

The lending practices of township micro-lenders and their impact on the low-income households in South Africa: A case study for Mamelodi township

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Abstract

Access to finance (cash/credit) is central to economic development and improving the living standards of people. Faced with uncertainty about future prospects, illiquid and irreversible nature of assets, the low-income households become vulnerable to unpredictable events like illness and death. Traditional requirements of formal collateral, asymmetric information and high transaction costs used by the formal financial institutions are barriers to the provision of credit. The low-income households therefore resort to township micro-lenders to access credit in order to bridge the effects of these events. The objective of this article is to assess the lending practices of the micro-lenders and their impact on the households and to determine effective measures that need to be taken to protect the households from such practices. The article adopts a case study approach based on micro lending in the Mamelodi township situated in the Gauteng Province in South Africa. Both random and snowball sampling were employed to conduct personal interviews with micro-lenders and households (borrowers). The findings reveal that these micro-lenders, though easily accessible, exploit the households and place them in emotional and financial distress (over-indebtedness). Based on the findings, this article recommends the development of social self-regulatory mechanisms to protect the households from exploitative practices of township micro-lenders.

Keywords: Micro Lending; *Mashonisas*; Regulation; Financial Institutions; Low-Income; Credit.

Introduction

Historically, applying for a loan (credit) at a financial institution in South Africa requires one's credit history which has an impact on one's ability to obtain a loan. This information is then used by the institutions to assess the probability that you would default on your payments and whether you are considered a low or high risk borrower. Song¹ emphasises that any classification of credit means allocating estimated risks of non-payment based on the assessment of a borrower's repayment capacity to meet his obligations under the loan contract.

Access to cash or credit is essential in decreasing exposure to unpredictable events like illness, diseases, food insecurity and death as well as smoothing consumption. Without cash, it becomes difficult to bridge the effect of these events and/or to survive. The majority of the low-income households who live in townships are unable to access credit from the formal financial institutions, especially banks, and therefore depend on the financial services of township micro-lenders, popularly known as *mashonisas*, for a range of needs like food, clothing, health care and funeral expenses.² Low-income households are described as those in Living Standard Measures (LSM) 1-3, that is, estimated average monthly income of R1080 and R1485³ or R1000-R1400.⁴ Low levels of education condemn most of the households to very low skill jobs outside the formal economy where they engage in informal jobs earning insufficient income. According to Micro Finance Regulatory Council,⁵ 63% of the borrowers earn less than R4000 per month. These micro-lenders often have fifteen to twenty clients borrowing an average of R150-R250 at a time. Wilson⁶ points out that the clients earn quite small amounts of income per month, normally in the range of R2000-3000. Aliber⁷ mentions that a number of these households that mostly constitute women are pensioners, domestic workers in the private homes and street traders earning very little income. In many cases, the street traders are the unemployed who resort to self-employment where they engage in informal and survivalist activities to

1 I Song, "Collateral in loan classification and provisioning", IMF Working Paper (WP/02/122) (International Monetary Fund, 2002) pp. 2-4.

2 G Wilson, *Bank management* (Washington, Mckinsey and Co, 1996), p. 15.

3 South African Advertising Research Foundation (SAARF), *Living standard measures* (South Africa, 2005).

4 Gauteng Provincial Government, *Socio-economic review and outlook* (South Africa, Department of Finance, 2010).

5 Micro Finance Regulatory Council, *Finance on indebtedness* (South Africa, Micro Lenders Association, 2005).

6 G Wilson, *Bank management* (Washington, Mckinsey and Co, 1996), p. 15.

7 M Aliber, *Study of the incidence and nature of chronic poverty and development policy in South Africa: An overview* (South Africa, University of the Western Cape, 2001), pp. 44-58.

cater for unforeseen circumstances and to survive. Survivalist activities are activities by people unable to find a paid job or get into an economic sector of their choice.⁸ Income generated from these activities usually falls short of even a minimum income standard, with little capital invested, virtually no skills training in the particular field and only limited opportunities for growth into a viable business.

Despite the increasing need for credit or cash by the low-income households, such credit from the formal financial institutions, especially banks, is inaccessible due to collateral constraints, high interest rates and asymmetric information. The households only need small amounts of loans to run their day-to-day expenses and to survive but extending small amounts of loans is perceived by the financial institutions as risky, costly, and unprofitable. The concern of the institutions is that the unit costs of administering a large number of small loans are high. The lack of sufficient collateral to secure loans, lack of information (asymmetric information) about the creditworthiness of the borrowers lead to high transaction costs of advancing credit to such borrowers.⁹ The institutions hesitate to lend to people whose repayment capacities seem uncertain and risky. This means that financial institutions (or banks) will have little recourse against defaulting borrowers. As a result, these households resort to the township micro-lenders known as *mashonisas* in the black communities and who provide small loans for a range of needs. These micro-lenders operate informal lending and borrowing businesses in both townships and small cities and exist as the only and immediate sources of credit available to the households. The importance of these micro-lenders is ascribed to easy access to loans which is characterised by social aspects like long-term relationships, reputation, respect and loyalty. These social aspects remove the risks of collateral and asymmetric (incomplete) information and lack of credit history in the lending and borrowing activities.

The underlying problem is that although the township micro-lenders appear to be responsive to the credit needs of the low-income households, these lenders use exploitative practices which place the vulnerable households in debt spirals causing them emotional and financial distress. The objective of this article is to assess the impact of exploitation by the township micro-

8 Department of Trade and Industry, *Financial access for SMMEs: Towards a comprehensive strategy*, A draft discussion document (South Africa, Centre for Small Business Promotion, 1998).

9 P Meagher and B Wilkinson, "Filling the gap in South Africa's small and micro credit market: An analysis of major policy, legal, and regulatory issues", Revised final report submitted to the Micro Finance Regulatory Council of South Africa, (IRIS Center, University of Maryland, 2001), pp. 12-19.

lenders on the low-income households and to determine effective measures that need to be taken to protect the households from such exploitation.

