The Status of Agricultural and Rural Finance in South Africa

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Acronyms

ABC	Agricultural Business Chamber
AFRACA	African Rural and Agricultural Credit Association
AgriSETA	Agricultural Sectoral Education and Training Authority
AMFISA	Association of Micro Finance Institutions of South Africa
ASCA	Accumulating savings and credit association
ASISA	Association for Savings and Investments South Africa
ATM	Automatic teller machine
AU	African Union
BankSETA	Banking Sectoral Education and Training Authority
BASA	Banking Association of South Africa
BBBEE	Broad Based Black Economic Empowerment
BEE	Black Economic Empowerment
CAADP	Comprehensive Africa Agriculture Development Programme
CASIDRA	Cape Agency for Sustainable Integrated Development in Rural Areas
CASP	Comprehensive Agricultural Support Programme
CBDA	Cooperative Banks Development Agency
CCA	Consumer Credit Association
CGAP	Consultative Group to Assist the Poor
CGS	Credit Guarantee Scheme
CIBA	Centre for Inclusive Banking in Africa
CLARA	Community Land Rights Act
CPA	Credit Providers Association
CPSS	Committee on Payment and Settlement Systems
CRDP	Comprehensive Rural Development Programme
DAFF	Department of Agriculture, Forestry and Fisheries
DBSA	Development Bank of Southern Africa
DCA	Development Credit Authority
DGRV	German Cooperative and Raiffeisen Confederation

DRDLR	Department of Rural Development and Land Reform
DFI	development finance institution
DFID	UK Department for International Development (UKaid)
ESA	East and Southern Africa
EFT	electronic funds transfer
FAIS	Financial Advisory and Intermediary Services
FET	Further Education and Training
FIC	Financial Intelligence Centre
FNB	First National Bank
FSB	Financial Services Board
FSP	Financial Services Programme
FSP	financial service provider
GDP	Gross Domestic Product
GPFI	Global Partnership for Financial Inclusion
HE	Higher Education
IDC	Industrial Development Corporation
IDT	Independent Development Trust
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
INSETA	Insurance Sectoral Education and Training Authority
IoDSA	Institute of Directors of South Africa
KZN	KwaZulu-Natal
LB	Land Bank
LED	local economic development
LRAD	Land Redistribution for Agricultural Development
LREF	Land Reform Empowerment Facility
MAFISA	Micro-Agricultural Finance Initiative of South Africa
MDG	Millenium Development Goal
MEGA	Mpumalanga Growth Agency
MFRC	Micro Finance Regulatory Council

MFSA	Micro Finance South Africa
MFW4A	Making Finance Work for Africa
MMT	mobile money transfer
NASASA	National Stokvels Association of South Africa
NCR	National Credit Regulator
NDMA	National Debt Mediation Association
NEF	National Empowerment Fund
NERPO	National Emerging Red Meat Producers' Association
NGO	non-governmental organization
NHFC	National Housing Finance Corporation
NPS	National Payments System
NYDA	National Youth Development Agency
OECD	Organization for Economic Cooperation and Development
PASA	Payments Association of South Africa
PCH	Payments Clearing House
PLAS	Pro-active Land Acquisition and Settlement
REGO	Regional Economic Growth Office
RHLF	Rural Housing Loan Fund
ROSCA	rotating savings and credit association
SACCO	savings and credit cooperative
SACCOL	Savings and Credit Cooperative League of South Africa
SADC	Southern African Development Community
SAIA	South African Insurance Association
SAMAF	South African Microfinance Apex Fund
SAMOS	South African Multiple Option Settlement
SAPPO	South African Pork Producers' Association
SARB	South African Reserve Bank
SCG	savings and credit group
SEF	Small Enterprise Foundation
SEFA	Small Enterprises Finance Agency

SETA	Sectoral Education and Training Authority
SLAG	Settlement and Land Acquisition Grant
SMEs	small and micro enterprises
SMMEs	small, medium and micro enterprises
SSA	Sub-Saharan Africa
TSP	technical service provider
USAID	United States Agency for International Development
VSLA	village savings and loan association
WDB	Women's Development Business

1. Executive summary

Background

Commissioned by FinMark Trust in terms of its mandate 'to make financial markets work for the poor', the study examines the current state of agricultural and rural finance in South Africa. The study aims to understand the nature, extent and causes of the problems and challenges faced by poor rural communities in accessing and making use of financial services, ultimately, to derive a set of recommendations for addressing the challenges. (Well-established, large scale commercial farmers, whose financial services needs are generally well catered for, fall outside of the scope of the study.) Parallel studies have been carried out in Botswana, Malawi, Mozambique, Zambia and Zimbabwe, with the collective object of facilitating the development of a regional level agricultural and rural finance policy framework.

Introduction

The study is located in the context of centuries of formal and informal racial division in South Africa. Since the institution of democratic government in 1994, much emphasis has been given by the state to creating a more racially representative agricultural sector, led by its policy of land reform. The 'land restitution' and 'land redistribution' thrusts of this policy have established a class of land reform beneficiaries in the former 'white rural areas' who, in most cases, are attempting to engage in large scale commercial farming. State grants for land, fixed improvements and machinery have not been matched by the farms' ability to raise working capital, which has been seriously hamstrung by tenure restrictions which do not allow beneficiaries to use their physical assets as collateral for loans. About 50% of such farms – which number at most only a few thousand - are no longer functional.

By contrast, there are 2,5-3,5 million households in the 'black traditional' farming areas engaged in small scale agriculture for their own consumption (referred to in the study as 'subsistence' farmers) and an estimated 350 000-700 000 who produce some part of their output for the market (referred to as 'emergent farmers'). With very few exceptions, these farmers are also unable to use the land that they farm for collateral, as the state owns almost all land in these areas. This not only makes borrowing more difficult, but also obstructs land rental, thereby hindering the development of economies of scale for those who would like to farm commercially. The number of small to medium scale farmers who are more or less fully commercial (referred to as 'small-scale commercial farmers'), spread between the former 'white' and 'black traditional' farming areas, can be estimated at between 11 000 and 15 000.

Demand

The study develops a typology and profile of these client groups and their needs for financial services, drawing primarily on three FinMark Trust surveys - the FinScope Consumer Surveys, 2010 and 2011 and the FinScope Small Business Survey, 2010. At an aggregate level (including those who used more than one category of service), almost half of rural adults (aged 16+) made use of some form of bank service in 2010, against nearly 70% in urban areas. At 38%, women were significantly less 'banked' than men (61%). In 2011, just on 30% used some form of formal non-bank financial service (insurance, supplier credit, etc.), with much the same percentage making use of an informal financial service. A similar proportion of rural adults did not use any kind of financial service in 2010, against 21% in urban areas. There was a strong correlation between being poor and not having access to financial services.

More than one in every two (2-2,5 million of the total of 3-4 million) rural households were involved in small or micro-enterprise activity in 2010. Nationally, as many as 13,5% of SME owners reported undertaking some form of agriculturally-related activity: growing and selling something, selling by-products of animals, rearing and/or selling livestock/poultry and selling something that was collected from nature. 60% of rural SME operators were women and more than a third used a banking service. In respect of the four main financial services considered – savings, transmission/transactions, credit and insurance – again just more than a third used formal savings and transmission services, but only about 10% formal insurance services and less than 4% formal credit (2,5% from a bank). Membership of informal savings and credit groups (SCGs) is significant among rural SME owners: 15% reported saving through this medium and 10% borrowing – 4 times the percentage borrowing from banks.

Following FinScope's 2010 Small Business Survey, 'small farmers' were defined to include only the roughly 700 000 who derived some degree of cash income from agriculture, i.e. 'emergent' and 'small commercial' farmers. 'Subsistence' farming households were taken into account as 'rural households'. On this definition, a surprisingly high 46% of small farmers – almost equal proportions of whom are male and female – are to be found in formal or informal urban areas. As with many other countries in Africa, earning income from small-scale agriculture is now clearly a significant component of many urban residents' livelihood strategies. More than a half of urban small farmers use banks' services (53,4%), as against 38,4% of their rural counterparts, suggesting that ease of physical access is an important determinant of formal financial inclusion. Nearly half of small farmers used formal savings and/or transmission services and about 30% formal insurance services, but, as with SMEs, only a small percentage formal credit services (5,6%), just 2,5% from a bank. In common with SMEs, family and friends were the most frequently tapped source of credit. Informal SCGs more often serve as a vehicle for saving the funds required for annual agricultural inputs than as a source of loans for this purpose.

With the private sector generally catering adequately for land reform beneficiaries' and small farmers' savings, transmission and insurance needs, state policy to assist small farmers has focused on capital provision in the form of grants for once-off fixed and movable asset acquisition and loans for recurrent working capital needs. State grants for land totalled R13,6 billion between 2008 and 2012 and R3,4 billion for fixed improvements and movable equipment between 2004 and 2012. The state appears to have been the largest lender of working capital, through the Department of Agriculture, Forestry and Fisheries' (DAFF) Micro-Agricultural Finance Initiative of South Africa (MAFISA) programme, managed by the Land Bank. However, the annual value of these loans has only averaged about R900 million in recent years. The total value of annual lending to land reform beneficiaries and small farmers by other parastatal development finance institutions (DFIs) and commercial banks is unknown, but is probably of the order of half of the value of MAFISA loans.

The acute shortage of working capital experienced by these farmers can best be appreciated against commercial grain farmers' rule of thumb of needing to spend the equivalent of the combined value of a farm's land, fixed improvements and movable equipment on annual inputs. Relative to the R18 billion that the state has spent on acquiring land, fixed and moveable assets for historically disadvantaged farmers, annual working capital loans of about R1,5 billion are seriously inadequate.

Supply

The description of the supply side of the market is presented at the macro- (or policy), meso- (or industry) and micro- (firm or individual supplier) level. The macro-level of the financial system consists of the legislative and policy framework necessary for maintaining the reliability and sustainability of the system. The laws and regulations applying to the financial sector differ by product/service and by institutional arrangement. Comprehensive specific sets of laws govern commercial banks, state banks and other financial service providers, including insurers, specialized credit providers, cooperatives and co-operative banks. Each sub-sector is overseen by a public body tasked to regulate and enforce prudential and market conduct legislation. These bodies include: the

South African Reserve Bank, the National Credit Regulator, the Financial Services Board, the Cooperative Banks Development Agency and the Financial Intelligence Centre.

There are no specific laws or regulations on agricultural finance, other than those governing the operation of the Land Bank. No comprehensive statements of policy on agricultural finance appear to have been made by DAFF, although the Department is known to have drafted and re-drafted a Development Finance Policy Framework on a number of occasions. The 'Kampala Principles' for agricultural financial inclusion in Africa, agreed by a wide range of stakeholders in 2011, could serve as a foundation for such a policy framework. *De facto,* the main mechanisms for financing agricultural asset purchase for land reform beneficiaries and small farmers have been the successive forms of land acquisition grants offered by the Department of Rural Development and Land Reform (DRDLR) since the middle 1990s and, for movable equipment and some types of fixed improvement, DAFF's Comprehensive Agricultural Support Programme (CASP) grants, since 2005. For working capital, the main public sector mechanism has, since 2006, been the MAFISA programme.

The meso-level of the financial system consists of sector-wide infrastructure and support services. Beyond associations representing the various main groups of service providers – commercial banks, insurers, microfinance institutions and so on – the main meso features include:

- the National Payments System, a highly rated clearing mechanism for inter-institutional transactions
- the National Loans Register, a mandatory public credit registry, populated by private credit bureaus
- consumer protection mechanisms, involving consumer affairs courts and ombudsmen for each of the various major categories of financial service
- professional finance-related training organizations, including 'sectoral education and training authorities' (SETAs) for banking, insurance and agriculture, as well as universities and private sector/NGO institutes
- donor-funded programmes, including credit guarantee schemes
- parastatal wholesale finance programmes to promote SME growth. Those with a significantly rural focus include DRDLR's Land Reform Empowerment Facility, DAFF's MAFISA programme and the Rural Housing Loan Facility. Through financial intermediaries, such as commercial banks and other parastatal DFIs, the LREF provides mortgage-based loans to entrepreneurs and farm workers to invest in agriculture, agro-processing and eco-tourism. The LREF also offers an equity share finance facility for farm workers. MAFISA's activities have already been described. By 2010, it was reported by DAFF to have assisted about 11 000 small farmers and land reform beneficiaries, but to have created only 560 permanent and 7500 seasonal jobs. There is little evidence that any of these institutions have successfully reached large numbers of targeted clients.

At the micro- (or individual firm) level, services are provided through a range of different providers such as commercial banks, development finance institutions, microfinance institutions, specialist credit providers, insurers, retailers, large value chain participants, 'stokvels' - rotating savings and credit associations (ROSCAs) - accumulating savings and credit associations (ASCAs), 'mashonisas' - loan sharks, and family and friends. A typology of financial service providers and their products is developed, focusing in particular on the rural and agricultural sectors.

South Africa's financial sector is dominated by four large commercial banks (the so-called 'big four' – Absa, First National Bank (FNB), Nedbank and Standard Bank) which focus primarily on firms – including large scale commercial farms – and households that are at the upper end of the income distribution. In recent years, these banks have all launched initiatives, mostly in branchless banking and micro-enterprise finance, to increase inclusivity. The results have been mixed. Profitable large scale outreach to low-income rural areas by banks is still a challenge, but noteworthy successes are now being achieved.

Most commercial banks are reluctant to disclose details of their lending to small farmers and land reform beneficiaries. However, Absa reports a portfolio to the value of R360 million (advanced to about 1 000 farmers), mainly funding value chain off-take agreements with large processors and retailers for on-lending to such farmers, while FNB refers to a facility of R50-R100 million for on-lending by similar intermediaries, where acceptable collateral is lacking. Other such off-take lending is funded independently by processors and retailers. It appears that this source of capital for small farmers and land reform beneficiaries – and the technical assistance that it often also entails – may be becoming increasingly important.

In the parastatal realm, a number of national and provincial DFIs have an interest in rural development. Of these, the most significant in an agricultural context is the Land Bank, which is mandated to provide financial services to the agricultural sector. Though much of the largest part of its loan book by value is in large scale commercial farming, about a third of its roughly 21 000 retail clients – to whom standard collateralized short, medium and long term loans are advanced – are black farmers. Loans to the latter stood at a total of R876 million (or an average of a little more than R100 000 per farmer) in March 2012. The performance of many of these loans is problematic. More innovatively, through its Retail Emerging Markets division, the bank also lends on a short or medium term basis to small farmers who are unable to offer land-based collateral. Such loans are usually either secured by crop lien and/or are advanced on a wholesale basis through intermediaries, mostly the agricultural cooperatives and former cooperatives, commodity associations, farmers associations and microfinance institutions which are the bank's MAFISA sub-agents. The total value of such loans is not known, but the amount disbursed by MAFISA on-lenders by 2012 was R179 million.

The Industrial Development Corporation's (IDC) Agro-Industries Division focuses on investments and large-end loans to agro-processing (food and non-food), beverages (alcoholic and non-alcoholic) and aquaculture. Although 'empowerment' projects to assist historically disadvantaged groups are emphasized, it does not fund primary agricultural projects or land-based transactions/acquisitions. Most of its investments are in large scale fruit and wine projects. The National Empowerment Fund also has a rurally-focused division, which made loans averaging R2 million to 480 rural entrepreneurs, some in agricultural production or processing, in 2011/12. At the micro-end of the market, much the most important parastatal player – though in no way agriculture-specific – is the PostBank, which offers mainly savings and transmission facilities through its wide network of rural branches, but has now also entered the credit market, through its social grants-based debit card initiative. It also plays an essential support role to microenterprise lenders who require group members to make repayments at a local bank.

Among South Africa's formal microfinance services, micro-deposit-taking and salary-based micro-lending are well established, though micro-enterprise lending is in its infancy. However, while many registered microfinance institutions operate in rural towns and a few are known to be keen to support rural development, very little is known about their rural clientele.

Informal microfinance institutions are widespread, both in urban and in rural communities. These include at least 11 000 'stokvels' – popular rotating savings and credit associations (ROSCAs) – village savings and loans associations (VSLAs) and burial societies. Some stokvels extend credit to members, some invest in assets that can generate income for the members, while some are used only to save funds towards a particular event such as the beginning of the school year. VSLAs, modelled along accumulating savings and credit association (ASCA) lines, are now playing an increasingly important role. The savings and credit groups (SCGs) promoted by SaveAct in Kwa-Zulu Natal and the Eastern Cape are good examples. Typically about two thirds of the savings of these groups is mobilized into loans at any moment. They are a particularly important source of capital for subsistence farmers: in many instances SCGs time the annual distribution of savings and interest to coincide with the beginning of the summer crop planting season, thereby providing the funds necessary to purchase seed and fertilizer, without having to borrow for this high-risk purpose and without needing to generate a flow of cash income to service and repay a loan.

About 30% of small farm enterprise owners have some form of formal insurance. Most policies relate to funeral or life assurance. Agricultural insurance is not widely used in the South African emerging agriculture sector given the high transactions cost and exposure to moral hazard. Market penetration in the small farmer sector is estimated to be less than 1%. About 6 million South Africans are thought to belong to informal burial societies.

Enablers and disablers of demand and supply

High political priority has been given by successive African National Congress administrations to rural development. While this ought to be an unqualified enabler, stimulating both the demand for and the supply of financial services in rural areas, rhetoric has not been matched by the performance of the two main implementing departments, DRDLR and DAFF, or by their ability to coordinate.

The state's land transfer – and fixed improvement and machinery/equipment – grants have been a major enabling factor in terms of public financial service delivery. However, in terms of their impact on the demand for financial services, it has often been more to increase the size of potential demand than of effective demand, given the restrictions placed on using assets transferred as collateral for loans. The de-racialization of state social grants and the introduction or extension of some categories of grant has hugely benefitted rural areas. By 2012, no fewer than 65% of social grant recipients in rural areas were being paid their grants electronically, which helps account for as many as 48% of adults aged 16+ living in South Africa's rural areas ('formal' and 'tribal') being 'banked' in 2010. There is evidence that state social grants have fuelled both informal savings and credit activity and agricultural production/income in some low-income rural communities. This, in turn, has helped fuel the savings flowing into SCGs, thereby setting up a virtuous circle of development. However, it is sometimes argued that the grants have a disincentive effect on recipients' willingness to engage in economic activity, though solid evidence to support this and to assess the impact on labour force participation is hard to find.

South Africa has financial infrastructure, regulation and banking systems that compare favourably with most developed economies. Macroeconomic performance has generally been sound since 1994. There are few financial policies that cause financial market distortions, in particular, relating to interest rate ceilings. However, some state/province-owned DFIs display negative symptoms similar to those of many of their counterparts abroad. To date, subsidies on credit to small farmers and land reform beneficiaries provided by the state and parastatal institutions have been modest and have done little to crowd out private sector/NGO lenders. But probably the most important deficiency in the country's agricultural financial infrastructure is the absence of a single champion and coordinating body for agricultural finance.

Farmers in the 'traditional' black rural areas have experienced many of the disabilities that have beset their counterparts in most other African countries: typically, distance from markets, poor infrastructure (affecting transport, water, energy and communications), poor services (for inputs supply, marketing, extension, finance, health, education, among others) and poor local government/municipal service delivery. Much progress has been made since 1994 in overcoming the major infrastructural backlog in 'traditional' black rural areas. The aspect of infrastructure in which the fastest growth has occurred, is communications, where the greatest part of investment has been undertaken by cellphone companies. Cellphone-based finance technologies offer rural residents ready access to transmission/transactions services. ‘Branchless banking’ through retail chains is now spreading rapidly, accompanied by significant reductions in transactions costs. Even more than cellphones, this is broadening the uptake of formal financial services, given that it is not confined to transactions/transmission services, and needs neither a cellphone nor the literacy to use it for financial purposes.

South Africa also has a wide range of rural finance and non-financial support institutions, but it does not seem that small farmers make extensive use of these services. DAFF has struggled to improve the poor quality of extension services provided to black farmers, and, perhaps even more to the detriment of agricultural development, ‘land tenure reform’ – the third major thrust of DRDLR’s land reform programme – has simply not materialized. In practice, there has been little change to the tenure systems that applied under apartheid.

From a tenure perspective – and also for purposes of lending – what would help greatly would be the evolution of existing tenure systems to allow more readily for the rental of un- or under-utilized land for agricultural usage. This would open up the possibility for those wishing to enter or expand commercial production to acquire the use of sufficient land to generate an income which competes well with earnings from other sources and to realize economies of scale. The inability of both small farmers in ‘traditional’ black rural areas and land reform beneficiaries to use the land that they farm as collateral for bank loans makes lending more difficult. Progress is now being been made in finding alternative bases for lending, mainly through value chain finance on-lent by processors and retailers. However, this is limited to the very small group of farmers who are firmly integrated into value chains. A major challenge is to broaden the size of this group.

When the costs of formal financial transactions are taken into account on a comprehensive basis, many low-income rural clients prefer to use local informal financial institutions, for which the transport and opportunity are low, regulatory and compliance requirements and prerequisites are absent and the social/cultural and psychological costs are generally known and manageable.

Levels of financial literacy in low-income communities, measured conventionally, remain a challenge. Familiarity with formal financial products is limited, as is awareness of formal sources of help. However, it is also evident that many poor rural clients are adept at managing day-to-day cash flows, are able to service and repay informal SCG loans which they use to capitalize their enterprises, and manage to mobilize substantial combined savings capital for loans, with attractive rates of return and low default rates. Awareness of the risks of agriculture leads such clients to use annual savings and interest pay-outs to finance farming, rather than borrowing for this purpose. This defies the notion that low-income rural households, SME owners and small farmers are financially illiterate.

Formal financial institutions need to market their products better in this community, to make them competitive with informal products and to find ways to complement the services that their informal competitors offer. It is also important to reconsider the way in which financial literacy is understood, measured and addressed. It is critical for formal financial institutions to increase their own understanding of small scale agriculture. To this end, it would be helpful to establish specialized in-country staff training courses focusing on small-scale farming in South Africa and to engage more actively in Africa-wide processes to increase agricultural financial inclusion.

Recommendations

Table 12 of the report enumerates (non-exhaustively) major issues to be addressed to improve low income rural communities’ access to and uptake of financial services and makes corresponding recommendations.

2. Background

Access to financial services is an important contributor to enterprise productivity the world over. In sub-Saharan Africa, where most people still live in rural areas and agriculture is the mainstay of the rural economy, access to financial services of all kinds appears still to be poor. Yet relatively little is known about the demand for, supply of and effective level of access to rural and agricultural finance and about the policies, institutions and many other factors that determine them.

As part of its mission to 'make financial markets work for the poor' in southern Africa, FinMark Trust commissioned the Centre for Inclusive Banking in Africa in 2010 to undertake a study to examine the current state of rural and agricultural finance in the region to enable the development of regional and country level policy frameworks and strategies that will significantly improve access to and the uptake of rural and agricultural finance. The specific objectives identified were:

- to conduct country and regional level assessments of the current state of agricultural and rural finance in southern Africa,
- to identify best practices in agricultural and rural finance in Africa and elsewhere,
- to develop an overall policy framework and strategic approach to address agricultural and rural finance challenges at regional and country level,
- to assist country level programmes towards operational action and impact in terms of access,
- to provide a benchmark for agricultural and rural finance in southern Africa and to develop a structure for long-term monitoring of progress, and
- to identify a small number of promising projects to assist.

This report summarizes the findings of the first phase of the work for South Africa, namely, an assessment of the current state of rural and agricultural finance in the region. The research has been carried out in six countries – Botswana, Malawi, Mozambique, South Africa, Zambia and Zimbabwe – drawing mainly on secondary sources. It was completed during 2012.

3. Introduction

Despite rapid urbanization in recent decades, sub-Saharan Africa's (SSA) population and economy are still predominantly rural and poverty is still primarily a rural phenomenon. The United Nations' International Fund for Agricultural Development (IFAD, 2011) reports that more than 70% of the continent's poor live in rural areas and depend mainly on agriculture for their livelihoods. Agriculture provides about 70% of employment and about 30% of the combined Gross Domestic Product (GDP) of SSA.

In Eastern and Southern Africa (ESA) the concentration of poor people is among the highest in the world. Most of the region's estimated 130 million poor live in rural areas and IFAD's research indicates that rural poverty is deepening. In 10 of the 21 countries in the region, average per capita income was less than US$1,10/day in 2009 – below even what is generally accepted as the 'extreme poverty' level of income. Growth in the rural economy is slow, in part because arid or semi-arid land makes up almost 40% of the region's land base. Yet, while agricultural productivity is stagnating or decreasing, IFAD (undated) reports that more than 85% of the rural population live on land that has medium to high potential for increased productivity. It is the limited use of this natural resource base that leads to low productivity and low incomes in agriculture, which, in turn, limits the inclination of smallholder farmers to invest. This will make it difficult to attain Millennium Development Goals (MDG), especially MDG 1 – the halving of hunger and poverty by 2015 – and the 6% per annum increase in agricultural productivity aimed at by the African Union's (AU) Comprehensive African Agriculture Development Programme (CAADP).

The constraints on agricultural productivity are multiple and well recognized. Many are exogenous, brought about by policies and practices entirely beyond the control of farmers, including low public sector expenditure on agriculture and inadequate infrastructure, producer incentives, marketing structures, extension services, water management, research and development support, and financial services. Public sector expenditure on agriculture seldom reaches the 10% of national budgets agreed to in the 2003 Maputo Declaration. The low public sector expenditure on agriculture is caused partly by the decline in development aid. The collective impact reduces the returns on investment in agriculture to levels which are unattractive to most households and also aggravates the food security situation in the region.

But other constraints are endogenous. While most households that engage in small-scale farming are adequately supplied with labour, many will lack the technical and/or managerial skills to undertake anything but subsistence farming. Furthermore, few households will have the internal capital resources to produce more than occasional surpluses for the market.

It is in this context that the significance of access to financial services (transactional, savings, credit and insurance products and services) becomes clearest. Given the size of the outlays required to cover their annual, medium-term and long-term needs, most commercial farmers - especially annual crop farmers - find it necessary to borrow part or all of the funds needed. For grain producers, the cost of annual inputs often exceeds the value of their mortgagable medium and long term assets. Whatever other improvements – for example, to infrastructure or water management – are made to raise the returns that agriculture offers and to encourage small-scale farmers to increase the volume of output marketed, most farmers will have difficulty in producing more for the market and improving food security without adequate access to and greater usage of borrowed capital and other financial services.

