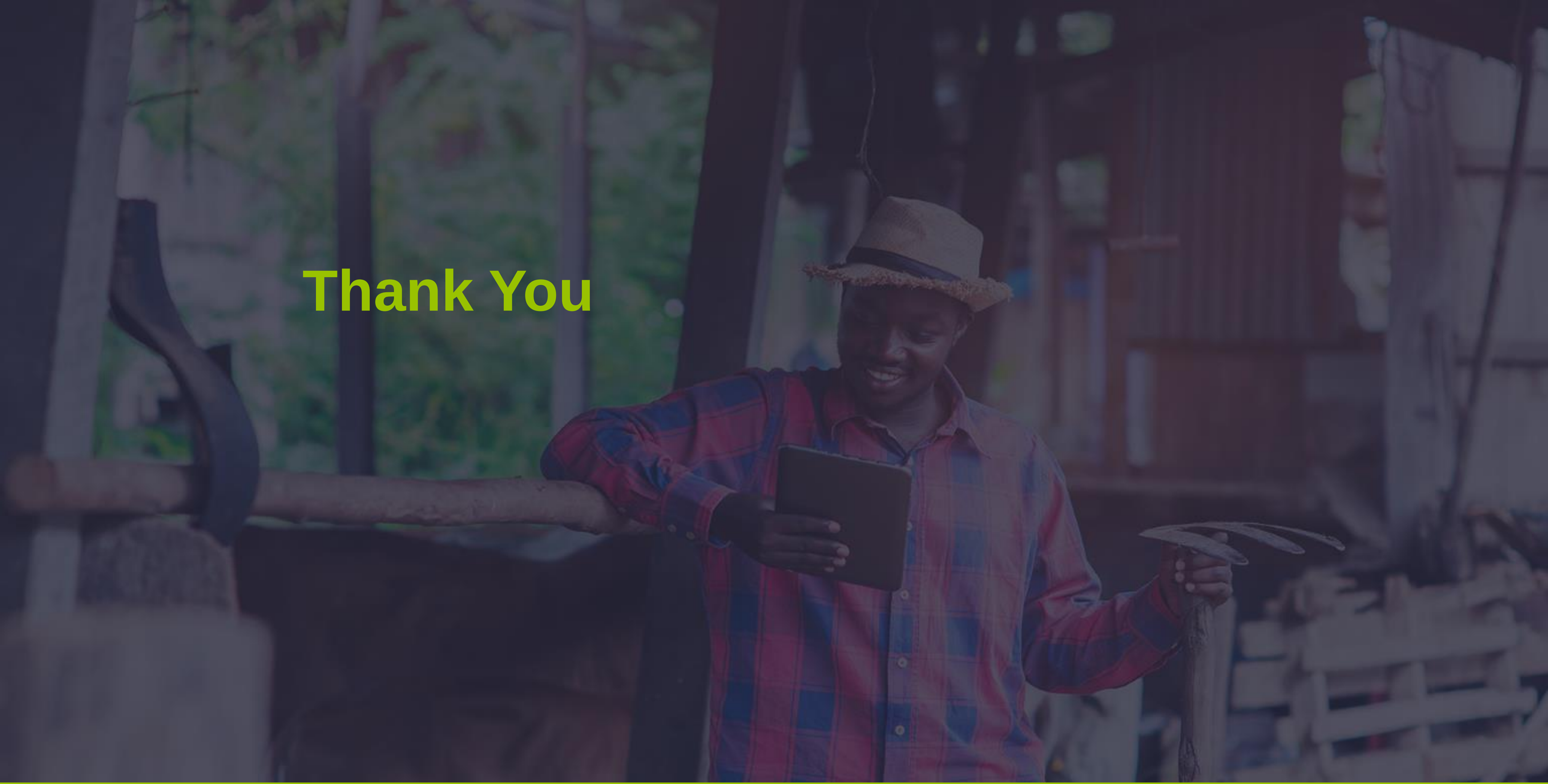
60+ **50.02**

SA Average = 48.42

The NCR plays a huge role in financial literacy through workshops, seminars and other learning programmes. However these efforts are not enough. A need for combined efforts from the private sector and the lending institutions will be able to drive an increase in adult financial literacy.

Source: SALDRU 2019

Note: The figure shows the mean financial literacy score in the age, gender, education and race categories.
The data is weighted to be Nationally representative. Weights are benchmarked against Statistics South Africa weights.



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