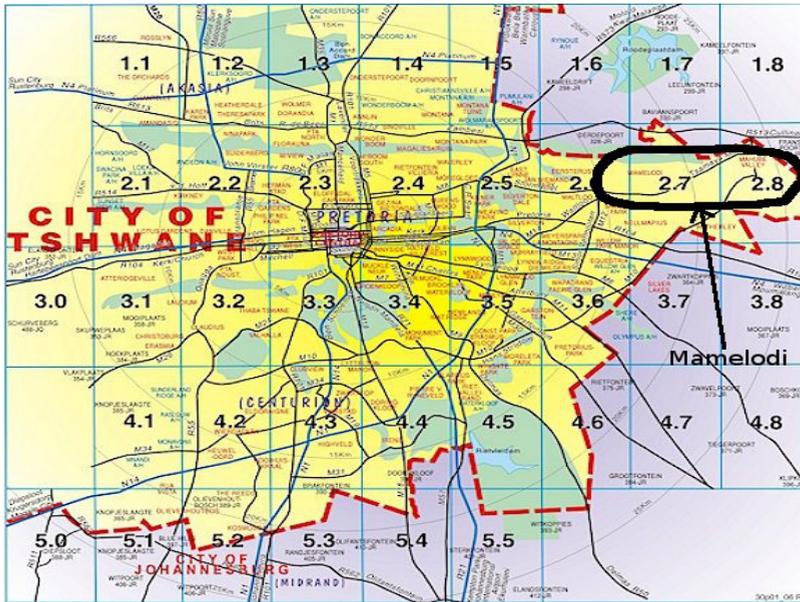
Research method and the field site

The research adopts a case study approach based on township micro-lenders (*mashonisas*) operating lending activities in the Mamelodi, established in 1953, which is primarily a black township situated about 20 kilometers on the north eastern outskirts of the City of Tshwane (Pretoria) in the Gauteng Province in South Africa with an unofficial population of close to one million people.¹⁰ Although Mamelodi township is well established with a large permanent residential component with old four-roomed houses, a number of self-built decent houses, Reconstruction and Development Programme (RDP) houses, and low-cost housing and upmarket dwellings, there exists substantial informal residential component or informal settlements comprising mostly of the poor people who have built their own shacks made out of corrugated iron or plastic sheets. Historically known as Vlaktefontein farm, its name was changed to Mamelodi in 1962. Mamelodi is bordered by Magaliesberg Mountain on the northern and eastern sides and the Pretoria-Witbank highway on the South. Watloo, East Lynne, Eersterust and Silverton are its closest neighbours with the Moretele/Pienaars River running through it.¹¹ The choice of Mamelodi is informed by common practices, sociological conditions, relationships and social dynamics of the general black population in the South African townships. One is likely to find a high degree of connectedness in terms of informal financial arrangements between *mashonisas* and borrowers which are characterised by mutual social relations, trust, respect and reputation.

¹⁰ City of Tshwane, *South African townships: Mamelodi* (South Africa, Tshwane City Council, 2010), p. 2.

¹¹ JT Pila, *Mamelodi geographical information* (Pretoria, KPT Media, 2011), p. 3.

Image 1: Map of Mamelodi



Source: City of Tshwane, *South African townships...*, p. 2.

Micro-lenders (*mashonisas*) are generally prevalent in the South African black townships and operate homogeneously with regard to lending practices which include providing small scale credit to the local communities, especially those that are marginalised by the formal financial institutions.¹² These communities depend on micro credit or *mashonisas* to meet basic needs such as food, privatised services such as water, energy, housing and school fees.

To establish the lending practices of the micro-lenders and their impact on the households, fieldwork was conducted between August and November 2011 in the Mamelodi township. The findings were based on the primary data which was collected through interviews. Due to the nature of this research, a sampling technique was used to ensure a good mix of participating micro-lenders (*mashonisas*). Both random and snowball sampling were employed in this research. Random sampling helps to get unbiased and representative sample of micro-lenders because it ensures that not only the micro-lenders that are known are selected. Although the township micro-lenders are known to the local community in which they operate, they can be difficult to reach by others. Snowball sampling has, in this case, assisted in expanding a pool of the

¹² D James, *Money-go-round: Personal economies of wealth, aspiration and indebtedness in South Africa* (South Africa, LSE, 2010), p. 6.

lenders to participate in the research. One or two key people who were also micro-lenders have been requested to recommend other similar lenders who would be willing to be interviewed. The information on which the research is based has also been collected through a literature study having a bearing on the research topic.

Unstructured personal interviews were conducted with 15 *mashonisas* to guide explanations and discussions and thereafter with 37 borrowers drawn from 27 families of which 1-2 family members utilise financial services of *mashonisas*. Only ten *mashonisas* were randomly selected. The choice of these was informed by the fact that their interest rates run in the range of 30-40% per month (that is seven (46.7%) of them charge 30% interest rates and three (20%) charge 40% interest on loans advanced to borrowers. Snowball sampling was used to select the remaining five *mashonisas* (33.3%). These are the few among those in Mamelodi who charge 50% interest rates. The purpose of the interview is that it is most appropriate for asking questions of a personal nature and it may result in more accurate and honest responses since the interviewer can explain the purpose of the research as well as individual questions. Additional probing questions can, in this case, also be asked. Data analysis took place while the interviews were still underway as well as at the end of the interviews. At the end, a detailed analysis of the information gathered from the respondents (micro-lenders and borrowers) was done and compared to discover the connections between themes and finally integrate these themes into a theory that offered a comprehensive and accurate interpretation of the lending practices of the township micro-lenders and how these practices impact on the low-income households.

Historical overview of township micro-lenders (*Mashonisas*)

Mashonisas are informal sources of credit who provide credit to the households who have been marginalised by the formal financial sector due to, for example, collateral constraints and lack of credit history or who are not creditworthy. Micro lending is, historically, not a new act, even before the advent of money, people had borrowed, lent and saved.¹³ They have done this within their own communities, using their own systems and methods without any external assistance or resources. The difference today lies in the systems and resources

¹³ C Gardner, *Assessing and improving the impact of micro credit* (USA, Summit Financial Partners, 1998), pp. 17-19.

that have become available in response to the inability of commercial banks and/or the formal financial sector to serve the financial needs of the low-income (and poor) households. Historically, in the 1960's, a micro-lender was known in the South African black communities, as *u-mashonisa*, a Zulu word, figuratively meaning a person who depletes or drain someone's financial resources through exorbitant interest rates, or translated by Greene and Berroth¹⁴ as someone who continues to take money indefinitely. Smit et al¹⁵ refer to *mashonisa* as a person who kills (i.e squeezes money from others) because of the high interest rates charged and a loan agent with a good job earning an above average income. The adverb "*shonisa*" is a Zulu word which means to financially take someone down or drain his/her financial resources. It has to be noted that in the history of black communities, the word was and is still popularly known to many Sotho and Tswana speaking people as *mashonisa*, and therefore the word is used as such in this article. Mashonisa, as a proper noun, is known in colloquial terms as a loan shark. A loan shark is defined by Cambridge Dictionary Online¹⁶ as a person who charges very large amounts of money for lending money to someone or a person or body that offers unsecured loans at illegally high interest rates to individuals, often forcing repayment by blackmail or threats of violence or bodily harm. At that time, during the preliterate era (the time relating to a society that has not developed a written language or the period before written history),¹⁷ little information on how *mashonisas* conducted their businesses was available¹⁸ and there was no documentation of information on events and activities that took place or any regulatory framework or rules governing *mashonisas*, especially prior to 1992.

