An impact assessment of the regulation of microfinance institutions in Namibia

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Declaration

I, Emma Haiyambo, declare that the entire body of work contained in this thesis is my own, original work, that I am the sole author thereof (save to the extent explicitly otherwise stated), that reproduction and publication thereof by the University of Stellenbosch will not infringe any third party rights and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

E. Haiyambo December 2016

Dedication

To my late mother, who until her last days in April 2016 kept on encouraging me not to quit, as *“Karunga kwato eyi ayi mu vhuru”* [nothing is impossible with God], and for always reminding me to do the right thing – even when circumstances dictate otherwise. To my father, a retired teacher, who since my primary school has encouraged me to always pursue higher grounds: Thank you Mom and Dad for having set the tone! My son, Jet’aime, for the maturity shown (beyond his age) during the period of preparing this thesis – I was not always available, but you understood. And Bonny, this period has yet confirmed the consistent and supportive partner I have in you – I am truly grateful.

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Abstract

This study aimed at contributing to the current debate on the regulation of microfinance institutions (MFIs), through providing important inputs for evidence-based policy dialogue and decision making, particularly on the issue relating to whether MFIs should be regulated and supervised and how they should be regulated. Using the case of Namibia, it entailed a critical evaluation of the potential impact of regulation on MFIs and hence on the microfinance sector. Through an application of the Rationale-Objectives-Indicator (ROI) methodology, an analysis of a regulatory impact assessment (RIA) was performed at two levels, namely an ex-post level using a case study of a deposit-taking MFI that has been regulated under conventional banking law and an ex-ante level of the likely impact of the proposed microfinance regulatory framework. It was found that regulation has generally had a positive impact on the operations of the regulated MFI, as reflected in improvements in most of its performance indicators (profitability, portfolio quality, liquidity and access to finance, given substantial increases in the number of savers and borrowers) during the post-licensing period. The ex-ante RIA of the proposed new microfinance regulatory framework also pointed towards a greater probability of the envisaged regulatory framework achieving its intended regulatory objectives. This will however depend on the degree to which regulatory requirements are going to be enforced and the prevailing macro-economic conditions in the country. As such, it was concluded that, while necessary, regulation alone may not be sufficient to attract relevant players into the microfinance sector and develop the sector, given the structural weaknesses of the Namibian economy. Broader policy and reform initiatives, including additional incentives, might be required to spur the development of the country's microfinance sector.

Keywords: microfinance, regulation, supervision, impact assessment, Namibia

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List of abbreviations

ADB	Asian Development Bank
AfDB	African Development Bank
AgriBank	Agricultural Bank of Namibia
AMFI	Association of Microfinance in Kenya
ATM	Automated teller machine
BBA	Basic Bank Account
BBEE	Broad-based Economic Empowerment
BFS	Business Financial Solutions
BIA	Banking Institutions Act
BoN	Bank of Namibia
Canamco	Canada Namibia Cooperation
CAR	Capital adequacy ratio
CGAP	Consultative Group to Assist the Poor
CMA	Common Monetary Area
DBN	Development Bank of Namibia
DCD	Division of Cooperative Development
DFN	Development Fund of Namibia
DMFIs	Deposit-taking microfinance institutions
ELO	‘Loans and Savings Association’ in Oshiwambo
FIDES	International Finance for Social and Economic Development
FIM Bill	Financial Institutions and Markets Bill
FNB	First National Bank
GDP	Gross domestic product
GIPF	Government Institutions Pension Fund
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HDI	Human Development Index
IMF	International Monetary Fund
IPPR	Institute for Public Policy Research
IT	Information technology
MAWF	Ministry of Agriculture, Water and Forestry
MFI	Microfinance institution

MIX	Microfinance Information Exchange
MSMEs	Micro, small and medium enterprises
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFI	Non-banking financial institutions
NPSV	National Payments System Vision
NDP4	National Development Plan 4
NEEEF	New Equitable Economic Empowerment Framework
NFSS	Namibia Financial Sector Strategy
NGO	Non-governmental organisation
NHAG	Namibia Housing Action Group
NHE	National Housing Enterprise
NIM	Net interest margin
NPLs	Non-performing loans
PAR	Portfolio at risk
RIA	Regulatory impact assessment
ROA	Return on assets
ROE	Return on equity
ROI	Rationale-Objectives-Indicator
ROSCA	Rotating savings and credit association
SACCO	Savings and credit cooperative
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAIS	Southern Africa Innovation Support
SCA	Savings and credit association
SDFN	Shack Dwellers Federation of Namibia
SMEs	Small and medium enterprises
TIPEEG	Targeted Intervention Program for Employment and Economic Growth
WSBI	World Savings Banks Institute

CHAPTER 1

INTRODUCTION AND BACKGROUND OF THE STUDY

1.1 INTRODUCTION

In addition to unemployment and high poverty rates, a lack of access to finance and financial services has been identified as among the key challenges faced by developing countries for many decades. Traditional banks and other conventional financial institutions typically serve only a small percentage of the population, estimated at approximately 30 per cent[1] in the developing world (IFC, 2011). This leaves the remaining majority of the population and small businesses unserved.

The emergence of the microfinance industry four decades ago has been considered an opportunity to extend financial services to the excluded majority. In particular, microfinance is increasingly seen as an important instrument in the effort to alleviate poverty. In fact, poverty reduction has been the main focus of microfinance, although the provision of credit by this sector has also been viewed as a way to generate self-employment opportunities for the poor. The earlier role of microfinance institutions (MFIs) of ‘credit extension only’ has transformed into a much wider role, such that MFIs are now providing additional services in the form of savings and money transfers, among others. This changing role comes with greater responsibility and accountability, given the risks involved, including the possibility of loss of savers’ money. There is therefore an increasing interest internationally in terms of whether MFIs should be regulated and supervised (CGAP, 2012).

Differing views, both for and against the regulation of MFIs, have been raised in the process. Advocates of regulation have argued that regulation and supervision[2] will improve the performance of these institutions, protect depositors in the case of deposit-taking MFIs and ensure their sustainability as well as the soundness and stability of the financial system,

[1] The International Finance Corporation, in its 2011 publication *Toward universal access: Addressing the global challenge of financial inclusion*, indicates that almost 70 per cent of the population in developing countries has no access to formal financial services.

[2] The Oxford dictionary (no date) defines ‘regulation’ as a rule or directive made and maintained by an authority, and ‘supervision’ as the role of observing and directing the execution of a task or activity.

especially in the case of significant MFIs.[3] However, the uniqueness of these institutions, in terms of the clients they serve and the nature of the products and services they offer, has also raised opposing views to their regulation. These include the possibility of regulation creating barriers to the efforts of increasing access to financial services and the possibility of regulation curtailing the ability of MFIs to allocate financial resources efficiently, and thereby the potential to dampen their development. What has also become clear from the discussions on this issue is that there are differing objectives being advanced for regulation (CGAP, 2000).

According to the Consultative Group to Assist the Poor (CGAP) (2000), these objectives range from non-governmental organisations (NGOs) with microcredit operations wanting to be licensed and regulated to access deposits from the public, MFIs believing that regulation will promote their business and improve their operations, and governments and donors wanting financial licenses to be more widely and easily available in order to expand savings services for the poor, to donors and governments expecting that setting up a special regulatory window for microfinance will speed up the emergence of sustainable MFIs. In the case of Namibia, the government, in particular the central bank, in realisation of the need to develop the microfinance industry to address the lack of access to finance by individuals and small and medium enterprises (SMEs), has considered that regulation would create an environment that would entice investors to invest in the microfinance sector. This view is in line with some of the above-listed arguments for the regulation of MFIs.

Given that the experimentation with microfinance regulation and supervision is recent, and the fact that individual country situations vary greatly, confident general conclusions are not easy to make on what the reasons for regulations ought to be (CGAP, 2000). However, there seems to be a general understanding among most policy makers, donors and private investors involved in microfinance that there is a great demand for financial services by the poor, and not just for credit, and that “the ability of the market to respond to this demand depends not only on providers developing sustainable, low-cost ways to provide such services, but also on having an enabling policy and regulatory environment” (CGAP, 2012: vii). According to CGAP, it is based on that realisation that the relevant question generally being posed nowadays relates to the kind of regulation and supervision that will help achieve the intended objectives of increasing access to finance (CGAP, 2012). With the above in

[3] According to Hardy, Holden & Prokopenko (2002), in some countries (especially in very matured markets), there are MFIs with so many borrowers and depositors such that their balance sheets size is comparable to that of a commercial bank.

mind, this study evaluated the case of Namibia by looking at its experience with MFIs and regulation.

1.2 BACKGROUND TO THE STUDY

Namibia is a country faced by high unemployment and poverty rates. The 2012 Namibia Labour Force Survey estimates the unemployment rate at 27.4 per cent (NSA, 2012a), while the Namibia Poverty Dynamics Report of the same year indicates a 28.7 per cent poverty rate (NSA, 2012b). The informal sector and SMEs, like in many other developing countries, have been playing a role in generating employment. While no comprehensive estimate has been done for Namibia so far to determine the contribution of SMEs to employment creation, the latest indication[4] from two studies (Stork et al., 2004, and Arnold et al., 2005) cited by BoN (2010b), that focused on SME development, gave some indication of SMEs' contribution to employment of approximately 20 per cent in both 2003 and 2004. These sectors have however remained undeveloped because of a lack of finance, as evidenced by the World Bank Enterprise Survey of 2006 (the latest on Namibia), which indicates that only 16.2 per cent of surveyed firms[5] had a bank loan or line of credit (World Bank, 2006). This is despite the existence of a relatively well-developed formal financial sector, which has considered those sectors too risky to finance. FinMark Trust (2011) also estimated the financial exclusion rate of Namibia at 31 per cent. This is a potential market for MFIs to serve, given the reluctance of commercial banks to serve them. At the same time, there is currently a limited number of 'true' microfinance service providers in the Namibian market that can provide microenterprise lending, microsavings and other financial services specifically targeted at the lower end of the market.[6] In this situation, the Namibian SME sector cannot expand to create the much-needed jobs to reduce unemployment and poverty, while the majority of low-income earners of the population will continue to live in poverty.

The increasing drive to alleviate the financial constraints of the poor has been noticeable globally. This has followed the general acknowledgement among financial sector practitioners, policy makers and regulators of the need to do just that. At the same time, there has been realisation that the alleviation of financial constraints may require the

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[4] These are just indications, because at the time the estimates were made, there was no sample frame; hence the inability to conduct nationally representative business surveys.

[5] The scope of the survey was 329 manufacturing firms.

[6] There is actually also no clarity with regard to who is regarded as an MFI in Namibia, such that some calls have been made to define MFIs.

existence of a diverse spectrum of financial institutions with different risk and cost profiles, and there has therefore been a concurrent acceptance of microfinance as the medium that can ensure access to finance for the poor and as a powerful tool for sustainable development (Lützenkirchen & Weistroffer, 2012). This acceptance has been based on the fact that during its existence, microfinance has proven to have made a difference in facilitating access to finance by the poor, and therefore in the lives of those who were once considered to be too risky to qualify for conventional banking services, through applying non-traditional credit risk-mitigating measures.

The Namibia Financial Sector Strategy (NFSS) 2011–2021, a recently developed ten-year roadmap for the transformation of the Namibian financial sector,[7] has recognised the need to develop relevant financial institutions, such as MFIs, that will facilitate the growth and development of the SME sector and ensure financial access to the majority of the country's poor. Regulation has been viewed as one of the ways to develop the microfinance sector through providing an enabling environment that would entice more entry into the sector. In this regard, the country engaged consultants that assisted the Bank of Namibia (BoN) in creating such a regulatory framework. In its communicating the objective of the engagement during the process of stakeholder consultations in 2013, the BoN indicated that it sought to increase access to finance for SMEs and low-income individuals in Namibia through the development and deepening of the Namibian formal financial system by creating an enabling legal, regulatory and supervisory framework for microfinance. As such, the main objective of the BoN in creating a regulatory framework for MFIs is actually to develop the MFI sector in Namibia, which will enhance access to finance for SMEs and low-income people. This action is adherent with the notion of 'regulation leading the market'.

The need for a regulatory framework for MFIs is not unique to Namibia, but occurs in other countries around the globe too. This is because, while the history of microfinance globally evolved outside a regulatory framework, in the form of informal savings and credit groups (CGAP, 2006), and this environment has enabled MFIs to innovate and engage approaches to the provision of financial services that are distinct from traditional approaches of conventional banking, the scope and scale of microfinance have evolved beyond the traditional microcredit (Lützenkirchen & Weistroffer, 2012). While initially microfinance meant the extension of traditional micro loans of small and smallest amounts to the rural poor, it has evolved into providing financial services for all the unbanked in emerging and

7 The NFSS has been developed as a result of the realisation of the role the financial sector can play in the economic development of the country (Republic of Namibia, no date).

developing markets, and the process has also involved a widening of the product range and customer base and a change in the way of serving them (Lützenkirchen & Weistroffer, 2012). Microfinance has therefore expanded and is growing into a more commercialised industry (Lützenkirchen & Weistroffer, 2012). This has come with risks and as such, the issue of regulation of microfinance has been a discussion in one country after another (CGAP, 2000).

In Namibia, in the absence of a regulatory framework that cater for DMFIs, one MFI has been licensed and regulated under the Banking Institutions Act (BIA), Act No. 2 of 1998, as amended, i.e. the law that regulates and supervises commercial banks. This means that it has to adhere to the same prudential guidelines, including minimum capital, reserve and liquidity requirements, as well as non-prudential requirements, as conventional commercial banks. In the meantime, work on a new regulatory and supervisory framework for MFIs had been finalised at the time of this research where BoN was in the process of amending the BIA to provide for the regulation of MFIs.

Given the existence of alternative forms of regulating MFIs, experience in other countries and/or regions is worth looking at. CGAP (2000: 13) indicates that in countries such as Indonesia and the Philippines, “the availability of a special legal charter with low capital requirements brought forth large numbers of private rural banks”. It further reveals that the Latin American region, with longer experience than other regions in regulatory windows created specially for microfinance only, had only 16 per cent of the total multimillion dollar market coming from institutions licensed through microfinance-oriented windows, while the bulk of microfinance had been provided under licensing through other windows (CGAP, 2000). This is evidence of the fact that a general one-size-fits-all conclusion on which regulatory approach a country should follow is not easy to make. This study therefore posed the question to the specific case of Namibia, i.e. is the regulatory framework (in both the existing form and the anticipated amended form) the right approach that will help Namibia achieve the intended regulatory objective of developing the microfinance sector to increase access to finance in the country? The researcher believed that this question could only be answered by undertaking a regulatory impact assessment (RIA); hence the current study, which is equivalent to evaluating both how the existing regulation has impacted the regulated MFIs (ex-post assessment) and how the anticipated special window created through amending the existing regulation is likely to impact the development of MFIs, and hence the provision of microfinance in Namibia (ex-ante assessment).

While the importance of MFIs in filling the financial services gap in the Namibian market has been recognised, as stated above, there is a need to direct efforts at comprehensively examining the unique nature of these very institutions, so as to map out evidence-based policies that will position them better to perform their expected role of facilitating access to financial services for the poor and SMEs. For instance, the efforts by the BoN to provide a regulatory framework for MFIs through amending the BIA are good regulatory intentions; however, the outcome of any regulation is not guaranteed, as regulation could have either positive or unintended negative impacts.

To ensure positive regulatory outcomes, other countries (especially OECD [Organisation for Economic Co-operation and Development] countries, but increasingly also other countries) have been performing ex-ante RIAs, and Namibia is doing one through this study. Ex-post regulatory assessments are also performed to determine what the exact impact of regulation had been after its implementation. This current study also entailed an ex-post assessment of a currently regulated MFI under the BIA, to gauge the impact exerted on it by being regulated under commercial banking law, which should provide good insight and lessons for the country. This is especially necessary, given the above stated viewpoint that MFIs should not be blindly subject to the same regulatory framework as conventional banks. Therefore, the question for Namibia is whether the BIA (in its current and anticipated form) is the appropriate legal instrument for regulating MFIs.

Staschen, Dermish and Gidvani (2012: 2) explain that “conducting structured impact assessments provides regulators with the analytical toolkit to systematically think about impact, carefully design policy and critically evaluate existing policies”. In the same vein, the aim of the ex-ante assessment of this study was to inform the design of the policy in the future, while the ex-post regulatory assessment was premised on the need to assess the validity of some views, including those that MFIs should not be regulated by the same regulatory frameworks used for conventional banks because they are unique institutions. There is also an argument that states that regulated MFIs are likely to perform better, as the licensing requirements spelled out in the regulations would provide clear performance targets for them (CGAP, 2000). Both views are worth finding empirical evidence for and this study sought to do that for the case of Namibia.

The study entailed an impact assessment of the regulatory and supervisory framework (both existing and anticipated) on the microfinance sector in Namibia. The main goal was the provision of information that should inform the process of how best to create an environment that enables MFIs to effectively and efficiently play their expected role. The study was therefore based on the following key questions:

i) What is the nature and state of the microfinance sector in Namibia?
ii) How has the current regulatory framework (the BIA) affected MFIs?
iii) Will the proposed amended BIA meet the overall objective of developing the microfinance sector in Namibia?
iv) Should the microfinance sector be regulated and supervised, as proposed by the amended BIA?

1.3 RESEARCH AIM AND OBJECTIVES

The main aim of this research was to review the regulatory framework of MFIs in Namibia and assess its potential impact on the provision of microfinance in the country. To be able to perform a meaningful assessment, it was important to have a clear understanding of the MFI sector itself as well as the existing regulatory and supervisory framework and how it is applied to the sector. The specific objectives of the study that embodied this view were therefore as listed below:

i) To obtain a better understanding of the nature and state of microfinance in Namibia
ii) To obtain a better understanding of the regulatory and supervisory environment for MFIs in Namibia
iii) To assess the existing and potential impact of regulation on the Namibian microfinance sector
iv) To make policy recommendations based on the results of the study.

Below is an elaboration of these four objectives:

To obtain a better understanding of the nature and state of microfinance in Namibia

Understanding the nature and state of institutions regulated and/or to be regulated was important, as it would ensure a meaningful analysis of the impact of either an existing regulation or potential regulation. It was deemed that this process would provide the necessary information on the characteristics of the existing MFIs, and reveal any diversity in the type and form of available MFIs in the country. The information is important at the stage of making any policy recommendations, which may need to be tailored to the specific types of MFIs.

To obtain a better understanding of the regulatory and supervisory environment for MFIs in Namibia

The aim of this objective was to ensure that the regulatory framework is properly understood, as a pre-requisite for undertaking any meaningful impact analysis of such regulation on the MFIs. The process identified the weaknesses, strengths and/or gaps in the regulatory framework, and how those have possibly and/or would potentially affect the MFIs. It is on that basis that any recommendation can be made, which could be, for example, in the form of proposing changes to the regulatory framework.

To assess the existing and potential impact of regulation on the Namibian microfinance sector

Firstly, this objective aimed at assessing the impact of existing regulation on the MFI currently regulated together with normal banks under conventional banking law as a case study. Secondly, the objective also aimed to further assess the potential impact of the proposed regulatory window for MFIs, being provided for under the amended BIA, on the development and growth of the microfinance sector in Namibia and the enhancement of access to finance.

Facilitating access to finance through developing the microfinance sector has been the overarching reason for creating the MFI regulatory window in Namibia. The assessment process yielded answers pointing to whether or not the new MFI regulatory framework would address the identified weaknesses constraining the development of the microfinance industry in Namibia. It also identified and assessed whether or not other additional regulatory and supervisory objectives of this window would be achieved; and whether the ultimate position of the expected regulatory benefits and costs would likely be a net benefit or net cost.

To make policy recommendations based on the results of the study

This objective ensured that the study makes recommendations based on the findings of the other three objectives. The aim was to facilitate evidence-based policy formulation and decision making and hence the nature of the recommendations made under Chapter 9 of this study.

1.4 RELEVANCE OF THE RESEARCH

In the literature, much of the impact assessment research done has been limited to case studies of successful MFIs in developing countries of Asia, Latin America and Africa, mostly focusing on the micro-economic impacts and relationships between MFIs and their clients (Hulme & Mosley, 1996; Khandker, 1998 and Wood & Sharif, 1997, cited by Chiumya, 2006). Very little research on issues pertaining to the regulation and supervision of MFIs has been done, especially in Africa. In fact, it can be concluded from the literature reviewed that research on the impact of regulation on the development of the microfinance sector is still in its elementary stages. Most of the work done in this area has focused on descriptive country case studies, presenting the experiences of selected licensed MFIs (Churchill, 1997; Drake & Rhyne, 2002 and Rock & Otero, 1997, cited by Chiumya, 2006), except for a few that assessed the impact of regulation on the MFI sector, including that by Randhawa and Gallardo (2003) for Ghana and Tanzania, Chiumya (2006) and Okumu (2007) for Zambia and Uganda, respectively, as well as Cull, Demirguc-Kunt and Morduch (2009), who performed an assessment of a total of 67 developing countries. The findings of these studies can only be generalised to a limited extent, because of the heterogeneity of environments in different countries. Variables such as the maturity of the microfinance sector, the relative strength of different interest groups in the legislative process and the responsiveness of clients and MFIs to regulatory changes are country-specific and would usually determine the regulatory impact. This study therefore adds to the body of knowledge relating to MFIs by focusing on the regulatory impact on the microfinance sector, using the Namibian case.

Moreover, as indicated earlier, little research has been undertaken on the Namibian microfinance sector, especially on the regulation of the sector. Most of what has been done focused on describing the state of affairs of the sector. To the researcher’s knowledge, there has not been any study that has performed a RIA on the MFIs in Namibia. An attempt that analysed the sector based on a regulatory perspective is that by Mushendami, Kaakunga, Amuthenu-Iyambo, Ndalikokule & Steytler (2004), which examined the role of regulation and supervision in promoting microfinance activities in Namibia, but like other studies, this was more descriptive in nature. The current study therefore contributes useful detailed information and provides insight into the state of regulation of MFIs in Namibia, as well as its current and potential impact on these institutions.

The research findings are necessary information for policy makers and regulators whose course of action may include amending the regulation, stimulating new reforms or seeking deeper understanding. Further, as challenges faced by developing countries in this field are believed to be similar, the study also contributes to the current debate on the regulation of MFIs. Ultimately, the conclusions of the study should provide important inputs for evidence-based policy dialogue and decision making in the area of microfinance.

1.5 THE STRUCTURE OF THE STUDY

The rest of the study is organised as follows: After Chapter 1, which has given the introduction and background to the study, Chapter 2 focuses on the background to the Namibian economy with special emphasis on the financial system. It contextualises the subject matter of the research (i.e. microfinance and regulation), in terms of both the macro-economic situation of the country (i.e. economic growth, poverty and employment, etc.) and the status and scope of the financial sector. To that effect, the chapter reviews the structure and performance of the financial sector and its contribution to the economy, and identifies a gap in the system which microfinance is supposed to fill so as to justify Namibia wanting to develop its microfinance sector.

Chapter 3 is an in-depth literature review with emphasis on the theory and empirical evidence of financial regulation and supervision. It begins by looking at the link between both the broader financial system and microfinance to the economy, followed by a discussion of issues relating to financial regulation and how the aspect of regulating microfinance is analysed in literature. It therefore looks at issues relating to, among others, which MFIs to regulate and how to regulate them, what approach to follow (i.e. self-regulation or external regulation) and what type of regulation to apply (prudential or non-prudential), before it ends with a discussion of the empirical findings relating to the aspect of microfinance and regulation.

The remaining chapters (4 to 9) are structured as follows: Chapter 4 describes the research methods and methodology for this study, followed by Chapter 5, which presents an analysis (trends, scope, structure, etc.) of the microfinance landscape in Namibia. In Chapter 6, the regulatory and supervisory framework in Namibia is discussed. The impact of regulating and supervising MFIs (using a case study of a regulated MFI) is presented in Chapter 7, while in Chapter 8 an assessment of the potential impact of the envisaged new MFI regulatory framework is presented. The key findings of the study, conclusions, limitations, policy recommendations and suggestions for further research are contained in Chapter 9.

CHAPTER 2

BACKGROUND TO THE NAMIBIAN ECONOMY WITH SPECIAL EMPHASIS ON THE FINANCIAL SYSTEM

2.1 INTRODUCTION

This chapter provides an overview of the Namibian financial system with a view to identifying the existence of any gaps in the system. To that effect, the chapter reviews the strengths and weaknesses in the processes of the sector playing its intermediation role in the economy. For contextualisation purposes, the discussion begins with an overview of the economy in terms of its achievements and challenges since the country became independent in 1990 as well as the opportunities that have presented themselves, especially those having an impact on the financial sector.

2.2 OVERVIEW OF THE NAMIBIAN ECONOMY: ACHIEVEMENTS, CHALLENGES AND OPPORTUNITIES

Namibia turned 24 years old on 21 March 2014. The country's fourth National Development Plan (NDP4)[8] adopted in 2012, alludes to government having inherited a dual economy with four interrelated challenges of low economic growth, an inequitable distribution of wealth and income, high unemployment and a high rate of poverty (Republic of Namibia, 2012.). While the country has recorded positive economic growth averaging at approximately 4.2 per cent since independence (refer to Figure 2.1 below), this has not been sufficient for the required employment creation, poverty reduction and achievement of greater income equality. In fact, the gross domestic product (GDP) has increased at a higher rate than the increase in population (of approximately 2 per cent on average), resulting in the country achieving a high per capita income that has led to its classification as an upper-middle income country since 2009 (Republic of Namibia, 2012). This status does not augur well with the prevailing high-income inequality in the country. With a Gini coefficient of 0.59 (NSA, 2012b), Namibia is estimated to be among the highest income inequality countries of the world. This is however an improvement from 0.74 in 1993 (UNU-WIDER, 2011), when the country was considered

[8] NDP4 is Namibia's fourth National Development Plan after having had its three predecessors (NDP1, NDP2 and NDP3). The plan's implementation period spans from the fiscal year 2012/13 to 2016/17.

to have been the highest unequal society in the world. The level of inequality remains higher when compared with Gini coefficients of some other selected countries[9] in the region.

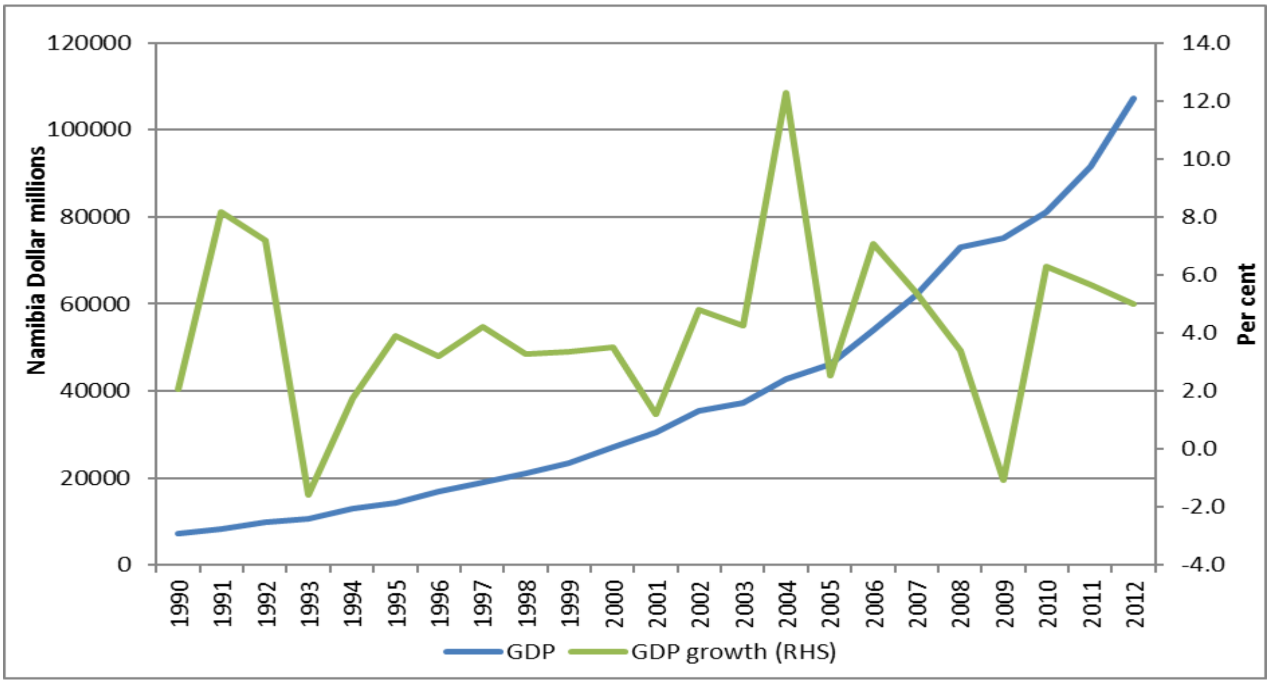

Figure 2.1: GDP and GDP growth

Source: Statistics Division of the BoN[10]

Unemployment, particularly among women and the youth, has been a serious challenge for the country. The 2012 Labour Force Survey estimated the country's unemployment rate at 27.4 per cent (NSA, 2012a). It should however be encouraging for the country to have observed that unemployment improved remarkably when compared to the rate of 51.2 per cent in 2008 and 36.7 per cent in 2004. The high unemployment situation has been attributed to the inadequate and volatile economic growth, coupled with a shallow economic base (Republic of Namibia, 2012). It is further attributed to the fact that the growth experienced mainly originated from the capital-intensive sectors of the economy, such as the mining sector, which virtually dominates the economic activities in Namibia but only creates a few jobs (as shown in Figure 2.2 below). Further, the country's manufacturing base is very

[9] The 2011 World Income Inequality Database of the World Bank indicates Gini coefficients of other selected Southern African Development Community (SADC) countries as follows: Lesotho (0.58), South Africa (0.57), Botswana (0.54), Swaziland (0.51), Zimbabwe (0.51) and Zambia (0.51).

[10] The data was obtained from the administrative records of the BoN through an e-mail by an official of that organization, Mr Abiatar Andreas on 15 April 2014 [Available e-mail: abiatar.andreas@bon.com.na].

small, resulting in its abundant natural resources (minerals, fish and beef) being exported raw, therefore also not making the required contribution to employment creation through value addition. At the same time, the country has been importing even the basic consumable goods. The current economic structure has hence not been able to generate sufficient jobs. Government has always made clear its desire to diversify the economy through the promotion of value-addition activities. Meanwhile, the informal sector and SMEs, like in many other developing countries, have played a role in generating employment,[11] despite being undeveloped due to the many challenges they encounter, the key being the lack of access to finance.

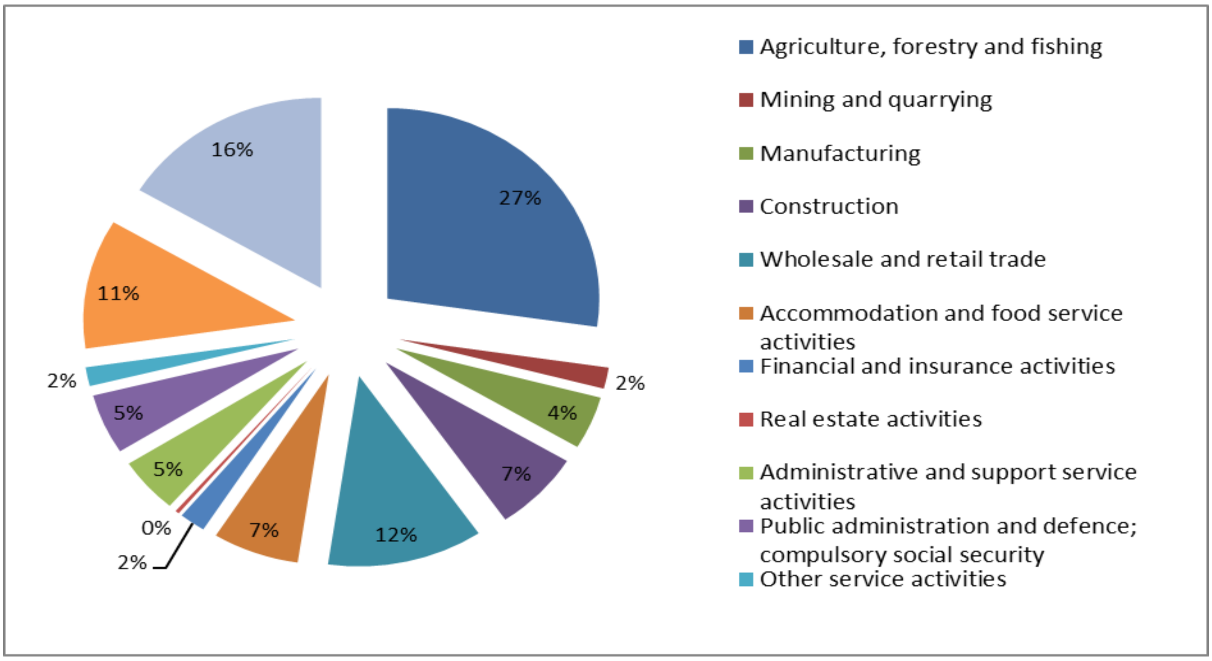

Figure 2.2: Employment creation by sector

Source: NSA (2012a)

Namibia has also lagged behind in its Human Development Index (HDI). In 2012, the country's HDI was estimated at 0.608, which is higher than the average of 0.475 for sub-Saharan Africa but below the world's average of 0.682. The country ranked 128 out of 187 (UNDP, 2013). This is an indication that despite its upper-middle income country status,

[11] Statistics on the SME sector is currently very sketchy, but available statistics show that the sector contributes approximately 12 per cent to the GDP and 20 per cent to employment (BoN, 2010b)

there remains much to be done in getting the country to its desired level of a developed nation in accordance with its Vision 2030. [12]

Poverty (measured as the proportion of the population living on less than a $1 per day) has been rife in the country, estimated at 28.7 per cent in 2012, with the share of severely poor individuals standing at 15.3 per cent (NSA, 2012b). Poverty has however improved from a rate of 69.3 per cent and 37.7 per cent in 1993 and 2004, respectively. Given these relatively high poverty levels in the country, the country has engaged programmes aimed at reducing the poverty level in accordance with its Poverty Reduction Strategy. The observed reduction in the poverty rate might be a reflection of some successes in the implementation of the programmes of the Strategy, although more still needs to be done to reduce the proportion of the severely poor to below 10 per cent by 2017, as desired by the NDP4.

Given the above socio-economic challenges, Namibia has continuously reviewed its five-year NDPs, which are the essential implementing plans for achieving the country's overall ambition articulated in its Vision 2030. Despite some observed progress,[13] reviews have revealed persisting challenges and weaknesses, as discussed above. This has led government to change strategy, placing emphasis on the prioritisation of economic sectors and initiatives that should make maximum impact towards the achievement of Vision 2030. In this regard, four sectors have been prioritised as 'strategic high-growth sectors', namely logistics, tourism, manufacturing and agriculture. While other sectors of the economy are not necessarily to be neglected, the focus over the NDP4 period (2012/13–2016/17) is on these four sectors, i.e. more investment is to be made in these sectors. It is believed that planned strategies regarding these sectors "will create momentum for higher economic growth and set the country on a path to achieve its Vision 2030" (Republic of Namibia, 2012) if implemented effectively. With this prioritisation approach, the country aims to achieve three main goals by the end of the NDP4 period (2017), namely:

- high and sustainable economic growth;
- increased income equality; and
- employment creation.

By assessing and determining whether or not the newly introduced MFI regulatory window will create an enabling environment for MFIs, the current study serves to catalyse action that

[12] With Vision 2030, Namibia aims to be an industrialised country with a high income by the year 2030.

[13] In addition to having created a stable macro-economic environment, Namibia is said to have made progress in critical institutional areas such as good governance, the rule of law and protection of property rights (Republic of Namibia, 2012).

will contribute to the achievement of the three goals listed above. This is because an enabling environment in which MFIs flourish and facilitate access to finance for productive economic activities will stand to contribute to employment creation and the economic growth of the country. It will also complement efforts towards reducing the prevailing high income inequality through wealth and assets creation for previously disadvantaged citizens.

2.2.1 Policy reforms

In order to mitigate the socio-economic challenges experienced by the country discussed under the sections above, the country has initiated several policy and structural reforms. The most notable ones, which are relevant to this study, are discussed below.

2.2.1.1 Targeted Intervention Program for Employment and Economic Growth

To address the high unemployment rate coupled with the realisation of the far-reaching consequences that prolonged unemployment can cause (and therefore the urgent need to create job opportunities), government, through its National Planning Commission adopted a programme called the Targeted Intervention Program for Employment and Economic Growth (TIPEEG) in 2011. This is a short-term (three-year) programme aiming towards creating temporary employment in an attempt to arrest the situation in the shortest possible time. Despite its temporary nature, it is believed that the programme "will go a long way in enabling beneficiaries to have better prospects for long-term employment" (NPC, 2011: 4).

The programme is structured in such a manner that it supports the strategic high-growth economic sectors of the NDP4 period mentioned earlier (i.e. logistics, tourism, manufacturing and agriculture). To that effect, government has aimed to deliberately make more investment in these sectors (NPC, 2011), especially in terms of allocating resources to high-labour-intensive projects. In terms of this policy reform, not only does the programme have to create jobs in these sectors, but the design of the programme also embodies the element of speedy implementation, an aspect that was lacking in previous programmes (NPC, 2011). While it cannot only be attributed to the existence of the TIPEEG, the country has experienced a recent significant reduction in the unemployment rate to 27.4 per cent from 51.2 in 2008 (NSA, 2012a).

2.2.1.2 New Equitable Economic Empowerment Framework

In an attempt to address the highly skewed income distribution situation in the country, government has initiated a policy framework called the national broad-based New Equitable Economic Empowerment Framework (NEEEF). The ultimate objective of the framework, which (at the time of this research) was yet to come into effect, can be summed up as the creation of an equitable and socially just society (OPM, 2015).[14] NEEEF entails a set of policies aimed at encouraging the private business sector to become more equitable and make a greater contribution towards the intended goal of national economic empowerment and transformation. Government aims to use its procurement programmes and licensing regimes as promotional tools for transformation and empowerment of especially the previously disadvantaged citizens,[15] and has identified six empowerment pillars, as listed below, through which transformation is to be promoted (OPM, 2015):

- *Ownership*, where a more equitable and balanced ownership of businesses is envisaged through assisting previously disadvantaged Namibians to either buy into existing businesses or establish new businesses
- *Management control and employment equity*, where it is expected that the management structures and workforces of businesses in Namibia should more accurately be reflective of the demographics of the population; this is to be achieved through means including the introduction of sectoral legislations that will make it a requirement for boards of directors and top management in certain categories of companies to be fully reflective of the Namibian demographic make-up
- *Human resources and skills development*, where Namibian businesses are to be encouraged to play a greater role in training and skills development in the country, as this is viewed as key for effective empowerment and transformation
- *Entrepreneurship development*, under which government envisages to enhance entrepreneurship among the previously disadvantaged Namibians through the procurement process, taking into consideration the extent to which businesses wanting to engage in business with government have assisted previously disadvantaged businesses through procurement, mentorship, joint ventures, etc.
- *Corporate social responsibility*, which aims to encourage good corporate citizenship in the country through making it part and parcel of the business environment;

[14] This policy, while discussed at some point by the National Assembly, was still undergoing public consultations at the time of writing this research.

[15] Previously disadvantaged citizens are that section of the population that was discriminated against under the apartheid South African regime that ruled the country before independence.

accordingly, NEEEF will require businesses above a certain size to devote at least 1 per cent of after-tax profits to community investment, while government also undertakes to reward businesses that establish operations in depressed communities

- *Value addition, technology and innovation*, which aims to transform the economy by encouraging manufacturing, value addition and export instead of trading and extraction, as well as sharing of knowledge and technology among entrepreneurs; the aim of NEEEF is therefore to make value addition a requirement for licencing of new enterprises while existing businesses would be required to achieve value addition to a certain level of processing by a certain defined date.

As an incentive-driven framework, NEEEF is to be applied on a scoring basis mechanism, so that it is ensured that the companies that fail to comply with the set targets would be excluded from tendering for government- or state-owned enterprise contracts. While participation is on a voluntary basis, it is the wish of government that all businesses would embrace the policy and be participants. Once it becomes effective, this framework is expected to make a meaningful contribution to the country's goal of becoming a more equitable society[16].

The researcher is of the view that, if implemented effectively, the strategies devised in the TIPEEG and NEEEF discussed above should foster economic growth, which will facilitate the process of addressing Namibia's socio-economic challenges of unemployment, poverty and income inequality.

2.3 OVERVIEW OF THE NAMIBIAN FINANCIAL SECTOR

2.3.1 Introduction

This section of the chapter provides a review of the Namibian financial sector, pointing out its strengths as well as examining the gaps and constraints identified in the process of the sector playing its intermediation role in the economy. This is not only relevant for the contextualisation of the subject matter of this study, but also necessary, given the existence of a link between financial development and economic growth advocated by economic theory – an aspect that is elaborated on under the literature review section of the study in Chapter 3.

[16] Stakeholder consultations on NEEEF were still ongoing at the time of this research.

2.3.2 The structure of the financial system in Namibia

The formal financial system of Namibia consists of commercial banking institutions and a range of non-bank financial institutions (i.e. pension funds, insurance companies, asset managers, unit trusts, micro-lending institutions, a stock exchange and stockbrokers) (Republic of Namibia, no date). The activities of these categories of institutions are overseen and supervised by two regulators, one for the banking industry and the other for the non-bank financial industry. Specialised and development finance institutions also exist in the country, while in recent years the sector has also witnessed the emergence of private equity and venture capitalist funds, although this segment of the industry is still relatively small. While a small number of government financial institutions came into existence, especially after independence, most financial institutions are private institutions with strong ownership links to South African institutions. A summary of the current status of each of these categories is provided below.

2.3.2.1 The structure of the banking sector

At the time of conducting this research, the banking sector comprised six commercial banks, of which four are traditional commercial banking institutions (namely First National Bank [FNB] Namibia, Standard Bank of Namibia, NedBank of Namibia and Bank Windhoek), while two were specialised banking institutions that entered the market three- and one year respectively, before this research started in 2013, namely FIDES (International Finance for Social and Economic Development) Bank Namibia, which is a microfinance deposit-taking bank that entered during 2010, and the SME Bank, that joined in 2012.[17] With the exception of one commercial bank, three of the traditional ones have strong ties with South African banks in that they were previously branches of South African banks before their recent incorporation as fully fledged Namibian banks. The BoN 2014 Annual Report indicates that there is also one representative branch of a South African bank (Absa Bank), mostly handling enquiries and administrative issues on behalf of the bank. A most recent entry to the banking industry has been in the form of an e-bank (also called EBank Namibia), which was licensed in 2014 (BoN, 2014). The Bank's form and mode of operation are purely electronic. Although its operations have not taken full effect yet, expectations are that this bank will add to the increasingly changing face of the banking industry in Namibia. There are

[17] This information was listed on the corporate website of the BoN at the time of conducting this research (BoN, no date).

prospects for more banks entering the industry, as evidenced by the observed expression of interest through applications for licenses made to the Central Bank in recent years.

The 2014 annual report also revealed that the Namibian banking sector was well capitalised, sufficiently liquid and profitable (BoN, 2014). Data obtained from the annual reports of the BoN for the period 2004–2013 show that total assets of the sector have grown substantially by 229 per cent over a ten-year period (2004–2013). They represented 63.4 per cent of the GDP in 2013, an increase from 54.8 per cent of the GDP in 2004. Figure 2.3, however, also shows that the pace of growth has reduced in later years of the decade relative to the beginning of the same period.

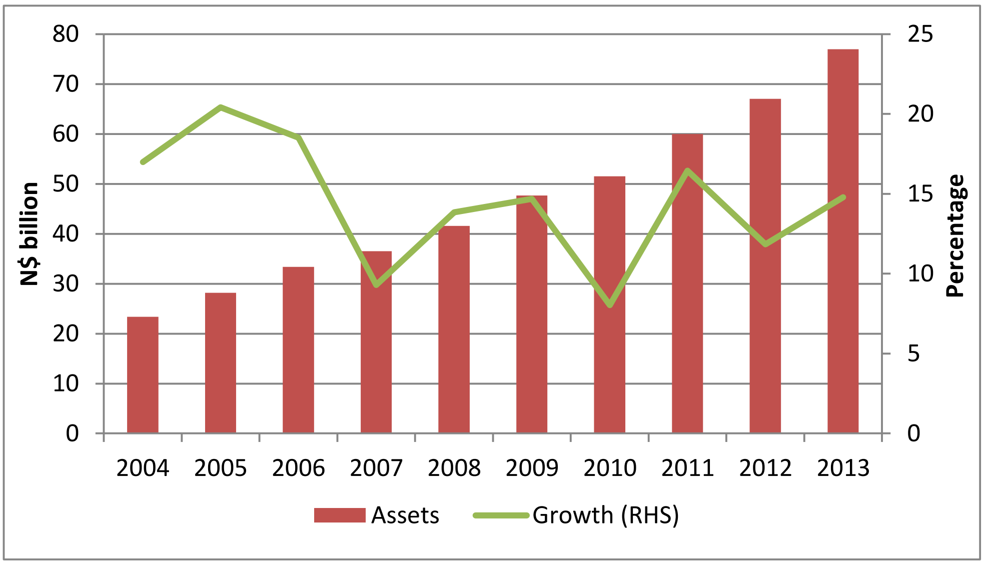

Figure 2.3: Banking sector assets and growth

Source: BoN annual reports for periods 2004–2013

The largest portion of bank assets (approximately 70 per cent) is loans and advances extended to the various sectors of the economy (BoN, 2013a). Loans extended to the private sector increased significantly by 193 per cent from 2004 to reach N$59 322.9 million at the end of 2013. This shows that the banking sector has been actively lending in the economy during the decade under review. The value of loans extended by commercial banks to various sectors of the economy amounted to 48.8 per cent of the GDP in 2013 (the ratio was 47.4 per cent of the GDP in 2004), which is testimony that the sector has, in actual fact, been a primary source of financing for the Namibian economy. Figure 2.4 below depicts the growth in credit extended to the private sector for the period 2004-2013.

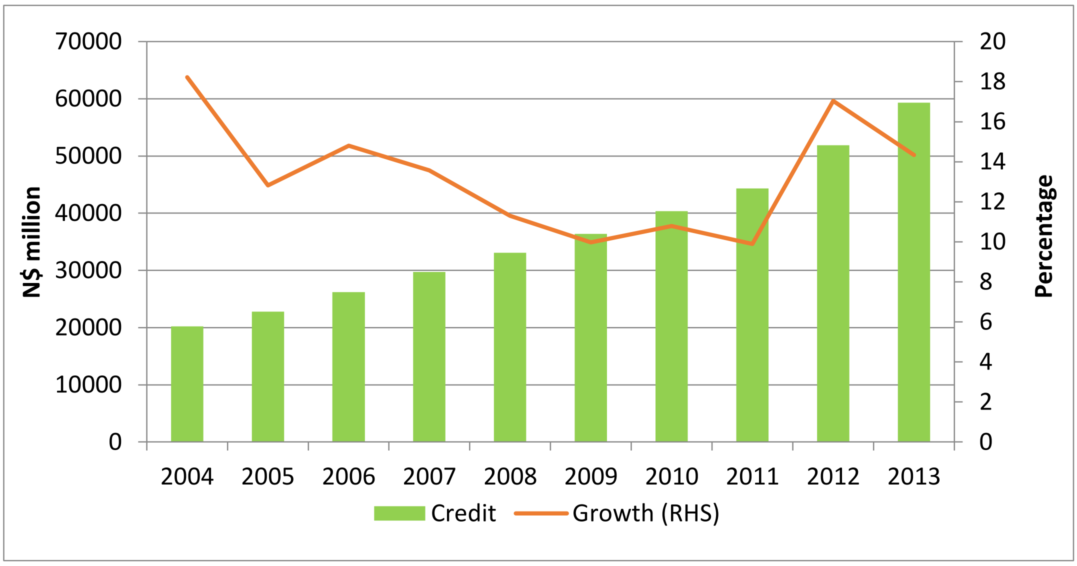

Figure 2.4: Bank private sector credit and growth

Source: Statistics Division of the BoN[18]

The bulk of both the industry's total assets and loans (more than 90 per cent for both) belongs to the four main commercial banks that have been operating in the industry for a long time relative to the other two specialised banks mentioned earlier. Figures 2.5 and 2.6 below show the distribution of assets and loans between the banks.[19]

[18] The data was obtained from the administrative records of the Statistics Division of BoN through an email by an official of the Division, Mr Abiatar Andreas on 15 April 2014 [Available e-mail: abiatar.andreas@bon.com.na].

[19] Due to the small size of the banking industry, codes (A, B, C and D) are used in this study instead of names of banks so as to preserve the confidentiality of individual banks by not making it possible to link specific data to a specified institution. This was done after the interview with the Chairperson of the Bankers Association at the time of field work indicated that the manner in which the data is presented would matter to the industry as the industry would expect that confidentiality was preserved.

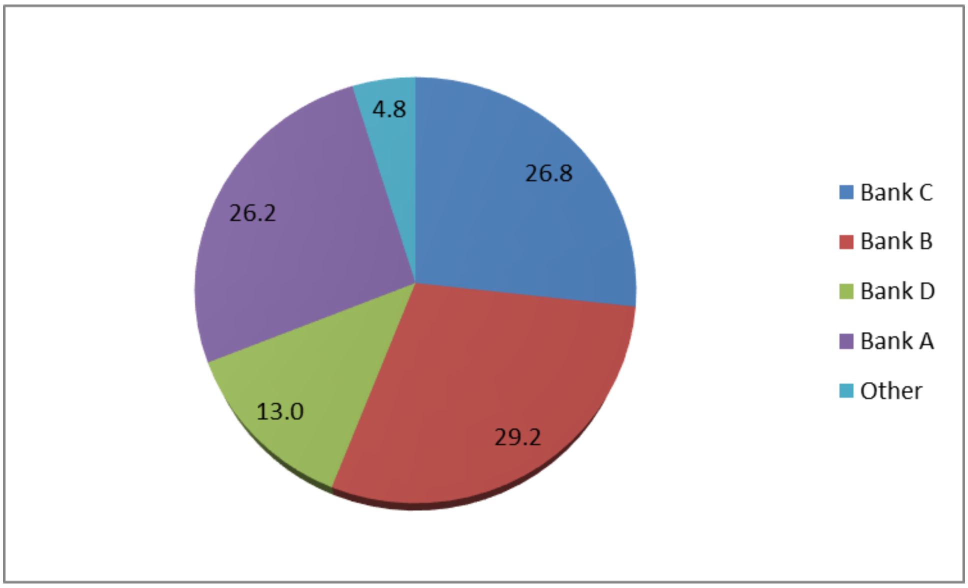

Figure 2.5: Bank percentage share in total industry assets

Source: BoN[20]

Figure 2.5 shows that the biggest chunk of the industry's assets belongs to Bank B (29.2 per cent), while there is only a slight difference between the shares of Bank C (26.8 per cent) and Bank A (26.2 per cent). Bank D has the smallest share among the mainstream banking institutions (13.0 per cent). As indicated earlier, loans and advances constitute the largest portion of the banking industry's total assets. A noteworthy aspect with regard to bank loans in Namibia is the high exposure to individual real estate mortgages. Mortgages made up more than half of total commercial banks loans and advances (52.8 per cent at the end of 2013). This has raised credit risk concerns, although the non-performing loan ratio of the banking industry has on average remained below the international benchmark of 4 per cent over the past decade. Figure 2.6 below depicts the share of each banking institution in total industry loans.[21]

[20] The data was obtained from the administrative records of the Banking Supervision Department of the BoN.

[21] These are total loans of the main four commercial banks only, excluding those of the two specialised banking institutions, i.e. SME Bank and the microfinance bank (FIDES).

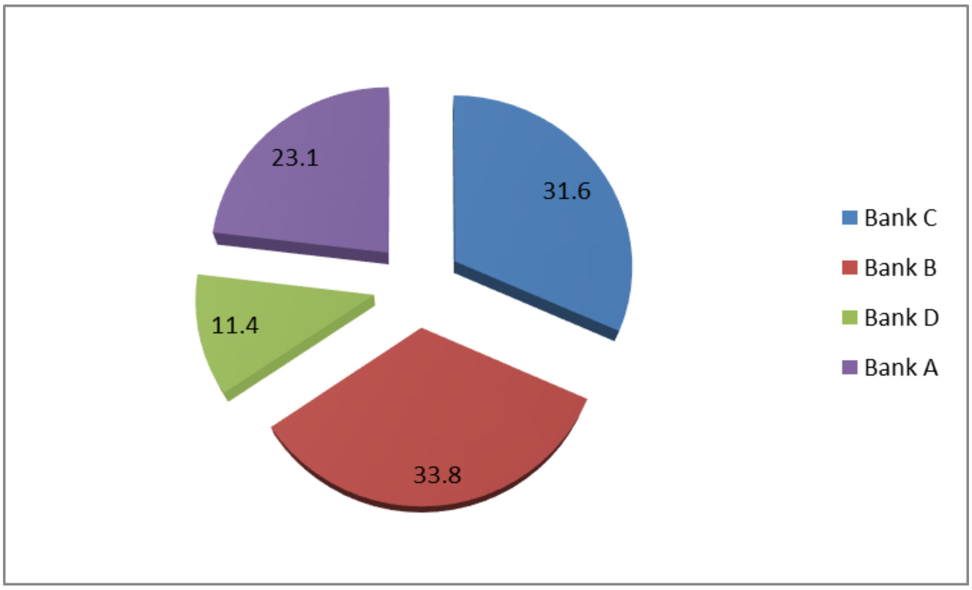

Figure 2.6: Bank percentage share in total industry loans

Source: BoN[22]

The structure of shares of commercial banks in total industry loans resembles that in assets, with Bank B taking up the largest share and Bank D the smallest share. There is however a huge difference between the portions held by Bank C (31.6 per cent) and Bank A (23.1 per cent) compared to the closeness observed in their shares to total assets. In terms of liabilities, total industry deposits, which constitute the main liability portion, have seen tremendous growth over the period 2004–2013. At the end of 2013, the deposits of the banking industry amounted to N$73 486.5 million, an increase of 316.7 per cent from the level recorded at the end of 2004, when it was only N$17 636.2 million (Figure 2.7). They represent 60.9 per cent of the GDP.

[22] The data was obtained from the administrative records of the Banking Supervision Department of the BoN.

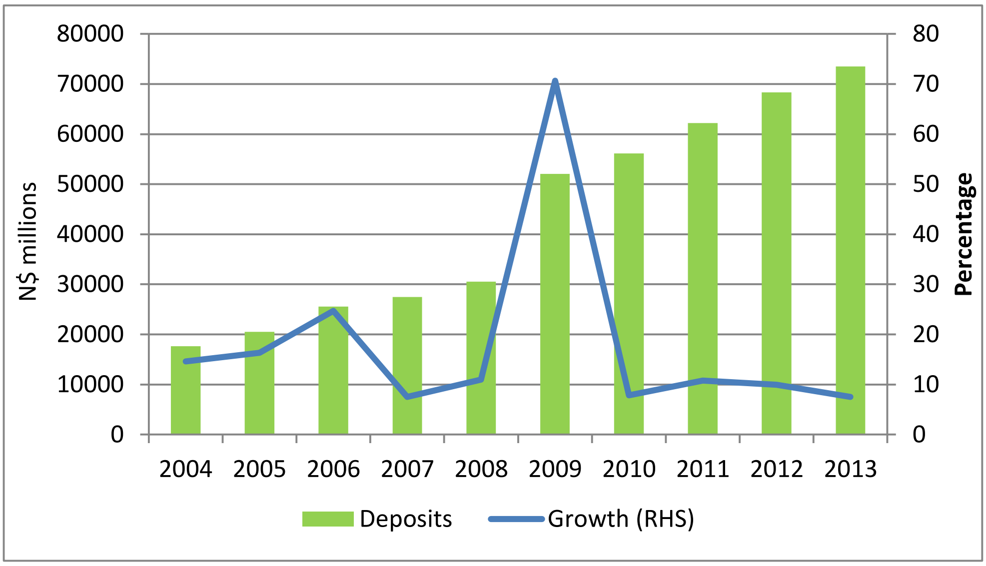

Figure 2.7: Banking industry deposits and growth

Source: Statistics Division of the BoN[23] and researcher's calculation for growth

Figure 2.8 below shows the distribution of deposits among the banking institutions. The distributional structure of the value of deposits is similar to that in assets and loans, where Bank B holds the majority of deposits and Bank D the smallest. The differences are however not too significant, especially between those for banks A, B and C.