Although credit is emphasised above, a similar logic applies to other financial services, such as for saving, insurance, transmission and even foreign exchange. Savings facilities make it easier to accumulate internal capital and encourage less risk-averse behaviour by farmers. Insurance services also promote less risk-averse behaviour by both farmers and service providers. Transmission facilities make it easier to send and receive money, thereby reducing the cost and encouraging remote transactions, for example, to procure farming inputs. Foreign exchange facilities make it easier for farmers and traders to market output and buy other products across borders – a flourishing business in the region. Often the track record built up by using one or more of these facilities lays the foundation for borrowing.

Like advances made in easing any other constraint, improvements in financial services will probably not, on their own, bring about greater investment, productivity or income from agriculture or any other rural enterprise. Nevertheless, if such improvements are insufficient on their own to ensure progress, they are clearly a *sine qua non* for such gains. Yet, of the many pre-conditions for agriculture and rural development, the provision of financial services remains one of the most poorly fulfilled almost throughout Africa and the nature, extent and causes of the deficiencies remain among the most poorly understood.

South Africa clearly differs fundamentally from most other countries in the region, both because of the extent of its large scale commercial agriculture, which is responsible for about 95% of its farm output (Tregurtha et al, 2010), and because of the highly developed services that cater for the financial needs of this sector. Large scale commercial agriculture is dominated by white-owned enterprises, which have not only been well-supported by private financial and other services, but which received multiple forms of state support prior to democracy in 1994.

Since 1994, it has been a state priority to develop smaller and larger black-owned agricultural enterprises, in part through increasing such farms' access to financial services and through articulating these services to their needs and resources. To date, as the analysis below indicates, only limited success has been achieved, either in respect of establishing viable black-owned commercial or commercially-orientated farming enterprises, or in respect of providing effective financial services support for such enterprises. In this critical sense, South Africa differs little from the rest of the region and the continent.

3.1 Objectives, ambit, methodology

Sponsored by the FinMark Trust to further its objective of 'making financial markets work for the poor', this study examines the status of agricultural and rural finance in South Africa, focusing in particular on access to and the uptake of financial services by smaller and larger black-owned farms, small and micro enterprises (SMEs) in rural areas and poor rural households. The study aims to understand the nature, extent and causes of the problems and challenges faced in delivering and making use of these services, ultimately, to derive a set of recommendations for addressing the challenges. The nature and extent are gauged by analysing and comparing the demand for and the supply of financial services in the low-income rural economy. Insight into the causes of the problems and challenges is gained by identifying the factors that have either enabled or disabled progress in the provision of financial services to this sector of the economy. The recommendations aim at extending the enablers and eliminating or ameliorating the disablers.

In assessing the gap between demand and supply, attention is paid not only to the effectiveness of small farms' and rural enterprises' and households' access to finance – or lack thereof – but also to the appropriateness and sustainability of the products and services offered in relation to their needs. Special emphasis is given to agriculture, as farming is the most widely undertaken economic activity in South Africa's low-income rural areas, even if it is nowadays only a minor contributor to income and wage employment. This is done without losing sight, on the one hand, of the importance of financial services for other types of rural business – which are also widespread – and for rural households' needs as consumers, and, on the other, of the growth of small-scale farming as an urban activity. Almost half of South Africa's small scale farmers are now to be found in urban or peri-urban areas.

Bearing in mind the different levels at which policy and practice operate, the enablers and disablers are identified as macro- (or policy-), meso- (or industry-), micro- (or firm-) or client-level phenomena.

The information used for this study was obtained mainly from secondary sources, given time and budget constraints. However, a small number of face-to-face interviews relating to the supply of financial services were also conducted with key informants.

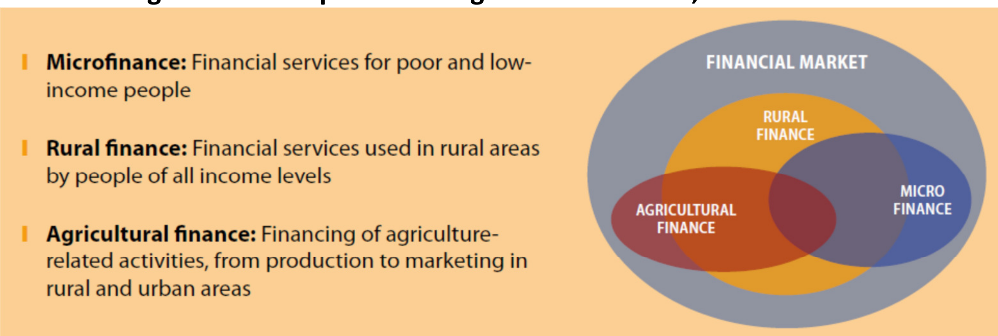
3.2 The structure of the market for agricultural and rural financial services

"Agricultural finance refers to financial services, including savings, transfers, insurance and loans, potentially needed by the agricultural sector, meaning farming and farm-related activities including input supply, processing, wholesaling, and marketing. Most of these activities are conducted in rural areas, but large processing facilities and agribusinesses, as well as (many) largely subsistence-level smallholders, are also located in urban and peri-urban areas" (MFW4A, 2012)[1]. Indeed, the extent of small-scale farming in South Africa's urban areas is surprisingly large: the FinScope Small Business Survey, South Africa, 2010,[2] reported no less than 37% of households engaged in small-scale farming as being in formal urban areas and a further 9% in informal urban areas.

Beyond agriculture, financial services providers need also cater for the requirements of the 2 – 2,5 million rural SMEs (including those in agriculture) whose existence the survey also reports – more than one rural household in two is engaged in some form of small business activity – as well as for those of the estimated 3 – 4 million rural households (FinScope Consumer Survey, South Africa, 2011)[3], in their role as consumers rather than producers.

This section of the report describes, on the one hand, the environment and the financial service needs and demands of rural dwellers and farmers, and, on the other, the provision or supply of agricultural and rural finance services, as they presently exist in South Africa. The description will also include brief insights into the developmental microfinance sector, which is particularly important in serving the entry-level financial services needs of low-income households in rural areas, the majority of whom are engaged in some form of agriculture, as well as those of their counterparts in urban and peri-urban areas. The diagram below depicts the inter-relationships between rural, agricultural and microfinance.

Figure 1: Overlap between agricultural finance, microfinance and rural finance



Source: International Fund for Agricultural Development (IFAD) (2010), republished in 'Policy Brief on Agricultural Finance in Africa', Making Finance Work for Africa, March 2012

[1] 'Policy Brief on Agricultural Finance in Africa', Making Finance Work for Africa, March 2012
[2] http://www.finscope.co.za/new/pages/Initiatives/Small-Business.aspx?randomID=60577535-1fdc-4f08-abcf-870931dab843&linkPath=3&lID=3_3. This survey focused on building a nationally representative view of small business in South Africa.
[3] www.finscope.co.za

The structure of the market may be helpfully conceived by dividing it into four levels: macro, national or policy level; meso, or industry level; micro or firm level – all relating to the supply of financial services – and client level – relating to the demand for such services. Diagrammatically, a working financial market may be represented with the clients at the core, individual retail suppliers of finance (formal and informal) directly surrounding the core (micro-level), with financial industry-level infrastructure surrounding and supporting the suppliers (and demanders) of financial services (meso-level) and the national policy, legislative and institutional framework or enabling environment sustaining the market (macro-level).

Figure 2: Financial market structure and relationships

Source: Development Alternatives, Inc, 2006.

Section 4 of this report addresses the client level, that is, the demand for agricultural and rural financial services, while section 5 focuses on their supply, at the macro-, meso- and micro-levels.

4. The demand for agricultural and rural financial services

4.1 Historical context and its present-day impact

The supply of and demand for financial services in South Africa's low-income rural communities, whether for productive or consumptive activities, needs to be located in the context of centuries of formal and informal racial division, the imprint of which is still all too evident on agriculture, after nearly 20 years of democracy. Most obvious is the continuing division of agriculture into large-scale, exclusively commercial farming – currently about 40 000 farming units (Department of Agriculture, Forestry and Fisheries (DAFF), 2010a, p5) – and small-scale, predominantly non-commercial farming, entrenched under apartheid. As noted earlier, the financial services needs of the former are well catered for and fall outside the scope of this report.

From the early years of the twentieth century until the 1990s, agricultural land in South Africa was effectively demarcated into areas in which only whites could farm (about 86%) and those in which blacks – including 'coloureds' and Asians – could farm (about 14%) (DAFF, *ibid*, p4). Since the institution of the first non-racial, democratic government in 1994, much emphasis has been given by the state to creating a more representative agricultural sector, led primarily by reforms to increase the ownership – or, more precisely, the occupancy – of land by black South Africans. This policy has had three major thrusts:

- 'land restitution', to transfer land acquired by whites after 1913 through the displacement of black occupants back to these occupants and/or their descendants,
- 'land redistribution', to purchase land otherwise acquired by whites, for the purpose of settling new (groups of) black commercial farmers, and
- 'land tenure reform', to reshape the tenure systems in operation in the 14% of agricultural land previously reserved for blacks – almost none of which provided for freehold ownership – partly to adapt them better to the needs of commercial farming.

The joint goal of the first two of these thrusts has been to ensure that at least 30% of farm land previously demarcated for whites is owned by blacks by 2014. Through the initiatives of the Department of Rural Development and Land Reform (DRDLR), only about 8% had been transferred by March 2012 (SA Institute of Race Relations, quoted in Business Day, 22 January 2013, p4). However, the actual total that has changed hands from white to black is considerably greater – possibly quite close to the 30% target – when transfers through the open market are included. Owing to the present nature of land registration procedures and to the complexities of ownership, especially by corporate entities, it has so far not been possible to track the racial distribution of land ownership accurately.

What is most relevant here is that between them, 'land restitution' and 'land redistribution' have established a class of land reform beneficiaries who are in most cases attempting to engage in large scale commercial farming. As the general intention has been for them, with some adaptations, to continue operating the commercial enterprises acquired for them by the state, this group cannot be classified as 'small farmers', although in some instances it is possible that the farms acquired have been sub-divided informally into individual smallholdings.

Clearly, such farms have financial services needs similar to those of any other large scale commercial enterprise. In respect of credit, a large part of these needs has been met by state grants for land, fixed improvements and machinery. However, their capacity to raise the working capital needed for these medium and long term assets to generate recurrent income has been seriously hamstrung by tenure restrictions which do not allow the new owners to use such assets as collateral for loans. Understandably, government does not wish either to see land purchased with public funds for restitution or redistribution passed back into white hands through forced sales on the open market or to be obliged to purchase it a second time – from a bank or other financier – in the event of default.

However, the effect of the restrictions is all too often for land reform transactions to end in a losing situation for all parties – the beneficiaries, the state and the country as a whole (in terms of lost production) – except the previous owner. By the Department's own admission, about 50% of such farms are no longer functional – though it is not unlikely that the actual percentage is far higher – and a programme is now under way to recapitalize them. At the end of 2011, 595 such farms were being assisted in this way (Business Day, 24 October 2012, p4) and the Minister of Rural Development and Land Reform is reported as having lamented to Parliament that 'land reform benefits whites more' (Business Day, 21 February 2013, p2). While the causes of failure are multiple, there can be no doubt that working capital deficiencies have been a major contributor. This is investigated in more depth in sections 4.4.3 and 7.1.

These two thrusts of the overall land reform agenda have received the lion's share of the state's attention and financial resources, but the exact number of such new farming entities that have been created is seldom disclosed. That it can probably be measured in thousands is evident from a speech by the State President on 23 October 2012, in which he noted that '11 000 new 'smallholders' (had) been established since 2009, out of a target of 50 000 aimed for by 2014 … (although) only 5 381 were involved in agribusinesses and (only) 3 910 were linked to markets' (Business Day, *ibid).* DAFF's estimate of the number of 'small, medium and micro (SMME)-agribusiness company producers' in 2012 was only 200, while for 'agribusiness company commercial producers' (probably mostly predominantly white-owned companies) it was 120 (DAFF, unpublished, 2012b). However, the roughly 40 000 'family-based commercial producers' identified by DAFF will now no longer all be white, adding to the total number of black commercial agricultural producers.

By contrast, the number of households engaged in some form of agriculture in the 'traditional' black farming areas – mostly on plots of about one hectare – is estimated at up to 4 million (DAFF, *ibid*, 2012). The number may not be as great as this, as the findings of FinScope's Consumer Survey, 2010 indicate that the total number of households in these areas, including those not engaged in farming activities of some kind, is probably closer to 3 million, although a surprising percentage of South Africa's small-scale farmers are to be found in urban and peri-urban areas (see 4.4.3 below). The Department reckons about 350 000 of these farmers to be 'emerging smallholder family-based producers' – referred to as 'emergent' farmers in this study – that is, marketing some part of their output. FinScope's Small Business Survey 2010, on the other hand, puts this figure at 600 000 – 700 000. Either way, this is vastly more than the number of land reform beneficiary farming units or the number of households classified as land reform beneficiaries, even excluding the 2,5-3,5 million households who are engaged in some sort of agricultural activity for their own consumption – referred to as 'subsistence' farmers in this study.

With very few exceptions, these farmers are also unable to use the land that they farm for collateral, as the state owns almost all land in the 'traditional' black rural areas. This not only makes borrowing more difficult, but it also obstructs land rental, thereby hindering the development of economies of scale for those who would like to farm commercially. In the absence of freehold ownership – unlikely in the foreseeable future - even firm defined period rental agreements might make banks less reluctant to advance working capital loans to smallholders in these areas.

The number of small- to medium-scale farmers who are more or less fully commercial (referred to as 'small-scale commercial farmers'), spread between the former 'white' and 'black traditional' farming areas, can be estimated at between 11 000 (the number referred to by the State President and the number of recipients of MAFISA loans (see section 5.2)) and 15 000 (roughly the number estimated by FinScope's Small Business Survey, 2010).

4.2 Major client categories

It is to the needs and circumstances of these two main groups of farmers – the beneficiaries of land transfers, attempting to farm on a large commercial scale, and the smallholders in 'traditionally black' areas, struggling to meet their own nutritional requirements and, in perhaps as many as 20% of households, also to produce for the market – that financial service providers, formal and informal, in the private and public sectors need to respond. The presence of such land reform beneficiaries introduces an additional dimension to the three basic small-farmer client groups identified by the Consultative Group to Assist the Poor (CGAP, 2012):

1. **non-commercial smallholders ('subsistence farmers')**, who, typically, produce only staples for their own consumption; have very limited access to land and external inputs/services; are the poorest and most vulnerable; are heavily dependent on off-farm income; and are usually the largest percentage of producers (probably between 65 and 85 per cent, or 2-3 million, in South Africa)
2. **smallholders in loose value chains ('emergent farmers')**, who, typically, produce some surplus staples and non-staples ('cash crops'); market opportunistically; have greater, but still limited, access to land and external inputs/services than subsistence farmers; are also poor and vulnerable, but are not the poorest; are less, but still substantially, dependent on off-farm income; and are usually a smaller, but still significant, percentage of producers (probably between 10 and 20 per cent, or 350 000-700 000, in South Africa)
3. **commercial smallholders in tight value chains ('small scale commercial farmers'),** who, typically, produce mainly non-staples for marketing through agreed buyer(s); have greater access to land and external inputs/services than other smallholders; are least poor, vulnerable and dependent on off-farm income; but who are usually a relatively small minority of producers (certainly less than 1 per cent, or about 5 000, in South Africa and mostly in the cane sugar industry, although also in cotton and some other sub-sectors, including livestock/poultry, annual grain/oilseed crops and horticulture (fruit, wine and vegetables). FinScope's Small Business Survey 2010 estimated that there were 15 781 small farms operating as small businesses in South Africa (Tipoy, 2010, p1), excluding the many in category 2 who earned some level of income from the sale of agricultural produce.

Again, it is important to recall (see section 3.2 above) that, beyond agriculture, the client base includes large numbers of non-agricultural rural SMEs (about 1,5-2 million), as well as rural households (3-4 million).

4.3 Typology of demand for financial services

Each of these client groups has a distinct set of financial services needs. For the three groups of small-scale farmers just referred to, following CGAP's analysis (2012), adapted to South African circumstances, these needs may typically be outlined as in Table 1. Typical rural SME and household financial need profiles are described in Table 2. The four basic categories identified – savings, credit, transmission and insurance – of course exclude many others, such as accounting, tax, foreign exchange and estate administration services, less likely to be demanded by low income households and enterprises. Where the demand for a service category by subsistence farmers is possible, but is unlikely to be widespread, this is noted by the use of brackets.

Table 1: Small-scale farmer client groups: typical financial services need profiles

Service category	Financial goal	Subsistence farmers	Emergent farmers	Small-scale commercial farmers
Savings	Have money to pay for farming inputs at right time	**X**	**X**	**X**

	Large purchases, investments in fixed/movable assets	**(X)**	**X**	**X**
Credit	Have money to pay for farming inputs at right time	**(X)**	**X**	**X**
	Large purchases, investments in fixed/movable assets	**(X)**	**X**	**X**
Transmission	Receipt of harvest payments/payments from clients		**X**	**X**
	Payments to input suppliers	**(X)**	**X**	**X**
Insurance	Crop/livestock insurance		**X**	**X**
	Fixed/movable asset insurance		**X**	**X**

Table 2: rural SMEs and households: typical financial services need profiles

Service category	**Financial goal**	**SMEs**	**Households**
Savings	Investments in household fixed assets (e.g. buildings) and consumer durables (e.g. TVs), programmed household expenses (e.g. school fees/uniforms/ books), personal risk management/emergencies (e.g. ill health, unemployment), consumption smoothing		**X**
	Investment in fixed/movable productive assets	**X**	
	Business working capital needs, e.g. to pay for inputs at right time, carry debtors	**X**	
Credit	Investments in household fixed assets (e.g. buildings) and consumer durables (e.g. TVs), programmed household expenses (e.g. school fees/uniforms/ books), personal risk management/emergencies (e.g. ill health, unemployment), consumption smoothing		**X**
	Investment in fixed/movable productive assets	**X**	
	Business working capital needs, e.g. to pay for inputs at right time, carry debtors	**X**	
Transmission	Payments from clients	**X**	
	Payments to suppliers	**X**	**X**
	Receiving social grants, remittances, etc.		**X**
Insurance	Fixed/movable asset insurance	**X**	**X**
	Life/funeral cover		**X**

The overlap between the respective categories of clients is extensive: while a household may neither be involved in any form of agricultural or small business activity, the majority will be engaged in either one or both of these activities, making their financial services needs profiles more complex and including most or even all of the financial goals in the two tables.

For these needs to translate into what economists refer to as 'effective demand', clients must have adequate access to the service concerned and be both willing and able to pay for it. The number that meets all of these requirements measures the actual level of uptake of a service. The percentage of the total possible number of households, farms or SMEs that make use of a particular category of financial service is referred to as the 'degree of financial inclusion' for that service.

Should any of the 'able', 'willing' and 'access' prerequisites not be fulfilled, the nature of demand becomes 'potential'. This is considerably more difficult to measure, because there are no agreed definitions of what constitutes any of these prerequisites and, even if there were, it is doubtful that many of the data needed to measure them would be collected routinely.

However, potential demand is of much more than mere theoretical relevance: on the one hand, potential clients clearly have unfulfilled, but no less real, needs, while, on the other, potential service providers find themselves unable to take advantage of the corresponding market opportunities. Both for public and for private sector/NGO policy and practice, it is critical to determine what the major unfulfilled prerequisites are and what it is that is constraining their fulfilment, as well as to get an order-of-magnitude sense of the extent of such pent-up demand. In principle, the difference between involuntary exclusion, e.g. 'too far from the nearest financial service provider', and voluntary self-exclusion, e.g. 'don't need this service', can be distinguished and FinScope (Small Business Survey, 2010) has gathered valuable information on the reasons for exclusion, which throw some light on the degree to which access is not complemented by uptake, i.e. to which there is voluntary self-exclusion. These issues are examined in sections 4.4 and 7.4 below, which identify current 'enablers' and 'disablers' of demand, and in section 8 which considers their implications for policy and practice.

In the section that follows, the focus is on the nature and extent of the effective demand for the four core categories of financial service identified Tables 1 and 2 – savings, credit, transmission and insurance – in South Africa's low-income agricultural and rural communities, as most recently measured.

4.4 Analysis of effective demand

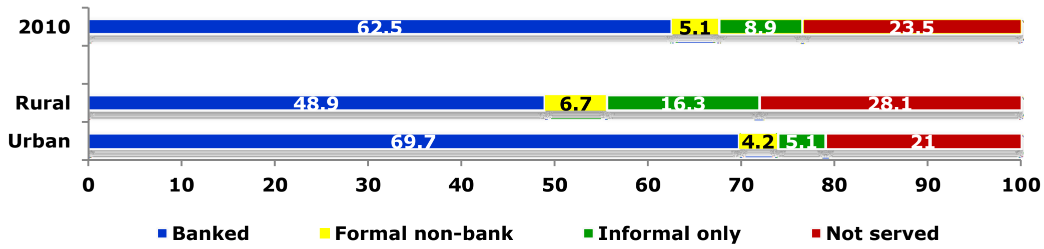
Much of the most recent information about the demand-side of rural and agricultural finance was published by FinMark Trust in 2010 and 2011. This study draws heavily on three surveys - the FinScope Consumer Surveys, 2010 and 2011 and the FinScope Small Business Survey, 2010 – to provide a comprehensive overview of the demand side of rural finance in South Africa. Detailed information about the agricultural and rural sectors from the recently completed FinScope Consumer Survey, 2012 was not available at the time of writing.

From an overview of the demand side for individuals (age 16+) for the whole of South Africa, the analysis moves on to profile rural SMEs and small farmers. As far as the information allows, all of the four major financial service categories covered in Tables 1 and 2 are addressed.

4.4.1 Overview for South Africa

Figure 3 provides a country wide view of the financial access strand for South Africa, and a comparison on rural and urban basis.

Figure 3: Uptake of financial services by individuals (age 16+), South Africa, 2010



product or service, in 2010. Against this, 6,7% had or used only other formal (non-bank) financial services or products, such as insurance, while 16,3% used only informal financial services.

More helpfully, FinScope 2011 provides information on the many individuals who had or used more than one such group of products and services simultaneously:

- the percentage of rural individuals who had or used a commercial bank product or service, regardless of whether they had or used some other form of financial product or service (46,0%) – a small drop from 48,9% in 2010,
- while only 6,7% had or used just a formal non-bank product/service and no other financial products/services – the same as in 2010 – as many as 29,6% had or used some form of formal non-bank product as well as some form of bank and/or informal service,
- and, while only 9,6% used solely informal financial services – significantly down from 16,3% in 2010 – as many as 30,1% used such services as well as formal financial products and services.

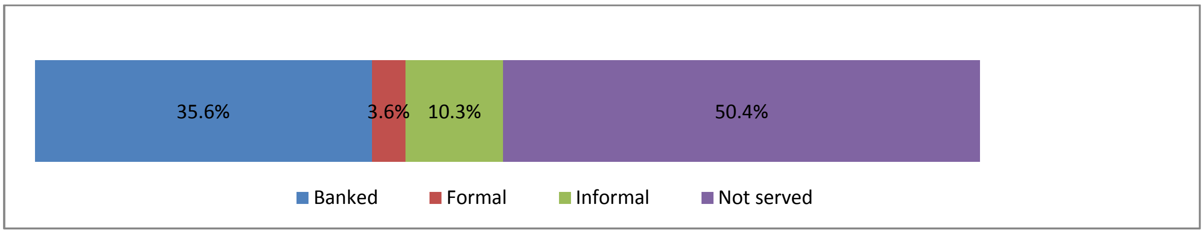
The percentage 'excluded', that is not having/using any form of formal or informal financial service rose sharply from 28,1% in rural areas in 2010 to 37,7% in 2011. While the reasons for this increase are not clear, the reality revealed by the exclusion from other services – particularly basic services such as formal housing, electricity, piped water, hygienic toilets and garbage disposal – is that there is a strong correlation between being poor and not having access to financial services.

4.4.2 Rural SMEs

While almost half (48,8%) of SMEs nationally were involved in 'selling something in the form in which it was bought' in 2010 and a further 21,3% provided some form of non-retail service – from taxi driving to hairdressing to construction – as much as 13,5% reported undertaking some form of agriculturally-related activity: growing and selling something, selling by-products of animals, rearing and/or selling livestock/poultry and selling something that was collected from nature. 60% of rural SME owners were women. As rural women (age 16+) were considerably less banked than men – 38% and 61% respectively – this helps to explain the comparatively low percentage of SME owners who used formal banks' services (see Figure 4). About 91% of owners were black, 21,9% had matriculated and a further 20% had some secondary education.

Rural SMEs were not as well served financially as urban, but, as Figure 4 shows, slightly more than a third (35,6%) nevertheless used some form of formal banking service:

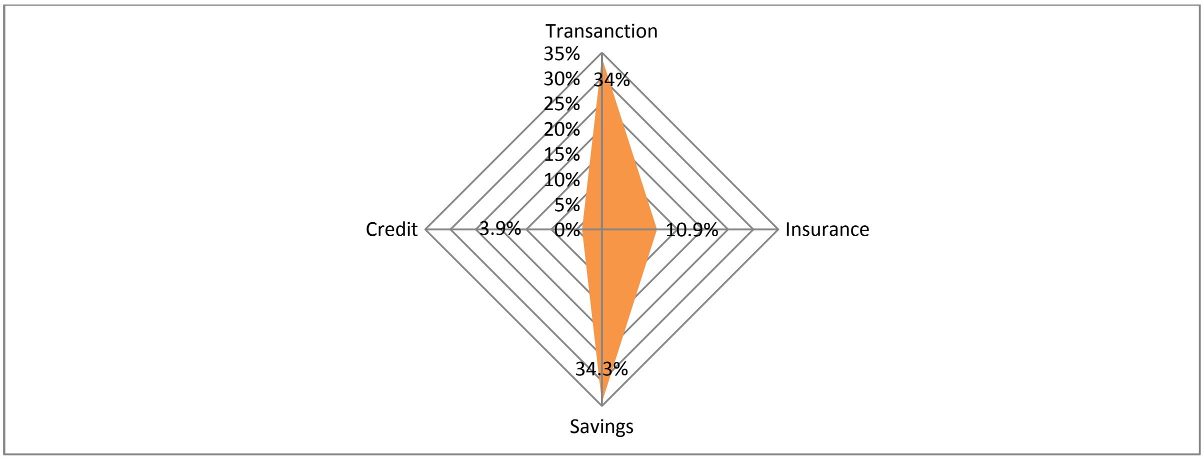
Figure 4: financial access strand for rural SME owners, South Africa, 2010



Only 3,6% were recorded as using some kind of formal non-bank financial service, typically insurance, but not bank services, but probably around 15% would have used both. Similarly, only 10,3% were recorded as using informal saving and/or credit services and no other financial service, but probably around 30% would have used both.