According to Orute,¹⁹ these micro-lenders (*mashonisas*) were and still are regarded as very helpful, especially to those who have been marginalised by the formal financial sector and who experience financial distress and need cash. The micro-lenders provide instant cash to their regular clients, which the banks and other formal financial institutions cannot. They usually operate at the premises of the owner or chosen member and most of them normally

14 A Greene and A Berroth, *The kwa Khulisa project report: A study of how "Creative Africa South" can empower women through creativity and business* (South Africa, Wellensley College, 2002).

15 PC Smit, DJ Dams, JW Mostert, AG Oosthuizen, TC Van Der Vyver, and W Van Gass, "Economics: A South African perspective" (South Africa, Jua & Co, Ltd, 1996), p. 592.

16 Cambridge Dictionary Online, *Loan sharks* (USA, Cambridge University Press, 2011); C Gardner, *Assessing and improving...*, pp. 17- 19.

17 The Free dictionary, *Preliterate* (USA, Houghton Mifflin Company, 2000), p. 21.

18 PC Smit, et al. "Economics: A South African perspective" (South Africa, Jua & Co, Ltd, 1996), p. 592.

19 VO Orute, *Living in the world of shylocks* (Tanzania, Arusha Times, 2005), p. 2.

run their businesses in mobile phone outlets or at corners of buildings in rural areas, townships and cities. When there was no other alternative for borrowers, *mashonisas* were the solution, and specialised in short-term loans, generally for thirty days. These micro-lenders were respected people in the black communities in which they operated and were viewed as rich heroes. They were and still are most prevalent in townships and lend mostly to people whose ability to repay can verify. Many households utilise the financial services of township micro-lenders because of easy access and quick processing of financial transactions or flexible lending terms. Money can be borrowed at any time for any reason. *Mashonisas* may be well equipped because of their local knowledge to respond to the financial requirements of the marginalised households. This is due to the fact that the households (as borrowers) and *mashonisas* (as lenders) live in the same areas and that it is easy to get to know each other very well. In this case, familiarity at the personal or community level therefore greatly reduces the normal transaction costs of lending where borrowers are charged very low interest rates. Lenders do not require collateral to secure credit and borrowers repay the loans mainly to protect their reputation and to be able to access future credit. Lenders only need assurance that the loan will be repaid on a certain date.

Mashonisas were, historically, violent and feared by colleagues and community members and had powers to do anything to get their money back.²⁰ Lending and borrowing activities used to take place at a workplace without any contact with the employer. The micro-lender (*Mashonisa*) would know exactly how much, and to whom, the loan was granted without documenting any transaction. At that time, no interest or very little was levied on loans and borrowers would know how much to repay. However, honesty and trust played an important role and colleagues were prepared to repay loans. *Mashonisas* would wait at the employer's gate at the end of the month to collect their money from those who owed them. They were viewed as lenders of last resort for financial assistance on emergencies like illness and funerals.

Today, *mashonisas* still play a pivotal role in the provision of credit to the low-income and poor households in South Africa. Their existence is as a result of inaccessibility of credit to the households who do not have credit histories and/or collateral to secure credit. Although these micro-lenders are perceived negatively because of their lending methods, their existence is however

20 C Gardner, *Assessing and improving the impact of micro credit* (USA, Summit Financial Partners, 1998), pp. 17-19.

attributed to their different capacities to provide credit to the marginalized households and their ability to take advantage of the weaknesses of contract enforcement.²¹ Micro-lenders' strength lies in their ability to access and use local information about borrowers, which makes them to reduce the problem of asymmetric information and inaccessibility to credit. However, these micro-lenders, though preferred by the low-income households in the black communities, exploit the households by using methods which include, among others, charging exorbitant interest rates and using violence or exploitative measures to recover loans. The interest rates range between 30-60% per month. Although most micro-lenders charge interest rates of between 30 and 40%,²² there exist those who take advantage of the households' vulnerable situations and exploit them by charging more than 50% interest rate on loans. These micro-lenders use market power and inside knowledge to exploit the households. Majority of the borrowers do not normally consider the cost of lending but the fact that the lender is easily accessible and immediately responds to their financial needs.

Despite the high interest rates they charge, these micro-lenders who are unregulated and operate in an informal manner, are still highly preferred by the households because of easy access and the positive atmosphere in which they operate their lending and borrowing business. Majority of the borrowers are illiterate and do not understand the intricacies involved in lending. What is important to them is that credit is available at any time it is needed. However, lending and borrowing are relationship-based, with borrowers gaining reputation as they build a clean repayment record. According to Finance and Enterprise,²³ these micro-lenders often have fifteen to twenty clients borrowing an average of R150-R250 at a time. Clients earn quite small amounts of income per month, normally in the range of R2000-3000 and mostly between R1200-R1700. The largest proportion of clients consists of people who have jobs (low-income earners) or those who are self-employed but live beyond their means. Schreiner²⁴ points out that *mashonisas* and clients are close to each other and loyalty, reputation and trust play an important role in the lending and borrowing activities. *Mashonisas* have comprehensive and perfect information on the creditworthiness of their clients based on long-term relationships they have with each other compared to the situation of the

21 M Schreiner, "Informal finance and the design of microfinance", *Development in Practice*, 11, 2000, pp. 637-640.

22 Finance and Enterprise, *Report on costs and interest rates in the small loan sector* (South Africa, 1999), p. 27.

23 Finance and Enterprise, *Report on costs...*, (South Africa, 1999), p. 27.

24 M Schreiner, "Informal finance...", *Development in practice*, 11, 2000, pp. 637-640.

formal financial institutions.