[23] The data was obtained from the administrative records of the Statistics Division of BoN through an email by an official of the Division, Mr Abiatar Andreas on 15 April 2014 [Available e-mail: abiatar.andreas@bon.com.na].

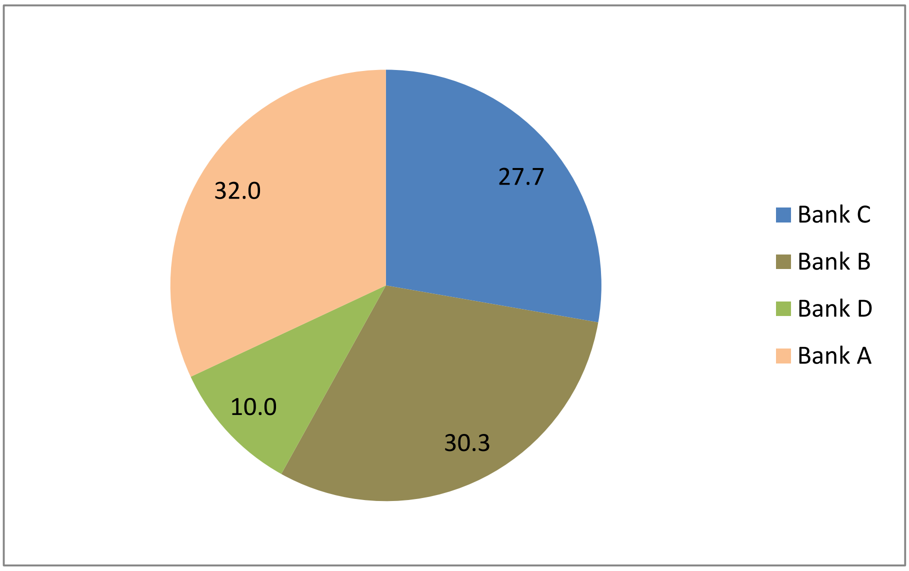

Figure 2.8: Bank percentage share in total industry deposits

Source: BoN[24]

Although sound and well capitalised, as indicated above, the Namibian banking industry is highly concentrated and lacking competition. According to the September 2013 Financial Stability Report of Namibia (BoN, 2013b), the industry's estimated measure of concentration through the Herfindahl–Hirschman Index has ranged way above 2 000 points over the years, which is considered highly concentrated (Figure 2.9). The standard is 1 000 points at which a system or industry would be considered competitive.

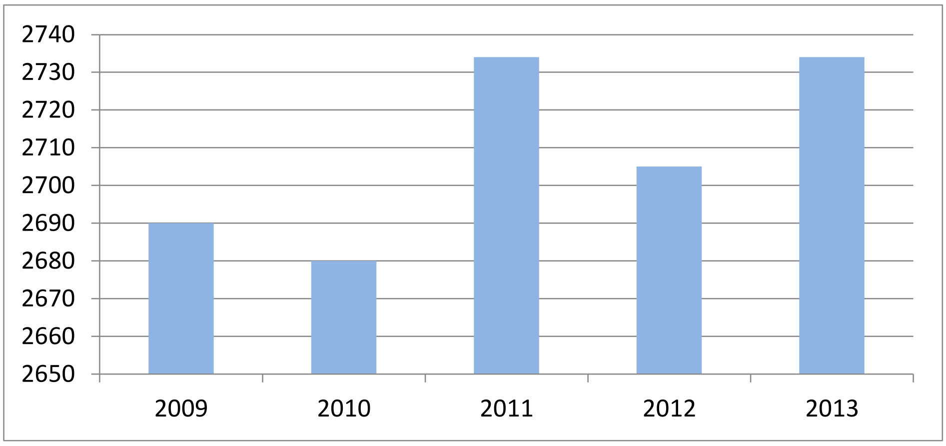

Figure 2.9: The Herfindahl–Hirschman Index for the Namibian banking industry

Source: BoN (2013b)

[24]The data was obtained from the administrative records of the Banking Supervision Department of the BoN.

Figure 2.9 shows that the Herfindahl–Hirschman Index (representing the level of the market concentration for the banking industry) of Namibia amounted to 2 734 points at the end of 2013. In fact, it has been fluctuating in the range of 2 680 and 2 734 points over the period 2009–2013. These figures show a highly concentrated and uncompetitive Namibian banking industry, given they are way above the desirable level of a 1 000 points, at which a system or industry would be considered competitive, as mentioned earlier. This state of affairs is attributable to the fact that the four major commercial banks (FNB Namibia, Standard Bank of Namibia, Bank Windhoek and NedBank Namibia) dominate the banking industry. According to the September 2013 Financial Stability Report of BoN (BoN, 2013b), the four banks account for almost 100 per cent of the total assets and deposits. There is therefore a lack of competition, which has, at times, led to speculations of the presence of bank collusion in Namibia. Feasibility (2010: 7) posits that the big four banks “behave like oligopolists, each with some market power, but unwilling for the most part, to compete on prices”, as evidenced by their sustained profitability.

The highly concentrated status of the industry is undesirable, given the negative impact that it might have on the savings mobilisation process and channelling of resources to investors. Competition would lead to greater transparency, diversification and expanded product offering. In fact, Ikhide (2000) indicates that given the high levels of profitability of the Namibian banking industry and the fact that most of the existing firms were producing at the falling portion of their average cost curves, the industry could still accommodate more banking firms without necessarily compromising industry profitability. In line with this finding, according to the country’s current Financial Sector Strategy 2011–2021, “attracting new foreign financial institutions could provide a competitive stimulus that the country so much needs and spur innovation in products and practices” (Republic of Namibia, no date: 18).

2.3.2.2 Conclusion on the structure of the banking sector

From the discussions in the above section, it is clear that the banking industry has evolved over time. The sector is well capitalised, relatively developed and profitable. The sector has however been very concentrated and has lacked competition, given the low number of banking institutions, where the longstanding ones (four banks) have been dominating the sector. The lack of competition and a highly concentrated status of the industry are undesirable, given that these issues may have a negative impact on the savings mobilisation process and channelling of resources to investors as well as impede transparency on the side of the banks and the diversification of product and service offerings. In the context of this study, this situation is considered to have the potential of hampering the outreach by banks, as they may not necessarily see the need to enhance their outreach and therefore exclude some segments of the population from their services. Whether this has been the case in Namibia or not is evidenced in Section 2.4 of this chapter.

2.3.2.3 The structure of the non-banking financial sector

The non-banking financial sector of Namibia boasts a relatively high number of diverse institutions and intermediaries compared to the banking industry. As at the end of 2012, there were 18 long-term and 14 short-term insurance companies, 121 registered pension funds, 41 investment managers, 12 unit trusts, 275 micro-lending institutions, 11 medical aid funds, 3 friendly societies, 1 stock exchange and 6 registered stockbrokers that intermediate between investors and the stock exchange (NAMFISA, 2013). As in the case of the banking sector, the non-bank financial sector also has strong links to South Africa in that most of the institutions are subsidiaries of South African companies. The NFSS 2011–2021 envisages having these companies locally incorporated.

With the exception of the stock exchange that has remained one ever since its establishment in 1985, the sector has grown bigger in terms of both the number of institutions per sub-sector and assets. The total assets of the sector had grown significantly to N$149.7 billion by the end of 2012 from only about N$906 million at the end of 2004. At that level, they represented 139 per cent of the GDP (BoN, 2013b). Following below is the detailed information on each of the non-bank financial industries, with the exception of the microlending industry, which is discussed under a separate section (Section 2.3.2.7).

(a) The pension funds industry

The pension funds industry consists of both public and private institutions. Namibia has a high number of registered pension funds. At the end of 2012, there were 121 active registered pension funds, covering 289 689 members (NAMFISA, 2013). It is the biggest industry of the non-banking financial sector, in that the bulk of the total assets of the non-banking financial sector (N$85.8 billion) belongs to the pension funds industry (NAMFISA, 2013). This amounts to approximately 80 per cent of the GDP and as such, Namibia is among the countries with the highest rates of pension assets ratio to GDP in the world.

The Government Institutions Pension Fund (GIPF) is the major contributor to the pension assets by approximately 70 per cent. These assets have been finding their way out of the country, i.e. the country has been a net exporter of capital for many years, mostly through institutional investors. As illustrated in Figure 2.10 below, capital outflows reached a peak of N$10 417 million in 2007 before they reduced to N$4 639 million at end of 2013. The continuous flows of capital out of the country have not boded well with the level of investment needed by the country to develop its own economy. In the quest of curbing capital outflows and to spur local investment, government amended the regulatory requirements relating to institutional investors in 2013[25] to compel long-term insurers and pension funds to invest a portion of their assets in the domestic economy. Regulations 28, 15 and 29 therefore require pension funds and long-term insurers to invest a minimum of 35 per cent domestically, of which 1.75 per cent should be in unlisted local investments.

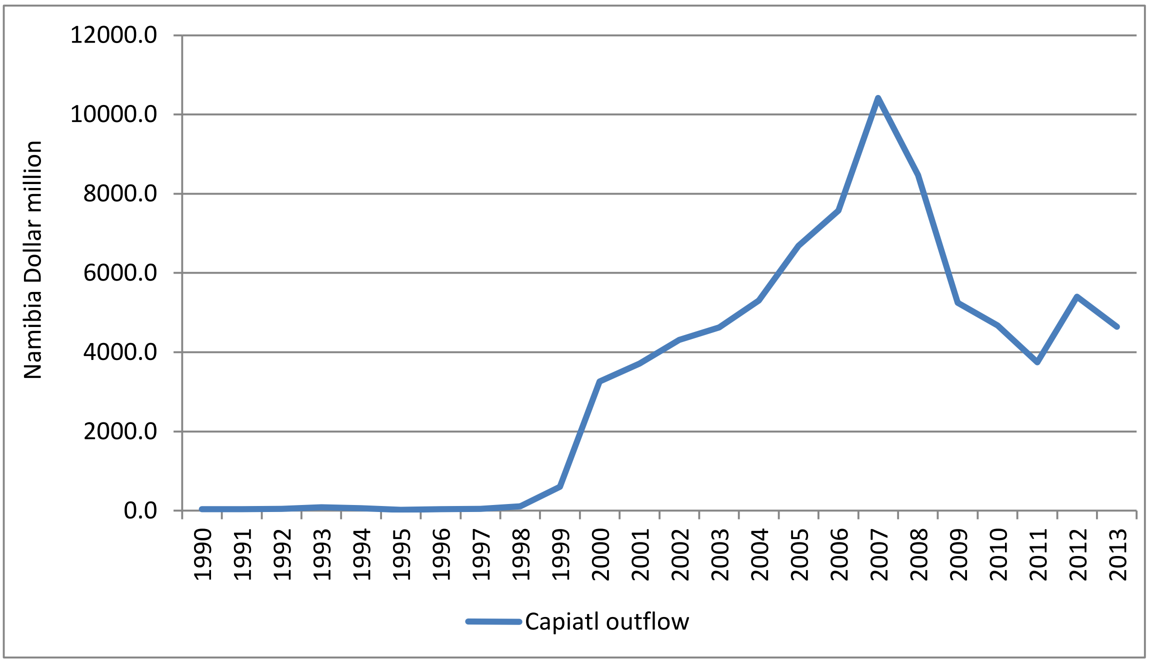

Figure 2.10: Capital outflows over the period (1990–2013)

Source: Statistics Division of the BoN[26]

[25] The regulations became effective at the beginning of 2014.

[26] The data was obtained from the administrative records of the Statistics Division of BoN through an email by an official of the Division, Ms. Angelina Landsberg on 16 April 2014 [Available e-mail: angelina.landsberg@bon.com.na].

(b) The insurance industry

The insurance industry consists of a long-term (or life insurance) and short-term component as well as insurance brokers and a re-insurer. Eighteen long-term insurance companies and one re-insurance company were in existence at the end of 2012 in Namibia. During the same period, the industry's assets amounted to N$31.6 billion (NAMFISA, 2013), accounting for 29.6 per cent of the GDP. According to the regulator, the industry is well capitalised, with coverage ratio of surplus assets (3.8 in 2012) way over the required capital adequacy ratio (CAR) of 1.5 per cent (NAMFISA, 2013). Despite this good performance, the FinScope Namibia 2011 Survey found that 64 per cent of individuals in Namibia have not used long-term insurance products or services.

Feasibility (2010) found that three life insurance companies (Old Mutual, Sanlam and Metropolitan) dominated the long-term insurance industry, accounting for more than 80 per cent of total industry assets. The same study also found the existence of cross-holding between these companies and banks, in that Old Mutual had a majority shareholding in Nedbank; Capricorn Holdings, who is the majority shareholder of Bank Windhoek, owned shares in Sanlam; while FNB had majority shareholding in Metropolitan. According to the study, the cross-holdings could encourage bundling of products between related firms, which may not always benefit the consumer.

There were 14 short-term insurers at the end of 2012, one re-insurer, as well as 121 insurance brokers and 395 insurance agents. The assets of the short-term insurance industry totalled N$3.0 billion at the end of 2012, compared to N$1.5 billion at the end of 2008 (NAMFISA, 2013). From premiums and claims, it is clear that the bulk of the short-term industry is in the form of vehicle, personal and fire insurance. Three companies (Mutual and Federal, Santam and Hollard) were found to dominate the short-term industry (Feasibility, 2010), with these companies also having strong links with South African short-term insurance companies in terms of shareholding. One of the smaller short-term insurers, Legal Shield, which is a subsidiary of the Trustco Group, was owned by various Namibian interests (Feasibility, 2010). As in the case of long-term insurance, the FinScope Namibia 2011 Survey found that usage of the short-term insurers' services has also remained low.

(c) Medical aid funds

According to the 2013 annual report of the non-bank financial institutions regulator, there were 11 registered medical aid funds in Namibia, with a total membership of 162 471 at the end of 2012 (NAMFISA, 2013). The same report shows that total membership consisted of 68 389 principal members, 3 460 pensioners and 90 622 dependents, while net member contributions amounted to N$1.9 billion at the end of 2012 and claims stood at N$1.7 billion, or 89.2 per cent of contributions. The above membership numbers imply that only 42.1 per cent of all employed Namibian people were principal members of a medical aid fund in 2012, while only 24 per cent of the Namibian population were covered by a medical aid fund. It follows then that the healthcare for the rest of the population (more than 70 per cent) is either funded personally or by government (NAMFISA, 2013).

(d) Unit trusts

The unit trust industry in Namibia has also evolved and grown tremendously, especially during the post-independence era. Registered unit trust companies increased to 12 at the end of 2012, compared to only a few before independence (NAMFISA, 2013). Within a span of five years, total funds under the management of these institutions reached N$32.1 billion at the end of 2012, from N$23.5 billion at the end of 2008 (NAMFISA, 2013). The bulk of the funds (76.8 per cent) were invested in money market instruments, for which the sources are depicted in Figure 2.11. Natural persons were the main source, followed by companies and unit trust schemes, in that order.

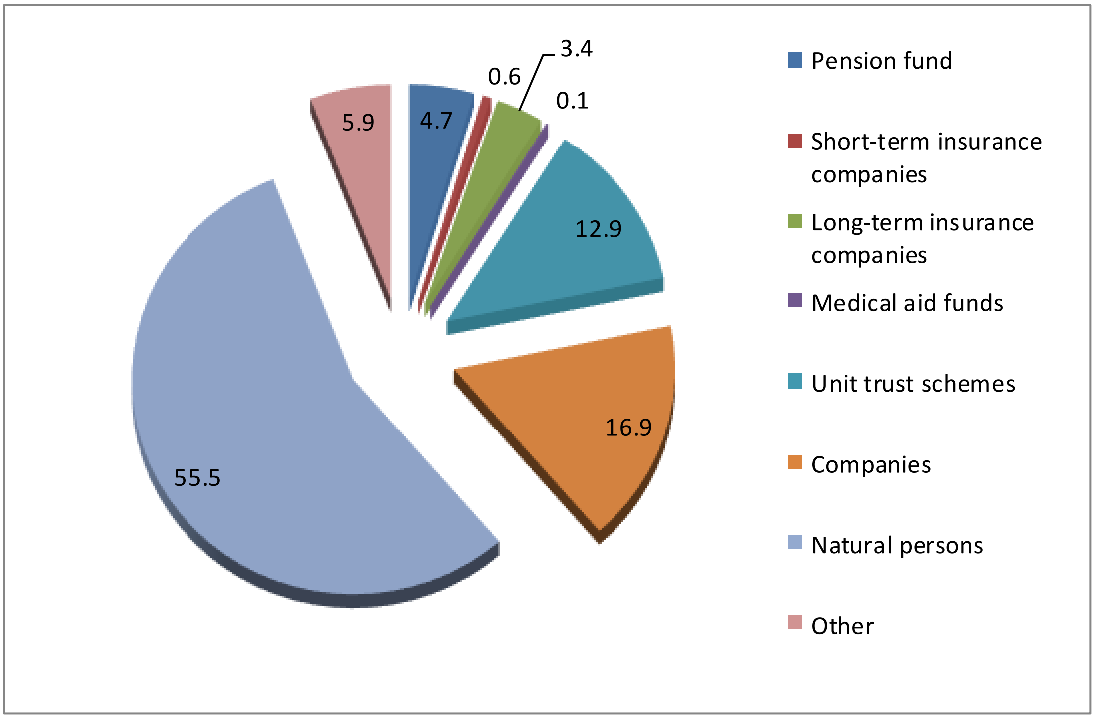

Figure 2.11: Sources of assets under management (per cent)

Source: NAMFISA (2013)

(e) Investment managers

Investment managers play the role of investing and managing resources on behalf of other financial institutions discussed earlier (i.e. pension funds, long-term and short-term insurers, medical aids and unit trust schemes) as well as companies and households. At the end of 2012 there were 41 investment managers in the country, with total assets or total funds under management amounting to N$109.4 billion (NAMFISA, 2013). This is a significant increase when compared to N$75.8 billion four years back (in 2008). The bulk of the funds under management belongs to pension funds (57.2 per cent) followed by unit trusts (24.0 per cent) and long-term insurance (14.8 per cent) in that order, as depicted in Figure 2.12. Medical aid funds, companies and natural persons are among those with the lowest assets managed by investment managers, as also shown in the same figure.

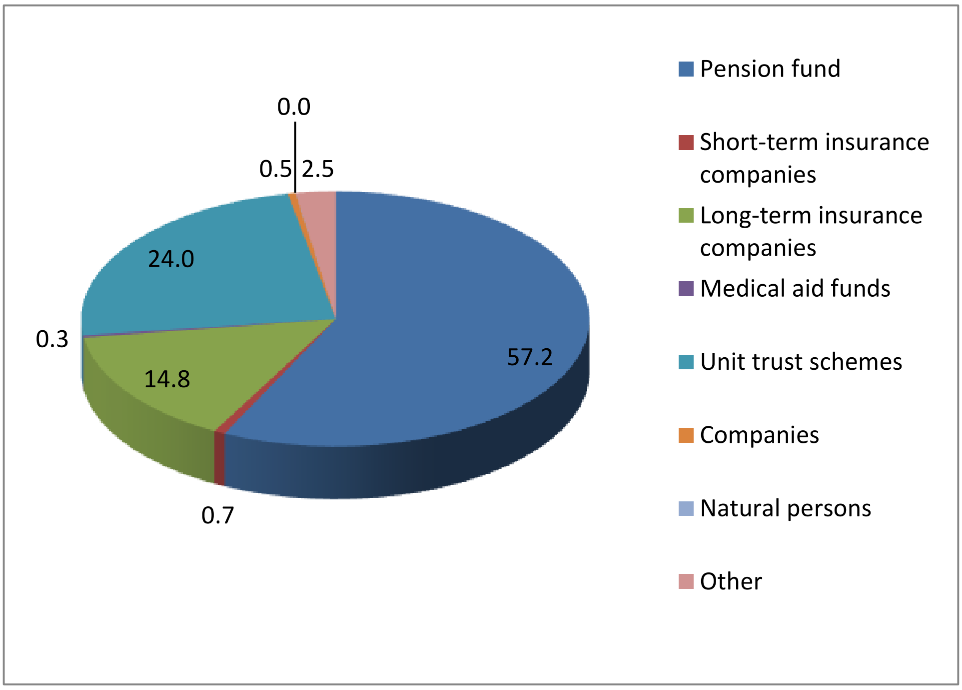

Figure 2.12: Sources of assets under management (per cent)

Source: NAMFISA (2013)

(f) Stock exchange

Namibia only has one stock exchange, called the Namibian Stock Exchange (NSX) and licensed in terms of the Stock Exchanges Control Act (Act No. 1 of 1985). Securities listed on the NSX comprise dual-listed South African companies and primary-listed Namibian companies, with the dual-listed portion dominating (see Table 2.1 below). Dual-listed securities constitute more than 99 per cent of the total market capitalisation of the listed securities on the NSX (NAMFISA, 2013). The overall market capitalisation of the NSX was N$1.41 billion in 2013 compared to the local market capitalisation of N$18.73 million (Table 2.1).

Table 2.1: NSX local and overall market

	2008	2009	2010	2011	2012	2013
Local market (N$ million)						
Market capitalisation	5 720	7 126	7 782	9 304	11 057	18 729
Listed securities	7	7	7	7	7	8
Liquidity (%)	0.02	0.03	0.02	0.01	0.05	0.02
Overall market (N$ million)						
Market capitalisation	741 625	1 047 527	1 178 257	1 148 879	1 357 247	1 407 654
Listed securities	29	33	33	33	33	34
Liquidity (%)	1.24	0.85	0.66	0.29	0.30	0.39

Source: NAMFISA (2013), NSX for 2013 data and researcher's calculations for liquidity

The NSX has been characterised by low levels of liquidity. This has been a result of insufficient available trading instruments in the market, which has led to most investors in Namibia adopting a buy-and-hold strategy (Republic of Namibia, no date). This situation has been ascribed to the need for investors to comply with regulatory local investment requirements of 35 per cent of their total assets, referred to earlier in this study. Furthermore, only a few local companies are listed on the stock exchange, with the number of listings having remained constant over the years, although there has been a recent listing as presented in Table 2.1 above. The national bourse has been working on a strategy that aims, among other things, to improve the situation in terms of addressing the need for a critical mass of stock issues and trade to create an efficient and liquid stock exchange. In this regard, the NFSS 2011–2021 (Republic of Namibia, no date) is advocating for the encouragement of state-owned enterprises to issue more bonds as well as enticing more companies to list on the stock exchange.

(g) Private equity and venture capitalist funds

In Namibia, the private equity and venture capital industry is still in its infant stages of development, although some operations of this nature have been ongoing in the country. At the time of writing this research, there were fewer than ten private equity and venture capital companies operating in the country as revealed by a study commissioned by Business Finance Solutions in 2012 (BFS, 2012). The same study indicates that the oldest private equity fund in the country (Stimulus Investments Limited) was established in 2004 and is listed on the Namibian stock exchange. It has mainly invested in well-established companies, i.e. those with the number of employees ranging between 10 and 100 people (BFS, 2012).

Another significant fund in the unlisted investment space is the Development Capital Portfolio of the GIPF, established in 1996, and which was the first initiative of unlisted investments that made direct investments into some local enterprises. GIPF committed some N$660 million to this portfolio (GIPF, 2010). The Development Capital Portfolio registered some positive experiences with its investments, such as those in two commercial banks (Bank Windhoek and FNB), and some in the real sector of the economy that brought about the establishment of entities that have delivered excellent returns and have become exporting entities. The scheme however also suffered significant losses, which led to its termination in 2003 (GIPF, 2010). The GIPF has recently reinvented and established another unlisted investment portfolio to the tune of N$2.3 billion in the form of a functional model of managing and investing local savings in the real economy (SAIS, 2013). According to a Southern Africa Innovation Support (SAIS) study that looked at the local providers of venture capital, private equity and angel funding in Namibia (SAIS, 2013), only approximately N$800 million of this portfolio has so far been invested into the market, and although the portfolio is biased towards infrastructure and/or property development, it is expected to leave a positive mark in terms of creating and supporting the private equity and venture capital funds in the country. It has so far caused the creation of and has supported a number of fund managers and funds that are structured as venture capital, private equity and specialised funds. The rest of the private equity and venture capital funds entered the market in later years, i.e. they were established between 2010 and 2013, the earliest of them being the Namibia Procurement Fund and VPB Namibia Growth Fund, which were established in 2010. These were yet to fully establish themselves in the market.

Overall, while the need for private equity is believed to be rife in the country especially for financing start-up projects and feasibility studies (Republic of Namibia, no date),[27] awareness and knowledge of these funds has generally remained low, while the fear of giving up ownership and control through the exchange of equity capital for shares has also contributed to small businesses not venturing into calling up these much-needed funds to grow their businesses. There seems to be renewed efforts in this area, with investigatory studies[28] on the need and approach being carried out in the country.

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[27] The NFSS has identified a need for funds that provide investment capital by way of equity risk capital into private sector companies.

[28] Business Finance Solutions undertook a study on the need for venture capital in Namibia in 2013 undertaken by the Institute for Public Policy Research (IPPR), while the Development Bank of Namibia also commissioned a study in 2014 under the NFSS to investigate the need for a national risk-financing facility in Namibia.

2.3.2.4 Conclusion on the structure of the non-banking financial sector

The above has shown that the non-banking sector consists of a diverse spectrum of institutions, offering different products and services, although dominated by a few big players, especially the insurance industry. It was also evident from the above structure that the sector has strong links to South Africa, with most of the companies being subsidiaries of South African companies. Like the banking sector, the non-banking sector is also well capitalised, posing a high coverage ratio of surplus assets than is statutorily required. However, it was observed that the venture capital and private equity funds industries, which would be more beneficial for microfinance development by investing in MFIs, are still small and developing. There is therefore a need for raising more awareness about the existing few and the importance of the type of funding they offer, so that more qualifying entrepreneurs can make use of those.

2.3.2.5 Public finance institutions

The country also has a few specialised government-funded financial institutions, mostly developmental-related for purposes of funding economic activities specific to their respective mandates, as discussed below.

(a) The Development Bank of Namibia

The Development Bank of Namibia (DBN) was established in 2004 through an act of Parliament (the DBN Act, Act No. 8 of 2002) with the aim to contribute to national economic development through the financing of various types of economic enterprises, projects and activities. Government's expectation, as per the mandate expressed under Section 5(1) of the DBN Act of 2002, is that carrying out the mandate will increase economic activity in the country, which will lead to improved social welfare and quality of life of the citizens. Information on the corporate website of DBN at the time of undertaking this research revealed that the DBN provides finance to both the public and the private sector (including emerging entrepreneurs and SMEs) for start-ups and expansions, equity deals, bridging finance, enterprise development finance, trade finance, SME finance, public–private partnerships, public sector infrastructure, local authorities as well as bulk finance to microfinance providers (DBN, no date).

The bank had total assets of N$2.4 billion at the end of 2013 financial year, a loan book of N$1.7 billion and recorded a profit of approximately N$104 million (DBN, 2013). The bank has been placing emphasis on financial sustainability and this has at times led to criticism in terms of whether or not enough efforts were being devoted to its developmental role and whether or not it is over-compensating for risk, which might in the process compromise its developmental mandate, especially to the SME sector. Further criticism of the bank was related to the turnaround time of loan applications (over two weeks on average), which is considered too long, a situation that the DBN has indicated (on several occasions during its public engagements) to aim to improve on.

The DBN has however been very active in the SME sector, in terms of both financing and providing other non-financial services and support. Loans provided to the SME sector ranged between N$250 000 and N$3 million and were repayable over a maximum period of five years, while interest rates on the loans as well as collateral were determined on a project-to-project basis (FinMark Trust, 2011). There has been more emphasis on introducing relevant products for the SME market, which saw the introduction of the tender-based financing instrument through which the bank assists SME entrepreneurs allocated with government tenders without working capital.

According to information obtained from its 2010 annual report, the DBN also has a microfinance support framework where it extends loans to organisations that provide microcredit. It also has an innovation fund, covering loans up to N$50 000 for innovative ideas. In addition to direct financial services, the DBN supports a number of local service providers that provide training and mentorship to emerging entrepreneurs (DBN, 2010). It is however understood that with the establishment of the SME Bank in 2010, DBN is planning to reduce its SME-financing activities to concentrate on financing larger developmental projects and allow the SME Bank to play a more prominent role in that space.

(b) The Agricultural Bank of Namibia

The Agricultural Bank of Namibia (AgriBank) was established by the Agricultural Bank of Namibia Act, Act No. 5 of 2003, as amended. According to Section 4 of the Act, AgriBank has the mandate to lend to individuals, companies or financial intermediaries for the development of agriculture and activities related to agriculture. As such, AgriBank provides loans for agricultural- and fisheries-related economic activities, including to small-scale farmers. It finances the entire value chain, from land acquisition, production inputs and harvesting to transporting, processing and marketing of the products (AgriBank, 2011). Available information showed that the bank had an asset base of N$1.5 billion and a loan book totalling N$1.6 billion at the end of 2011 (AgriBank, 2011).

Information on its corporate website showed that AgriBank had different funding products in place, including a loan guarantee fund (AgriBank, no date). The guarantee fund was initially only set up to guarantee co-operatives loans in order to have access to finance, but was redesigned later to include the small-scale farmers on the green scheme[29] to facilitate their access to finance. The bank planned to develop a comprehensive agro financing scheme with the aim to develop products across the value chain with a special focus on small-scale farmers in the non-title deed areas (i.e. communal areas) where collateral is a challenge. The bank also serves as the delivery channel for government's Affirmative Action Loan Scheme for the agriculture sector, under which loans are issued to previously disadvantaged farmers at special repayment provisions, with the aim of assisting them to become successful commercial farmer (FinMark Trust, 2011).

Among the qualifying criteria for loans is that loans are granted against security of fixed property (mortgage bond) or any other acceptable form of security, such as fixed deposits investments and surrendering value of policies (FinMark Trust, 2011). As such, the bank's outreach to the poor has been criticised by stating that what is acceptable as security are all the things that the poor do not possess, and therefore they do not qualify for loans.

(c) The National Housing Enterprise

The National Housing Enterprise (NHE) was established in 1993 by the National Housing Enterprise Act (Act No. 5 of 1993) with a mandate to finance housing and provide for the housing needs of Namibians, especially affordable housing for the low-income category of the population. In order to fulfil that mandate, NHE provides loans and develops low-cost housing for individuals in the low- and middle-income brackets. Loan sizes vary according to affordability, calculated at 25 per cent of household income plus housing subsidy, or at 20 per cent in the case of prospective clients without a housing subsidy (FinMark Trust, 2011). NHE housing loans are capped at a maximum of N$550 000, with a loan repayment rate of prime minus 1 per cent over a repayment period of between 20 and 30 years (BoN, 2011b). The NHE further applies strict qualifying criteria similar to commercial banks (FinMark Trust,

[29] The green scheme project of government involves the irrigation projects alongside the Kavango and Zambezi rivers in the Kavango and the Zambezi regions of the country, respectively.

2011), and which have at times made access difficult for the poor. Prospective clients are required to provide proof of income, such as a payslip and/or bank statement, while those who are self-employed are to provide audited financial and bank statements as well as a 10 per cent deposit of the value of the house (FinMark Trust, 2011).

Since its establishment until 2010, the NHE delivered over 8 000 houses, an average of just above 400 houses per year (BoN, 2011b).[30] This is well below the required delivery of 1 200 houses per year to achieve the country's Vision 2030. There is therefore a huge backlog in the provision of houses in Namibia. Factors attributed to the NHE not delivering according to expectations are mainly of structural nature, including the lack of available serviced land and complex land development and registration procedures. Other identified factors include high real estate prices and housing finance costs relative to incomes, as well as an increase in the costs of building materials (BoN, 2011b). The BoN Annual Symposium of 2011 dedicated to issues relating to the housing sector revealed that these factors have created a wide affordability gap that hinders low- to middle-income housing provision. The housing backlog has led to government introducing a mass housing project launched by the country's president in 2013, activities of which have since been ongoing in most of the regions of the country.

(d) NAMPOST Savings Bank

The corporate website of NAMPOST Holdings reveals that its subsidiary, the NAMPOST Savings Bank, was founded in 1992 when its holding company became a commercialised entity in that same year (NAMPOST, no date). The FinScope Namibia 2011 Survey revealed that NAMPOST Savings Bank has over 400 000 account holders. It offers relatively low fees and flexible account-opening requirements and has been expanding rapidly, opening on average 4 500 new accounts per month (FinMark Trust, 2011). It has been leveraging on the 135 post offices of its mother company, through which it serves its clients (FinMark Trust, 2011).

In comparison with commercial banks, the 135 branch networks of NAMPOST compares to 119 branches for Bank Windhoek, 126 branches for FNB, 82 branches for Standard Bank and 57 branches for Nedbank Namibia (FinMark Trust, 2011). Bank Windhoek and FNB have almost the same number of branches as NAMPOST, but their geographic focus is

[30] The 2011 Annual Symposium of the BoN focused on issues related to housing in Namibia.

much narrower, with 36 and 49 banks respectively in the capital region, compared to 22 of NAMPOST (FinMark Trust, 2011). It can be deduced from the above that NAMPOST has been investing far more than commercial banks in reaching a broader set of customers. Of the 42 per cent expansion in total bank branches between 2007 and 2012, commercial bank networks only contributed 7 per cent, while the rest was attributed to NAMPOST's branch expansion (FinMark Trust, 2011).

In addition to offering savings accounts, NAMPOST Savings Bank also offers other services such as money transfers, account payments, telephone and municipal bill payments, payments for insurance and pension premiums, utility bills payments, salary and wage services and collection for selected loans (FinMark Trust, 2013). The fact that it can offer certain product such as tax-free interest rate savings products, which commercial banks are not able to offer, has been viewed by other market players as an advantageous position for the Savings Bank, and those have called for the need for a level playing field, arguing that the Savings Bank should also be regulated as a banking institution. While the Savings Bank is not involved in lending activities, it introduced micro loans in 2010 through its subsidiary, PostFin, which forms part of the microlending industry discussed later in this chapter under Section 2.3.2.7 and in Chapter 7 of this study.

2.3.2.6 Conclusion on the structure of public finance institutions

From the above outlined activities, it is clear that public finance institutions have made strides in their respective areas. While this is the case, financing challenges still remain, especially for SMEs in accessing credit, including small-scale farmers. Their less-than-optimal delivery can be attributed to many factors, including the fact that their credit facilities are in certain instances subject to strict terms and conditions, as illustrated above, especially in the case of the NHE, and like commercial banks, their loans are also subject to collateral. Furthermore, all these institutions have a limited outreach, given their representations in only some of the administrative regions of the country. For example, at the time of writing this research, the DBN was only represented in three of the fourteen regions of the country, AgriBank in seven regions and the NHE in five regions. There is therefore a need to increase the geographical presence of these institutions so as to provide easier access to services by local people in the regions.

2.3.2.7 Microfinance institutions

CGAP[31] (2006: 1) defines microfinance as “financial services for the poor”, i.e. it views microfinance as the provision of financial services to low-income people and the poor. This definition essentially refers to enabling the poor to have access to financial services. CGAP (2006: 6) posits that:

> Access is not only about having a bank account, but also about the convenience of and safety of the account and whether the services are fairly priced, meets the needs of customers and are offered by a solid institution that will be around over a long haul to help its customers manage their financial lives.

Inherent in this definition are elements relating to the availability of quality and safe financial services and products that are affordable to the poor, and that are offered by sustainable financial institutions. Although different authors may have defined microfinance in different ways, the elements highlighted above are evident in almost all of those definitions. Hence, this thesis took into account those important elements as it determined the structure of the microfinance sector of Namibia and assessed its status in the ensuing sections and chapters.

Various types of institutions offer microfinance around the world. These include NGOs, cooperatives, credit unions, commercial banks and some government-owned institutions. Most of these types of MFIs have also been prevalent in Namibia, albeit in relatively small numbers, as will be evident from the information below. However, to be able to better understand the current status of the Namibian microfinance sector, one needs to have a background of its origin and how it has evolved. This section therefore first provides an overview of the emergence of microfinance activities in Namibia so as to pave a way for the analysis of its current status. The essence of doing this was to determine whether or not the same institutions or organisations were still in existence at the time of undertaking the research (which would give a sense of whether or not MFIs have been sustainable), whether or not there has been growth in the sector as well as whether or not there was a difference in type between the current and early-years microfinance activities and providers.

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[31] This is a member-based organisation, which brings together bilateral, multilateral and private donors as its members and is therefore a global resource centre for microfinance standards, operational tools, training and advisory services.

2.3.2.8 The evolution of microfinance activities in Namibia

The emergence of microfinance activities in Namibia can be said to have been a result of the unavailability of financial services for the majority of the country's population, especially those who were living in the underdeveloped rural areas and small towns, both before the country obtained its political independence in 1990 and just after independence. The commercial banks existing in the country at the time were only serving a small section of the population especially in terms of the provision of credit, as they were mostly dealing with the more affluent clients and businesses (Republic of Namibia, no date). The root cause of this situation was the discriminatory policies of the apartheid system in place at the time (i.e. prior to the country obtaining its political independence), which neglected certain groups of the population – a situation that resulted in a skewed distribution of the country's income among its population, discussed earlier in the chapter, as well as pervasive poverty, especially in the informal sector. This situation begged to be salvaged, hence the birth of microfinance-related activities in the country.

During the initial stages of microfinance-related activities in Namibia, which were mainly in the form of providing credit to micro entrepreneurs and small businesses, donors and NGOs were mostly the drivers of these activities, although other institutions such as public finance institutions[32] and commercial banks also became involved. According to information from Tonin, Dieci, Ricoveri, Foresi and Hansohm (1998), donors, in conjunction with NGOs, started setting up various loan schemes in Namibia as far back as the 1980s, mainly aimed at financing developmental and welfare activities.

Tonin *et al*. (1998) point to the following as having been some of the prominent donors and NGO-owned microfinance projects at the time: (1) Okutumbatumba Hawkers' Association, established in 1989, which catered for street hawkers in Windhoek; (2) a Hanns Seidel Foundation-sponsored Institute of Management and Leadership Training, which initiated a Revolving Credit Fund in 1994 as a pilot scheme for credit provision to small enterprises in Namibia; (3) the Lisikamena, which used to operate in the Kavango region (in the northeastern part of the country) and used to provide credit through two loan schemes, namely the Individual Loan Scheme that started in 1994 and the Micro Loan Scheme implemented in 1996; (4) the Community Small Enterprise Development Agency established

[32] Public finance institutions that were involved at the time are the Development Fund of Namibia (DFN), which was initially established before independence in 1987 as the Development Fund of South West Africa, and the Namibia Development Corporation (NDC), established in 1993.

in 1995,[33] which, through a Savings and Credit Scheme (named Ngaturitunge Pamwe),[34] provided credit to micro and small businesses operating in Windhoek and its outskirts of Katutura; (5) the Adult Skills Development for Self-Employment set up by the Ministry of Basic Education and Culture in 1996 with the assistance of an Italian NGO, Comitato Internazionale per lo Sviluppo dei Popoli, and the European Commission, and that intended “to link Namibia’s education system with efforts to create a favourable environment for job creation and self-employment in the country” (Tonin *et al*., 1998: 25); (6) Limbandungila, a credit scheme established in 1996 by a London-based NGO called Co-operation for Development, which targeted female entrepreneurs in the informal market of the Oshakati town in the northern part of Namibia; (7) the Lihepurura Kavango Trust, a five-year programme, with an end period of 1997, implemented by Oxfam Canada through the NGO Canada Namibia Cooperation (Canamco) in the Kavango region and which was aimed at “improving the quality of life of the rural poor in the region by providing the necessary assistance to increase agricultural production and build cottage industries and co-operatives in the region” (Tonin *et al.*, 1998:30); (8) Koshi Yomuti,[35] established in 2002 as a microfinance pilot project with the sponsorship of FIDES AG (Switzerland), the Namibian Department of Trade and Industry and GTZ (the Deutsche Gesellschaft für Internationale Zusammenarbeit) (now GIZ, the Deutsche Gesellschaft für Technische Zusammenarbeit), and which used to operate only in the north central underserved regions of the country; and (9) a microfinance arm of Project Hope, a USAID-sponsored welfare-oriented NGO established in 2005 that focused on assisting women who took care of orphans and vulnerable children, with the objective of enabling them to participate in economic activities and improve their standard of living.

From the above listed donor-sponsored and NGO-owned microfinance projects, it is clear that the activities were mainly location-bound, i.e. targeting to serve a specific group of a community (such as women) in a specific locality (mostly a town). Another notable aspect is the fact that the NGO schemes were more women-biased schemes, and this could suggest that women were considered more as welfare enhancers then men. In general, these schemes were characterised by low default rates, which could be ascribed to the normal risk mitigation strategies and strict control measures exerted by the respective donors that sponsored the schemes.

[33] This was initially established in 1991 and operated under a different name as the National Job Creation Service.

[34] This is translated in English as ‘let’s develop ourselves together’

[35] When translated in English this means ‘banking under the tree’.

In terms of government-owned institutions, the NDC, established in 1993 by statute (the Namibia Development Corporation Act, Act No. 18 of 1993) to replace the First National Development Corporation, which existed before the country obtained political independence, used to operate four schemes in the 1990s, namely the SME scheme that provided loans in the range of N$1 000 to N$200 000, a start-up scheme for loans of up to N$80 000, the Small Builders Bridging Fund and a Tenants' Aid Fund (Tonin *et al*., 1998). According to Tonin *et al*. (1998), the loan fund for the SME scheme amounted to approximately N$5 million, which made it the largest informal lender to the SME sector at the time. Further, the DFN, which was initially established before independence in 1987 as the Development Fund of South West Africa, had a loan portfolio of N$56 million. Its objectives had the overall essence of engaging in activities that would promote Namibia's economic and social development through the allocation of finance to needy entrepreneurs, financing defined projects to ensure the fund's sustainability, providing technical assistance and training in development-related activities and assisting with the implementation of approved projects. The fund operated an SME lending scheme in conjunction with commercial banks (Bank Windhoek, FNB and the then Commercial Bank of Namibia) in terms of the disbursements and collection of loans, while the fund itself assessed applications and made allocation decisions (Tonin *et al*., 1998). The scheme, which also had a bias for women (i.e. 85 per cent of the disbursed loans went to women), ceased operating and its capital went to establish the DBN in 1994, an institution that has also continued to play a role in the SME sector, as discussed earlier in Chapter 2.

The 1990s also saw the involvement of some commercial banks in the provision of microfinance-related loans in Namibia. They either operated jointly with some of the NGOs and/or public finance institutions, as is evident from the above discussion, or developed their own products to enter the market. In terms of own initiated activities, the FNB launched a scheme in 1993, operated jointly with the Northern Namibia Chamber of Commerce and Industry, the Evangelical Lutheran Church in Namibia and the Finnish International Development Agency, but it terminated the scheme in 1998 due to a very high default rate (Tonin *et al*., 1998). The bank later began to actively develop its own SME financing products and has since been one of the active players in SME financing.

Standard Bank of Namibia also started a SME pilot scheme in 1996, which targeted sectors such as manufacturing enterprises, carpentry, small take-away shops, mobile shops and bakeries (Tonin *et al*., 1998). In 2012, the bank also launched an SME financing product called SME quick loans to increase its participation in that sphere (Diza, 2013). The then

Commercial Bank of Namibia participated in credit schemes for SMEs funded by international donors and the government of the Republic of Namibia, as mentioned earlier, while NedBank Namibia's participation in the microfinance sector was through the acquisition of a microlender called the Finance in Education Pty Ltd in 2002 and another scheme called NedLoan, which was deregistered later (Tonin *et al*., 1998). Bank Windhoek entered into partnership with the now defunct Small Business Credit Guarantee Scheme of the Ministry of Trade and Industry, which was set up in 1999 to provide financial assistance to new and existing entrepreneurs that lacked collateral for accessing credit (Tonin *et al*., 1998). The bank actually became the pioneer in setting up an independent SME branch later, which was still in existence at the time conducting this study.

In summary, what is noteworthy from the above discussion on early-day microfinance activities in Namibia is the fact that most of the schemes were donor-sponsored NGO MFIs that ceased to operate after donors pulled out. This gives a hint that they were donor-dependent and not sustainable schemes. Further, most of those schemes were jointly operated by NGOs and commercial banks and/or parastatals and commercial banks. While such cooperation also took place in the country at the time of this study, it was on a much reduced scale, as will be evident in later discussions. This could be because most commercial banks have in recent years also entered the microlending business by either establishing separate microlending branches/institutions or creating units within their banks that are dedicated to offering credit to SMEs. It is the view of the researcher that the early-day schemes laid the foundation and raised awareness with regard to the need, approach and methods regarding microlending or microfinancing, and this example may have culminated into the creation of the schemes prevailing in the country.

2.3.2.9 The current setup and status of the Namibian microfinance sector

The current microfinance sector in Namibia can be categorised into deposit-taking (or savings-mobilising) and non-deposit-taking (or credit-only) MFIs. The structure consists of one deposit-taking microfinance bank, some smaller savings-mobilising MFIs (NGO-based MFIs), savings and credit cooperatives (SACCOs) and savings and credit associations (SCAs),[36] some public finance institutions that provide financial services to SMEs, as

[36] SACCOs are associations where members put their savings together into a common pool of money, which is then used to provide loans to the members. SCAs do the same, except that they are normally smaller than SACCOs, mostly operating at grassroots, village level. Allocation of benefits to members is often on a rotation basis, and are then referred to as ROSCAS, (rotating savings and credit association) (Besley, Coate & Loury, 1990).

discussed under the public finance institutions section above, and non-deposit-taking MFIs. The non-deposit-taking MFIs mainly comprise of legally regulated and supervised microlenders (classified by the Regulator into pay-day lenders and term lenders) that include subsidiaries of commercial banks.

While a full account of the operations of each of the above-mentioned categories is provided in Chapter 5 of this study, which is dedicated to appraising the current microfinance landscape of Namibia, suffice it to summarise here that the industry is, as sketched above, relatively small and undeveloped when compared to what happens in other countries around the globe, especially in Asia, but also even in sub-Saharan Africa. As stated above, a full account of the existing MFIs and activities are discussed in Chapter 5.

2.3.2.10 Financial sector regulators and supervisors

The Namibian financial sector regulatory system consists of the BoN, i.e. the central bank of the country, established in 1997 by the Bank of Namibia Act, Act No. 15 of 1997, which regulates the banking sector, and the Namibia Financial Institutions Supervisory Authority (NAMFISA), established by the Namibia Financial Institutions Supervisory Authority Act, Act No. 3 of 2001, which regulates the non-banking financial institutions (NBFIs). To fulfil their regulatory mandate, both the BoN and NAMFISA perform on-site and off-site supervisory activities, aimed at ensuring compliance with regulatory requirements. Worth mentioning is the observed close cooperation between the two regulators in that they undertake joint on-site supervision at times on matters of mutual concern, while preserving their separate mandates. The researcher considers this as a positive aspect, especially given the fact that there exists cross-shareholding between banks and non-banking institutions that requires consolidated supervision. A detailed account of the state of the regulatory and supervisory framework is part of the subject matter of Chapter 6 of this study. It is however important to mention at this stage that the financial sector regulatory environment has been considered to be generally conducive for business (IMF, 2006).

In the case of other financial institutions that are not regulated by neither the BoN nor NAMFISA, such as the public finance institutions listed under Section 2.3.2.5 above and the SACCOs, they are governed by their respective establishing acts and/or are supervised by the line ministries under whose custody they have been placed. NGO-owned MFIs are also monitored and supervised by the relevant ministries, depending on the nature of their activities, while they in addition do some reporting to other authorities (such as the central bank) as may be required, on matters such as those related to external funds inflow.

2.4 THE PERFORMANCE OF NAMIBIA'S FINANCIAL SECTOR

As indicated earlier under this chapter, the Namibian financial sector is considered as relatively developed, especially when measured against those of most other sub-Saharan African countries, excluding South Africa. There is a good and efficient financial services infrastructure as revealed by the International Monetary Fund (IMF) through the Namibia Financial System Stability Assessment in 2006. Following below is an assessment of the sector's performance and its implications for the economy.

2.4.1 Financial sector performance

This latest assessment of the country's financial system stability by the IMF concluded that the banking sector is mature, very profitable and well capitalised (IMF, 2007). Presented in Figure 2.13 below are the return on equity (ROE), return on assets (ROA) and the net interest margin (NIM) for commercial banks in Namibia during the past decade (2004–2013). On average for the past ten years, the ROA and ROE have been approximately 2 per cent and 21 per cent respectively, while the NIM has been approximately 4 per cent (Figure 2.13). These ratios compare well with those for other southern African countries, especially those with which the country shares membership in the regional trading and monetary area blocks such as the Southern African Customs Union (SACU) and the Common Monetary Area (CMA). For example, a comparison of Namibia's bank performance ratios to countries such as Botswana, Lesotho, South Africa and Swaziland for the year 2011 shows a competitive situation for Namibia, although they have been outperformed by Botswana and Lesotho in respect of ROE and by Lesotho in respect of NIM (Table 2.2)[37]. The ratios are also favourable when compared to the sub-Saharan region averages of 1.9 per cent (ROA) and 16.3 per cent (ROE). Important to mention, though, is the fact that these high ratios, especially the NIM, could be a reflection of the high concentration in the banking industry discussed earlier in this chapter.

[37] The ratios are from the 2013 World Bank Financial Development and Structure Database (World Bank, 2013a)

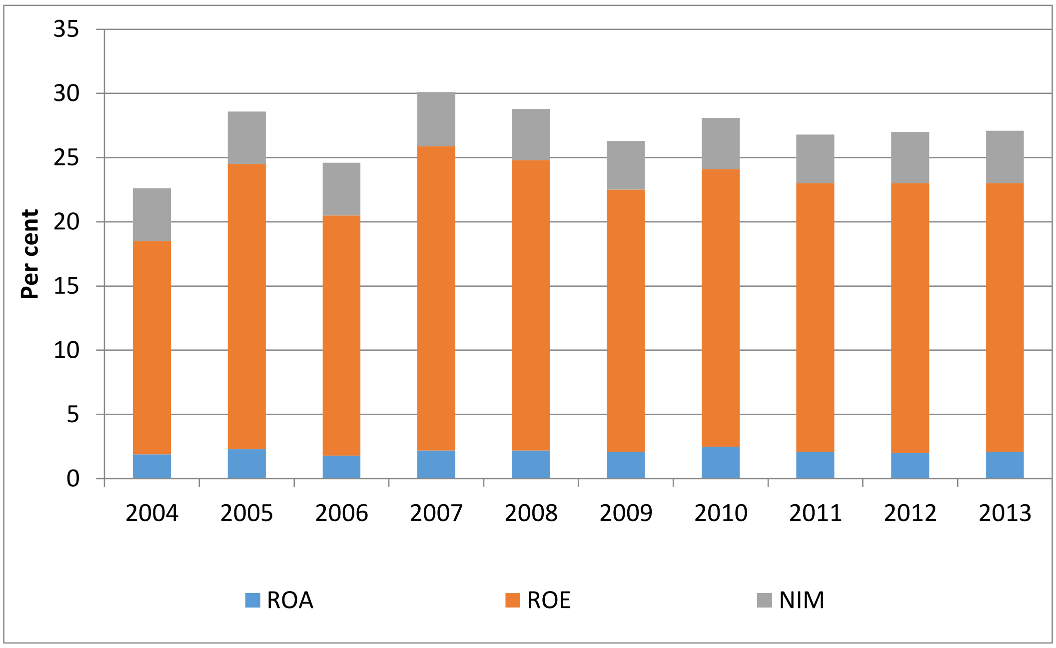

Figure 2.13: The performance of the Namibian banking sector (per cent)

Source: BoN annual reports for 2009–2013

Table 2.2: Comparison of Namibian bank performance to selected countries, 2011 (per cent)

	ROA (%)	ROE (%)	NIM (%)
Botswana	3.2	39.9	5.8
Lesotho	2.7	29.6	6.3
Namibia	3.3	23.5	6.1
South Africa	1.1	15.8	2.8
Swaziland	2.8	17.8	5.7
Sub-Saharan Africa	1.9	16.3	7.1

Source: World Bank (2013a)

Another important indicator of the performance of the financial system is its depth. Ahokpossi, Ismail, Karmakar and Mesmin Koulet-Vickot (2013) indicate the importance of deeper financial systems with wider access to credit for the promotion and support of entrepreneurship, social mobility and broad-based economic growth. The level of financial depth is therefore an important measure of the extent to which the financial system is able to broadly and efficiently supply financial services. Measured in terms of the ratio of private sector credit to GDP, the depth of the Namibian financial system, as shown in Table 2.3, increased to an average of 48.8 per cent during the last five years of the last decade compared to an average of 48.1 per cent during the first five years of the last decade. The average ratio for the past ten years was therefore 48.4 per cent. Noticeable from the table below is the declined ratio in the year 2008 (that actually started in 2007), which is reflective of the impact of the global financial crisis that was prevailing during that period. Overall, however, the ratio compares well with other countries in the region, e.g. the ratio for sub-Saharan Africa stands at 38.7 per cent.

A comparison to some countries in the sub-region,[38] such as those in SACU and the CMA, yield the same results. Namibia's financial depth compares well with that of Botswana (23.7 per cent), Swaziland (22.5 per cent) and Lesotho (10.9 per cent), although it is way below that of South Africa (150.7 per cent), which is the biggest economy in the sub-region. A similar picture is painted when financial depth is measured in terms of the ratio of broad money supply (M2) to GDP. However, much still needs to happen in the country if it is to reach the levels of developed economies, to which it aspires in its Vision 2030. For example, the ratio of private sector credit to GDP averages at 100.1 per cent for East Asia and 103 per cent in the developed economies (IMF, 2013b).

Table 2.3: The financial depth of Namibia

	2004	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**Aver age**
Private sector credit as % of GDP	47.4	49.4	48.5	47.8	47.2	49.3	49.5	49.0	47.2	48.8	48.4
M2 as % of GDP[39]	37.1	37.6	41.7	39.8	41.7	65.9	64.4	64.9	55.6	56.8	50.6

Source: Researcher's calculations from BoN data[40] and IMF (2013b)

The importance of the financial depth of a country has been emphasised in literature. The IMF World Financial Development Report (IMF, 2013) confirms that financial depth has a strong statistical link to long-term economic growth and poverty reduction. Beck, Levine and

[38] The ratios for these countries have been derived from the 2013 Global Financial Development Database of the World Bank.

[39] Financial depth can also be estimated by expressing broad money supply as a ratio of GDP. The results for Namibia using this measure also compare well to other countries in the region.

[40] Data on money supply (M2) and GDP were obtained from the administrative records of the Statistics Division of BoN through an email from the responsible official of the Division, Mr Abiatar Andreas on 15 April 2014 [Available e-mail: abiatar.andreas@bon.com.na].

Loayza (2000) and Beck, Demirguc-Kunt and Levine (2007), as cited by Beck (2006), posit that countries with higher ratios of private sector credit to GDP experience higher GDP per capita growth and faster rates of reduction in the headcount and the share of population living on less than a dollar a day, i.e. they experience a faster rate in the reduction of poverty.

2.4.2 Contribution of the financial sector to the economy

Measured by the share of financial intermediation to GDP, the Namibian financial sector currently accounts for 3.5 per cent of total output. In terms of employment creation, the Namibia 2012 Labour Force Survey showed that the sector was only able to employ approximately 2 per cent of the total labour force of the country, as shown earlier in Figure 2.2. The country's Vision 2030 expects the contribution of the financial sector to the economy to be approximately 6 per cent on average in order to meet the requirements of the country.

On an industry level, the pace of growth in commercial bank lending to the private sector has slowed to 14 per cent in 2013 from 18.4 per cent registered ten years ago (see Figure 2.14 below). In relation to the GDP, credit to the private sector increased from 47.4 per cent in 2004 to 48.8 per cent in 2013 – an average of 48.4 per cent over the period 2004–2013.