Figure 5 combines an access indication for all four core financial products; transactions, savings, credit and insurance.

Figure 5: rural SME owners' access to formal savings, transactions, credit and insurance services, South Africa, 2010



As with the use of bank services, a little more than a third made use of savings and transaction/ transmission services, about 34% in both instances. However, only 10,9% had some form of insurance – mostly for funeral costs or life cover – while just 3,9% made use of credit, around 2,5% (or about two thirds of the few that did have such facilities) from banks. The reasons for this very low rate are discussed in section 7 ('enablers'/'disablers').

For those SME owners (including small emergent and commercial farmers) that did borrow in 2010, the most frequently reported reason, nationally, was 'growing my business' (about 44%), followed by 'day-to-day business needs' and 'financing stock' (about 30% and 22% respectively) – all current business needs. However, about 12% did also report borrowing for personal needs. Longer term needs – for buying fixed and movable productive assets (premises, machinery, etc.) – were reported by around 20% of small services providers, but only around 2,5% of small retailers. It is not mentioned whether longer term needs were matched by longer term facilities. No average values were recorded for loans made for the various different purposes and no distinction was made between the percentages for 'urban' and for 'rural' SME owners. Of those that had bank accounts, day-to-day business cash flow (deposits and withdrawals) management was the most frequently reported use (averaging about 50%), but the use of accounts for transmission purposes (payment of accounts) was very widespread, up to about 30% for paying monthly municipal utilities bills. This is reflected in Figure 5. Over time, the information about clients that becomes available to banks from their transmission transactions should also serve as a basis for increasing lending to them. The widespread provision of debit cards to the substantial percentage of rural households receiving social security grants electronically, i.e. through a bank or PostBank account, is a step in this direction (see section 7.1.1).

All transmission and insurance services were recorded as being provided by the formal sector. In contrast, about 15% (nationally) of those making use of savings facilities, did so through informal channels, while about 10% (nationally) of borrowers used informal credit facilities, revealing the disproportionate importance of informal credit sources in rural communities. Research undertaken for FinMark Trust in 2012 (Delany et al., 2012) on an informal savings and credit group (SCG) movement promoted by an NGO, SaveAct, with about 16 000 members operating in about 750 branches in rural communities in KwaZulu-Natal and the Eastern Cape, found:

- that more than half of SCG members operated one or more SMEs and that the percentage involved in such enterprises grew with the number of years that their SCGs were in operation;
- that between 59% and 78% of SCG members engaged in SME activities had borrowed from their SCG to finance the activities of an existing SME at some point during the previous 12 months;
- that about 10% had used a SCG loan to start a new enterprise (more than twice the percentage that had borrowed from some other source for this purpose); and
- that between 5% and 13% of all loans made by SCGs were used to finance SMEs and between a further 6% and 15% agricultural activities.

With about a 90% female membership, this source of credit compensates to a degree for the relatively limited access that rural women have to formal sector credit. Indeed, it is more than likely that many find access to informal sector credit of this nature preferable to commercial loans, which are generally more difficult to obtain and which involve more travelling and other costs (see section 7), even though the interest charged may be lower.

However, in the broader picture, the most frequently used source in most rural communities is family and friends: almost one in every four SMEs (24,1%) in the FinScope Small Business Survey reported this form of borrowing. With access to credit, as a crucial source of working capital, being so low and with savings, transmission and insurance facilities generally being well supplied by the private sector (even if not widely taken up in all instances), a major focus of state policy to assist SME growth has, correctly, been start-up and expansion grants and short-term loans. Of those who did have formal credit facilities, the most frequent use for small retailers was to finance stock, while for small service providers it was to upgrade equipment.

It is clear from this high level descriptive analysis that, to start a small business, owners in most cases have to generate their own finance from grants, savings or selling assets. This raises the important question: if many SMEs have an adequate level of assets to finance their own way forward, is there not an opportunity – that is now largely being missed – for a financial institution to use these assets as security for a loan?

4.4.3 Small farms

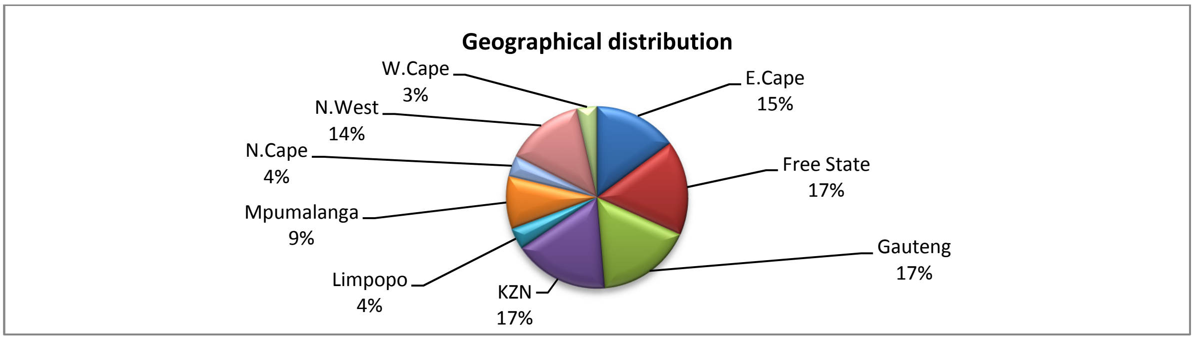
The analysis presented here is also drawn mainly from FinScope's Small Business Survey (2010). For the purposes of this analysis, a small farm was defined as a small business that:

- Rears livestock/poultry and sells e.g. chickens;
- Sells by-products of animals e.g. meat, eggs, milk;
- Grows something and sells, e.g. fruit, vegetables and plants.

This definition means that the analysis is confined to 'emergent' and 'small commercial' farms, as defined in section 4.2, or between 10 and 20% of South Africa's small farming households. (It does not appear that FinScope's Small Business Survey included larger scale commercial farms transferred through land restitution/redistribution.) As noted in section 4.3, this does not mean that the financial services needs of the remaining 80 to 90% - the overwhelming majority – are any the less real, but that, because they do not generate cash income from agriculture, they are understood simply as 'rural households' – with a corresponding set of financial needs (as identified in section 4.3) – as opposed to farms.

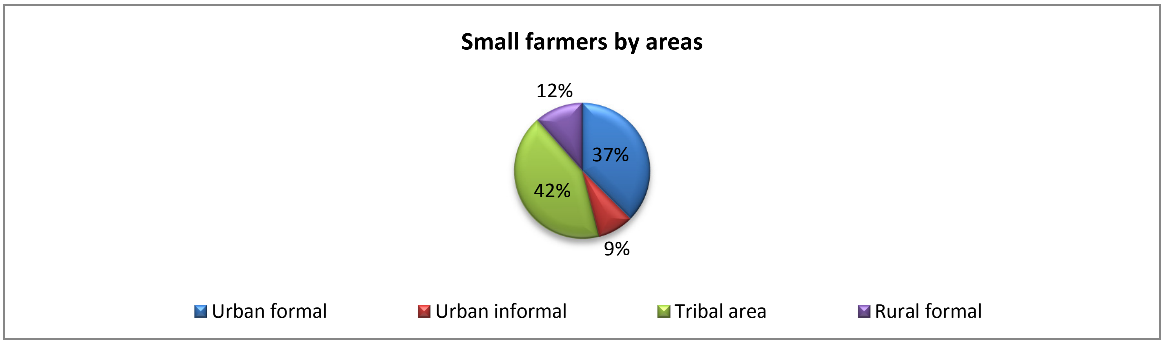
On this definition, as Figure 6 shows, more than half of the country's small farmers are to be found in KwaZulu-Natal, the Free State and Gauteng (17% each), with the Eastern Cape (15%) and North-West (14%) contributing a further 29% and the other four provinces the remaining 20%. The contrast with the overall geographical distribution of small farms, including 'subsistence' farms, is noteworthy: in the latter, KwaZulu-Natal, Limpopo and the Eastern Cape are most heavily represented and the Free State, North-West and, especially, Gauteng are relatively small players. This should be borne in mind in interpreting the analysis.

Figure 6: Distribution by province of 'emergent' and 'small commercial' farmers, South Africa, 2010



Still more surprising is the distribution of small commercial and emergent farms between rural and urban areas. As noted in section 4.1, almost half of these farms (46%) are to be found in formal and informal urban areas.

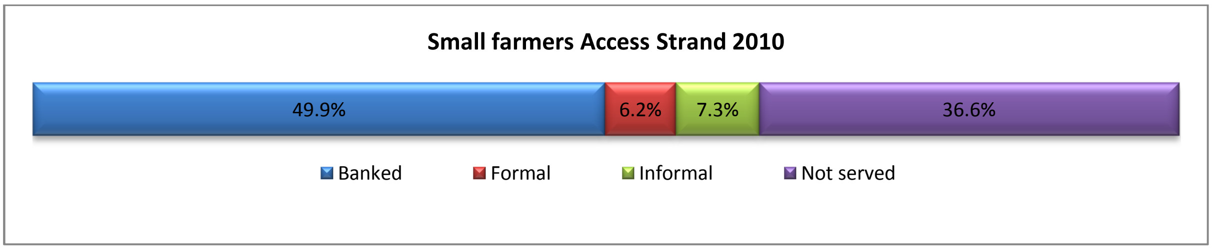
Figure 7: Rural-urban distribution of small commercial and emergent farmers, South Africa, 2010



As with many other countries in Africa, earning income from small-scale agriculture is now clearly a significant component of many urban residents' livelihood strategies. Slightly more urban small farmers (53.4%) were banked than the national average for small farmers (see Figure 8). Further research to understand the nature of urban farming better would be helpful for the design of policy to assist livelihoods (in part through increasing financial inclusion). But at least from the perspective of physical access, in terms of distance to formal financial service points, those farming in urban areas should not experience any major barriers. This indicates that the emphasis for this group should be on other aspects of policy/practice. In contrast, only 38,4% of rural-based emergent and small commercial farmers used banks' services, suggesting that for this group physical access remains an important issue for policy and practice.

In relation to rural SMEs, as Figure 8 shows, small farms were well served financially: almost half (49,9%) were banked – against one third for SMEs – and only 36,6% were financially excluded – against just more than half (50,4%) for SMEs. 6,2% of small farm owners reported using formal non-bank products/services (but no other financial services) and 7,3% informal financial services (but no other financial services).

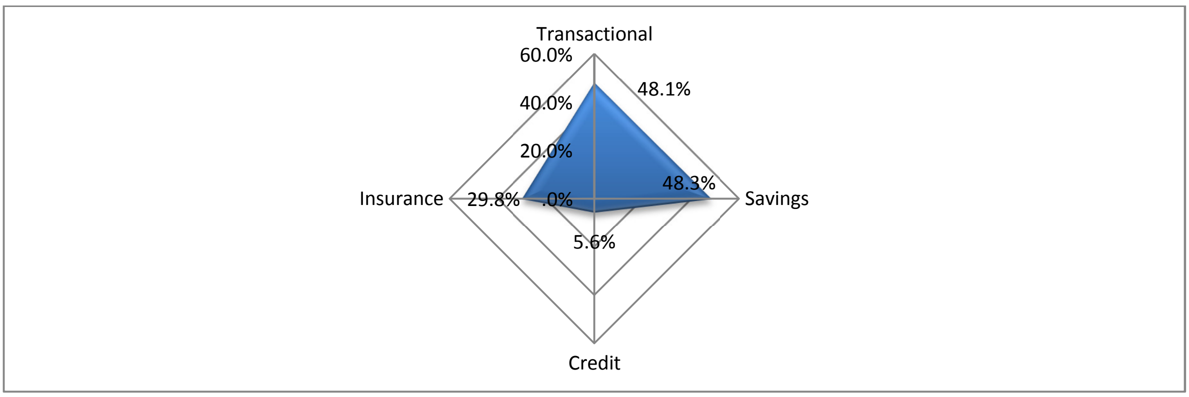
Figure 8: Small emergent and commercial farmers' usage of financial services, South Africa, 2010



Once more, when the overlap between these groups (not recorded in FinScope's surveys) is taken into account, the percentage using formal non-bank products/services and some other types of financial service, as well as the percentage using both informal and formal financial services is likely to be much greater – closer to 30% in each instance, if the overall figures for rural individuals are taken as a guide.

When financial services are disaggregated into the four core services (see Figure 9), the impression of small emergent and commercial farmers' being better served than rural SMEs is confirmed. The rate of inclusion both for savings and transmission services is substantially higher – close on one half of farmers for both – while the difference in insurance usage is even greater – almost 30% for farmers, about three times greater than for SMEs. No details of the nature of insurance coverage are provided, but it can safely be assumed that most would have been for funeral and life assurance, although short term cover for farm assets may also make up a small part. It does not appear that any crop insurance products geared to the needs and resources of small farmers are yet available in South Africa. As a branch of the broader SME group, all transmission and insurance services were provided by the formal sector (see 4.4.2).

Figure 9: emergent and small commercial farmers' usage of savings, transmission, credit and insurance services



In keeping with the pattern, a slightly higher percentage of small farmers made use of credit facilities (5,6% against 3,9% for SMEs as a whole), but 5,6% is still a very low rate of inclusion. Again, family, friends and informal savings and credit groups are the most widely used sources, accounting for 3,4% of credit users, with only 2,5% obtaining credit from banks.

In the instance of informal savings and credit groups, it should be noted that these groups more often serve as a vehicle for saving the funds required for annual agricultural inputs than as a source of loans for this purpose. Both the individuals and the groups appreciate only too keenly the high level of risk involved in agriculture and for this reason prefer not to borrow or lend for this purpose. Especially for ‘subsistence’ farms, where the output is important for food security, but no cash income is generated from farming activities, savings are a much more appropriate source of funds for agricultural inputs than loans, which need to be repaid from income generated. The mechanism used to fund agricultural inputs is therefore generally an annual pay-out of accumulated savings and interest, for which accumulated savings and credit associations (ASCAs), such as those promoted by SaveAct, are particularly well adapted, rotating savings and credit associations (ROSCAs), such as most traditional ‘stokvels’ – where pay-outs are made to members in a rotating sequence – less so. Indeed, many of SaveAct’s SCGs time their annual group pay-out for the beginning of spring, when funds for agricultural inputs are most needed.

As the degree to which most types of farm engage in commercial activity grows, the capacity of annually-generated savings to provide sufficient working capital for their activities declines and externally sourced loans usually become more necessary. So ASCA/ROSCA membership should not be viewed as an ideal or adequate source of working capital for the small emergent and commercial farms that are the main focus of this section, though there is no mutual exclusivity to the respective sources.

For small farmers, the most frequently reported source of start-up funds was ‘own funds’ (37,4%), derived from savings (12,7%), state grants (8,5%), retrenchment packages (4,5%), pension/retirement funds (4,1%) and other, smaller sources. Of the 23,6% who said they had borrowed for this purpose, only 1,4% indicated that this had been from formal sector sources.

As for SMEs as whole, with the private sector generally catering adequately for small farmers’ savings, transmission and insurance needs – although less than 1% of black households reported having short term insurance to cover agricultural equipment – state policy to assist small farmers has focused on capital provision in the form of grants for once-off fixed and movable asset acquisition and loans for recurrent working capital needs. In terms of grants, state assistance has been generous: combined land acquisition grants, i.e. for both restitution and redistribution, totalled R13,6 billion between 2008 and 2012 (National Treasury, 2008-12), while grants for movable equipment and fixed improvements amounted to R3,4 billion between 2004 and 2012 (DAFF, unpublished, 2012c).

However, for land, fixed improvements and movable equipment to generate income, they need to be complemented by working capital. Although the ratios involved vary from one branch of agriculture to another, a typical large scale commercial grain/oilseed crop farmer will need to employ more working capital annually than the value of his/her farm’s fixed and movable assets, making large scale annual borrowing unavoidable for most. It is in respect of borrowing for working capital needs that both small emergent and commercial farmers and land reform beneficiaries attempting to farm on a larger scale have experienced their most acute financial services difficulties, and that the gap between effective/actual and potential demand is unquestionably greatest.

In common with their counterparts across most of Africa and the developing world, commercial banks have viewed small-scale agriculture with suspicion. The reasons for this are discussed in section 7.2 (supply enablers/disablers), but the upshot in South Africa has been only limited commercial bank-to small farmer/land reform beneficiary lending (see section 5.3, esp. Table 8) and undisclosed – probably also small – levels of indirect lending via third parties. Usually such intermediaries are commercial input providers and/or output processors in value chains, such as sugar mills, cotton ginners and, more recently, large retail chains and fruit/vegetable processors.

As in most other developing countries, state and parastatal bodies have attempted to improve the flow of working capital through directed lending, most often – although not always – with unfavourable results. Some examples of successful interventions are discussed in section 8.2. In South Africa, pre-1994 governments did likewise for marginal and sub-marginal white commercial farmers, with similar results. Noting the negative track record of direct government-to-small farmer lending in most other developing countries, post-1994 administrations in South Africa have, wisely, preferred to lend through third parties, in terms of DAFF's Micro-Agricultural Finance Initiative of South Africa (MAFISA) programme. Although the rates of interest charged to intermediaries have been sub-market, it is not clear if their on-lending to farmers has also been at sub-market rates.

For the greater part of MAFISA's operation, the managing agent has been the parastatal Land Bank, which has apportioned the programme's funds to accredited sub-agents – in some instances large scale private sector input suppliers/processors/commodity associations (the South African Sugar Association, Magaliesberg Graan Kooperasie and Kaap-Agri), but also black farmers associations, (the National Emergent Red Meat Producers Association's finance arm), semi-state provincial development banks (the Mpumalanga Economic Growth Agency, the Gauteng Enterprise Propeller and the Eastern Cape Rural Finance Corporation) and NGO microfinance institutions (Peulwana and Hlanganani) (DAFF unpublished, 2012d).

Land Bank itself is still much the largest lender. Both directly on an individual farmer basis and through non-MAFISA accredited on-lenders, such as existing and former commercial farmers' cooperatives, the bank had about 7 000 small farmer/land reform beneficiary clients in 2011, to whom it was lending R768 million (see section 5.3) – figures that had changed little since 2007, shortly after the MAFISA programme had commenced. Between them, the 9 sub-agents had MAFISA-financed loan books totalling about R179 million in March 2012 (DAFF, *ibid*), representing about 56% of the funds advanced to them for on-lending. While a total of about 11 000 small farmers and land reform beneficiaries had received MAFISA-financed loans (from Land Bank or one of the sub-agents) by 2010, the slowness of disbursement by both parties is a matter for serious concern when seen against the acute difficulties experienced by small farmers and land reform beneficiaries in raising working capital (see next paragraph). The reasons for this are examined in sections 7.1 and 7.4 (demand enablers/disablers).

Including the value of direct and indirect loans by commercial banks (see section 5.3), the total of formal financial sector lending to emergent and small commercial farmers and land reform beneficiaries for short and medium term needs is of the order of R1,5 billion – less than 10% of the value of land, fixed improvements and movable equipment purchased with state grants between 2008 and 2012 (R18 billion). When the value of all such assets possessed by small farmers and land reform beneficiaries prior to the award of grants is taken into account, the percentage falls further. If the rule-of-thumb of commercial grain/oilseed farmers' needing to borrow roughly the equivalent of the value of these assets to finance their annual working capital requirements is recalled, even if the volume of working capital employed annually by farmers engaged in other activities is not as great, the magnitude of the shortfall in small emergent and commercial farmers' working capital – the gap between effective/actual and potential demand – can be appreciated. Recalling the sources of start-up capital for small farmers noted above, no less important to appreciate is the extent to which state assistance has been skewed towards assisting land reform beneficiaries engaged in large scale commercial farming, at the expense of small emergent and commercial farmers.

Given the difficulties that they, like land reform beneficiaries, experience in raising working capital, the permanence of small emergent and commercial farmers' involvement in agricultural activity is open to question: while 88.2% of small farmers reported having started the business on their own and 42.4% said that they had started farming to make add to income and/or to provide for their family, 32.9% said that they had done so because they could not find wage employment and a further 23.2% because they had lost such employment. It is possible that many in the last two groups (which jointly make up 56,1% of small farmers) will cease farming as soon as wage based opportunities arise – more likely for those in urban areas. This is especially concerning as FinScope's Small Business Survey also indicates that small emergent and commercial farmers created almost a million (925 700) full- , part-time and temporary work places.

An unexpectedly high percentage (67%) reported farming as being their sole source of income. While this may reflect either the phenomena just discussed, i.e. the absence of wage employment alternatives or the recent loss of a wage-paid job, or possibly even the desire to 'professionalize' as a farmer, this is concerning as a livelihood strategy. With income from farming being notoriously volatile, even well-established large scale commercial farmers place great importance on ensuring some diversity in their income sources. Certainly, multiple income-source livelihood strategies are the norm in most low-income communities, both for income maximization and for risk management. With wage employment hard to come by, especially for older men and women, either qualification for some form of social grant or engagement in SME activity offer themselves as the most likely complementary sources of income for purely agriculture-dependent small farmers. For SME entry, with access to financial services being a major advantage, small emergent and commercial farmers, as a group, are better-placed, given the higher rate of their financial inclusion.

Most small farmers (33%) were between the age of 45 and 59 years, followed by those between 35 and 44 years (27%). This means that 60%+ were over 35 years, perhaps a positive factor in respect of likelihood of permanence in agriculture, but possibly a negative factor in respect of readiness to adopt new financial access technologies. From the perspective of financial literacy, it is relevant that 49% of small farmers had some high school education and that 14% had matriculated.

While the gender distribution of small farmers in 2010 was virtually equal – 51% of farmers were male and 49% female – 61.7% of males were banked and a further 3.1% informally served, while only 37.6% of females were banked and another 11.6% informally served. The disparity in bank usage makes it particularly important to be certain that gender disabilities are not a significant constraint on female farmers. An important group of disablers in many African countries, largely unexplored in the secondary sources drawn on for the six country studies, relate to gender. The disabilities suffered by many women in the region, especially those in rural communities – which are more likely than urban to be governed by tradition – are highlighted in the Southern African Development Community (SADC) Protocol on Gender and Development, signed in 2008, but not yet ratified by all member states.

However, to the extent that such disablers are still present in South Africa, they are not likely to be of a legislative nature, with gender equality firmly entrenched in the Constitution. School attendance is also effectively gender-neutral nationally, although no statistics are kept specifically of rural attendance. So the gender disparity in the percentage banked may be related more to marital, customary or social factors. Again, additional research is important from a policy perspective.

4.5 Summary

In general more South Africans are banked (63%) than their counterparts in the rest of SADC. However there is a wide variation, with rural people, especially women, significantly less banked. Financial exclusion is associated closely with being in a lower income stratum.

Rural small business owners use fewer financial services than the average for the country and have extremely limited access to credit, especially from formal sector sources. This is a serious constraint on setting up and growing a business.

Small emergent and commercial farmers have better access to financial services than rural small business owners. Small farmers are almost equally split between the genders, with male farmers being better financially served. Urban farmers, who make up nearly half of small emergent and commercial farmers, have greater access to financial products than those in rural areas. Although almost half of the small farmer group uses transactional and savings products, access to formal sector credit is almost non-existent and is one of the main obstacles to growth. Own funds and loans from friends and families are the main source of capital.

5. The supply of rural and agricultural financial services

The supply-side information in this report focuses mainly on the provision of agricultural finance to small farmers and land reform beneficiaries and on the supply of formal and informal microfinance services to all users – farms, SMEs and households – in low-income rural communities. The description of the supply-side of the market is presented at three levels, namely, the macro- (or policy), the meso- (or industry) and the micro- (firm or individual supplier) level. As noted already, section 4 addresses the client level of the market.

5.1 Macro-level environment

"The macro- level of the financial system consists of the legislative and policy framework that is necessary to the reliability and sustainability of the financial system."[4]

In 2000, the German Cooperative and Raiffeisen Confederation (DGRV) commissioned a study on access to and use of rural financial services in South Africa[5]. The report noted that at the time of the transition from apartheid into a new democracy (1994-96), the agricultural finance policy environment received considerable attention through the Commission of Inquiry into the Provision of Rural Financial Services, chaired by Dr Conrad Strauss and better known as the 'Strauss Commission'. Some of the critical recommendations made by the Commission were that public policy should focus on:

- improving access to rural financial services;
- broadening and deepening state grants, which would be needed in some circumstances, but with the caveat that a clear plan should be defined as to how to phase out subsidies and grants in the long term;
- playing a leading role in co-ordinating and facilitating access to agricultural finance, with the Land Bank proposed to fulfil this role; the commission saw the Bank playing a "wholesale" function to enable "retailers" to serve the agrarian needs of individuals and groups in rural areas;
- developing an integrated rural development approach of the nature required to have maximum impact, including the coordination of services related to land, housing, power, water, sanitation, refuse removal, etc.;
- continuing and expanding the supply of wholesale finance by government across different sectors in rural areas;
- ensuring a dedicated focus on the agricultural sector by the Land Bank;
- designing a clear, sustainable approach to finance - with guidelines and some flexibility - for provincial development corporations;
- instituting a multi-pronged approach for retail financial services in rural areas through the Post Office, commercial banks and NGOs providing enterprise lending, recognising that none of the existing institutional approaches had yet achieved broad based outreach;
- harmonizing legislation governing agriculture, banking and land;
- reviewing the need for legislation to govern some categories of financial institution which were not regulated at the time e.g. co-operatives, and;
- creating special support services to enhance access to financial services in rural areas.

Subsequent to the 1996 White Paper on Agriculture and the Strauss Commission's report, the DGRV study found that no clear statements on public policy on agricultural and rural finance had been made prior to the time of publication of the Report in 2000. Since then, no further comprehensive

[4] IFAD Decision Tools for Rural Finance, Assessing the Market,, http://www.ifad.org/ruralfinance/dt/e/2.pdf
[5] http://www.dgrvsa.co.za/Publications/Access%20and%20use%20of%20rural%20financial%20services.pdf

statements of policy on this aspect of finance appear to have been made, although DAFF is known to have drafted and re-drafted a Development Finance Policy Framework on a number of occasions.