The past of micro lending

Historically, the concept micro lending is derived from numerous examples of traditional informal financial systems that have existed around the world of ages. Micro lending involves the distribution of small-scale loans or financial services to the low-income and poor households or solidarity lending groups including consumers and self-employed, who traditionally lack access to banking and related services.²⁵ Micro lending is an aspect of microfinance, which is, more broadly, a movement whose object is a world in which as many low-income, poor and near-poor households as possible have permanent access to an appropriate range of financial services, including not just credit but also savings, insurance, and fund transfer. Banks hesitate and resist effort to service these kinds of households who have little or no cash income and are therefore regarded as risky and unprofitable due to substantial costs incurred by banks in managing clients' accounts regardless of the sums of money involved. Banks' concern, according to Meagher and Wilkinson is that the fixed cost of processing loans of any size is considerable as assessment of potential borrowers, their repayment prospects and security, administration of outstanding loans as well as collecting money from borrowers has to be done in all cases. Micro lending can be traced back to the middle of the 1800s around the world when banking activities were conducted by private individuals who had any additional capital and wished to lend it out.²⁶ Small credits were lent to entrepreneurs and rural farmers as a way of getting the people out of poverty. In 1864 Friedrich Wilhelm Raiffeisen's village bank was established in Germany and by the year 1901 the bank had reached 2 million rural farmers. At that time, people could be relied on to repay their loans. Moneylending/micro-lending, according to Brook²⁷ is referred to as "usury", which is understood to mean excessive interest or illegal interest (which is never defined). The actual definition is the practice of lending money at interest. Even people who were not directly involved in the lending and borrowing practice benefitted by means of access to the goods and services

25 P Meagher and B Wilkinson, "Filling the gap...", pp. 12-19.

26 Y Brook, *The morality of moneylending: A short history*, paper delivered at second Renaissance Conference, Anaheim, California, July 2001, pp. 7-9; A Perkin, *A short history of microfinance* (UK, Guardian, 2008), pp. 1-3.

27 Y Brook, *The morality of moneylending: A short history*, pp. 7-9; Mercy Corps, *The history of microfinance* (Portland, Global Envision, 2009), pp. 1-5; A Perkin, *A short history...*, pp. 1-3.

made possible by the practice.

In the early 1900s, moneylending models were implemented by government agencies through privatised banks in parts of rural Latin America aiming at increased commercialisation of the rural sector by mobilising idle savings and increasing investments through credit and reducing oppressive feudal relations that were enforced through indebtedness. These banks became inefficient and abusive.²⁸ Between the 1950s and 1970s, government interventions focused on access to agricultural credit and emphasised targeted credit through state-owned development finance institutions that received concessional loans and on-lent at below-market interest rates. However, these subsidised schemes were unsuccessful due to subsidised lending rates and poor repayment rates and that credit ended up in the hands of better-off farmers only while the poor farmers were marginalised. During the Dark and Middle Ages in Europe, (Germany, England and Holland) in the time of famine and plague, when the primary means of trade was barter, subsistence-level lending such as barter-based loans were used (by the Jews) to help people to survive. In this case, most loans were made with goods and the interest was also charged in goods.²⁹ However, around 1290, from the Christian perspective, the emphasis was that one's moral duty was to help those in need without expecting anything in return and anyone lending upon usury was violently opposed and usury was explicitly condemned as lenders were viewed as enriching themselves (through profit) at the expense of the weak.³⁰ Micro lending throughout the world continued to exist around the 1960s and people had, within their own communities and working environments, conducted lending and borrowing activities with no regulatory framework or financial assistance from any formal source.³¹

In the 1970s, organizations such as the Grameen Bank of Bangladesh started shaping the modern industry of micro lending.³² At that time, micro lending initiatives introduced many new innovations which, among others, removed

28 Mercy Corps, *The history of microfinance* (Portland, Global Envision, 2009), pp. 1-5.

29 Y Brook, *The morality of moneylending: A short history*, pp. 7-9.

30 Y Brook, *The morality of moneylending: A short history*, pp. 7-9; Mercy Corps, *The history of microfinance* (Portland, Global Envision, 2009), pp. 1-5.

31 C Gardner, *Assessing and improving the impact of micro credit* (USA, Summit Financial Partners, 1998), pp. 17-19.

32 MP Mashigo and CH Schoeman, "Micro credit and the transforming of uncertainty since 1976: International lessons for South Africa", *New Contree, A Journal of Historical and Human Sciences for Southern Africa*, 61, 2011, pp. 149-175; D Porteous, *Is Cinderella finally coming to the ball?: South African micro finance in broad perspective* (South Africa, FinMark Trust, 2001), pp. 1-3; J Murdoch, "The Microfinance Promise", *Journal of Economic Literature*, 37(4), 1999, pp. 1569-1614.

the need for physical collateral and decreased asymmetric information and people could be relied on to repay their loans using joint-guarantees. Today, practitioners and governments are increasingly focusing on expanded financial services to the poor and low-income in frontier markets on the integration of microfinance/lending in financial systems development. In South Africa today, the provision of credit by the formal financial sector, especially banks, is hampered by collateral constraints, asymmetric information and high transaction costs. Therefore micro lending emerged in its current form as an alternative to conventional banking and has become a major tool of development among the low-income (and poor) segments of society.³³

The regulation of micro lending in South Africa

Since there was no regulatory body in South Africa in the past, especially before 1992, micro-lenders conducted business in any way they liked and many borrowers suffered from their exploitative nature. Micro-lenders used illegal methods to conduct lending and borrowing activities, for example, illegal provision of credit and collection methods were used. Micro-lenders commonly charged exorbitant interest rates on loans, took their clients' bank cards, personal identification numbers (PIN), pay slips and identity documents as prerequisite for obtaining a loan, and so that they can draw interest and redemption payments from the cash dispenser after pay has been remitted to the borrower's account.³⁴

Since 1992, the micro lending industry in South Africa grew significantly on the basis of focusing on consumer credit and experienced exponential growth. It has become a mainstream development activity and a means of deriving economic growth. According to the Press Release,³⁵ 1992 marked the exemption of small loans from the interest rate limitation. The state issued an Exemption to the Usury Act of 1992 that removed interest rate ceilings on small loans under R6 000 with a repayment period of less than thirty-

33 P Meagher and B Wilkinson, "Filling the gap...", Revised Final Report submitted to the Micro Finance Regulatory Council of South Africa, (IRIS Center, University of Maryland, 2001), pp. 12-19; MP Mashigo and CH Schoeman, "Micro credit...", *New Contree, A Journal of Historical and Human Sciences for Southern Africa*, 61, 2011, pp. 149-175.

34 Micro Finance Regulatory Council, *Registration of micro-lenders* (Johannesburg, MFRC, 1999), pp. 1-8; M Grenfell, "Overview of the market for micro lending in South Africa: Demand and supply", (South Africa, Finance and Enterprise, 1999), pp. 48-59.

35 Press Release, 2001. Inspections on unregistered micro-lenders, *Micro Finance Regulatory Council: News Archives* (available at: <http://www.mfrc.co.za/detail.php?s=112>, as accessed on 20 April 2006).

six months. The purpose of the Usury Act of 1992 was to place limitations and responsibilities on micro-lenders to protect consumers from usurious exploitation by micro-lenders. Grenfell³⁶ mentions that this resulted in the tremendous growth in the micro lending industry with a central focus on providing short-term cash loans at very high interest rates on a large scale. Due to aggressive lending by both formal and informal (township) micro-lenders as well as the uninformed and vulnerability of borrowers, these borrowers found themselves in a spiral of debts.