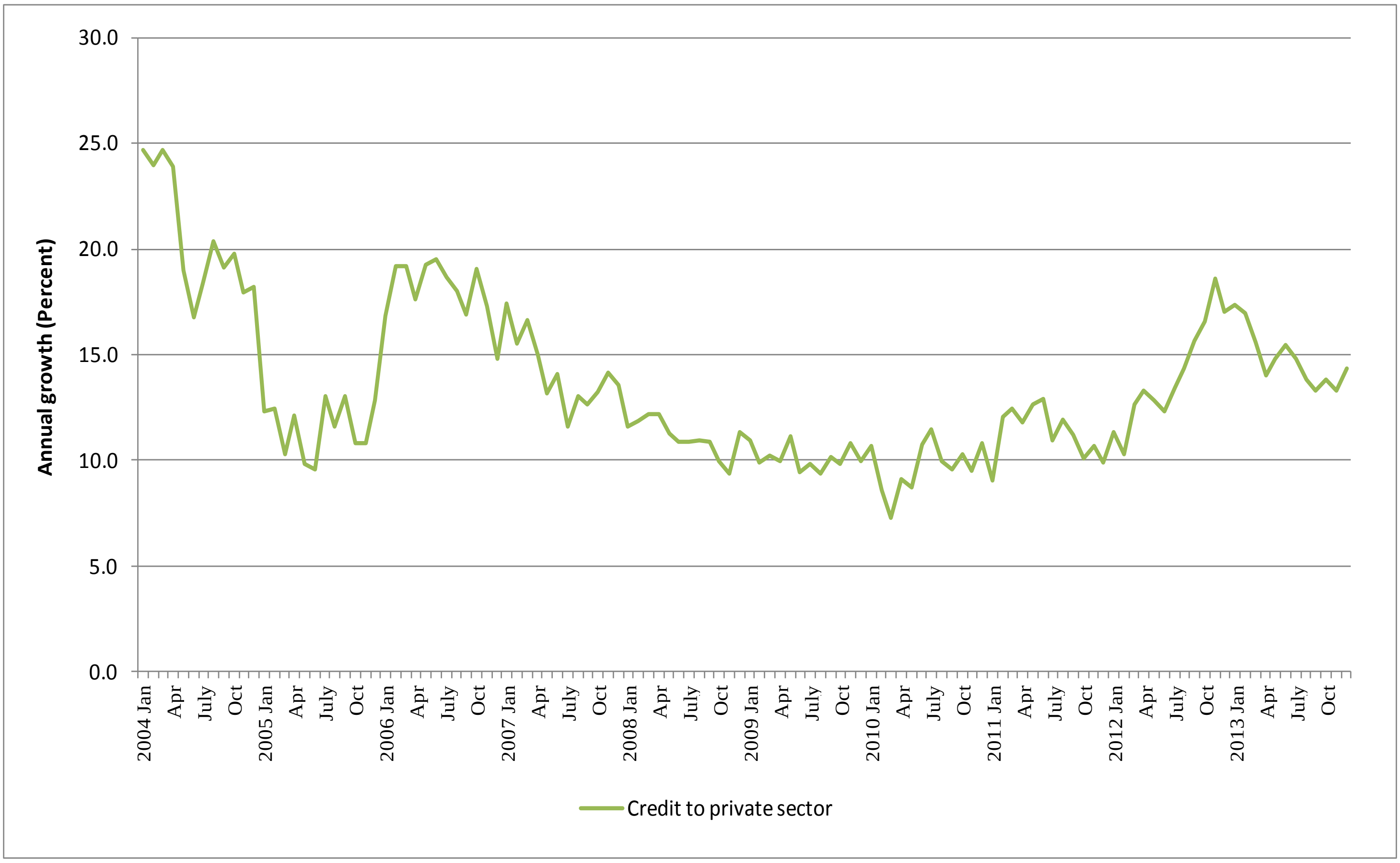

Figure 2.14: Annual growth in credit to private sector (2004–2013)

Source: Statistics Division of the BoN[41]

The above situation is not desirable, especially when considering the sector's capacity. Commercial banks' ability to lend, as measured by the ratio of liquid assets to total assets, has been 12.4 per cent on average over the last decade (2004–2013) and an average of approximately 15 per cent for the period 2009–2013. A comparison of these ratios to some selected countries reveals those for Namibia to have been comparable to, for example, that of the biggest economy in the southern African region, South Africa, which stands at approximately 16 per cent for the period 2009–2013. In addition, Namibia's ratio is higher than those of other countries in regions such as Asia, such as Malaysia, an economy that

[41] Data on money supply (M2) were obtained from the administrative records of the Statistics Division of BoN through an email from the responsible official of the Division, Mr Abiatar Andreas on 15 April 2014 [Available e-mail: abiatar.andreas@bon.com.na].

has made significant strides in the provision of access to finance,[42] which registered a ratio of approximately 12 per cent during 2006–2011. The above indicates massive lending capacity for Namibia, which has not been utilised fully. For instance, previously disadvantaged low-income people and SMEs have remained insufficiently served as access to financial services has been limited in Namibia, as will be evidenced by the discussions in Section 2.4.3.

The non-alignment of the lending capacity of the system with the actual lending that has taken place in the country could have led to the observed massive capital outflows discussed earlier in this study, as the banks found themselves with access funds at their disposal, and this created a financing gap locally in terms of access to finance. This could be an indication of some weaknesses and/or inefficiencies in the financial system, given that literature portrays evidence of the relationship between a sound financial intermediation process and efficiency in the banking system (e.g. Horward & Haynes, 2001; Kenny & Moss, 1998; Vittas, 1991 as cited by Aikaeli, 2008). It therefore becomes important to look at the efficiency level of Namibian commercial banks and other relevant aspects that might explain the prevailing situation. Measuring bank efficiency gives an indication of whether or not unnecessary costs are being made in bringing products to the market (Bikker, 2010). Falkena *et al.* (2004: 38) cited by Ncube (2009) explain, “if a few players dominate the market, they may be sheltered from competitive forces and may use rule-of-thumb rather than best practice methods”.

Information from the BoN indicates bank cost-efficiency ratios for the period 2009–2013 to have ranged above the international benchmark of 50 per cent, as depicted in Figure 2.15 below. In fact, for 2013 and 2012, the cost-efficiency ratio of the banking industry was 55.7 per cent and 56.6 per cent, respectively (BoN, 2013a). Given the fact that a lower ratio (of 50 per cent) is preferred (i.e. the lower the ratio, the better), it can be deduced that commercial banks in Namibia have been operating inefficiently. This inefficiency could be a result of the dominance of the industry by the four main banks[43] and therefore the lack of competition[44] that was alluded to earlier in Section 2.3.2.1 of this chapter.

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[42] Malaysia was ranked number one in the world for three consecutive years (2009–2011) in the area of ‘getting credit’ in the World Bank Doing Business reports for the period 2009–2011.

[43] The four major commercial banks (FNB Namibia, Standard Bank of Namibia, Bank Windhoek and NedBank Namibia) dominate the banking industry.

[44] According to the September 2013 Financial Stability Report of the BoN, the four banks accounts for almost 100 per cent of the total assets and deposits.

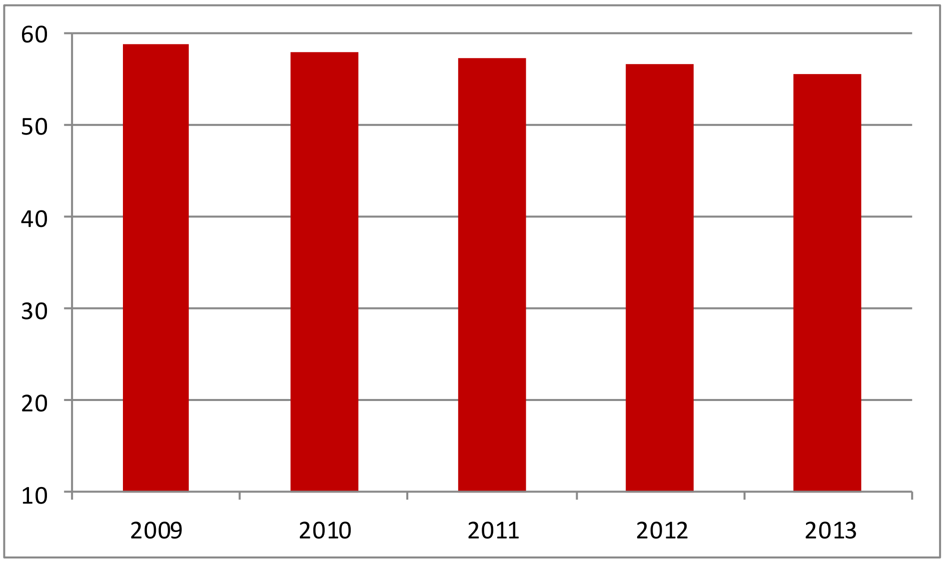

Figure 2.15: Bank cost-efficiency ratio in Namibia (per cent)

Source: BoN (2013a)

Another weakness identified in the Namibian financial system, which has rendered its intermediation role ineffective, is the insufficient financial instruments currently available to serve the market. In their Country Strategy Paper for 2014–2018, the African Development Bank (AfDB) identified a lack of appropriate and innovative finance products (such as microfinance) and instruments as among the key factors limiting access to finance in Namibia (AfDB, 2014). This finding is in line with the call by the NFSS 2011–2021 to the financial sector to devise more innovative products to meet the different needs of the country. Product offering by the current banking system in Namibia has been insufficient, as commercial banks had for a long time broadly engaged a similar business of offering commercial banking services. Products such as deposits, transmission services and loans and advances have been on offer to businesses and corporates, the private sector and standard retail customers from households (mainly those in regular employment or who have a steady income). It is however worth noting that in recent years, the regulating authority has introduced changes to the banking law to encourage the opening of diversified banking models.

A further identified weakness relates to the cost of financial services in the country, as evidenced by the findings of the FinScope Namibia surveys of 2007 and 2011 and the study on user fees and charges for financial services in Namibia and their effect on the access of the poor and the MSME to those services, which was commissioned by the Ministry of Finance in 2010 and undertaken by Feasibility (Pty) Ltd. It is also evidenced by the spread between the lending and deposit rate, which has been evidently very wide over the period 2004-2013, as shown in Figure 2.16 below.

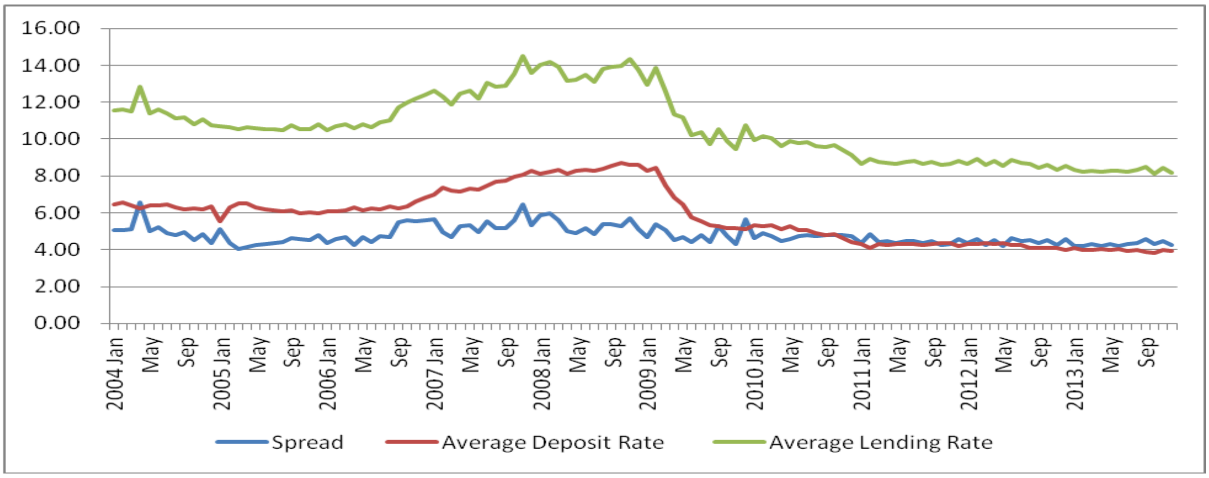

Figure 2.16: Interest rate spread of the Namibian banking industry (per cent)

Source: Statistics Division of the BoN[45]

Both the FinScope surveys and the study on user fees and charges by Feasibility cited above regard the high cost of financial services as among the key contributors to financial exclusion[46] in the country. To illustrate this fact, Feasibility (2010) used an analysis based on the nominal cost and income of an individual earning N$3 500 and another earning N$1 750 to determine the affordability of financial services in terms of share of income. They considered this to be a more useful benchmark than just the nominal price. Their findings pointed to the fact that in Namibia, the cheapest, simplest offerings for transaction bank accounts ranged between 0.5 per cent and 3 per cent of the gross monthly income of an individual earning N$3 500 and between 0.9 per cent and 6 per cent of one earning N$1 750. Based on past studies that suggested a benchmark of a 1 per cent or 2 per cent share of income as an indicator of an acceptable cost of a basic transaction account and by applying the 2 per cent rule, the study concluded that those Namibians with an income of N$3 500 were theoretically served with the current offerings if the profile of account usage reflected their transactions needs.

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[45] Data on money supply (M2) were obtained from the administrative records of the Statistics Division of BoN through an email from the responsible official of the Division, Mr Abiatar Andreas on 15 April 2014 [Available e-mail: abiatar.andreas@bon.com.na].

[46] The FinScope Namibia 2011 Survey has estimated the exclusion rate at 31 per cent, a reduction from 51.7 per cent estimated in 2007, but viewed by the NFSS as still high, and expects it to reduce further to 26 per cent by 2021 (Republic of Namibia, no date).

The study however found that there is far lower access for those earning N$1 750 or less, i.e. it is not affordable for that category of people (Feasibility, 2010). This implies that the majority of the population who are poor and low-income earners cannot afford financial services in Namibia. This situation has led to the country embarking on a banking fees and charges reduction programme, which has been implemented under the framework of the National Payments System Vision (NPSV) 2015 driven by the BoN. This process has seen the introduction of a basic bank account (BBA) by all commercial banks as well as an elimination of cash deposit fees, which have been identified as among the constraints to financial inclusion in the country, for low-income people with earnings of N$2 000 per month and small businesses with a turnover of N$1 million or less per year (BoN, 2013a).

In the case of the non-banking sector, although its performance has been generally satisfactory, the main weakness nonetheless relates to the fact that the capital market is underdeveloped. The stock market is characterised by low liquidity due to a lack of trading. There is also a lack of instruments in the market. Available instruments include shares listed and traded on the stock exchange, listed government stock and bills, debentures and bonds issued by state-owned enterprises (Republic of Namibia, no date). These have been viewed as insufficient, and the sector has been called to devise more innovative products to meet the different needs of the country, including those of SMEs. The insufficient availability of financial instruments referred to earlier has caused investors to adopt a ‘buy-and-hold’ strategy, resulting in an underdeveloped secondary market for bonds (Republic of Namibia, no date). In actual fact, the NFSS indicates that almost no trading takes place in this market. There is consequently a need for a critical mass of stock issues and trade to create an efficient and liquid stock exchange. In this regard, the NFSS is advocating for the encouragement of state-owned enterprises to issue more bonds and enticing more companies to list on the stock exchange.

2.4.3 The state of access to financial services in Namibia

From the finance-growth nexus it is clear that finance is important for growth. It follows therefore that access to financial services is important. A savings account provided to individuals will enable accumulation of funds in a secure place over time, access to credit enables them to borrow funds and strengthen their productive assets, access to mechanisms that facilitate transactions such as electronic transfers of regular remittances can reduce risks for households, while access to insurance can also minimise the negative impacts of shocks on future income (Ellis, Lemma & Rud, 2010). Further, access to credit is important for firms to finance their working capital and investment (CAF, 2011). As such, access to financial services is a key factor in economic development and social welfare (CAF, 2011). It is for these reasons that improving access to financial services has become an important policy objective, especially in the developing world (Ghalib & Hailu, 2008).

In Namibia, access to financial services has remained limited, especially for previously disadvantaged low-income people and SMEs, as mentioned earlier. The high cost of services mentioned earlier, coupled with the limited outreach of commercial banks, as illustrated under Section 2.4.4, has left certain areas (especially the rural areas) of the country unserved. Figure 2.17 depicts the latest survey results on access to banking services in Namibia.

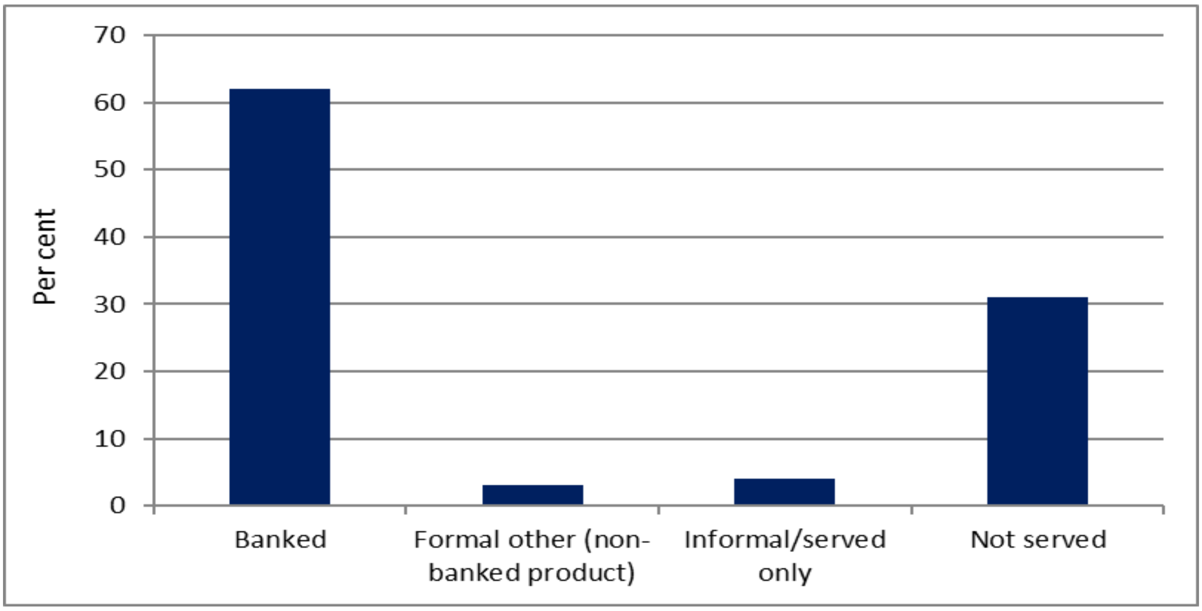

Figure 2.17: Access to financial services: Banked and unbanked population

Source: FinMark Trust (2011)

The above figure shows that while 62 per cent of the Namibian economically active population is banked, approximately 35 per cent[47] is not served by banks. This is however a reduction from 51 per cent registered in the previous FinScope Survey of 2007. While this is clearly an improvement in the banked population between 2007 and 2011, it is important to note that access to finance in Namibia does not necessarily represent credit usage, but mainly deposits (FinMark Trust, 2011). For instance, the results indicate that 64 per cent of

[47] The FinScope Namibia 2011 Survey has defined this to include those that are informally served.

the population has access to a formal savings account and the survey attributes this to significant outreach efforts by the Namibian postal service, NAMPOST, through the introduction of its smart card[48] during that period.

The survey found only 13 per cent of the population having had access to a formal loan, while informal sources (including family and friends and informal institutions) were found to be the main source of borrowing for 19 per cent of Namibians. The remaining 68 per cent did not have access to any form of borrowing whatsoever (FinMark Trust, 2011). A similar situation is revealed with regard to insurance products and services, in that 64 per cent of Namibians were found not to have used any insurance product or services before, hence non-coverage of their risk. This is not an ideal situation, as access to savings and credit as well as non-credit services is important for an effective financial inclusion process.

The survey further found the unserved to be mainly those residing in the rural areas, typically the low-income people and the poor. Figure 2.18 shows that 76 per cent of the urban population in Namibia is banked, compared to 51 per cent of the rural population. In terms of the unbanked population, 45 per cent[49] of the rural population is unbanked, compared to 33 per cent in the urban area.

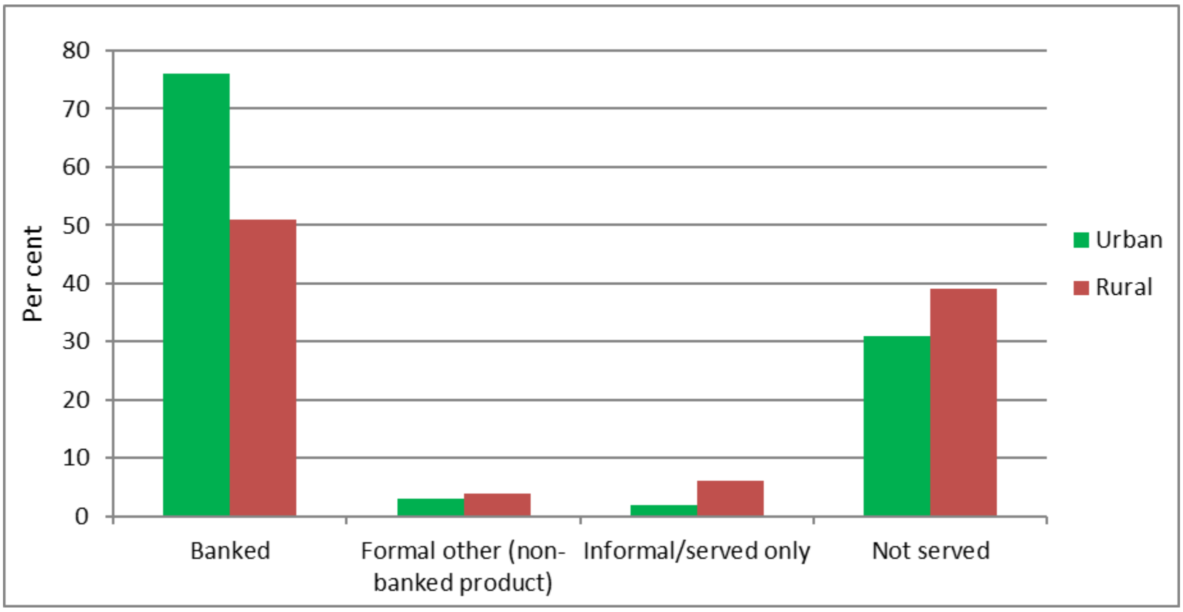

Figure 2.18: Access to financial services: Urban and rural banked and unbanked

Source: FinMark Trust (2011)

[48] This is a savings card introduced by Nampost in 2010/2011, through which even pensioners have been receiving their monthly pensions.

[49] This includes the informally served.

The above shows the disparity levels at which the Namibian banking sector serves the different income groups and different parts of the country, i.e. those in urban areas get served better (receive better coverage) than the low-income people of the rural areas.

Namibian small businesses have also remained insufficiently served, despite their identified importance to the economy.[50] A 2012 study of registered SMEs, commissioned by Business Finance Solutions and carried out by the IPPR to assess the market demand for private equity and venture capital among SMEs in Namibia, found business owners having perceived access to finance as a serious constraint to grow their companies and that the cost of finance is particularly high. It further revealed that only approximately 36 per cent of respondents had used bank loans as starting capital while approximately 76 per cent had used own savings and the remainder used borrowings from family and friends (BFS, 2012). The 2014 IMF Financial Access Survey also uncovered a similar situation, namely that in Namibia both outstanding commercial bank loans to SMEs and outstanding SME deposits with commercial banks amount to only approximately 1 per cent of GDP (IMF, 2014). This is a persistent situation considering that in 2010 the annual symposium of the BoN, which focused on SME development, reported the share of formal and informal businesses that had not been able to access finance from the financial sector during 2008/9 to have been very high at above 50 per cent (see Figure 2.19).

The symposium also revealed at the time that the informal businesses who managed to access finance sourced it mainly from friends and relatives, as is evident from Figure 2.19. In fact, the symposium concluded that a lack of access to finance was the key constraint that had hampered the development of the Namibian SME sector. Other key challenges highlighted were access to land and the cost of utilities.

[50] The importance of the SME sector to an economy is a generally accepted notion, as it has been proven empirically. In Namibia, the contribution of SMEs to the GDP is estimated at between 10 and 20 per cent. Although there is no official estimate of the contribution of SMEs to the GDP in Namibia, various reports have made references in that range.

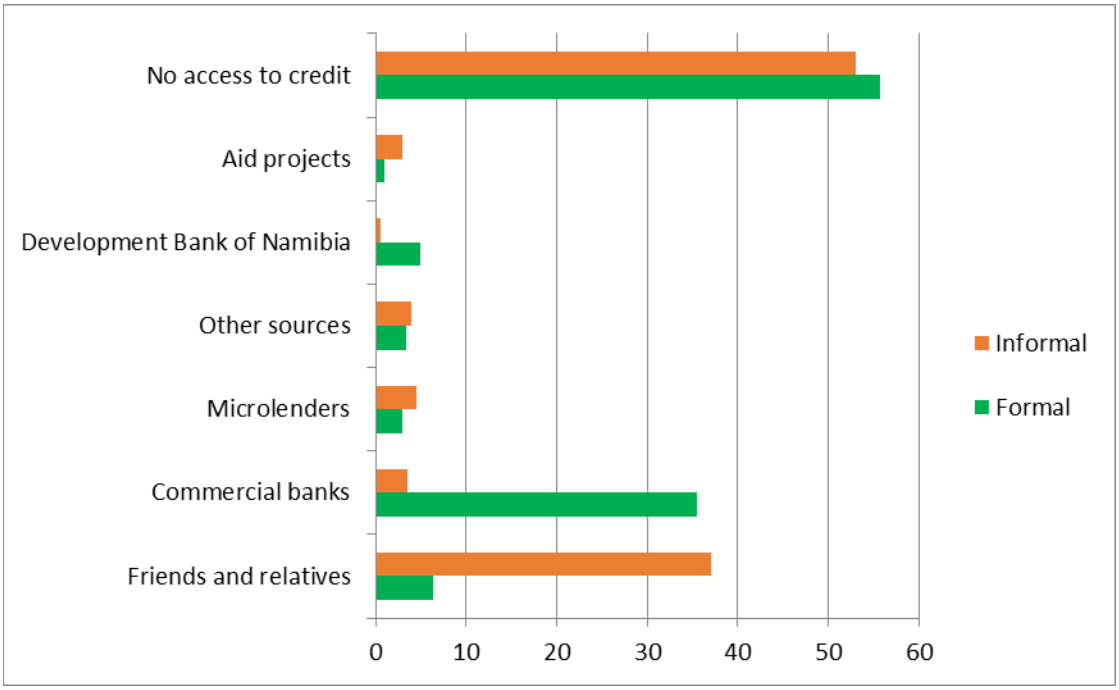

Figure 2.19: Formal and informal businesses accessing finance during 2008/9 (per cent)

Source: Adapted from BoN (2010b)

The low access to financial services by Namibians has been ascribed to a lack of collateral and limited effective demand for financial services due to low incomes as a result of high poverty (28.7 per cent) and unemployment (27.4 per cent) (AfDB, 2014; FinMark Trust, 2011). Moreover, the collateral requirements by banks for lending has limited the participation of previously disadvantaged people and SMEs in the system, given the lack of assets to pledge to the banks for loans. Furthermore, the country's land tenure system, in terms of which all communal land belongs to government, has not made it easy for inhabitants who hold leaseholds, as trading of land is not allowed and therefore land or properties built on it cannot be pledged as security.[51] These challenges have caused high expectations by the Namibian public for the recently established SME Bank to play a meaningful role in financing SMEs. This however remains to be seen once the bank has fully operated in that space. The researcher is of the view that the outcome might not fully align to expectations in the end, given that this bank, which is considered a specialised SME Bank, is licensed as a full commercial bank, just like all other existing commercial banks, and its focus is not entirely on the SME sector. Given this status, and the competition it presents, the bank might find itself operating based on the same principles as conventional

[51] The 2012 annual symposium of the BoN, which focused on the theme of unlocking the economic potential of communal land, found the tenure security or its absence in rural areas to have been a major constraint to accessing finance from banks.

commercial banks without necessarily granting special treatment to SMEs. There is also a possibility of the bank being lured into financing more large-scale businesses rather than small businesses and avoiding financing a large number of SMEs that are generally viewed as inherently risky. This situation is not ideal, as it constrains the capacity of the SME sector to make a meaningful contribution to the economy. As Klapper, Laeven and Rajan (2006) posit, countries that provide a supporting, enabling environment, including easier access to finance, are the ones that experience entry and growth of small firms. SMEs have the potential to contribute to the GDP and growth and significantly expand the well-being among Namibia's low-income communities.

Further, in the context of Namibia's insufficient economic growth (averaging below 5 per cent) and prevailing high unemployment (Republic of Namibia, 2012), SMEs become particularly important as a source of employment and a strategic avenue to increase domestic economic activity and enhance economic growth. There is therefore a need for Namibia to engage deliberate efforts geared towards the support of its SME sector with the aim of overcoming the barriers to finance for entrepreneurs.

2.4.4 Commercial banks' coverage and outreach

When looking at bank branch coverage, a similar situation is revealed, i.e. branch coverage is in favour of urban areas. By the end of 2013, the total number of bank branches and agencies in the country stood at 178, a remarkable increase from only 85 at the beginning of 2004 (BoN, 2009; 2013a). This shows the continued relevance of brick-and-mortar branch banking in Namibia and may imply that Namibia has experienced an increased presence of commercial banks in its regions. The bulk of these branches are however in cities and towns, i.e. the distribution is highly skewed in favour of urban areas, as represented by the blue circles in Figure 2.20 below. This could actually explain the FinScope Namibia 2011 Survey finding of a higher rate of access to finance in urban areas relative to rural areas discussed earlier.

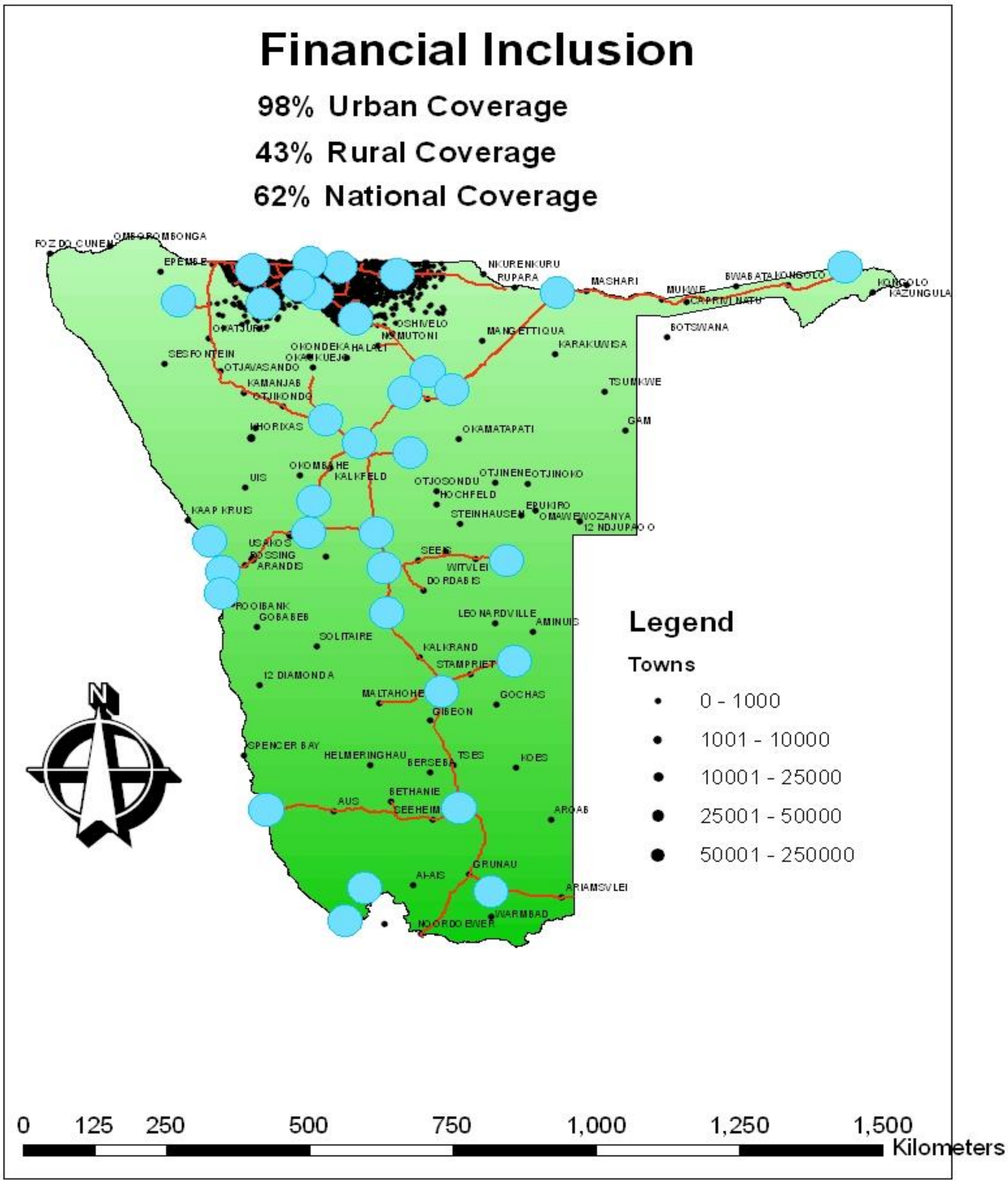

Figure 2.20: Traditional brick-and-mortar banking coverage

Source: Adapted from a BAN (2011)[52]

Table 2.4 below shows a comparison between Namibia and selected countries of the southern African sub-region (specifically other SACU[53] member countries) in terms of the

[52] This was presented at the Financial Inclusion Advisers Programme for Namibia, a workshop held on 21–22 February 2011 in Windhoek and co-hosted by the BoN and Bank Negara Malaysia, under the theme "Coordinated policy making towards financial inclusion in Namibia". Although the data are for 2011, no substantial difference with the current situation is expected, especially no significant shift between urban and rural coverage.

[53] SACU is a customs union made of five countries, namely South Africa, Namibia, Botswana, Swaziland and Lesotho.

outreach of commercial banks through bank branches and other payment infrastructure or facilities, such as automated teller machines (ATMs), during 2013.[54] It is clear from the table[55] that there are areas where Namibian banks are underperforming in their outreach to potential depositors, consumer loan clients and SME loan clients. For example, Namibia and Botswana boast the smallest ratio of bank branches per 1 000 square kilometres and the second-smallest ratio (to Botswana) in terms of ATMs per 1 000 square kilometres. However, Namibia has the highest ratio when it comes to bank branches per 100 000 adults and second-highest to South Africa in terms of ATMs per 100 000 adults. Although not depicted in the table, available data also reveal that Namibia's ratios of loan accounts per 1 000 adults lags behind those of Botswana and South Africa.

Table 2.4: Outreach of commercial bank branches relative to population

	Namibia	**Swaziland**	**Lesotho**	**South Africa**	**Botswana**
Commercial bank branches per 1 000 km^2	0.22	2.73	1.58	3.07	0.22
Commercial bank branches per 100 000 adults	12.70	6.16	3.70	10.34	9.34
ATMs per 1 000 km^2	0.92	11.16	4.71	18.40	0.69
ATMs per 100 000 adults	52.63	25.18	11.02	61.88	29.38

Source: IMF (2013a)

The situation in terms of inadequate banking coverage has largely remained the same to that prevailing ten years before this research was undertaken. A study on the viability of commercial bank branches conducted by the BoN in 2004 found that Namibia had the second-best banking density ratio (number of people to a bank) in the SADC region, though this could have been mainly because of a very small population of just over two million people. It found that its ratio of 456 704 people per bank was second only to Botswana's ratio of 322 000 people per bank. It however found that the country's people to bank branch ratio of 20 074 people per branch was the lowest banking density ratio in the sub-region (BoN, 2004b).

[54] Data for Swaziland are for 2012, as the latest figures were not available.

[55] Data used in this paragraph are from the IMF 2013 Financial Access Survey.

A number of reasons were found by that study to have played a role in commercial banks deciding to set up a bank branch in a specific area. These include whether there are prospects for profitability, whether or not there is competition, the availability of physical infrastructure and buildings, the presence of security, the presence of trained staff and the potential transaction volumes. The study concluded that many of the above-listed aspects were either absent or available only at a high cost in rural areas, causing the reluctance on the side of commercial banks to engage rural areas.

While in recent years innovative initiatives relating to offering branchless banking products and services have emerged globally, which is an ideal trend that can enhance the outreach by financial institutions, this is still in its infancy in Namibia. The BoN gazetted regulations on e-money in 2012 to both promote and facilitate these types of services and products and ensure that users of these services are protected at the same time. At the time of writing this research, there were four licensed e-money issuers in the country: one commercial bank (FNB Namibia) and three non-banking institutions (NAMMIC, MobiPay and NAMPOST Savings Bank). This development is positive, as one of the many weaknesses identified in the financial system, which has rendered its intermediation role ineffective, is the insufficient financial instruments currently available to serve the market (Republic of Namibia, no date).

As new innovative ways of delivering banking services such as e-money products, online banking facilities and cellphone banking increase in the country, the need for bank branches might reduce going forward. The country has good telecommunication infrastructure, which could facilitate such innovative products and services. In fact, some commercial banks in Namibia have already begun to invest in electronic banking channels, while there has also been an entrance of an e-bank, referred to earlier in this thesis.

The above are all good developments in the country and are steps in the right direction. However, given the risk averseness and profit maximisation aim of commercial banks, the lack of access to finance of the poor, low-income people and SMEs will take time before it changes. Further, the extent at which these initiatives will contribute to financial intermediation remains to be observed. As such, the country may need to continue devising strategies aimed at finding a solution for SME financing.

2.4.5 Conclusion on the performance of the financial sector

From the above, it is clear that the performance of the Namibian financial sector has not been optimal, both in terms of its intermediation role and therefore its contribution to economic growth and in terms of serving those at the bottom of the societal pyramid and SMEs. Overall, while the banking sector has evolved over the years, the presence of the unserved and underserved sections of the population has persisted. This will require a complete paradigm shift, given the usual profit maximisation motive of commercial banks and the profiles of those that are not currently served. There is therefore a gap in the financial system, evidenced by the limited bank branch coverage, products and services offered by commercial banks, and which has translated into limited outreach.

The same condition applies to the non-banking sector, i.e. not only is the capital market underdeveloped and financial instruments limited, but low-income earners' insurance needs have also not been met. Filling this existing gap in the financial system requires the emergence and/or entrance of other types of financial institutions with different motives and agendas and different financing approaches that are geared to serving those groups and segments of the population, such as the MFIs. This will set the sector on a path that would ensure it plays its expected role in the economy.

2.5 SOME CURRENT INITIATIVES AIMED AT BUILDING A SOLID, RESPONSIVE AND INCLUSIVE FINANCIAL SYSTEM

The importance of building a solid and responsive financial system cannot be overemphasised, not only because of the increasingly globalised world that comes with wider market interactions, but also because of the complexity of local markets as they evolve. Threats of the global marketplace have become real, as witnessed by the recent financial crisis of 2010, which affected many countries. It is therefore vital for financial sectors around the globe to prepare and ensure that they remain effective and responsive to the challenges posed by this globalised and liberalised environment (Schmukler, 2004). Although the recent financial sector crisis only exerted minimal effects on the Namibian economy (mainly because of limited exposure[56] to global financial markets), the vulnerability that comes with increasingly globalised financial systems of the world requires the country to build a solid and resilient system that is ready to withstand crises, should they occur.

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[56] The control exchange restrictions imposed on Namibia due to CMA membership limit exposure to global financial markets.

Moreover, the Namibian financial sector is less optimal given the existence of weaknesses identified earlier in this study, including its inability to serve certain segments of the population, such as low-income people, SMEs and the poor. The financial system has therefore not been fully responsive to the needs of the domestic economy. The study came across some ongoing initiatives being implemented by the country aimed at addressing the identified weaknesses and building a solid and responsive financial system. The notable ones that are relevant to this study are discussed below.

2.5.1 Developing the Namibia Financial Sector Strategy 2011–2021

A review of the financial system in 2008/09 revealed structural weaknesses in the financial system as the reason for the sector's ineffectiveness in addressing the financial needs of the economy. This led to the development of the NFSS 2011–2021. Launched in 2012 by the Minister of Finance, the ten-year strategy is a roadmap for the development of the Namibian financial sector and aims to address the weaknesses identified by the review so as to enable the financial sector to play a meaningful role in the development process of the country's economy.

The identified weaknesses include a shallow financial market; limited competition, especially in the banking industry; a limited financial safety net; an under-developed capital market; inadequate and less effective regulation; limited access to financial services; a lack of consumer protection; limited skills; and the dominance of foreign ownership of financial institutions (Republic of Namibia, no date). It is in these same areas where reform is being affected to achieve the ultimate goal of a more efficient, competitive and resilient financial system by 2021. The strategy consequently aims to address the above-mentioned inherent weaknesses in the system and assist in the country's developmental agenda in accordance with the development objectives of the country, as contained in the various development plans (i.e. the NDP4 and Vision 2030). As such, the strategy expects the following outcomes[57] presented in Table 2.5 below by the year 2021:

[57] One of the weaknesses of the strategy is that at the time of its development, there were no baseline data for most of the expected outcomes. This had to be worked on later after implementation had already started.

Table 2.5: Namibia Financial Sector Strategy 2011–2021 goals and outcomes

Goal	Outcome
Financial markets deepening and development	An active capital market with the stock exchange local market capitalisation reaching 75 per cent of the GDP
Financial safety nets	Having in place appropriate financial safety nets, which are currently non-existent in the country
Financial inclusion	○ A reduction in the rate of financial exclusion to 26 per cent from the baseline of 51.7 per cent in 2007 ○ Having in place institutions that provide sufficient support to SMEs and offer adequate products, services and knowledge ○ An increased national financial literacy rate from the recently determined baseline of 42.75 per cent (in 2013) ○ Having an implemented consumer protection legal framework in place
Localisation of the financial sector	○ Increased Namibian ownership of financial institutions ○ Significant representation of Namibians on boards and management level of financial institutions
Skills development in the financial sector	To identify and develop skills needed by the financial sector

Source: Republic of Namibia (no date)

It is expected that, if implemented effectively, the strategies devised in the NFSS should create a financial system that is effective, efficient and responsive to the needs of the Namibian economy. So far within its first four years of implementation (2011–2014), the focus has been mainly on aspects relating to regulation so as to create an enabling and safe legal environment within which financial activities can flourish; enhancing financial inclusion, given that 31 per cent of the population is still excluded from participating in mainstream financial systems; as well as enhancing financial literacy so that the country has well-informed consumers who can serve as their own advocates as they participate in the financial sector.

2.5.2 Modernising and strengthening the legislative and regulatory environment

Sparked by the realisation that regulation is an important aspect that can either facilitate or derail the progress and effective intermediation of the financial sector, the country has engaged a process of modernising the regulatory environment in the financial sector as well as strengthening its capacity in crisis-monitoring surveillance (Republic of Namibia, no date). On the legislative and regulatory front, various amendments to legislation and creation of new laws for the sector have been taking place. Of relevance to this study are the amendments effected to the BIA, Act No. 2 of 1998, as amended, aimed at providing for the regulation of microfinance deposit-taking institutions; the amendments to regulations 28 (the Long-term Insurance Regulations) and 15 (the Regulations for Pension Funds) as well as the introduction of Regulation 29 (Regulations on Investment of Pension Fund Assets in Unlisted Investments),[58] all of which are aimed at addressing the challenge of capital outflows the country has experienced so as to promote domestic investment; and the creation of a new Financial Institutions and Markets Bill (FIM Bill) that is to replace a myriad of laws applicable to the non-bank financial industry, some of which have been viewed as outdated.

The amended regulations 28 and 15 and the introduced Regulation 29 mainly aim to compel institutional investors and asset managers to invest a portion (35 per cent) of their assets domestically, of which 1.75 per cent should be in unlisted investments. This provides an opportunity for existing and potential MFIs to benefit from this statutory requirement and expand their businesses with the capital from investors who are seeking to place their mandatory local investments. This opportunity flows not only from the fact that MFIs are unlisted institutions themselves, but also because of the current small market for unlisted investments in Namibia being chased by a massive pool of funds that are being made available by the regulatory requirement. It is also the researcher's expectation that the improved and modernised regulatory environment that the FIM Bill aims to create will have a positive impact on the regulated institutions through creating an enabling environment.

As indicated earlier in this study, the regulatory environment for the banking sector is generally conducive, i.e. commercial banks in Namibia are well capitalised and bank failures have been very few.[59] Amendments are however being affected to the BIA, as mentioned earlier, to, among other things, provide for the regulation of microfinance banking institutions in the country and facilitate their development. It remains to be established what the impact of these amendments would be on the microfinance industry that the country so much needs

[58] Regulations 28 and 15 where issued under the Long-term Insurance Act, Act No. 5 of 1998, and the Pension Funds Act, Act No. 24 of 1956, while Regulation 29 was added to existing regulations under the Pension Funds Act, Act No. 24 of 1956.

[59] At the time of conducting this research, only one bank failure occurred in Namibia (the then City Savings and Investment Bank of Namibia).

to help it address the challenges of poverty and unemployment. The current study aimed to get some indication of such impact in Chapter 8. Important questions being posed in this regard relate to how the regulation of microfinance banks will affect the growth of the industry, whether or not more MFIs will emerge as a result of regulation in this sector, and whether regulation will not stifle new MFIs and lending.

2.5.3 Enhancing financial inclusion

In recognition of the importance of financial inclusion (i.e. access to finance) in ensuring inclusive economic growth and development, the Namibian government has developed a financial inclusion agenda under the framework of its ten-year NFSS. While the NFSS has six outcomes, as listed earlier under Section 2.5.1, one of the highlight in its first years of implementation has been financial inclusion, i.e. there has been special emphasis on the two envisaged outcomes of this goal, namely reducing the rate of financial exclusion to 26 per cent from the baseline of 51 per cent in 2007 and having in place institutions that provide sufficient support to SMEs and offer adequate products, services and knowledge (Republic of Namibia, no date).

The special emphasis on financial inclusion is an attempt to facilitate the availability of financial services to the previously disadvantaged groups of the population who have not been able to participate in the mainstream financial system (Republic of Namibia, no date). This was partly because of Namibia having been a very divided society under the apartheid system prior to independence, where some citizens were discriminated against on the basis of ethnicity and skin colour to the extent that certain groups, especially those at the bottom of the pyramid, have not been able to participate in the financial system.

The situation however also continued even in the post-independence era, as high bank charges and fees that have characterised the Namibian banking system alluded to earlier have made affordability of financial products and services difficult, especially for low-income-earning citizens. The collateral requirements by banks for lending purposes also meant that previously disadvantaged citizens would not participate in the system, given the lack of assets to pledge to the banks for loans. The land tenure system in Namibia, where all communal land belongs to government, has also not made it easy for inhabitants who hold leaseholds, as trading of such land is not allowed and therefore land or properties built on it cannot be pledged as security (Republic of Namibia, no date). The 2012 annual symposium of the BoN, which focused on the theme of unlocking the economic potential of communal land, found the tenure security or its absence in rural areas to have been a major constraint to accessing finances from banks (BoN, 2012b).

The prevalence of a lack of financial services has been widely recognised by both the government-led NFSS referred to above and the voluntary[60] Financial Sector Charter, discussed below. As such, the country has placed high expectations on the effective implementation of these two documents, in the hope that such will ensure that the financial sector plays its intermediation role effectively. In particular, the promotion of innovative products and services such as e-money advocated by the NFSS could help enhance the provision of financial services in the country. The introduction of a BBA by all commercial banks in 2012, which does not attract the usual banking fees and charges, has been welcomed and is expected to enhance the outreach of banks to low-income people going forward. Opening up the banking industry to more competition would also lead to a further expanded product offering, including innovative savings and borrowing instruments adapted to different needs (Republic of Namibia, no date).

From the above, it is clear that the goal of financial inclusion in Namibia, which relates to both access to financial services and products and participation and ownership by the previously disadvantaged in the financial sector, is being embraced by the country, because it is seen as an opportunity to address the past discriminatory policies and empower the previously disadvantaged. MFIs can be an important and relevant part of the financial sector in this process of the country striving to enhance financial inclusion, given their lending approach and innovative financing methods that ensure the development of products and services that are suitable to their clients. This is especially the case as commercial banks have not been able to cater for the majority of the previously disadvantaged (who are mainly the poor), due to their business approaches being profit-driven (Republic of Namibia, no date). The prevailing situation of high levels of unemployment, poverty and income inequality renders Namibia a market conducive to the proliferation of microfinance.

[60] This is a non-regulatory industry charter to which most financial institutions in Namibia are signatories. It has a performance scorecard to which the financial sector has committed itself in the quest of reforming itself and enabling it to play a more meaningful role in the economy. Implementation is voluntary, but there is an understanding between the industry and government that progress being made under the charter will be tracked under the monitoring and evaluation framework of the government-led Financial Sector Strategy.

2.5.4 Enhancing financial literacy

According to Lusardi and Mitchell (2013), well-informed consumers who can serve as their own advocates are one of the best lines of defence against the proliferation of financial products and services that are unsuitable, unnecessarily costly or abusive. This is especially so because as new financial products and services grow widespread, financial markets become increasingly accessible to the small investors and those who did not have access before. These categories of the population can therefore be vulnerable to unfair and abusive practices and can make uninformed decisions or even lose their hard-earned money if they are not financially literate.

Lusardi and Mitchell (2013) give an example of the recent global financial crisis where consumer credit and mortgage borrowing had burgeoned, mentioning that people who had credit cards or subprime mortgages were in the historically unusual position of being able to decide how much they wanted to borrow. This is believed to have contributed to the crisis. It follows therefore that efforts to enhance access to financial products and services (i.e. financial inclusion) discussed above should be accompanied by those geared to getting the users of such services financially literate so as to enable them to make informed decisions.

Users of financial products and services also need to be protected both from possible unfair and abusive practices by providers of such products and services and from losing their savings and/or investments through appropriate regulatory frameworks. Such consumer protection efforts can only be effective in an environment where consumers of such products and services are aware of their rights and obligations and are financially literate and able to exercise their rights.

It is in recognition of the above facts that the country developed a strategy (the Financial Literacy Strategy) in 2012. The aim is to ensure that financial literacy is enhanced in the country and a well-informed Namibian society is able to make informed decisions relating to financial transactions that are being made available to them through the process of financial inclusion (including those provided by MFIs) and are able to exercise their rights and obligations towards service providers. A baseline survey conducted in 2013 revealed Namibia's financial literacy level at a low of 42.75 per cent (FLI, 2013), and this information will be used to determine whether the programme, going forward, makes any progress.

2.5.5 The introduction of a voluntary Financial Sector Charter

The Namibian Financial Sector Charter is a sector transformation charter developed and adopted voluntarily by the Namibian financial sector, which came into effect on 1 March 2009 with the aim of “providing a framework for addressing BBEE [Broad-based Economic Empowerment] in the financial sector of Namibia” (NFSC, 2009: 11). The importance of this charter lies in the fact that it “constitutes a framework for empowerment and establishes the principles upon which empowerment should be implemented in the Namibian financial services industry” (NFSC, 2009: 4). As such, this is seen as a vehicle through which the sector is to contribute to developing and ensuring an inclusive financial sector in the country. In this endeavour, the industry, in acknowledgement of the socio-economic challenges faced by the country, has voluntarily committed to a set of ‘transformation agents’ and an accompanying scorecard for measuring the achievement of the charter objectives. Through this, the financial sector envisages finding itself in a position where it should have achieved all goals of its charter by the year 2019 and has therefore developed a framework for progress-reporting purposes.

As is the case with the government-led Financial Sector Strategy, access to finance is one of the transformation agents, as can be seen from Table 2.6 below. In fact, almost all of the transformation areas of the charter are also contained in the strategy, which should give an indication that the socio-economic challenges that the country has been facing are being felt and recognised at both government and private sector level.

Table 2.6: Financial Sector Charter transformation areas

Transformation area	Aim
Human resource development	Equipping current leadership incumbents with appropriate knowledge and capacity to drive the transformation of the sector
Preferential procurement and enterprise development	Developing and promoting the sustainability of BBEE businesses to foster entrepreneurship in previously disadvantaged communities and increase participation of BBEE suppliers to the sector
Access to and affordability of financial products and services	Developing and offering sustainable and affordable financial products and services aimed specifically at and appropriate for lower-income households
Ownership and control	Promoting economic transformation to enable meaningful participation of designated groups in the sector through ownership and control of financial institutions so as to achieve substantial change in the racial and gender composition of ownership and control
Empowerment financing	Increasing the sector's client base from designated groups and businesses through promoting and increasing awareness of available financing opportunities
Enterprise development	Contributing to ensuring the development of entrepreneurial skills, investment and financial market education and business management skills for designated groups
Corporate social investment	Implementing projects that will uplift the standard of living of disadvantaged and marginalised communities
Consumer protection and education	Educating and protecting consumers on issues related to the financial sector

Source: NFSC (2009)

Although implementation of some of the commitments has been slow initially, there is high expectation on the deliverables of this private sector-led charter, especially given the efficiency with which the private sector is normally associated.

2.6 CONCLUSION ON THE NAMIBIAN ECONOMY AND ITS FINANCIAL SECTOR PERFORMANCE

This chapter has provided an overview on the Namibian economy in general and the financial sector in particular. It revealed that the Namibian economy has achieved some successes since its independence in 1990, such as having created and maintained a stable macro-economic environment and having registered positive economic growth rates over the years. It also showed that socio-economic challenges have persisted in the form of high unemployment, high income inequality and high poverty rates, although some declines have been observed in recent years, especially in the unemployment and poverty rates. The chapter further revealed some of the policy-related reforms that have been introduced by the country as an attempt to address the challenges, namely the TIPEEG and NEEEF.

In terms of the financial sector, it provided an analysis of the structure and performance of the sector. It revealed that quite a number of different types of financial institutions (banking, non-banking and other specialised institutions) are operational in the country and that the sector is sound, well capitalised and profitable, and has good and efficient financial services infrastructure. However, the financial system is considered shallow with an underdeveloped capital market, while the banking industry is concentrated and lacking competition, with four longstanding banks dominating and two others having joined recently (between the period 2010–2014). It also found the existence of a Financial Sector Strategy and a voluntary industry charter in the country, aimed at reforming the financial sector. Other challenges in the system have been identified as the high costs in terms of fees and charges for financial services and a lack of diverse and targeted products that have contributed to the exclusion of low-income people from participating in the system, as services have been unaffordable for this group.

Small businesses were also found to have remained insufficiently served, as the banks consider them too risky to finance without collateral and hence a lack of access. High costs also compound the situation. Given the importance of the SME sector to any economy, the situation does not augur well with the country’s efforts to develop the sector and reduce unemployment and poverty.

The above findings clearly show a gap in the outreach of the financial system and the banking system in particular. It also makes clear the fact that there are certain categories in society, such as the poor and SMEs, that do not fit the ideals of profit-maximising institutions such as commercial banks, and that require a different model of financial services other than those currently offered by commercial banks. A financing model such as that typically followed by MFIs has been empirically proven to serve those categories better. This suggests the need for such institutions in Namibia, where the microfinance industry is currently small and undeveloped. As stated in Chapter 1, which provided the introduction and background of the study, the country has considered creating a regulatory framework for MFIs under the BIA (i.e. through amending the BIA) as an effort to spur the development of the industry by providing an enabling environment for both consumer protection and investor confidence. Part of the primary objective of this study was to determine the likelihood of this act leading to the achievement of this intended objective.

The following chapter reviewed the literature on financial regulation and supervision, with special emphasis on how the aspect of regulating microfinance is analysed in literature and what the empirical findings on that front have been. This was necessary to set the context for the regulatory impact analysis performed in subsequent chapters.

CHAPTER 3

LITERATURE REVIEW

3.1 THEORETICAL BACKGROUND AND LITERATURE REVIEW

This chapter outlines the theoretical framework and the theoretical and empirical literature that underpins financial regulation and supervision in the microfinance industry. For contextualisation purposes, it begins with a discussion of the literature on the link between the broader financial system and the economy, before it touches on the rationale and approaches for regulating the system. It then moves to discuss issues relating to the theory underpinning microfinance and regulation. In this regard, the link between microfinance and the economy is first established, before it engages issues relating to regulating MFIs. It ends with a discussion of the empirical findings relating to the aspect of microfinance and regulation.

3.1.1 The financial system and economic growth

The link between the financial system (of which MFIs are part) and economic growth has been a debatable issue. While some studies have viewed financial development as an important driver of growth (King & Levine, 1993; Schumpeter, 1911, quoted by King & Levine, 1993), others have either opined that its importance is overstated (Lucas, 1988, cited by King & Levine, 1993) or argued that finance follows growth (Robinson, 1952). In particular, the causal direction between financial sector development and economic growth has been a bone of contention, i.e. there has been ambiguity as to whether financial sector development leads growth or financial markets develop as a consequence of economic growth, and therefore the question of causality remains unresolved (Dal Colle, 2010).

However, the positive contribution of financial sector development to economic growth through banks and equity markets nowadays is a proven hypothesis and has been widely tested at the cross-country, industry and firm levels (King & Levine, 1993; La Porta *et al*., 1998 and Rajan & Zingales, 1998, cited by Maksudova, 2010). In particular, the financial system has been found to play a role in the evaluation of prospective entrepreneurs, mobilisation of savings to finance the most promising productivity-enhancing activities, diversification of risks associated with innovative activities, and revealing expected profits from engaging in innovation rather than the production of existing goods using existing methods (King & Levine, 1993). Through that process, economic aggregates such as savings and investments are affected positively, and ultimately so is economic growth. A conclusion by King and Levine (1993: 735) follows therefore that “policies that alter costliness and efficiency of financial intermediation exert a first-order influence on economic growth”. This view is relevant to this study, which sought to ensure evidence-based policies through a RIA.