De facto, the main mechanisms for financing agricultural asset purchase for land reform beneficiaries and small farmers have been the successive forms of land acquisition grant offered by DRDLR (Settlement and Land Acquisition Grants (SLAG), Land Redistribution for Agricultural Development (LRAD) grants, Comprehensive Rural Development Programme (CRDP) and Pro-active Land Acquisition and Settlement (PLAS) grants), since the middle 1990s and, for movable equipment and some types of fixed improvement, DAFF's Comprehensive Agricultural Support Programme (CASP) grants, since 2005. For working capital, the main public sector mechanism has, since 2006, been the MAFISA programme (see section 4.4.3).

Legislation and regulation
The legislation and regulations in the financial sector differ for the range of products or services offered to customers and the institutional arrangements of each. There are different laws that govern commercial banks, state banks and other financial service providers, including insurers, specialized credit providers, cooperatives and cooperative banks. This section outlines the most important of the numerous laws governing the provision of financial services and their objectives in order to provide a background to the financial services supply landscape. There are also a number of additional laws related specifically to agriculture, land, municipal services, training and skills development which have a more or less direct bearing on financial services provision, that are not addressed in this section.

Table 3: Essential financial services legislation in South Africa

Act	Descriptive title/ high level purpose[6]
National Credit Act 34 of 2005	To promote a fair, prudent and non-discriminatory marketplace for access to consumer credit
Banks Act of 1990 and numerous amendments	To provide for the regulation and supervision of the business of public companies taking deposits from the public; and to provide for matters connected therewith
Mutual Banks Act (No. 124 of 1993)	To provide for the regulation and supervision of the activities of juristic persons doing business as mutual banks
Financial Advisory and Intermediary Services Act 37 of 2002	To regulate the rendering of certain financial advisory and intermediary services to clients
Financial Intelligence Centre Act, 2011 and amendments	To establish a Financial Intelligence Centre and a Counter-Money Laundering Advisory Council in order to combat money laundering activities and the financing of terrorist and related activities
Consumer Protection Act 68 of 2008	To promote a fair, accessible and sustainable marketplace for consumer products and services
Cooperatives Act 14 of 2005	To provide for the formation, registration and winding up of cooperatives and the establishment of a Cooperatives Advisory Board
Cooperative Banks Act 40 of 2007	To promote and advance the social and economic welfare of all South Africans by enhancing access to banking services under sustainable conditions; to promote the development of sustainable and responsible co-operative banks; to establish an appropriate regulatory framework and regulatory institutions for cooperative banks that protect members; to provide for the registration of deposit-taking financial services cooperatives as cooperative banks; to provide for the regulation and supervision of cooperative banks; and to provide for the establishment of a

[6] http://www.acts.co.za/

Act	Descriptive title/ high level purpose[6]
	cooperative bank supervisor and a development agency for cooperative banks
Dedicated Banks Bill (not yet enacted)	To provide for the regulation and supervision of the activities of certain public companies registered as 'dedicated banks' that have lower capital adequacy requirements and a narrower scope of allowable financial services
Long term Insurance Act 52 of 1998	To provide for the registration of long-term insurers, for the control of certain activities of such insurers and intermediaries
Short term Insurance Act 53 of 1998	To provide for the registration of short-term insurers, for the control of certain activities of such insurers and intermediaries
Land and Agricultural Development Bank Act	To provide for a juristic person known as the Land and Agricultural Development Bank (Land Bank); to provide for the mandate of the Bank; to provide for governance of the Bank; to regulate the management and control of the Bank; to provide for the funding of the Bank; to provide for the business of the Bank; to provide for risk management of the Bank
Post Office Act	To consolidate the laws relating to the Post Office (including savings)

Figure 10: Developments in the legal environment for credit in South Africa since 1968

The development of the credit industry is one that has been influenced considerably by the legal and regulatory framework governing the industry in South Africa. In the early days of the Usury Act, there was little or no formal lending to low income customers, as the costs of lending often amounted to more than the interest revenue that could be earned. In 1996, the first Usury Act exemption allowed for higher interest rates to be charged for loans below R6 000. This led to an increase in lending and the start of an era of unscrupulous practices in the lending market. The amended exemption to the Usury Act introduced in 1999 led to the formation of the Micro Finance Regulatory Council (MFRC) that was tasked with the registration and regulation of institutions that took advantage of the Usury Act exemption. Loans limits were increased to R10 000 and 36 month terms under the new exemption. The personal loan industry grew considerably in this period, however, a gap started to emerge in the market for loans of between R10 000 and R50 000 and enterprise lending supply was not following the growth observed in consumer lending. In 2005, the National Credit Act was introduced which aimed to regulate the industry in a less fragmented way and to protect consumers more effectively against over-indebtedness and exploitative market practices.

Based on the laws highlighted in the table above, the following regulatory bodies exist to regulate and enforce prudential and market conduct legislation.

- National Credit Regulator (NCR) – the NCR is responsible for the registration of credit providers, debt counsellors and credit bureaus in South Africa and the regulation thereof
- South African Reserve Bank (SARB) - the Reserve Bank is responsible for bank regulation and supervision in South Africa. This function is performed by issuing banking licences to banking institutions, and monitoring their activities in terms of either the Banks Act (No. 94 of 1990), or the Mutual Banks Act (No. 124 of 1993) and the Cooperative Banks Act (No 40 of 2007).
- Financial Services Board (FSB) - regulates insurers, intermediaries, retirement funds, friendly societies, unit trust schemes, management companies and financial markets in general[7]

[7] www.fsb.co.za

- Cooperative Banks Development Agency (CBDA) – the CBDA is responsible for the development of financial services cooperatives to meet the requirements of a registered Cooperative Bank and to regulate Cooperative Banks
- Financial Intelligence Centre (FIC) - to oversee compliance and to provide high quality, timeous financial intelligence for use in the fight against crime, money laundering and terror financing, in order for South Africa to protect the integrity and stability of its financial system, develop economically and be a responsible global citizen[8].

There are no specific laws or regulations on agricultural finance, other than those governing the operation of the Land Bank, which, *inter alia,* permit the bank to lend for most standard agricultural purposes but not to accept deposits or operate current (cheque-type) accounts. However, depending on the product or the institution providing the product, all of the above laws could apply.

5.2 Meso-level environment

"The meso-level of the financial system consists of financial-sector infrastructure and support services. It includes domestic rating agencies, credit information bureaux, audit firms, deposit insurance agencies, training and technical service providers (TSPs), professional certification institutes, and the networks, associations and apex organizations of financial services providers (FSPs). These actors work to reduce transaction costs, improve sector information and market transparency, increase access to refinancing and enhance skills across the sector. They facilitate activities in the financial sector, but do not themselves provide retail financial services."[9] This section of the report will describe the meso-level stakeholders in the landscape.

Financial Sector Industry Associations

The financial sector is grouped into a range of member-based associations that represent their interests. These industry bodies provide mechanisms for policy dialogue, industry level information and research and coordination. They play a valuable role in the meso-level of the broader financial sector. As far as is known, none of these bodies has a particular focus or chapter for agricultural finance or other sector-specific interests.

Table 4: Financial sector industry associations in South Africa

THE BANKING ASSOCIATION SOUTH AFRICA [10]	The Banking Association South Africa (BASA) is an industry body representing all registered banks in South Africa.
MFSA MicroFinance South Africa [11]	Micro Finance South Africa (MFSA) is a representative body of registered and legal Microfinance Credit Providers in South Africa.
AMFISA [12]	The Association of Micro Finance Institutions of South Africa (AMFISA), which 'is dedicated to improve the lives of the poor through greater financial inclusion' (www.amfisa.org.za, 2012)
SAIA SOUTH AFRICAN INSURANCE ASSOCIATION [13]	The South African Insurance Association (SAIA) to promote and represent the interests of the short-term insurance industry.

[8] https://www.fic.gov.za/default.aspx
[9] IFAD Decision Tools for Rural Finance, Assessing the Market, http://www.ifad.org/ruralfinance/dt/e/2.pdf
[10] http://www.banking.org.za/about_us/overview/overview.aspx
[11] http://www.mfsa.net/new/
[12] http://www.amfisa.org.za/
[13] http://www.saia.co.za/

ASISA [14]	The Association for Savings and Investments South Africa (ASISA) represents the majority of South Africa's asset managers, collective investment scheme management companies, linked investment service providers, multi-managers, and life insurance companies.
NDMA NATIONAL DEBT MEDIATION ASSOCIATION [15]	The National Debt Mediation Association (NDMA) was established by the credit industry to provide debt mediation services in terms of the Credit Industry Code of Conduct to combat over indebtedness.
CPA CREDIT PROVIDERS ASSOCIATION [16]	The Credit Providers Association (CPA), previously named the Consumer Credit Association (CCA), provides a self-regulatory framework by which consumer credit data is shared between all the members of the Association.

National Payment System

The National Payment System (NPS) refers to the infrastructure that enables firms and individuals to transact with one another by using different means of payments including cheques, debit and credit cards, electronic funds transfers and ATM withdrawals. South Africa's NPS is internationally acclaimed and recognised. In some cases it has set the trend for international best practices. Cooperation and commitment from all participants is crucial in maintaining a system of the highest standard. In the year ending August 2006 transactions worth R47.87 trillion were facilitated through the NPS. This was 37 times the value of South Africa's GDP in 2004 (R1.3 trillion) and the value of South Africa's banking assets (R1.4 trillion).[17]

The National Payment System Act came into commencement on 18 October 1998. It has since been amended to include laws related to the National Payment System Amendment Act 22 of 2004, National Credit Act 34 of 2005, Co-operative Bank Act 40 of 2007 and Financial Services Law General Amendment Act 22 of 2008. The National Payment System Department within the Reserve Bank of South Africa is responsible for the overall management and oversight of the NPS.

The highest level of access to the NPS is the access to the settlement system. At the core of South Africa's settlement system is the South African Multiple Option Settlement (SAMOS) system that is owned and operated by the Reserve Bank. SAMOS is a real time gross settlement system and includes all financial market transactions, interbank transactions and the settlement of foreign exchange transactions with other international banks. Strict rules and regulations are applied regarding access to SAMOS and as of 2010 there were only 23 settlement participants in the NPS.

The second level of access to the NPS is to the clearing system. The Reserve Bank Committee on Payment and Settlement Systems (CPSS) defines clearing as "the process of transmitting, reconciling, and in some cases, confirming payment orders or security transfer instructions prior to settlement, possibly including the netting of instructions and the establishment of final positions for settlement". In the NPS Act it is defined as "the exchange of payment instructions". Traditionally only banks were allowed to clear, but with the NPS's evolution, more non-banks have been able to participate and provide value added services to banks and their clients. Section 6(3)(a) of the NPS Act allows the Reserve Bank to designate a non-bank as a non-bank clearing system participant if the Bank believes it is in the interests of the "integrity, effectiveness or security of the system". The participant is then allowed access to the clearing domain and membership of the payment system management body

[14] http://www.asisa.co.za/
[15] http://www.ndma.org.za/
[16] http://www.cpa.org.za/
[17] Annex 3: Background on the National Payment System, http://www.compcom.co.za/assets/Banking/Submissions/ABSA-Annex-3-Background-Info-on-NPS.pdf

but is excluded from direct access to the settlement system. Designated participants must also be able to comply with all of the related security and payment industry standards that are applicable.

The third level of access is access to a Payment Clearing House (PCH). All the requirements relating to access to clearing and settlement arrangements also apply here and there are a number of additional criteria:

- approval from all existing members in letter form
- payment of membership fees
- approval from the Payments Association of South Africa (PASA) for two or more PASA approved banks to create a new PCH.

Sponsorship is another method by which new entrants may gain access to the payment system. Sponsorship comprises the processing of transactions in the name of the sponsoring bank on behalf of the sponsored client. At present only the banks, and the sponsored non-banks Postbank and Ithala, can obtain sponsored access.

It is the responsibility of PASA to ensure that clearing services are available to all banks on identical price structures and that it does not encourage any undisclosed cross-subsidisation, although the prices charged to individual firms differ according to their volume of transactions. In 2006 the volume of all non-SAMOS transactions through BankservAfrica, Africa's largest automated clearing house, was dominated by Electronic Funds Transfers (EFT) (53%) and ATM transactions (17%).

Credit bureaus

The credit information market in South Africa is very advanced in comparison with many other developing economies. Credit bureaus are required to register with the National Credit Regulator. A public credit registry (National Loans Register) was also established for sharing information on loans in an attempt to create a holistic and mandatory library of data for use by credit providers to combat indebtedness. The NLR populated by private credit bureaus is undergoing extensive changes to enable ease of compatibility between the various bureaus.

The most prominent credit bureaus in the South African market are:

- CompuScan – evolved out of the consumer microfinance sector
- Experian
- TransUnion
- XDS
- KreditInform – focus on business profiling
- TPN – focus on the rental market (tenant profiles).

Consumer protection mechanisms - Ombudsmen

Consumers have various avenues that can be pursued in the event that they need to seek recourse, depending on the provider of the service. Aside from ombudsmen, there are consumer affairs courts in most provinces where consumers can lodge complaints. The most widely used alternative dispute resolution mechanism is ombudsmen. An ombudsman is an official appointed to receive and investigate grievances raised by consumers. In the financial sector in South Africa, there are a range of different ombudsmen that represent different sub-sectors including:

- The Ombudsman for Banking Services – handles grievances from bank clients across the range of services;
- The Credit Ombud – focuses on complaints related to credit and credit information (bureaus);
- The FAIS Ombud – handles grievances for registered financial service providers – statutory Ombudsman, as per the Financial Advisory and Intermediary Services Act;
- The Ombudsman for Long-Term Insurance; and

- The Ombudsman for Short-Term Insurance

The number of ombudsmen with different jurisdictions makes this landscape confusing for the average financial sector consumer. Levels of awareness about ombudsmen are also low.

Professional Training

There are a number of professional training organisations that promote the capacity building and training of professionals in the financial services sector including:

- The Banking Sector Education and Training Authority (BANKSETA)[18] – a statutory body, established by the Minister of Labour, to support and grow the level of current and future skills needed in the banking sector.
- The Insurance Sector Education and Training Authority (INSETA)[19] - to grow the pool and quality of scarce and critical skills in the insurance sector, enhancing the sector and supporting the country's transformation.
- The Agricultural Sector Education and Training Authority (AgriSETA[20]), a government institution established to provide relevant, good quality training and skills development within the agricultural sector. The mission of the AgriSETA is to "create and promote opportunities for social, economic and employment growth for agri-enterprises, in conjunction with other stakeholders in agriculture, through relevant, quality and accessible education, training and development in both primary and secondary agriculture."
- Service providers can apply to access funding from the AgriSETA to implement stipulated programs or training programs that address particular skills needs in the industry.
- Centre for Inclusive Banking in Africa (CIBA) – this centre within the University of Pretoria aims to improve financial inclusion through increasing affordable access by poor and low-income people – predominantly in South Africa's rural areas and in agriculture – to a range of responsible financial services provided by viable and sustainable financial institutions, in order to contribute to economic development and poverty alleviation in Africa[21]. The primary focus of the centre is training and research.
- Milpark Business School[22] - is a private, registered provider of accredited Higher Education (HE) and Further Education and Training (FET) qualifications that has a range of banking qualifications and that is developing courses for the microfinance sector.
- Institute of Directors of Southern Africa (IoDSA)[23]- is a non-profit organisation that represents directors, professionals, business leaders and those charged with governance duties in their individual capacities in southern Africa. It fulfils this mission through director development and arranging networking events and has developed a governance assessment tool for institutions to use to assess their governance in terms of the King III framework.
- Universities – a number of universities offer courses that provide banking qualifications. A few provide qualifications or offer electives and short courses in microfinance. In some instances this includes a rural and agricultural finance component.

Donor programs

The data on the various donor programmes and projects are based on the information obtained from the respective websites and published annual reports.

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[18] http://www.bankseta.org.za/
[19] http://www.inseta.org.za/about/default.asp
[20] http://www.agriseta.co.za/default.asp
[21] http://web.up.ac.za/default.asp?ipkCategoryID=3841
[22] http://www.milpark.ac.za/
[23] http://www.iodsa.co.za/HOME.aspx

Table 5: Financial sector donor assistance programmes in South Africa

USAID	The bilateral 'union' between the South African government and USAID runs a programme to assist economic growth through improved access to credit and business development services for small and medium enterprises (SMEs). The overall goal of the programme is to expand access to financial services and lower the cost of finance services and products for small and medium enterprises. This objective is addressed through the union's Financial Sector Programme. The FSP's activities are designed to contribute to improved access to financial services for SMEs by improving the internal management systems and processes of financial intermediaries. Another focus area of the programme is increasing the bankability of SMEs through improving financial literacy (USAID, 2010[24]). There is no particular focus on rural or agricultural finance.
DFID	The 'Making Financial Markets Work for the Poor' approach, initiated by the United Kingdom's Department for International Development (DFID) in the 1990s and adopted subsequently by a wide range of international and national organizations, forms the founding philosophy of FinMark Trust, a research and advocacy non-profit NGO which plays a catalytic role in the financial sector in South and Southern Africa and beyond in improving access by poor households and SMEs to financial services. Among other activities, it has supported South African banks to implement the Financial Sector Charter, thereby ensuring that over 3.3 million more South Africans now have access to low cost bank accounts (British High Commission, 2010[25]). One of its primary focus areas is research to enable informed public and private sector policy making, for which it established the FinScope market research methodology, now applied in South Africa and 14 other African countries. It has a theme or focus on rural and agricultural finance.

Credit Guarantee Schemes

According to the OECD[26], "Credit Guarantee Schemes (CGSs) first emerged in Europe in the 19th and the early 20th centuries. Currently, there are over 2 250 schemes implemented in different forms in almost 100 countries" (OECD, 2010[27]). CGSs provide guarantees to groups that do not have access to credit by covering a share of the default risk of the loan. In case of default, the lender recovers the value of the guarantee. In South Africa, a number of such schemes are presently in operation, including:

- **Khula Credit Guarantee Scheme** – which was established by government in an attempt to reduce the risk for commercial banks to lend to small enterprises. Unfortunately, this scheme has achieved the desired results only to a limited degree. According to TIPS[28], "banks shun the Khula guarantee scheme due to high default rate, poor quality of applications and a claims process marred by red tape".
- **Thembani International Guarantee Fund**[29] - which uses loan and grant capital raised from

[24] http://transition.usaid.gov/locations/sub-saharan_africa/countries/southafrica/index.html
[25] British High Commission Pretoria http://ukinsouthafrica.fco.gov.uk/en/about-us/working-with-south-africa/development/what-have-we-ach-so-far
[26] www.oecd.org/dataoecd/52/5/45324327.pdf
[27] OECD (2010), Facilitating access to finance Discussion paper on Credit Guarantee Schemes, p.3, http://www.oecd.org/investment/psd/45324327.pdf
[28] http://www.tips.org.za/files/4_featured_schemes_pg28_-_42.pdf
[29] http://www.tigf.co.za/About-us.html

individuals and organisations in the United States and Europe as security for guarantees to cover loans from South African banks to SMEs

- **USAID Development Credit Authority (DCA)**[30] – which stimulates lending to small enterprises by financial institutions and others through the use of credit guarantees. The DCA was established in 1999 and now has more than 225 partial credit loan and bond guarantees throughout the world. It offers four guarantee products:
    - individual loan guarantees - cover a single loan from a financial institution to a specific borrower for a particular activity (USAID, 2004[31]),
    - loan portfolio guarantees - cover a pool of new loans from one financial institution to multiple borrowers in an area or sector (USAID, 2004[32]),
    - bond guarantees - help ensure that investors in a bond receive the stated repayments from their investment. These guarantees are used to support the sale of various types of bonds by financial institutions, private-sector corporations, or sub-national entities (USAID, 2004[33]), and;
    - portable guarantees - similar to loan guarantees except that the guarantee starts out with the borrower, not the lender, where the lender has not yet been identified (USAID 2004[34]).

All of the different guarantee mechanisms cover up to 50 per cent of the default risk. USAID strongly believes that the DCA program is sustainable because of its design which enables and encourages private lenders to extend financing to under-served borrowers in new sectors and regions even after DCA funding has expired. Worldwide between 1999 and 2011 the DCA has made $US2.3 billion in credit available to support the fields of agriculture along with health, environment, small business, microfinance housing, water, energy, infrastructure and education. This has enabled $10 million in bank fees to be received, $8.3 million worth of claims to be paid with only a 1.75% default rate.[35]

USAID/Southern Africa[36] Regional Economic Growth Office (REGO) has five SME DCA guarantee agreements in place, including deals with Absa Bank, Blue Financial Services, Spartan Technologies, True Group and Mettle Administrative Services. The total portfolio amount under these five deals exceeds $100 million. To date DCA has helped 386 SMEs raise $28,260,000 in funding.

None of these schemes have a particular focus on the rural or agricultural sector and it is unknown what percentage of the portfolio, if any, has an agricultural/rural dimension.

Wholesale Finance

As many foreign donor agencies no longer provide capitalization grants, government has filled the gap via five wholesale development finance institutions, namely, the National Housing Finance Corporation (NHFC), the Rural Housing Loan Fund (RHLF), Khula Enterprise Finance, South African Microfinance Apex Fund (SAMAF), and the Micro-Agricultural Finance Initiative of South Africa (MAFISA). Of these, RHLF and MAFISA have a particularly rural focus. However, there is little evidence that these institutions have successfully reached large numbers of targeted clients. Khula Enterprise Finance and SAMAF have merged with the small business focus in the large-scale

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30 www.oecd.org/dataoecd/52/5/45324327.pdf
31 http://pdf.usaid.gov/pdf_docs/PDACD575.pdf
32 http://pdf.usaid.gov/pdf_docs/PDACD575.pdf
33 http://pdf.usaid.gov/pdf_docs/PDACD575.pdf
34 http://pdf.usaid.gov/pdf_docs/PDACD575.pdf
35 http://transition.usaid.gov/our_work/economic_growth_and_trade/development_credit/pdfs/2012/1210-usaid-onepager-v5-4_2.pdf
36 http://sa.usaid.gov/south_africa/node/68

parastatal Industrial Development Corporation (IDC) to form the Small Enterprise Finance Agency (SEFA), which provides wholesale and retail finance to micro and small enterprises.

Table 6: Parastatal wholesale finance for SMEs in South Africa

The South African Microfinance Apex Fund (SAMAF)	SAMAF was an initiative of the Department of Trade and Industry, which was launched in 2006, to provide wholesale microfinance services to the rural poor. This was done through a registered financial services cooperative or microfinance institution. The SAMAF's mandate was to facilitate the provision of affordable access to finance for micro, small and survivalist businesses for the purpose of growing own (client) income and asset base. The fundamental driver behind this initiative was poverty and unemployment reduction, but also to extend financial services to reach deeper and broader into the rural and peri-urban areas. Further to this, SAMAF wanted to build a network of self-sufficient and sustainable microfinance institutions. SAMAF aimed to provide a range of support structures for capacity building, training, working capital, operational costs, management information system, and savings mobilisation (SAMAF, 2010[37]). This function is now fulfilled by the SEFA Wholesale Department who provide investment finance to more than 40 different institutions.
The Land Reform Empowerment Facility (LREF) of the former Khula	The LREF is a programme set up and funded by the Department of Land Affairs, now the Department of Rural Development and Land Reform. The wholesale finance facility supports previously disadvantaged (black) emerging farmers. Through financial intermediaries, such as commercial banks, the LREF aims to provide loans to entrepreneurs and farm workers who would like to invest in agriculture, agro-processing and eco-tourism. The two products under the LREF that are available are the mortgage loan facility and the equity share scheme. Since the inception of the project, Khula has funded a total of 72 projects through intermediaries such as the 'big four' commercial banks, IDC (NorthWest Province), Ithala Finance (KwaZulu-Natal) and the Spier Group (Western Cape). A critical component of both the mortgage loan facility and the equity share scheme is the emphasis on capacity building for the emerging farmers and farm workers who make use of the facilities. This is facilitated through the AgriSETA and Khula's mentorship program. This emphasis on skills for beneficiaries makes the schemes attractive for commercial banks and other intermediaries, as it increases the likelihood that the beneficiaries will have sufficient capacity to implement their projects successfully and repay the facility. The financial intermediary carries the full credit risk as Khula does not underwrite or provide any indemnity under LREF. Khula intends to revise its terms of engagement to include a graduated risk-sharing facility, based on the following: • loans of up to R3 million – 20% of the risk covered by Khula • loans of R3 million – R6 million – 30% of risk covered by Khula • loans of R6 million + - 40% of risk covered by Khula Khula's incentive structure encourages larger rather than smaller loans by

[37] http://southafrica.smetoolkit.org/sa/en/content/en/7695/The-South-African-Micro-Finance-Apex-Fund-SAMAF-

	allowing borrowers to bear a smaller share of the risk on the former. The bulk of the LREF portfolio lies in the Western Cape, through the equity share scheme that supports emerging farmers involved in grapes and citrus fruit production. The LREF portfolio value currently stands at R192m of which about 43% is in the Western Cape. Some dairy projects have been successful in the Eastern Cape and the bulk of the portfolio in Gauteng is for poultry.
The Micro-Agricultural Finance Initiative of South Africa (MAFISA)	This programme was established by the Department of Agriculture, Forestry and Fisheries (DAFF). The pilot project started in 2005/06 and is still underway today on the back of a government grant of R1 billion provided in that budget year. At present there is no indication that additional funds will be provided to continue the MAFISA programme, once current funds have been fully disbursed. Loans of between R2 500 and R500 000 over a maximum of five years, are provided to emerging farmers through different intermediaries in all 9 provinces in South Africa. All facility advances to intermediaries are now made through the Land Bank. MAFISA loans can be used in agriculture, forestry (except for the establishment of forests) and fishing. The loan repayment structure depends on the size of the loan, the type of enterprise (field crops may have very different production cycles to livestock or fruit, for example) and the development status of the enterprise. As noted in section 4.4.3, the intermediaries who provided the loans to small entrepreneurs on behalf of MAFISA between April 2008 and March 2012 include a mixed group of parastatal development finance institutions, farmers' organizations, former private sector agricultural cooperatives (now private companies), commodity organizations and specialist microfinance institutions. The interest rate charged by intermediaries is capped and has always been less than the prime rate (currently it is fixed at 8% p.a.). Though disbursements have been slow, by 2010 the scheme had assisted 11 000 farmers and created about 560 permanent and 7 500 seasonal jobs (DAFF, 2010e[38]).