Although micro-lenders were forbidden by law to engage in harmful and exploitative practices, some still do and the practice is very prevalent in small cities, townships and/or rural areas. This provided the impetus for a second and new Exemption to the Usury Act in 1999.³⁷ This, therefore, resulted in an establishment of the Micro Finance Regulatory Council (MFRC) in 1999 as a regulatory body and the new regulations to govern the industry. This called for revisions to the amount of small loans to be increased from R6 000 to R10 000. The main purpose of the MFRC was to promote sustainable growth of the micro lending industry, serve the unserved credit needs, while ensuring that consumer rights are protected. The lenders only focused on the low-income borrowers who were formally employed so that their salaries could be tapped to ensure repayment of the loans. The borrowers had to become bank customers as repayment was guaranteed through the provision of a bank debit card and personal identity number (PIN) to the lender. The vast majority (up to 80%) of the South African low-income groups started to borrow funds from micro-lenders as an alternative source of finance.

It was stipulated in the rules that the moneylender will only be permitted to operate after registration with the Council on 15 September 1999.³⁸ The MFRC inspected all documents of registered micro-lenders to determine whether they adhere to the registration criteria. The Council also monitored all accredited institutions to ensure that they comply with the regulations. Anyone lending money under the conditions provided for in the Act, who was not a registered member of the MFRC would be acting illegally and the Department of Trade and Industry would act against such a person.

36 M Grenfell, "Overview of the market..." (South Africa, Finance and Enterprise, 1999), pp. 48-59.

37 P Meagher and B Wilkinson, "Filling the gap...", Revised Final Report submitted to the Micro Finance Regulatory Council of South Africa, (IRIS Center, University of Maryland, 2001), pp. 12-19.

38 Republic of South Africa, Micro Finance Regulatory Council, *Registration of micro-lenders* (Johannesburg, MFRC, 1999), pp. 1-8; M Grenfell, "Overview of the market..." (South Africa, Finance and Enterprise, 1999), pp. 48-59.

Following the continuous exploitation of borrowers by micro-lenders, the MFRC implemented a number of mechanisms which were intended to modify micro-lender behaviour and reckless lending. These included the establishment of the National Loan Register (NLR) which was responsible for providing the micro-lenders with information with which to assess the borrower's level of debt and to also provide the MFRC with mechanisms through reckless lending in order to take appropriate disciplinary action.³⁹ A database of micro loans was created through NLR. Credit bureau also provided the information regarding the borrowers' debt position. The use of credit bureau to check on the new clients encompassed the majority of the short-term borrowers. This led to a more formalised modern micro lending sector in the 30-day cash lending industry.

Additionally, the rules stipulate that to protect the rights of consumers when they borrow money from micro-lenders, the requirements for disclosing all terms of the contract including all amounts and charges (interest rates) to be paid by borrowers, remained legally binding (Rule 2.4 (2.4.2), (2.4.3), (2.4.4), in Annexure "A" of the Usury Act Exemption).⁴⁰ This meant providing the borrower with the exact loan amount and the amount repayable with interest over a stipulated period. Micro-lenders, after having registered with the MFRC, were required to lend within the Usury Act's interest rate limits which are between 29 and 33% per year.⁴¹ Failing to comply with the Usury Act, they will be contravening the rules and will be subject to the penalties of the Usury Act.

However, the continuous increase in reckless lending which placed the low-income households in financial distress was cause for concern. Poor information flow between the lenders and borrowers contributed to borrower exploitation, that is, lenders not providing accurate information to the borrower about the rules and regulations governing the micro lending business and the implications of the cost of lending. This compounded the danger of

39 Press Release, 2004. Changing face in the micro finance industry, *Micro Finance Regulatory Council: News Archives* (available at: <http://www.mfrc.co.za>, as accessed on 25 April 2006); Micro Finance Regulatory Council, Submission to the portfolio committee on finance on indebtedness (Johannesburg, MFRC, 2003), p. 5.

40 Micro Finance Regulatory Council, *Registration of micro-lenders* (Johannesburg, MFRC, 1999), pp. 1-8; M Grenfell, "Overview of the market..." (South Africa, Finance and Enterprise, 1999), pp. 48-59.

41 Press Release, 1999. The MFRC warns micro-lenders against the retention of bank cards and identity documents, *Micro Finance Regulatory Council: News Archives* (available at: <http://www.mfrc.co.za/detail.php?s=353>, as accessed on 11 August 2005); Micro Finance Regulatory Council, Submission to the portfolio committee..., p. 5.

over-indebtedness. According to Baumann,⁴² the dependence of low-income groups on micro-lenders leaves them deeply vulnerable to losing any scarce assets they may have and to rising cycles of indebtedness.

The weakness of the micro lending sector, according to Schoombee⁴³ is that it was largely unregulated and even unscrupulous lenders who exploited the low-income borrowers by charging them exorbitant interest rates and causing them to be over-indebted, entered the sector. Disclosing personal identity numbers and surrendering the bank cards violate the banking confidentiality and increases the danger of fraud on the side of the micro-lenders because the borrowers lack experience in personal finance and do not know exactly how much is deducted from their accounts. According to Grenfell,⁴⁴ the exemption to the Usury Act of 1992 originally intended to protect the consumers from such exploitation by micro-lenders who charge very high interest rates. High interest differentials among different lenders with identical products indicate lack of effective regulation. This exacerbates, instead of reducing, exploitative practices of micro-lenders. The households are unable to afford high interest rates and Meagher and Wilkinson⁴⁵ point out that the households are micro borrowers who need small loans for consumption, education and emergencies.

Furthermore, the 1999 developments brought about by the regulations were also ineffective because the MFRC was unable to enforce the regulation on the entire micro lending industry. Schoombee⁴⁶ emphasises that there still exist a large number of unregistered lenders who contravene the Act by offering vulnerable borrowers loans of various amounts and at exorbitant interest rates. The Usury Act also allowed the formal and registered lenders to operate with the interest rate ceilings, and the usury restrictions led to limited access to credit by the consumers such as the low-income who do not have established relationships with the micro-lenders as well as credit records or collateral as

42 T Baumann, *Microfinance and poverty alleviation in South Africa* (South Africa, Bay Research and Consultancy Services, 2001), pp. 13-19.

43 A Schoombee, *South African banks and the unbanked: Progress and prospects* (South Africa, University of Stellenbosch, Department of Economics, 1998), p. 4; S Staschen, *Regulation and supervision of micro finance institution: State of knowledge* (Netherlands, Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH, 1999), p. 14.

44 M Grenfell, "Overview of the market...", (South Africa, Finance and Enterprise, 1999), pp. 48-59.

45 P Meagher and B Wilkinson, "Filling the gap...", Revised Final Report submitted to the Micro Finance Regulatory Council of South Africa, (IRIS Center, University of Maryland, 2001), pp. 12-19.