3.1.2 The rationale and considerations for financial regulation

GTZ (1999) quotes Chavez and Gonzalez-Vega (1992: 2) as having defined the term ‘regulation’ as “a set of enforceable rules that restrict or direct the actions of market participants, altering, as a result, the outcomes of those actions”. Implicit in this definition are the reasons for regulation, which are mainly to restrict or direct the actions of market participants.

The regulation of financial institutions is premised on two broad grounds: the consumer protection argument and systemic risk concerns (Gallardo, 2001). The consumer protection ground refers to the need to protect depositors’ savings, but also consumers in general from exploitative lending and unfair practices by financial institutions. The systemic risk ground concerns the possibility that failure by a financial institution would be contagious to other institutions and result in the system collapsing (Gallardo, 2001). The aim is therefore to protect the financial system from the so-called contagion effect, and financial regulation therefore aims to monitor the soundness and stability of the financial system. The above have mainly been the justification for regulating financial markets, although the considerations for achieving competitive equality among institutions that are engaged in the same type of business is increasingly being added to the list as an additional ground. There is also moral hazard, which is rather a risk of regulation that often surface in the regulatory process. Moral hazard arises as a consequence of consumer protection in that consumers would know their deposits are protected and would therefore not take the necessary precautions in monitoring their deposits as they would if protection was not available.

Haq, Hoque and Pathan (2008) emphasise the need to protect depositors’ savings, preserve their confidence and strengthen the financial system as the basis for prudential regulation of financial institutions. With prudential regulation, the aim is the protection of the stability of a financial system as well as of deposits, focusing mainly on the safety and soundness of the financial system (Brownbridge, Kirkpatrick & Maimbo, 2002). The process involves reporting on some prudentially required aspects by financial institutions to a regulator (government or public agency) in an attempt to protect the financial soundness of the regulated institutions. This shows that risk mitigation has been at the core of regulating financial institutions prudentially. While prudential regulation alone cannot prevent bank failures, it can reduce the risk of failure and save depositors from the potential loss of savings.

It is worth mentioning that prudential regulation imposes costs[61] on regulated institutions, and therefore the dilemma for policy makers is how to exercise the function of safeguarding the soundness of the financial system, while still encouraging access to financial services Porteous, Collins and Abrams (2010). According to Porteous *et al*. (2010), the pursuance of the objective of encouraging access to financial services may require having in place a diversity of financial institutions with different risks and cost profiles, while at the same time it is also difficult to supervise numerous diverse entities. They posit that the principle should be to avoid burdensome prudential regulation where risk is minimal, given that risk is the basis for financial regulation (Porteous *et al*., 2010).

There are also the non-prudential and the hybrid (i.e. composing aspects of both prudential and non-prudential) forms of regulation. Non-prudential regulation would normally involve the monitoring and supervising of institutions with the aim of protecting consumers, enabling a range of institutions that provide a mix of appropriate products and services and providing information to governments to carry out economic, financial and criminal law enforcement (CGAP 2012).

Usually, regulation is thought of in terms of state regulation. This need not necessarily be, as there are also cases of delegated supervision and self-regulation or internal regulation. A delegated supervision system involves an arrangement where the state financial supervisor entrusts direct supervision to an outside body, but controls the work of that body (CGAP, 2003). While state regulation refers to a regulatory system that involves a government financial supervisor such as a ministry of finance or central bank, self-regulation refers to a system where regulation or supervision is performed by a non-government body that is effectively controlled by regulated entities themselves (CGAP, 2003). According to CGAP

[61] Although non-prudential regulation also imposes costs, it is not at the same level and scale as prudential regulation would do, given that the requirements and/or required reporting under non-prudential regulation is relatively less cumbersome than under prudential regulation.

(2003), self-regulation is often applied in cases where it is not deemed cost-effective for a government regulator to provide direct oversight of certain institutions. For instance, the disclosure of matters such as individuals controlling a company does not necessarily need to be dealt with by government or its agencies, but may often be largely self-executing and can be handled by agencies outside government (CGAP 2003). While the question often posed is whether or not self-regulation would ensure as healthy financial intermediaries as state regulation would do, it may actually have some benefits in that self-regulated entities get to begin a reporting process and conform to basic standards of good practice (CGAP, 2003). They can change later to state regulation if the situation so dictates. According to CGAP (2003), self-regulation of financial intermediaries in developing countries has not been effective in protecting the soundness of the regulated organisations.

Regulators apply the form (between the above forms of regulatory approach) appropriate to specific institutions, based on risk considerations. In general, preference has been for a situation where government only intervenes to correct market failure (Litan, 2011). This is the essence of the traditional public interest theory found in literature. In fact, literature points to three broad political economy theories of regulation, the other two being the public choice theory (or economic theory of regulation) and regulatory capture (Litan, 2011). These theories, which explain experiences in the regulatory area, have a bearing on financial regulation.

The public interest theory regards market failure as the reason for regulation, where regulation corrects the inefficiency created by the failure (Peltzman, 1989, cited by Guerin, 2003). It argues that because regulation is needed to fix some market failure in the economy, it is imposed in the public interest. Externalities such as pollution, asymmetries in information between buyers and sellers, monopoly power, etc. would make good examples of where imposing restrictions would be in the public interest (Litan, 2011).

The public interest theory is based on the following three assumptions: that the market is not capable itself to fix the market failure when it occurs, that government is capable of fixing such failure to ensure optimal efficiency and that the benefits of fixing the market failure and/or imposing the regulation to address market failure will outweigh the additional costs created by such intervention (Guerin, 2003). According to Guerin (2003), if these assumptions are relaxed, it will lead to regulatory failure. He further explains that this theory was not universally convincing in the 1960s, which led to the emergence of other two broad theories discussed below.

The public choice theory, on the other hand, postulates a case where the regulated firms want the regulation imposed, mainly because they are to benefit from such an intervention (Litan, 2011). The benefits could include the regulation serving as barriers to others who might want to enter the same lines of business, thereby preventing additional competition. This also explains why firms would normally oppose the introduction and/or removal of certain regulations which they perceive would impact their businesses unfavourably (Litan, 2011). Due to the usual heterogeneous nature of entities even within the same industry (either in terms of different line of business, sizes and interests), regulators often land themselves in a situation where they have to mediate these varying interests as well as those of the consumers (Litan, 2011).

The theory of regulatory capture presents a situation where regulated parties strongly influence and determine the behaviour of regulators towards them (Litan, 2011). Regulators are viewed to be susceptible to capture for various reasons, including control of information by industry, the effects of repeated interactions with regulated entities and career opportunities (Posner, 1974, cited by Guerin, 2003). Under this theory, situations can arise where regulation benefits one group on behalf of another.

According to Biggar and Heimler (2005: 2), financial institutions globally, especially the banking institutions, have been subject to a “non-exhaustive list of regulatory requirements”. The list of requirements includes: 1) restrictions on branching and new entry, where entry into the banking business or market by foreign banks or subsidiaries is restricted so as to insulate them from foreign competition;[62] 2) restrictions on pricing, where interest rates are controlled and/or other controls are imposed on prices and fees; 3) line-of-business restrictions and regulations on ownership linkages among financial institutions, where the types of business to be engaged by banks are restricted; 4) restrictions on the portfolio of assets that banks can hold, such as requirements to hold certain types of securities or requirements and/or not to hold other securities, including requirements not to hold the control of non-financial companies; 5) provision of compulsory deposit insurance through payment of a premium in the form of an expectation that government will bail out depositors in the event of insolvency; 6) capital-adequacy requirements, where banks are required to take care of their risk to ensure that they will be able to absorb a reasonable amount of loss

[62] An example is the Glass-Steagall Act of the USA during the 20th century that prohibited interstate banking and prevented banks from trading in securities and insurance, with the intent of preventing banking collapses, but also prohibited state-wide branch banking in many cases as small-town bankers .... to limit their competitors by creating geographic monopolies (Biggar & Heimler, 2005).

and comply with statutory capital requirements; 7) reserve requirements, which are requirements to hold a certain quantity of the liabilities of the central bank; 8) requirements to direct credit to favoured sectors or enterprises in the form of either formal rules or informal government pressure (sometimes referred to as policy-based lending); 9) adherence to special rules concerning mergers, which are not always subject to a competition standard, or failing banks; and 10) adherence to other rules affecting cooperation within the banking sector, e.g. with respect to payment systems. In the context of the current study, a relevant question to ask given the uniqueness of MFIs[63] is whether or not they should be subject to these same requirements and to the same extent as conventional commercial banks; and if they should, how they would be impacted by those requirements.

Moreover, the recent global financial crisis brought about sensitivity towards the dealings of financial institutions, resulting in more stringent regulatory approaches (Visco, 2013). This is because the crisis revealed the existence of weaknesses in the global regulatory system. As such, financial regulators around the globe have become more careful in terms of what financial activities they are to allow and this has brought with it changing regulatory regimes and has enlarged the list of requirements (Visco, 2013). For example, the review of the Basel core principles that culminated into Basel III has brought with it implementation costs, and discussions about counter-cyclical capital requirements have also been ongoing. This could make it difficult to allow MFIs to engage in innovative ways and come up with different products and approaches to serving their clients. What is positive for microfinance from these processes, though, is the emphasis on risk-based banking supervision rather than compliance alone, as this could reduce the regulatory burden on MFIs, given their activities are considered to be less risky to the financial system, as indicated earlier.

In Namibia, regulation places certain requirements and limitation pertaining to the dealings of financial institutions. For example, due to these regulatory requirements, commercial banks in Namibia have had limited exposure to high-risk or exotic assets as well as limited off-balance-sheet operations. They also have had limited reliance on foreign funding and limited integration with international capital markets. In fact, it has been a regulatory requirement under Section 8.1 of the Determinations on minimum local assets issued under the Banking Institutions Act, 1998 (Act No. 2 of 1998), that deposits sourced locally can only be used for

[63] MFIs are considered as unique financial institutions relative to conventional banking institutions because of the fact that they operate in a high-risk environment due to the nature of the clients with whom they deal, typically the poor and/or low-income people who mostly have little or no collateral at all. This state of affairs forces them to devise unconventional ways, methods and products for serving their clients. MFIs might therefore require special treatment when it comes to regulation.

acquiring assets locally and this has limited the scope for banks to venture outside the borders of Namibia. These regulatory restrictions seem to have paid off, as the Namibian banking system has been relatively resilient to the impact of the global financial crisis (BoN, 2010).

3.1.3 The microfinance phenomenon: Definition, perspective and approach

As indicated in Chapter 2, CGAP (2006) defines microfinance as financial services for the poor. Typically, these people who are clients of MFIs belong to the lower-income segments of the population, and are perceived to be risky clients by the conventional banking institutions. In addition to the perceived riskiness of these clients, conventional banking institutions have generally shied away from serving these clients due to the high operational and administrative costs associated with smaller amounts, which these clients require. They have therefore concentrated on serving the higher-income-earning people. This has created a market for MFIs because poor and low-income people also need financial services. The reality is that not everybody might qualify for credit, but all human beings, including the poor, are deposit-worthy (WSBI, 2009). This has been proven by the tremendous growth that the global microfinance industry has experienced over the years. Through its operations, microfinance has managed to empower low-income people by providing them with the opportunity to build assets and improve their quality of life. These low-income people have proven to be credible clients of the MFIs (WSBI, 2009).

The World Savings Banks Institute (WSBI, 2009) explains that the ability of microfinance to contribute directly to people's economic and social progress by allowing them to invest and multiply their scarce assets makes it unique among other economic development initiatives. The institutions involved in this type of business are therefore also rendered unique by the type of clients they serve and the approach they employ to serve them.

3.1.4 Microfinance and economic growth

Since its birth in the 1970s, the main aim of microfinance has been that of lifting people out of poverty and thereby facilitating economic growth. The importance of microfinance can be best captured when fitting it into the general finance-growth nexus, where microfinance can be presented as an important segment capturing informal intermediation and directly contributing to financial sector development (Maksudova, 2010). Maksudova perceives the impact of microfinance to economic growth to be through direct and indirect channels. He explains the direct channel to be through poverty reduction, welfare increase and production value added from entrepreneurship activities of the poor, and the indirect channel as the contribution of microfinance to an increase in liquid liabilities through financial deepening and the development of retail banking systems. Figure 3.1 below presents Maksudova's (2010) graphical illustration as a base of the above channels of microfinance transmission.

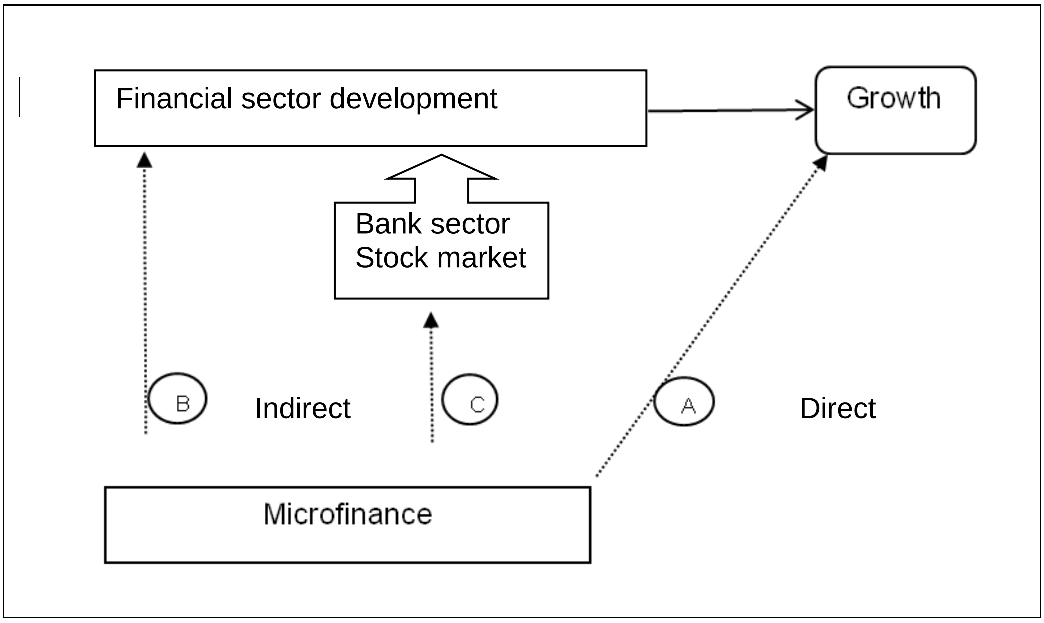

Figure 3.1: The microfinance channels to economic growth

Source: Adapted from Maksudova (2010)

A, B and C in the above figure are the arrows that link microfinance with its external environment and ultimately affect economic growth. A is the direct channel that shows how microfinance impacts growth through poverty reduction, welfare increase and production value added from entrepreneurship activities of the poor, while B and C depict the indirect channels through which microfinance impacts growth, when microfinance activities contribute to an increase in liquid liabilities through financial deepening and the development of retail banking systems. It follows that MFIs are an integral part of the financial system, have a role to play in the economic growth of a country through the above-explained channels, and are hence participants in the finance-growth nexus.

Despite the above-illustrated important role played by microfinance in the economy, the optimality of the MFIs' operations has been questioned. The important aspect that has been pondered upon is how MFIs can be supported to better perform their role in assisting poor, low-income people and SMEs (CGAP, 2012). Increasingly, the need to ensure the sustainability of MFIs is being acknowledged (see Gallardo, 2001; Okumu, 2007). It is believed that MFIs' financial sustainability would ensure microfinance systems that can grow and provide microfinance services on a permanent basis to the poor. Regulation has been identified as among the factors that can facilitate the road to MFIs' sustainability, in addition to protecting consumers (CGAP, 2010).

3.1.5 Financial regulation and MFIs: Is there a case for regulating MFIs?

Internationally, there has been an increasing interest in the regulation and supervision of MFIs (CGAP, 2012). Literature also acknowledges at the same time that MFIs are unique financial institutions that are distinct from conventional financial institutions. The key difference between MFIs and conventional financial institutions has been identified as being the difference in their clientele, their risk-handling and management approach as well as information advantages across different population groups (CGAP, 2003, CGAP, 2010). MFIs deal with low-income and poor people who do not have collateral, and therefore they employ innovative ways of serving them, including ways of substituting physical collateral as risk-mitigating measures. While MFIs are unique institutions, being an integral part of the financial system, as explained, render them susceptible to risks faced by the overall financial sector. Risk is the basis for financial regulation, as discussed under Section 3.1.2 above.

The distinct nature of MFIs has sparked a debate on whether or not they should be regulated, and if they should, how they should be regulated. There have been arguments for and against the regulation of MFIs. Dominating the arguments for regulating MFIs is the consumer protection ground of regulation (CGAP, 2010). Proponents have argued that there is a need to protect clients of MFIs against unfair or deceptive practices, which might include those related to being charged exploitative interest rates, unfair collections and advertising (CGAP, 2010). Occurrences such as the Indian microfinance crisis of 2010, which led to the country instituting legislation to regulate its microfinance sector, particularly reinforced this view. The microfinance crisis experienced by India in that year resulted from the 'arm-twisting' repayment tactics employed by the industry to ensure loan repayments, which led to borrowers committing suicides at an increasing rate (Stiglitz, 2014). In its 2010 report on financial access, CGAP was of the view that regulating MFIs would improve transparency, as they would be required to disclose full, plain, adequate and comparable information, including those on prices and the terms and conditions of their financial products and services (CGAP, 2010).

An argument often considered more binding relates to the fact that regulation is frequently a prerequisite for taking up savings, and MFIs are increasingly engaging in the savings business (CGAP, 2003; CGAP2012). Accepting savings is a deposit-mobilisation process and therefore has legal implications in terms of the protection of depositors' money, which is usually a responsibility of a country's monetary authority (CGAP, 2012). Therefore, when MFIs engage in deposit taking, proponents argue, it calls for their regulation.

A further argument for regulation relates to the fact that the increasing demand for MFIs' products and services resulting from the many prospective borrowers (given that poor and low-income people are in the majority in developing countries) may render MFIs unable to meet their growing funding needs with only their own resources, and that MFIs may need to access external finance. It is argued that regulation would enable them to get access to refinancing facilities by wholesale financial institutions, as regulated MFIs are considered properly constituted and sound. For instance, regulation determines the possibility for MFIs to access capital markets and mobilise savings (Goujon, 2009). Van Greuning, Gallardo and Randhawa (1998) examined the issue of MFIs and regulation and came to the conclusion that the continuum of institutions providing microfinance cannot develop fully without a regulatory environment conducive to their growth; without such an environment, fragmentation and segmentation would continue to inhibit their institutional transformation. It follows that regulation that enhances efficiency and stability will keep the line of funds open to the MFIs and facilitate their growth, development and sustainability, which in turn will enhance access to finance (Van Greuning *et al*., 1998).

Critics of the regulation of MFIs have, on the other hand, advanced views relating to the possibility of unintended consequences that regulation may have on MFIs and those they serve. These include the possibility of regulation creating barriers to the efforts of increasing access to financial services and reaching the unbanked segment of the population. This is especially true for the case where prudential regulation installs barriers to entry through minimum capital requirements and/or cause increased cost of capital, resulting in increased transactional costs for the MFIs (Goujon, 2009).

A further concern is that regulation may actually curtail the ability of MFIs to allocate financial resources efficiently and therefore has the potential to dampen their development. Although not solely caused by legislation, an example can be made of the collapse of MFI Finansol[64] in Colombia, which was a regulated entity under the banking law of Columbia, as among the aspects that provided a basis of questioning whether banking regulation is in fact appropriate for MFIs (GTZ, 1999).

There however seems to be a general understanding currently of the nature of MFIs and the important role the sector is to play in an economy, i.e. that of filling the gap that exists due to market failure.[65] CGAP (2012) is of the view that the ability of the market to respond to the increasing demand for financial services by the poor depends not only on MFIs developing sustainable low-cost ways to provide such services, but also on having an appropriate and enabling policy and regulatory environment. It explains that such environment is critically important in bringing to poor and low-income people the financial services they need. According to CGAP (2012), the question being posed now rather relates to the kind of regulation and supervision that will help achieve the intended objectives of increasing access to finance.

3.1.6 What would be the appropriate approach to regulating MFIs?

Before the regulatory approach can be decided upon, there are aspects that any country considering to regulate MFIs should carefully examine. These include deciding on who (or which MFIs) should be regulated, how to regulate them and who should regulate them. These are important questions that a country should strive to answer to ensure that an appropriate regulation is created. The nature of each of those considerations is discussed below.

[64] The collapse of Finansol came as a result of a crisis it experienced that caused a severe deterioration of its portfolio quality, and hence suffered serious loan losses. This resulted from the dual and non-transparent business structure pursued by its holding company (Corposol), which lead to undesirable business practices not being picked up early enough by the supervisor (CGAP, 2000).

[65] Market failure is defined as “the inability of a market or system of markets to provide goods and services either at all or in an economically optimal manner” (Dollery & Wallis, 2001: 9).

3.1.6.1 Important considerations: Whom and how to regulate?

From the above discussions, it is clear that microfinance involves a particular set of services, providers and customers. As such, there is a need to carefully examine the issues that are fundamental to this sector and its regulation that might render them different to conventional financial institutions and therefore requiring a different regulatory approach. The immediate issue that comes to mind, taking the objective of microfinance into consideration, is the need to ensure that any framed regulatory piece for MFIs should balance the objective of regulation, which hinges on financial stability, financial integrity and depositor protection with the effective financial access objective (CGAP, 2012). It follows that policy makers ought to weigh the potential benefits of regulating against the potential barriers to access that might result from the cost of compliance and enforcement (CGAP, 2012). For example, most MFIs may not be able to meet the onerous reserve and CAR requirements of financial legislation (Coetzee, 1998) and therefore might require special treatment.

Another important aspect to take into consideration when formulating regulations for MFIs relates to the fact that MFIs operate in a high-risk environment due to the nature of clients with whom they deal. These are poor or low-income people who mostly have little or no collateral at all, while the business MFIs are involved in is also costly (i.e. they involve high transaction costs, etc.). The above facts might therefore require a consideration for relaxation of some legal requirements that normally apply to conventional financial institutions. At the same time, literature also argues that MFIs may not be too risky for a country's financial system stability, given that their total assets are usually too small to pose a risk (CGAP, 2003). This means that the risk profile of MFIs is different. It is also important to take into account the different types of MFIs (e.g. credit-only, savings-mobilising, etc.) when deciding on whether to regulate them or not, which MFIs to regulate and how to regulate them (CGAP, 2003).

The decision on which MFIs to regulate would normally be country-specific, given different environments and different types that might be available in different countries (CGAP, 2003). It is however still important for every country to look at the characteristics of its MFI institutions, e.g. whether they are deposit-taking or only credit extension-related, as well as the size and scale of their operations. Roy (2013) quotes work by Meagher (2002) that comparatively reviewed the experience of microfinance regulation in developing countries[66]

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[66] This study looked at the microfinance regulatory systems of ten jurisdictions, namely Bangladesh, Bolivia, Ethiopia, Ghana, Indonesia, Peru, the Philippines, South Africa, Uganda and the West African Economic and Monetary Union.

that have begun to address the legal and regulatory framework for microfinance, and indicates that most of the countries reviewed had found ways to exclude the smallest institutions for which regulation makes little sense, through either formal or informal exemptions. According to Roy (2013), small informal institutions and traditional rotating and credit associations in almost all countries are exempt from regulation. Related to this, work carried out by Mushendami *et al*. (2004) on a regulatory and supervisory perspective to promote microfinance institutions in Namibia suggested the need to consider the scale of operations and size of a microlender (or MFI) and/or certain categories of such institutions in deciding whether to regulate or not so as to minimise regulatory and supervisory burden for the bank.

The above highlighted factors are important aspects to consider when determining which institutions to regulate. Any regulation constituted without considering them may run the risk of defeating the objective of increasing financial access to the poor through negatively impacting on the ability of MFIs to serve the poor. For example, some regulatory requirements (especially prudential requirements) may be too restrictive and/or may place a burden on MFIs as they attempt to comply with the requirements, which may even prove difficult to meet, and as a result they may fail in the role of providing access to finance to the poor. The challenge therefore becomes how to create a model regulation that will best suit MFIs and the interests of the poor, which is the subject matter of the next two sections.

3.1.6.2 Important consideration: What should be the regulatory approach for MFIs?

The decision about which regulatory approach to follow requires consideration for both the approach and the type of regulation. In their work that tried to craft a framework for regulating MFIs, Van Greuning *et al.* (1998), as cited by Coetzee (1998) suggested two approaches to regulation of MFI operations: internal regulation through governance and external regulation by a supervisory agency. It is also possible to have a blended regulatory approach consisting of the two regulatory approaches (internal and external regulation).

Coetzee (1998) is of the view that a point of departure would be to differentiate regulatory and supervision activities on the basis of the institutional characteristics of financial institutions. Accordingly, Coetzee (1998) suggests that self-regulation would be suitable for member-based MFIs where most members are involved in the running of the business, while complete adherence to legislation and supervision by a regulator and/or supervisor of financial institutions would be needed for an MFI where members are not directly involved in running the business. The suggestion is based on the fact that it becomes riskier when members are not involved in the day-to-day activities of the MFIs, as their ‘agent’ may engage in activities that might threaten the sustainability of the business. An example that fits this situation is that provided by Porteous *et al*. (2010) about an unregulated SACCO in Uganda called Front Page Microfinance, which had been run by an ‘agent’ (i.e. manager) and had grown rapidly from 238 members in 2005 to 20 000 members in 2007, making deposits through 14 branches, with some but not all receiving loans. This rapid growth was obtained through aggressive marketing campaigns, including sponsoring social events and sports teams, with advertised low-interest and no collateral credit programmes. The view back then, according to Porteous *et al.* (2010), was that Front Page Microfinance had helped the Ugandan government to mobilise people to embrace saving and access credit. This view, however, changed as Front Page Microfinance’s aggressive growth model showed strain by 2007. Members seeking to withdraw savings were denied withdrawal requests, or were receiving merely 20 to 25 per cent of their savings balances, until it failed as time progressed. While it was not specifically stated in the work of Porteous *et al*. (2010), it is unlikely that members had recovered their money from this failed MFI, given its unregulated status.

Van Greuning *et al.* (1998), as cited by Chiumya (2006), undertook an analysis of MFIs’ liabilities that helped them distinguish features of different types of MFIs. They proposed self-regulation for MFIs that depend on donor grants and small-scale compulsory savings as loan collateral. They proposed external regulation or regulation by a registering agency or bank supervisor or securities and exchange agency for those that use commercial paper and large certificates of deposit. Cooperatives authority or bank supervision authority is recommended for those who depend on members’ money and bank supervision for those who depend on savings deposits. They justified the analysis based on the liabilities of MFIs as appropriate, given that factors that distinguish between MFIs are mainly on the liabilities side and not on the assets side. This could also be a good basis for policy makers to consider when deciding on which institutions to regulate.

Literature also points to the fact that when the need for external supervision as well as institutions to supervise have been identified, a tiered approach could be followed based on the unique features of the institutions and the risk involved (Van Greuning *et al.* (1998). This could be in the form of specifying a microfinance window for regulation and supervision, so as to facilitate varying supervision towards MFIs relative to conventional financial institutions. It will also help solve the problem of the high capital requirement, which MFIs are not able to meet. As it is argued that total assets of MFIs are usually too small to pose a threat to financial stability, a tiered approach will also ensure that regulation and supervision cost is proportionate to the risks involved. This is important because for MFIs, cost reduction is crucial for expanding their outreach (CGAP, 2012).

Another important consideration should be given to whether regulation will be by existing or new legislation (i.e. special window) (CGAP, 2012). While the special window might be appealing given the uniqueness of MFIs, it is not preferred for consistency and efficiency, as financial regulation may work best when the focus is on activities/functions and not on the type of institutions (CGAP, 2012).

3.1.6.3 Which type of regulation to follow: Prudential or non-prudential?

As discussed above, the financial sector makes a distinction between prudential regulation and non-prudential regulation. Prudential regulation deals with depositor protection and the systemic risks that can be posed by failing financial institutions, while non-prudential regulation basically deals with issues related to market conduct to ensure discipline, transparency and therefore consumer protection (Vogel & Schulz, 2011). A report by the Asian Development Bank (ADB) that looked at the role of central banks in microfinance in selected countries[67] of Asia and the Pacific in 2000 states that MFIs are mostly subject to non-prudential regulation (Roy, 2013). It indicates that most countries have in place processes for registering NGOs, cooperatives and other institutions engaged in microfinance that do not usually involve central banks, although cases existed where central banks were involved in the registration or licensing of certain categories of MFIs.

As indicated earlier, it is a considered view that most MFIs are not big enough to threaten the health of a financial system, although regulation is still needed so that poor customers do not lose their savings, especially in the case of DMFIs. It could also be that regulatory requirements (especially prudential requirements) may prove difficult for MFIs to meet and MFIs might just fail in their role of providing access to finance to the poor in an attempt to comply with regulation, as indicated earlier in this chapter. In supporting their finding of a negative association between supervision and profitability of MFIs, Cull *et al.* (2009) refer to a notion that profit-oriented MFIs absorb the cost of supervision by curtailing outreach to market segments that tend to be more costly per dollar lent and that although MFIs that rely

[67] Countries studied were 12 developing member countries of the ADB. These are Bangladesh, the People's Republic of China, India, Indonesia, the Kyrgyz Republic, Nepal, Pakistan, Papua New Guinea, the Philippines, Sri Lanka, Vanuatu and Vietnam.

on non-commercial sources of funding and are therefore less profit-oriented do not adjust loan sizes when supervised, their profitability is significantly reduced. This might therefore affect the extent to which MFIs are able to reach out and serve the poor. Taking these facts into consideration, preference is normally for a non-prudential regulatory approach for MFIs with simpler reporting requirements than for normal commercial banks (CGAP, 2012).

3.1.6.4 Important considerations: Regulatory challenges and limitations

Various challenges and limitations to regulating MFIs have been identified in literature. Pouchous (2012) points to the complex nature of microfinance regulation and supervision, and is also of the view that it is very contextual. In some countries there may be numerous MFIs and quite often they are too small in size (Pouchous (2012). Regulating and supervising them can therefore be a challenge, as the capacity of regulatory and/or supervisory authorities might not be enough to handle the numerous institutions (Pouchous (2012).

Coetzee (1998) quotes Rock and Otero (1997) in saying that the transaction costs of supervising a large number of small institutions are high and can dampen efficient supervision. There is therefore reason for weighing the costs and benefits of supervising MFIs and a need to identify and set levels for those to be regulated (CGAP, 2012). The cost estimation should also include the potential unintended consequences of regulation, especially those relating to innovation and competition (Pouchous, 2012). Pouchous (2012) cautions that prudential rules and consumer protection should not be blindly extended to MFIs, but some specific adjustments have to be effected to capture the specificities of microfinance activities. Pouchous (2012) elaborates that this would be necessary for both prudential and non-prudential regulation. With regard to supervision, Pouchous (2012) is of the view that oversight mechanisms are critical to properly frame microfinance activity, and that there are costs involved in doing that. These costs need to be realistically estimated and their impact monitored. Ultimately, taking the above highlighted challenges into consideration (on the side of both MFIs and the regulator and/or supervisor), regulation and supervision have to be proportionate to the risk involved (CGAP, 2012).

3.2 EMPIRICAL LITERATURE REVIEW

Many studies have been written on the aspect of microfinance and MFIs regulation, and country-specific experiences have been reported. Some studies have pointed towards the positive impact regulation has had on the growth and performance of MFIs, while others have revealed either certain drawbacks or mixed outcomes of MFIs regulation.

Exploring the impact of regulation on 245 of the world's largest MFIs in 67 developing countries using OLS regression, Cull *et al*. (2009) found a negative association between supervision and the profitability of MFIs. They further controlled for the non-random assignment of supervision via treatment effects and instrumental variables regressions, and found that supervision was associated with substantially larger average loan sizes and less lending to women, although not significantly associated with profitability. They viewed this pattern to be consistent with the notion that profit-oriented MFIs absorb the cost of supervision by curtailing outreach to market segments that tend to be more costly per dollar lent, and that by contrast, MFIs that rely on non-commercial sources of funding and therefore are less profit-oriented do not adjust loan sizes, or lend less to women when supervised, but their profitability is significantly reduced.

Hartarska and Nadolnyak (2007) performed another assessment of the impact of regulation using data for 114 MFIs from 62 countries (in an empirical model where performance is specified as a function of MFI-specific, regulatory, macro-economic and institutional variables). It was found that regulatory involvement did not directly affect performance in terms of either operational self-sustainability or outreach. They also found less leveraged MFIs to be associated with better sustainability, implying that the transformation of MFIs into regulated financial institutions may actually not lead to improved financial results and outreach. They however also found that MFIs that collect savings reached more borrowers, which suggested the potential of indirect benefits from regulation, especially in an environment where regulation is the only way for MFIs to access savings.

In Africa, Kassa (2010) assessed the achievements and challenges of the regulatory and supervisory framework of the microfinance business in Ethiopia and suggested that regulation and supervision of MFIs in that country brought many benefits. The benefits identified by Kassa include the creation of an enabling environment for the establishment of specialised formal financial institutions to serve those previously considered as unbankable as well as MFIs being able to offer a wide range of products such as savings, money transfer and other related services to lower-income sections of the population in addition to credit. Kassa further refers to regulation having promoted standardisation and transparency in the sector.

Okumu (2007) analysed the Ugandan case and found that in the short run, financial regulation negatively influenced the outreach of MFIs, but positively affected their sustainability, while in the long-term, financial regulation positively influenced both the sustainability and outreach of MFIs. One of the key policy issues recommended by Okumu and which is relevant to this study pertains to the importance of adequately assessing the benefits and costs of legislation before its enactment and to ensure that the benefits outweigh the costs in both the short and the long run.

In the case of South Africa, Muganga (2010) assessed whether regulation enabled or created barriers to increasing access to financial services and reaching the unbanked population in that country. He found that regulation, alongside other macro-economic reforms, had played a key role for the state of development of that country's microfinance market. Muganga (2010) is of the view that regulation constituted a facilitator to enhance the growth of the industry by setting standards, increasing efficiency and promoting fair competition, while strongly protecting consumers.

The results of the study by Chiumya (2006) were not conclusive with regard to the impact of the existing regulatory framework on the microfinance sector in Zambia. It observed that the lack of regulatory and supervisory attention may have resulted in the growth of the microfinance sector, which might not have happened if the sector had been regulated from the start. On the other hand, it also found that growth of the industry may have been due to the change in government policy and/or the increased interest by the donor community and developmental agencies in funding microfinance, rather than any absence of regulatory and supervisory attention. The study is further of the view that the development of a vibrant microfinance sector is dependent on a number of contextual factors, including high population densities, the presence of quality physical infrastructure, a stable macro-economic environment, monetisation and opportunities for income-generating activity, factors which cannot be addressed through the introduction of a regulatory and supervisory framework alone.

For Namibia, Mulunga (2010) found a lack of regulation to be one of the main challenges that hampered the development of the microfinance industry, and noted that there was effort being made directed at finding a solution. No RIA has however been done on Namibia before, and therefore the state of affairs is unknown.

The above are interesting findings, which should have policy makers in those respective countries thinking, especially those in countries where undesirable outcomes were highlighted. It is clear from this literature review that the evidence of the impact of regulation on MFIs is inconclusive, and there is therefore a need to focus on individual country studies, given the heterogeneity of environments in different countries. The above is therefore evidence of the existence of a gap in the literature, which the current study aimed to fill.

It is also important to mention the fact that the issue of regulation is relatively young in the microfinance industry, as evidenced by literature. The observed increasing pressure for regulating MFIs has originated from the belief that there is a need for transformation of MFIs into regulated financial intermediaries and that regulation would allow them to evolve into such institutions, especially the ones that aim to take deposits (Cull, Demirgüç-Kunt & Morduch, 2009; Hartarska & Nadolnyak, 2007). This is seen as a way of increasing MFIs' loanable funds (Campion & White, 1999, cited by Hartarska & Nadolnyak, 2007) so as to serve their markets better. It implies that regulating MFIs would lead to increased outreach and therefore increased access to finance, i.e. commercialisation of MFIs will enhance access, as it guarantees sustainability. Cull, Demirgüç-Kunt and Morduch (2009), however, also caution of the potential trade-offs of regulation in that complying with regulation and supervision can be costly, and that any factor that causes costs to rise, including the costs associated with complying with prudential regulation, is likely to result in MFIs increasing their pricing (interest rates) or loan sizes so as to maintain the same level of profitability. When that happens, they argue, MFIs may curtail their outreach, which may lead to the exclusion of some potential borrowers. These views and the above varying findings confirm the complexity involved in deciding how MFIs should be regulated to ensure that they still play the expected role of providing access to finance for the poor and SMEs, and this is where RIAs on microfinance become important. Without a RIA on Namibia so far, the findings of the current study should provide good insight.

The next chapter outlines the research methods and methodology used in this study that aimed to assess the regulatory impact on MFIs and the microfinance sector in Namibia.

CHAPTER 4

THE RESEARCH METHODS AND METHODOLOGY FOR THE STUDY

4.1 INTRODUCTION

This chapter discusses the research methods and methodology followed in this study. Before outlining the research methods and methodology, it is important to point out that the primary objective of the study was the assessment of the impact of regulation on MFIs, as indicated in the introduction and background sections of Chapter 1. In other words, the impact assessment undertaken by the study was regulatory in nature, i.e. a RIA, specifically as it relates to microfinance (i.e. as it relates to financial inclusion). This was done in acknowledgement of the fact that the regulator is a decisive actor in financial inclusion (Goujon, 2009).

There may be slight differences in approach to the general impact assessment of social programmes. The notion of a 'fit-for-purpose methodology' has been applied for this thesis, which suggests that "there is rarely an ideal type of impact evaluation that can be appropriately rolled out in all contexts", as stated by Garbarino and Holland (2009: 18). For example, the starting point for a RIA is the core objectives for regulating in the first place (Goujon, 2009). This aspect makes up the core of the RIA framework, as will be evident from the below discussions on the methodological approach of this research. Coglianese (2012) posits that the appropriateness of any measure is dependent on the purpose of the evaluation, which in turn would derive from the purpose of regulation itself, and that what is centrally relevant to any evaluation of a regulation is what the regulation aims to obtain.

It is also worth reiterating that the issue of regulation is relatively young in the microfinance industry, as indicated in the preceding chapter. As such, there had only been a few RIAs conducted outside of developed countries at the time of this research (Staschen *et al*., 2012). Therefore, a thorough methodology for assessing regulatory impact on microfinance (Staschen, 2010) has not been established. A general RIA existed until Staschen developed the Rationale-Objectives-Indicator (ROI), which he successfully applied to Uganda in 2010 and which earned him a PhD.[68]

[68] Staschen (2010) identified the lack of a "thorough methodology to assess and explain the impact of regulatory reforms in microfinance" and used the opportunity presented by new developments at the time in terms of the growth in specific legal

4.2 RESEARCH METHODOLOGY

The research methodology and approach of this study derived from the objectives of the study listed in Chapter 1, namely obtaining an understanding of the nature and state of microfinance in Namibia, obtaining an understanding of the regulatory and supervisory environment for MFIs and assessing the existing and potential impact of such regulatory and supervisory environment on the microfinance sector (i.e. performing an RIA on the microfinance sector). To achieve these objectives, the study undertook a survey and held interviews with relevant stakeholders in addition to desk research and documentary review. The information obtained was used to firstly gain an understanding of the microfinance landscape of Namibia (presented in Chapter 5) and its regulatory framework (presented in Chapter 6) as a prerequisite for performing the RIAs, and secondly to feed the impact assessment processes themselves, presented in chapters 7 and 8.

The impact assessment involved a two-level analysis, namely at micro and macro level. The micro level analysis entailed a case study of the only regulated microfinance bank in Namibia, which has been regulated by the BoN together with commercial banks under conventional banking law since it first obtained its licence in 2010, given the absence of a microfinance regulatory framework. The assessment here is therefore an ex-post RIA. The use of the case study approach has been often criticised by literature for a lack of rigour and not being generalisable. This criticism is especially strong in the case of a single case study such as this one. However, despite this limitation, the decision to use a case study for this thesis was not only based on the situation of Namibia at the time of conducting the study, of having only one regulated microfinance bank, but also on considerations of the advantages and benefits that can derive from case study research as well as the strengths of case studies alluded to by literature. Hodkinson and Hodkinson (2001) posits that case studies are grounded in lived reality and can facilitate the construction of detailed and in-depth understanding of what is to be studied, given their restricted focus; hence the detailed account of how the MFI was affected as a result of being a regulated institution will contribute to greater understanding of the Namibian microfinance sector and its regulatory and supervisory environment, i.e. to the research objectives addressed later in chapters 5 and 6.

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frameworks for microfinance and new research in the area of RIA. He developed the ROI and successfully applied the methodology to the case of introducing a special microfinance law in Uganda.

With regard to the limitation of case study results not being generalisable, this thesis supports the argument by Yin (2003) and Blumberg, Cooper and Schindler (2011) that the generalisation of case study results is made to theory and not to populations. Yin (2003) further explains that case studies follow a replication logic rather than a sampling logic and that case study results can therefore be expected to replicate under similar conditions (i.e. a literal replication) and not generalised to the population from which a sample has been drawn. Yin posits that the goal with case study research is to expand and generalise theories (i.e. analytical generalisation) as opposed to enumerating frequencies (i.e. statistical generalisation). Case study research can therefore yield valuable results if a rigorous methodological path is followed, including posing careful and thoughtful research questions and following a systematic procedure, an approach that the researcher followed.

Based on the above highlighted strengths and advantages of case study research, the researcher is of the view that the case study approach is particularly suited to this thesis, as it will facilitate a holistic and in-depth investigation of what the impact of regulation can be on MFIs in Namibia, using the experience of the regulated microfinance bank. In other words, it describes the real-life context in which the regulatory intervention occurred (i.e. the MFI being licensed and regulated under the conventional BIA), and provides evidence of what can potentially happen when MFIs are regulated under a normal banking institutions regulatory framework. The researcher further argues that this case study represents a critical case and provides an opportunity to test theory in the case of Namibia, given the desire by Namibia to develop its microfinance sector with regulation facilitating that process, as alluded to under the background chapter of this thesis, and the fact that it can be possible to replicate the results obtained from this case study to the overall microfinance sector by detecting patterns that can form a general picture.

At the macro level, the potential regulatory impact of the draft amended BIA (which has made provision for regulating MFIs) on the microfinance sector as a whole was evaluated, and this constituted the ex-ante RIA part of the study. The specific research methods, the data-collection techniques and the data-analysis process employed in addressing the study objectives are outlined in subsequent sections.

The rest of the chapter is organised in the manner that it first outlines the analytical framework for both the micro (ex-post) and macro (ex-ante) assessment, before explaining the data-collection techniques for both cases. The rationale is that whatever data were collected and/or data-collection technique was followed needed to fit the objectives of the research and the analytical framework.

4.2.1 The analytical framework

The impact assessment was done within the RIA framework. Kirkpatrick (2001) describes RIA as a tool that provides a method for assessing the benefits and costs of existing or potential regulatory measures. He elaborates that "regulatory impact assessment includes both regulatory appraisal and regulatory evaluation, where regulatory appraisal is used to describe the ex-ante assessment of proposed new or revised regulations, and regulatory evaluation refers to the ex-post assessment of existing regulations" (Kirkpatrick, 2001: 8). This was considered an appropriate analytical framework for this thesis, which undertook both ex-ante (i.e. regulatory appraisal) and ex-post (regulatory evaluation) impact assessments. RIA is however an "umbrella term often used to describe differing methodologies aimed at evaluating regulatory impact" (Staschen *et al*., 2012: 1) and as such a selection of a suitable RIA analytical method had to be made for this research. The ROI approach developed by Staschen in 2010 referred to earlier was selected and applied to this study. The method appealed to the researcher as the best method for the study, mainly because it is specifically tailored to microfinance (Stachen, 2010; Staschen *et al*., 2012) and it has been tested on another country already (Uganda), i.e. it was developed specifically for conducting impact assessments for financial inclusion regulation, which includes microfinance regulation, and which is the subject matter of this study. This was complemented by a cost-benefit analysis. The two approaches are discussed in sections 4.2.1.1 and 4.2.1.3.

4.2.1.1 Explaining the process of the ROI approach

Developed on the basis of the public interest theory, which stipulates that financial regulation should only be imposed if there is an obvious economic rationale for it, "a ROI assessment provides a pragmatic framework through which to conduct an examination of the consequences of a policy or regulatory choice(s) and assess the positive and negative impacts of existing or potential regulatory measures" (Staschen *et al*., 2012:1). The ROI also advocates the need for regulatory impact to be measured against a benchmark with a clear causal link to the rationale for regulation (Staschen, 2010). Staschen *et al*. (2012) have broken up the ROI approach for a particular regulatory intervention into six steps, as illustrated below. This study has adopted this approach in its analysis.

As a first step, the study identified the main rationale for the regulatory intervention, which according to Staschen (2010) is generally market failure. In the case of this thesis, this was possible to determine from the policy documents and the draft amendment act (BIA). This was followed by a process of defining the public interest objectives linked to market failure as a second step.

Staschen (2010) has identified five public interest objectives for microfinance regulation, each of which is targeted at alleviating market failures, counteracting their negative consequences, or protecting market participants against their negative consequences. These are (1) the promotion of the safety and soundness of MFIs, (2) guarding against systemic risk, (3) establishing a competitive market, (4) protecting consumers and (5) improving access.

The researcher reviewed the related policy documents for Namibia and the specific bill (draft amended BIA) to compare and spot any additional objectives that might not have been part of the above listed ones, but the process yielded nothing different from the literature. The bill specifies two regulatory objectives, namely enhancing access to finance and protection of depositors, while some of its provisions also contain elements of the other three objectives of promoting the safety and soundness of the MFIs, guarding against systemic risk and enhancing competition. The potential performance of the draft amended BIA was therefore then assessed in terms of the possibility of it attaining the identified public interest objectives.

The third step was to identify the quantitative and qualitative indicators for use in measuring the regulatory impact. The study therefore measured the potential regulatory impact on the above listed objectives (i.e. the likelihood of achieving the objectives), using a set of impact indicators, which are presented later in this chapter as tables 4.2 and 4.3. The main assessment criterion was whether regulation would lead to progress in the indicators and therefore achieve the regulatory objectives or not.

The fourth step concerned the actual collection of data on those indicators, while the actual measurement of the impact using the indicators then followed as the fifth step. The last step was to draw recommendations from the findings of the assessment, which can then be used for policy making, as presented in Chapter 9 of the thesis. Table 4.1 below graphically presents the above-discussed steps for ease of reference.

Table 4.1: Six steps of the ROI approach

1	Rationale	What is the rationale for the regulation?	4	Collect data (quantitative and qualitative) on the chosen indicators
2	Objectives	What are the objectives of the particular regulation?	5	Assess the impact of the regulation
3	Indicators	Which indicators can be used to assess the regulatory impact?	6	Apply the findings to policy-making decisions
Define assessment benchmark			**Determine impact**	

Source: Adapted from (Staschen *et al.*, 2012: 1)

The above table illustrates that to assess the impact of regulation, two basic issues must be addressed, namely defining a 'benchmark' against which to measure regulatory success, and isolating the impact of regulatory change from other changes in the market occurring at the same time, i.e. the 'attribution' of regulatory impact, especially in the case of the ex-post assessment. This is an aspect discussed under Section 4.2.1.2 of this chapter. The benchmark for measuring impact has already been defined by the ROI as being what the regulation intends to achieve. Therefore, the benchmark for this assessment part of the study was taken to be the degree to which the identified regulatory objectives are likely to be achieved.

4.2.1.2 Selection and evaluation of impact indicators

This process differentiated between the ex-ante and ex-post impact assessments as follows:

(a) Indicators for the ex-post impact assessment (i.e. assessment of the impact of the existing BIA on a regulated MFI)

As stated earlier, the ex-post assessment involved the use of a case study (a single case study) to determine what the impact of the existing regulatory framework (i.e. the existing BIA under which DMFIs are regulated) has been on the microfinance sector. The focus was therefore on the performance of the MFI and the study used the performance indicators adapted from the model developed by Staschen (2010), especially those on which data were available, as listed in Table 4.2 below.

Table 4.2: Performance indicators and sub-indicators used for quantitative analysis

Indicator	Sub-indicator	Definition
Profitability	ROA (%)	Profit (loss) from operations after tax/average assets
	ROE (%)	Profit (loss) from operations after tax/average equity
Leverage ratios	Debt to equity ratio (%)	Total liabilities/total equity
Capital ratios	Capital/asset ratio (%)	Total equity/total assets
Portfolio quality	Portfolio at risk (PAR) >30 days/gross portfolio (%)	Value of outstanding loan balance with payments past due > 30 days (end of period)/ value of outstanding loans (end of period)
Access	Number of borrowers	Number of active loan clients (end of period)
	Total savings	Total short-term deposits (end of period)
	Number of savers	Total number of clients with savings (end of period)
Efficiency	Operating expense ratio (%)	Operating expense/average gross loan portfolio
Liquidity	Liquid ratio (%)	(Cash and near cash + deposits in banks + short-term investments)/total assets

Source: Adapted from Staschen (2010)

The process involved examining the annual evolution of each of the quantitative indicators as well as analysing the indicators of the qualitative factors. The focus was on changes in the impact indicators instead of their absolute levels. The outcomes were then related to the regulatory objectives to measure their potential achievement.

The impact indicators were further benchmarked to the scale of the Morgan Stanley developed approach for assessing credit risk in the microfinance industry (the Morgan Stanley Credit Analysis and Rating Methodology of Microfinance Institutions) to see how the MFI compared to others elsewhere. The outcome was also compared to commercial banks with whom the MFI has been regulated under the same banking law to further verify the aspect of regulatory impact. This addressed the first category of the primary research objective of determining the impact of the regulatory framework on the microfinance sector, i.e. the ex-post RIA.

While the use of the above indicators gave an indication of the changes in the performance of the case study MFI over time, an additional important duty of the research was to determine the attribution of impact to regulation, especially as this case study assessment was an ex-post assessment. This aspect is a key difference between the ex-post assessment and the ex-ante assessment, which did not require any attribution of impact.

The aspect of attributing regulatory impact seeks an answer to the question of how to ensure that what is observed is attributable to the specific regulation. The emphasis is on the need to isolate the impact of a specific regulatory intervention from other changes in the market occurring at the same time (such as changes in the macro-economic environment, policies in other areas such as tax or even political stability), i.e. controlling for other exogenous changes happening at the same time (Staschen *et al*., 2012). Achieving this, together with the measured performance of the MFI (through the performance indicators), helped address the first part of the primary research objective of determining the impact of the regulatory framework on microfinance. As Coglianese (2012) puts it, to say that a regulation works (or has not worked) is to attribute it causally to positive (or negative) changes in indicators.

To isolate the regulatory impact and attribute changes to the intervention, the ROI assessment may either use a control group not subject to the same regulatory treatment, or identify a structural break caused by the treatment using trend data (Staschen *et al*., 2012). The ideal approach of conducting an impact assessment is actually the use of a control group in a 'double difference' method, i.e. the difference-in-difference method (Staschen, 2010). In the case of this thesis, this method would have compared the treated MFI (i.e. the regulated MFI) with a non-treated entity/entities), before and after the treatment (i.e. before and after it became a regulated entity). However, due to the small market size and hence the unavailability of data for a counterfactual (i.e. the treated MFI having been the only true MFI with its magnitude and thereby a lack of an identifiable control case) that rendered the use of statistical techniques such as regression or correlation analysis impossible, the researcher had to adopt an analytical approach that relied on something other than evidence for the counterfactual to make a causal inference, i.e. the 'modus operandi' method of demonstrating causality.

The essence of this method is the ability to demonstrate, through a process of elimination of other possible causes, that the treatment caused the outcome (Mohr, 1999). This process is possible given the fact that it relies on the idea that each possible cause has a 'signature' and if the signatures of other possible factors can be proven to have been absent while that of the treatment was present, then the cause can be established (Mohr, 1999). The approach therefore aspires to establish instances of causality through what is referred to as ‘physical causation’, i.e. through demonstrating persuasively that a particular kind of physical connection took place as opposed to ‘factual causation’ that relies on a counterfactual claim[69] (Mohr, 1999). The thesis has combined this approach with the structural breaks method (in the case of variables where data are available) to form an alternative to the difference-in-difference method of impact attribution.

Staschen (2010) refers to structural breaks as a less-demanding method in terms of data availability, as time series data are only needed for the treatment group (or in the case of this thesis, the treatment case, i.e. the regulated MFI) and that it can be an alternative to the difference-indifference analysis when the availability of data is much better for the treatment group (or for the treatment case in the case of this thesis). According to Staschen *et al*. (2012), the structural breaks method can be applied provided one is confident that the most important change during the observation period has been the change in regulatory treatment. They explain that the method requires time series data for quantitative indicators and qualitative information for at least a few years prior to the treatment year, and that a sudden change in trend (i.e. a structural break) in the defined indictors around the time when the treatment occurs can then be attributed to the treatment. Accordingly, they posit that the only thing that is of interest is those changes that go beyond normal good business practice (e.g. the interest is not in the new software system, which would have been bought anyway, but only in those new modules that were needed as a result of reporting requirements under the new law). The structural breaks approach is therefore consistent with the physical attribution concept and therefore it was possible for the two methods to complement each other in this process of attributing impact, especially as the concept of structural breaks can also be used for qualitative observations. The outcome of this process is presented in Chapter 7.

(b) Indicators for the ex-ante impact assessment (i.e. the assessment of the potential impact of the envisaged amended BIA on the microfinance sector)

As noted above, the ex-ante assessment (aimed at determining the potential impact of the envisaged regulatory framework on the microfinance sector in Namibia) involves the appraisal of the likelihood of achieving the regulatory objectives as listed earlier under

[69] The notion of factual causation refers to a relation between statements, truths or facts, as opposed to physical causation, which refers to a relation between events in the natural world (Strawson, 1985, cited by Mohr, 1999).

Section 4.2.1.1. In this assessment scenario, while the objectives are to indicate the direction in which a regulation should aim, they cannot say anything about the amount that would be appropriate to achieve (Staschen, 2010). As such, judgement of whether a proposed regulation would be successful becomes difficult. According to Staschen (2010), this requires that more quantified objectives be specified in terms of a series of indicators (quantitative and qualitative), as the achievement of some objectives cannot be measured directly with a single variable. Staschen (2010) has therefore identified the main broad areas of impact indicators for each of the MFI regulatory objectives alluded to earlier, which this thesis has adapted, as presented in Table 4.3 below, as a basis for measuring the likelihood of achieving the regulatory objectives. The table also presents the rationale for selecting the specific indicator(s) in its last column.

Table 4.3: Impact indicators for each of the MFI regulatory objectives

Regulatory objective	Type of indicator	Indicator(s)	Rationale and remark
1. Promote the safety and soundness of MFIs	Performance indicators of MFIs (quantitative)	- Profitability - Portfolio quality - Capital - Liquidity ratios, etc.	Better performance is first and foremost good for the MFIs. However, for cases of relatively recent regulatory changes (such as Namibia), it might be that the impact is not yet showing strongly in the data. Hence, institutional changes brought about by regulation are valuable indicators for the future performance of MFIs.
	Institutional changes	- Ownership - Governance changes - Credit information sharing systems, etc.	
2. Guard against systemic risk	Quantitative	- The number of systemic events	Occurrence of systemic crises can have serious consequences for the sector. The number of systemic events can provide an indication of the incidence of crises spreading from one financial institution to another, even if these did not lead to sector-wide crises. Other indirect indicators can also be used to assess the probability of future systemic events, as listed below.
	Other indirect indicators	- All indicators for Objective 1 above - Deposit insurance system - Lender of last resort facility	The best defence against contagion is sound financial institutions (and macro-economic stability, which lies outside the reach of financial regulation) (Carmichael (2004:107, cited by Staschen, 2010). Therefore, all indicators for Objective 1 were used as proxy indicators for this objective, as well as indicators such as the deposit insurance system, which should reduce depositors' incentives to run on an MFI and lender of last resort facility, which reduces contagion risk through the credit channel.