5.3 Micro-level environment

This section of the report provides information about **which** providers supply **what** products and services and to **whom**. The supply of financial services is usually considered to consist of loans, equity investment, insurance, savings and transmission. These services are provided through a range of different providers such as commercial banks, development finance institutions, micro-finance institutions, specialist credit providers, insurers, retailers (e.g. Pep Stores), value chain participants (e.g. suppliers of inputs or purchasers of outputs), stokvels (rotating savings and credit associations (ROSCAs), accumulating savings and credit associations (ASCAs), loan sharks or 'mashonisas', family and friends. In instances where the formal or semi-formal financial services sector does not provide adequate services or services that are sufficiently accessible, informal services emerge.

A typology of financial service providers is outlined, focusing in particular on those supplying services to the rural and agricultural sectors. It is not precise, in that some institutions, such as banks, straddle all three subsectors and extend beyond that as well.

[38] DAFF stakeholder interview notes

Figure 11: Micro-level financial service providers by sub-sector

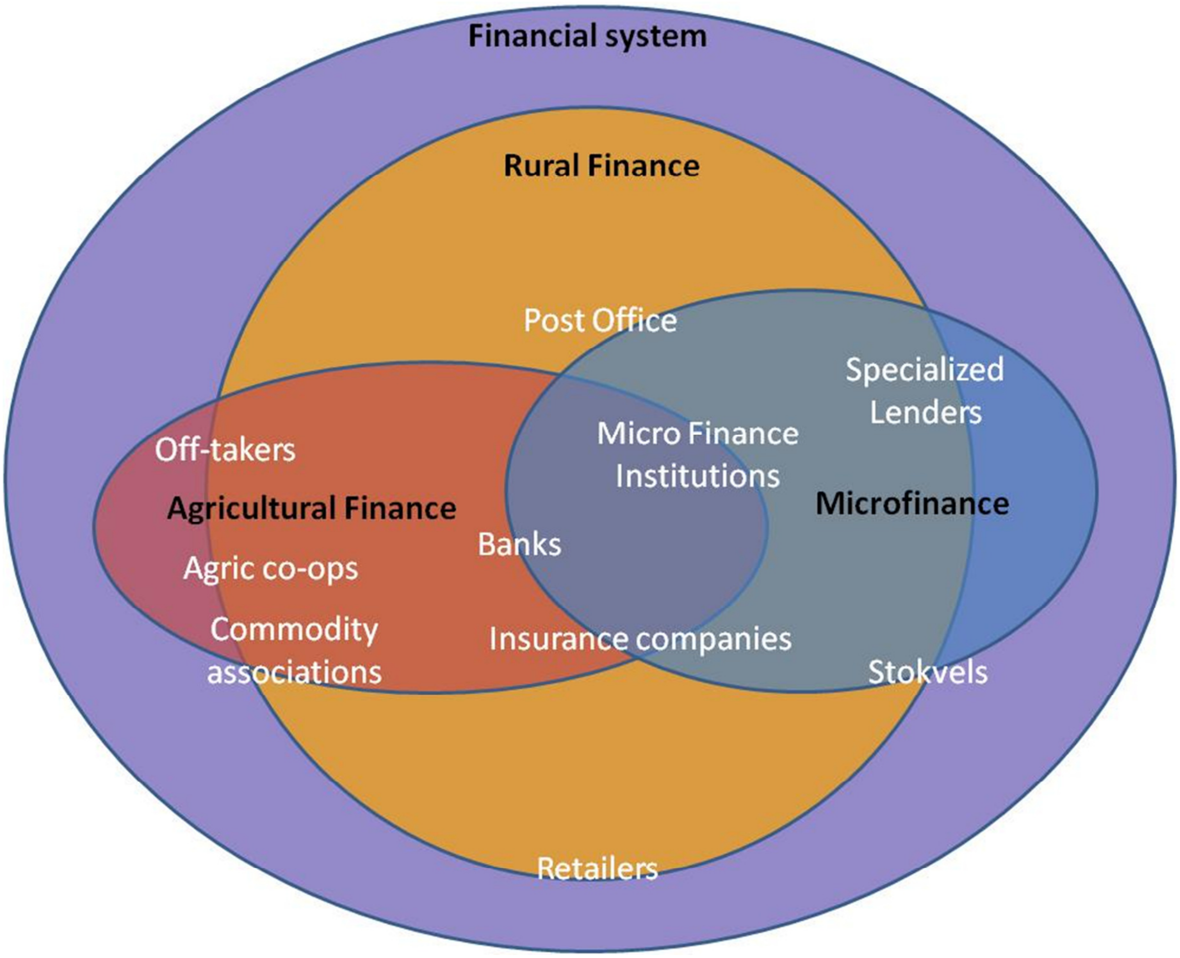

Table 7 summarises services made available to farmers, rural people and microfinance clients by the institutions listed below. It does not provide an exhaustive list of all suppliers, only some prominent examples of the various types of financial service provider.

Table 7: Major micro-level financial service providers in South Africa and services offered

Products & services available to customers → / Institutions ↓	Grants	Savings account/ service	Fixed Deposit account	Transactional account	Branchless banking solution (mobile, POS)	Personal loans mainly for consumption	Personal loans for enterprise purposes	Short term production loans	Medium term Agric Loans (Moveable assets)	Medium term Agric loans (Orchards)	Long term loans (land)	Equity Finance	Wholesale finance	Finance for secondary sectors (e.g agro processing)	Transactional capability (loan linked card)	Cash handling capability	Crop insurance	Agri-asset insurance	Funeral insurance	ST household insurance inc business (stock, etc)	Credit life insurance
Commercial Banks																					
Absa Bank & Insurance Company		♦	♦	♦	♦	♦	♦	♦	♦	♦	♦			♦	♦	♦	♦	♦	♦	♦	
Standard Bank		♦	♦	♦	♦	♦	♦	♦	♦	♦	♦					♦					
First National Bank		♦	♦	♦	♦	♦	♦	♦	♦	♦	♦					♦					
Nedbank		♦	♦	♦	♦	♦	♦	♦	♦	♦	♦					♦	♦	♦			
Capitec Bank		♦	♦		♦	♦										♦			♦		♦
African Bank					♦	♦										♦			♦		♦
Co-operative Banks																					
Ditsobotla Co-operative Bank		♦				♦	♦												♦		
Government DFIs																					
Land Bank								♦	♦		♦		♦								
Khula (now part of SEFA)	♦						♦	♦					♦								
SAMAF (now part of SEFA)	♦												♦								
National Empowerment Fund							♦		♦			♦									
Industrial Development Corporation (now part of SEFA)												♦		♦							
Development Bank of Southern Africa																					
Small Enterprise Finance Agency (SEFA)	♦						♦	♦					♦								
Post Bank (South African Post Office)		♦	♦	♦															♦		
Ithala (provincial)								♦	♦	♦	♦	♦		♦							
CASIDRA (provincial)								♦	♦												

Mpumalanga Economic Growth Agency (MEGA) (provincial)							◆	◆	◆		◆										
Insurance companies																					
Santam																	◆	◆		◆	
Mutual & Federal																	◆	◆		◆	
Zurich																	◆	◆			
Hollard																			◆	◆	◆
Momentum																			◆	◆	◆
Developmental Microfinance Institutions																					
Small Enterprise Foundation							◆	◆													◆
Marang							◆	◆													
Women's Development Business							◆	◆													
Off-takers/ buyers																					
Pick 'n Pay (and Ackerman Foundation)	◆								◆												
Registered Credit providers (4,000)						◆															
Informal services																					
Stokvels/ROSCAS/ASCAS		◆																			
Financial Service Cooperatives		◆																			
Family and friends		◆				◆	◆														
Burial societies																			◆		
Mashonisas/loan sharks						◆	◆														

a. Commercial Banks and Specialised Commercial Lenders

South Africa's financial sector is dominated by four large commercial banks (the so-called 'big four' – Absa, First National Bank, Nedbank and Standard Bank) which focus primarily on firms and households that are at the upper end of the income distribution. The approximate market value of the five largest banks (i.e. Absa, Nedbank, First Rand, Standard Bank and Investec) is R360 billion (BASA, 2008[39]). Several analysts (Ardington et al., p1[40]) have noted that the services and products of commercial banks are generally limited to firms and salaried workers and, thus largely exclude the poor, the unemployed, lower-income self-employed and the informally employed. In the last five to ten years, most of these banks have initiated projects, pilot programs and business units focusing on being more inclusive, with mixed results.

The retail divisions of all four of the big banks provide a range of financial products to the well-established commercial agricultural sector including transactional facilities, short term loans for production, overdrafts, medium term loans for asset acquisition and capital improvement, long term loans for land or enhancements to fixed property and insurance. Beyond many other services, some of the banks also provide agriculturally-related information as a service. For example Standard Bank provides comprehensive reports on agricultural sectors, advice on strategic planning and expansion programmes and price risk management tools to producers, processors and traders.

Table 8: Selected characteristics of South Africa's 'Big Four' banks

	ABSA Today, tomorrow, together. [41]	Standard Bank [42]	FNB First National Bank [43] [44]	NEDBANK [45] [46]
Year Established	1991 – Amalgamated Banks of South Africa Limited was formed through the merger of UBS Holdings, the Allied and Volkskas Groups and certain interests of the Sage Group.	Standard Bank has a 149 year history in South Africa. It has been listed on the JSE since 1970.	First National Bank has its early roots in the Eastern Province Bank (1838). FNB was listed on the JSE in 1998 and now trade as a division of FirstRand Bank. The WesBank Division provides asset finance for the group.	Nedbank ordinary shares were first listed on the JSE in 1969. Five main divisions: Nedbank Capital, Nedbank Corporate, Nedbank Business Banking, Nedbank Retail and Nedbank Wealth of which Nedbank Capital provides services to 10-15 large agricultural corporates.
Number of Branches	990 staffed outlets; approx. 9,500 ATMs	703 branches and loan centres in South Africa.	722 representation points (branches, agencies, EasyPlan)	121 staffed outlets (including 68 regional offices)

[39] South African Banking Sector Overview, Table 2, p.3, www.banking.org.za/getdoc/getdoc.aspx?docid=1130
[40] Ardington, C. and Leibbrandt, M. (2004), African Development and Poverty Reduction: The Macro-Micro Linkage, Financial Services and the Formal Economy, http://www.tips.org.za/files/Financial_Services_Ardington.pdf, p.1
[41] www.absa.co.za
[42] www.standardbank.co.za
[43] www.fnb.co.za
[44] http://www.bop.org.za/BOP_Lab/Publications_files/FNB09.pdf
[45] www.nedbank.co.za
[46] http://www.nedbankgroup.co.za/pdfs/nbgFactSheet31December2011.pdf

		519 branches in the rest of Africa. 7,945 ATMs (in 18 countries)	and 5,906 ATMS.	and 389 ATMs.
Number of Customers	12.1 million Less than 1000 emerging farmers	12.3 million	7.1 million	
Number of Staff	39,659 (2011)	52,217 (2011) 53,351 (2010)		22,935 (2011)
Emerging farmer portfolio size	Approx. R360 million	Not disclosed	R50-100 million in funding is available provided the criteria are met	Not disclosed
Emerging farmer product offering	Off-take agreements with large processors/retailers that provide production support & market access (e.g. McCain, Pick 'n Pay)		Supply chain lending model[47] that helps to secure markets for emerging farmers, while managing to avoid some of the challenges faced by emerging farmers to secure credit when they lack collateral	
Microfinance focus	Yes – Absa Micro Enterprise Finance – provides loans to informal micro enterprises	Yes – Tutuwa Trust has a fixed pool of funds that is used to lend to informal micro-enterprises		
Branchless banking/rural outreach	Yes – developing ATM- and 'point of sale' (POS-)based branchless banking model to enable ease of access to cash deposit and cash withdrawals at low cost to client and low cost to the bank; now being extended to some retail chain stores	Standard Bank has established a large network of independent 'bank shops' for handling cash withdrawals and deposits, though it is not clear how many do so in practice.		

In common with most other aspects of their portfolios, the banks are reluctant to disclose details of the value and number of loans to small farmers. So the information from ABSA on the size of its small farmer portfolio is particularly welcome. As one would expect, it is all channelled through large value chain players – retailers and processors – who are better positioned to make informed assessments of individual farmers' creditworthiness. The total amount loaned out (R360 million to fewer than 1 000 clients) indicates that the average value of individual loans is in excess of R360 000 – larger than one would expect most small emergent and commercial producers to be able to absorb and probably at least 5 times the size of the average MAFISA-funded loan. If the R360 million has

[47] http://www.bop.org.za/BOP_Lab/Publications_files/FNB09.pdf

been fully on-lent by the intermediaries, this could either reflect the inclusion of large land reform beneficiary farms or it could mean that many of South Africa's 'small scale' emergent and commercial (black) farmers are operating on a scale and/or at an intensity not hitherto appreciated. Most likely is that land reform beneficiaries who are attempting to farm on a large commercial scale also included as 'emergent' farmers. It is notable that similar sized loans are being made by some other agencies (see Box 2 below).

Either way, the amount adds significantly to the total value of working capital loans advanced to this group of farmers from MAFISA-funded sources (estimated at R900-950 million – see section 4.4.3) and is very welcome both on this account and because it signals the willingness of some of the major commercial banks to engage seriously with small scale farmers and/or land reform beneficiaries attempting to farm on a large scale as clients. But, relative to the overall value of these groups' land, fixed improvements and movable assets, it is clear that their shortage of working capital is still acute.

However, though reliable statistics are hard to come by, it appears that this source of capital for small farmers and land reform beneficiaries – and the technical assistance that it often also entails – is becoming increasingly important, driven partly by the Black Economic Empowerment (BEE) credits that it generates for the large firms involved.

In addition to the commercial banks there is a specialised agricultural business and finance solutions company based in Stellenbosch in the Western Cape. Capital Harvest provides a range of financial products including term loans, hire purchase agreements, production loans to small and medium agriculture clients in the primary and secondary sector. Although not a registered bank, all processes and structures are based on banking best practice (including a Basel-based risk grading model developed specifically for the agriculture sector). Capital Harvest is built on a model that relies on highly knowledgeable, specialised and experienced staff. Capital Harvest reports that because of the calibre of its staff, it is able to implement a decentralised credit model (the credit manager goes on-site for all customers) and more flexible financial solutions that are aimed at meeting the needs and circumstances of individual farmers. However, it remains to be determined how what appears to be a high-cost model can be sustained commercially.

Capital Harvest was established in 2006 through a partnership with AFGRI. After the global recession severely impacted on AFGRI's credit lines and their ability to fund Capital Harvest, the management of Capital Harvest approached the Land Bank for additional funding. This led to an exit agreement being successfully negotiated with AFGRI. The Land Bank has advanced R750 million to Capital Harvest for on-lending, though it is understood that this is not earmarked specifically for small farmer/land reform beneficiary loans.

Capital Harvest realized that their of model engaging farmers has high relevance in providing finance to emerging farmers as they form a deep understanding of the farming business, the managers and farmers and the risks that need to be mitigated. Faans Roos of Capital Harvest, says that the main reason for the challenges faced in agricultural transformation is that the programme only allowed for the transfer of land to previously disadvantaged farmers and made little provision to allow them access to production finance, finance for the further development of the farms or finance to maintain and/or replace moveable assets.

Capital Harvest therefore developed the Capital Harvest Production Finance Facility (CHPFF) by identifying the risk associated with the growing, harvesting and exporting of fruit. The rules, conditions and monitoring of the facility are specifically tailored to manage the risks associated with this branch of farm, so that CH is in a position to place an actual value on the crop as a form of security. One of critical qualifying criteria is that developing farmers become part of a mentoring programme, as well as an established exporting program, although he adds that, in his opinion, mentoring programs have often not been effective in assisting and training developing farmers. However, participation in such a programme is essential to ensure that the production risks involved in the growing, harvesting and exporting of fruit are properly managed and addressed. The medium term goal remains to ensure that developing farmers 'graduate' from the mentoring program and can enter the South African commercial farming mainstream as self-supporting producers.

In summary, commercial institutions do provide loans to emerging farmers, but they typically do so with a third party taking a considerable role in reducing the risk to the bank. Where institutions have the flexibility to offer more relationship-based service offerings which reduce the information gap between the borrower and lender, there is greater potential for small farmers to gain access to loan capital.

The banks have increasingly also reached into the inclusive banking realm with initiatives in branchless banking and micro-enterprise finance. The results have been mixed and some important lessons have been learned. Perhaps most significantly, they demonstrate a commitment to expanding access, partly following from undertakings given in the Banking Charter, but also because of the awareness of unexploited market potential. Profitable large scale outreach to low-income rural areas by banks is still a challenge, but noteworthy successes are now being achieved.

b. Development finance institutions and facilities

National development finance institutions (DFIs) and facilities are based on the schedules of the Public Finance Management Act, 1999 and include the Development Bank of Southern Africa (DBSA), Land Bank (LB), the Independent Development Trust (IDT), the Industrial Development Corporation (IDC), Khula Enterprise Finance (Khula), the National Housing Finance Corporation (NHFC) and the National Youth Development Agency (NYDA). All are involved in development finance activities of some sort in the rural areas of South Africa. The same is true for a range of provincial public sector financial intermediaries. These include: Casidra (Western Cape); Ithala Development Finance Corporation (KwaZulu-Natal); Eastern Cape Development Corporation; Free State Development Corporation; Mpumalanga Economic Growth Agency; LimDev (in Limpopo); North West Development Corporation and the Northern Cape Economic Development Agency. Furthermore, there are also institutions classified as "unincorporated provincial public entities not classified as quasi-corporations", such as the Eastern Cape Rural Finance Corporation.

LAND BANK
1912 - 2012

The Land Bank is mandated to provide financial services to the agricultural sector and is now structured into three divisions, namely, Business and Corporate Banking (BNCB), which caters for the corporate agricultural sector - Retail Commercial Banking (RCB) and Retail Emerging Markets (REM) – which started operations in October 2011 as a transitional segment for emerging farmers prior to their moving into RCB. The bank has 27 branches, 15 of which are in the northern region (i.e. north of Bloemfontein).

RCB provides secured long term (5-15 years), medium term (3-8 years) and short term (up to 18 months) loans in excess of R3 million to farmers. The four main products are mortgages (for land), production finance, instalment sale finance (for moveable assets) and medium term loans for infrastructure (e.g. for pack houses).

RCB has 21 600 clients, 7 092 of whom are black farmers. The portion of the RCB loan book that funds black farmers, referred to as the 'development book', stood at R876 million in March 2012. This portion has created considerable challenges in respect of repayment. The non-performance of this section of the book is mainly due to haphazard historical lending practices, when customers were not properly assessed. REM has also subsequently shied away from trusts, associations and Community Property Associations due to the perceived risk and the bank's experience of lending to these institutions.

REM focuses on loans of less than R3 million for emerging commercial farmers – not subsistence farming. The loans can be granted to individuals or corporations. The criteria for credit are different to RCB. Cession of off-take agreements is used as security for loans for production inputs. No bonds or mortgages are granted. Only short term and some medium term loans are provided in this segment. Loans are provided with concessionary interest rates. Loans are specifically for black farmers with no or low assets but who have access to land through a lease, Permission to Occupy (PTO) or through traditional rights of tenure. Loans are for primary production only. REM also provides wholesale loans to intermediaries for on-lending to farmers as well as for lending directly to farmers. Wholesale loans are provided to, among others, cooperatives and former cooperatives, now operating as private companies, and commodity associations, or that are familiar with the needs of emerging farmers, provide support to such farmers and have the ability to reach farmers relatively easily.

IDC
Industrial Development Corporation

The Industrial Development Corporation (IDC) was established in October 1940. It is a development finance institution, mandated and fully owned by government and reports to the Ministry of Economic Development. The IDC's objective is to support industrial capacity development through providing risk capital (industrial finance or project finance). The IDC's regional mandate includes South Africa and the rest of Africa (since 1998). The total value of the IDC's equity base is R93 billion. It made an annual profit of R2,7 billion last year and has a Debt/Equity of ratio = 7%. The IDC has an active portfolio of R8,4 billion invested in South African companies.

In the Agro-Industries division, focus areas include agro-processing (food and non-food), beverages (alcoholic and non-alcoholic) and aquaculture. The IDC does not fund pure primary agricultural projects or applications, which are referred to the Land Bank, or land-based transactions/acquisitions. There are also certain sectors and types of transaction which it does not fund, e.g. hard liquor (not including table wines)[48], tobacco, wholesale and retail activities, empowerment deals and overdrafts.

The IDC's mandate allows it to provide funding for activities outside South Africa. However, investments in South African companies are required to facilitate the creation of new industrial capacity, and jobs and must be for at least R2 million (for loans) or R5 million (for equity and/or quasi-equity), but not more than R1bn. Risk-sharing by private sector investment partners is essential.

The IDC offers a range of financial products including:

- equity investments in 'strategically important' sectors (minority stake only)
- long term loans
- mezzanine funding - cash flow- not security-linked
- bridging finance against contracts
- wholesale finance
- other financial products, such as guarantees and trade finance

The geographical distribution of the IDC's agro-processing portfolio is concentrated in the deciduous

[48] Includes any drink with proportion of alcohol exceeding 12 per cent volume; most table wines do not exceed this limit.

fruit and wine industries in the Northern and Western Cape.

The National Empowerment Fund (NEF) was established by the National Empowerment Fund Act No 105 of 1998. The NEF became operational in 2006 and was capitalised by national government to the amount of R2.2 billion. Its mandate is to be the driver and a thought-leader in promoting and facilitating black economic participation through the provision of financial and non-financial support to black empowered businesses, as well as by promoting a culture of savings and investment among black people. The NEF enhances other DFIs and their mandates by sharing its specialist sector expertise and knowledge of Broad Based Black Economic Empowerment (BBBEE).

The NEF fulfils its mandate through three main products, namely: Asset Management (retail savings and investment products), Fund Management (financial and non-financial solutions across a range of sectors to black empowered businesses for start-up, expansion and equity transformation purposes) and Strategic Project Funds (venture capital finance).

Aside from investments in agro-processing, the NEF has a fund focused specifically on rural and community development. The Rural and Community Development unit of the NEF was established in 2009. The fund is designed to promote sustainable change in social and economic relations and to support the goals of growth and development in the rural economy through the financing of sustainable enterprises. This is to be achieved through the mobilisation of rural communities into legal entities or cooperatives, in order to participate in the broader economic activities and to realise the economic transformation goals in rural South Africa. The fund provides capital for project finance, business acquisition, expansion capital and start-up/greenfields enterprises - with funding ranging from a minimum of R1 million to R50 million. In the 2011/12 financial year funding for 228 deals totalled R1.013bn. The fund supports 480 entrepreneurs directly and has created 32,000 jobs.

The sectors earmarked for funding include primary and secondary agriculture, agro-processing, manufacturing, tourism, agro-forestry, retail property development, aqua- and marine-culture, small-scale mining and renewable energy.

Box 1. Criteria for National Empowerment Fund Investments
The criteria for investment include:

- Projects must be financially sustainable
- BEE applicants should be actively involved in the day-to-day operations of the business
- Technical partners should be actively involved in the day-to-day operations of the business
- NEF will invest using debt, equity and quasi-equity investments
- Minimum black ownership of 25.1% or more is required
- Joint ventures between black and non-black partners must support skills transfer
- The business should be able to repay the NEF's investment
- Business must have a clear value-add with a sustainable business case
- NEF will exit from the investment in 5-10 years
- NEF reserves the right to oblige applicants to participate in NEF mentorship programmes.

Khula Enterprise Finance Ltd was recently incorporated into the SEFA division of the IDC called the Small Enterprise Finance Agency as part of a merger with SAMAF. Prior to the merger, it was established in 1996 to focus on the promotion and development of small and medium enterprises (SMEs). Its role was to maximise access to finance for small businesses with the purpose of promoting job creation and sustainable and economic growth. Until recently, Khula was purely a wholesale finance institution, working through intermediaries, such as banks and microfinance institutions. However in 2011, it commenced retail operations through its Khula Direct business unit on a pilot basis for micro and small enterprises. Khula had two main products which are described in more detail in the Meso-Level section of this report. The products are the Credit Indemnity Scheme and the Land Reform Empowerment Facility (LREF), a wholesale finance facility that aims to support previously disadvantaged (black) emerging farmers. The LREF will continue as a special project in the new entity (SEFA –Small Enterprise Finance Authority). Khula also intends to introduce new products that will focus on input and infrastructure/ mechanisation finance.

The Development Bank of Southern Africa (DBSA) contributes to development by mobilising financial knowledge and human capital to support public and other development institutions. The bank plays a direct role in financing and implementing infrastructure development projects in rural areas. This contributes to employment creation, economic development and overall development of rural areas. The Siyayenza Manje programme is a programme through which the bank plays a more interactive, project directed role at the municipal level (DBSA, 2007[49]).

The DBSA characterises itself as playing the following role in respect of regional development (DBSA, 2010):

- Financier - to contribute to the delivery of basic services and promote economic growth through infrastructure and development funding;
- Advisor - to build institutional, financial and knowledge capacity for development;
- Partner - to leverage private, public and community stakeholders in the development process;
- Implementer - to originate and facilitate key interventions for building capacity and providing development solutions; and
- Integrator - to mobilise and link stakeholders, resources and initiatives for sustainable development outcomes.

The DBSA is committed to investing in commercial agriculture, given the multiplier effects that lead to job creation, food security and growth in the rural economy. In partnering with other stakeholders, such as LB, IDC and NEF, the DBSA has endorsed its commitment towards commercial agriculture with a view to helping achieve the Millennium Development Goals. There is however, a stated bias towards agricultural infrastructure projects in the region (DBSA, 2010).

DBSA’s assistance to the agricultural sector is mainly through technical assistance grants and loan funding in the following areas (DBSA, 2010):

- On-site private/project fixed infrastructure – e.g. irrigation schemes;
- Land as part of a project package structure, but not subject to land claims or part of the land reform process;
- Movable assets/equipment; and
- Production input finance (in exceptional cases).

Cape Agency for Sustainable Integrated Development in Rural Areas (Casidra) is a wholly owned implementing agency of the Western Cape Provincial Government that works closely with the province’s Department of Agriculture, which provides its funding. The main focus of the Casidra’s activities is integrated rural development in poor rural communities of the Western Cape.