46 A Schoombee, *South African banks...*, p. 4; P Meagher and B Wilkinson, "Filling the gap...", Revised Final Report submitted to the Micro Finance Regulatory Council of South Africa, (IRIS Center, University of Maryland, 2001), pp. 12-19; RW Lindholm, "Money and banking: An introduction" (USA, Adams & Co, 1958), pp. 4-9.

security for loans to ensure repayment and are therefore marginalised.⁴⁷ These, according to Coetzee,⁴⁸ increases transaction costs which make the loans to be more expensive and inaccessible.

The challenge facing South Africa was to revise the legislation governing micro lending. Given the weaknesses in consumer credit legislation in South Africa, a regulatory framework, the National Credit Act No. 34 of 2005 (NCA), was introduced and came into force on 1 June 2007 repealing numerous legislations, including the Usury Act of 1968 and related subordinate legislation that allowed micro lending. The main purposes of the NCA include improving accessibility of the credit market to all South Africans, including the previously disadvantaged consumers, enhancing consumer rights and education, consistent treatment of all consumers and credit providers, as well as promoting responsibility in the credit market by encouraging responsible borrowing, avoiding over-indebtedness and discourages reckless credit granting by credit providers.⁴⁹ This means the Act provides for consumer rights including protection against discriminatory and unfair credit market practices such as over-indebtedness and the right to be given reasons for credit being refused or discontinued.

In order to achieve the purposes of the NCA, the National Credit Regulator (NCR) has been established in terms of the Act to oversee the NCA and to regulate and enforce consumer credit. In developing an accessible credit market, the NCR will promote and support a credit market and industry that is fair, transparent, responsible, efficient and accessible. In addition, the NCR submits proposals related to regulatory or policy initiatives which would improve access to credit for historically disadvantaged persons, low-income persons and communities and sparsely populated or remote areas.⁵⁰ Further research on the National Credit Act has to be conducted to determine its impact on the low-income households. However, majority of the low-income households are unable to access credit from the formal financial sector and therefore resort to township micro-lenders (*mashonisas*). The problem is that although the township micro-lenders appear to be responsive to the credit

⁴⁷ P Meagher and B Wilkinson, "Filling the gap...", Revised Final Report submitted to the Micro Finance Regulatory Council of South Africa, (IRIS Center, University of Maryland, 2001), pp. 12-19.

⁴⁸ G Coetzee, "Regulation and supervision of micro finance institutions: The experience in South Africa", (Pretoria, University of Pretoria, Department of Agricultural Economics, 1998).

⁴⁹ Republic of South Africa, *National Credit Act* (Act No. 34 of 2005) (Pretoria, Government Printers), p. 5; Bankseta, *National Credit Act* (Pretoria, Teba Bank, 2006), p. 2.

⁵⁰ Republic of South Africa, *National Credit Act...* (Act No. 34 of 2005) (Pretoria, Government Printers), p. 5; Bankseta, *National Credit Act ...* (Act No. 34 of 2005) (Pretoria, Government Printers), p. 2.

needs of the low-income households, they use exploitative practices which place these vulnerable households in debt spirals causing them emotional and financial distress. It is evident that consumer protection, as espoused in the objectives of the NCA, is less important in the townships due to relationships and consistent service between micro-lenders and borrowers. Registration and adhering to formal laws or legislation may therefore not be necessary for these lenders.

In light of this, the legislation proved unable to enforce the regulation on the activities and practices of informal and/or unregistered micro-lenders such as *mashonisas* operating lending and borrowing businesses in the black townships like Mamelodi. These lenders, according to Schoombee,⁵¹ contravene the legislation and continue to do business as normal and impact negatively on vulnerable borrowers by offering them multiple loans and at exorbitant interest rates, causing them to be over-indebted. Mashigo⁵² found that the lenders continue to confiscate vulnerable borrowers' bank or ATM (Automated Teller Machine) cards and using these to withdraw the money owed to them at the end of the month. This, in itself, presents conflicting objectives between the regulation and the operation of *mashonisas*. The regulation ignores the fact that these informal lending practices in the townships are continuing and intensifying and *mashonisas* are difficult to track and regulate.⁵³

The operation of township micro-lenders and their impact on the low-income households

Mashonisas (Micro-lenders) in the Mamelodi Township are an integral part of the community and all the 15 *Mashonisas* (100%) who have been interviewed indicated that they do not fall under the jurisdiction of monetary laws or any form of financial regulation. According to Schoombee, the South African legislation is unable to enforce against informal township micro-lenders who are difficult to track or regulate. According to ECIAfrica Consulting,⁵⁴ there exists very little information about the overall size and scope of micro-lenders

51 A Schoombee, "South African banks...", (South Africa, University of Stellenbosch, Department of Economics, 1998), p. 4; D James, *Money-go-round...* (South Africa, LSE, 2010), p. 6.

52 MP Mashigo, "Extending credit to the low-income and poor households in South Africa: A system of principles" (Ph.D., University of Johannesburg, 2007), p. 77.

53 A Schoombee, *South African banks...*, p. 4.

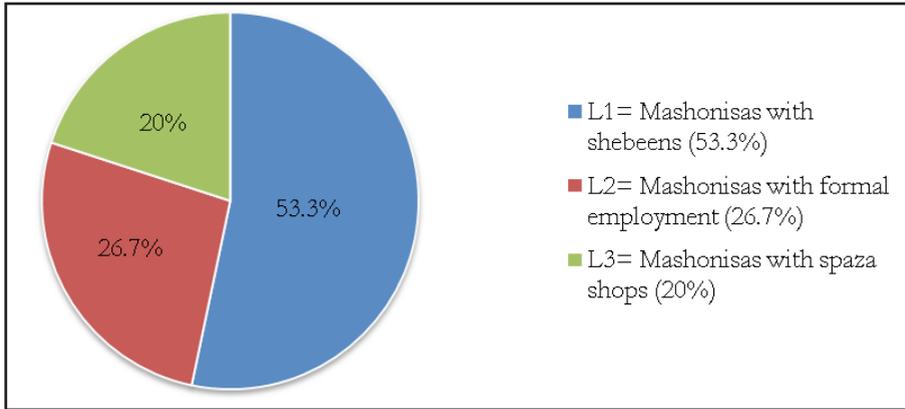
54 ECIAfrica Consulting, "Overview of the market for micro lending in South Africa: Demand and supply", A report prepared for Micro Finance Regulatory Council (South Africa, MFRC, 1999), pp. 8-11.

operating lending and borrowing businesses in township areas. The research found that 53,3% of *mashonisas* are shebeen owners, 26,7% are formally employed but indicated that they operate a joint micro-lending business and augment their own money by borrowing from the bank (eg. African Bank). Some of the *mashonisas* (20%) own and operate spaza shops. This is depicted in the Pie Chart as in Image 2 below. ECIAfrica Consulting⁵⁵ found that most funding for the micro-lenders' businesses comes from family members and friends while few use retrenchment packages. None had any external funding. The Pie Chart in Image 3 depicts the percentages of borrowers' knowledge of the micro lending regulations. It was found that 66% of the borrowers do not have any idea about whether micro-lenders are regulated or not. On the one hand, only 20% of the borrowers indicated that they heard about the regulation of micro lending industry (they referred to the National Credit Act) and that it is intended to protect consumers but do not have a slightest idea how whereas, on the other hand, 14% of them know about the micro lending industry and its regulation, however, these borrowers indicated that they still prefer local *mashonisas* due to easy access for loans.