Regulatory objective	Type of indicator	Indicator(s)	Rationale and remark
3. Establish a competitive market	Indicators for market saturation and structure-related measures	- Number and volume of loans/savings accounts - Number of branches - Concentration ratio or Herfindahl-Hirshman Index	In addition to quantitative indicators that measure market saturation and structure of the market, institutional changes brought about by regulation can be used as indirect measures of competition to indicate aspects such as increased barriers to entry, etc. In the case of this thesis, where the regulatory framework is yet to come into effect, and hence the assessment being ex-ante, the focus was more on institutional changes.
	Institutional changes	- Licensing conditions and procedures - Openness to foreign participation	
4. Protect consumers	Quantitative	- Number and type of consumer grievances, and redress mechanisms employed	Measured in three core consumer protection principles: (transparency, fair treatment and effective recourse). Statutory provisions specifically dealing with consumer protection are good indicators, as well as financial literacy programmes that measured the capability of consumers to process information offered to them.
	Qualitative	- Customer satisfaction surveys - Changes in consumer protection regime - Consumer empowerment and financial literacy	
5. Improve access	Breadth of access	- Number of clients reached - Volume of various financial products - Number of various financial products sold.	Access has various dimensions: depth, breadth, scope and length of access (Schreiner, 2002, cited by Staschen, 2010). The number of clients reached is further to be broken down by repeat clients and new clients. In the case of this thesis, where the impact assessment was ex-ante, the focus was on the expected direction of impact. The same is true for other indicators of improving access discussed below (i.e. depth of access, length of access and scope of access).
	Depth of access	- Loan size - Geographical reach of financial services	For microfinance, the depth of access measures whether or not MFIs are reaching poorer clients.
	Length of access	- All indicators for Objective 1	The bottom line is that an MFI is safe and sound; therefore, indicators for Objective 1 are also indicators for length of access. These give an indication of the self-sustainability of MFIs for long-term survival.

	Type of indicator	Indicator(s)	Rationale and remark
	Scope of access	- Range of products offered and their characteristics	Scope of access is defined as the number of types of financial contracts supplied (Schreiner, 2002:596, cited by Staschen, 2010). For example, if the regulatory change allows MFIs for the first time to introduce savings services, this should lead to a substantial increase in the scope of access. Characteristics include: individual versus group loans, flexibility of repayment schedules, tenor, loan amounts, costs, collateral requirements for loans, minimum balance requirements, interest paid, restrictions on withdrawals for savings and transaction accounts, etc.
	Quality of access	- Customer perceptions of and satisfaction with the supply of products	Customer surveys, such as FinScope surveys, social performance or impact studies, were the source of information for this.

Source: Adapted from Staschen (2010)

This ex-ante assessment on the yet-to-be-implemented regulatory framework (provided for under the envisaged amended BIA) is a process-tracing approach without quantitative data, hence the focus was on determining the likely impact of the provisions of the envisaged amended act on the quantitative and qualitative indicators listed in Table 4.3 above after it becomes effective (i.e. on what the direction of impact is likely to be). In other words, the focus was on determining whether or not the regulatory requirements are likely to lead to progress in the respective indicators and hence the potential achievement or non-achievement of the regulatory objectives. Essentially, the outcome was then compared to the possibility of the same situation occurring without the new regulatory framework for DMFIs, as a counterfactual. To firm up the results from the above process and enhance the validity of the obtained evidence from the ROI process, the analytical process was complemented by a cost-benefit analysis, the rationale of which is discussed in the next section.

4.2.1.3 Explaining the process of the cost-benefit analysis

The cost-benefit analysis is a widely used tool in financial regulation analysis that not only identifies the costs and benefits incurred during the process of regulation, but also how they are distributed between different stakeholders (Carrasco, 2006). As introduced under Section 4.2.1, a cost-benefit analysis complemented the ROI (i.e. the main analytical method for this study) in the RIA process. This was necessitated by the fact that while the ROI approach would allow for the measurement of benefits of regulation (defined here as the progress in the achievement of any of the regulatory objectives), it would not provide information on the costs caused by regulation.

The process of regulation incurs costs for market participants, i.e. the regulator, regulated institutions and the wider economy, and costs change the behaviour of market participants and therefore the achievement of regulatory objectives (Staschen, 2010). Therefore, to provide a complete picture of the RIA, the study also attempted to perform a cost analysis and identify potential main costs to be incurred by those stakeholders.

Literature has identified the likely costs of regulation to include institutional costs (relating to the expenditure of the regulator), compliance costs (incurred by regulated institutions in complying with regulatory requirements) and structural or indirect costs that arise as a result of market failures (Staschen, 2010). The researcher therefore attempted to identify the various provisions of the proposed new microfinance regulatory framework that are likely to result in those type of costs and performed an analysis of their expected direction of impact. The aim of doing this was therefore not to derive a figure for the net social benefit of the regulation, but to list major costs created by individual regulatory provisions. This is because the same limitation of not having quantifiable information, mentioned earlier in the case of measuring the achievement of regulatory objectives, given it was an ex-ante appraisal, is also applicable here.

In an ex-post assessment scenario, quantifiable information on the expenditure of the regulator would have been sourced from the regulator (the BoN), while those on the costs of regulatory compliance would have been obtained from regulated MFIs. In the current scenario, only qualitative information could be collected through interviews with both the regulator and MFIs that are potential entrants to the industry once the new regulatory framework comes into effect. The identified cost indicators were then compared with the benefits derived from the ROI approach, i.e. a cost-benefit analysis was carried out. It is acknowledged that there were some limitations in the process of identifying the costs, but the researcher is confident that some conclusions can be drawn from the analysis.

4.3 DATA-COLLECTION METHODS

Appropriate data collection was a significant element of this study. In this regard, a comprehensive questionnaire was prepared (see Appendix A) and administered to some selected MFIs as well as interviews undertaken with relevant stakeholders to collect the necessary data and information. This process took place during the period April 2014 to October 2015. The researcher did not follow a random sampling approach, which would ideally have been better suited for this study, but employed purposive sampling in that the selection of participating MFIs was done on consideration of the size of the local industry and the research questions and objectives.

During selection the intended goals and objectives of the regulator for introducing the regulatory provisions to regulate MFIs were also taken into consideration, as these provided a lead in terms of which MFIs are potential candidates for regulation under the amended BIA going forward. As such, the selection process also engaged the regulators and took their views into consideration in terms of which type of institutions they are targeting for regulation. This was a necessary process to undertake, as confirmed by Garbarino and Holland (2009: 20):

> Your results (as good and rigorous as they may be) will not feed back into policy if government and other stakeholders do not have ownership of the process and the results … hence the process of building ownership ... amongst policy makers and bureaucrats early and sustainably into the research process is key to ownership and traction of the impact evaluation.

Participants in the survey were therefore purposively selected (refer to the next paragraph on who they were and why they were selected). The selection of interviewees also followed the same approach, i.e. interviewees were selected based on purposive sampling, covering executives from regulatory authorities, executives of MFIs, experts on the subject and practices of microfinance as well as other relevant stakeholders to the subject matter, such as relevant industry associations and policy makers (refer to interviewee list in Appendix D). An interview guide was prepared (as presented in Appendix C) to guide the process.

While, inherently, purposive sampling can produce biased findings resulting from the selection process because of the fact that participants may be chosen out of convenience as the researcher exercises judgement in the selection process, the method can also produce reliable and robust data (Tongco, 2007). Its strength lies in its intentional bias (Bernard, 2002; Lewis & Sheppard, 2006; Poggie, 1972 and Tremblay, 1957, as cited by Tongco, 2007). As Tongco (2007) notes, what comes out of the research process depends on the research question and objectives of the research, while it is also important to ensure that care is exercised in the interpretation of the results such that they are not applied beyond the sampled population. In the case of this study, which aimed to determine the potential of developing a specific industry (i.e. the deposit-taking microfinance industry) through regulation, the researcher believes that the purposive sampling process described above has produced reliable findings.

In line with the above explanation, the scope of the MFIs selected and surveyed for the study was reduced. As noted earlier in Chapter 2, there are different categorisations of MFIs in Namibia. They range from unregulated savings-mobilising MFIs such as NGOs to a regulated deposit-taking microfinance bank and regulated microlending institutions (i.e. cash and term lenders) and SACCOs. For this thesis, the scope of MFIs survey was limited to the categories considered relevant to the aim of the study. Therefore, it only took into consideration MFIs that are likely to be impacted (positively or negatively) by the specific regulation that is the subject matter of this thesis, i.e. the draft amendment BIA that has provided for the regulation of DMFIs. Based on the regulatory objective of facilitating the growth and development of the microfinance industry in the country to finance SMEs as well as the insight from the regulators on who the targeted institutions are, the focus of the survey was on the credit-only microlenders that operate on a term basis in terms of loan repayment (eight institutions supervised by NAMFISA).

The survey also focused on the only existing microfinance bank regulated by the BoN to provide a picture of the performance of a regulated DMFI, which is the subject matter of Chapter 7. As indicated earlier, use was made of both quantitative data and qualitative information, i.e. aspects that were found not quantifiable are discussed qualitatively. The data sources and collection techniques for the different objectives are discussed in sections 4.3.1 to 4.3.3 below.

4.3.1 Data collection for understanding the state of the microfinance sector and its regulatory framework

In addition to a desk research and documentary review, data to address these two objectives was obtained through a survey to MFIs and interviews with relevant stakeholders. In this regard, a standardised questionnaire was used while semi-structured interviews (with senior executives of regulated institutions, regulators, experts in the field of microfinance, policy makers as well as other interest groups) and documentary reviews were also undertaken.

The interviews were further recorded on voice recorder (except in the case where respondents objected), transcribed and analysed. This process yielded data and information including those on the characteristics of MFIs, their legal arrangements, products and services offered, performance of MFIs, and perceptions on the current and envisaged legal environment. The aim was to gauge information from a cross section of stakeholders and use that to address the research objectives.

4.3.2 Data collection for the ex-post regulatory impact assessment (existing regulatory framework on a regulated MFI as a case study)

To make a good case study requires a collection of information from a range of sources (Blumberg, Cooper & Schindler, 2011). Blumberg *et al*. (2011) suggest three methods of data collection for a case study, namely interview, documentary review and observation. The data required for the case study MFI were those on the performance indicators of this MFI, as identified earlier under the analytical framework (under Section 4.2.1.2), as well as relevant qualitative information to clarify and back up the data.

The quantitative data were obtained from the Microfinance Information Exchange (MIX) Market database (MX, no date), which hosts performance data of MFIs, as this MFI used to submit its data to MIX Market. The researcher also obtained reports and annual financial statements of FIDES, which provided additional information. Being a staff member of the regulatory body, the researcher was also able to obtain insight information from discussions with staff in the supervisory department of the regulator involved in the on-site and off-site supervision. Qualitative information was obtained through both a survey sent out to the regulated MFI and interviews with its staff and other stakeholders involved with the MFI, such as board members and regulating authority staff.

4.3.3 Collection of information for the ex-ante regulatory impact assessment (amended BIA on microfinance sector)

Information used for this assessment was obtained through the same survey and interview processes discussed under Section 4.3.1 that fed the process of understanding the state of the microfinance sector of Namibia and its regulatory framework. Important to mention is that the focus here was on MFIs that are potential candidates for regulation under the proposed new microfinance regulatory framework (i.e. the draft amendment BIA). In this regard, semi-structured interviews with senior executives of the MFIs that are potential candidates for regulation under the proposed new framework as well as experts in the field of microfinance, regulators and policy makers) were conducted.[70] As mentioned in Section 4.3.1 above, interviews were recorded on a voice recorder, except in the case where respondents objected, transcribed and analysed. Being a staff member of the regulatory body that will administer the envisaged regulatory framework, the researcher was also able to perform documentary/report reviews (such as policy documents, the draft amended bill itself and its draft implementing determinations as well as relevant internal correspondences pertaining to the discussions that led to the development of the draft amendment BIA) and obtain insightful information from discussions with relevant staff.

This process yielded information including that on why the specific proposed approach of amending the BIA to provide for the regulation of MFIs was taken instead of any other approach, such as creating a specific legislation for MFI regulation, etc., what the objectives are for providing for MFI regulation in this form, the legal requirements imposed by the draft amendment BIA on MFIs, the expected outcomes of regulating MFIs through the envisaged legal environment and the perceptions of stakeholders on the likelihood of achieving the intended objectives.

4.3.4 Aligning the data-collection methods and survey design to the research objectives

It was ensured that the above data-collection methods employed as well as the design of the survey and interview instruments mirrored the research objectives. Table 4.4 below presents how the data-collection methods were aligned to the research objectives.

[70] Due to time limitation and therefore unavailability, three of the identified interviewees requested to respond to questions in writing.

Table 4.4: Data-collection methods as aligned to research objectives

Research objective	Research method	Justification
Obtain an understanding of MFIs and the environment in which they operate	Questionnaire survey, in-depth interviews with relevant stakeholders (such as top executives of MFIs, BoN & NAMFISA employees, bankers association, microfinance experts, etc.) and documentary reviews	The questionnaire survey allowed the researcher to gauge information from surveyed entities and what the spread of any particular respondent's insight was. Most importantly, it allowed for comparison of views collected. In-depth interviews provided an opportunity for follow-ups and revealed respondents' insights into the environment, challenges and opportunities. The two methods were then triangulated, so as to ensure the corroboration of findings and enhance the validity of obtained data/information. Documentary reviews provided additional facts in term of which stakeholder consensus has been reached through consultations, etc.
Research objective	**Research method**	**Justification**
Obtain an understanding of the regulatory and supervisory framework of Namibia	Questionnaire survey, interviews and documentary reviews	The questionnaire survey allowed the researcher to obtain vital information from MFIs who were also consulted. The questionnaire was structured to reflect variables that were of interest to the study. The interviews revealed more insight and clarity, such as the views of regulators (BoN as current regulator of DMFIs and NAMFISA as current supervisor of microlending institutions) on the regulated and supervised entities and possible challenges and opportunities in as far as the regulated industry is concerned as well as those of experts in the field of microfinance. They provided an opportunity for follow-ups.
Assess the (potential) impact of regulation and supervision on the microfinance sector	- Ex-ante assessment: survey, interviews, documentary reviews - Ex-post assessment: survey, interviews, documentary review, observation ROI assessment and cost-benefit analysis	A survey and the interviews were important in providing required information from the selected entities to feed the ROI impact indicators. This was complemented by other techniques, as listed under that section. The documentary review process revealed insight into the regulatory objectives, etc. The data-collection techniques listed under the ex-post assessment section provided data on the performance indicators and for statistical analysis. The ROI was useful in the analysis of the collected data and evaluation of the performance of the existing regulatory framework as well as the potential impact of the draft amended BIA. The cost-benefit analysis assisted in performing a systematic appraisal of the potential costs and benefits associated with the envisaged new regulation.

Apart from the above outlined data-collection methods and techniques, the study also benefitted from previous study findings on the Namibian microfinance sector as well as the researcher's personal insight from involvement in the NFSS 2011–2021 as coordinator and secretariat, both during the drafting stages of the strategy and the ongoing implementation process.

4.3.5 Coding of data

To preserve the confidentiality aspect of data and information collected, some data/information obtained from the survey and interviews as well as from unpublished documents (such as internal reports and papers) were coded using a simple coding system. The principle used in coding the data was that of determining who the source is (institution or individual and under what category they fall), what type of information it is (e.g. policy document, legislation, unpublished paper), how many documents were obtained falling under that category or how many people were interviewed from that specific institution and what number was allocated to that specific interviewee or document. The list of coded unpublished documents is provided in Appendix E and that for interviewees is in Appendix F.

4.3.6 Ethical considerations

As indicated under Sections 4.3.2 and 4.3.3 above, one of the aspects that facilitated the data collection and information gathering for the study was the fact that the researcher was a staff member of the regulatory body (i.e. the central bank) that has initiated the creation of the envisaged regulatory framework for DMFIs under the BIA amendment bill, and that will administer the envisaged act once enacted. As such, the researcher was able to perform documentary/report reviews and obtain insightful information from discussions with relevant staff. Although this may not be viewed as an impartial research process and therefore may be viewed as a potential research bias, the process did not create any conflict of interest in the data gathering and analysis, as the information so collected was already in existence, created for other purposes and was just used as secondary sources. As such, being an insider was rather a mixed blessing, as it helped the researcher to obtain direct access to the necessary information and main actors related to the subject of the research.

4.4 CONCLUSION ON THE RESEARCH METHODOLOGY AND METHODS

The overall process of the research involved the following main phases: short meetings with some of the selected participants to clarify the objectives and scope of the study, administration of the survey questionnaire, desk research including documentary reviews, stakeholder interviews, and analysis and report writing. It is clear from the above that the study did not perform a regression analysis. However, the researcher believes that the methods outlined above have been sufficient to bring some useful conclusions and support the arguments to answer the research questions and support the analysis of this thesis.

The following chapter appraised the microfinance sector in Namibia with the aim of obtaining a better understanding of the nature and state of regulated MFIs and/or those to be regulated under the envisaged microfinance regulatory framework. This was deemed important to ensure a meaningful analysis of the impact that was performed under Chapters 7 and 8.

CHAPTER 5

APPRAISING THE STATE AND NATURE OF MICROFINANCE IN NAMIBIA

5.1 INTRODUCTION

This chapter aims to appraise the Namibian microfinance sector (in terms of its nature, scope, structure and performance) with a view to address the research question of obtaining a better understanding of the microfinance sector in Namibia. It draws on the results of the survey, interviews, administrative reports and documentary review. The rest of the chapter is organised as follows: Section 5.2 sketches the current setup of the microfinance sector in Namibia (using administrative reports and documentary review information) as background to the subsequent appraisal of the sector, while Section 5.3 appraises the sector through the results of the fieldwork with a view to gaining an understanding of the potential for developing it. Section 5.4 presents the implications of the fieldwork findings for designing a regulatory framework for the sector, followed by the chapter conclusion in Section 5.5.

5.2 THE SETUP OF NAMIBIA'S MICROFINANCE SECTOR

Microfinance is provided by different types of institutions that can be classified into formal, semiformal and informal (Srnec, Divišová, & Svobodová, 2008). Van Greuning *et al*. (1998) categorise formal MFIs into SACCOs, credit unions, incorporated NGOs or windows and departments created by commercial banks for small businesses; and informal MFIs to include ROSCAs, various groupings that pool members' savings for loans, village banks and money lenders. Most of these categories also prevail in Namibia, i.e. there have been formal, semiformal and informal microfinance providers and/or profit- and non-profit-seeking MFIs in the country. The focus of this thesis was on the formal or registered institution component of MFIs, given its emphasis on regulatory matters. The current formal microfinance sector of Namibia can be categorised into deposit-taking or savings-mobilising and non-deposit-taking (or credit-only) MFIs. Informed by administrative reports and documentary review information, the structure and performance of each of these categories are discussed below. The aim is to provide an overview of the current setup of the sector before appraising its state, performance and potential for further development in subsequent sections.

5.2.1 Deposit-taking or savings-mobilising microfinance institutions

At the time of conducting this research, there was only one deposit-taking microfinance banking institution in Namibia, which until the end of August 2014 was called FIDES Bank Namibia (FIDES), but was taken over by the Trustco Group Holdings Limited and is now called the Trustco Bank Namibia Limited (BoN, 2014). FIDES was granted a license by the BoN in 2010 after having been a microfinance pilot project called Koshi Yomuti[71] since 2002 (FIDES, 2010). Before it was licensed, Koshi Yomuti used to operate only in the north central, underserved regions of the country, where it managed to demonstrate that savings and loans village associations can be sustainable even in low-density rural areas (FIDES, 2010). The need for licensing therefore followed the successful operations as a project and the extent at which savings were being mobilised (FIDES, 2010).

Being a specialised microfinance bank, FIDES had been viewed as the only 'true' MFI operating in Namibia; providing a comprehensive package of microfinance products and services, including microloans and microsavings products to empower micro and small entrepreneurs. It had further developed a micro, small and medium enterprise (MSME) facility offering, lending to established micro-enterprises, and kept its focus on the low end of the market (FIDES, 2010). This comprehensive package and offering are not only in line with the desirable definition of microfinance outlined earlier under the literature chapter, but also augurs well with the type of offering advocated by the country's Financial Sector Strategy (i.e. the need to have MFIs serving SMEs).

The total assets of FIDES stood at approximately N$40 million, while it had close to 13 000 active borrowers at the end of 2012 (FIDES, 2012). Its gross loan portfolio was approximately N$32 million at the end of that period. More than 70 per cent of the loan book comprised of loans to micro entrepreneurs through loan and savings associations, with the remaining portion belonging to SME borrowers (FIDES, 2012). The majority of loans were in rural areas (85 per cent), with 13 per cent in peri-urban areas and 2 per cent in urban areas (FIDES, 2012). Through its primary savings product "Step-Up Savings," the bank had managed to grow its savings portfolio to approximately 50 per cent of its loan portfolio (FIDES, 2012). Discussions with relevant stakeholders (i.e. those attached to the new bank and regulators) in this regard seemed to suggest that the new bank may not strictly follow the exact model and approach of FIDES going forward.

[71] Koshi Yomuti can be literally translated as meaning 'banking under the tree'.

The other forms of savings-mobilising MFIs are the registered SACCOs and NGO-sponsored MFIs. Their common characteristics relate to the mobilisation of savings from their members and allocation of credit to the same. In Namibia, the Ministry of Agriculture, Water and Forestry supervises SACCOs. The Ministry has created a division, called the Division of Cooperative Development (DCD) to regulate and supervise the activities of these institutions, in accordance with the Co-operatives Act, Act No. 23 of 1996. The information provided by the Ministry showed that there were more than a hundred registered cooperatives in Namibia, of which only five can be referred to as pure SACCOs that were operational at the time of writing this research. Others were multipurpose cooperatives,[72] involved with production activities in different sectors of the economy, mainly in agriculture and manufacturing. Financial information on the SACCOs were scant, with available data for most of them being outdated. In addition, some registered SACCOs had been dormant. Table 5.1 below shows the number as well as the membership and savings status of registered SACCOs in Namibia at the time.

Table 5.1: Registered savings and credit cooperatives in Namibia

	Name of co-operative	**Members**	**Savings balance (N$)**	**Status**
1	Nantu-Likwafela Co-operative Ltd	29	73 513.12	Active
2	Kwamashi Savings & Credit Cooperative Ltd	11	694.94	Dormant
3	Windhoek Savings & Credit Cooperative Ltd	7	28 220.00	Newly registered and active
4	Credo Co-operative Ltd	73	Unknown	Due to delay in audit
5	Khorixas Savings and Credit Co-operative Ltd	20	Unknown	Dormant
6	Okatunda ka Haudano Savings and Credit Co-operative Ltd	123	86 724.66	Newly registered and active
Total		**263**	**189 152.72**	

Source: Directorate of Cooperative Development of the MAWF[73]

[72] Members of these cooperatives sell surplus produce and use the income generated to save and have access to credit.

[73] This information was provided by Mr Ruben Isak during the interview on 7 August 2015 [Available e-mail: RubenI@mawf.gov.na].

As the name postulates, SACCOs mobilise savings and provide credit to their members. Currently, existing ones are mainly executing this function to rural-based members and are playing a role in addressing the socio-economic needs of their members. By law (Section 2(4)(a) and (b) of the BIA) SACCOs may only have a membership of up to 20 people, but as can be seen from Table 5.1, some of them have not complied with this provision. They have however complied with the requirement of not exceeding a total of N$500 000 mobilised savings.

SCAs also exist in Namibia and as with SACCOs, they are also subject to the same Co-operatives Act, Act No. 23 of 1996 administered by the DCD. SCAs are relatively smaller voluntary associations of mostly people at grassroots, village level that operate as self-help groups and where members benefit (Besley *et al.*, 1990). Benefits to members can actually also take effect on a rotating basis. Besley *et al*. (1990) identified two main forms of ROSCAs, namely a random allocation approach and a bidding approach. They explain that in a random allocation approach members put a fixed amount of money into a pot for each period of the life of the ROSCA, lots get drawn and the pot is randomly allocated to one of the members at a time, with the process repeating itself in the following periods, but excluding previous winners every time until each member has received once. At that point, the group either gets disbanded or begins over again (Besley *et al*., 1990). The bidding approach on the other hand follows a process whereby priority of who gets the allocation first is based on who bids the most in the form of a pledge of higher future contributions to the association or one-time side payments to other members (Besley *et al*., 1990). The DCD indicated that there was actually only one registered SCA in Namibia that had transformed into a SACCO due to volumes.

According to the DCD staff members to which the researcher spoke, the role of the DCD in Namibia was mainly to register and supervise the SACCOs and SCAs, audit their financials from time to time and provide training on the basic book-keeping principles[74] – an approach that has raised questions of the safety of members' savings. The mandate of the Ministry is however to prudentially regulate them, though according to the Ministry, this has proven not possible due to both a lack of capacity and the absence of regulatory rules and guidelines. The DCD further revealed that the Ministry had attempted to obtain experts to design the regulatory rules, but the exercise was found to be very expensive, and that it will continue to investigate affordable ways of coming up with the prudential regulatory rules. It is worth

[74] This information was revealed through an interview with an official from the DCD, (Mr Ruben Isak,, held on 7 August 2015 [Available e-mail: RubenI@mawf.gov.na].

noting that literature finds the aspect of prudential regulation to be a complex one that needs careful consideration, as effective prudential regulation, especially for smaller institutions, can be costly and difficult (CGAP, 2006). It argues that small and remote financial institutions such as savings and loan cooperatives and member-owned financial cooperatives may likely not be effectively supervised. The researcher is therefore of the view that the DCD in Namibia should take these facts into account going forward and make an informed decision on the best approach for treating SACCOs.

A review of the emergence of microfinance in Namibia done in Chapter 2 showed that donors and NGOs have played a role in sponsoring MFIs in Namibia. In addition to having initiated Koshi Yomuti, discussed earlier, the Namibia Housing Action Group/ Shack Dwellers Federation of Namibia (NHAG/SDFN) that has microfinance activities incorporated into their overall welfare programme, also exists in the country. A close look at the documents on the operations and activities of the SDFN revealed that, as a member of Shack Dwellers International, SDFN was initially a member-based network of housing schemes established in 1998 for purposes of providing low-cost housing to the low-income people living in shacks and rented rooms or those without any accommodation, but later engaged in operating a savings scheme and a loan facility called the Twahangana Loan Fund (NHAG/SDFN, 2010/11). Through this loan facility, the SDFN provides funds to the poor for income-generating activities in addition to those provided for building houses and other services, and the organisation keeps separate financial accounts for each of those activities (NHAG/SDFN, 2010/11). Information availed by the organistion shows that it had disbursed a total of N$3.3 million on income-generating loans for 1 925 members.[75] An interview with the organisations' regional coordinator[76] revealed that in order to participate in the scheme, potential members are required to form savings groups, which would then enable them to borrow as a group, i.e. the organisation applies the group-lending approach discussed earlier under the literature review chapter.[77] According to information provided by the NHAG/SDFN through the survey, the organisation has representation in both rural and urban areas and has achieved significant outreach in terms of savings (reaching a value of N$14.5 million in 2013), which has in turn enabled it to disburse loans to its members.

[75] Information was provided through an e-mail received on 20 June 2015.

[76] An interview with the regional coordinator, Mr Heinrich Amushila, was held on 11 November 2014 [Available e-mail: hanhag@iway.na.

[77] The group-lending approach refers to a process whereby loans are disbursed to group members instead of to individuals (Kodongo & Kendi, 2013).

Most of the other donor-sponsored organisations that also engaged in microfinance-related activities in earlier years have either stopped their microfinance activity (for example Project Hope, which used to provide small loans to women taking care of orphans and vulnerable children for emergencies and income-generating purposes) or closed shop (such as the case of Canamco Namibia and Lihepurura that were operating in the north-eastern region of the country, but also similar others in other regions), mostly at the time of donors withdrawing their presence in Namibia.

5.2.2 Non-deposit-taking microfinance institutions

The non-deposit-taking MFIs mainly comprise legally supervised credit-only microlenders that include units and/or branches of commercial banks. Regulated and supervised by the non-bank regulator, NAMFISA under the Usury Act, Act No. 73 of 1968, microlenders have grown in number, reaching 289 institutions by 2014 from 275 in 2012 (NAMFISA, 2015), and are scattered in urban centres all over the country. Two of these institutions belong to two commercial banks (namely Bank Windhoek and Nedbank Namibia), which created separately run entities (BW Finance and Nedloans, respectively, although the latter has been deregistered recently). Although commercial banks are registered under the BIA and regulated by the BoN, these separate entities fall under the supervision of the NBFI supervisory authority (i.e. NAMFISA) and not the BoN, as is the case with all other microlending institutions. There is an established association for microlenders in Namibia (called the Namibia Microlenders Association), which looks after the interest of its members.

According to NAMFISA, microlenders are further classified into pay-day lenders (i.e. those lenders whose loans are repayable over a 30-day period) and term lenders (i.e. whose loans are repayable in equal monthly instalments over a period of up to 60 months) (NAMFISA, 2015a). Pay-day lending institutions are set up by private individuals who provide cash loans out of their retained earnings to help salaried individuals to smooth their consumption needs (Adongo & Stork, 2005). At the time of writing this thesis, NAMFISA revealed that the 289 microlenders referred to above include a total of eight term lenders that also mostly lend to salaried individuals [UP/P/2/1]. Therefore, the difference between the two categories lies in the repayment period, as lending by both of these categories is salary-backed. According to NAMFISA (2015a), approximately 209 402 borrowers made use of the services offered by microlenders for the period ending 31 December 2012, of which 46 per cent were civil servants. Microlending actually constitutes the bulk of lending activity in Namibia in terms of volume.

The increased microlending activity has caused considerable controversy in the country. The institutions involved are considered exploitative because they are viewed as charging exorbitant interest rates[78] and mainly lend for consumption purposes. They have been referred to as 'loan sharks' at times despite the fact that those licensed under the Usury Act have to comply with the applicable interest rate caps imposed by that act. In fact, information collected through the interviews (as will also be evident later in sections 5.3.5.3 of this chapter) revealed that policy makers viewed consumption lending as not being in line with the type of lending that would assist the country in its developmental efforts.[79] There has however also been counterarguments to this from other corners of the country that consumption lending too is a necessity that is complementing the income of low-income people in times of need, thereby contributing to the Namibian economy in that sense. This argument is supported by CGAP (2012), which states that while microcredit clients engage in productive activities, their loans are not used only for business purposes, but also for non-business purposes, such as consumption smoothing and financing of social, medical and educational expenses. This notwithstanding, the expressed objective of the NFSS 2011–2021 is on building MFIs that can lend for entrepreneurial (productive) purposes.

The fact that this type of microlending only caters for salaried individuals has also been viewed as not auguring well with the country's goal of microlending for poverty reduction and employment creation through financing micro and small-scale entrepreneurs advocated by the Financial Sector Strategy. In terms of the strategy, this goal would be achieved through the country developing a solid base of 'real' MFIs, as these would better serve the poor and small-scale enterprises.

Non-deposit-taking public finance institutions such as the DBN and AgriBank have also been providing loans to small businesses, as discussed in Chapter 2, which provided detailed activities of these institutions. The government of Namibia, however, took a decision in 2015 to streamline the public finance activities so that the DBN can move out of that space and concentrate on big-scale projects going forward, and so that the recently established SME Bank can be the only state-owned financial institution serving the general SME sector,[80]

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[78] Most pay-day loans are offered at a benchmark rate of 30 per cent per month in accordance with the Exemption Notice requirements (UP/P/1/1).

[79] The Financial Inclusion Council (which comprises of ministers whose ministries are economic-issues related and chaired by the prime minister), a committee that oversees the implementation of the NFSS, has expressed this view at several meetings, at which the researcher has been serving as secretary.

[80] This is insightful information, as at the time of this research, the researcher was a board member of the DBN, which was requested to implement this decision, and the issue was also widely reported on by the media.

while AgriBank continues to serve those in the agricultural sector. Work on investigating the best way of implementing this decision was ongoing at the time of preparing this research report. However, the impact of the recently established SME Bank on the SME sector remains to be observed going forward.

5.2.3 Observation on the current setup of the microfinance sector in Namibia

From the above discussion on the current status of the microfinance industry in Namibia, it is clear that the Namibian microfinance industry is relatively small and undeveloped, especially when compared to what happens in other countries around the globe, especially in Asia, but also even in sub-Saharan Africa, where the industries are big in terms of average loan amounts disbursed and loan book size. For instance, in neighbouring South Africa, some leading MFIs have been disbursing larger amounts of loans, e.g. the Blue Financial Services, a leading MFI in product innovation that has disbursed loan amounts of approximately N$15 000[81] (Calvin & Coetzee, 2009) compared to the average of N$1 000 disbursed by pay-day lenders and N$13 000 by term lenders [UP/P/2/2]. Further, the majority of what is referred to as MFIs in Namibia are the pay-day lenders that lend to salary-based individuals and especially for consumption purposes. The situation does not augur well with the type of MFIs envisaged by Namibia through its Financial Sector Strategy 2011–2021 and which the country wishes to see developing to better serve the poor and SMEs. Therefore, this requires the country to lay a foundation of solid microfinance as opposed to the current state. It is for this reason that this thesis sought to establish the role regulation can play in the process of laying such foundation, i.e. the thesis aimed to determine whether or not regulation will help to institute real MFIs in Namibia.

5.3 UNDERSTANDING THE POTENTIAL FOR DEVELOPING THE NAMBIAN MICROFINANCE SECTOR: INSIGHT FROM THE FIELDWORK

5.3.1 Introduction

Based on the background of Namibia having taken a decision to develop its microfinance sector, especially the deposit-taking microfinance industry to finance SMEs, as discussed earlier, this section aims to determine the potential scope for developing such an industry in Namibia.

[81] The Namibia dollar is pegged one on one to the rand.

As noted in the previous section, there are different categorisations of MFIs in Namibia. They range from unregulated savings-mobilising MFIs, such as NGOs, to a regulated deposit-taking microfinance bank and regulated microlending institutions (i.e. pay-day and term lenders) and SACCOs. For this thesis, the scope of the MFI survey was limited to the categories considered relevant to the objective of the study, i.e. determining the potential impact of regulation under the amended BIA on the development of the microfinance sector, which was the primary subject matter of this thesis. In this regard, the study was therefore confined to MFIs that are likely to be impacted by the envisaged amended BIA, i.e. those that have been identified as potential entrants to the deposit-taking industry (which are essentially credit-only term-lending institutions) and the one existing DMFI, although the details of the regulatory impact on this DMFI will be discussed in Chapter 7, which is solely dedicated to it as a case study. Essentially, the aim is to establish whether the proposed regulatory provisions will facilitate the intended development of the industry, and hence contribute to the development of the overall microfinance sector in Namibian.

5.3.2 The targeted and surveyed segment of the sector

As indicated in Section 5.3.1 above, the analysis in this section of the chapter focuses on the credit-only term-lending microlenders, i.e. the category of microlenders that provide loans for repayment over a period of up to 60 months, while that of the country's only DMFI is to be discussed in Chapter 7. Also as indicated above, these credit-only term lenders are currently non-prudentially registered and supervised by the country's non-banking financial sector supervisory authority, NAMFISA. This supervisory approach is in line with arguments normally advanced in literature (CGAP, 2012; Chance, 2011) that prudential regulation should be risk-based, as complying with prudential regulatory rules can be too burdensome for credit-only MFIs. It is therefore often argued in literature that credit-only MFIs should not be prudentially regulated because they are either too small such that even if they should fail they would have limited impact on the soundness of the financial system, or because their regulatory costs tend to be higher, both in terms of supervisory cash costs for the supervisor and supervised and in terms of stifling innovation and outreach (CGAP, 2000). However, as they move into the deposit-taking sphere, the classical justifications for prudential regulation that include the protection of the financial system and small depositors and/or managing the country's money supply become applicable (CGAP, 2000). It is further becoming increasingly clear that the optimal potential of microfinance "lies in a licensed setting because it is only that setting that can permit massive and sustainable delivery of financial services to the poor" (CGAP, 2000: 2). This is because when credit is combined with savings (allowed by regulation), MFIs can reach a large segment of individuals and SMEs.

In the context of this thesis, the selection to focus on this category of MFIs (i.e. credit-only term-lending MFIs) was not only based on the fact that the focus for the regulatory provision for MFIs in the amended BIA is on the potential for microlending institutions that have grown and therefore have the capacity to become DMFIs, as has been identified through the documentary review process, but the researcher also considered the link between term lending and the role of credit in economic growth, which ties in well with the earlier discussed reason expressed by Namibia for wanting to develop its microfinance sector.

In an article that explains aspects relating to bank capital and liquidity, the Bank of England's third quarterly bulletin of 2013 explains this relationship as follows (2013: 202):

> Borrowers frequently need sizable longer-term loans to fund investments, but those with surplus funds may individually have smaller amounts and many want swifter access to some or all of their money. By accepting deposits from many customers, banks are able to funnel savers' funds to customers that wish to borrow. So, in effect, banks turn many small deposits of a short-term maturity into fewer longer-term loans.

From the above it can be deduced that term lending ensures the supply of financing with long-term maturities to meet the growing investment needs of the real economy. Moreover, the ability to repay a loan over a much longer period accorded to businesses through term lending provides an opportunity for businesses to expand their supply capabilities and/or the range of their business. Hence, without implying that short-term loans are not important, Kpodar and Gbenyo (2010) point to the existence of a theoretical basis for the hypothesis that long-term credit fosters faster growth than economies where long-term financing is constrained. Therefore, if microloans are provided on this basis to SMEs (which is one of the categories targeted by the policy of developing the microfinance sector in Namibia), it can make a difference in the operations of SMEs and lead to enhanced economic activities, which is good for economic growth. This is the opposite of short-term lending, such as that provided by pay-day (30-day) lenders in Namibia that may exert repayment pressure on small businesses and constrain their potential. This is because repayment over a long term attracts relatively lower monthly premiums than repayment in one month.

While term lenders in Namibia do not lend to SMEs currently, this thesis is of the view that, in the context of Namibia, they are the potential candidates that can upgrade their scope through savings mobilisation and attracting new investment to serve the SMEs sector. This is because they have the capacity relative to pay-day lenders as demonstrated by their current average loan amount of N$13 000 compared to N$1 000 of pay-day lenders. They are therefore the potential institutions that could be a springboard to the achievement of the policy goal of developing the real microfinance sector in Namibia.

The above view on term-lending microlending institutions being potential entrants to the deposit-taking microfinance industry was confirmed through the researcher's engagements with financial sector regulators that revealed that they considered this type of MFIs to be the relevant institutions that can possibly upgrade and become DMFIs to be regulated under the amended BIA. According to them, the natural progression for this type of institutions is to become microfinance banks when they have grown and reached a scale big enough for such progression.[82] They backed up their view by providing examples that two of the term-lending institutions had already applied to the relevant regulator for licenses under the current legal framework, with one of them (Letshego Micro Financial Services [Pty] Ltd) having been allocated a provisional license[83] already in 2014, while the application of the other was still being assessed at the time of writing this thesis.[84] Further, a recent unpublished document by the regulator of banks also provides insight into which institutions the regulatory provision for MFIs in the BIA is targeting. It states the following:

> In consideration of the microlending industry that has experienced considerable growth in recent years ..., the Bank of Namibia has allowed under the banking law, qualifying microlending institutions to take deposits as microfinance banks to expand the scope of access to banking and financial services [UP/RD/1/1: 5].

This is evidence that those targeted institutions are essentially the microlending institutions that operate on a term basis in terms of loan repayment, as these are the ones that would have the capacity to qualify as per their institutional characteristics and sizes. These are therefore the appropriate institutions and industry that the researcher has targeted for the

[82] This view was expressed during the researcher's interviews with senior staff in the regulatory authority for microlenders.

[83] Issued for a period of six months, a provisional licence enables the applicant (i.e. the potential bank) to get its house in order and to be able to meet all necessary requirements to the satisfaction of the regulatory authority, after which a full license can be issued. During the period of provisional license, the license holder is not allowed to conduct banking business.

[84] As the amended BIA providing for the regulation of deposit-taking microfinance banks has not been promulgated yet, the licenses are being issued under the current BIA.

assessment of what the likely impact of the amended BIA on MFIs would be. The other microlending institutions (i.e. pay-day lenders) are small institutions (as per the size of their loan books and loan amounts they disburse, noted earlier in this chapter) that will for a considerable time remain operating at the level at which they currently are due to a lack of capacity to enter into the deposit-taking business. The same applies to the SACCOs, as they not only lack capacity (as per the data presented in Table 5.1 above), but also their mandate and purpose for existence currently is the welfare of their members, other than profit-making. As such, the researcher expects that whatever evidence is established from the targeted surveyed group of MFIs (i.e. term lenders) would be even more pronounced for these smaller MFIs that were not included in the survey. The outcomes of the survey are presented in the next sections together with those from the interviews.

5.3.3 The sample

As indicated under the methodology chapter, a purposive-judgement sampling approach was followed in that eight institutions that make up the term-lending industry in Namibia were considered relevant and surveyed. Only five of the eight term lenders were willing to participate (i.e. only five institutions completed and returned the questionnaire). Of the five institutions that participated, two provided data for a period longer than five years, depending on the time they had been in business (in fact the establishment period of all these institutions falls within the period 2002–2009), two provided data for a period of five years, while one only provided for two years, as they were simply not willing to spend time to retrieve records from historical documents. All these cases also had data gaps in some of the variables requested. This raises the question of the importance placed on data by these institutions.

Furthermore, with the exception of one participating term-lending institution whose headquarter is based in neighbouring South Africa, four of the institutions are headquartered in the capital city of Namibia, Windhoek, and have presence around the country. The head offices of these institutions, which in most cases direct decisions on branch operations, provided information on their overall operations. For the analysis, the five institutions were allocated with simple codes, namely MFI1, MFI2, MFI3, MFI4 and MFI5, so as to ensure they are not identified, thereby preserving the confidentiality of their information.

5.3.4 Fieldwork results

This section presents findings from the survey of the targeted industry, which assisted the researcher to appraise the state and nature of the targeted industry and to determine its potential for becoming the springboard for developing the microfinance sector in Namibia. It provides information on the institutional and client profiles and characteristics and the legal form and ownership of the MFIs, as well as an understanding of their scope of operations and performance, including the services and products offered. The survey was complemented by interviews with relevant stakeholders[85] that were aimed at gauging views on aspects such as the understanding of the term 'microfinance', thereby establishing what microfinance in the Namibian context is, as well as their views on the growth and/or growth constraints of the Namibian microfinance sector. The results from the survey and interviews relevant for this chapter are presented below.

5.3.4.1 Profile of the surveyed industry

Establishment and legal form: From the survey, it was established that term-lending MFIs are all registered companies that fall under the same regulatory and supervisory authority of the non-bank financial institutions (NAMFISA). They include the ones that are subsidiaries of commercial banks as well, despite the fact that banks fall under the banking institutions regulatory authority. This is because the current regulatory framework (Government Exemption Notice 189 of 2004 issued in terms of Section 15 of the Usury Act, Act No. 73 of 1968) requires that banks that want to conduct microloan transactions separate from their banking operations need to establish a separate legal entity that would engage in such activities. There is only one such entity currently, as the other one has deregistered a few years back, as indicated earlier in this chapter.

As mentioned earlier, participating term-lending MFIs were all established during the period 2002–2009,[86] therefore they are still in a nascent stage. This period falls within the post-political independence era of Namibia,[87] which could suggest a relatively more conducive environment for setting up these types of institutions, as they saw an opportunity to fill the gap for microloans created by traditional banks that had not been ready to serve this type of

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[85] Key stakeholders of microfinance as defined by Ledgerwood, Earne and Nelson (2013) include providers of financial services (banks, MFIs, NBFIs and their associates), regulators (central banks, financial regulators, consumer protection agencies) as well as consumers, individuals and advocacy organisations.

[86] MFI2 was established in 2002, MFI1 in 2004, MFI3 in 2008, MFI5 in 2005 and MFI4 in 2009.

[87] Namibia gained its independence in 1990.

market, given their risk-averse nature discussed earlier in this thesis. The political environment during the period prior to independence (when the apartheid system was practised) would have made it difficult for this type of institution to exist, as the environment was more conducive to conventional banking.

Ownership and funding: The ownership aspect is an important issue to examine in the context of this study, as it is among the possible factors that would determine the motive for an institution wanting to upgrade to a microfinance bank level and whether or not it would be willing to align itself with the policy expectation of serving the identified needy market (i.e. the poor and SMEs) once it has obtained that status.

Staschen (2010), citing the case of Uganda, is of the view that ownership composition is probably the most important determinant for MFIs remaining true to their mission of serving the poor. The argument normally advanced in this regard is that when MFIs become commercialised (formalised) and start pursuing financial objectives, they would lose sight of social objectives, i.e. their mission of providing banking services to the poor by lending very small sums to very poor borrowers, as they would now prefer catering for customers who are better off than their original customers (Strøm & Mersland, 2010). This situation is normally referred to as MFIs experiencing a ‘mission drift’ as they become more commercialised. Strøm and Mersland (2010) quote an example by Rosenberg (2007) of the initial public offering of Banco Compartamos in Mexico that led to a handful of people making a fortune to the tune of US$450 million as among the events that have sparked the fear towards commercialisation of MFIs.

However, the issue of whether or not ownership influences the mission of MFIs has been a debatable one in the literature. In their study that sought to establish evidence of mission drift by analysing 379 MFIs in 74 countries, Strøm and Mersland (2010) found no evidence of mission drift in the overall industry. They however found some evidence of possible mission drift in individual MFIs that had transformed to profit-seeking, but at the same time found that the effect is neutralised if the MFI is more cost-efficient, and they therefore recommended that the focus be on reducing an MFI’s costs rather than on the aspect of profit making. Further, Mersland and Strøm (2008), in their study on whether ownership mattered for the performance and trade-offs in microfinance organisations, found the difference between shareholder-owned microfinance organisations (i.e. formal MFIs) and non-government microfinance organisations (i.e. semiformal MFIs) to be minimal. This reinforces the conclusion, in their earlier study that investigated whether NGOs and specialised MFIs incorporated as shareholder firms differ in bringing along social benefit to their clients, that they are more similar than different, and this led to the rejection of their hypothesis that NGOs are more socially oriented than shareholder firms. Their findings further revealed that the benefit in scale and scope by shareholder firms was not related to ownership, but to legal constraints that impede NGOs to mobilise savings (Mersland & Strøm, 2007).

The above findings imply that MFIs' ownership and form of funding is not an impediment to the provision of socially oriented financial services. These empirical findings should provide some guidance to Namibia in this regard. A key message from the empirical evidence is the fact that MFIs that have become more profit-oriented have better depth of outreach in the long run and are more sustainable. In fact, Rhyne (1998) and Christen and Drake (2002), cited by Mersland and Strøm (2010: 2), suggest that "a more commercialised microfinance industry is better able to serve the poorest members of the community, since their profit motives lead them to be more efficient and more willing to seek out new markets for their loan products".

In the case of Namibia, the survey found that credit-only term microlenders that responded to the survey are either subsidiaries of other regulated non-bank financial institutions (1), commercial banks (1) or other registered companies (3). These are in most cases single shareholding institutions with own funding, as only one of them (MFI5) has been sourcing funds from an international development partner. The researcher's observation from fieldwork results points to the fact that inasmuch as these MFIs have also been serving low-income salaried people, they have been more profit-oriented than development-oriented, i.e. they have had preference for catering for better-off customers (earning a regular income) who mainly borrowed for consumption purposes rather than productive purposes. Given this fact, and in its effort to have relevant institutions lined up to the policy objective of developing a microfinance sector that will serve SMEs and the poor, Namibia might place consideration on the ownership of the would-be industry entrants as one of the qualifying criteria to entry, and the researcher is of the view that it should do so taking into account the above highlighted arguments in literature.

Based on the advocacy by the Namibian Financial Sector Strategy, the issue of localising Namibian financial institutions is for instance one of the prominent aspects in the draft amended BIA, i.e. financial institutions in Namibia, including DMFIs, are expected to be majority-owned by Namibians going forward. The strategy views locally owned financial institutions as more "better suited to respond to the country's needs than foreign owned institutions" (Republic of Namibia, no date: 33). While there could be merit in the intent to enhance local ownership of DMFIs, the researcher argues that there could be a need for some differentiation in ownership rules applicable to DMFIs, especially if the intended objective of developing the industry is to be achieved. The proposed differentiation could be either in the form of having shareholding limits that are different from those imposed on other established and matured financial institutions or industries, or applying some flexibility to accord DMFIs a transition period for limits in their shareholder diversification. This is because not only would current shareholders of existing MFIs (who are potential entrants to the DMFI industry) wish to retain majority shareholding in the institutions they have built, but attracting new entrants into the industry might also require incentives. This also becomes important when considering the possible new capital and technical expertise that foreign investors can bring to the industry, which could be of great help in the process of developing the industry. It is therefore important for Namibia to take into consideration the above as well as earlier cited empirical evidence as it designs its measures and limits on ownership of DMFIs going forward.

5.3.4.2 Products and services offered

Participating MFIs reported that they only provide microcredit. In fact, a documentary review revealed that all microlenders (pay-day and term lenders) in Namibia are only allowed to extend microcredit and not to take deposits. The reported minimum loan size for the responding term lenders are in the range of N$500 to N$2 599 and the maximum between N$8 000 and N$50 000. These fall within the statutory requirement of a microloan not to exceed an amount of N$50 000, as stipulated in Section 1(a) of the Government Exemption Notice No. 189, discussed earlier in this chapter. Their repayment term is up to 60 months, also in accordance with the requirements of the same Exemption Notice (Section 1(b) of the Exemption Notice).

The fact that these MFIs only provide credit is considered undesirable, because generally around the globe MFIs are playing or are expected to play an important role of filling the financial services gap for the poor that exists in the economy due to market failure, and such a gap also exists in Namibia, as discussed in Chapter 2. This is because poor and low-income people, like those in more advantageous economic situations, need a variety of basic financial services (including savings, insurance, money transfers, etc.) and not just credit (CGAP, 2012). In fact, Ledgerwood *et al*. (2013) argue that going forward, a great deal of the demand from poor people will outstrip that of products and services on which the microfinance industry has focused during its first three decades of existence. Accordingly, they are of the view that the demand for savings may surpass the demand for loans and the demand for general-purpose loans may outstrip the demand for micro-business investment, while that for long-term savings, borrowing and insurance is as strong as that for short-term savings and loans. As such, providers of financial services (including those in Namibia) are expected to develop sustainable low-cost ways to provide such services and respond to the demands and needs of the poor.

In view of the fact that the surveyed institutions (together with pay-day lending institutions) form the majority in the Namibian microfinance sector, the researcher further argues that it would have made a difference on the financial inclusion front, i.e. it would possibly have helped reduce the financial exclusion rate that is still a problem in the country,[88] if these institutions were to offer other financial services as well. Offering credit only as a product creates a gap in the financial system referred to above in terms of institutions that would provide comprehensive microfinance products and services, including microsavings, micro-insurance and money transfer services in addition to microcredit. The researcher has noted that commercial banks in the country have started to attract small savers through own efforts, but also through the statutory-imposed BBA[89] introduced by the BoN in 2013, and are therefore complementing the very small number of MFIs that provide microsavings services in the country, which were discussed in Section 5.2. Micro-insurance, however, remains a relatively new concept to the Namibian market.

The survey also found that a fixed interest rate of prime rate times 2 is charged by all the surveyed MFIs in accordance with the caps imposed by the Usury Act and its accompanying Exemption Notice provisions that regulate them (Exemption Notice No. 189 of 2004), details of which are discussed in Chapter 6, which appraises the legal and regulatory environment of the Namibian financial sector.

The issue of interest rate ceilings, i.e. the limits on the level of interest rates that financial institutions are allowed to charge, such as these caps, is among the debated issues in literature, especially in as far as MFIs are concerned. While the argument often advanced as justification for the caps is the high cost of loans and possible predatory lending practices (i.e. consumer protection), it is also counter-argued that high fees and charges keep MFIs

[88] Financial exclusion rate is estimated at 31 per cent by the FinScope Namibia 2011 Survey.

[89] The BBA is developed for low-income earners and the poor and does not attract any transaction fees.

afloat (CGAP, 2006) and are needed for their sustainability, especially when considering the high transactions cost involved in their lending processes, given the tiny transactions they have to deal with and the need for face-to-face interactions with clients as a substitute for formal collateral (Helms & Reille, 2004). Imposing interest rate ceilings is therefore said to have an effect of making it difficult for MFIs to cover their costs, and this could have the resultant effect of either driving them out of the market or even becoming an entry barrier to potential MFIs (Helms & Reille, 2004). When this happens, it can lead to a lack of access to financial services by poor clients as MFIs retreat from the market due to their inability to cover operating costs.[90] One good example of this is Zambia, a neighbouring country to Namibia, where the recently introduced interest rate limits[91] have been reported to not only have led to an unintended consequence of constraining the credit sector, but also to increased average loan sizes and tenures as MFIs attempt to remain sustainable and profitable (Brouwers, Chongo, Millinga & Fraser, 2014). A resulting consequence of the lack of access to financial services would be for poor clients to revert to informal credit markets, which are even more expensive, such as money lenders (Helms & Reille, 2004), and this would have a backward effect on the efforts of enhancing access to finance for the poor, low-income people and SMEs. Striking a balance between the above views (i.e. taking the cost of credit and the MFI sustainability aspect into consideration) is therefore important. What is necessary is for regulators to have an enabling legal environment in which MFIs can thrive and which enhances competition so that competition would eventually bring down interest rates (Armendáriz & Morduch, 2010).

Most surveyed institutions also reported on a practice where they offer credit life insurance as a condition for providing loans to clients. In this regard, a loan is only extended on condition that a client takes out credit life insurance, which can be considered as forced insurance. The fact that these institutions provide uncollateralised loans in Namibia can be taken to mean that they are using credit life insurance as both a risk-mitigating strategy and an additional revenue source, and this could be viewed as unfair towards the borrowers. This is because from a consumer protection perspective, conditional selling would be viewed as putting undue pressure on clients (who may not be financially literate) to buy unwanted products and just end up taking what they are offered, the consequences of which could be detrimental. The Centre for European Policy Studies (CEPS, 2009) states that practices that

[90] Helms and Reille (2004) cites research by ACCION International, which found interest rates ceilings in Colombia to have repressed the development of commercial microfinance in the country, primarily by discouraging microfinance NGOs from transforming into licensed financial intermediaries

[91] Zambia introduced interest rate ceilings for commercial banks in 2012 and for the NBFIs and microfinance sector in 2013, but they were removed recently in 2015.

restrict customer choice without producing efficiencies for consumers are considered to be unfair, if not objectively justified.

There is however vastly increasing literature on the need for micro-insurance to accompany microcredit, as it is considered not only to serve as security for the lender, but that the client also has huge advantages from being insured. According to Shand and Angove (2013), credit life insurance protects the lender against defaults on repayment and provides them with an opportunity to earn additional fee income in the form of commission and administration fees, while at the same time allowing them to offer a broader set of financial products. On the side of the borrower, they assert that it protects the dependents of the client from the obligation to repay in the event that the borrower (policyholder) dies and/or the borrowers themselves in the event they become retrenched or disabled. Shand and Angove (2013) further view credit life insurance as having the potential of playing a significant role in supporting access to finance and as a stepping stone to economic development across a broad base, given the decreased risk it provides to lenders. They further argue that credit life insurance is often the first insurance encounter for low-income consumers. In fact, credit life insurance has been reported to dominate micro-insurance worldwide, as evidenced by a global insurance scan in the 100 poorest countries by the Microinsurance Centre in 2007, which found that 36 per cent of all the insured and 60 per cent of life products were directly linked to credit schemes (Roth, McCord & Liber, 2007, cited by Calvin & Coetzee, 2009).

In South Africa, a country where micro-insurance has been most prevalent relative to other countries in southern Africa, it is estimated that credit life insurance constitutes 40 per cent or more of the total formal micro-insurance in the country (Calvin & Coetzee, 2009). An investigation by Shand and Angove (2013) that sought to gauge trends in the consumer credit insurance market in South Africa from the customers' perspective found as questionable the value derived by South African consumers from credit life insurance and concluded that credit life insurance served the interests of the credit provider in the first instance.[92] They particularly found credit life insurance to be seemingly more expensive than life policies available on the open market, and that they limited the ability of consumers to exercise freedom of choice for the possible cheapest available option in the market. They also found information on credit life insurance to be insufficiently disclosed. While no study could be located on Namibia on this issue, the researcher is of the view that similar findings

[92] They however cautioned of a limited sample of interviewees and that results cannot necessarily be generalised.

could be applicable to Namibia. As such, while some of the literature discussed earlier in this section suggest that this product, offered by the surveyed institutions in Namibia as a condition for obtaining a loan, may prove to be beneficial to the clients of those institutions as well, the above findings on South Africa present good lessons for Namibia. The researcher therefore sees the need for Namibia to ensure that regulation on insurance programmes for the poor balance the above discussed competing outcome possibilities.