[49] DBSA Media Release Word Document, ‘Siyenza Manje Doing it for Municipalities Constrained by Lack of Capacity’, 30 August 2007

According to Casidra's Strategic Plan[50], it has played a major role in the delivery of the (national) Department of Agriculture, Forestry and Fisheries' Comprehensive Agricultural Support Programme (CASP). In the five years of its operation, Casidra's project budget has grown from R3,2 million (2005/06) to R90 million (2010/2011). R145 million in Casidra funding was available and fully disbursed in the financial year (2011/2012).

Casidra has three core functions, namely:

1. to assist the province's Department of Agriculture to implement smallholder projects related to infrastructure (e.g. the construction of warehouses). R80 million per annum is set aside for this;
2. to help maintain smallholder farmers' fixed and movable assets (e.g. servicing of basic machinery or infrastructure), and;
3. to provide monitoring and information to smallholder farmers, to DAFF's Agricultural Integrated Management System (AIMS) and to CASIDRA's GIS system.

The only types of finance provided by CASIDRA are grants for the acquisition or upgrade of infrastructure or equipment (CASP grants). The value of the grants depends on the business plan of the farmer, but the maximum grant is R4.5 million. Casidra can also provide support further up the value chain (e.g. for the construction of a warehouse for a processor), where up to R16 million over 2 years can be made available. The grant funds are sometimes provided in partnership with sector bodies, such as Hortgro, that have relationships with a segment of farmers.

Ithala Development Finance Corporation is KwaZulu-Natal's provincial development agency. It has three major wholly owned subsidiaries; Ithala Limited (investments, insurance products, personal and home loan products), the KZN Growth Fund Managers (investment in infrastructure in KwaZulu-Natal) and Ubiciko Twines and Fabrics (Pty) Ltd. Ithala Development Finance Corporation's mandate is to promote development within KwaZulu-Natal and to increase the participation of black people in all sectors of the economy. It is 52 years old and only operates in KwaZulu-Natal.

Ithala Development Finance Corporation offers loans for land and fixed asset improvement (for up to 20 years), equipment, for working capital (for varying terms) and for bridging finance. The loan book is currently made up of 305 accounts, 45% of them within ±25 kilometres of Durban and with a total portfolio value of approximately R300 million.

The history of PostBank[51] (previously known as the Post Office Savings Bank) dates back to the late 1980s when the bank's national savings certificate was conferred allowing the Post Office to accept savings. Post Bank provides transactional products, savings (including a term saving offering) and, more recently, a funeral insurance product. PostBank does not offer credit services directly, but allows Bayport Financial Services to provide microloans through selected outlets (Calvin and Coetzee, 2010). PostBank operates through a country-wide network of Post Office branches and therefore has a wide outreach in rural areas to people, many of whom do not have easy access to electronic banking services.

[50] http://www.casidra.co.za/admin/Upload/Publications/Casidra%20Strategic%20Plan%202012__2016.pdf
[51] http://www.postbank.co.za/Default.aspx

According to the Microfinance Review[52], "The PostBank plays a critical role in extending banking services to the people of South Africa, particularly in rural areas. It also plays an essential support role to microenterprise lenders who require group members to make repayments at a local bank."

c. Micro-finance supply

In a recent review of the microfinance sector[53], Calvin and Coetzee defined three main categories of product offerings in the microfinance sector in South Africa, namely, micro deposit services, salary based micro-loans and micro-enterprise loans. They found that both micro-deposit services and salary based micro-loans were in mature stages of development, with providers diversifying their product offerings, in contrast to the micro-enterprise lending sector, that demonstrated limited outreach and single product offerings. This sector of the financial services landscape in South Africa is in its very early stages of development.

Calvin and Coetzee identified six profiles of formal providers of microfinance services in South Africa, namely:

- not-for-profit microenterprise lenders
- salary-based micro-lenders
- primary banks (mentioned above)
- alternative banks[54]
- cooperative financial institutions
- retail development finance institutions (mentioned above)

In addition to these, micro-insurers provide micro-insurance services (often in partnership with retail chain partners e.g. Edgars). A wide range of informal financial services providers also exists, including 'stokvels' (rotating/accumulating savings and credit associations), burial societies, loan sharks, family and friends.

Not-for-profit micro-enterprise loans providers

At the time of publication of the Microfinance Review (Calvin and Coetzee, 2010)[55], there were three large not-for-profit lenders providing loans to the market, using the group lending methodology, namely Small Enterprise Foundation (SEF), Women's Development Business (WDB) and Marang Financial Services. At the time, they reached a combined client base of 115 000 with a potential market of approximately 2 million small/micro enterprises. Since, 2009, SEF has actively grown its client base from 57,000 to 74,000 (in 2012)[56]. Marang and Women's Development Business (WDB) have not made figures available in the public domain. Both SEF and Women's Development Business focus on rural environments, whilst Marang is more focused on urban centres.

A further four micro-enterprise lending institutions had less than 3 000 active clients each at the time of the Microfinance Review, namely Akanani Financial Services, Tetla Financial Services, Tiisha Financial Services and Vengro Capital. Since the review some new institutions have appeared. Phakamani Foundation, based in White River, Mpumalanga, has grown its client base to 5 000[57]. Ndiza Finance with operations in Gauteng and rural Limpopo has a portfolio of R5 million as well as a small book focused on micro-franchises in more urban settings. Details of four further microfinance institutions cited in the review are unknown.

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[52] Calvin, B and Coetzee, G.C., A Review of the South African Microfinance Sector 2009: Successes, Challenges, and Policy Issues (2010), University of Pretoria and FinMark Trust, page 34, http://web.up.ac.za/sitefiles/file/1/3841/MF%20Review%202009%20-%2021%20July%202010%20FINAL.pdf

[53] Calvin, B and Coetzee, G.C

[54] African Bank, Capitec Bank, Teba Bank, PostBank, and WIZZIT Payments Limited

[55] Calvin, B and Coetzee, G.C.

[56] http://www.sef.co.za/statistics

[57] http://www.phakamanifoundation.org/

Some growth is evident in SEF's outreach and in the development of Phakamani and Ndiza, however outreach in this segment of the market is still low. Factors inhibiting financial services from reaching informal rural micro-enterprises in South Africa as opposed to elsewhere, according to the Microfinance Review (Calvin and Coetzee, 2009) are: "salary levels for management and staff are higher; markets are less dense and distances are further to travel; security costs are higher; (and) repayment discipline is harder to enforce". There is a relatively strong concentration of activities in more rural environments by these providers.

Salary-based microlenders and 'alternative banks'

Salary based micro-loans grew rapidly following Usury Act exemptions in 1996 and 1999. The majority of these loans are provided by primary and alternative banks, but the initial growth in this market was spearheaded by independent money lenders who proved that this was commercially viable. There are approximately 4 000 credit providers registered with the National Credit Regulator.

Aside from the large four banks, the alternative banks that provide loans in this market segment are Capitec Bank, African Bank and Ubank (previously Teba Bank). In addition to credit, Capitec also provides savings and transactional services to their rapidly growing customer base of approximately 4 million customers. The bank maintains over 500 retail branches nationwide. In August 2010, the asset base of Capitec Bank was in excess of R5 450 million, with shareholders' equity estimated at over R1 535 million[58]. The bank has grown rapidly from when it received its banking licence in 2001 and has strategically focused on making its footprint substantial in its chosen market – low- to middle-income salaried individuals.

African Bank, on the other hand, only provides credit products and insurance to salaried individuals (no savings and transactional offerings) and has also grown rapidly over the past 14 years.

Ubank has its roots in the mining sector where it started as a payroll administrator for the miners and their families. In time, the bank starting providing savings, credit, transactional and insurance services to mineworkers, communities around the mines and the rural communities where migrant workers had their homes (e.g. Eastern Cape). According to its annual financial statements (2011)[59], Ubank has savings deposits of R2,8 billion and a loan book of R700 million.

Cooperative banks and financial service cooperatives

The Cooperative Banks Act, No 40 of 2007, defines a cooperative bank as 'a cooperative, registered in terms of the Act, whose members (a) are of similar occupation or profession or who are employed by a common employer or who are employed within the same business district; or (b) have common membership in an association or organisation, including a business, religious, social, cooperative, labour or educational group; or (c) reside within the same defined community or geographical area'. Cooperative banks are meant to formalise the world of informal credit associations (group savings and lending schemes) and larger stokvels, which currently operate in a regulatory vacuum provided by an exemption from the Banks Act.

There are various tiers of cooperative banks. The first is for 200 or more members with at least R1-million in deposits, but no more than R20-million. These banks can invest their funds in permitted assets: formal banks' savings accounts, FSB-registered collective investment schemes (such as unit trusts), and government bonds, as well as higher tier cooperative bank deposits, where the higher tier bank has at least two cooperative banks as members. Such higher tier institutions may have more than R20-million in total deposits. Cooperative banks may choose to make loans but some may

[58] http://en.wikipedia.org/wiki/Capitec_Bank
[59] http://www.ubank.co.za/docs/ubank_Annual_Report_2011.pdf

be savings-only banks. First tier banks are supervised by the Cooperative Banks Development Agency.

There are also strict capital requirements and limits to the size of any one loan or deposit. An entire supervisory and development framework has been established to regulate cooperative banks, in terms of which National Treasury will supervise the first tier, the South African Reserve Bank larger institutions

The Savings and Credit Cooperative League of SA (SACCOL) is a national association that was formed in 1993 by informal savings and credit cooperatives (SACCOs) and credit associations around South Africa. SACCOL functions as a representative body and a regulatory body[60] as well as a SACCO development body. Member SACCOs own and control the activities of the league.

Informal sector financial institutions
These include stokvels and burial societies. Stokvels are a widespread form of rotating savings and credit association (ROSCA) which operate under a 2006 exemption to the Banks Act. Under this amendment, they are limited to holding savings of less than R10 million at any one time. As soon as they exceed this limit, they are required to register as a Mutual Bank. Some stokvels extend credit to members; some invest in assets that could generate income for the members; while some are used only to save funds towards a particular event such as Christmas or the beginning of the school year.

Village savings and loans associations (VSLAs) also play an important role in the informal sector. The savings and credit groups (SCGs) promoted by SaveAct in KwaZulu-Natal (see sections 4.4.2 and 4.4.3) are good examples. In terms of these, a self-selected community group saves money together (similar to shares), thereby creating a loan fund. Members can borrow from the fund a limited number of times a year and pay interest to the group on loans. Loans can be used for a range of purposes including enterprise, housing and education. Typically about two thirds of savings are mobilized into loans at any moment. These groups are a particularly important source of capital for subsistence farmers: in many instances SCGs time the annual distribution of savings and interest to coincide with the beginning of the summer crop planting season, thereby providing the funds necessary to purchase seed and fertilizer, without having to borrow for this high-risk purpose and without needing to generate a flow of cash income to service and repay a loan.

Burial Societies are informal funeral insurance schemes that provide for members to make monthly contributions that cover the costs of a funeral for the member or for her/his close family members. They operate under the Friendly Societies Act of 1956. An estimated six million South Africans are members of burial societies.

"The National Stokvels Association of South Africa (NASASA) registered as a Section 21 company in 1988 and is a national, self-regulating umbrella body for stokvels and burial societies. NASASA currently represents 150 000 members from 11 000 groups nationwide"[61].

d. Off-takers

[60] 'Cooperative Financial Institutions are regulated by one of four different bodies, depending on the size of the cooperative. The South African Microfinance Apex Fund (SAMAF) and the Savings and Credit Co-operative League of South Africa (SACCOL) are mandated to register and regulate all the smallest financial cooperatives in South Africa. Once the cooperative reaches 200 or more members and R1 million or more in deposits, the cooperative must apply for registration as a Cooperative Bank to the supervisor within the Cooperative Banks Development Agency (CBDA). Once a cooperative bank reaches deposits exceeding R20 million, they are required to apply for registration with the South African Reserve Bank (SARB).' Calvin, B. and Coetzee, G.C.

[61] Calvin, B and Coetzee, G.C.

An off-taker derives its definition from 'off-take agreements', in terms of which a producer of a resource and a buyer of that resource agree that the latter will purchase all or part of the former's future production. An off-take agreement is normally negotiated prior to the production. Examples of off-takers in the South African agricultural sector include Pick 'n Pay, WallMart, MassMart and McCain.

In such off-take models, the incentive for large private sector organizations to contribute to transformation is driven by BEE targets, as well as the need to find sources of particular resources. In the instance of Pick 'n Pay, 70-80% of the Ackerman Foundation's funding is spent on developing and supporting small, black agricultural producers in line with Pick 'n Pay's strategy for resourcing fresh produce. Pick 'n Pay supports such farmers by providing a linkage into its distribution network and enterprise development training. In some cases, soft loans and grants are also provided for the purpose of financing small farmers' capital investments. Pick 'n Pay also facilitates access to finance for these suppliers with ABSA and the Land Bank..

SAB Miller is involved in the agricultural sector through their need to procure inputs, such as maize, hops and barley, part of which they provide support to small (and large) scale farmers to produce locally for their South African operations. For example, it supports a project in Taung (Northern Cape) where emerging farmers grow maize. Its support takes the form of providing finance, seeds and other inputs, as well as extension services.

McCain also provides a secure market to farmers (particularly for potatoes) and, in addition, technical support and extension services to farmers to ensure that the produce meets the standards that are required in terms of the contractual agreement.

Though reliable statistics are hard to come by it appears that this source of capital for small farmers and land reform beneficiaries – and the technical assistance that it often also entails – is becoming increasingly important, driven partly by the Black Economic Empowerment (BEE) credits that that it generates for the large firms involved.

e. Agricultural cooperatives

A cooperative is an autonomous association of persons united voluntarily to meet their common economic, social, cultural needs and aspirations through a jointly owned, democratic enterprise. In South Africa, many of the traditional commercial agricultural cooperatives privatised and even listed as public companies following radical changes in agricultural marketing legislation in the 1990s. The result is that they are no-longer member-capitalized organisations, although some of the original members are still shareholders. Examples of such transformed organizations include AFGRI, SENWES, MGK and Cape Agri.

Most agricultural cooperatives derive the bulk of their income through the sale of agricultural inputs and through marketing agricultural outputs. Co-operatives generally have programmes focused on advancing Black Economic Empowerment, which, in some cases, include financing component.

For example, the Land Bank has provided a wholesale loan to the Humansdorp Cooperative in the Eastern Cape, which enables the Co-op to supply seasonal loans for production inputs as well as short term (monthly) credit facilities as part of the banks Retail Emerging Market wholesale offering to emerging farmers. Another example of a former agricultural cooperative - now a limited company - that is assisting emerging farmer with finance in this way is MGK, through its Temo Agric Services, which on-lends concessionary MAFISA funds.

Box 2: Temo Agri Services' BEE financing assistance scheme

MGK has a programme focused on assisting emerging black farmers called TEMO Agri Services. It is a joint venture between MGK & Temo Farmers Trust. The programme's objectives are to mentor and develop emerging farmers into self-sustaining commercial farmers. All farmers that join the programme are beneficiaries of the Farmer Share Trust that owns 10% of the acquired 22% MGK shares. The model is based on a holistic solution where an off-take agreement forms the basis of security for a loan, along with non-financial support in the form of mentorship and training. Services include: production loans, crop insurance (through Santam), production inputs, marketing & logistics and mentorship. The strength of the company lies in its mentorship programme, which aims:

- to ensure that farmers acquire the necessary technical skills to succeed in grain and oilseed farming;
- to train farmers in farm and human resources management; and
- to teach farmers finance planning and budgeting.

All decisions in respect of land preparation, planting and harvesting, crops and cultivars to be planted and the appointment of contractors are agreed upon by the farmer and mentor.

The program has reached approximately 272 farmers, involvingR155 million in loans.

Season	Number of farmers	Hectares ('000)	Crop loans (R'000 000)	Government grant (R'000 000)	MGK loan (R'000 000)	Insurance
2003/2004	22	2	0,4	Nil	0,4	Hail
2004/2005	45	4	3,0	Nil	3,0	Hail
2005/2006	75	9	7.1	2,8	4.3	Hail
2006/2007	128	16,3	21,1	5,8	15,3	Hail
2007/2008	129	17,1	41,7	6,2	35,7	Comprehensive
2008/2009	175	17	60	0	60	Comprehensive
2009/2010	272*	42**	155*	?	155*	Comprehensive

* Estimated ** Dry land (Irrigation Excluded)

Source: http://www.temoagri.co.za/

f. Commodity associations

Commodity associations play an important role in supporting emerging farmers – often from a non-financial support point of view. These services enable the farmers to create more sustainable farming enterprises through producing quality produce, gaining access to markets, running their businesses more effectively and securing access to inputs and sometimes to mechanisation. Indirectly this supports the farmer in accessing finance. In some cases, the commodity association also accesses wholesale funding and provides loans, as in the case of the National Emergent Red Meat Producers Association (NERPO). The section below provides selected insights into some commodity associations and the role they are playing.

Table 9: Financing roles being played by South Africa's agricultural commodity associations

COTTON SOUTH AFRICA	Cotton SA supports emerging farmers with non-financial services such as: providing seed of the right quality and grade, working with the Department of Agriculture, Forestry and Fisheries in the training of emerging farmers in disease control and the facilitating of transport of lint to the gins. They also offer formal training courses that include cotton production, financial management and budgeting. Lastly, Cotton SA facilitates mentorship of small scale farmers by commercial farmers. Over 1000 emerging farmers have been supported in this way.

NERPO	The National Emergent Red Meat Producers Association (NERPO) provides a range of services to emerging farmers, including access to finance (through a concessionary MAFISA wholesale loan from the Land Bank) and access to markets. NERPO also provides formal training and practical field mentoring to assist in improving the quality of emerging farmers' herds. Training includes commercial aspects of livestock farming, which helps give farmers with a realistic expectation of achievable profit levels. NERPO has found that where farmers are organised into associations or cooperatives, better access to the market is achieved. Such groups normally have enabling infrastructure, such as loading ramps, sales pens and water points and are usually better placed to secure transport. DAFF helps farmers to meet their infrastructure requirements through its CASP programme, often prompted by the advocacy of NERPO.
potatoes SOUTH AFRICA	Potatoes South Africa provides support to emergent farmers through bursaries, enterprise development and training. It also facilitates the linking of the emerging farmers with commercial farmers (buddy/mentor-farmer). The buddy is remunerated for his time in some cases. They provide emerging farmers with good quality seed on a grant basis for 4 years (1st year 100%, 2nd year 75%, and the 3rd and 4th years 50%), after which the farmers must stand on their own feet (incubator system). The pre-requisites for assistance are an adequate background in farming, access to at least 20 ha of arable land, a business plan and access to irrigation.
SAVPO SAPPO SOUTH AFRICAN PORK PRODUCERS' ORGANISATION	The South African Pork Producers' Association (SAPPO) sets aside 20% of its budget to assist emerging farmers. This is used for training in disease control, bio-security, farmers' days and mentorship by commercial farmers (buddy/mentor). In order to qualify for SAPPO support, emergent farmers require adequate access to suitable land, on-farm infrastructure (including bio-security), water and funds for feed and other production inputs. SAPPO provides formal training at a facility in KwaZulu-Natal. There is some resistance to the buddy/mentor system by commercial farmers because of the perceived risk of disease spreading from emergent farms.
HORTGRO SERVICES	Hortgro utilises 20% of levies raised through exports to assist emergent farmers. The funding is focused on worker equity-sharing schemes and the capital intensive process of establishing new orchards with black farmers. In the last year Hortgro has spent approximately R4 million purchasing deciduous and stone fruit trees for emerging farmers. It has also been instrumental in securing CASP funding for emergent farmers, which is typically used for soil preparation and irrigation in orchards. In addition Hortgro has spent about R6 million of its own funds in 2011-12 on infrastructure development and the purchase of tractors, sprayers, input costs and fertilisers.

g. Insurance companies

"FinScope's[62] findings on formal insurance product penetration paint an encouraging picture indicating a significant increase in the number of South Africans having insurance product/s. This has increased from 19.6% in 2008 to 19.9% in 2009, to 25.8% (8.6 million) in 2010/11 and remained at 25% in 2012". According to the PriceWaterhouseCoopers (PwC) insurance study (2012)[63], National Treasury has released a policy document entitled 'The South African Micro-insurance Regulatory

[62] http://www.finscope.co.za/new/pages/Initiatives/Countries/South-Africa.aspx?randomID=08e8e946-75ae-4749-bea1-9987c8b1049d&linkPath=3_1&lID=3_1_11

[63] Maximising value from today's opportunities: Strategic and Emerging Issues in South African Insurance, Fifth edition, June 2012, http://www.pwc.co.za/en_ZA/za/assets/pdf/south-african-insurance-2012.pdf

Framework[64]'. The document outlines the need to improve access to insurance and to strengthen customer protection. More than a dozen insurance firms that participated in the PwC study indicated that they were interested in establishing a separate entity to address the new opportunities in the micro-insurance sector.

FinScope reports that 29.8% of small farm enterprise owners have some form of insurance. It is likely that most of these policies relate to funeral or life assurance. Agricultural insurance is not widely used in the South African emerging agriculture sector given the high transactions cost and the complex nature of issues related to moral hazard. It is estimated that only about 40% of commercial grain farmers utilise some form of crop insurance in South Africa and even less in other commodity sectors, such as horticulture[65]. Market penetration in the emerging farmer sector is estimated to be less than 1%[66]. The main providers of crop insurance are Absa, Santam and Mutual & Federal. The main providers of agri-asset insurance are Mutual & Federal (largest), Absa, Santam and Zurich.

Table 10: Agricultural insurance available in South Africa

Santam	Santam has 82 years' experience in crop and hail research, as well as 93 years in asset insurance experience. It has an experimental farm in Bloemfontein, where it conducts research into understanding how crops are affected by certain weather conditions. It is also a member of ClimateWise, an international network to influence debate and decision-making on climate change. The insurer offers various types of crop insurance, asset insurance and vine insurance (farms, estates, cooperatives, restaurants and guesthouses). It offers two main products, namely single peril (hail damage cover only) and multi-peril (covers multiple risks, but excludes manageable risks resulting from poor farming practices). Given the number of challenges entailed in providing insurance to emerging farmers, Santam only provides insurance to two groups of emerging farmers (NWK grain farmers and MGK sunflower farmers) and is understood to have no plans to expand this part of its portfolio.
ABSA Today, tomorrow, together.	Absa's insurance arm offers single and multi-peril crop insurance, livestock insurance, aquaculture insurance and agri-asset insurance. It is one of the leading providers of insurance in the agricultural sector.
MUTUAL & FEDERAL PROTECTING WHAT'S IMPORTANT TO YOU. SINCE 1831	Mutual and Federal (M&F)[67] is the largest insurer in the agricultural sector, as established by interviews conducted during this research. The company offers insurance products that cover agricultural and household assets (e.g. homes & buildings, motor vehicles, livestock, irrigation systems), as well as business risks, personal accident insurance, public liability and cargo in transit. In addition they provide specialised crop and livestock insurance that covers direct risks (e.g. hail, fire, chemical overspray, transit) and systemic perils that relate to reduction in yield mass (e.g. drought, excessive rainfall). M&F also provides specialised insurance for the wine industry.

Insurers cited a number of challenges in providing insurance to the emerging market, primarily:

[64] National Treasury Policy Document, The South African Micro-insurance Regulatory Framework, July 2011, as seen at http://www.fsb.co.za/insurance/Microinsurance/PolicyDocumentMicroInsurance.pdf on 28 Feb 2013.
[65] Stakeholder interview, Absa Insurance Company, 2012.
[66] Stakeholder interview, Absa Insurance Company, 2012.
[67] http://www.mf.co.za/products/farmers/Pages/default.aspx

- poor farming practices;
- insurance products in South Africa indemnify against different risks based on the historical production on the particular farm (and this information may not be known if the farmer is new);
- no security of tenure in the former ‘traditionally black’ ‘bantustans/homelands’, leading to much land being in a sub-marginal condition for crop insurance purposes;
- Lack of experience and skills;
- Absence of suitable technical mentorship;
- Smaller farms (more concentrated risk);
- Complications related to the institutional structure of farms (group ownership of restituted land, tribal authorities, etc.);
- Lack of availability of resources, and;
- Poor management.

6. Access to and inclusion in financial services

The distinction between 'access' to financial services and the 'uptake' of those services was noted in section 4.3, as were the difficulties of measuring access. In practice, almost all of the data referring to the number and percentage of various client categories who use particular financial services measure uptake. With access being much less well-defined and more difficult to measure numerically, it is helpful to substitute verbal description.

Access to financial services can be viewed in terms of outreach, which in turn is a factor of breadth of outreach (the number of people reached or market penetration as depicted by the FinScope access web) and depth of outreach (reaching the poorest of the poor). It can also be measured in terms of the range of different services that are available to a particular segment of financial consumers. Table 11 outlines typical low-income households' access to financial services in South Africa.

Table 11: Low-income households' access to financial services in South Africa

Categories of financial service → Population segments ↓	**Credit**	**Savings**	**Transactional**	**Insurance**
Rural informal – mainly combination of social grants, remittance receipts, and SMEs (some in agriculture)	Limited formal access; Informal access (e.g. stokvels, ASCAs, SACCOs, money lenders (mashonisas), family, friends)	Informal access (e.g. stokvels, ASCAs, SACCOs, …)	Social grant card; limited usage; possibly some mobile money transfer (MMT)	Informal access (burial societies) & possibly funeral plans and/or life assurance
Rural semi-formal – casual labour or self-employed (irregular income) & subsistence agriculture	Limited access, possibly store credit	Informal access (stokvels); possibly a bank account but little to no usage	Possibly some MMT; possibly a bank account where wages paid	Informal access (burial societies) & possible funeral plans
Rural formal – employed, low but regular income	Money lenders, unsecured loans from mainstream/alternative banks, loan sharks (tends to be over-indebted)	Informal access (stokvels); possibly a bank account but little to no usage	Possibly some MMT; bank account where salary/wages paid but underutilised	Funeral plans and built-in (often unknown) credit life insurance; short term asset insurance
Peri-urban/Urban informal - combination of social grants, & subsistence agriculture	Money lenders/ loan sharks (some pensioners very over-indebted)	Informal access (stokvels); possibly a bank account but little to no usage	Social grant card; limited usage; possibly some MMT	Informal access (burial societies) & possible funeral plans

Peri-urban/Urban semi-formal – casual labour or self-employed (irregular income) & subsistence agriculture	Store credit; loan sharks	Informal access (stokvels); possibly a bank account but little to no usage	MMT/ branchless banking; bank account, typically underutilised	Informal access (burial societies) & possible funeral plans
Peri-urban/Urban formal - employed, low but regular income; remittance senders	Money lenders, unsecured loans from mainstream/alternative banks, loan sharks (tends to be over-indebted)	Informal access (stokvels); possibly a bank account but little to no usage	MMT/ branchless banking; bank account, typically underutilised	Funeral plans and built-in (often unknown) credit life insurance; short term asset insurance
Urban or rural emergent/small commercial farmers	Low/patchy access – certain loan types, sectors and profiles of farmers	Bank account but low level of usage	MMT/ branchless banking; bank account, typically underutilised	Limited/no agricultural insurance; funeral insurance prominent; short term asset insurance

There has been an observed improvement in recent years in terms of the breadth of outreach (more people gaining access) and in the range of financial services that are becoming available to customers within different segments (mobile money transfer, short term insurance products, lower cost transactional products, more ATMs, services available through retail service centres). However, there is still a lack of access to formal financial services in some substantial segments of the market. This is most widespread in rural settings, particularly in instances where income is earned informally or irregularly or where the need is more specialised (e.g. emergent and small commercial farmers).