The majority of *mashonisas* (68%) need proof of employment (for example payslips), residential address and the South African identity document from the borrowers whereas 32% need verbal assurance from their regular clients that money will be repaid on a certain date. Some *mashonisas* lend money to new clients only if these clients are brought and introduced by regular and trusted ones. When asked about record keeping, 69% of *mashonisas* indicated that they keep a book where every single borrower signs the agreement with them (*mashonisas*), i.e., date of loan issue, date of repayment, and the amount requested whereas only 31% have computers/laptops where they record the transactions and which are printed and signed. Majority of *mashonisas*, 82%, request the borrowers to sign a written agreement which, upon default, is used against the borrower and forceful measures are taken. Other *mashonisas* present the book or computer records to the South African Police Services (SAPS) for further action.

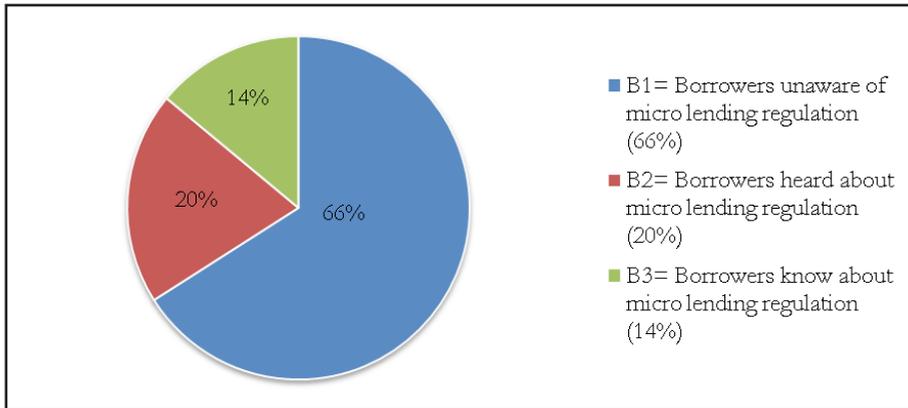
55 ECIAfrica Consulting, "Overview of the market..." (South Africa, Finance and Enterprise, 1999), pp. 8-11.

Image 2: Percentages of micro-lenders (*mashonisas*)



Source: MP Mashigo, "Extending credit to the low-income and poor households in South Africa: A system of principles" (Ph.D., University of Johannesburg, 2007), p. 79.

Image 3: Percentages of borrowers' knowledge of the micro lending regulation.



Source: MP Mashigo, "Extending credit to the low-income..." (Ph.D., University of Johannesburg, 2007), p. 80.

The social structures followed by these *mashonisas* are that they have more information on their clients regarding character, creditworthiness and reputation than the formal financial sector. Lending and borrowing contracts are relationship-based, with borrowers gaining reputation as they build a clean repayment record. *Mashonisas* and clients are close to each other and loyalty, trust and reputation play an important role in the lending and borrowing activities. One may argue, given these social connections and the difficulty to track township micro-lenders, how regulation in South Africa can be enforced against these micro-lenders. Their clientele are mostly people from the

neighbourhood. *Mashonisas* have comprehensive, almost perfect information on the creditworthiness of their clients, based on long-term relationships they have with them. To register and be regulated may not be worthwhile for *mashonisas*. These social connections therefore deal with the problems of high transaction costs, collateral and asymmetric information- a comparative advantage which *mashonisas* have over the formal and registered financial sector where acquisition of information about borrowers is costly and formal collateral is a requirement to access credit. It may be that these township micro-lenders need a very different approach in terms of the objectives as espoused in the regulation/NCA.

Micro-lenders and interest charged

The research found that majority of *mashonisas*' interest rates in Mamelodi Township run in the range of 30-50% per month. Only 20% of *mashonisas* charge 40% interest on loans advanced to clients, 46.7% charge 30% interest whereas 33.3% of them charge 50% interest. When asked about lending and borrowing contracts, 67% of the borrowers who were interviewed indicated that they only sign the contracts with no idea of interest rate charged and only discover when they have to repay the loans. The research found out that micro-lenders do not explain the contract to their clients with the result that clients sign the contracts with no idea of the interest rates and the duration of the contract. When asked about the duration of the loan repayment they only knew about paying at the end of the month but did not have any idea that the interest rate accumulates over a month. Similar findings were made by Campbell⁵⁶ where 30-day loans were extended to term loans of, for example, three-four months repayment which places the borrowers in debt spirals. This is depicted in Image 3. In example A, by month 3, the pensioner's loan repayment of R659 amounts to 80% of his/her monthly pension of R820. By month four, repayment of R856 exceeds his/her pension. In example B, by month three, repayment of R1098 exceeds his/her wage of R1000. Borrowers are caught in a debt spiral and end up in financial distress.

The households (borrowers) indicated that they do not normally consider the costs of lending but the fact that the micro-lender is easily accessible and instantly responds to their financial needs. Those that have been interviewed

⁵⁶ J Campbell, "The cost of credit in the micro-finance industry in South Africa" (MA Dissertation, Rhodes University, Law Department, 2006), p. 79.

mentioned that they earn between R1200-R1700 per month. The small proportion of clients consists of people who are self-employed but live beyond their means. It was found that *mashonisas* do not assess the borrowers' level of debt hence the borrowers are able to access loans from more than one or two *mashonisas*. This places the borrowers in debt spirals as repeated loans are taken out to repay previous ones. Debt spiral or over-indebtedness means using loans to pay off other loans and by allocating more than fifty percent of monthly net income to loan repayments.⁵⁷ It is a financial state that imposes restrictions on the household's ability to repay their total outstanding debt. What exacerbates the problem is that some of the households (33%) (see Image 4) access credit from banks (such as Capitec Bank).