5.3.4.3 Outreach

Most responding MFIs (four out of five) have branches widely spread around the country, although most of the branches are in urban areas. Figure 5.1 below depicts the geographical presence of surveyed term-lending institutions around the country. It shows that the northern part of the country as well as the central, western and eastern parts have been very attractive to the responding term-lending MFIs relative to the southern part of the country, i.e. fewer term-lending institutions have a presence in the southern part of the country.[93] This pattern could be a direct result of the fact that the majority of the population of Namibia lives in those parts of the country, especially the northern parts of the country, where more than 60 per cent of the population resides (NSA, 2012b).

Town-wise, there is a concentration of term-lending institutions around the capital city (i.e. all five responding term lenders have presence in Windhoek), but other towns are also fairly covered, as evidenced by the number indicated next to each town in the map below. The distribution is actually similar to that observed geographically, such that the northern towns of Rundu and Katima Mulilo, Grootfontein and Otjiwarongo as well as Walvis Bay and Swakopmund in the west and Gobabis in the east have the presence of four of the five responding MFIs and are therefore in second place to Windhoek. Towns in the southern part of the country have fewer representation. This pattern also follows the population pattern in that Windhoek is the most populated city in the country, followed by Rundu town in the northern part of the country and Erongo (Walvis Bay and Swakopmund) in the western part of the country. Towns in the southern part of the country are among the least inhabited in the country.

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[93] The northern part of the country is represented by the regions Omusati, Ohangwena, Oshikoto, Oshana, Kavango and Caprivi; the central part is represented by the Khomas and Otjozondjupa regions; the western part by the Erongo and Kunene regions, the eastern part by the Omaheke region; while the southern part of the country is represented by the Hardap and Karas (now called !Karas) regions.

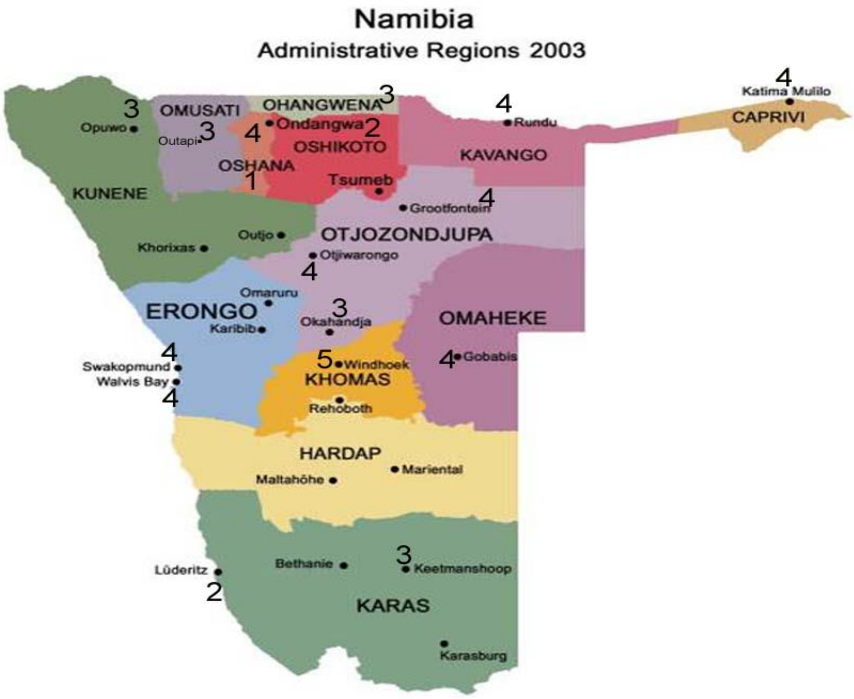

Figure 5.1: Regional presence of surveyed term-lending institutions

Source: Existing map adjusted with researcher information on presence of term lenders[94]

The numbers of active clients and outstanding loans are also good indicators of outreach. Total active clients reported by the survey respondents (four institutions) amounted to approximately 120 795 in 2013, while the number of outstanding loans for three responding term lenders ranges between the lowest of 7 708 and the highest of 48 524 over the same period, as can be seen in Table 5.2 below.

[94] New regions have been introduced in Namibia recently, while the names of some old ones have also changed. However, the old setup and names have been used here to align to the way availed data are organised.

Table 5.2: Outreach of surveyed MFIs (2013)

MFIs	Number of active clients	Number of loans outstanding
MFI1	23 473	22 585
MFI2	50 000	N/A
MFI3	5 642	7 708
MFI4	N/A	N/A
MFI5	41 680	48 524
Total	**120 795**	**78 817**

Source: Survey results; note: N/A stands for “not availed”

The above cited figures are however below the industry reality, as eight term-lending MFIs are in the country, while only four institutions provided their data on the number of active clients and only three provided data on loans outstanding. Therefore the data represent only approximately half of the industry position.

According to NAMFISA, total active clients of the microlending industry was 183 210 at the end of 2011 (which is approximately 8 percent of the Namibian population[95]). These figures are relatively comparable to those for MFIs in some countries on the African continent, such as Zambia but are significantly lower than for those in much MFI matured countries such as Kenya. The number of clients served by the consumer payroll MFIs in Zambia (that operate on a similar basis as most of the Namibian microlenders (including some term-lending MFIs) totalled 169 949 (Brouwers *et al*., 2014). In Kenya, the number of active clients of the credit-only MFIs amounted to 368 740 (AMFI, 2014). Although comparison at this level is generally not ideal, given the differences in population, this comparison gives an idea of how Namibia is faring in this area relative to other countries in Africa, especially as these surveyed institutions are leading in this sector in terms of the value of loans disbursed. Information on the repayment rates has not been provided, but the researcher assumed that these institutions would have high repayment rates, as most of them receive repayments through deduction at source, i.e. deductions are done by employers of clients on salaries.

The survey revealed that this type of MFIs mostly lend to employed and salaried people. Four of them (80%) also indicated that they do not require collateral (see Table 5.3 below),

[95] The latest available figure on the total population of Namibia is 2 392 000 (NSA, 2012b).

as the deduction for instalments are done at source through deduction codes[96] to the payroll. It was established that these deduction codes are provided by government, suggesting that the majority of people covered by these institutions are public servants. This in itself is a limitation to outreach, as the unsalaried, self-employed and poor people are not covered, which is not in line with the principle of the microfinance concept. Microfinance is defined as the provision of small-scale financial services to the poor or the poorest among the poor (WSBI, 2009). This definition implies that microfinance has a goal of providing an opportunity to these groups of people to become self-sufficient. All participating institutions also indicated that they offer consumption loans. It can therefore be concluded that credit extended by these types of institutions is meant to complement the monthly income of salaried individuals who already are participants in the financial system in one or the other way and does not necessarily enhance financial inclusion. As such, the current outreach of the term-lending MFIs is also not in line with the aspirations of the country, which aims to enhance financial inclusion.

Table 5.3 below presents some key data and information related to the MFIs' lending activities. The responding MFIs have managed to play a role in facilitating access to credit to their target segment to the extent represented by the number and value of loans extended depicted in Table 5.3. Accordingly, the number of total loans disbursed by these institutions stood at 121 413, while the average loan amounts fell between a low of N$4 293 and a high of N$20 000. Although this is not a total industry picture, but only a portion of the participating credit-only term-lending MFIs, it gives an indication of the scope of activities and operations of players in the industry, which is considered as a possible candidate for developing the microfinance sector in Namibia. Comparatively, however, these ranges are much lower than those reported for neighbouring South Africa, where microlenders provide varying loan sizes with maximum sizes of between N$7 000 and N$500 000 (Shand & Angove, 2013).

[96] Deduction codes are a means through which government facilitates preferential deduction of loan instalments for lenders through the payroll of government employees. Only a limited number of microlenders have been allocated such codes based on them having met certain requirements by government, such as lending for education purposes.

Table 5.3: Key data and information on credit provision of surveyed MFIs (2013)

MFI	Number of loans disbursed	Value of loans disbursed (N$)	Loan size range (min-max) N$	Average loan amount (N$)	Lending method	Profile of clients (% female)	Operation in rural & urban areas (%)	Collateral required?
MFI1	22 585	313 mil.	2 000–50 000	20 000	Individual	32.0	67 (urban)	No
MFI2	46 000	1.2 bil.	1 000–50 000	16 000	Individual	N/A	N/A	No
MFI3	4 304	25.9 bil.	500–8 000	4 293	Individual	41.73	N/A	Yes
MFI4	N/A	107 mil.	N/A	6 509	Individual	N/A	N/A	No
MFI5	48 524	517 mil.	2 599–21 599	12 099	Individual	N/A	N/A	No
Total	**121 413**							

Source: Survey results; note: N/A stands for "not availed"

Whether or not the term-lending microfinance industry has made an impact, which a microfinance industry would normally be expected to make (i.e. poverty reduction), needs to be judged based on their target market, which is employed people, mostly government employees that are based in urban areas. Based on that, the researcher argues that term-lending microlenders are not contributing to poverty reduction in Namibia. The fact that they do not lend to small businesses also renders their contribution to the development efforts of the country questionable.

5.3.4.4 Lending methodology and collateral requirements

In addressing the market failure of credit provision to the poor created through risk-averse conventional banking institutions, MFIs around the globe have been providing loans to their customers without requiring physical collateral. This has been made possible by employing the group-lending approach, where poor borrowers assume joint liability for the loans and thereby act as guarantors for each other (Ross & Savanti, 2005). Ross and Savanti (2005) cite early work by Stiglitz in 1990 and Varian (also in 1990) as initial literature providing the theory behind microfinance and group lending, as this analysed how joint liability may induce borrowers in a group to screen each other's abilities and monitor each other's efforts, thereby alleviating moral hazard problems.[97] This is in contrast to the individual or personal

[97] Moral hazard here refers to a situation whereby one member's failure to repay could lead to another doing the same.

lending approach, where credit is extended to an individual borrower (Maria, 2009, cited by Kodongo & Kendi, 2013).

Empirically, the group-lending approach has been used successfully in the microlending programmes of some parts of the world to expand their reach (Kodongo & Kendi, 2013). Group lending has been preferred because it is considered relatively of low repayment risk when compared with individual lending, which is associated with higher default rates, as clients of MFIs are typically low net worth individuals (Kodongo & Kendi, 2013). While MFIs also lend to individuals, a study by Kodongo and Kendi (2013), which evaluated individual lending and group lending using Kenya's microfinance data, found high interest rates to increase the odds of client delinquency and suggested a graduated scale for charging interest rates in which credit is extended to groups first to hedge the repayment risk of firms, after which firms can identify individuals within the groups with improved credit risk and progressively issue individual loans to those. Further, in terms of the social impact that can be made by the two different lending approaches, the outcome of a randomised field experiment in rural Mongolia on the comparative poverty impact of group versus individual microcredit conducted by Attanasio *et al*. (2013) revealed a positive impact of group loans on entrepreneurship and food consumption, but not of individual loans. The above implies that the group-lending approach has enjoyed some superior position to individual lending in those countries, although in some other parts of the world different models may have dominated.

In Namibia, the survey detected that term-lending microlenders lend to individuals and do not do group lending (see Table 5.3 above). This is inconsistent with the group-lending methodology followed in countries such as Kenya, discussed above, and other microfinance matured economies such as Bangladesh, as a repayment risk-mitigating measure, where group members serve as security for the loans, as discussed above. Most of the surveyed MFIs have a 'privileged security', whereby employers of their clients are collecting loan repayments on their behalf from the individuals' salaries, and they therefore do not need to be concerned with collateral issues and/or group lending as security. From the researcher's engagements with the surveyed institutions, it was concluded that the choice to lend on an individual basis seems to be simply a preferred business orientation.

While empirical literature cited in the previous paragraph associates individual lending with high default rates, this has not been the case for the surveyed institutions in Namibia. This could again be a reflection of the advantages of the deduction codes to payroll to which these institutions are 'privileged',[98] as the repayments by borrowers are directly deducted from their salaries. It could also be a confirmation of the assertion by Kodongo and Kendi (2013) that both the individual and the group approach to lending has strengths and weaknesses, and their quoting of the conclusion by Pereira and Mourao (2012: 101) that default risks of MFIs' credit are not to be generalised, "since they operate in places that are geographically isolated and hence their borrowers exhibiting varying characteristics".

5.3.4.5 Clients

Microfinance has been innately linked with women, i.e. since it started in the 1970s, microfinance has been mainly about women and female empowerment (Cumming, 2012). Cumming (2012) reveals that an average of 73 per cent of microfinance customers globally are female and that 42 per cent of microbanks had declared a conscious biased towards women. D'Espallier, Guérin and Mersland (2009) find a conscious gender bias to be associated with group-lending methodologies, international orientation, female leadership, smaller loans and a non-commercial legal status (which normally includes entities such as NGO-owned MFIs). The basis for bias towards women has been the fact that women have often demonstrated stronger willingness to pay than men (Armendariz & Morduch, 2007 and Phillips & Bhatia-Panthaki, 2007, cited by Kodongo & Kendi, 2013). Unlike NGO-owned MFIs, where distribution of loans is female-biased, very few gender-related differences in clients could be observed from the results of the industry surveyed by this study. Only two term-lending MFIs provided information on gender distribution of their loans. MFI1 reported 32 per cent of its loans to have been extended to women and MFI3's loans to women were reported at 42 per cent. This clearly shows no female bias on the side of these MFIs, and gives an impression that unlike the case of developmental and socially oriented NGO-owned MFIs, gender distribution of loans is not a consideration for credit allocation by the majority of the credit-only term-lending institutions in Namibia, which again shows that they are less development-oriented. Also only one institution (MFI1) was able to make a distinction between the rural and urban credit allocation and reported that 67 per cent of its loans extended went to urban-based clients (see Table 5.3). This reflects the fact that surveyed MFIs (i.e. credit-only term-lending MFIs) mostly lend to town-based salaried people, i.e. their selection of clients is based on earning a regular income. This bias towards urban areas is inconsistent with what is observed elsewhere, where MFIs normally focus on rural lending, given their mission of serving the poor and low-income people. Given that the majority of

[98] Only certain businesses are allocated with the salary deduction codes by government based on fulfilling required criteria.

Namibians (57 per cent) live in the rural areas (NSA, 2012b), where subsistence agriculture is the predominant occupation and poverty levels are high (37.4%), rural lending could have made a difference in those areas and help reduce poverty.

5.3.4.6 Industry performance

Efficiency and productivity are key indicators for measuring the performance of any institution. Abraham and Balogun (2012) cite work done by Jansson *et al.* (2003), CGAP/World Bank (2003) and Saltzman and Salinger (1998), which has identified efficiency and productivity indicators common to the microfinance industry to include the average operating expense ratio that gives an indication of their operating costs, cost per borrower ratio that shows their cost of maintaining an active borrower, the personnel productivity indicator that measures the average borrower per staff member and the portfolio quality that shows how vulnerable MFIs are to repayment risk. This section examines the efficiency and productivity of the term-lending MFIs based on those indicators where data have been provided. It also studies the sustainability of these institutions (both financial and operational), which is important for the continued enhancement of access to finance (Abraham & Balogun, 2012). Financial sustainability indicators for microfinance include ROA and ROE. They, respectively, measure the net operating income as a percentage of average total assets that indicates how MFIs use assets to generate profit, and the net operating income as a percentage of average total equity, which can be used by investors or shareholders to determine the returns on their equity investment (Abraham & Balogun, 2012). These profitability measurements can therefore be used by investors, operators and donors to evaluate the potential viability of an MFI (Abraham & Balogun, 2012); an aspect that becomes important to consider in the context of this study that assessed the potential of these institutions graduating into DMFIs and may therefore need new investors to come on board. The indicators also give an idea of whether or not MFIs have a competitive edge in the industry in which they are operating (Jansson, Rosales & Westley, 2004). Further, as they are expected to serve SMEs (and the poor), their sustainability is important to ensure that they have the capacity to continue serving those for a long time.

The survey results showed positive ROAs for all participating term lenders that provided information in this regard (four out of five institutions), which is a good sign for sustainability. In 2013, the average ROA for these institutions stood at 5.94 per cent, with the lowest ROA of 0.45 per cent belonging to MFI5 and the highest of 12.1 per cent belonging to MFI2. The average for sub-Saharan Africa reported by MIX stood at -0.2 per cent in 2010. The average

ROE of the surveyed institutions stood at 20.75 per cent, way above that of the overall sub-Saharan African region reported by the MIX at 2.3 per cent in 2010 and the 10 per cent benchmark for a financially healthy position published by the UN in 2013.

Further, the performance of these Namibian term-lending MFIs fares well compared to those of Asian countries known to be among the pioneers in microfinance, such as Bangladesh and India, for which MIX reports ROAs of -1.3 per cent and 1.4 per cent and ROEs of -7.4 per cent and 12.0 per cent, respectively. Term-lending MFIs in Namibia are therefore generally self-sufficient financially. This situation can partly be reflective of the fact that most term lenders have been benefiting from the arrangement to have their repayment done through salary deductions, which have provided the necessary security. Jansson *et al*. (2004) argue that the credit methodology, credit terms and markets in which to operate selected by institutions directly affect their efficiency and productivity. Table 5.4 presents the productivity and efficiency ratios and indicators for the participating term-lending MFIs.

Table 5.4: Productivity and efficiency ratios/indicators of participating MFIs (2013)

	Average operating expense ratio	**Cost per borrower (N$)**	**Average borrower per staff member**	**PAR>30 days**
MFI1	6.2	809	0.23	1
MFI2	18.1	N/A	0.10	N/A
MFI3	N/A	N/A	N/A	N/A
MFI4	1.67	108	0.21	N/A
MFI5	11	1114	0.13	3.9

Source: Survey results; note: N/A stands for “not availed”

The above table shows an average operating expense ratio of 9.2 per cent, way below sub-Saharan Africa’s average of 30.1 per cent reported by MIX in 2010, indicating that the operating costs of these institutions are within the tolerable limit. While the high continental average operating expenses have been attributed to high staff expenses and high transactional costs (MIX/CGAP, 2011 and Orodje, 2010, cited by Abraham & Balogun, 2012), the institutions surveyed do not necessarily have to endure those costs to that extent, given the lending and collection approach that they employ, i.e. loan repayments are deducted from clients’ salaries. The average borrower per staff member ratio for responding institutions, a productivity indicator, has been very low at 0.17 per cent, with the lowest (0.10 per cent) being for MFI2 and the highest (0.23 per cent) for MFI1. These are way below the 93 for sub-Saharan Africa published by MIX. The low ratios for surveyed Namibian MFIs could be a reflection of reduced workload for staff of the institutions, as they are not really engaged with the loan-recovery function, as repayment is mostly effected through deduction on salaries.

Only MFI1 and MFI5 provided data on the quality of their loan portfolio measured by the PAR>30 indicator. MFI1 reported a 1 per cent portion of its loan portfolio being at risk, while MFI5's repayment risk portfolio stood at 3.9 per cent. While these are above the MIX-reported ratio of 0.4 per cent for India and comparable to 3.4 per cent for Bangladesh, which are some of the matured countries in the area of microfinance globally, they are below the 5.9 per cent for the sub-Saharan Africa region. These relatively low risk ratios are again a reflection of an effortless loan-recovery process for term-lending MFIs, which should have put management of these institutions in a comfortable position.

Overall, the above findings revealed that the participating term-lending MFIs have performed efficiently and productively, and are profitable. The focus on urban salaried people has however been a setback to outreach and their contribution to poverty reduction in the country is questionable, given that this target market leaves as unmet the demand for credit in the rural areas of the country. This situation is identifiable with a funding structure that is mainly reliant on own funds, in which these institutions find themselves, in that they tend to focus more on well-off employed clients rather than the poor. With regulation allowing them to mobilise savings, the scope and breadth of their outreach may increase to also include other groups, such as the poor. This should therefore be the motivation for regulating these institutions going forward.

5.3.5 Stakeholder views on the Namibian microfinance industry

As indicated in the previous section, part of the fieldwork involved interviews covering various qualitative aspects aimed at gauging Namibians' understanding of the term 'microfinance', thereby establishing what microfinance is in the Namibian context and their views on the regulation of MFIs[99] as well as on the growth and/or constraints to growth of the microfinance sector, in addition to those obtained through the survey.[100] This was

[99] Views relating to the regulation of MFIs are discussed in Chapter 6.
[100] Views from the sector itself were also collected through the survey.

considered important, given the country's objective of developing the microfinance sector and hence the need to establish the extent of clarity among stakeholders on the aspect of microfinance and its regulation. The selection process of stakeholders was guided by a definition of key stakeholders of microfinance that include providers of financial services (banks, MFIs, NBFIs and their associates), regulators (central banks, financial regulators, consumer protection agencies) as well as consumers, individuals and advocacy organisations provided by Ledgerwood *et al*. (2013).

As stated in the methodology chapter, interviewees were also purposively selected based on the research aim and objectives of the thesis. A total number of 22 stakeholders were interviewed, drawn from the microfinance sector itself (i.e. practitioners), regulatory authorities, policy and law makers, relevant industry associations (such as the Bankers Association of Namibia and the Association of Microlenders in Namibia), other interest groups (including users of microfinance services) and experts in the field of microfinance. These groups were considered relevant for the research agenda of this study because of their experience in the sector and/or their expertise either as practitioners, policy- and/or law-makers, implementers and enforcers of policy and regulatory decisions, or having close links to the sector. They were therefore considered skilled and knowledgeable of the subject matter to be able to provide insight into the research. The researcher used a simple coding system to preserve the interviewees' confidentiality so that specific responses would not be linked to specific interviewees. However, in some cases specific names are cited, especially of those who did not have a problem with disclosing their names. The coding system used identifies first of all what category an interviewee belongs to (e.g. MFI, regulator, expert, etc.) how many institutions/organisations were involved (e.g. the number of regulating authorities or MFIs in that category), how many people were interviewed in that category or institution[101] and what number was allocated to that specific interviewee. Details of the codes, especially the first level of the codes, are presented in Appendix F. In order to differentiate between the MFIs surveyed (as coded earlier under the sections on survey results) and those to which interviewees belonged, the codes for the latter starts at MFI6, i.e. the number following the last one used for the surveyed MFIs, which is MFI5. Figure 5.2 below shows the number of interviewees per each of these categories.

[101] Where a category consists of only one institution then the next step goes directly to how many people were interviewed. This is especially true for the categories MFIs and regulators which are already split up into individual institutions.

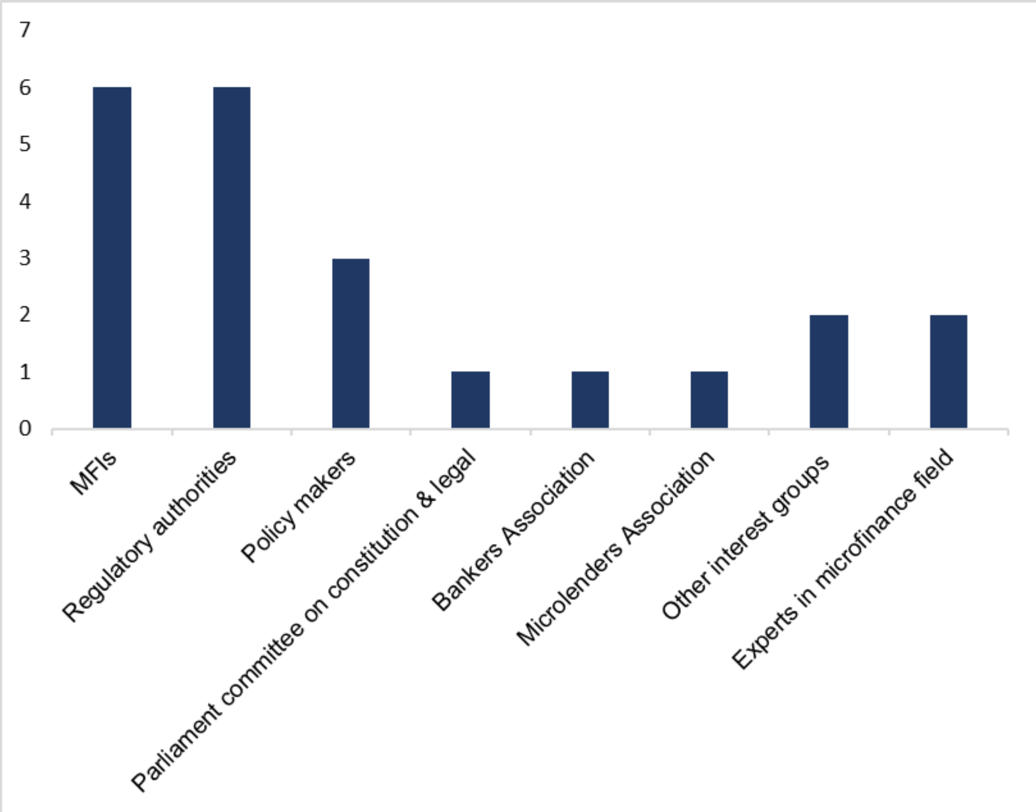

Figure 5.2: Interviewees per category (number)

Source: Researcher's records

Note: The MFI category includes those who sent in written responses as indicated in Appendix D

The ensuing sections present the interview outcomes. Where relevant, and for illustration purposes, response quotes that are most representative of the findings are also presented, while others can be made available on request.

5.3.5.1 Defining microfinance

In order to ascertain the understanding of the concept of microfinance by Namibians, the interviewees were asked to define microfinance. It was noted that the understanding of the microfinance concept differed among the participants, depending to a large extent on which category or group they belonged to, but also between individuals belonging to the same category/group. Experts in the field, those from the regulatory authorities and some practitioners (five interviewees in total), provided definitions that are in line with the standard definition of microfinance that broadly includes microenterprise lending, microsavings and any other financial services specifically targeted at the lower end of the market and which was presented earlier in this thesis. For illustration purposes, some of the definitions provided by the interviewees from these categories are quoted in the box below, on the specific question posed by the researcher (i.e. the interviewer).

Box 5.1: What is your understanding of microfinance?

"Offering financial services, banking services and lending products for [a] low-income population, with strong focus on micro and SMEs" [Exp/2/2(1)]

"It is a concept relating to the provision of finances such as microcredit, microsaving, agricultural microloans, money transfer in small sizes to low-income people, including small businesses" [MF6/1/(1)]

"Money extended to a natural person or company, but the main aim is the purpose of the loan. Need to be for productive purposes (generation of income). But don't limit it to income generation but even if it is for housing purposes. Microfinance also traditionally accepts savings" [Reg1/2/(1)]

The researcher observed an association of microfinance with small businesses and start-ups only by six interviewees, indicating it is not provided to individuals, as illustrated by some of the quoted responses in the box below. This view was mostly held by experts and regulators (four), though some practitioners (two) also expressed the same view. It diverges from the standard definition in that microfinance can also be extended to individuals who might in turn use it to engage in income-generating activity, and not only to small businesses.

Box 5.2: What is your understanding of microfinance?

"Microfinance is not for personal loans but is set on financing small businesses - more on a smaller scale. It is not for one person but say for a group of farmers, more for upliftment" [MLA/1/1(1)]

"It is for start-ups, near start-ups and small businesses emerging and trying to become businesses" [BA/1/1/(1)]

"It is finance for small or micro businesses which normally do not have access to formal banking services or finance" [Reg2/3/(3)]

Five interviewees, mostly from other interest groups and policy- and law-making fraternities, associated microfinance with microcredit only, showing that they did not have a clear understanding of what microfinance is. This could be because microlending provided by credit-only microlenders is the dominant activity in the country in this sphere, i.e. this is what most people in Namibia get to see and experience. The definitions also therefore diverge from the standard definition of microfinance, as it only contains one component of what microfinance should be. Quoted below is an example of a response that speaks to this finding.

> *"Dealing in transactions between a lender and a client or beneficiary in small loans, especially to low-income people"* [PM/2/3/(1)]

5.3.5.2 The Namibian context of microfinance

Only a small number of interviewees (three) believed that microfinance was happening in Namibia. The majority of the stakeholders (ten) that responded to this question thought there was either little to none happening in that area or that there was confusion about the whole issue of microfinance in the country and called for the need to define it and provide clarity. The quoted responses in the box below are an illustration of these findings.

Box 5.3: Can you define microfinance in the context of Namibia?

"Except for FIDES, the definition I provided earlier does not apply to Namibia, maybe DBN is doing it" [MLA/1/1(1)]

"In terms of financing, microfinance is happening in Namibia, but the component of micro-insurance is not there, money transfer is also not there. Most of the current providers are doing microcredit, but you also need microsaving and micro-insurance. There are no regulatory instruments or legislation to guide the process" [MFI6/1/(1)]

"It is fragmented with very little clear guidelines … not well coordinated … until we have that coordinated commitment nothing will happen to SMEs" [BA/1/3/(1)]

"Salary loans to government officials, almost bridging finance, to get them from one month to the next. They are not engaged in productive activities" [MFI8/2/(1)]

Interviewees who came forth as having a clear understanding of what microfinance is could not identify any other microfinance services or products offered in the country, although one of them made reference to the one microfinance bank in Namibia as well as the DBN as possible institutions that were doing that. There was also concern raised about the absence of an officially determined definition of microfinance in the country (as illustrated in the box below), which they thought was causing a lack of clear understanding of what should constitute microfinance.

Box 5.4: Can you define microfinance in the context of Namibia?

"The perception in Namibia is that microlending and microfinance is the same, i.e. anything not offered by banks, but it shouldn't be" [Exp/2/2(1)]

"In Namibia microfinance is small still, and is linked to microlending only which is getting small loans on an unsecured basis, but microfinance should be linked to social programmes. Namibians thus don't have a clear idea and initiatives of microfinance are little. They only think about consumption lending" [Reg/2/3/(2)]

"… currently we are indifferent in terms of what we call microfinance, there is a need for defining microfinance properly in the country" [Reg/2/3/(1)]

From the outcomes of the interviews discussed above, it is clear that microfinance in Namibia is mostly associated with microcredit only. A documentary review process revealed that NAMFISA, in accordance with the Government Exemption Notice of 2004, has a definition for a microloan, which is applicable to the microlending institutions it currently supervises, i.e. an amount not exceeding N$50 000, as discussed earlier in this chapter. While the current banking law does not speak to microlending, the draft amended BIA 2015 (i.e. the Bill) defines a microloan as "a loan of not greater than an amount as may be set by the Bank of Namibia by notice in the Government Gazette from time to time", which implies that the definition and/or the level is bound to change from time to time. In this regard, Section 10.1 of the current draft Determinations that will enforce the implementation of the provisions of the envisaged amended BIA sets the maximum size of a single microloan at N$200 000. Discussions with staff in the Banking Supervision Department at the BoN, however, revealed the intention to harmonise the two definitions so that a microloan is the same whether one takes it from a credit-only microlender or from a deposit-taking institution. CGAP (2012: 11) is of the view that "regulatory definitions of microfinance and microcredit should be tightly framed to meet specific regulatory objectives and should not simply be drawn from general literature on microfinance". This is a relevant aspect that the country should take into consideration in its process of defining what microfinance in the context of Namibia should be.

According to CGAP (2012), there is no standard regulatory definition of microcredit or microloan that would be suitable for global use, but there are general practical cautions from the experience of countries that have crafted their own definitions for a variety of regulatory objectives that can be considered. This therefore implies that while this process should be a country-specific matter, which should be informed by its peculiar environment, there is a need to learn from other countries regarding how they defined their microfinance, especially those with similar economic situations. The Microfinance Act 2006 of Kenya and the Micro Finance Deposit-taking Institutions Act 2003 of Uganda give an indication of how these countries define microcredit and small loans. Kenya defines a microloan in terms of the provision of loans to micro or small enterprises and low-income households and receiving deposits for on-lending; while GDP per capita is taken into account in defining small loans. Uganda defines microcredit by the principle of the principal business of accepting deposits and employing such deposits by lending, including the provision of short-term loans to micro-enterprises and low-income households, usually characterised by the use of collateral substitutes, while small loans are constituted as less than 1 per cent of core capital for individual borrowers and less than 5 per cent of core capital for group borrowers. These, and those of other countries which Namibia may consider as relevant to learn from, should provide guidance to the country in defining what should constitute microfinance and a microloan. Doing so will clarify the apparent confusion the absence of a clear definition of those issues has created among some of the stakeholders, as evidenced by the views of the respondents discussed earlier in this section.

5.3.5.3 The role microfinance plays in the Namibian economy

Through the responses provided to the question on the role they thought microfinance was playing in the Namibian economy, the interviewees generally held a view that microfinance is playing an important role in the economy. Three interviewees (a combination of those from the expert category and from the regulatory fraternity), however, qualified that role by cautioning on the role microcredit provided by credit-only MFIs that lend for consumption purposes (and that were in the majority in the country) was playing in the economy, and that they were not lending for productive purposes. This is illustrated by the quotes in the box below.

Box 5.5: What role do you think microfinance plays in the Namibian economy?

"Yes, they do play a role of filling a gap that the banks haven't fulfilled, they help the 'now' needs (emergency loans), for example to take a child to hospital, school fees, etc. A loan where you only need a pay slip and no collateral. Statistics show they do play a role, although the average of pay day lenders is N$1 000, while for term lender [it] is higher" [MLA/1/1(1)] *"They are playing an important role of enabling people to have access to finance and thus enhancing financial inclusion. Thus when regulating, you need to make sure that you [are not] an obstacle to that role"* [PM/2/3/(1)] *"It is tricky. Individually looked at, they might have a role because they are providing for a need which is there. It is a last resort thing and a client can benefit from that. Consumption financing is a problem, therefore it is difficult to see the relevance of microlenders. When you have proper specialised finance houses such as MFIs which offer microfinance products, they can play a role"* [Exp/2/2(1)]

Those who were concerned with the extent of consumption-related credit provided by credit-only microlenders would want microfinance to be directed to productive activities rather than consumption, as illustrated in the box below.

Box 5.6: What role do you think microfinance plays in the Namibian economy?

"I want to see it defined as financing for production purposes. If for consumption purposes, then there is no end result to it" [Reg/2/3/(1)] *"The availability of funds to entrepreneurs is critical. It doesn't matter how clever you are, if you don't have funds, you can't do anything. Responsible lending can create economic activity and if you have an enabling environment, benefits to the economy are enormous. Currently, the environment is not enabling, as it is very difficult to do business in Namibia"* [MFI8/2/(1)]

5.3.5.4 Growth of the microfinance sector

Views on whether or not the microfinance sector in Namibia was growing were also divergent. While the majority (six) of those who responded to this question thought the sector has been growing, especially based on the statistics they picked up from NAMFISA reports, a concern was also raised that the lack of a clear definition for the sector posed a limitation in determining whether the sector was growing or not (see illustrated answers in the box below).

Box 5.7: In your view, is the microfinance sector in Namibia growing?

"Yes, it is growing because of people needing overdrafts, etc. because of the high cost of living and some wanting to set up businesses. But whether at the pace and level they should be is a different matter" [PM/2/3/(1)] *"I am not sure because I am not sure who are the MFIs in Namibia – I only know of Namibia Housing Action Group… however more institutions are entering the microlending sector and thus there is growth there both in terms of entry and the loan book, approximately 30 new microlenders are registered every year. There is no national common understanding of MFIs in Namibia and thus everything is lumped in one, including microlenders"* [Reg1/2/(1)]

What has come out clearly from the interviews, though, is the fact that the credit-only microlending industry has been expanding tremendously, with more players having entered the market in recent years. To verify this fact, the documentary review process detected that in 2014 the industry had 289 institutions (281 pay-day lenders and 8 term lenders), a significant increase from only 137 in 2005, and that its book value had reached approximately N$2 billion in 2014 (NAMFISA, 2015b). One interviewee was of the view that the industry has been growing "because of people needing overdrafts to supplement their income due to the high cost of living" [PM/2/3/(1)]. Despite the observed growth, it remains to be seen how many credit-only MFIs would venture into entering the deposit-taking environment going forward. It will also depend on whether or not some of these microlending institutions would be willing to give up the current benefits they are enjoying, in the form of exemptions and adjustments to prudential regulation, which were discussed earlier in this chapter.

5.3.5.5 Constraints to the development of the microfinance sector

With regard to the question of whether the participants thought there were any constraints to the growth of the microfinance sector in Namibia, factors highlighted by stakeholders were both regulatory and non-regulatory in nature. Four interviewees highlighted regulatory-related constraints, including a lack of an enabling legal framework to spur the development of the sector. The current legal framework under which the only DMFI was being regulated together with conventional banks was viewed as limiting and an obstacle to entry, given it is meant to regulate traditional banking institutions. The same was felt applicable to the requirements of the Usury Act under which microlenders are being regulated. Also, the fact that Namibia does not have a small claims court and hence no fast way of dissolving disputes was cited as a constraint in that there is no mechanism to assist those who are lending on an unsecured basis to collect their dues efficiently. The box below provides an illustration of these findings.

Box 5.8: Are there any constraints to the development of the microfinance sector in Namibia? Please explain your answer.

"There is no enabling regulatory framework, as there is no dedicated legislation for microfinance. There is a need for a microfinance bill that makes provision for savings. The current microlending bill only caters for microlending" [Reg1/2/(1)]

"The Usury Act is a constraint to entry and thus needs to be removed. We also don't have a small claims court and thus no fast way of dissolving disputes, as the current legal process is too cumbersome. If I lend out without collateral, then I need a mechanism to assist me to collect my money" [MFI8/2/(1)]

Other sentiments expressed related to a combination of microlending being an unsecured business that comes with risks and the stricter requirements brought in by the new regulations on deduction codes that stipulate that the total cost of the loan of those to qualify for the use of deduction codes should not exceed the prime rate times 2, i.e. the interest rate has been capped for those wanting to utilise government's deduction codes as a debt-collection approach. See the quote below as an example of the type of responses in this regard.

> *"… because it is unsecured lending. The new regulations on deduction codes also make it difficult for any microlender to continue operating, as the risk has increased for service providers"* [MFI9/1/(1)]

The researcher understood from engagements with relevant staff in the Ministry of Finance that these new regulatory requirements are part of the bigger financial inclusion agenda of government that aims to facilitate affordable credit to previously disadvantaged Namibians.

5.4 IMPLICATIONS OF FIELDWORK RESULTS FOR THE DEVELOPMENT OF THE SECTOR

In this section, possible implications of the fieldwork and documentary review findings for developing the DMFIs in Namibia are discussed. These are issues that need to be taken into consideration as Namibia develops its regulatory framework for MFIs in order to ensure that it designs an appropriate regulatory framework that can facilitate the development of the sector envisaged by policy makers. This is important, especially in view of the fact that the country views regulation as an enabler in this process. The key issues identified by this thesis are discussed below.

5.4.1 A lack of official definitions of microfinance and microfinance providers

The fieldwork results pointed to the lack of definition of microfinance in Namibia as having caused confusion and a lack of understanding among stakeholders. As discussed under Section 5.3.5.2, the interviewees were not sure as to which institutions are supposed to be MFIs and which not; some associated microfinance with only credit provision, while others felt credit-only microlenders are not to be considered as MFIs. Another related concern raised by the stakeholders is the lack of distinction between consumption-driven microlending and micro-enterprise lending, which they considered to be more developmental-focused. They considered providers of micro-enterprise lending as the appropriate institutions that should be referred to as MFIs and not those involved in lending for consumption purposes, such as those in the majority in Namibia at the time of this research.

Considering that the policy objective for wanting to develop the microfinance industry in Namibia has been expressed by the country’s Financial Sector Strategy as part of financial inclusion and aims to facilitate increased access to micro-enterprise loans and other financial services such as microsavings and micro-insurance, it is important for the country to get the intra-definitional issue sorted and be able to determine which activities are to be considered as microfinance activities and hence which institutions are MFIs and which not. According to CGAP (2012: 11), “an appropriate regulatory definition must be based on a clear articulation of the country- and situation-specific objectives the regulation is meant to serve”. In the case of Namibia, therefore, and in order to design an appropriate regulation and enforce it with a financial inclusion objective achieved (through microfinance), regulators need to understand the distinctive characteristics of microfinance, including clients and their needs, products and services, and institutions providing those products and services (CGAP, 2012). This will also eliminate the current confusion among stakeholders which the researcher observed during the interviews, and enable both current and potential industry players to make out what they are into and/or getting into. For instance, the aspects of consumer microlending and micro-enterprise lending should be clarified, i.e. whether both are to be considered as microfinance or not.

Furthermore, because of the existence of many institutions that offer financial services to the poor alongside products targeting more affluent clients, and not necessarily as a primary business activity, there is a need to make that distinction, because often the risks that regulation and supervision are intended to address will be different in the context of a diversified financial service provider (CGAP, 2012: 6). As such, where banks are involved in the provision of microfinance, there should also be a clear distinction between microfinance business and pure banking business, such that only the microfinance operations of banks should be included in the definition. Currently, any small loan provided by commercial banks, regardless of the purpose it is taken for, seems to be considered as microfinance. Clarification is necessary to ensure proper monitoring and evaluation of the progress and impact made by the sector going forward, in terms of serving the poor and SMEs, a role which the country expects these institutions to play.

In the process of defining microfinance, it will be important to learn from other countries' definitions of microfinance and adapt relevant ones to the Namibian situation. For example, Uganda under the same Act referred to earlier (the Micro Finance Deposit-taking Institutions Act 2003) defines microfinance business as the acceptance of deposits and the whole or partial employment of such deposits in the provision of short-term loans to small or micro-enterprises and low-income households, usually characterised by the use of collateral substitutes, such as group guarantees or compulsory savings. The key elements contained in all of these examples relate to micro-enterprise lending with the typical characteristics of group-lending methodology, collateral substitutes and greater client interaction, as opposed to consumer lending, which seemed to dominate in Namibia.

It is however important to note that the microfinance sector is evolving. While microfinance initially was about extending loans of small and smallest amounts to the rural poor for income-generating activities, it has evolved into a tool for supplying access to financial services for the unbanked (i.e. it has become a tool for financial inclusion) in the emerging and developing economies (Ledgerwood *et al*., 2013; Lützenikirchen & Weistroffer, 2012). This has not only come with a widening product range and a changed base for microfinance customers, but also with larger average loan sizes and an increased share of finance for household needs (for consumption, but also education and medical care) other than just for investments. For instance, the share of household needs financing is estimated at an average of 25 per cent of MFIs' total lending volume, though the actual number could be higher given that it is difficult for MFIs to control what the loans are actually used for (Lützenikirchen & Weistroffer, 2012). There has therefore been an increase in the number of those served by the sector, and this has called for a more financially efficient sector. As such, the sector has transformed into a more commercialised sector as MFIs seek to be sustainable so as to be able to continue providing their much-needed services. Literature therefore suggests that the key consideration should be for the definition to be flexible enough so as not to deter desirable market entrants and innovation in terms of product offering, while at the same time not losing the social purpose and typical clientele of microfinance. The above should therefore guide the process of Namibia coming up with its definition of microfinance and MFIs.

5.4.2 Interest rate limits

The researcher learnt from the survey and documentary review about the existence of interest rate limits that are currently imposed on microlenders based on the Usury Act and the Exemption Notice provisions that regulate them. As discussed earlier in this chapter, the issue of interest rate ceilings, i.e. the limits on the level of interest rates that financial institutions are allowed to charge, such as the caps imposed by the Usury Act in Namibia, is among the debated issues in literature, especially in as far as the case of MFIs is concerned. CGAP (2006) quotes the findings of a study conducted by the UK Department of Trade and Industry that assessed the impact of imposing interest rate ceilings in countries such as the USA, Germany and France, which found that interest rates ceilings had a negative effect on low-income people. Despite the fact that the ceilings are meant to protect low-income people from high predatory lending practices and excessively high interest rates, the study findings revealed that when ceilings are imposed, the choice of loan products offered by financial institutions become narrow and less appropriate to the needs of the poorer clients (CGAP, 2006).

In the case of MFIs, while the argument of the high cost of loans and predatory lending practices could be valid and applicable, it is argued that high fees and charges keep MFIs afloat (CGAP, 2006) and are needed for their sustainability, especially considering the high transaction costs involved in their lending processes. Further, Helms and Reille (2004) argues that imposing interest rate ceilings also makes it difficult for MFIs to cover their costs, and this could have the effect of either driving them out of the market or even becoming an entry barrier to potential MFIs. When this happens, it can lead to a lack of access to financial services by poor clients as MFIs retreat from the market due to their inability to cover operating costs. A resulting consequence of this lack of access would be for the poor clients to revert to informal credit markets, which are even more expensive, such as money lenders (Helms & Reille, 2004).

It is clear from the above that imposing interest rate ceilings might not necessarily be advantageous for any of the stakeholders of microfinance (i.e. neither providers nor the clients). It is therefore important for regulation to take into consideration both the cost of credit and the sustainability of MFIs in determining the optimal interest rate to be charged by MFIs. In fact, the job of regulation should be to provide an enabling legal environment that encourages entry and enhances competition so that competition would eventually bring down interest rates and make credit more affordable for the poor.

5.4.3 Conditional selling

The fieldwork outcome also revealed a practice of term lenders offering credit life insurance as a condition for providing loans to clients, i.e. a loan is only disbursed if a client takes out such insurance. This could be considered as forced insurance and an unfair practice from a consumer protection perspective, as discussed earlier in this chapter. However, the vastly increasing literature on the need for micro-insurance to accompany microcredit suggests that micro-insurance not only serves as security of the lender, but that the borrower also receives huge advantages from being insured. In fact, Shand and Angove (2013) view credit life insurance as having the potential of playing a significant role in supporting access to finance and therefore a stepping stone to economic development across a broad base, given the reduction in risk that it provides to credit providers. The downside, however, lies in the evidence of the often associated misselling, misrepresentation, misuse and/or abuse by some providers found in some countries such as in South Africa, Australia and the UK. In South Africa, Shand and Angove (2013) found credit life insurance to be expensive relative to life insurance, with insufficient disclosure while it also offered low value to customers. Cases of misleading representations and pressure tactics and harassment used to induce consumers to purchase these policies were among the anomalies reported in Australia, while the UK had cases of consumers paying excessive prices for their credit life insurance, called Payment Protection Insurance, as well as cases of high pressure and unfair sales tactics (Shand & Angove, 2013). These are all factors that can hamper any advantages that this type of insurance can have for the consumers. The microfinance regulatory framework for Namibia should therefore ensure a balance in terms of having these insurance programmes to meet the needs of low-income and poor people, enhancing their affordability and accessibility as well as ensuring regulatory compliance in that insurers and/or other intermediaries conduct their business honestly and fairly.

5.4.4 Sector performance

The microfinance sector of Namibia was found to be relatively small and undeveloped. In terms of performance, though, the outcome of the survey discussed under Section 5.3.4.6 showed that participating term-lending MFIs have performed well, have been efficient and productive and are profitable. However, the focus on urban salaried people has hampered their outreach, leading to question marks over their contribution to poverty reduction, as this approach has left an unfulfilled demand for credit in the rural areas of the country.

An important aspect to consider going forward, in the spirit of the policy objective of growing the sector to address the unmet demand, therefore, is to ensure that the envisaged regulatory framework will be an enabler that will boost the sector and lead to its development, instead of curtailing its outreach through the process of MFIs struggling to comply with the regulatory requirements. It is therefore important for the regulatory framework to devise appropriate regulatory provisions that will avoid burdening the MFIs unnecessarily.

An approach used by some other countries is to have a tiered approach of regulation that has differentiated regulatory requirements for the different tiers of regulated institutions. Although the researcher established through interviews with the regulator that this is actually the intention with the draft amended act, in that the draft microfinance regulations stipulate a differentiated regulatory approach between traditional banks and microfinance banks, the researcher argues that it is necessary for Namibia to properly scan its own environment and determine what regulatory requirements and approach would be appropriate for its market and an enabler for the achievement of its goals.

5.5 CONCLUSION ON THE STATE AND NATURE OF MICROFINANCE IN NAMIBIA

This chapter addressed the research objective of understanding the nature and state of the microfinance sector in Namibia. Accordingly, it appraised the sector by analysing the survey and interview results as well as performing a documentary review, more particularly on the component of the microfinance sector found to be the most relevant for the research objectives of this thesis, i.e. the credit-only term-lending microfinance industry (and the only DMFI). The analysis has made it clear that the microfinance industry in Namibia has evolved over the years and is relatively small compared to what is found in other countries in Africa as well as in some other regions of the world, such as Asia.

With the exception of the one microfinance deposit-taking bank, an NGO-owned Namibia Housing Action Group and a few SACCOs, credit only microlenders (mainly pay-day lenders but also a small number of term-lending institutions) dominated the sector. Moreover, most of the microlending institutions were urban-based and served the salaried segment of the population, which is a limiting factor to outreach. It also became clear from the fieldwork results that the largest part of microlending in Namibia was consumption lending, while fully fledged MFIs that can offer comprehensive packages of microcredit, microsavings, money transfer and micro-insurance were very few. This situation does not augur well with the generally accepted role of microfinance that points to poverty alleviation, as the unemployed and self-employed are excluded. The scope of microfinance programmes and activities in Namibia has therefore not adequately addressed the problem faced by the poor, low-income people and SMEs regarding access to finance in the country. There is therefore a need to develop an industry of MFIs that will offer comprehensive packages of microcredit, microsavings, micro-insurance, money transfer services, etc. for these groups of the population.

Identified weaknesses and constraints to the growth of the Namibian microfinance sector include the absence of an enabling legal framework to spur the development of the sector, with stakeholders citing as examples the limitations to entry exerted by the legal framework under which DMFIs were being regulated together with conventional banks, the interest rates limitations of the Usury Act and its Exemption Notice under which microlenders were being regulated as well as the non-existence of a small claims court, meaning disputes cannot be dissolved quickly, and hence negatively impacting the recovery process of credit providers, as the current legal processes takes too long. A lack of key skills in the country to drive and manage microfinance was also identified as a constraint, with stakeholders calling for the need to build capacity in that area. An apparent lack of a national definition for microfinance and therefore confusion around what should be considered as microfinance and/or MFI was also observed. The researcher is of the view that any regulatory framework aimed at regulating the microfinance sector should first and foremost recognise the need for defining the sector, as this will assist in facilitating the process of determining whether interventions are appropriately targeted and intended regulatory objectives of the country are achieved. This will also ensure the designing of an appropriate and enforceable regulation (CGAP, 2012). The fieldwork findings also pointed to the fact that the MFIs in Namibia stretched over a diverse spectrum and that different regulators and supervisors regulated and supervised them under different acts – a situation which stakeholders believed to have caused uncoordinated microfinance activities, but which the researcher found not unique to Namibia, as the microfinance sectors of most countries are fragmented and uncoordinated.

The next chapter appraises the nature and state of the regulatory and supervisory framework of the Namibian financial sector under which MFIs operate, an exercise deemed necessary to obtain a clear understanding of the regulatory and supervisory environment so as to provide context for the impact analysis performed under subsequent chapters.

CHAPTER 6

APPRAISING THE NATURE AND STATE OF THE REGULATORY AND SUPERVISORY FRAMEWORK FOR MFIs IN NAMIBIA

6.1 INTRODUCTION

This chapter discusses the current regulatory and supervisory framework of Namibia as it pertains to the financial sector in general and the microfinance industry in particular. As indicated under the research aims and objectives section of this study (Section 1.3), proper understanding of the regulatory framework is a pre-requisite for undertaking any meaningful impact analysis of such regulation on the MFIs. This chapter therefore addresses the research objective of obtaining a clear understanding of the regulatory and supervisory framework of the Namibian financial sector under which the MFIs operate. The aim is to identify weaknesses, strengths, constraints and/or gaps in the regulatory framework that will in turn facilitate the RIA processes of the research. Observations and conclusions made in this chapter mainly derive from stakeholder views obtained through the fieldwork (i.e. survey and interviews) and from the analysis of documentary reviews of existing administrative records and reports. They also draw on the insight from the literature review in Chapter 3.

The rest of the chapter is organised in a manner that it first reviews the current legal framework for the financial sector in Section 6.2, followed by a discussion of the financial sector regulatory and supervisory environment and how it relates to the microfinance sector in sections 6.3 and 6.4 respectively. Section 6.5 looks at the perceptions of stakeholders of microfinance regulation as obtained from the fieldwork, while Section 6.6 presents the implications of the research findings for the envisaged legal framework. It then summarises and concludes in Section 6.7.

6.2 THE CURRENT LEGAL FRAMEWORK FOR THE FINANCIAL SECTOR

Before outlining the regulatory environment of the financial sector (i.e. the regulatory and supervisory practices in the Namibian financial sector), it is worth highlighting the legislation that regulates and governs the activities of financial institutions in the country. In line with the distinction of different financial institutions made earlier in Chapter 2, Table 6.1 distinguishes legislation into those that established and govern regulated and supervised financial institutions, those for public finance institutions and those that have a bearing on the activities of financial institutions (i.e. those that are not necessarily administered by the financial sector, but have a bearing on the sector). It is worth mentioning that in addition to the primary laws listed in the table, there are also subordinated or secondary laws in the form of regulations that regulate financial institutions, while determinations and/or directives are also issued in certain instances (see Appendix I) for those relating to the banking sector). The establishing acts govern unregulated financial institutions, such as public finance institutions.

Table 6.1: Legislation that regulates and governs activities of the financial institutions in Namibia

Legislation for regulated and supervised financial institutions	Other relevant legislation for the financial sector	Legislation for public finance institutions and SACCOs
Bank of Namibia Act (Act No. 15 of 1997)	State Finance Act (Act No. 31 of 1991)	Development Bank of Namibia Act (Act No. 8 of 2002)
Banking Institutions Act (Act No. 2 of 1998) (amendments to this act have been drafted and are awaiting Parliamentary approval)	Public Accountants and Auditors Act (Act No. 51 of 1951)	Agricultural Bank of Namibia Act (Act No. 5 of 2003)
Payment System Management Act (Act No. 18 of 2003)	Prevention of Organised Crime Act (Act No. 29 of 2004)	National Housing Enterprise Act (Act No. 5 of 1993)
Namibia Financial Institutions Supervisory Authority Act (Act No. 3 of 2001)	Financial Intelligence Act (Act No. 13 of 2012)	NAMPOST Act (Act No. 17 of 1992)
Pension Funds Act (Act No. 24 of 1956)	Competition Act (Act No. 2 of 2003)	Co-operatives Act (Act No. 23 of 1996)
Long- and Short Term Insurance Acts (Acts Nos. 4 & 5 of 1998)	Participation Bonds Act (Act No. 55 of 1981)	
Stock Exchanges Control Act (Act No. 1 of 1985)	Building Society Act (Act No. 24 of 1956)	
Unit Trusts Control Act (Act No. 54 of 1981)		
Inspection of Financial Institutions Act (Act No. 38 of 1984)		
The Usury Act (Act No. 73 of 1968)		
Friendly Societies Act (Act No. 25 of 1956)		

Source: Regulators and various websites of related institutions

As can be clearly seen from the above listed legislation, some of the legislation is archaic, dating as far back as the 1950s and 1960s. As such, their relevance has at times been questioned, a fact acknowledged by the NFSS 2011–2021. In fact, the NFSS has identified the need to revise and/or update, harmonise where relevant and align legislation to international best practices.

Some of the listed legislation, such as the Competition Act, the State Finance Act and the Public Accountants and Auditors Act, is not under the custody of the financial sector regulators per se, but is also applicable and relevant to the activities and dealings of the financial sector. It is also worth mentioning that legislation such as the Prevention of Organised Crime Act and the Financial Intelligence Act, which also cut across all sectors that are considered relevant to the achievement of their aims and objectives, has been placed under the delegated authority of the BoN by the Ministry of Finance, which is the legal custodian. Also, as stated above, some institutions, such as public finance institutions, are not regulated, but are governed by their establishing acts listed in column two of the table. Following below is an outline of the regulatory environment of the Namibian financial sector in terms of the current supervisory and regulatory practices.

6.3 THE REGULATORY AND SUPERVISORY ENVIRONMENT FOR THE FINANCIAL SECTOR

This section aims to outline the regulatory environment of the financial sector in Namibia in terms of current regulatory and supervisory practices. It also aims to highlight the strengths, successes, weaknesses, gaps and limitations in the system. The focus is on the two regulated sectors, i.e. the banking sector and the non-banking financial sector, including the microfinance sub-sector, but some observations are also made about the unregulated financial institutions. The aim is to obtain a clear understanding of how MFIs fit into this environment. This is important because the activities and outputs of the MFIs would be influenced by the legal framework in which they operate, i.e. by the legal environment around them.