In terms of product types, the most prominent gaps in access experienced by agricultural/rural financial consumers may be summarized as follows:

- crop/livestock insurance
- non-life related micro-insurance
- enterprise loans (including to small farms) and loans to self-employed individuals for short, medium and long term needs
- transactional services that are available on a cost effective branchless basis – ubiquitous mobile money transfer or branchless banking solutions, and
- effective formal micro-savings mechanisms.

As noted in section 4.3, the gap between access and uptake of financial services is of much more than just theoretical importance: together with increasing the level of access, it is a central goal of policy and practice to close this gap, both, from a demand perspective, to meet unfulfilled needs and, from a supply perspective, to take advantage of unexploited market opportunities. In this context, it is of less importance to try to gauge the gap between access and uptake than it is to discern the factors that, on the one hand, have made the current levels of access and usage possible and that, on the other, are constraining the growth of either or both. This is the subject of section 7.

7. Factors that enable or disable access to and/or the uptake of financial services

A wide range of factors influence the demand for financial services in and their supply to low-income rural and agricultural communities. Sometimes, the same factor influences both demand and supply simultaneously. Similarly, the same factor may have both an enabling and a disabling dimension. Consequently, in the discussion that follows, the factors are grouped into and analysed at macro, meso, micro and client levels – rather than attempting to divide them into 'demand-' or 'supply-related' – with both the positive and the negative aspects of each factor being weighed in considering that factor – rather than attempting to divide them into 'enablers' and 'disablers'.

7.1 Macro-level

(a) *Political priority of rural development:* High political priority has been given by successive African National Congress administrations to rural development. While this ought to be an unqualified enabler, stimulating both the demand for and the supply of financial services in rural areas, rhetoric has not been matched by the performance of the two main implementing departments, DRDLR and DAFF.

The slowness of implementation of DRDLR's land reform programme was noted in section 4.1. With the total value of land and fixed improvements in agriculture being about R124 billion in 2009 (DAFF 2010b, p82) – which can be adjusted to about R140 billion in 2012 – it can be estimated that the amount needed to purchase the 30% targeted by DRDLR's land reform programme by 2014 (see section 4.1) is of the order of R50 billion. Of this, the R13,6 billion spent between 2008 and 2012 (see section 4.4.3) represents only about a quarter[68]. While it can be argued that the programme is being held up by an inadequate budget, the size of the budget has been adjusted downwards by National Treasury in recent years because of repeated under-spending in previous years. The Department has acknowledged the slowness of land transfers and has frequently stated its intention to find ways of speeding the programme up. Presently a Green Paper on land tenure is being discussed, one component of which contemplates adjustments to the current 'willing buyer, willing seller' principle as a means of achieving this.

In respect of DAFF, the Auditor-General reported recently that the Department 'had met only 17% of its targets … although it spent 99% of its R4,9 billion budget' in 2011-12 (Business Day, 9 October 2012, p2). In the light of such performance, National Treasury has been reluctant to increase the Department's budget.

The performance of departments is also significantly influenced by their ability to coordinate with other departments in planning and delivering infrastructure and services, as well as by the planning and delivery capacity of all of the departments involved in any initiative, with the level of joint-capacity being determined by the lowest common denominator. Given the policy of making local government (municipalities) responsible for all infrastructure and service delivery within their areas of jurisdiction, and the low level of capacity, especially of rural municipalities, to fulfil their obligations in this regard (noted in successive annual reports of the Auditor-General to Parliament), this is a serious inhibitor of DAFF's and DRDLR's performance. A recent study conducted by the parastatal Human Sciences Research

[68] While this does not take into account the amount spent prior to 2008, the transfer of agricultural land took far longer to come on stream than financial compensation for the dispossession of urban land. Consequently, it is only relatively recently that most of the budget for land transfers/compensation has been spent on acquiring agricultural land.

Council found that 'managers with relevant skills only constituted 0,4% of the country's civil servants and the majority of them served in national departments … where you go deep into the municipalities, that is where we have a deficit of skills' (reported in The Citizen, 13 July 2012, p3).

However, coordination between DAFF and DRDLR is also not always optimal. For example, in respect of farms transferred under the land reform programme, it has already been pointed out (see section 4.1) that the restrictions placed on using assets transferred for collateral, make it considerably more difficult for DAFF's MAFISA programme to supply the working capital that the new owners of the farms need for their enterprises to function effectively. And, particularly where such farms are transferred in terms of the restitution programme and involve the settlement not just of one but of many households, the development of on-farm housing and associated infrastructure is critical for the success of the transfer, at least in the eyes of the beneficiary communities. Yet, more often than not, municipalities are simply unable to provide the infrastructure, let alone the services needed to make it function. Hence the reluctance of many 'beneficiary' households to relocate, or, once relocated, to remain on such farms.

While the reasons for the dysfunctionality of so many land reform farms are multiple, lack of coordination and the lowest common denominator of delivery constraint are certainly among the more important of them (Anseeuw and Mathebula., 2008). Different priorities, budgets, schedules and resource capabilities make inter-departmental coordination a considerable challenge and impose a serious constraint on the ability of government to deliver on its commitment to rural development.

(b) *State grants:* Whatever the limitations of the state's land transfer – and fixed improvement and machinery/equipment grants – they have, of course, been a major enabling factor in terms of public financial service delivery. However, in terms of their impact on the demand for financial services, it has often been more to increase the size of potential demand than of effective demand, given the restrictions placed on using assets transferred as collateral for loans. Some recommendations for converting potential into effective demand are made in section 8.

Even though it falls a little outside the agricultural sub-sector that is the focus of this study, the net impact on the demand for finance by the greater agricultural sector also calls for attention. Beyond the contraction in demand caused by transforming so many functioning commercial farms into non-functional enterprises (see section 4.1), the widespread uncertainty caused by pending land claims has, without doubt, led to a significant reduction in the volume of investment in commercial agriculture and, with it, the volume of borrowing for that purpose. One knock-on effect has probably been the accelerated depreciation of land, fixed and movable assets transferred under the state's land reform programme, entailing additional expenditure on DAFF's CASP grants to restore or replace machinery, buildings and fencing, but leaving land reform beneficiaries with depreciated soil, for which no provision for fertilizer, as a working capital expense, is made.

In contrast, there appear to be few negative impacts from the state social grants that flow into rural areas. The de-racialization of state grants that accompanied democracy and the introduction or extension of some categories of grant, in particular the Child Support Grant and the Foster Care Grant, have, without question, hugely benefitted rural areas, even though reliable comparative statistics for rural recipients are hard to find. For the poorest quintile of households in South Africa – who would be heavily concentrated in rural areas –

Woolard et al. (2010, pp19-20) record the proportion of income of contributed by state child, disability and old age pension grants in 2008 at more than two thirds (followed by wages/earnings – about a quarter and remittances – the balance), with child grants, in turn, making up about two thirds of the grants' contribution. Between 1997 and 2008, the percentage of households in this quintile that reported receiving any income from state grants rose from 15,9% to 63,4%.

In terms of financial service delivery, by 2012 no fewer than 65% of social grant recipients in rural areas were being paid their grants electronically (ATM Marketplace, 2012), which accounts for the fact that as much as 48% of adults aged 16+ living in South Africa's rural areas ('formal' and 'tribal') were 'banked' in 2010 (FinScope Consumer Survey South Africa 2010, Survey Highlights, p19). Banks and the Post Office usually make debit card facilities available to holders of accounts into which social grants are deposited monthly.

Interesting insight into the impact that social grants have on informal savings and credit services – and on agricultural development - is provided by research that FinMark carried out with SaveAct research in 2012 (Delany et al., 2012). In the two areas of KwaZulu-Natal (Bergville) and the Eastern Cape (Matatiele) that the research (random statistical sample of about 300 households participating in SaveAct savings and credit groups (SCGs)), social grants were the most frequently cited source of cash income (79-85% of households) and were ranked the most important source in one and the third most important source in the other (pp22-23).

Though it was household income as a whole that made it possible for the members to contribute to their SCG monthly – a minimum of R100 but often more – there can again be little doubt that the known amount and regularity of grant payments made it easier to save. Indeed, many groups timed their monthly meetings to follow shortly after grant payment days. The impact of these groups on agricultural activity has already been described (see section 4.4.3) and some idea of the scale can be gained from the presence of about 650 such groups with more than 15 000 members in 2012, who, at any point in the year had in excess of R15 million in savings, about R10 million of which was mobilized in the form of loans to members (pi).

Agricultural activity was the most frequently (28-30%) named source of cash earnings from own economic activities (as against cash income from all sources) by households in both areas (p20) and it will be recalled from sections 4.4.2 and 4.4.3 that a significant percentage of loans and an unknown but certainly substantial percentage of annual cash pay-outs were used to finance agricultural production. The inference that can be drawn is that state social grants have fuelled both informal savings and credit activity and agricultural production/income in at least some low-income rural communities, which, in turn, has helped fuel the savings flowing into SCGs, thereby setting up a virtuous circle of development. Social grants can therefore be very positive 'enablers' of agricultural/rural financial services. However, one should perhaps be cautious about generalizing from this example: it is sometimes argued that state grants have a disincentive effect on recipients' willingness to engage in economic activity, though solid evidence to support this and to assess the impact on labour force participation is hard to find.

It is notable, from FinMark's research with SaveAct that the movement is growing rapidly, entirely in response to demand from rural communities, that default and membership attrition rates are almost nil and that on average, members derive about a 30% rate of return on their savings annually (Delany et al., 2012, foreword). Another positive conclusion that can reasonably be drawn is that, for low-income households in rural areas, with relatively poor access to formal financial savings and credit services, membership of such informal SCGs is an excellent alternative. Indeed, with the structure, discipline and financial literacy that movements such as SaveAct are introducing or developing – in effect a process of semi-formalization – SCG members are being thoroughly prepared for entry into the formal financial services market. Recognizing this, one of the 'big four' banks, Absa, has recently made a substantial grant to SaveAct to continue scaling up its activities and several banks are now marketing group savings products for groups such as SCGs to use for holding excess liquidity.

It is also worth noting that, although the total annual value of South Africa's social grants is certainly the largest on the continent, given that it has the largest GDP, at 3,5%, the percentage of GDP that it allocates to social grants ranks only fourth in Africa, behind Mauritius, Ethiopia and Malawi (Woolard et al., p27). It is well-known that, in Ethiopia and Malawi, informal SCG activity is widespread, raising the interesting possibility that their social grant systems are playing a similarly valuable developmental role.

(c) *Public policy and participation in financial services:* A recent study of agricultural and rural financial services in six countries in the Southern African region (Botswana, Malawi, Mozambique, South Africa, Zambia and Zimbabwe) commissioned by FinMark Trust (Oxford Policy Management Limited et al., 2012)[69] found the following to be disablers in respect of 'the role of government and development policy', i.e. macro-level disablers, in most:

- unstable macroeconomic performance
- some financial policies cause market distortions, e.g. mandatory interest rate ceilings
- some governments are directly involved in financial services, e.g. through ownership/management of development finance institutions (DFIs), implementation of SME and guarantee funds
- agricultural policies that do not facilitate (crowd-out) private sector participation, e.g. some subsidies, export bans, price fixing, etc.
- inadequate financial infrastructure.

To the advantage of low-income rural and agricultural communities in South Africa, only a few of these apply, or may apply, locally. Macroeconomic performance has generally been sound and stable since 1994. There are few financial policies that cause financial market distortions, in particular, no interest rate ceilings. And, though there is certainly room for improvement in the country's financial infrastructure, for example in respect of ATM distribution and branchless banking systems, it is widely accepted that South Africa has financial infrastructure, regulation and banking systems that compare favourably with most highly developed economies.

However, one area of caution is the country's state/province-owned DFIs, some of which display negative symptoms similar to those of many of their counterparts abroad (Oxford Policy Management Limited et al., 2012, pp 100-101). It is difficult to trace details of the performance of the small farmer loan books of the various DFIs, although that of the Land Bank, as the country's seminal DFI, has already been referred to (see section 4.3). Of the other MAFISA funds (R140 million) distributed in 2008-9 to the three provincial DFIs (in Gauteng, Mpumalanga and the Eastern Cape) for on-lending, just over half (51,4%) had been disbursed by the end of 2011, but, in contrast to the Land Bank, details of the levels of

[69] 'Study of African and International Best Practices in Increasing Access to Rural and Agricultural Finance', conducted by Oxford Policy Management Limited and Kadale Consultants Limited.

arrears and defaults and of possible recurrent direct or indirect recapitalization from National Treasury do not appear to be available to the public.

A second area of caution relates to 'agricultural policies that crowd out private sector participation', if a recent announcement reported to have been made by the Minister of Agriculture, Forestry and Fisheries is followed through. The Minister declared that 'the Land Bank would be extending to all farmers – smallholders and commercial – (a) special interest rate of prime minus 5%' (Business Day, 15 October 2012, p4). The muted response from commercial banks and other finance institutions that followed suggests scepticism as to the likelihood of implementation, given the limited capacity of the Land Bank to handle the volume of lending entailed and the high cost to the bank, which relies on borrowing in the market to provide capital for on-lending. Only by recurrent injections of capital from the fiscus could such a policy be sustained – something that National Treasury in unlikely to support. If the policy were to be confined to emergent and small commercial producers and land reform beneficiaries, the cost would be far smaller, but it would still have the effect of crowding out private sector lending to these producers and the logic would not be clear, bearing in mind the high level of undisbursed MAFISA funds (see section 4.3).

But, arguably, the most critical deficiency in South Africa's agricultural financial infrastructure is the lack of a coherent agricultural finance policy framework (see section 5.1). This directly reflects the absence – as in many other African countries (and internationally) – of a single, champion and coordinating body for agricultural finance policy.

The Global Partnership for Financial Inclusion (GPFI) and the International Finance Corporation (IFC) Policy Report 'Scaling Up Access to Finance for Agricultural SMEs' notes that 'agricultural finance is a policy orphan (in many countries) – too often responsibility for policies impacting agricultural finance falls into a void among several government ministries, such as finance, agriculture, planning trade and commerce. Different government bodies often have divergent interests and perspectives concerning agricultural finance. Accordingly, the subject area is frequently pushed to the side and neglected, inhibiting a coordinated legal environment that promotes the cohesive development of strong, sustainable and socially-responsible agricultural finance policies and supportive underlying legal and regulatory systems'.

The report continues: 'Coordination of policies intersecting both the financial and agriculture sectors is critical to facilitating access to finance for farmers and agricultural SMEs. The appointment of a single coordinating body as advocate for agricultural finance can optimize policies that target farming as an economic enterprise to promote agricultural development through finance and investment. This high-level body can also reconcile and harmonize policies focused on objectives related to rural development, social support and food security that are aligned with, but not necessarily the same as, policies supporting agricultural finance. Coordination is often necessary between the ministry of finance, the ministry of agriculture, the central bank and the ministry of trade and commerce.' (2011, p22).

To address this, the first of the twelve 'Kampala Principles' (see Appendix A) for agricultural financial inclusion in Africa – the product of a seminal, widely-attended agricultural finance conference held in Kampala in 2011[70] - calls for 'agricultural finance policy strengthening (to

[70] The 'Zipping Finance and Farming in Africa: Harnessing the Continent's Potential' conference, organized by Making Finance Work for Africa (MFW4A) with support from a number of influential international development/financial institutions.

be addressed) through establishing a specific high-level (country) coordination body and by recognizing a single entity as the advocate for agricultural finance'[71].

It would be a major step forward for this principle to be implemented in South Africa. Indeed, the twelve principles could help lay the foundation for DAFF's Development Finance Policy Framework that has been so long in formulation. It is regrettable that no representatives of DAFF or DRDLR were present when the Kampala Principles were agreed and that the departments seem to have been reluctant - to their own detriment – to engage more actively in Africa-wide agricultural financial/development processes. The recent decision to participate in the Comprehensive African Agriculture Development Programme (CAADP) and to commence the programme's investment planning process is to be welcomed.

(d) *Structural difficulties faced by small farmers:* In a number of other important respects, it is evident that on-the-ground public sector delivery to low-income rural and agricultural communities also only matches political rhetoric to a limited degree. Farmers in the 'traditional' black rural areas have experienced many of the disabilities that have beset their counterparts in most other African countries: typically, distance from markets, poor infrastructure – affecting transport, water, energy, communications – poor services – for inputs supply, marketing, extension, finance, health, education, among others – and poor local government/municipal service delivery. 21% of small farmers in the 2010 FinScope Small Business Survey reported experiencing infrastructural and equipment-related constraints (Tipoy, 2010), access to transport, water and electricity ranking first, third and fifth in order of importance, respectively.

While significant advances have been achieved on a number of fronts post-1994, notably in respect of infrastructure (de Klerk, forthcoming), several agriculture-specific disabilities remain: DAFF has struggled to improve the poor quality of extension services provided to black farmers pre-1994 and, perhaps even more to the detriment of agricultural development, 'land tenure reform' – the third major thrust of DRDLR's land reform programme – has simply not materialized. In practice, there has been little change to the tenure systems that applied under apartheid. The one significant attempt to introduce tenure reform, through the Community Land Rights Act (CLARA), was fundamentally flawed in a number of respects and was declared invalid by the country's Constitutional Court.

Although from a lending perspective, it would be convenient for agricultural land tenure to be privatized, it is certainly not a sine qua non for agricultural development and it is far from clear that most low-income rural communities would support it. Elsewhere in Africa and internationally, where similar traditional tenure systems exist and privatization is not in prospect, alternative approaches to fulfilling small farmers' financial service needs (including for working capital) are in operation and/or are being developed (Oxford Policy Management Limited et al., 2012).

From a tenure perspective – and also for purposes of lending – what would help greatly would be the evolution of existing tenure systems to allow more readily for the rental of un- or under-utilized land for agricultural usage. This would open up the possibility both for those wishing to enter or expand commercial production to acquire the use of sufficient land to generate an income which competes well with earnings from other sources – most importantly urban jobs – and for reaping the benefits of economies of scale. 'Space to operate' was ranked second (12,4%) among 'obstacles' to growth cited by small farmers in

[71] Making Finance Work for Africa (2012), Policy Brief on Agricultural Finance in Africa (p2), http://www.mfw4a.org/documents-details/policy-brief-on-agricultural-finance-in-Africa

FinScope's Small Business Survey (Tipoy, 2010), with 'competition' (18,4%) being ranked first. As competitiveness is significantly dependent on the presence or absence of economies of scale, both can be seen as being related to land access.

Developments that facilitate the renting of agricultural land in 'traditional' black rural areas would also provide a new source of income for traditional occupants without threatening their claim to occupation, and would skirt round some of the political difficulties that bedevilled CLARA.

(e) *Rural finance support institutions:* On paper, South Africa also has a wide range of rural finance and non-financial support institutions, whose assistance should be available to all farmers and rural SMEs. These include not only the many public, private and NGO financial institutions listed in section 5, but also an array of business development services (BDS) and other similar support services, mostly public sector and parastatal bodies. In respect of agricultural production and marketing, since 1994 DAFF's extension services have focused specifically on meeting small farmers' needs.

Yet, as with the country's financial infrastructure, it does not seem that small farmers make, or are able to make, use of these services. The sheer ratio of small farmers to extension staff – many thousands to one – let alone the breadth of extension officers' duties, the skills needed and the limitations on departmental transport, mean that few farmers ever benefit from public extension services. And FinScope (Small Business Survey 2010, p30) found that most SMEs countrywide (74,5%) are unaware of any support services, leading CIBA to conclude: 'both in terms of access to credit and non-financial support, the small farmer fraternity has been failed by government in South Africa' (CIBA, 2010, p11). Again, section 7.4 provides more detail.

(f) *Communications infrastructure and financial technology:* It was noted in 7.1 (d) that, although small farmers still face significant infrastructural obstacles, much progress has been made in overcoming the major infrastructural backlog in 'tribal areas' that democratic South Africa inherited in 1994. Arguably, the aspect of infrastructure in which the fastest growth has occurred, is communications, where the greatest part of investment has been undertaken by cell phone companies. In 1998, only 0,3% of rural households had a cell phone. By 2010, nearly half (48,9%) of rural households had one or more (UNICEF, 2012, p13[72]).

In the context of rural finance, this is of particular significance, because of the access to cell phone-based finance technologies that this has offered rural residents, at least in respect of transmission/transactions services. That it has been taken advantage of is suggested by the fact that 27% of rural cell phone owners report using their phones to browse the Internet (UNICEF, 2011, p5). As the use of cell phones continues to broaden, so will this form of access to financial services, with the limitations that, for now, it is confined only to transaction/transmission services and that it requires 'cell phone financial literacy' to translate into effective demand.

For the many who do not have such a level of literacy – and for many who do – branchless banking through retail chains offers an especially attractive alternative, as it does not require cell phone literacy, provides access to cash at precisely the moment when most likely to be needed – that is, when shopping – and is beginning to offer access to other financial

[72] http://www.unicef.org/southafrica/SAF_resources_mobilegeneration.pdf

services, in particular savings. The cost of transactions has dropped substantially and some retail chains now even make no charge. With time, no doubt branchless credit facilities will also become available. From a demand perspective, branchless banking of this nature will broaden the usage of formal financial services still more than cell phones, given that it is not confined to transactions/transmission services and needs neither such a phone nor the literacy to use it for financial purposes.

The rapid spread of communications infrastructure coupled with the equally rapid evolution of branchless banking financial technology must therefore rank as one of the foremost macro-level demand enablers.

7.2 Meso level

(a) *Financial infrastructure:* The meso level appears to be well developed in terms of associations, training, credit bureaus, information, etc.. As remarked earlier, it is widely accepted that South Africa has highly advanced financial infrastructure, on a par with or better than many developed countries. This should be a major enabler, both for supply and for demand. The wide range of formal financial institutions serving low-income rural and agricultural communities has been well described in section 5. Yet, as elaborated on in section 7.4, small farmers rank 'access to finance' and 'cost of finance' as the third and fourth most important obstacles to growth respectively (FinScope, Small Business Survey 2010), indicating the presence of some significant demand disablers in respect of financial infrastructure in respect of these consumer groups.

(b) *Non-financial private sector/NGO infrastructure:* The Agricultural Business Chamber (ABC) plays an important role in terms of organising private sector organizations that operate in the agricultural arena. There is broad consensus about the importance of building the emerging farmer sector. The ABC's role is enhanced by the on-going dialogue that it conducts with government on the role that private sector can play and on the policy framework and the support needed to make its participation a success.

Universities and NGOs, such as FinMark Trust, also play an important role in conducting research programmes and producing relevant information for use by policy makers and legislators. This information is intended to provide a fact base or foundation for informed policy making. Especially notable in this area are the various FinScope research studies, some conducted on a regular two-yearly basis, that enable policy makers to observe trends in enterprise development and financial access across different sectors, including the rural and agricultural sectors.

(c) *Non-financial public infrastructure:* Despite very developed meso level financial infrastructure in South Africa, there is still a need for more effective coordination between different stakeholders involved in rural and agricultural development. However, coordination is challenging for a number of reasons. Firstly, several government departments are involved: municipalities provide basic local services, but some services are provided at provincial level. This means that budgets may not be aligned. Municipalities are generally designated as the implementing agency for public sector initiatives in their area of authority, but many – in fact, most in rural areas – do not have adequate capacity to play this role effectively. Hence, a rural community that requires coordinated inputs of different kinds – typically, roads, electricity and reticulated water, for an agricultural project to function well enough for loans to be secured and repaid – has to engage with different government departments. Most communities simply do not have the capacity to do this either.

Some attempts have been made to develop district level committees with representation from DRDLR, DAFF, district municipalities and the Land Bank. Some function with relative success for a period, but others struggle without effective involvement of the relevant people. In addition, these forums seldom seem to include relevant NGOs, agricultural commodity associations or the private sector (financial institutions, off-takers). Local economic development (LED) forums with comprehensive participation from a broad range of stakeholders – which feature large in public strategy - take some work to establish and maintain in effective operation. Yet, both for the demand and for the supply of finance for agricultural and rural development, their functioning is essential. A focused programme aimed at developing and maintaining such forums is required.

7.3 Micro-level

Despite a range of service providers supplying differentiated products to the various segments of the market, there are still considerable gaps in the supply of financial services to rural and agricultural markets. Important disabling factors include the high cost of operating in rural areas, the levels of education and cost of staff and the lack of knowledge and experience of management and staff.

(a) *Cost of operating in rural areas* continues to be an important disabler of financial service provision. Relative to the value of turnover, costs that are especially significant stem from the need for investment in physical infrastructure, such as office space in rural towns, and the distances that need to be covered to maintain and develop the needed infrastructure. The inadequacy of telecommunications that used to be a major constraint has now, to a significant degree, been resolved (see 7.1(f)). To reduce costs, most banks have opted to work in partnerships with retail networks and independent merchants to expand their footprint into rural areas through a branchless banking approach. This approach is still quite new and will need some time to mature and evolve. Experience from other contexts indicates that investment in education around these service offerings is an important element of success – to develop sufficient understanding of and trust in these services. In addition, the role of informal financial services is still important as formal financial institutions in their current form will not be able to reach more remote communities.