Image 4: 30-day loan and resultant debt spiral: Extended to term loans – 3-4 months repayment

	Month	Loan Amount	Interest at 30%	Repayment amount	Income
Example A	1	R300	R90	R390	R820 (pension)
	2	R390	R117	R507	
	3	R507	R152	R659	
	4	R659	R197	R856	
Example B	1	R500	R150	R650	R1000 (wage)
	2	R650	R195	R845	
	3	R845	R253	R1098	

Source: J Campbell, "The cost of credit ...".

The households in the Mamelodi Township were used to determine the level of indebtedness to township micro-lenders (*mashonisas*). This is depicted in Image 5 below. The researcher found that among the causes of over-indebtedness in South Africa is aggressive lending by micro-lenders. However, the micro-lenders exploit borrowers by lending them more than they need or want to borrow and charging them high interest rate.

⁵⁷ Ebony Consulting International (ECI) and Development Policy Research Unit (DPRU), Impact of credit and indebtedness of clients. A report prepared for the Micro Finance Regulatory Council, (Cape Town, University of Cape Town, 2001).

Image 5: The level of household indebtedness in Mamelodi Township

Monthly Income in Rand	Number of households	LOANS				OTHER EXPENSES					
		Savings with Bank	Bank Loan	1 st Moneylender Loan Repayment	2 nd Money lender	Pay House	Retail Store	Electricity & Water	Insurance Policies	Groceries	Social club
3000-3550	12	33	-	50%	67%	33%	83.3%	77%	16.7%	67%	83.3%
800-820	8	%	-	71.4%	42.85%	rental	71.4%	42.85%	-	42.85%	71.4%
940	7	-	-	85.7%	-	-	71.4%	57,1%	-	57.1%	85.7%
4980	6	-	16.7%	83.7%	33.3%	-	71.4%	57,1%	33.3%	66.7%	83.3%
1000	4	33.3%	-	-	-	-	-	-	-	-	-
TOTAL	37	-	-	-	-	-	-	-	-	-	-

Source: MP Mashigo, “Social structures and the delivery of financial services to the poor households in South Africa”, *Journal of Public Administration*, 47 (1.1), 2012, pp. 330-343.

The results in Image 5 suggest that between 50% and 85% are loans from more than 1 micro-lender. This, in the long run may put the borrowers in a vicious circle of debt. Between 71% and 83% of their money is used for social clubs (e.g burial). This kind of credit is termed “A double-edged sword”.⁵⁸ Over-indebtedness has in some extreme cases led to family suicides, and propensity to commit theft. 63% of borrowers earn less than R4000 per month.^{59 60} The study conducted by Industrial Organisation and Labour Studies (IOLS) Research Unit at the University of Natal Durban found that some workers are resigning to get their provident payouts to help pay or settle their debts with moneylenders.

Loan repayments and recovery methods in the past years

According to the micro-lenders, borrowers normally honour their obligations by personally making monthly payments on pay day. Furthermore, known and trusted borrowers with no pay slips but who only assured the lender that money will be repaid on a specified date, always honour their obligation. *Mashonisas*, however, also indicated that it sometimes happen when some borrowers do not repay on time but plead and request to be given few more

58 J Campbell, “The cost of credit...”, p. 79.

59 Republic of South Africa, Micro Finance Regulatory Council, *Registration of micro-lenders* (Johannesburg, MFRC, 1999), pp. 1-8.

60 Human Sciences Research Council (HSRC), “Household indebtedness in South Africa in 1995 and 2000”. A report prepared for the Micro Finance Regulatory Council, (Pretoria, HSRC, 2003).

days to make such repayment.

Retaining borrowers' bank cards and identity documents is still practiced by *mashonisas* and prevalent in township areas in spite of the regulation forbidding the practice. The research found that 30% of *mashonisas* retain the borrowers' bank cards until they have fully paid their loans. In such cases, the lender accompanies the borrower to the Automated Teller Machine (ATM) to withdraw the money agreed upon.

The research further found that 62% confiscate the borrowers' electrical appliances, furniture and/or other belongings if the borrower defaults. Some borrowers indicated that some *mashonisas* cut off electrical wires/connections in the borrowers' residences when they default on repayments whereas other *mashonisas* expose borrowers to public shame by beating them. *Mashonisas* have their own money collectors who also apply forceful recovery measures.

These money collectors' other responsibilities include identifying and recruiting new borrowers who are in need of loans. *Mashonisas* indicated that they are sometimes forced by circumstances to apply these measures because some borrowers default on repayments. Some borrowers mentioned that they are afraid to report such cases to the police because if they do, they are victimized or marked or even beaten. They also receive death threats which make them not to report cases. Other borrowers indicated that even if such cases are reported to the police, no arrests are being made due to reasons not known to them.

According to *mashonisas*, it is very risky to operate their businesses, for example, one mentioned that his unemployed client sold his personal belongings like cell phone and television set which were pledged as security for a loan and disappeared and could not be found.

While *mashonisas* are often accused of their exploitative practices and their role subject to much criticism, they still play an important role of filling the gap that the formal financial institutions are unable to and are preferred and viewed by their clients (especially regular and honest ones) as being responsive to their financial needs. Their services are convenient and fast, and can be very flexible when borrowers experience financial difficulties.

Conclusion

The article analysed the historical and present day lending practices of township micro-lenders and how such practices impact on the low-income households. It is evident that the low-income households in South Africa have limited or no access to formal financial institutions, especially banks, due to collateral constraints, asymmetric information and high transaction costs. The article demonstrates that micro lending, through history, have been viewed as important aspects of assisting the households or communities through access to (micro) credit. Financial system approaches around the world pragmatically acknowledge the richness of centuries of micro lending history and the diversity of institutions serving the low-income and poor households.

While there is no doubt that micro-lenders (*mashonisas*) in South African townships like Mamelodi have been found to play an important role of providing credit to the low-income households who are marginalised by the formal financial institutions and/or banks, these lenders use exploitative practices and methods of conducting lending and borrowing business. Although *mashonisas* are subject to criticism due to these practices, it becomes apparent that their services continue to be valuable as more low-income (and poor) households continue to gain access to loans. The households are prepared to pay high interest rates for quick loan disbursement and flexible repayment schedules. Useful social connections like the long-term relationships between borrowers and these micro-lenders, honesty, trust and reputation have been found to supersede the traditional/formal collateral and high transaction costs applied by formal financial institutions.

The question raised in this article is whether government legislation in South Africa will be able to make it possible to effectively track down informal township micro-lenders in order to improve their operation or deal with reckless lending or their exploitative practices. Of importance is how to maintain the social connections which justify and confirm the fact that *mashonisas* have comparative advantage over formal financial institutions in providing finance (credit) to the households.