6.3.1 The banking sector regulatory environment

The BoN prudentially regulates the banking institutions (including one deposit-taking microfinance bank) under the BIA (Act No. 2 of 1998), as amended. It conducts on-site and off-site examinations to fulfil its mandate. According to the FSA done by the IMF in 2006, which was the latest on the country at the time of preparing this research, the regulatory and supervisory frameworks for banking supervision have been broadly satisfactory (IMF, 2006), although the assessment report also identified weaknesses in the regulatory system. The identified weaknesses include a lack of sufficient knowledge and skills among supervisors as well as the inadequacy of risk-based supervision methodologies, the lack of supervision of bank holding companies and financial groups, as well as the absence of regulatory requirements on market and country risks (IMF, 2006). The crisis-simulation exercise performed by the country's Financial Stability Committee[102] with the assistance of First Initiatives[103] in 2014, which assessed the readiness of the banking sector in a crisis, also found the capability of the system to resolve failing banks as unsatisfactory, while the NFSS 2011–2021 has also identified certain weaknesses in the regulatory system that need addressing, such as the limited financial safety nets and a lack of consumer protection.

A review of the BoN annual reports for the period 2009–2014 (i.e. after the IMF FSA referred to above) reveals that over the years, the BoN has strived to address the identified weaknesses as well as to align itself to international regulatory and supervisory best practices. This has seen the regulator amending certain legislation and implementing the Basel core principles. Between the years 2010 and 2013, amendments were effected to the BIA, Act No. 2 of 1998. The 2010 amendments related to fees payable by banking institutions (i.e. annual fees and administrative penalties for non-compliance), while they also aimed to enhance the bank's supervisory powers and scope as well as to augment the governance standards in the industry (BoN, 2013a). The amended legislation also empowered the bank to carry out consolidated supervision, such that the conduct of bank holding companies and subsidiaries now also falls under the purview of the BoN (BoN, 2013a).

The 2013 amendments were aimed at consolidating the BIA, 1998 and the Banking Institutions Amendment Act (Act No. 14 of 2010), as well as to incorporate other necessary additional regulatory amendments (BoN, 2013a). The 2013 annual report of the BoN lists these to include issues relating to the enhancement of various definitions for purposes of clarity and ensure application thereof, prescription for foreign shareholding in banking institutions in support of what is envisaged by the NFSS, the prevention and deterrence of

[102] This is an inter-agency committee of the country's two financial sector regulators (BoN and NAMFISA) as well as the Ministry of Finance with an observer status.

[103] First Initiative is an international consultancy firm.

illegal financial schemes in the country, ensuring the existence of recovery plans for banking institutions and providing for resolution measures of problem banking institutions. These amendments were all said to have aimed at enhancing the regulatory system and capacity.

The year 2013 also saw another round of amendments to the BIA, although not promulgated yet at the time of preparing this research. These latest amendments were aimed at strengthening the supervisory power of the regulator and include the provisions for regulating DMFIs (BoN, 2013a). The provision for regulating this type of MFI has been sparked by the desire of the regulator to provide an enabling regulatory environment that would attract investors' participation in that industry (BoN, 2013a), which only consisted of one institution, and thereby achieve the ultimate goal of the policy makers of developing an industry that is able to serve the poor and SMEs better.

The above processes also saw parallel efforts by the regulator to address other weaknesses that were identified by the IMF FSA of 2006, such as those related to the lack of sufficient knowledge and skills among supervisors and the inadequacy of risk-based supervision methodologies, both of which are relevant for microfinance regulation. The BoN has implemented a risk-based supervision approach, which is a risk focus supervision process that emphasises the understanding and assessment of the risks of regulated banking institutions (BoN, 2013a). This is an aspect that is particularly relevant for microfinance, as regulating MFIs can be a very costly and burdensome endeavour. In addition, failure by MFIs might not necessarily pose any serious damage to the financial sector, given their size (CGAP, 2000), as alluded to in the literature review chapter, and hence the need for microfinance regulatory approaches and measures that are commensurate with the risk involved. The risk-based regulatory approach adopted by the BoN is therefore not only beneficial in the current setup, but will also prove to be relevant going forward as the BoN engages more in the regulation of deposit-taking microfinance banks.

In order to address the lack of sufficient knowledge and skills among supervisors, the BoN embarked upon a process of capacity building for its supervisors, especially in the area of microfinance supervision, which has become a new and specialised addition to its regulated industry and which requires a complete new set of supervisory skills. In this regard, the researcher noted from documentary review that the BoN brought in international consultants in 2011, including those from First Initiatives, to train its staff. This exercise also included the development of specialised operational manuals and procedures for supervising microfinance banking institutions, which were piloted on the one DMFI in the country

(FIDES). Some of the staff members were also sponsored to attend specialised microfinance courses abroad, such as the international Boulder Microfinance Training Program offered by the Boulder Institute of Microfinance in Rome, Italy. The documentary review revealed that capacity building has actually been part of a larger effort by the BoN to create a legal and regulatory framework attractive to other investors to engage in micro-enterprise lending and in other areas of financial inclusion, for which a draft bill was in place at the time of this research and in the context of which the primary objective of this thesis was analysed.

6.3.2 The non-banking financial sector regulatory environment

As mentioned earlier in this thesis, the NBFIs[104] are diverse and are as such also prudentially regulated by NAMFISA under different legislations (except for microlenders that are non-prudentially regulated), depending on the type of institutions and/or the industry in which they operate. The main legal instruments are the Namibia Financial Institutions Supervisory Authority Act (Act No. 3 of 2001), the Pension Funds Act (Act No. 24 of 1956), the Long-term Insurance Act (Act Nos. 4 of 1998), the Short-term Insurance Act (Act Nos. 5 of 1998), the Unit Trusts Control Act (Act No. 54 of 1981), the Stock Exchanges Control Act (Act No. 1 of 1985) and rules and regulations issued by the NSX, the Usury Act (Act No. 73 of 1968), the Friendly Societies Act (Act No. 25 of 1956) and the Inspection of Financial Institutions Act (Act No. 38 of 1984).

The IMF FSA performed in 2006, referred to under the section on banking sector regulation above, was also performed on the NBFIs sector. As in the case of the banking sector, a number of weaknesses were identified for this sector. The list includes a lack of capacity to regulate and supervise all the non-bank financial institutions; outdated laws that are not in line with international best practices leading to the existence of gaps in the legal framework; a lack of regulatory power in the regulator’s mandate for market conduct regulation and supervision; the inability to compile, verify, analyse and disseminate accurate and reliable data on the sector; and a lack of systems and skills to compile and analyse data to enforce certain supervisory functions (IMF, 2006). The NFSS 2011–2021 has also identified some of these weaknesses.

[104] These include insurance companies (long- and short-term), a re-insurance company, pension funds, asset managers, unit trust companies, microlenders, venture capital funds, medical aid funds and the stock exchange. Microlenders are however not prudentially regulated, but supervised for market conduct-related issues.

Unlike the case of the banking sector, which consists of ‘uniformed institutions’, the above listed weaknesses in the regulatory framework for the NBFIs sector could be a reflection of the difficulty and challenges involved in regulating a diverse type and number of non-bank financial institutions. However, judging from recent developments, NAMFISA has recognised the need to address the identified weaknesses and safeguard clients’ funds with which the NBFIs deal. As such, it has embarked upon a reform of the regulatory regime and the non-bank financial services sector in particular, and has since implemented a number of initiatives, including amendments to the laws under its custody. In this regard, the NAMFISA Act has been amended to expand the authority’s mandate, increase its powers to supervise and improve its governance of institutions (NAMFISA, 2015b), while a draft new Financial Institutions and Markets Bill, which aims to consolidate and modernise various related and outdated legal instruments into one piece of legislation, is also in place (NAMFISA, 2015b). A new microlending-specific bill to regulate microlending activities of the institutions regulated by the authority was also being worked on and was at an advanced stage at the time of writing this research. This is aimed at enhancing the enforcement capability of the regulatory authority, which has been identified as a weakness in the existing legal framework. A new Financial Services Adjudicator Bill draft, which will govern the market conduct of financial institutions once enacted, was also in place. All these draft bills were yet to be promulgated at the time of finalising this research.

The above legislative amendments seem to be a direct response by the authority to address the above listed weaknesses identified by the 2006 IMF FSA. For instance, the amendments to the NAMFISA Act aim to address the weaknesses relating to a lack of regulatory power in the authority’s mandate to regulate and supervise, while the Financial Institutions and Markets Bill addresses the issue of outdated laws to fill the gaps in the legal framework, as alluded to in the above paragraph. Further, the authority has taken steps in improving the weakness relating to the inability to compile, verify, analyse and disseminate accurate and reliable data on the sector, in that it has started releasing statistical quarterly bulletins since 2012 and has been co-producing the country’s Financial Stability Report with the BoN since 2013.

6.4 NAMIBIA’S FINANCIAL SECTOR REGULATORY ENVIRONMENT AND MFIs

As discussed under the literature review chapter, the history of microfinance globally reveals that it has evolved outside a regulatory framework in the form of informal savings and credit groups (CGAP, 2006). Accordingly, this environment has enabled MFIs to innovate and engage approaches to the provision of financial services that are distinct from traditional approaches of conventional banking. However, while initially microfinance meant the extension of traditional micro loans of small and smallest amounts to the rural poor, it has evolved into providing financial services for all the unbanked in emerging and developing markets, and the process has also involved a widening of the product range, customer-base and a change in the way of serving them (Lützenkirchen & Weistroffer, 2012). Microfinance has therefore expanded and is growing into a more commercialised industry (Lützenkirchen & Weistroffer, 2012), and this has come with risks. As such, the issue of regulation of microfinance has been topical in one country after another (CGAP, 2000). The challenge faced by policy makers and regulators is how to ensure a healthy financial system while at the same time encouraging access to financial services (Porteous *et al*., 2010).

In Namibia, the BoN has been regulating the only microfinance deposit-taking institution (the former FIDES Bank Namibia, now Trustco Bank)[105] together with conventional commercial banks under the BIA. In this regard, this DMFI is expected to comply with the same prudential guidelines, including minimum capital, reserve and liquidity requirements as well as other requirements, as conventional commercial banks. This approach of regulation has often raised questions as to its appropriateness, as will be evident from the stakeholder views presented in Section 6.5 below, given that this institution is a special and unique financial institution, namely a microfinance bank. As pointed out earlier, literature points to the need for regulation to acknowledge the uniqueness of MFIs and devise regulatory and supervisory approaches relevant to their unique characteristics and those of the clients they serve so as to ensure their role of providing financial services to the poor is not constrained by regulation. Chapter 7 of this thesis assesses what the impact of regulating this MFI under the conventional banking institutions regulatory framework (the BIA) has been.

In an attempt to spur the development of the deposit-taking microfinance banking industry in the country, Namibia has decided to create a window for regulating those type of institutions so as to provide an enabling regulatory environment. In this regard, a draft Banking Institutions Amendment Bill, referred to earlier, which aims to provide for the regulation of microfinance banking institutions, was at an advanced stage in the legislative process at the time of writing this research. Details of its scope as they pertain to that provision as well as an assessment of its potential impact on the MFI sector going forward is the subject matter of Chapter 8 of this thesis.

[105] FIDES was licensed in 2010 and was bought by the Trustco Group in 2014, and is now called Trustco Bank.

Microlenders are non-prudentially regulated in terms of the provisions of the Usury Act, Act No. 73 of 1968, which prescribes interest rate charges by the microlenders.[106] There is also an Exemption Notice No. 189 of 2004, which details the rules and regulations for microlenders. These are non-prudential regulatory rules with which NAMFISA controls the market conduct of microlenders such as those relating to the adherence to interest rate caps, transparency requirements and client confidentiality aspects. The Exemption Notice allows microlenders exemption from the Usury Act rate of average prime rate times 1.6[107] to charge an effective annual interest rate of average prime rate times 2 for term lenders and a maximum of 30 per cent for pay-day lenders. This exemption has been justified on the basis of the nature and risk associated with microlending. Loans that exceed the exemption limit, which is set at N$50 000, are subject to the lower Usury Act rate of prime rate times 1.6. The implication of this is that if a registered microlender disburses a loan above the threshold of the Exemption Notice, such a loan is charged at Usury Act rates and not Exemption Notice rates. These differentiated rates have been a bone of contention, especially with commercial banks playing in the microlending space having raised concerns of an unlevel playing field.

To fulfil its regulatory mandate, NAMFISA undertakes both post-registration and compliance inspections of the microlenders. With post-registration inspections, the regulator verifies whether newly registered micro-lenders meet basic requirements, such as those relating to office infrastructure, etc. Compliance inspection, on the other hand, aims at verifying compliance with the provisions of the Exemption Notice, such as those relating to loan agreement disclosure, interest rate charges, collection practices, adherence to confidentiality aspects as well as the display of registration certificates. In addition, information provided by NAMFISA revealed that it expects microlenders to submit financial and statistical returns on a quarterly basis, indicating the loan amounts disbursed, loan thresholds, number of borrowers, etc. Due to weaknesses observed in the regulatory framework, which is not only lacking enforcement power but is also archaic, NAMFISA indicated it is in the process of drafting legislation specifically for regulating microlenders.[108]

In the case of other institutions that also provide microloans but are not regulated by the financial sector regulators (i.e. by neither the BoN nor NAMFISA), and which are mostly public finance institutions, NGO-owned MFIs and SACCOs, they are either governed by their respective establishing acts (for example the DBN and AgriBank of Namibia) as listed under Table 6.1 above, or are supervised by the relevant line ministries under whose custody they

[106] The prescribed rate is the average prime times 1.6.

[108] This information was revealed during the fieldwork (i.e. during the interview process) by NAMFISA officials.

are placed based on the nature of their activities (for example the SACCOs and NGO-owned MFIs).

SACCOs are not prudentially regulated, but are supervised by a dedicated division within the Ministry of Agriculture, Water and Rural Development called the Division of Co-operative Development (DCD) under the Co-operative Act of 1996. Due to a lack of capacity, the role of the division has been confined to cooperative activity relating to the formation, registration and winding-up of activities, with not much focus on the financial activities of SACCOs, i.e. monitoring of this industry has been on a limited basis.[109] It is only recently when the DCD has engaged some basic forms of auditing function of the financial records of SACCOs. The fact that SACCOs take savings from their members has raised concerns about the safety of members' savings. In an interview with the researcher, a DCD official expressed the need for prudential regulation of these institutions in order to protect members' savings. According to this official, the Ministry of Agriculture, Water and Forestry had attempted to get in experts to design the regulatory rules, but the exercise was not engaged, as it was found to be very expensive, and the Ministry intended to continue investigating affordable ways of coming up with prudential regulatory rules for the SACCOs. Worth noting, though, is the fact that CGAP (2006) finds the aspect of prudential regulation to be a complex one that needs careful consideration, as effective prudential regulation, especially for smaller institutions, can be costly and difficult. It further states that small and remote financial institutions such as savings and loan cooperatives and member-owned financial cooperatives may likely not be effectively supervised. The researcher is therefore of the view that the Ministry of Agriculture, Water and Forestry in Namibia should take these facts into account going forward as they plan to engage a prudential regulatory process for the SACCOs.

An NGO-driven MFI (under the auspices of the Shack Dwellers Federation), the Namibia Housing Action Group, which also provides small loans for housing and income-generation purposes, is registered with the Ministry of Health and Social Welfare and is required to report on financial statements by the same ministry and the Ministry of Regional, Local Government and Housing as well as funding agencies, and to report on donor inflows statements to the BoN.[110] Being an unregulated member-based organisation that mobilises

[109] This information was revealed during an interview with one of the senior staff members at DCD, Mr Ruben Izak, on 7 August 2015.

[110] This information was revealed during an interview with the regional coordinator, Mr Heinrich Amushila, on 11 November 2014.

savings and extends loans to its members, the interest of stakeholders has been that of the safety of members' savings.

6.5 STAKEHOLDER OBSERVATIONS ON THE REGULATION OF MICROFINANCE IN NAMIBIA: FIELDWORK RESULTS

This section presents the views of stakeholders[111] obtained through interviews and a survey[112] (as per the same sample explained in Chapter 5) on how they viewed the state of microfinance regulation in Namibia. Key questions posed included whether or not stakeholders felt there was a need to regulate MFIs, the risks they thought regulation would address and/or the benefits regulated MFIs are to derive from that process, whether or not they thought there was a need to distinguish between different MFIs when regulating and who they thought the appropriate regulator for the microfinance sector in Namibia should be. It also discusses the regulatory constraints being faced by the MFIs, as highlighted by the same stakeholders. Outlined below are the questions posed to stakeholders and as was the case in Chapter 5, quotes of responses provided that are most representative of the findings are also presented for illustration purposes where relevant, while others can also be made available on request.

6.5.1 To regulate or not to regulate microfinance institutions

In line with the debates for and against regulating MFIs discussed under Section 6.4 above, the question of whether or not MFIs should be regulated was posed to interviewees and survey respondents to gauge their views on the issue.

With the exception of one stakeholder from the regulatory fraternity who had mixed views on the issue (i.e. he provided a 'yes and no' answer), indicating regulation should depend on the size of the amounts involved, everybody else (15 participants) who responded to this question firmly thought there was a need to regulate MFIs, although the reasons provided for doing so varied. Those in the regulatory authority space and experts in the microfinance field cited the consumer protection reason, while practitioners (i.e. providers of financial services), including those in the conventional banking sector, considered regulation to be necessary to

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[111] Stakeholders referred to here are the same as defined under Section 5.3.5 of Chapter 5 (i.e. providers of financial services, policy and law makers, regulators, local experts in the field of microfinance and other interest groups).

[112] The survey also contained some qualitative questions and hence included in the analysis of this section are the views of the MFIs that responded to the survey.

provide guidelines and set standards for the industry and to create a level playing field for all industry participants. An interesting argument came from one of the regulatory officials who felt that if microfinance is extended for productive purposes, there was no need to regulate, but if for consumption purposes, then there is a need to regulate those providing it [Reg 2/3/(1)]. A few other reasons for regulation were also mentioned by interviewees, including the need to enforce responsible lending and reduce over indebtedness and that the industry involved greed for high returns, which also needs to be regulated. To illustrate these findings, presented in the box below are some quoted answers in response to the specific question posed by the researcher.

Box 6.1: Should microfinance institutions be regulated?

"Yes, the principle of banking should be applicable to MFIs too, especially when they are taking deposits" [Exp/2/2/(1)]

"Yes, you may still find MFIs that mobilise public savings and thus the need to protect the public" [Reg1//2/(2)]

"Yes, a regulated industry provides for fair business practices and credit granting to consumers. It creates a level playing field for competitors in the industry and prevents abuse of power" [MFI/2/1/(1)]

"There is a need to ensure that lenders do their homework before lending out money so as to ensure their clients repay their loans. Also, the nature of the industry is such that there is a lot of greed in it, as people want higher returns and the greed needs to be regulated. Laws that preclude people from getting into excessive debt [are] beneficial" [MFI8/2(1)]

"Yes, to avoid overcharging and protecting the clients' rights" [MFI9/1/(1)]

Some caution on how MFIs should be regulated was also provided, especially by practitioners (two), but also interest group members (two) and regulators (one), relating to issues such as the importance of keeping regulation very clear and simple and differentiating MFIs from conventional banks, the need to provide incentives to encourage and assist MFIs to serve the people better and the need to appropriately structure regulation, taking their activities and risks into account. The researcher found the argument of differentiating between MFIs and conventional banks to be in line with what is advocated in literature, as discussed under the literature review chapter.

One of the practitioners further felt that regulation should only kick in when an issue arises to regulate that specific issue so as to allow things to develop informally first with little control and only regulate later so that MFIs are deliberately set up for success first [BA/1/3/(1)]. This view is also not too far from that of CGAP (2000) that regulation can not only cramp competition, but also stifle innovation. CGAP (2000) posits that the cramping of competition and stifling of innovation by regulation can happen because setting rules for microfinance also involves deciding on the kind of MFIs that should be allowed to engage in that business, as well as the loan methodologies and what is considered appropriate operating procedures. As such, this can draw boundaries to the extent that any other innovation outside those boundaries is excluded. The box below quotes some specific views as provided by the respondents.

Box 6.2: Should microfinance institutions be regulated?

"Yes but regulation should be structured appropriately, taking their activities and risks into account. They should not be regulated the same as banks" [MF6/1/(1)]

"Yes, microfinance institutions should be regulated but the extent of such regulation may be less stringent in most areas than the traditional banking institutions" [Reg2/3/(3)]

"Yes, but not over-regulated, it should be for key things. They need to be given latitude to be able to do what they need to do. The more you regulate and the more you control, you inhibit innovation. … don't regulate them like commercial banks that are highly regulated" [BA/1/(1)]

Also in line with the views expressed by CGAP (2000) that it would often be best to allow certain small institutions to take deposits on the basis that they are providing a necessary service, one respondent thought whether or not MFIs should be regulated should depend on the risk involved. He explained as follows:

> *"… if the amounts are small and the impact of that is not big if anything goes wrong, then no need to regulate. But also even if the amounts are small but more people are involved, then you need to regulate and protect the public"* [Reg1/2/(2)]

Some other risks and benefits of regulation were also identified upon a follow-up question of whether stakeholders thought there were any risks to be addressed by regulation or benefits to be derived from regulating MFIs, and hence why they should be regulated. The key risks to be addressed by regulation mentioned by interviewees relate to possible loss of public funds in the case of DMFIs and therefore the need for regulation to safeguard those, the possible abuse and 'ripping off' of clients, and hence the need to regulate the market conduct of MFIs as well as guarding against the instability of MFIs.

The key highlighted benefits to be derived from regulating MFIs included the promotion of good behaviour on the side of MFIs; that regulation enforces a culture of good governance and ensures the existence of appropriate systems in place; that regulation leads to the improvement of skills, efficiency and productivity, which enhances the reputation of the institutions and is good for investors; and that MFIs can grow and develop in a regulated environment. Most of these identified risks and benefits are also in line with the arguments discussed in the literature review in Chapter 3 and were mostly raised by those in the regulatory sphere, some practitioners and experts, which indicates a comparatively high level of awareness about microfinance-related issues among these groups of stakeholders who are directly involved with the sector. They could have picked up this understanding from training courses and related seminars that these groups would normally be expected to undergo compared to other interviewees. See quoted responses in the below box for illustration purposes.

Box 6.3: Are there any risks to be addressed by regulation and/or benefits to be derived from regulating MFIs?

"The biggest risk is to the customer in terms of their money disappearing and the benefit is that of regulation taking care of the risks, as there will be proper systems in place" [Reg1/2/(1)]

"The risk is that they are dealing with third party money. The looser your regulatory framework is or the looser it is enforced, the more you find people in the sector who should not be there and stability is affected negatively. The benefits relate to the improvement of skills, efficiency, productivity, etc. MFIs can grow because of the enabling environment" [Exp/2/2/(1)]

"The risk depends on the activities of the MFIs ... if deposit-taking then there is [a] need to ensure the soundness and stability of the MFIs, but if only credit then only regulate the conduct of their businesses. The benefit is that of bringing order in the market ... MFIs will keep good behaviours, as regulation brings out the best in MFIs by guiding what to do and how to do, investors and customers will have confidence to deal with MFIs" [MFI6/1/(1)]

"It promotes prudence in the conduct of the microfinance business so as to ensure stability of the financial system" [Reg2/3/(3)]

6.5.2 To distinguish or not between different types of MFIs when regulating

In addition to the above questions on whether or not MFIs should be regulated and why they should be regulated, the researcher sought to establish whether stakeholders saw the need to distinguish between the different types of MFIs when regulating them. This was deemed necessary to determine the level of understanding in Namibia of the different types and roles of MFIs and how they should be treated by regulation. In this regard, responses were mixed. Two respondents from the policy-making and regulatory fraternity spheres did not see the need for differentiating and either thought that they all fit the definition of microfinance and hence no need or that if microfinance is properly defined, there should not be a need to distinguish them for regulation. One of the experts in the field of microfinance also did not see the need for differentiating the MFIs when regulating them, but for a different reason, namely that he believed the playing field needed to be level for all participants (see some quoted answers to the specific question posed by the researcher in Box 6.4 below).

Box 6.4: Is there a need to distinguish between different types of MFIs for regulation?

"I don't see the need for distinction – if microfinance is properly defined then no need for distinction" [Reg1/2/(1)]

"I believe that the playing field has to be level for all, it doesn't matter if it is an NGO, money lender, etc. I think the regulation should be the same. The rules should be applicable to all institutions … we should have a set of laws for lending and a set of laws for deposit taking" [MFI8/2/(1)]

Those in favour of differentiation consisted of a mixture from classes of stakeholders interviewed. Two respondents thought that some MFIs might not need to be subject to a uniformed piece of legislation, but felt that the problem in Namibia was that things were so fragmented and uncoordinated and that something needed to be done to correct the situation.

Some others (four), mostly industry practitioners, expressed that the microfinance industry is very different from the classic and traditional banking industry in many ways and believed there was a need for a separate regulator for microfinance and saving and loans institutions (such as SACCOs). This group therefore argued that there has to be a distinction so that every institution or MFI is clear on where they fall and what is required of them. They gave an example that it would for instance not be fair to regulate credit-only MFIs together with savings or DMFIs because their profiles and motives are different, and that regulation therefore should be tailor-made to fit the establishing objectives of the institutions. They further opined that categorisation would avoid unnecessary reporting for those who do not need to and that as those types of MFIs develop and grow, they could then be formalised by way of regulation. One interviewee from the practitioner group was even of the opinion that there should be regulatory differentiation within the credit-only microlenders group in terms of whether they were pay-day lenders or term lenders. The specific question posed and some quoted answers are presented below to illustrate the findings.

Box 6.5: Is there a need to distinguish between different types of MFIs for regulation?

"Yes, they need to be distinguished on the basis of deposit-taking or not, ... what kind of products they are allowed to offer, and what kind of capital requirement [is] needed" [Exp/2/2/(1)]

"Yes, everyone will be clear where they fall and what is required of them, regulating credit-only MFIs together with deposit-taking is not fair, risk profiles are different. Thus there has to be categories to avoid unnecessary reporting" [MFI6/1/(1)]

"Yes because they are different … microfinance is more into development financing while microlending is consumption lending. Also, microlenders are differentiated between pay-day lenders and term lenders" [MLA/1/1(1)]

"Yes, microlenders have different motives, and lend against own capital, as they grow then they must become formalised" [BA/1/1/(1)]

"There is no right answer, … some of them might not need to be subjected to one piece of regulation" [Reg1/2/(2)]

The necessity of differentiated regulation for MFIs from that of conventional banks as well as among the types of MFIs themselves has been acknowledged in literature, as discussed in Chapter 3. This has been on the basis that the fundamentals of the microfinance business render them different to conventional banking, while different types of MFIs also have different profiles, and may therefore require a different regulatory approach. In addition, different MFIs may engage in different activities, such as deposit-taking or savings mobilisation or only credit extensions, in which case the focus may shift to determining the risks involved in the business of each of these types and determining appropriate regulatory measures accordingly.

CGAP (2000) is of the view that while prudential regulation is important for DMFIs, it may be reasonable to non-prudentially regulate credit-only MFIs in some situations, i.e. it may be reasonable to only require such MFIs to register and produce financial statements as well as to be transparent towards clients in terms of providing them with the necessary information. This is because the costs of prudential regulation tend to be high, both in terms of cash costs to the supervisor and the supervised, and in terms of stifling innovation and outreach

(CGAP, 2000). CGAP (2012) further argues that it is better to regulate activity than to distinguish regulation based on the type of institutions. The above stakeholder arguments are therefore in line with the literature.

6.5.3 Who the regulator of microfinance institutions in Namibia should be

Another question posed to the interviewees is whom they thought the regulator for MFIs should be. This was a necessary question in view of the existing various approaches/alternatives to regulation that can be applied to regulating microfinance, as discussed under the literature review chapter. Stakeholder views were again divergent. Five stakeholders, from the policy-making arena, regulatory authorities, MFI practitioners and microfinance experts, limited themselves to the current situation and felt that it all should depend on the regulatory setup of the country, how MFIs are defined and what they are allowed to do. They felt that each of the existing regulators in the country has its own defined mandate (e.g. the BoN regulating DMFIs and NAMFISA regulating credit-only microlenders), and that as such, MFIs should simply belong to the correct regulator based on what they do. These findings are illustrated by the quotes below.

Box 6.6: Who should regulate microfinance institutions and why?

“It depends on how MFIs are defined and what they are allowed to do; each existing regulator has its own defined mandate, they should just belong to the correct one” [MFI6/1/(1)]

“Deposit-taking should be regulated by BoN, and those not taking deposits by NAMFISA” [Exp/2/2/(1)]

“It depends on the type of objectives one wants to pursue and thus then decide who is best suited to regulate. If not MFI banks, then NAMFISA should because you don’t want duplication and creating additional institutions unnecessarily” [Reg2/3/(1)]

“It does not matter as to who (central bank, Ministry of Finance or a separate body) should regulate microfinance as long as such institution is credible. What really matters should be tailor-made regulations for microfinance institutions” [Reg2/3/(3]

Four others, also a mixture of regulators and practitioners, were of the view that the BoN was well placed because microfinance involved the acceptance of deposits and savings. Those from the practitioner group further elaborated that the type of business in which MFIs are involved is more related to banking than insurance, hence the BoN being the suitable regulator for MFIs. They further argued that because the central bank already regulates commercial banks, it has acquired the necessary experience and expertise over time and is better equipped to take care of the regulatory function from a prudential perspective. From the above arguments it is clear that this category of stakeholders consists of those who have a comprehensive view of microfinance, i.e. they consider microfinance to be those who not only offer microcredit but also microsavings, etc., as illustrated in the box below.

Box 6.7: Who should regulate microfinance institutions and why?

"Bank of Namibia because it involves the acceptance of deposit and savings from the public" [Reg1/2/(1)]
"BoN because it is about the acceptance of savings from the public and since BoN already regulates commercial banks and have acquired the necessary experience and expertise and are better equipped to take care of it from a prudential perspective. Those just floating around need to be regulated to protect consumers" [Reg1/2/(1)]
"Bank of Namibia because they are deposit-taking, but also microlenders should be under Bank of Namibia because the business is more related to banking than insurance" [MLA/1/1(1)]

There are also those who thought it should not be the BoN because it regulates commercial banks, and those who thought it should be NAMFISA (2), but one was at the same time questioning the capacity and mandate of NAMFISA to do that. They therefore suggested the creation of a 'new institution' that should be given the specific mandate. This category of participants associated microfinance with credit extension by microlenders only. Some of the responses to the question are quoted in the table below.

Box 6.8: Who should regulate microfinance institutions and why?

"Not Bank of Namibia because they regulate commercial banks, it should be NAMFISA but they don't seem to have the mandate, no skills and no human resources, thus there is a need to create a new NAMFISA with that specific mandate" [*BA/1/1/(1)]*
NAMFISA because they took on the role of regulating financial institutions. But currently there is a lot of confusion in the market regarding the difference between NAMFISA's role and the Bank of Namibia's" [MFI8/2/(1)]
"In Namibia there are banking institutions and non-banking financial institutions and the law distinguishes Bank of Namibia for banks and NAMFISA for microlenders. Thus, the microlenders should fall under NAMFISA" [PM/2/3/(1)]

A caution that came from one of the interviewees with links to a regulatory institution pointed to the fact that while it did not really matter who is decided upon to regulate MFIs, it mattered in the end to ensure that whoever the regulator is has the necessary resources and legal backing to enforce the function and to provide a comprehensive and effective regulation:

> *"It does not matter who, but that person must be better placed resource-wise and legal-wise and needs to have enforcement so as to have a comprehensive and effective regulation"* [Reg1/2/(2)]

A study on the review of microfinance regulatory and policy assessment in the SADC region (of which Namibia is a member) undertaken by Brouwers *et al*. (2014) concluded, based on the current practice in the region where the trend is to allow for the licencing of non-bank deposit-taking institutions, that central banks are the ideal regulators for microfinance, especially in the case where microfinance is not defined by the type of institutions that are offering the service. It posits that central banks would have the pre-requisite experience and skills to carry out both prudential and non-prudential supervision that may be necessary. This argument is in line with the view of CGAP (2012), which found the authority responsible for commercial banks to be in most cases the best supervisor for depository microfinance, as that approach would benefit from existing skills, although additional specialised skills may still need to be developed.

However, lessons from an ADB study of 2000 cited in the literature review chapter indicates that most countries have in place processes for registering NGOs, cooperatives and other institutions engaged in microfinance, which do not usually involve central banks, although cases also existed where central banks were involved in the registration or licensing of certain categories of MFIs (Roy, 2013). It is also true that certain situations are peculiar to specific environments in specific countries, hence the need for Namibia to analyse its environment and decide on an arrangement best suited to its environment. As one respondent put it:

> *"It all depends on the regulatory setup of a country. In certain jurisdictions there is a single regulatory body housed under the central bank or independently outside the central bank. In some other countries there is separation between deposit-taking and non-deposit-taking institutions. The deposit-taking institutions are regulated by the central bank while non-deposit-taking is a responsibility of a separate body"* [Reg2/3/(3)]

6.5.4 Regulatory and supervisory obstacles for providing financial services in Namibia

The stakeholders were also asked to provide their views on whether they thought there were legal and regulatory constraints to the provision of microfinance in Namibia currently. This was viewed a necessary question, because as stated under the introductory section of this chapter, one of the aims of the chapter was to identify weaknesses, strengths, constraints and/or gaps in the current regulatory framework so as to assist with the RIA process objective. The key identified areas of concern included a lack of an enabling regulatory framework for MFIs, the lack of relevant skills in the country (on both the regulators' and the practitioners' side) as well as the repayment ability of clients. One of the stakeholders, an industry practitioner, raised concern about the fact that the regulator and supervisor for banks and DMFIs in Namibia is the same, while these are different institutions. The box below illustrates respondents' identified areas of concern in response to the specific question.

Box 6.9: What are the major regulatory- and supervisory-related obstacles for providing financial services in Namibia?

"There is no enabling regulatory framework, meaning there is no dedicated legislation for microfinance. There is a need for a microfinance bill that makes provision for savings. The current microlending bill only caters for microlending" [Reg1/2/(1)]

"There are those created by Government such as the payroll thing. Those people in government cannot access our products even when we have better products. Only those with deduction codes can access those people. Also the N$50 000 limit or even the new proposed N$100 000 limit is a constraint because it does not take the changing buying power into consideration. How regularly can you update that?" [MFI10//1/(1)]

"The skills issue is a constraint, also sometimes government procurement in terms of whom they source from" [Reg1/2/(2)]

"BoN supervisors had to polish up their skills to be able to supervise these new institutions" [Reg2/3/(2)]

Addressing the identified areas of concern such as the need for an enabling legal framework and building the skills required by the microfinance sector (for both the supervisors and the practitioners) would be necessary for the microfinance sector to thrive. However, it is important to note that the perception that a dedicated microfinance legislation is required for MFIs may not necessarily be the best approach for the sector and for attaining the country's objectives, especially if not effectively implemented. For instance, dedicated legislation could also come with other unintended consequences such as the potential for creating regulatory arbitrage in that, depending on how favourable the terms of such regulation are, existing institutions and new entrants may manoeuvre their way into qualifying as MFIs (CGAP, 2012). Those institutions not able to meet certain regulatory requirements (especially prudential requirements such as minimum capital requirements in the case of commercial banks), may disguise to be licenced under the MFI-dedicated legislation with the aim of benefitting from such favourable terms under the dedicated legislation without necessarily having the motivation to serve low-income clients effectively (CAGP, 2012). Local factors should however determine what approach a country should take (CGAP, 2012). It is therefore important for Namibia to carefully assess its own environment and ensure that whatever approach is adopted will be effectively implemented so as to avoid the unintended consequences.

6.6 IMPLICATION OF THE RESEARCH FINDINGS FOR AN MFI REGULATORY FRAMEWORK IN NAMIBIA

The stakeholder views presented under Section 6.5 of this chapter as well as the identified constraints and other issues noted from documentary reviews have implications for the design of any new regulatory framework aimed at governing the microfinance sector in Namibia going forward. The key ones considered relevant for the context of this thesis are discussed in the ensuing subsections. These are areas of concern that the country should consider addressing in order to have an appropriate regulatory framework for MFIs that should be able to better facilitate the development of the sector envisaged by policy makers.

6.6.1 To have dedicated microfinance legislation or not

The fieldwork results above pointed to the lack of dedicated legislation for the sector, and that this could be the reason why the country does not have a national common definition of what microfinance is and who the MFIs are. This, according to the stakeholders, has led to the uncoordinated and fragmented state of the sector, i.e. they felt that the current MFIs in Namibia stretched over a diverse spectrum and that different regulators and supervisors regulate and supervise them under different Acts. The stakeholders therefore called for dedicated legislation for the microfinance sector.

The researcher did not find the lack of dedicated microfinance legislation to be a unique situation to Namibia, as many other countries around the globe are without dedicated legislation for the microfinance sector, while their microfinance sectors are also fragmented and uncoordinated. According to CGAP (2000), the binding constraint to the growth of microfinance in most countries had not necessarily been a lack of a dedicated legislation, but a shortage of licensable MFIs. What is necessary for Namibia therefore is to have legislation for well-defined institutions and under which MFIs can thrive as well as an enabling regulatory framework attractive to new entrants.

As discussed earlier in this chapter, regulators have to consider many issues when creating and reforming policies (Armendáriz & Morduch, 2010). Depending on the circumstances of the country, a choice can be made between creating microfinance-specific legislation, amending existing legislation to make provision for MFI regulation, or do nothing. An important first step in this decision process, before the complex task of creating a new legislation is engaged, is for the country to determine whether and how the existing sector regulation is a barrier to the achievement of the country's intended objective (CGAP, 2012), which in the case of Namibia is the provision of financial services to the poor and SMEs. It should also be determined whether there is existence of a critical mass of qualifying institutions and which actors are likely to respond to the new legislation (CGAP, 2012), as without this, the creation of new and dedicated legislation would not necessarily lead to the achievement of this objective. Depending on the findings of the investigation, therefore, it may be sufficient to go the route of amending existing law and provide for the regulation of MFIs.

According to CGAP (2012: 20), "several countries have built technically sound new regulatory windows for microfinance but have seen little response". These are all important aspects that Namibia has to consider in its quest to create an effective microfinance regulatory framework. It is also important for the country to decide which MFIs are to be regulated, as not all microfinance activities can be regulated. CGAP (2000) recommends regulation to be aligned to the risk posed by MFIs. In this regard, the consideration should be to avoid burdensome regulations to both MFIs and regulators (Armendáriz & Morduch, 2010), but at the same time ensure the ability to regulate effectively.

A further related concern raised by stakeholders was that the perceived lack of a dedicated legal instrument for MFIs led to the fact that DMFIs are being regulated under the same act as conventional banks and are hence expected to comply with the same prudential regulatory requirements, which affect their operations negatively. This concern is of particular interest to this research, given that one of its objectives was to determine the impact of regulating a microfinance bank under the BIA together with conventional banking institutions (presented in Chapter 7). The results of this investigation are therefore expected to either confirm or refute this finding.

6.6.2 Prudential vis-á-vis non-prudential regulation of MFIs

As alluded to in the literature review chapter, one of the considerations for deciding on how to regulate MFIs is whether they should be prudentially or non-prudentially regulated. Prudential regulation has to do with the protection of the financial system and the safety of depositors, while non-prudential regulation deals with issues of consumer protection, interest rate limits, transparency and disclosures, fraud prevention, ownership limits, tax and accounting-related matters (Christen *et al*., 2003, cited by Armendáriz & Morduch, 2010). In other words, while prudential regulation is concerned with the soundness of financial institutions, non-prudential regulatory requirements focus on business- or market conduct-related issues.

Arguments for imposing prudential regulation on banks and other financial intermediaries relate to the need to protect public deposits, as banks fund their operations with third-party money (CGAP, 2012). The need to ensure the soundness of those institutions is also based on the fact that any loss of confidence by depositors in one institution could spread to other depositors of other banks and could cause a deposit run, which could then destabilise the whole financial system (CGAP, 2012). In the case of MFIs, Armendáriz and Morduch (2010) argue that most MFIs do not have the scale where their insolvency could threaten the stability of the financial systems in which they operate, although the savings of the poor could still be at risk. This then poses the question of whether MFIs should be subject to prudential regulation or not. In this regard, CGAP (2012) is of the view that most of MFIs' depositors have very small account balances, and further argues that compliance with and enforcement of prudential regulation is usually complex, difficult and costly compared to non-prudential regulation. Pouchous (2012) echoes this view and posits that there may be numerous MFIs in some countries and quite often they are too small in size and that regulating them can be a challenge, given that the capacity of regulatory and/or supervisory authorities might not be enough to handle the numerous institutions. It follows then that the decision to regulate DMFIs should be based on the risk involved, as discussed in the literature review chapter. CGAP therefore suggests that in the "absence of extraordinary circumstances, non-depository MFIs should not be subjected to prudential regulation and supervision” (CGAP, 2012: 14).

Some form of non-prudential regulation for MFIs is however necessary so as to ensure that consumers are protected from abusive and unscrupulous lending practices and that customers understand the contracts they enter into as well as their related obligations. This type of regulation is also important for the prevention of fraud and financial crime (Armendáriz & Morduch, 2010).

Although the views from interviewed stakeholders on whether to prudentially regulate Namibian MFIs or not were divergent, the general argument on this issue pointed towards a differentiated approach, which is in line with the above arguments from literature. The majority of interviewees argued that whether to prudentially or non-prudentially regulate should depend on the activities of the MFIs, such that DMFIs would need to be regulated to ensure their soundness and stability, while in the case of credit-only MFIs, it would suffice to only regulate their market conduct (i.e. that non-prudential regulation is enough for those types of MFIs). These views are broadly in line with the arguments in the literature cited in the above paragraph. As such, what is key for Namibia is to weigh the costs against the benefits of supervising and regulating MFIs as well as the risk involved and to identify those to be regulated and how to regulate them. It is therefore necessary to differentiate between different types of MFIs (i.e. deposit-taking, credit-only, etc.) when deciding on the approach of regulation to follow, given the different profiles and mandates of different MFIs. This process should also take into consideration the challenge of the complex nature of regulating and supervising microfinance prudentially and the cost involved alluded to by CGAP (2012) and Pouchous (2012) in the above paragraph, so as not to waste scarce supervisory resources and/or saddle MFIs with unnecessary compliance burdens that could result in the unintended consequence of constraining the development of the sector. Although Namibia’s scale might be relatively small (in terms of the number of MFIs), the above arguments are of great importance for the country to take into consideration, particularly given the objective to grow the sector and the fact that the regulation of MFIs is a relatively new aspect and the country still needs to strengthen its capacity in supervising and regulating such institutions.

6.6.3 Regulating microfinance activity vis-á-vis microfinance providers

While the case of deposit-taking microfinance banks is clear, i.e. they need to be prudentially regulated, the question that arises, especially with the other categories of microfinance providers, and which relates to the issues of achieving a coordinated approach as well as the need to have a level playing field called for by stakeholders, is which of these institutions are to be regulated, how and what exactly to regulate. CGAP (2012) is of the view that to advance the promotion of a level playing field for access to finance, similar activities should be subject as much as possible to similar regulation, regardless of the institutions being regulated. This implies that regulating the activity (i.e. following an activity-based regulatory approach) is better than distinguishing regulation based on the type of institution.

According to CGAP (2012), this is important not only for creating a level playing field, but also to foster competition and reduce the risk of regulatory arbitrage, referred to earlier in Section 6.5.4. The researcher views this as an important aspect for Namibia going forward, if it is to achieve the regulatory objective of developing a real microfinance sector. Considering that the policy objective for wanting to develop the microfinance industry in Namibia has been expressed by the country's Financial Sector Strategy as aiming to facilitate increased access to micro-enterprise loans and other financial services such as microsavings, the legal framework for microfinance that aims to promote such objective should therefore ensure that it caters for the microfinance activity instead of only the providers of these special services. For instance, while it is necessary to distinguish pure banking business from microfinance business, the microfinance operations of conventional banks (to be defined from the purpose of such operations) should be included in the determination of microfinance activities in the country and be regulated similarly to similar activities offered by non-bank MFIs.

CGAP (2012:18), however, argues that "the ability to regulate activities similarly will depend on both the specific regulatory issue being addressed as well as how the different institutions are regulated (i.e. under one or many laws)". This aspect is also relevant for Namibia to consider and address, given its current setup where MFIs are regulated by two different regulators (DMFIs by the BoN and credit-only MFIs by NAMFISA) under two different laws, i.e. the country needs to determine whether there could be a possibility of following the activity-based regulatory approach and how that is to be implemented. For example, while prudential rules could be based on the type of institution, differentiating them on the basis of permitted activities and capital adequacy, non-prudential rules such as those related to consumer protection and anti-money laundering and combating financial terrorism could be made applicable to all microfinance service providers, regardless of the type (CGAP, 2012).

6.7 CONCLUSION

This chapter aimed at addressing the research objective of understanding the current regulatory and supervisory framework for microfinance in Namibia. This was viewed a necessary process to facilitate the RIA for MFIs, reported on in subsequent chapters. From the analysis of this chapter, a picture emerged of the existence of a financial sector regulatory framework with emphasis on both prudential and non-prudential regulation, supported by two regulatory authorities (the BoN and NAMFISA) that have the necessary instruments to collect information about the sector and enforce regulatory provisions.

There is a clear distinction between the regulation and supervision of the banking sector and that of the NBFIs in Namibia for which each of the two financial sector regulatory authorities are respectively responsible. It is also clear that the system is still evolving, especially in as far as the regulation of the new and special area of microfinance is concerned. At the time of the conducting the research, the deposit-taking microfinance industry comprises one DMFI that is regulated by the BoN together with normal banks under the BIA Act No. 2 of 1998, as amended, an approach that surveyed and interviewed stakeholders criticised. The basis for regulating credit-only micro-lenders is currently the Usury Act No. 73 of 1968 and the Exemption Notice issued by government, which allow lenders registered with NAMFISA to charge interest rates and other fees over and above the usury limits. As this is not a law that established microlending institutions, a gap in terms of the authority effectively enforcing regulatory power has been identified and is in the process of being addressed by the relevant regulatory authority at the time of the fieldwork for this research.

The need for regulating MFIs as well as the appropriateness of the current regulatory approach was tested through the survey and stakeholder interviews. Most engaged stakeholders saw the need for regulating MFIs for various reasons, but mainly for consumer protection purposes, especially in the case of deposit-taking and savings-mobilising MFIs, and also to bring order in the sector and enhance the sustainability of the institutions. However, the stakeholders raised concerns about a lack of a dedicated legislation for microfinance activity in Namibia which, in their view, led to the existing DMFI being regulated under the same regulation as normal banks as well as the fragmented treatment of MFIs, which they saw as the cause for a lack of understanding about what microfinance is and who the MFIs in Namibia is. They therefore called for a coordinated approach to the microfinance sector in the country as well as a clear definition of MFIs to address the seemingly current state of confusion. In this regard, the researcher is of the view that what is needed is a microfinance regulatory framework that would ensure effective regulation and supervision, taking lessons from other countries and the country's specific regulatory objectives into consideration. In this regard, the proposed amendment BIA providing for the regulation of DMFIs and the envisaged microlending should go a long way in enhancing the regulatory and supervisory framework for MFIs in Namibia once they become effective, although it is not yet known to what extent there would be harmonisation of key aspects between these two pieces of legislation. For example, while the draft implementing determinations of the amended BIA [UD/L/2/1] suggest a microloan extended by DMFIs to be an amount not exceeding N$200 000, the draft Microlending Bill [UD/L/2/2] proposes the maximum for a microloan extended by credit-only microlenders to be N$100 000. Harmonising common aspects of microfinance, such as the definition of microcredit, MFI, etc., is important, as this will help address some of the above-cited concerns raised by stakeholders engaged by this study.

The chapter also identified the need for capacity building in microfinance regulatory and supervisory skills, given that this is an area that is relatively new to the country. This is key because in the end, the effectiveness of regulation lies in its enforcement.

Now that the state and nature of both MFIs and the regulatory environment they operate in has been determined in chapters 5 and 6 respectively, Chapter 7 below assesses the impact of regulation and supervision on microfinance in Namibia through the use of a case study, which is a first stage in addresses the primary of determining the impact of regulation on MFIs in Namibia.

CHAPTER 7

THE IMPACT OF REGULATING AND SUPERVISING MFIs: A CASE STUDY OF A REGULATED MFI

7.1 INTRODUCTION

This chapter seeks to determine the impact of regulation and supervision on microfinance in Namibia. It does that through assessing the experience of an MFI that became a regulated entity, under the current regulatory regime (the BIA), together with conventional banks, as a case study. The chapter is therefore a first step of addressing the primary research objective of determining the impact of regulation and supervision on the Namibian microfinance sector (i.e. an ex-post assessment at a micro level), which will be looked at further at a macro level in Chapter 8 through performing an ex-ante RIA of the envisaged amended act.

At the time of fieldwork (during April 2014 to October 2015), the case study MFI was the only MFI licensed by the BoN under the BIA[113] (BoN, 2014). The intention with this case study was to explore the regulatory impact of having this MFI regulated on the same terms as conventional banks. The findings of this exercise should serve as validation of whether or not regulation and supervision actually achieves the objectives that were cited in the literature review chapter as justification for regulating and supervising MFIs. These include the promotion of financial system stability, consumer and/or depositor protection, improving MFIs' performance standards, enhancing investors' confidence in the institution and thereby increasing funding opportunities, and ensuring the effective use of public and/or investor funding.

The rest of the chapter is organised as follows. Section 7.2 gives a background to the case study MFI in terms of its establishment, ownership structures, services and products offered and the lending methodology employed. The case study MFI's experience as a licenced entity is sketched in Section 7.3, while Section 7.4 contains an analysis of the regulatory impact on the MFI. Section 7.5 presents the chapter conclusion.

[113] Due to non-existence of a regulatory framework for DMFIs, this MFI had to be licensed under the normal regulatory framework for conventional banking institutions.

7.2 BACKGROUND TO THE CASE STUDY

Koshi Yomuti (translated in English as ‘banking under the tree’) was established as a microfinance pilot project in 2002, in the form of a private company/NGO with a share capital, registered under Section 54(1) of the Companies Act of 1973. The project was sponsored by FIDES AG (Switzerland), the Namibian Department of Trade and Industry and GTZ (now called GIZ). It used to operate only in the north central underserved regions of the country, where it demonstrated that savings and loans village associations can be sustainable even in low-density rural areas (FIDES, 2010).

Lending was on a group basis, while loans disbursed used to range between N$500 and N$20 000, with a repayment on small amounts having been done on a weekly basis (FIDES, 2010). With a repayment rate of 99 per cent, Koshi Yomuti grew considerably over the years and became the largest MFI in terms of outreach and client base. By 2004, it had established 57 groups (FIDES, 2010) and this increased further to 65 by 2009. Given its successful operations and the extent to which savings were being mobilised, Koshi Yomuti was granted a license on 1 February 2010 by the BoN under the BIA, Act No. 2 of 1998, as amended, and became FIDES. It therefore transformed from a project to a public company limited by share capital, as required by the BIA of 1998.

FIDES was established by four shareholders at the time, namely Swiss Microfinance Holding, which is the investment arm of the FIDES Group (32,67%); Kreditanstalt für Wiederaufbau of Germany (24,90%); Investisseur et Partenaire pour le Développement, which is a private company owned by European entrepreneurs (22,45%); and Volksvermogen (16,67%), a Belgium-based investment company (FIDES, 2010).

Being a specialised microfinance bank, FIDES has been viewed as the only ‘true’ MFI operating in Namibia, providing a better package of microfinance products and services, including microloans and microsavings products, to empower micro and small entrepreneurs compared to microlenders that offer only lending. It had further developed an MSME facility offering lending to established micro enterprises at the time of becoming a microfinance bank and had kept its focus on the low end of the market, as it used to do while it was still a pilot project, with women entrepreneurs being its largest client base (FIDES, 2010). Its plan to offer micro-insurance had to be suspended on request of the regulator to sort out a few issues, including the pricing structure. FIDES’s product offering is not only in line with the desirable definition of microfinance outlined earlier in this thesis, but also augurs well with the type of offering advocated by the country's Financial Sector Strategy, i.e. having MFIs serving SMEs to enhance economic activities and employment creation.

Information from the FIDES 2012 annual financial statement revealed the total assets of FIDES to have stood at approximately N$40 million, while it had close to 13 000 active borrowers at the end of 2012. Its gross loan portfolio was approximately N$32 million at the end of that period. More than 70 per cent of the loan book comprised of loans to micro entrepreneurs through loan and savings associations, with the remaining portion belonging to SME borrowers. The majority of loans were in rural areas (85 per cent), with 13 per cent in peri-urban areas and 2 per cent in urban areas. Through its primary savings product 'Step-Up Savings', according to which clients were allowed to deposit an amount of their choice on a weekly or monthly basis, FIDES had managed to grow its savings portfolio to approximately 50 per cent of its loan portfolio.

A review of FIDES's 2010 annual report revealed the information provided below. Collateral for loans (called 'Step-up Lloans') was in the form of a joint and several guarantee provided by the solidarity groups, called the ELO ('Loans and Savings Association' in Oshiwambo) groups.[114] Each group had its elected committee members. As additional security, each borrower had to deposit 6 per cent of the loans acquired into a guarantor fund account at FIDES, where it earned interest, and this could be withdrawn after full repayment of the loan and if there was no default[115] in the specific ELO group. Further, there were community workers who used to visit clients on a weekly basis and dealt with group committee members. MSME loans, on the other hand, were fully secured with guarantors and pledges of assets in addition to loan officers visiting clients regularly (FIDES, 2010). Through this process, the bank managed to have a good repayment ratio and low PAR, as will be shown in the analysis section later in this chapter.

In addition to its head office, which was based in Ongwediva, FIDES had three branches (in Ondangwa, Oshakati, Oshikango) and four satellite offices (in Outapi, Okahao, Okongo and Omuthiya) also in the northern regions of the country (FIDES, 2010). As part of its plan to expand its operations to other regions of the country, it opened a branch in the capital city

[114] These are village associations which FIDES used as its main outreach channel. Each ELO had board/committee members with whom the community workers of FIDES (called Avenelo) would directly deal on a weekly basis to reconcile loan repayments and/or savings deposits that have been made at one of the FIDES branches or via NAMPOST Savings Bank (FIDES, 2010).

[115] If a loan is in default, no new loan is extended to the group and the individual guaranty funds may be activated (FIDES, 2010).

Windhoek (specifically in a suburb called Katutura). However, the operations in the city turned out to be not as successful, as the branch ran into financial problems and had to be closed later.

7.3 FIDES'S EXPERIENCE AS A LICENCED MFI

This section looks at the experience of FIDES as a licensed MFI. As indicated under the introduction section, FIDES transformed from Koshi Yomuti, a microfinance project that used to provide savings and credit services to mostly the rural population in the far northern region of Namibia, after the project demonstrated that the provision of rural financial services was feasible and could become sustainable (FIDES, 2010). Despite being a microfinance-oriented bank, FIDES was licensed under conventional banking law due to the absence of a legal framework for licensing deposit-taking microfinance banks. As such, FIDES was subject to the same prudential and non-prudential regulatory requirements as conventional banking institutions. These will be discussed below as background information to the RIA reported on in subsequent sections of this chapter. Where relevant, the expected effect of the regulatory requirements (as drawn from the literature) is also highlighted to serve as a base for such assessment.

7.3.1 Prudential regulation

As discussed in the literature review chapter of this thesis, prudential regulation is aimed at maintaining the financial solvency and soundness of regulated financial institutions (banks, in this case), and consequently at protecting depositors' funds and maintaining stability of the financial system. While literature advocates for adjusting these standards for MFIs to align them to the risks posed by MFIs as well as to minimise compliance costs, FIDES was broadly subject to the same prudential standards as normal banks. The key prudential requirements are outlined below.

7.3.1.1 Minimum capital requirement

The Basel Committee on Banking Supervision (2010) describes the minimum capital requirement as the amount of start-up capital expenditure that investors need to contribute as equity in order to set up the bank infrastructure and operate successfully. In Namibia, this amount is set at N$10 million for commercial banks by Section 28(1) (a) of the BIA Act No. 2 of 1998. This means that FIDES had to ensure, first and foremost, that it fulfilled this requirement in order to be licenced. At the time of the licence application, FIDES's authorised and paid-up capital was N$15 million (FIDES, 2010), compared to the statutory requirements for banks of N$10 million. This was achieved after shareholders had agreed to subscribe to additional shares (FIDES, 2010). From this it can be deduced that meeting the minimum capital requirements was not a problem for FIDES and did therefore not constitute an entry constraint.

The required minimum capital is however in contrast to the lower initial capital requirements considered appropriate for MFIs by the Basel Committee on Banking Supervision in its Guidelines on Microfinance Activities and the Core Principles for Effective Banking Supervision, based on the limited complexity, scope and size of the operations of these institutions, especially in rural areas (BIS, 2010). Given that the afore-mentioned characteristics are also inherent for FIDES and the fact that its operations were mostly in rural areas, a lower minimum capital requirement could have been considered applicable to FIDES had it not been licensed under the banking institution law and had there been a microfinance-specific regulation in place. It can therefore be said that, as an MFI, FIDES found itself in a disadvantageous position because of this undifferentiated situation which it had to endure.