(b) *Human resources* in more rural settings tend to have less experience in financial services provision, lower financial literacy levels and lower education levels. The training needed to make up for this is costly and premiums usually need to be paid to induce sufficiently knowledgeable, experienced staff to relocate to rural areas. The initiative that the parastatal banking industry training body, BankSETA, has launched to invest in skills development in the microfinance sector is notable for including rural small town operations in a learnership programmes and for covering the costs of travel for training purposes.

(c) *Financial institutions' lack of business and agricultural expertise and experience:* Many institutions do not understand adequately how specialised the agricultural sector is and how difficult it is to succeed and/or transform from an emerging farmer into a commercial farmer and to acquire the skills and traits needed to make an SME or a small farm a business success. This process of growth requires very long term interventions, as learning how to farm on a commercial basis requires years of experience, practical learning and formal training. In some cases partnerships between commercial farmers and emerging farmers have worked effectively in the provision of mentorship, support and training. Other partnerships of this sort have also been unfairly exploited by one of the parties.

Where joint ventures or equity schemes are established they need to be developed with experienced individuals who understand the importance of developing suitable incentives and penalties for the different parties to ensure that the partnership is fair and in respective parties' interests. Banks (including the Land Bank) tend to shy away from such joint ventures and partnership agreements given bad experiences in the past. However, much has evolved in this space and there is a need for financial institutions to better understand what can make these arrangements function acceptably, to facilitate access to finance.

No less than for other economic sectors, designing or adapting products and providing the accompanying services needed to cater effectively and sustainably for emerging and small commercial farmers' and land reform beneficiaries' needs calls for an in-depth understanding of the sector. While most of the big four banks have considerable expertise in servicing the various branches of large scale, commercial agriculture, this is not sufficient: substantial differences in, among others, input and output markets, individual capital and skills bases, land tenure and community norms and relationships need to be appreciated and responded to – as well as the substantial untapped potential that these farmers represent. Other roads to greater inclusivity, such as farm worker equity/joint management schemes, also require a nuanced understanding of the needs, perspectives and social circumstances of worker communities.

Because small 'traditional tenure' farmers make up the overwhelming majority in most other African countries, formal financial institutions there are more advanced in developing products – especially those not requiring land-based collateral – and skills for this market, though the challenges to be met are still substantial. It would be valuable for South African banks entering this market to support the establishment of specialized in-country staff training courses, to take advantage both of the similarities and of the differences between South Africa and other African countries. For example, there may be greater scope for large scale-small scale farmer collaboration in South Africa. But there also is much to be learned from industry counterparts up north and to be gained from participating in their collective skills development activities, such as those mounted by the African Rural and Agricultural Credit Association (AFRACA).

For the subsistence farming market, some of the greatest sources of expertise reside in local and international NGOs, such as SaveAct (see sections 4.4.3 and 5.3), CARE and the Catholic Relief Services, which are making considerable headway in the field of savings-led credit. The long term potential of this approach for developing formal commercial markets to serve this, much the largest, agricultural client group, is enormous, if sufficient understanding, sensitivity and innovation can be brought to bear. Absa's recent decision to support the up-scaling of Save Act's activities is far-sighted and promising.

7.4 Client level

(a) *Lack of collateral security:* The inability of both small farmers in 'informal rural areas' and land reform beneficiaries to use the land that they farm as collateral for bank loans has already been noted (see sections 4.1 and 7.1.1(d)). Clearly, this makes lending more difficult, from banks' point of view, as acceptable alternative sources of physical or financial security are generally limited or absent. This also has the effect of stifling effective demand, through reducing willing borrowers' ability to raise the working capital needed to generate the income required to enable them to service and repay loans.

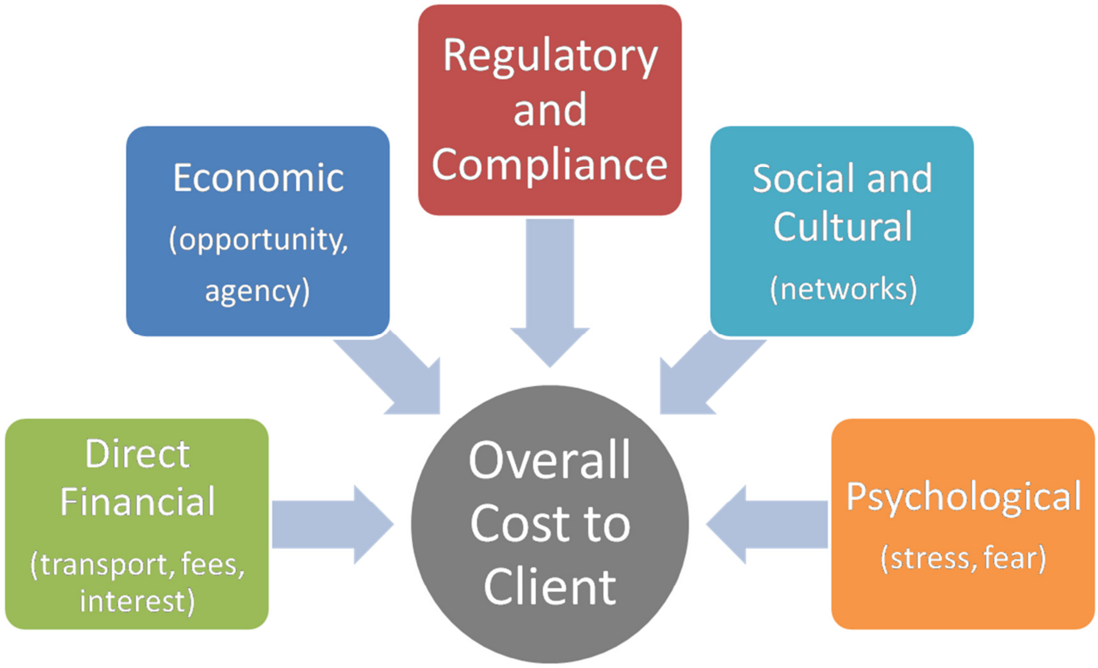
However, it was also noted that elsewhere in Africa and abroad, where similar restrictions on the use of land for collateral apply, substantial progress has nevertheless been made in finding alternative bases for lending and for mitigating the risks inherent in lending for agricultural production, with or without security. These are examined and their implications for policy in South Africa are analysed in section 8.

(b) Inability of farming to compete as an income-earning occupation: Still on land tenure, the difficulty of hiring land in 'informal rural areas' was noted as another constraint on small scale farming, thereby limiting the scale of individual farmers' production, their ability to reap economies of scale and the scope for organizing themselves into the sorts of producer group that facilitate integration into agricultural value chains. In combination with the various other structural disabilities mentioned (in 7.1), this makes it hard for farming in these areas to compete with other occupations, especially formal employment in urban areas, as an income earner. 'Competition' was ranked as the biggest obstacle to small scale farming by respondents in FinScope's 2010 Small Business Survey (CIBA, 2010). This has a massively depressing effect on the demand for financial services by small scale farmers. The policy implications of this are also examined in section 8.

These constraints also contribute to some of the reasons given by SMEs (nationally) as to why they didn't have a bank account in 2010, the three most widely quoted reasons being: 'business/income is too small' (35-40%); 'income is too irregular' (27-332%); and 'not enough money from business' (24-27%) (FinScope Small Business Survey 2010, p53).

(c) *High costs to users of formal financial services:* When the costs of financial services are being considered, it is most often direct transaction and interest charges that are referred to. Of course, rural clients are subject to these charges and find them onerous – 'cost of finance' was ranked fourth among the obstacles to growth by small farmers in the same survey (Tipoy, 2010) – although the charges in South Africa are probably the lowest in the region and interest rates are presently at an all-time low, while 'bank charges' were mentioned by 6-8% of SMEs nationally as a reason for not having a bank account (FinScope *ibid*, p53). However, what is often not appreciated is the many other costs that clients – particularly those in low-income rural communities, who are relatively far from the nearest formal financial institution and are relatively poorly educated – are subject to. Figure 12 illustrates:

Figure 12: Direct and indirect transactions costs borne by clients



Source: Coetzee et al., 2011, p12

The average cost of transport to formal financial facilities will certainly be higher for widely dispersed rural clients than for those living in urban areas, and because average travelling times will be longer, the opportunity cost of lost income-earning time is also likely to be greater, at least relative to total earnings.

Over and above these costs, to deal with formal financial institutions, there are a number of important compliance requirements, each with an associated cost, for example, the cost and time of getting an ID book and proof of address – not easy for most people living in rural areas. The Post Office is understood to have made giving households in rural areas a postal address a priority in recent years. 5-10% of SME owners in FinScope's 2010 survey said that they hadn't tried to open a bank account because they hadn't registered their business (p53).

For low-income rural people, less familiar with urban institutions' norms and methods of operation, there are also substantial social/psychological costs, manifested in fear of the unknown and fear of being rejected as a client. 11-15% of SME owners (rural and urban) in the FinScope 2010 survey reported being 'too scared' to try to borrow from a bank; 4-8% said they thought they wouldn't qualify for a bank account; and 1-6% saw it as being 'too complicated' (p53).

In the light of all of these costs, it is scarcely surprising that many low-income rural clients prefer to use local informal financial institutions, for which the transport and opportunity costs of time are little or nothing, regulatory and compliance requirements and prerequisites are absent and the social/cultural and psychological costs are generally known and manageable. Mashonisas – and SaveAct's SCGs - certainly charge much higher interest rates than banks (of the order of 50%/month and 10%/month respectively), but when costs are calculated on a comprehensive basis, for many rural residents local informal institutions obviously offer a better deal than their formal sector competitors.

(d) *Financial literacy:* Financial literacy is usually understood as the combination of consumers'/ investors' understanding of formal financial products and concepts and their ability and confidence to appreciate financial risks and opportunities, to make informed choices, to know where to go for help and to take other effective actions to improve their financial well-being (Messy et al., 2012)[73], such as keeping adequate financial records and being able to analyze and deduce business strategy from such records. Poor financial literacy also restricts the ability of small producers to bargain with large up- and downstream value chain players, even when they are well organized.

In South Africa, on the basis of this understanding, levels of financial literacy, especially in low-income communities, remain a challenge. The limited familiarity of rural households and enterprises with formal financial products has already been noted (see 7.1(c)), as has both the lack of awareness of small farmers of formal sources of help and the inadequacy of these sources (see 7.1(f)).

However, when viewed at the informal level, the picture appears quite different: in terms of cash flow management, as FinMark's research with SaveAct SCGs shows (see section 4.4.2), given the slimness of their resources, low-income households have to be experts to survive by balancing borrowing and lending between sources from day to day. The research also shows how rural SME owners (including small farmers) use SCG loans to help capitalize their enterprises and service and repay loans (of up to 3x their savings) within a maximum of 3 months. Also, how SCG groups using SaveAct's model are able both to mobilize about two thirds of their combined savings capital for loans at any moment, in the process generating average annual returns of about 30% and achieving almost a zero default rate. And, as pointed out in section 4.4.3, SCG members' acute awareness of the risks of agriculture leads to their preferring to use annual savings and interest pay-outs to finance farming, rather than borrowing for this purpose.

All of this defies the notion that low-income households, SME owners and small farmers are financially illiterate. Working within a system that they understand and trust, the members of SaveAct's SCGs are able to save, borrow, repay and earn income, with the basic training that they have received and the subsequent occasional support that they are able to call on. As SaveAct's model is built on the stokvels (ROSCAs) that are so popular in low-income communities – especially in rural areas where the composition of communities is comparatively stable and members get to know one another better – there is no reason to suppose that its SCG participants are in any way unrepresentative or that, given appropriate support, the financial literacy that they so manifestly display is not inherent in the broader low-income rural community.

What is needed is to provide this support – and for formal financial institutions to market their products better in this community, to make them competitive with informal products – what bank can offer a 30% annual return on savings? – and to find ways to complement the services that informal financial institutions offer – not hard, when the limitations of informality are recalled. Further, there is a need to improve the capability and outreach of public and parastatal support institutions in the context of enormous numbers of small farming and non-farming enterprises.

There is also a need to reconsider the way in which financial literacy is conventionally understood, measured and addressed. In terms of understanding and measurement, it is

[73] Messy, F. and Monticone, C. (2012), The Status of Financial Education in Africa, OECD Working Papers, http://www.oecd-ilibrary.org/finance-and-investment/the-status-of-financial-education-in-africa_5k94cqqx90wl-en

important to take into account the aspects of literacy that *are* present in the informal economy in shaping efforts to improve it. In terms of addressing it, at a formal level there are a number of successful initiatives in other African countries – such as the West and Central African cocoa industry's 'farmer business schools' (Akinola et al, 2011) – from which to learn. At an informal level, the initial training that SaveAct's SCG members are obliged to undergo, and the subsequent optional SCG support and individual short business development courses that SaveAct provides, are useful examples to investigate for possible replication.

(e) *Farmer organization:* Though hard evidence is difficult to find, there seem to be only limited examples of small farmers' being able to organize themselves to drive better bargains with large up- or downstream value chain players or to take advantage of potential economies of scale. At an informal level, evidence from FinMark's research with SaveAct (Delaney et al., 2012) reveals many instances of groups of small farmers clubbing together to buy sufficient quantities of fertilizer, seeds and other inputs to avoid having to pay the punitive prices of very small packs and to share transport costs. However, most farmers in these instances fall into client groups 1 or 2, as identified in section 4.2, that is, they produce entirely for their own consumption or are not tied tightly into formal value chains.

At a more formal, client group 3 level, where small farmers are tightly tied into commercial value chains – typically where the unprocessed product cannot readily be consumed domestically (e.g. sugar, cotton, tea, coffee) – the driving force for organization almost always appears to come from processors, who are often also the major input suppliers. This is certainly to mutual advantage and boosts both the demand for and the supply of financial services, but it also reveals small producers' incapacity to organize themselves and the weakness of their monopsony bargaining position, relating to every aspect of output and input supply, including the nature and cost of financial services.

7. Implications and recommendations for policy and practice

The analysis of the preceding 7 sections has exposed a number of issues that call for appropriate responses in terms of public and/or private sector/NGO policy and practice. Bearing in mind the focus on financial services, the recommendations that follow are confined to those that will help most directly to achieve the goals of progressively increasing access and of closing the access-uptake gap. A wide range of interventions for both the public and the private sector/NGOs is outlined, many of which will need to be pursued and coordinated over an extended period for them to bear fruit. This calls both for dedicated championing, ideally by the single agricultural finance coordinating body, the need for which was identified in section 7.1(c). Especially in the absence – but even in the presence – of such a body, there also a valuable facilitating role that could be played by an NGO with a research and advocacy mandate, such as FinMark Trust.

Table 12 enumerates the issues (non-exhaustively), grouped by category of farmer/SME client, and suggests appropriate responses.

Table 12: Critical issues and recommendations for public and private sector policy and practice

Section	Issue	Implications/recommendations for policy, practice	
		Public sector	**Private sector/NGOs**
4.4.2 Demand for and supply of financial services by rural SMEs	(i) Low rate inclusion of rural SMEs in formal financial services	• Maintain payment of social grants and increase incentives for rural recipients to Take delivery electronically • Increase number of PostBank branches and ATM connections in rural areas • Increase budget for rural physical public infrastructure • Reconsider current staffing, skills improvement systems to build delivery capacity of rural municipalities; reconsider system of tasking municipalities entirely with delivery, maintenance of infrastructure; improve inter-departmental coordination/collaboration • Raise profile and increase effectiveness of public sector business development services, e.g. SEDA • Conduct research on best practice public sector policy/practice to promote SMEs internationally, especially in comparable low/middle income countries in Africa, Asia, Latin America • Increase interaction with/participation in international organizations/initiatives to promote SMEs • Prioritize establishment, effective functioning of local economic development platforms • Collaborate with private sector to support	• Continue to broaden product range, deepen outreach and reduce direct transaction costs of branchless banking services, cell-phone based services and ATMs • Lower indirect/hidden transaction costs of products, e.g. by reducing 'red tape' requirements • Make marketing more user-friendly, e.g. through simplifying leaflets, ensuring customer relations staff approachable, empathetic, speak local languages • Promote savings as an attitudinal/informational/collateral foundation for credit • Add flexibility to forms of collateral accepted • Prioritize connecting with, learning how informal SCGs operate, looking for complementarities, ways to integrate, e.g. through group savings accounts when SCGs have excess liquidity and limited group loans when liquidity shortage; raise profile with, market through SCGs • Use corporate social responsibility grants to support NGOs promoting 'semi-formalization' of SCGs and financial literacy to enable consumers to make

		the development of tertiary-level training courses in rural and agricultural finance at South African learning institutions • Focus on educating consumers about their rights and responsibilities in respect of financial services	informed choices for their financial well being • Conduct in-depth research on SMEs and informal SCGs through FinScope/other surveys • Conduct research on best practice private sector/NGO policy/practice to promote SMEs internationally, especially in comparable low/middle income countries in Africa, Asia, Latin America • Increase interaction with/participation in international organizations/initiatives to promote SMEs • Collaborate with public sector to support the development of tertiary-level training courses in rural and agricultural finance at South African learning institutions
	(ii) Women operating rural SMEs less banked than men	• Given high percentage female-headed households in rural areas, all recommendations for public policy/practice in 4.4.2(i) also relevant	• FinScope/other research should investigate reasons on a gender-specific basis for inability/reluctance of SME owners to use banks' services • Build relationships with informal SCGs (members predominantly women) – see recommendations for 4.4.2(i)
4.4.3 Demand for and supply of financial services by small farmers	(i) Low rate of inclusion of client group 1 ('subsistence') farmers in formal financial services, especially for credit	• Finalize, implement DAFF's Development Finance Policy Framework; take note of and consider using Kampala Principles as foundation for framework; ensure appropriate emphasis given to client group 1 farmers • Establish single coordinating driver for	• All recommendations for private sector/NGO policy/practice in 4.4.2(i) relevant (applied to small scale farming)

		agricultural finance policy development • Intensify measures to improve capacity of, delivery by DAFF's agricultural extension services, both in rural and in urban areas; focus support of services mainly on client group 1 farmers (largest and least likely to receive private sector value chain development support) • Increase funding for, priority given by Department of Cooperative Governance and Traditional Affairs' Community Work Programme to assisting individual households to improve, maintain domestic gardens • Increase state support for NGOs assisting growth of domestic gardens in low income communities, financial literacy • All (except last) recommendations for public policy/practice in 4.4.2(i) again relevant (applied to small scale farming)	
	(ii) Low rate of inclusion of client groups 2 ('emergent') and 3 ('small commercial') farmers in formal financial services, especially for credit	• All (except last) recommendations for public policy/practice in 4.4.2(i) again relevant (applied to small scale farming) • Appoint body to investigate harmonization of land, agriculture and financial services policy, legislation and practices and move toward implementing a more harmonized approach • Finalize, implement DAFF's Development Finance Policy Framework; retain focus on credit, as opposed to savings, transmission/transactions and insurance	• All recommendations for private sector/NGO policy/practice in 4.4.2(i) again relevant (applied to farming), but with less emphasis on actions to promote informal SCGs, whose capacity to capitalize farms is inversely related to size and degree of commercialization • Form partnerships with and use major value chain players as agents for on-lending to farmers; support partners/ agents in initiatives to form small scale commodity producers organizations • Large value chain players to provide

		• Allocate a greater percentage of DRDLR and DAFF’s annual expenditure away from land restitution/redistribution to assist rural development in former ‘homelands’/’bantustans’ • Prioritize review of, amendments/ adjustments to land tenure systems in these areas to facilitate land rental for agricultural purposes • Institute effective measures to improve performance of, coordination between DAFF and DRDLR; develop specialized capacity to serve small farmers in urban areas; leave agricultural extension support for small commercial/emergent farmers to input suppliers/processors in respective value chains • AgriSETA to provide technical assistance, including extension services, to small farmers through input suppliers/processors in respective value chains; advise small farmers to diversify their income sources within and beyond agriculture • Increase rate of disbursement of MAFISA funds by, amongst others, appointing additional value chain sub-agents, raising individual loan limits, investigating and responding to reasons for slow on-lending of funds by sub-agents, including (a) in respect of demand, addressing constraints on the competitiveness and ‘loan absorption capacity’ of small farmers	technical assistance, including extension services, to small farmers through input suppliers/processors in respective value chains; advise small farmers to diversify their income sources within and beyond agriculture • Collaborate with partners/agents to develop/expand small farmer-appropriate financial product/service range, emphasizing non-land-based collateral products such as warehouse receipt finance and input loans secured by crop/livestock cession for established value chain producers • Consider role of, need for partial loan guarantors, such as AGRA; contract, if appropriate • Equip staff with skills, orientation required to serve farmers and on-lending partners/agents effectively • Develop specialized capacity to serve small farmers in urban areas • Use corporate social responsibility grants to assist initiatives to develop farmers’ financial literacy/management and related skills, such as ‘farmer business schools’

		identified in section 7, and (b) in respect of supply, assisting the development of new non-land-based collateral products, such as warehouse receipt finance, input loans secured by crop/livestock cession for established value chain producers and incentivizing/subsidizing the costs of improving staff skills and systems • Conduct thorough review with Land Bank of reasons for small size, lack of growth and poor performance of the bank's small farmer loan book and address issues arising (as for MAFISA sub-agents); review Land Bank Act and, among others, reconsider amendment to allow bank to take deposits (partly to augment funding, but also to facilitate lending to small farmers through deposit-based collateral) • Examine carefully implications, likely impact of adding (further) subsidies to Land Bank/other DFI/MAFISA loans • Conduct similar review for all other public/parastatal development finance institutions involved in agricultural finance and address issues arising (as for MAFISA sub-agents). • Review mandate split between IDC and Land Bank around agricultural production and agro-processing finance to increase coordination and facilitation of value chain project development involving small farmers. • Investigate advisability of, best options for	

		providing partial loan guarantee facilities, including securing the assistance of external agents, such as the Alliance for a Green Revolution in Africa (AGRA) and/or building public sector capacity to take on this role • Incentivize/otherwise assist contract farming and formation of small scale commodity producer organizations with/through major value chain players • Review effectiveness of, assistance/ incentives to existing public and private sector farmer skills development schemes, placing additional emphasis on farmers' financial literacy/management skills; address issues arising • Review effectiveness of, assistance/ incentives to existing public and private sector agricultural finance skills development schemes; address issues arising	
	(iii) Limited access of land reform beneficiaries to working capital	• Appoint body to investigate harmonization of land, agriculture and financial services policy, legislation and practices • Review current restrictions on use of restituted/redistributed land and fixed/movable assets for collateral, for example, to consider resale to other (black) land reform beneficiaries or other black buyers, in the event of loan default • Promote, facilitate the formation of innovative partnerships/leasing arrangements to improve post-transfer	• Form partnerships with and use major value chain players as agents for on-lending to farmers; support partners/ agents in initiatives to integrate land reform farming enterprises into value chains • Collaborate with partners/agents to develop/expand appropriate financial product/service range, emphasizing non-land-based collateral products such as warehouse receipt finance and input loans secured by crop/livestock cession

		management and facilitate access to working capital • Research reasons for frequent failure of land reform farming enterprises and respond accordingly, for example, to make the remuneration of management agents partly dependent on enterprises' profitability and/or to ensure effective organizational development and better governance in beneficiary communities; use feasibility assessments to ensure viable business- given the number of beneficiaries - well defined and structured contracts between joint venture partners • To consider suspending part of the payment to outgoing owners and to make full payment dependent, for example, partly on the effective maintenance of assets (including soil quality) after the registering of a land claim and/or on continuing enterprise profitability after change of ownership • Provide technical assistance, including extension services, to small farmers through input suppliers/processors in respective value chains	for established value chain producers • Promote, facilitate the formation of innovative partnerships/leasing arrangements to improve post-transfer management and facilitate access to working capital • Provide technical assistance, including extension services, to land reform beneficiary farmers through input suppliers/processors in respective value chains; advise land reform farmers to diversify their income sources within and beyond agriculture • Consider role of, need for partial loan guarantors, such as AGRA; contract, if appropriate • Equip staff with skills, orientation required to serve farmers and on-lending partners/agents effectively • Use corporate social responsibility grants to assist initiatives to develop land reform beneficiary farmers' financial literacy/management and related skills, such as 'farmer business schools' • Support NGO initiatives to land claim communities to establish working partnerships, handle relationships between various partners and provide long term mentorship

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9. Appendix A

THE KAMPALA PRINCIPLES

Financial inclusion is a key to achieving MDGs and Africa's development. While Agricultural Finance is a part financial system of a country, the financial services needs of Agriculture Sectors in Africa are pressing and demand special attention.

- Establish a specific high-level coordination body and by recognising a single entity as the advocate for Agricultural Finance
- Strengthen farmers' organizations so that the production end of agricultural value chains becomes an effective influence on agricultural finance policy making
- Focus public sector policy on a value chain/commodity approach, with clustering of smaller farmers to facilitate economies of scale in input purchase, value addition, marketing and advisory services.
- Ensure legislation is in place and is implemented to foster innovation and to remove barriers to financing the business of agriculture, through measures such as, but not limited to: asset-backed products, warehouse receipts, contract farming, credit reference bureaux (and better client identification), consolidation of small but viable rural financial institutions and other support to the informal financial sector.
- In accordance with CAADP Principles, and in encouragement of private sector investment, increase public sector expenditure in areas such as, but not limited to: crop and livestock research and extension, water for irrigated crop production and livestock farming, infrastructure for crop insurance, rural energy supply, communications and roads.
- Support transformation of the agricultural sector through encouragement of **longer term productivity-enhancing, on-farm investments** such as water supply/irrigation, fencing and farm buildings, through consensual approaches to land tenure issues.
- Enable financial institutions to meet the **demand for longer term financing** by developing financial markets so that lenders can gain access to the term liabilities required.
- Encourage the **commercialisation of agriculture and of farming as a business**, whether by consolidation of small holdings or through involvement of the private sector (domestic and foreign); in both cases ensure that social, cultural and environmental concerns are met and , in the latter case, that appropriate controls are in place to prevent undesirable exploitation.
- Develop and implement concrete actions **to improve financial literacy, consumer protection and farmer business education, with a special focus on gender and youth issues**.
- **Drive research, training and dissemination of knowledge** to foster private sector investment in developing and marketing added-value agricultural products and services.
- **Ensure a sustainable flow of information is available** in areas such as, but not limited to: markets, output prices, costs of inputs and cost and conditions of financial products and services.