7.3.1.2 Capital adequacy requirement

Namibia is a Basel II regime, i.e. in 2010 it adopted the Basel II Capital Adequacy Measurement Principles, an international standard for measuring the capital position in banking institutions (BoN, 2011). While the CAR for commercial banks in Namibia stood at 10 per cent of the risk-weighted assets, as prescribed by Section 9(c) of the BoN's determinations on capital adequacy (BID5), an interview with one of the regulatory officials revealed that the regulatory authority does consider the size and extent of the business plans or models and prospective growth plans of new entrants when determining the levels of capital expenditure needed for banking operations, i.e. it can in absolute terms determine a precautionary higher level of capital amount when the situation so warrants [Reg2/3/3]. As a commercial bank licence holder, FIDES, a microfinance bank, was initially required to comply with the capital adequacy standard for conventional banks, i.e. 10 per cent of its risk-weighted assets. This however increased to 15 per cent two years after licensing, i.e. effective from 31 May 2012 (FIDES, 2011). The increased capital ratio was a requirement of the regulatory authority[116] and in line with what is stated above, this higher rate is a reflection of FIDES's business model and a measure aimed at safeguarding the operations and sustainability of the institution, especially at the time when the bank had rapid credit growth and escalating losses [Reg2/3/3].

While not prescribing a specific CAR for MFIs, the Basel Core Principles of Banking Supervision[117] (see Appendix I) advocates for a tailoring approach, indicating areas where a higher CAR could actually be applied to MFIs. The Core Principle on CAR states that when setting an appropriate CAR for MFIs, the nature of microfinance risk, the size and constituents of capital of MFIs should be considered (BIS, 2010). This therefore implies differentiated capital requirements for conventional banks and MFIs. The expected resultant effect of a stricter CAR is that of reducing the amount of funding available for lending (Staschen, 2010). The researcher therefore sought to establish FIDES's experience in this regard during the RIA, reported on later in this chapter. In other words, the researcher sought to determine how the relatively high CAR might have influenced its lending.

7.3.1.3 Reserve requirements

In Namibia, banks are required to maintain an amount equal to 1 per cent of the average total liabilities (deposits) to the public, i.e. the minimum reserve requirement that was also applicable to FIDES is 1 per cent, although the central bank can vary this from time to time to achieve desired monetary policy objectives [UP/PD/2/2]. While it may be a necessary requirement, as it covers a bank's liabilities and is hence a depositor protection mechanism, the profiles of depositors of MFIs such as FIDES are normally smaller relative to those of conventional banks, given that they serve less affluent clients.

CGAP (2000) argues that most of the clients of MFIs are in a net debtor position most of the time and therefore the risk to them in the case of an MFI failing is relatively low. As such, there is more need for depositor protection and therefore a requirement for reserve requirements in the case of conventional banks than in the case of FIDES. This requirement also has the effect of having idle money that could have been utilised for more business

[116] This was also revealed by one of the regulatory authority officials [Reg/2/3/1] during an interview with the researcher at the time of fieldwork on 2 April 2014/15.

[117] These are international standards under the framework of the Bank of International Settlement that guides setting of requirements for regulatory and supervision purposes.

activity such as lending. FIDES could therefore have been disadvantaged by having to comply with the requirement.

7.3.1.4 Portfolio quality and loan loss provisioning requirements

Commercial banks in Namibia are subject to the loan classification and provisioning criteria depicted in Table 7.1 below. Licensed under conventional banking law, FIDES too had to comply with these requirements.

Table 7.1: Loan classifications and provisioning requirements

Number of days overdue	Classification	Minimum provision
Up to 89 days in arrears	Pass/Acceptable	1%
90–119 days in arrears	Special mention	2%
120–209 days in arrears	Substandard	10%
210–389 days in arrears	Doubtful	50%
390 or more days in arrears	Loss	100%

Sources: UP/RD/2/1

In terms of portfolio quality, the regulatory authority monitors the PAR, that is more than 90 days (i.e. PAR>90), of regulated institutions. Literature considers portfolio quality as the primary risk in MFIs and argues that because microfinance loans are typically short-term, small amounts that are repaid in frequent intervals, their loan portfolio is more prone to quick deterioration due to delinquency, which causes the need to quickly and accurately identify the risk posed by past due loans and for a robust manner in which MFIs portfolios are to be dealt with (BIS, 2010). In fact, the Basel Committee on Banking Supervision advocates for the loan classification system and provisioning approach, which accounts for the number of days of non-performance of loans and missed repayments, applying the PAR>30 and PAR>90 of the gross portfolio principle.[118] In this regard, the committee recommends an application of a conservative provisions schedule for MFIs relative to conventional banks that starts early and migrates faster to high risk levels.

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[118] This refers to PAR>30 and PAR>90, which are calculated on a gross portfolio, i.e. taking into account all the outstanding principal balances of all of the MFI's outstanding loans, including current, delinquent and restructured loans.

The same committee further recommends prudent loan write-off policies and procedures to also form part of the portfolio quality management. The fact that FIDES was expected to operate on conventional banks' provisioning schedule could therefore be viewed as having been beneficial, as it did not have to endure the stricter provisioning requirements advocated for MFIs. However, this could also have disadvantaged FIDES to a certain extent, given the nature and characteristics of its loan portfolio that needed to conform to the provisioning standards recommended for MFIs. The impact assessment performed later in this chapter gives an indication of how the situation was with FIDES's loan portfolio quality.

7.3.1.5 Liquidity requirements

The minimum liquid assets ratio for banks in Namibia, as stipulated in the Determinations on Minimum Local Assets (BID-6) issued under the BIA, Act No.2 of 1998, as amended, and which has been applicable to FIDES, is 10 per cent. Literature considers the dynamics of asset and liability management in MFIs as justification for a tailored approach, and argues that MFIs may have more limited access to funding sources than traditional banks, and therefore a higher minimum liquid assets ratio should be considered as ideal for MFIs (Basel Committee on Banking Supervision, 2010; CGAP, 2009).

Commonly in most countries, these ratios are in the range of 15 per cent to 20 per cent for MFIs (CGAP, 2009). It follows then that FIDES Bank Namibia as an MFI was subject to a lower liquid asset ratio than is normally the case for MFIs, which could be taken as an advantage of being regulated under the conventional banking institutions law. However, it might not have augured well with the fact that as an MFI, FIDES's liabilities were very liquid, while its funding sources were limited relative to commercial banks that rely on other market sources of liquidity. The RIA undertaken later in this chapter have provided an indication of the developments in the liquidity position of FIDES and how that have affected the bank's ability to meet its repayment obligations, during the period of its existence.

7.3.1.6 Requirements on large and unsecured exposure limits

With the aim to restrict the extent of credit exposure of banks to a single or group of related borrowers in relation to their capital, Namibia imposes 30 per cent capital funds for a single party as well as an aggregate limit of 800 per cent of all large exposures, i.e. loan amount equalling 10 per cent of the bank's capital funds.[119] This allowable exposure limit of 30 per cent is considered too large for an MFI when compared to other jurisdictions. For example, in Uganda, limits of 1 per cent of core capital for individual borrowers and 5 per cent for group borrowers are applied to DMFIs, relative to 25 per cent of total capital for banks (Staschen, 2010). The large allowable exposure limit (30 per cent) actually provided an opportunity to FIDES to shift to serving more affluent customers than its target market if it wanted to, i.e. it could have caused a 'mission drift' for FIDES, especially when considering that as holder of a commercial bank licence FIDES was not confined to microloans.

Limits are also set on Namibian banks to prevent concentration of credit exposures to certain industries or geographical locations. Being an MFI-oriented institution, the question that naturally arises is how feasibility and practical these exposure limits have been for FIDES, given its focus on a specific target market. In fact, the Basel Committee on Banking Supervision, in its Guidelines on Microfinance Activities and the Core Principles for Effective Banking Supervision, has acknowledged that the fact that MFIs focus on serving specific geographical areas where poor people reside would make such restrictions, coupled with industry limits, most impractical for MFIs. However, in the case of FIDES, the researcher understood that these exposure limits did not have any impact on its business, as its credit policy capped the maximum loans extended at a level that never reached the 10 per cent limit of the capital funds to be considered a large exposure [Reg2/3/(2)].

7.3.1.7 Loan file documentation

Strict loan file documentation requirements are applied to commercial banks in Namibia. In this regard, banks are to keep formal documents on their borrowers, such as financial statements, business plans, proof of business registration and/or ownership, etc. This requirement was also applicable to FIDES. According to literature (Basel Committee on Banking Supervision, 2010; CGAP, 2012), loan documentation is a challenging aspect for microfinance businesses. This is because unlike conventional banks, the economic status and low skills and literacy levels of their clients do not allow MFIs to collect this formal documentation as part of their loan-appraisal process (CGAP, 2012). Instead, they use alternative ways for loan-application appraisals, including the evaluation of household cash flows, appraisal by group members, interviews with village leaders, etc. As such, the loan

[119] These limitations are set by the Determinations on Exposures to Single Borrowers, Large Exposures and Concentration Risk (BID-4) issued by the BoN in Government Gazette No. 290 of 6 November 2009.

files of MFIs would normally contain limited information, typically relating to a loan application; a customer's identity document; loan appraisal, including household cash flow; customers' previous repayment performance; approval by a loan committee or manager; an execution note; an amortisation table, etc. (CGAP, 2012). It is because of this challenge that most regulators would normally waiver the strict loan documentation requirements that are otherwise applicable to banks and allow flexibility for MFIs. This flexibility could however not be applied to FIDES, being a holder of a commercial bank license, and therefore FIDES found itself in a disadvantaged position.

7.3.2 Non-prudential regulations

Non-prudential regulation concerns the regulation of how regulated entities conduct their business, with the objective of licensing the entities, achieving reporting and institutional transparency and consumer protection. As such and as discussed under the literature review chapter, non-prudential requirements are often equally applied to all types of financial institutions, including banks and deposit-taking and lending-only MFIs.

FIDES has been subject to the same non-prudential regulations as banks. CGAP (2009) suggests to have specific requirements for MFIs that take into account their characteristics (i.e. scale of business and inherent risks) and argues that what is important is that the required reporting, details of submissions and the frequency thereof should aim to minimise the cost burden on MFIs. The researcher endeavoured to establish the details of the non-prudential regulatory requirements on FIDES, as discussed below.

7.3.2.1 Licensing

As stated, FIDES, a microfinance bank, was licenced under conventional banking law, and hence had to conform to conventional banking requirements. However, the Basel Committee on Banking Supervision actually emphasises the need to tailor the licensing criteria to the type and size of MFIs, instead of literally applying the criteria for banks. In fact, BIS (2010) suggests a tiered licencing framework and flexible entry rules. It further advocates for a risk-based licensing approach in order to reduce the burden on supervisory resources. It therefore recommends that regulators should take cognisance of the systemic significance of MFIs and develop an approach that is proportional to the systemic risk they pose.

The above suggested differentiation could unfortunately not be applied to FIDES, given the lack of a specific regulatory framework for DMFIs in Namibia and hence this MFI had to be licenced under the normal banking institutions legal framework and was expected to comply with regulatory and supervisory requirements for normal banks.

7.3.2.2 Reporting and institutional transparency

To ensure the increased accuracy of information and protect consumers, commercial banks in Namibia are subject to reporting and information disclosure procedures. Licensed under the same law with commercial banks, FIDES was required to adhere to the same reporting requirements and information disclosure as normal banks, as stipulated under the BIA of 1998. In this regard, information from the survey pointed to the fact that FIDES was expected to provide its financial statements, audited accounts, cash flow projections, donor inflows statements and operational manual.

Reporting and compliance generates costs, which can depress the profitability of an institution (Staschen, 2010). The type of information collected, the level of details and frequency of reporting that MFIs are subject to should naturally differ from those of conventional banks so as to lessen the cost burden on MFIs as well as not to stifle their profitability and development (CGAP, 2009). In the case of FIDES, reporting took place monthly, quarterly and yearly, depending on the nature of information required. Information collected from the company indicated that the same frequency of reporting is also their preferred frequency. They however complained about the many reports required, often on data that are not applicable to an MFI, and recommended that a set of well-formulated reporting should be developed specifically for the MFI. The researcher sought to get some some indication in the ensuing sections on whether or not the reporting process has had an impact on FIDES and in what manner.

7.3.2.3 On-site inspections

As is the case with commercial banks, on-site supervision of FIDES was done once every year and those were informed by the off-site inspections. With off-site supervision, the regulator received returns on a monthly and quarterly basis, which gave an indication of where the company was in terms of capital, liquidity, etc. (basically seeking to determine compliance with the requirements discussed under Section 7.3.1 above). As such, and depending on the findings of the off-site reports, supervisors could engage on-site supervision on an even more regular basis.

FIDES was also subject to detailed external audit standards like conventional banks. In fact, some of the interviewees viewed this process to be the most significant cost resulting from regulation in terms of audit fees that the company had to incur, as one interviewee put it:

> *"We had too many compliance to do, and compliance was expensive, but this was paid by the donors and thus that did not cause the failure of FIDES"* [MFI8/2/(1)]

Notwithstanding the above statement, the researcher was still interested in finding out whether compliance with external audit standards were overbearing on this MFI. This is especially so because the regulatory goal should be that of safeguarding the sustainability of FIDES without depending so much on donor funds. As such, the researcher sought to determine (as part of the RIA) whether or not the type of regulation FIDES was subject to was able to further that sustainability course.

7.3.2.4 Requirements relating to consumer protection

The BoN places a strong emphasis on the protection of consumers. In this regard, regulated institutions are required to disclose and be transparent about their fees and charges to the extent that such are displayed in the branches of commercial banks as well as on their websites. This is a form of both consumer protection and ensuring that clients are able to analyse, compare and make informed choices through the use of availed information.

As a regulated entity, FIDES was required to comply with the above-stated requirements. Further, in 2012, the BoN developed guidelines for consumer protection, the principles of which were later used to guide commercial banks in developing an industry Code of Banking Practice. In addition, the central bank issued guidelines and procedures for laying customer complaints against practices of commercial banks to the BoN, which were launched together with the code in the same year. It also created a functional unit to specifically deal with customer complaints. These guidelines for laying customer complaints and available redress mechanisms have also been applicable to the clients of FIDES, i.e. they have had the same avenue for laying complaints. This is positive, because consumer protection is considered a key element in the provision of financial services to the poor, given their low financial literacy and therefore their vulnerability to abuse and unfair treatment. They should therefore be accorded protection against predatory lending practices, misinformation and over-indebtedness. The law should also require confidentiality and security of customers' data by MFIs, as it is required of banks. At the time of the fieldwork, the Complaints Unit at the BoN revealed that no customer complaints had been received in respect of FIDES.

The next section discusses the assessment of the impact of both the prudential and the non-prudential regulatory requirements, discussed above, on FIDES.

7.4 ASSESSING THE IMPACT OF REGULATION AND SUPERVISION ON FIDES

This section assesses the impact of the regulatory and supervisory framework discussed above on FIDES. It does that, firstly, by examining the evolution in performance indicators of FIDES from its initial establishment and operating as an unregulated MFI (i.e. as Koshi Yomuti) to periods when it was licenced and became a regulated MFI. In other words, the regulatory impact is measured by observing changes in the performance indicators of FIDES, which, in the absence of client level data, is the most obvious way to measure regulatory impact (Staschen, 2010). This is complemented by an assessment of relevant qualitative indicators (i.e. collected evidence from information sources such as interviews and the documentary review undertaken).

Both the performance indicators and the qualitative indicators are further benchmarked to and assessed against the Morgan Stanley approach to assessing credit risk in the microfinance industry (see Appendix H for details on the rating scale) that helps to give an indication on how FIDES compared to international standards. The impact assessment process therefore involves an examination of the annual evolution of each of the quantitative indicators (i.e. changes in the impact indicators) and related qualitative information or factors as well as how those relate to what is acceptable internationally. Where possible, an analysis of the expected impact for the specific performance indicator has been also provided.

The aim of this analysis is to empirically establish what impact the regulatory requirements under the conventional banking law, discussed in Section 7.3, have had on the operations of FIDES and what that meant for the achievement of the regulatory objectives identified under the methodology chapter of this thesis, which is the reason why MFIs, including FIDES, are regulated in the first place. Hence the interpretation of the results is with reference to their relevance for achieving the regulatory objectives as per the adopted ROI methodology of analysis, discussed in Chapter 4. Through this, the researcher sought to establish whether or not the regulatory process and approach applied to FIDES had led to enhancing its operations, i.e. whether regulation had positively or negatively impacted FIDES's operations.

As discussed under the methodology chapter, the process of assessing regulatory impact involves an impact attribution exercise that will make it possible to show that the observed developments (changes) were indeed taking place because of the institution being regulated in the manner that it was regulated, i.e. the need to be able to isolate regulatory impact from other factors that could potentially have impacted the observed outcomes.[120] The researcher also did this, using the methodology explained below as a restate from the methodology chapter for ease of reference.

In the methodology chapter, reference was made to Staschen *et al*. (2012) having identified the ideal approach of conducting an impact assessment to be through the use of the 'double difference' method, i.e. the difference–indifference method. This method would have compared the treated MFI (i.e. FIDES) with non-treated entities, before and after the treatment (i.e. before and after FIDES became a regulated entity). However, the small market size and hence the unavailability of data for a counterfactual (i.e. FIDES having been the only true MFI with its magnitude and therefore a lack of an identifiable control case) rendered the use of statistical techniques such as the regression or correlation analysis impossible. The researcher had to adopt an analytical approach that relied on something other than evidence for the counterfactual to make a causal inference, i.e. the 'modus operandi' method of demonstrating causality. The essence of this method is the ability to demonstrate, through a process of elimination of other possible causes, that the treatment caused the outcome (Mohr, 1999). This process is possible given the fact that it relies on the idea that each possible cause has a 'signature' and if the 'signatures' of other possible factors can be proven to have been absent while that of the treatment was present, the cause can be established (Mohr, 1999). The approach therefore aspires to establish instances of causality through what is referred to as 'physical causation', i.e. through having to prove the existence of a direct physical connection as opposed to 'factual causation', as explained under the methodology chapter. The researcher combined this approach with the structural breaks method (in the case of variables where data were available) to form an

[120] This aspect is a key difference between the ex-post assessment and the ex-ante assessment, which does not require any attribution of impact.

alternative to the difference-in-difference method of impact attribution, as will be observed in the ensuing sub-sections. The indicators used are adapted from those identified by Staschen (2010), as discussed in the methodology chapter.

7.4.1 Data used

Data for the performance indicators were mainly taken from the MIX[121] Market database (Mix. no date), a database that compiles information on MFIs and to which FIDES was one of the reporting institutions that had provided data for the period 2002–2012, i.e. the period before it was licenced (2002–2009) and after it became a regulated entity (2010–2012). Although some gaps were observed in the data, MIX data are considered reliable given the comprehensive review process they are subject to and the fact that they are cross-checked against source documents (such as audits and ratings) and follow international financial reporting standards. MIX is also a standard source for MFI performance data, which are widely used in academic research, as the data are easily comparable to that of other countries and institutions. MIX does however not track data on some of the variables required by this study, and as such the MIX data were complemented by that obtained through the survey to FIDES and audited financial statements of the entity obtained from its annual reports. Qualitative evidence was obtained through interviews with relevant stakeholders (employees, board members and regulators) and the documentary review.

7.4.2 The evolution of FIDES's performance indicators

This section looks at the performance of FIDES over the years, both before it was licenced and after it became a regulated MFI in 2010, using selected performance indicators discussed under Section 7.4.1 above. These include those relating to areas of profitability, capital adequacy, portfolio quality, access, efficiency and liquidity (see Appendix G). The aim was to observe the changes that might have occurred in these indicators over the years and identify structural breaks in the indicators, if any, while at the same time also performing a comparison of this DMFI's performance to international benchmarks, using the Morgan Stanley approach of credit risk assessment in the microfinance industry.

The Morgan Stanley approach mentioned above operates on a scale basis of six levels and uses rankings of very good to very poor, with 6 as very good and 1 as very poor (see

[121] MIX aims to promote the exchange of information within the microfinance sector and to help create a microfinance market by offering data-collection services, performance-tracking tools, sector comparisons and specialised information services.

Appendix H).[122] Further, while the issue of impact attribution has been addressed by the type of methodological approach followed by this study, the researcher decided to look at the developments in some of the performance indicators of normal banks that have been regulated under the same act (i.e. on the same basis) with FIDES, where possible, to see how the trend has been, just as an additional cross-checking mechanism for regulatory impact. The indicators so compared are those relating to profitability, portfolio quality, efficiency and liquidity.

7.4.2.1 Profitability

ROA and ROE are two generally used indicators for profitability. As such, these are also the indicators that regulators would monitor to ensure the soundness of financial institutions. Investors also have interest in these indicators, especially the ROE, as it gives them an indication of the growth and safety of their investment. Over the period of FIDES's existence, and except for the two initial years of establishment (2002–2003) when it was still in a pilot project phase, these two indicators have consistently been in the negative, i.e. the MFI made losses, as can be seen in Figure 7.1 below.

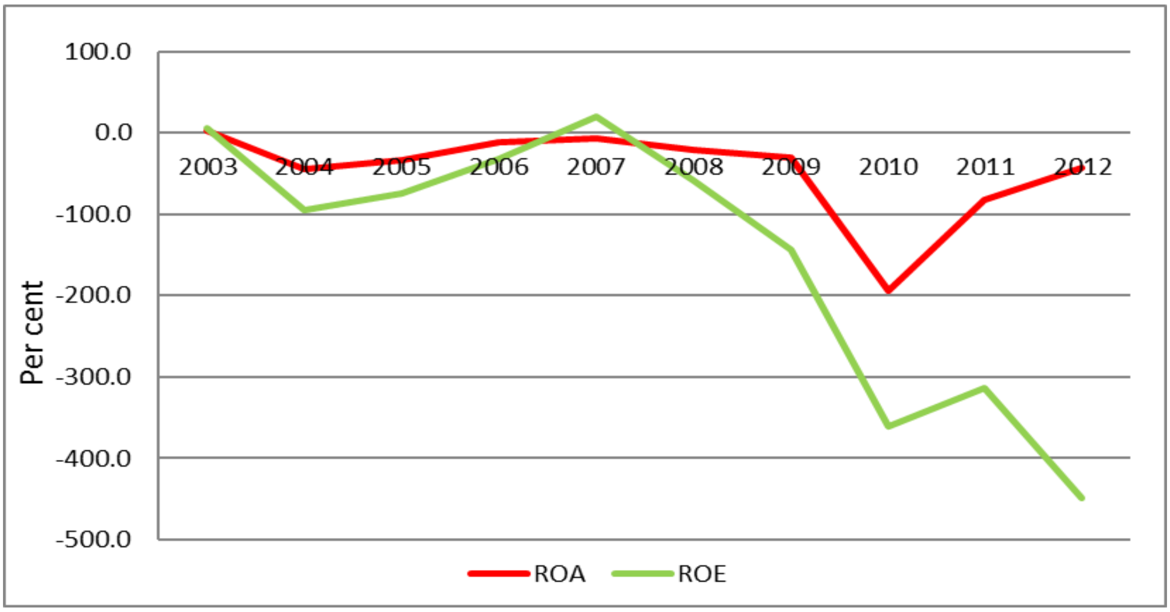

Figure 7.1: FIDES's ROA and ROE

Source: MIX (no date)

[122] See Appendix G for an exposition of the Morgan Stanley approach of credit assessment.

Two profitability indicators show significant changes to have taken place, mostly during the year FIDES was licenced (2010) and then throughout the regulatory period. For example, the decline in the ROA enlarged by 163.6 per cent compared to 2009 to reach 194.7 per cent in 2010. This was a result of the transformation process that involved significant expenses and the fact that the regulated entity now had to comply with stricter provisioning and write-off rules imposed by regulation for the first time,[123] hence a structural break in this performance indicator. This accords with the findings by Cull, Demirguc-Kunt and Morduch (2009a) cited by Staschen (2010) that reduced financial self-sufficiency (an alternative measure of profitability) is associated with additional costs of complying with prudential supervision.

The decline in the ROA of FIDES however slowed significantly by 111.9 per cent in 2011 to reach an ROA of -82.9 per cent and further reduced by -39.4 per cent to reach a level of -43.5 per cent in 2012. This slowdown in the pace of decline after the treatment year (2010), as shown in Figure 7.1 above, can be attributed to regulatory efforts, as one of the duties of the regulator is to ensure, through the implementation of various regulatory measures (such as the regulatory standards aimed at promoting financial stability and soundness of regulated entities), that regulated entities strive to achieve at least minimum levels of profitability larger than zero (Staschen, 2010). By registering this improvement, FIDES seems to have been on the path to achieving just that. As such, it can be said that regulation resulted in progress in this profitability indicator of FIDES. A similar trend was observed in the ROE when the decline expanded by 219.5 per cent in 2010 to reach -360.2 per cent before slowing by 46.1 per cent in 2011 to reach -314.1 per cent, but further widening again by 134.8 per cent to reach a level of -448.9 per cent in 2012. Very small changes averaging just about -21 per cent per year were observed in the ROE during the period before licencing.

The above improved but consistently negative ROA and ROE of FIDES seem to be a reflection of the heavy dependence on equity, which the researcher observed in the availed data. The bank had liquid assets coming in as availed by shareholders on several occasions. Further, the data reflected an unleveraged situation, i.e. FIDES had relatively little debt as a source of funding initially (as a project, i.e. before licencing), except for the sub-ordinated

[123] FIDES reported in its 2010 annual report that the operational results of the bank in 2010 had been impacted by heavy human investment made to create and implement the comprehensive set of operating procedures at all levels (operations, administration, accounting, etc.), and that the vast project encompassed training, follow-up and checking that all administrative and accounting procedures for clients' management were operational and done in conformity with banking regulations.

loans that used to be extended in later years by its shareholders as a way of recapitalising the company, often on requirement of the regulator. This situation is represented in the low debt to equity ratio (i.e. leverage ratio) initially (i.e. before the company was licenced), as depicted in Figure 7.2 below, although this picked up significantly later just before and after the treatment year (i.e. when it became a regulated institution), as shown in the same figure.

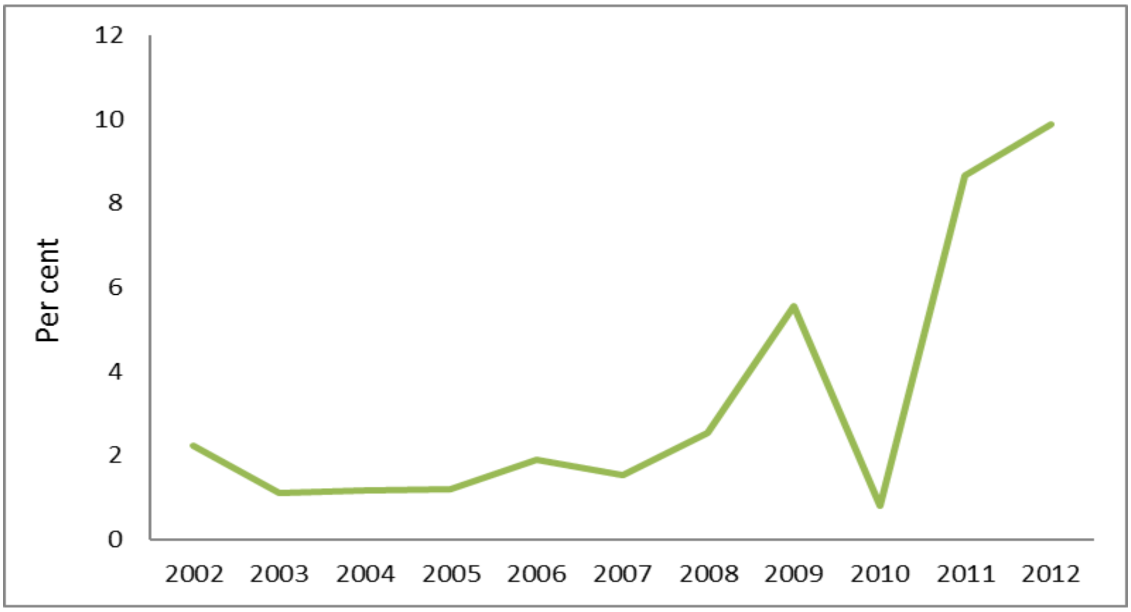

Figure 7.2: Debt to equity ratio
Source: MIX (no date)

The average debt to equity ratio of FIDES was 2.1 per cent during the pre-licensing period, but increased to 6.5 per cent during the post-licensing period. The lowest ratio was 0.8 per cent achieved in 2010 (the year it obtained a licence), while the highest ratio of 9.9 per cent was achieved by the end of the second year after receiving the licence (i.e. in 2012). As can be seen in Figure 7.3 below, changes in the debt to equity ratio over the period were actually minimal initially, but started widening a year before obtaining the licence and peaking one year after that, which signals that the company had huge capital injections to finance its operations. The increased ratio during the post-licensing era was a result of increased share capital, which came about as a result of the company ensuring that the regulatory requirements are met [MFI8/2/2], as discussed earlier.

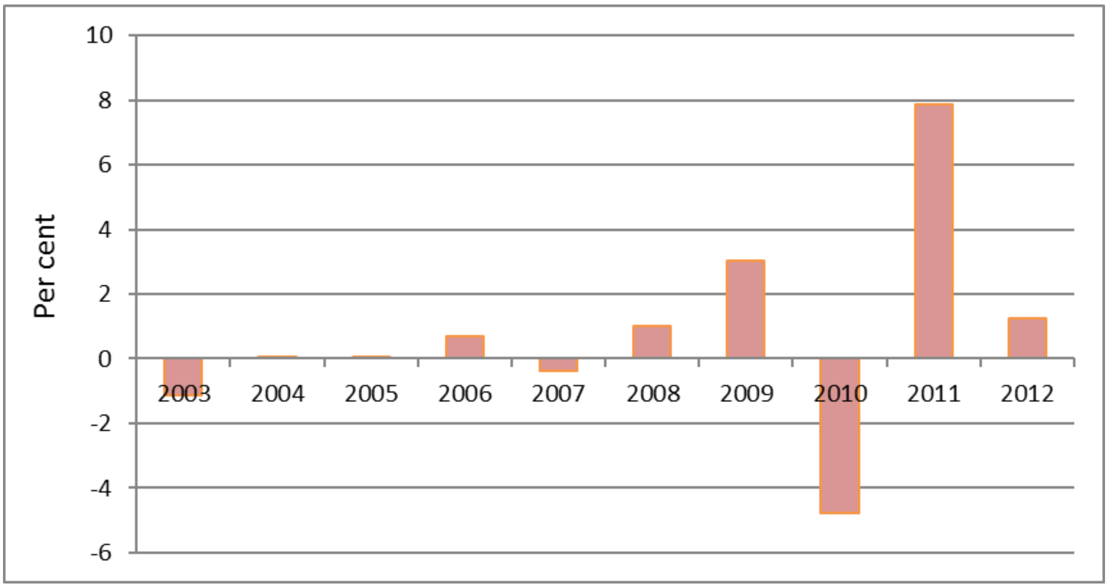

Figure 7.3: Change in FIDES's debt to equity ratio

Source: Researcher's calculation from MIX (no date)

A comparison to the developments in the profitability indicators of normal banks that have been regulated under the same law with FIDES shows that commercial banks on average achieved an ROA of 2.3 per cent per year during the same period (2002–2012). The trend has been positive and generally constant, with minimal changes of approximately 0.1 per cent per annum, as shown in Figure 7.4 below. The same positive trend is observed in their ROE, posting an average of 22.5 per cent over the period, also with only minimal variations on a yearly basis, especially from 2004 onwards. These are respectable levels of profitability achieved by Namibian commercial banks, and in the same vein as argued for FIDES, regulation should have played a role in ensuring these positive results through the same channels of impact, such as setting standards and rules of operation, ensuring adherence to minimum requirements for capital and portfolio quality, etc.

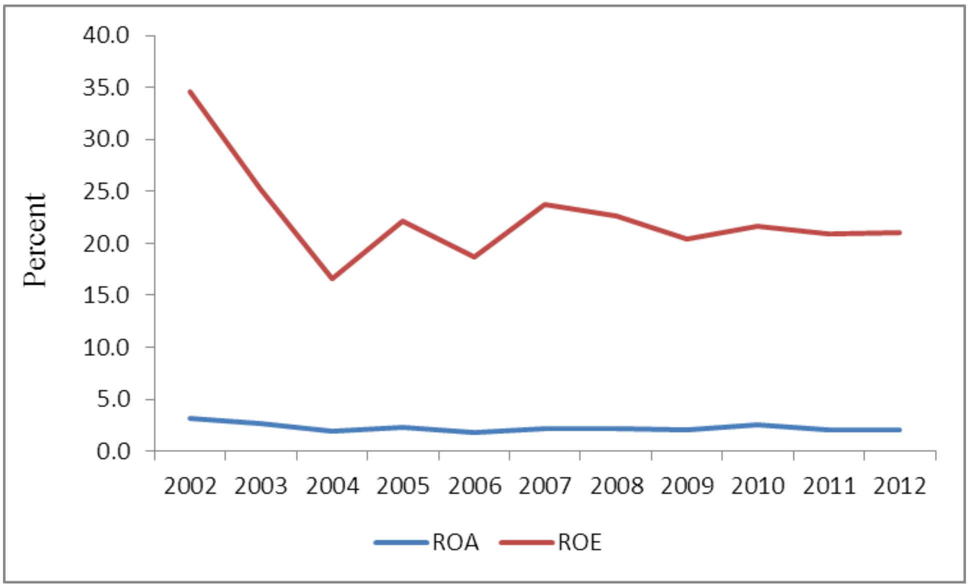

Figure 7.4: Commercial banks' ROA and ROE

Source: BoN annual reports 2002–2012

7.4.2.2 Capital

As stated earlier, FIDES had low leverage ratios initially, given it made less use of external borrowing as an NGO, i.e. it had high capital ratios. This could be a result of the fact that it was mainly financed by donors initially when it was a project (and later by shareholders after it became a bank). In fact, its capital to asset ratio was declining in the years prior to it becoming a regulated entity, i.e. the ratio showed a declining trend up to the year 2009, from a high of 47.6 per cent in 2003 to 15.3 per cent in 2009, as shown in Figure 7.5, but shoot up significantly by 40.3 per cent in the year of treatment (2010) to reach 55.5 per cent as shareholders subscribed to additional shares in that year to meet the licencing requirement, as discussed under Section 7.3.1.1. The significantly increased capital to asset ratio in 2010 can therefore be referred to as a 'structural break' in the ratio, which could be ascribed to regulation that normally expects regulated entities to conform to the capital adequacy requirements, and this was happening to FIDES for the first time.

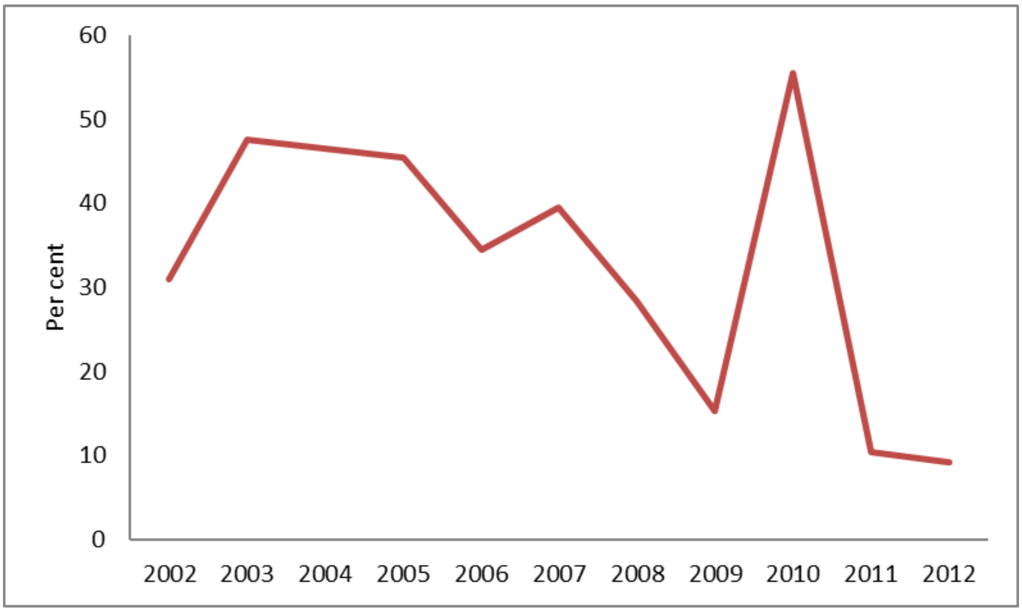

Figure 7.5: FIDES's capital to asset ratio

Source: MIX (no date)

The ratio however immediately fell back into a declining mode a year after licensing and maintained that trend (Figure 7.5) until FIDES found itself in breach of capital adequacy requirements. The bank therefore had to obtain approval by the regulator to operate below the minimum required capital adequacy until end of May 2012 (FIDES, 2011). The CAR during 2011 and 2012 were 10.4 per cent and 9.2 per cent, respectively, lower than the required 15 per cent at the time. The drop in the ratio after 2010 could be a reflection of lower magnitudes of shareholder capital injection in 2011 and 2012 relative to 2010. FIDES experienced a situation of dwindling capital and the unwillingness by the shareholders to continue injecting more capital into the business, which the researcher detected from the interviews with the stakeholders, has reportedly led the institution into a 'crisis' until its takeover in 2014. Specific statements by interviewees are quoted below to illustrate this point.

> *"Shareholders did not have commitment to continue capitalising the bank"* [MFI8/2/(1)] [124]

[124] One of the former employees of FIDES however argued that this happened only after shareholders had been asked to invest capital several times already and they had realised that the loss of their investment was becoming imminent, as the business plan was not working out as planned [MFI6/2/1].

> *"Strike and fraud also came in, which also required shareholders to put in more and more money, and in the end they gave up"* [Reg2/3/(2)]

As discussed under Section 7.3.1.2, FIDES, based on assessment by the regulatory authority, was at some point subject to a higher CAR of 15 per cent relative to the 10 per cent applicable to normal banks, and this forced shareholder to inject capital into the business. Shareholders actually had to subscribe to more shares on three occasions in the regulated era (in 2010, 2011 and 2012) to meet regulatory requirements and keep the operations going, until they later developed a reluctance to continue pumping more capital into the institution.

Contrary to the above experience by FIDES, normal banks in Namibia remained adequately capitalised throughout the period (2002–2012), with only minimal changes observed on an annual basis (0.1 per cent on average over the review period). This reflects shareholders' confidence in these institutions. Further, no instances of non-compliance with the capital adequacy requirements by commercial banks have been reported for the review period. During this period, the capital to asset ratio of commercial banks recorded an average of 7.8 per cent (8.0 per cent before FIDES came on board and 8.1 per cent after FIDES was licensed). An interesting observation is the similar increase in year 2010, the year FIDES was licensed (Figure 7.6), although this is significantly lower than FIDES's capital expense ratio in that year.

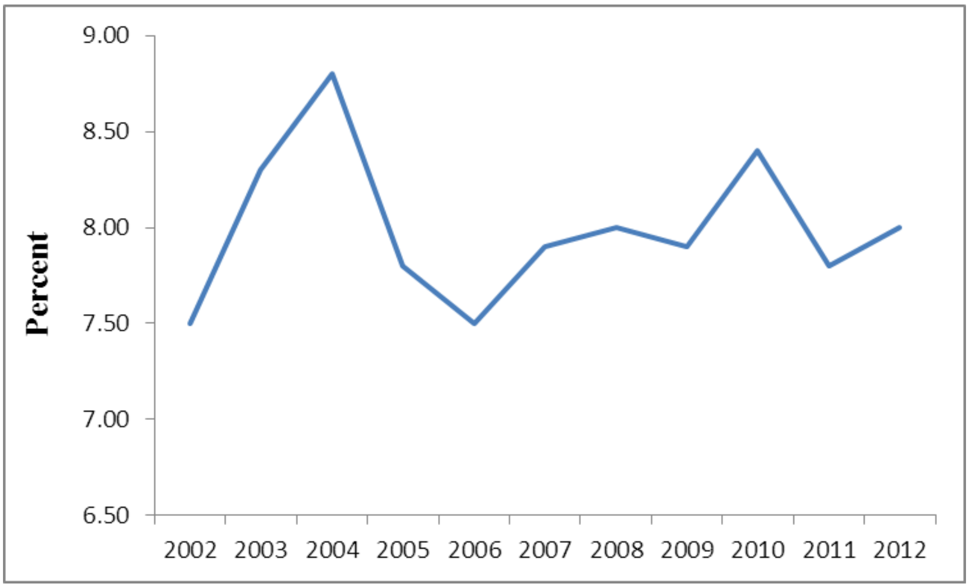

Figure 7.6: Commercial banks' capital to asset ratio

Source: BoN annual reports 2002–2012

7.4.2.3 Portfolio quality

Regulators are interested in monitoring the quality of the loan portfolio of regulated institutions. This is because it gives an indication of the extent of credit risk involved in the outstanding portfolio to help them ensure that such does not threaten the stability and soundness of regulated institutions. Financial institutions themselves, including MFIs, also ought to monitor the quality of their loan books to avoid unexpected losses that can be detrimental to their operations and sustainability.

Conventional banking institutions normally monitor the non-performance loans (i.e. loans that are overdue by more than 90 days), while the standard used in the microfinance industry is the PAR over 30 days (PAR>30), or simply the value of outstanding loans with overdue payments of 30 days or more (Arvelo, Bell, Novak, Rose & Venugopal, 2008). In this regard, the benchmark for MFIs according to the Morgan Stanley credit risk assessment approach is <3 per cent when a portfolio is considered to be of good quality (Morgan Stanley, 2008). An MFI with values below this benchmark reflects not only its good recovery policy, but also its ability to control the risk (Ayayi, 2011). Contrary to this, a PAR>30 that is higher than the benchmark of 3 per cent over time threatens the lending ability of the MFI, as fewer funds would be available given the high non-repayment, a situation that would not be conducive to the performance of an MFI (Ayayi, 2011).

In general, FIDES had a performing loan portfolio from the initial stages of its establishment (i.e. when it was still a project) up to the treatment year. As can be seen in Figure 7.7 below, the PAR of FIDES, measured as PAR>30 days, had hovered below 2 per cent on average up to the treatment year, implying an excellent loan portfolio quality when measured against the Morgan Stanley credit assessment rating benchmark of 3 per cent. This means that the portion of FIDES's loan portfolio that was at risk of being repaid had been very small. Although slightly higher ratios than the benchmark were observed for two years within that same period (3.3 per cent in 2008 and 3.2 in 2009), this still falls in the second-highest level of the Morgan Stanley scale. The ratio further declined during the treatment year to reach 1.4 per cent and therefore it continued to have an excellent loan portfolio quality. This could be an indication of the fact that as a regulated MFI, FIDES now needed to comply with regulatory requirements concerning loan-provisioning standards. In this regard, FIDES was subject to the same treatment of non-performing loans standards as conventional banks, as discussed under Section 7.3.1.4 of this chapter. Accordingly, the MFI was expected to maintain its portfolio quality within those provisioning standards, thereby possibly resulting in the good portfolio quality.

The PAR however started increasing significantly by 36.2 per cent a year after the treatment year (i.e. in 2011) to reach 40.2 per cent in 2012 (see Figure 7.7 below), which is not only way above the benchmark, but is also out of the rating scale of Morgan Stanley, and therefore a deteriorating portfolio quality. This could have been triggered by the significantly increased number of borrowers during that same period (as will be evident later from discussions of the access to finance indicator), partly as a result of the additional branch established in the capital city, Windhoek, during 2012. The new branch addition turned out to threaten the MFI's collection process, as the usual group-lending model (with members of groups serving as security) that had worked well in the rural setup did not work properly in this city environment, as FIDES discovered soon after the establishment of that branch.[125] The new branch was opened during the last quarter of 2012 and by the first quarter of 2013, the branch experienced a problem of non-repayment of loans. Theoretically, the very high PAR>30 ratio observed after the treatment period should have negatively affected FIDES's lending ability and hence its outreach. The assessment of the financial access indicator in later sections did shed light on the real situation of FIDES in this regard. Suffice it to mention here that FIDES did experience problems later that led to its takeover.

[125] FIDES's lending approach was group lending through the ELOs, where committee members used to collect repayments and deposit the money into a bank account. The same approach was implemented in Windhoek, but this did not work out due to the setup in the city, which is different from the rural area, where everybody knows almost exactly where the other person lives and how they conduct themselves, etc.

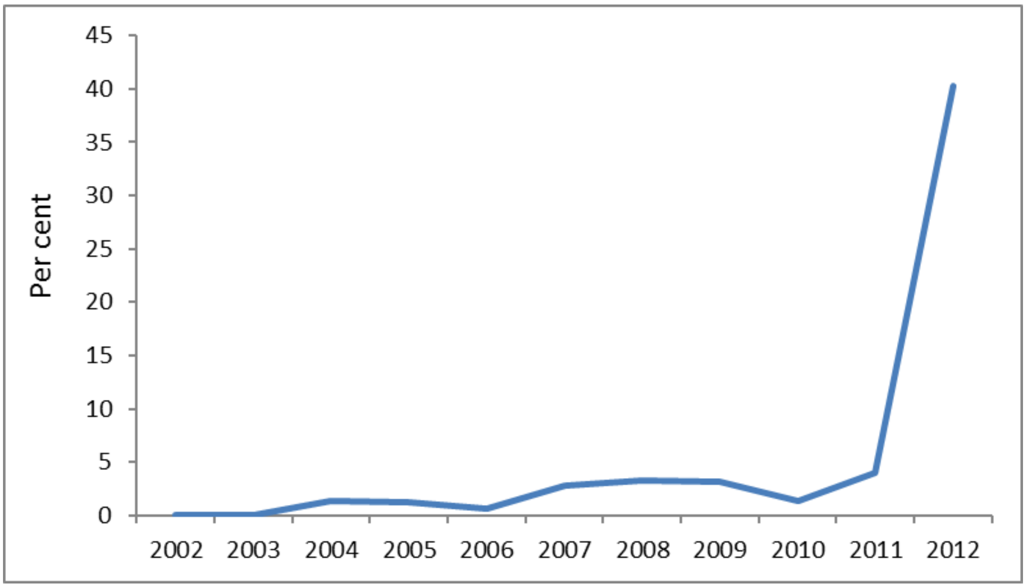

Figure 7.7: PAR>30 days

Source: MIX (no date)

The change from the low level in the pre-regulation era to the high level of loan PAR during the post-regulation era of FIDES raises a question of whether or not regulation has been effective in monitoring the situation, while it also supports the argument that regulation does not necessarily mean that regulated institutions cannot fail. It is also important to note that a lower PAR>30 ratio, such as that experienced by FIDES for the most part of its existence, could also mean that the institution had been avoiding bad loans on its books and could have simply written off those that are delinquent for 30 days or more, a situation that can be detected from the write-off indicator of the MFI (Ayayi, 2011). FIDES's write-off ratios were very low in the pre-licensing era, averaging at 0.003 per cent. The unavailability of data, however, did not make it possible for the researcher to determine the exact write-off condition during the regulated era, but one can assume a relatively higher average write-off ratio due to the deteriorated loan portfolio quality and the collection problems experienced by the bank as highlighted above.

In the case of commercial banks in Namibia, they recorded a persistent trend of low risk portfolio over the period, both before and after FIDES was licensed, as can be seen in Figure 7.8. The PAR for one months to less than three months (i.e. PAR>30) averaged at a low ratio of 1.1 per cent over the period 2004–2012. A key observation from the comparison is that while FIDES experienced a decline in its PAR>30 ratio during the treatment year, the average for the commercial banks was increasing in that year (Figure 7.8) and while the ratio for FIDES was increasing a year after its treatment (in 2011), as discussed earlier, that for commercial banks was declining, although both showed an increasing trend after that.

Figure 7.8: PAR>30 for commercial banks

Source: BoN annual reports 2004–2012 data

In fact, the non-performing loans (NPL) ratio of commercial banks averaged at 2.5 per cent below the international benchmark of 4 per cent, depicting a declining trend over the review period (see Figure 7.9). Similar to the case of FIDES, the regulatory requirement to maintain portfolio quality within provisioning standards should have resulted in a good portfolio quality.

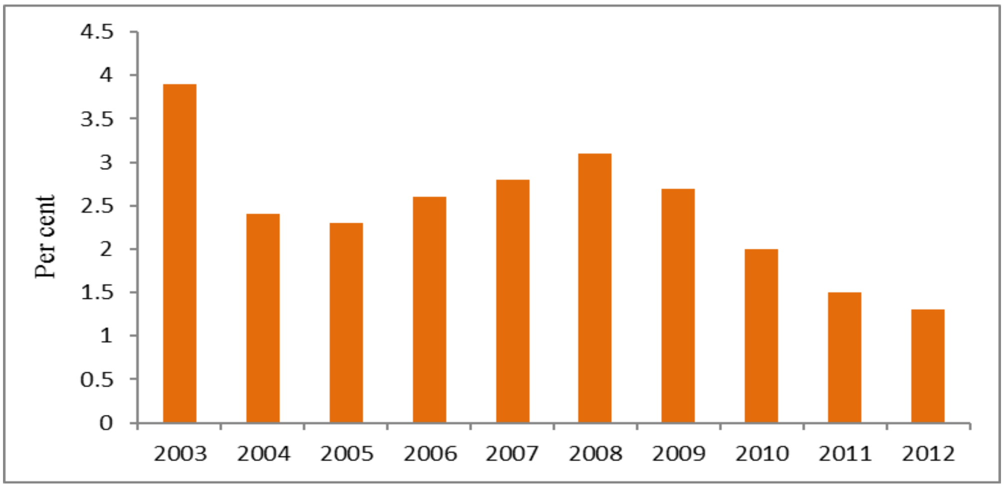

Figure 7.9: NPL ratio for commercial banks
Source: BoN annual reports 2005–2012

7.4.2.4 Access to finance

This section gives an analyses of FIDES's performance with regard to providing access to financial services and products. Looking at this aspect is important, especially in the case of MFIs, for which the belief is generally that they are enhancers of access to financial services and products for the poor and small businesses, as discussed in Chapter 3 of this thesis. In this regard, the researcher also showed during the review of empirical literature in Chapter 3 that regulation does generally facilitate and enhance the performance of MFIs in terms of enabling them to provide the necessary services and products to their target audience. Following below is an analysis of some of the access indicators for which data are available in respect of FIDES's performance. As indicated in the introduction section of this chapter, the focus is on the changes in the indicators and not absolute numbers.

(a) Number of borrowers

Developments in the number of borrowers are an important aspect to look at in the context of this chapter, which assesses the impact of regulation on a regulated MFI. This is because when MFIs transform to become commercialised, the process often comes with a shift to larger and fewer loans (Christen, 2001, cited by Staschen, 2010). It was therefore of interest to the researcher to establish what the experience of FIDES has been.

The number of borrowers served by FIDES increased significantly in the first two years of the licencing period, i.e. in 2010 and 2011, by 2 582 and 5 385 borrowers respectively, to reach 5 313 and 10 698, respectively. The pace of increase slowed to 1 986 borrowers by 2012, although it still managed to push the total number of borrowers to 12 684 in that year. This is a significant shift from the pre-licensing period (2002–2009), where the increase had on average been by only 364 borrowers per year (see Figure 7.10).

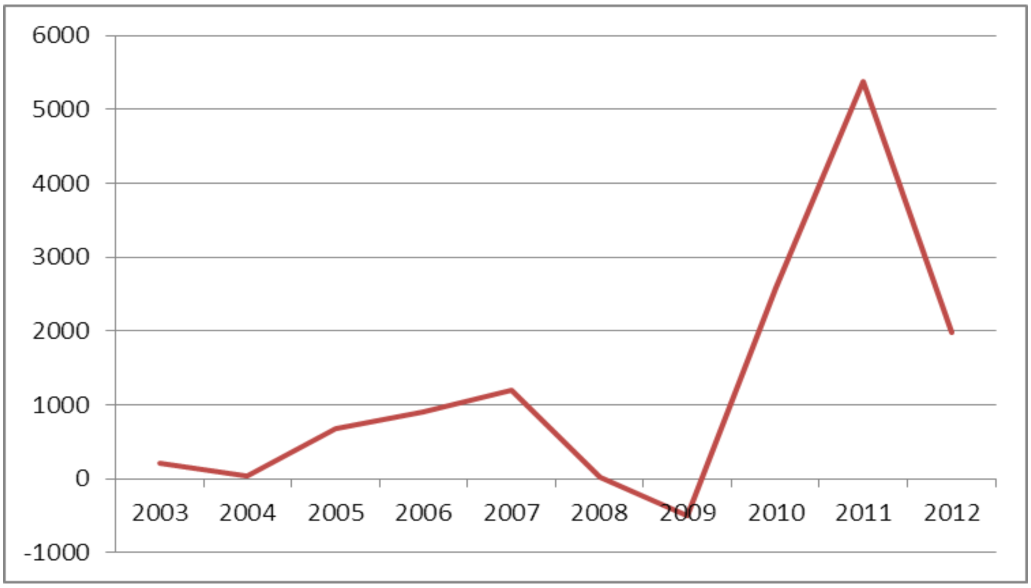

Figure 7.10: Change in the number of borrowers for FIDES

Source: Researcher's calculation from MIX (no date)

The increasing trend in the number of borrowers observed during the post-licensing period relative to the pre-licensing period clearly shows a structural break, as depicted in Figure 7.11 below, and suggests that there has been progress in this indicator of access to finance in the post-treatment period. This can be attributed to regulation, because the increase in the number of borrowers can be reflective of an increase in the perceived credibility level of FIDES being a regulated entity. In the absence of any other observed factor that could have caused this significant increase in the number of borrowers around the licenced period, it can be attributed to the clients' increased confidence in this MFI, resulting from the fact that it was now a regulated entity and therefore a credible institution to deal with, which is in line with the advantages of regulation advanced in literature, as discussed under the literature review chapter. This is also in line with findings of international cross-country studies such as that of Fernando (2004), cited by Staschen (2010), which showed that regulation had a positive impact on the number of borrowers.

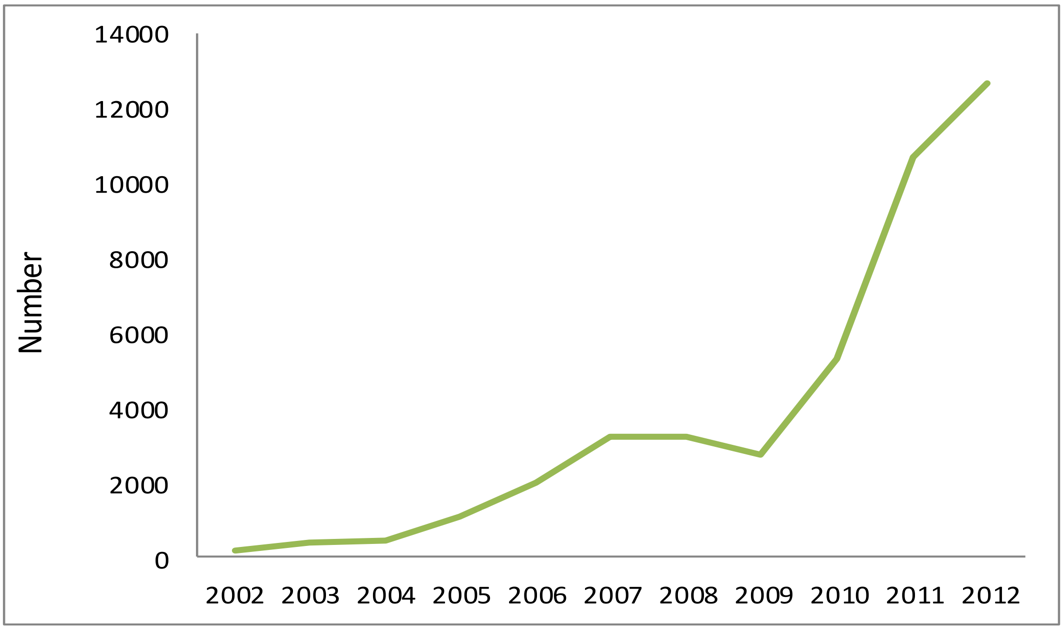

Figure 7.11: Number of borrowers

Source: MIX (no date)

(a) Total savings

The same trend observed in the number of borrowers indicator is observed on the savings side. Figure 7.12 below shows that FIDES experienced huge jumps in the first two post-licencing years. Total savings grew remarkably by USD496 076 between 2009 and 2010 to reach a level of USD510 040, and further by USD630 081 between 2010 and 2011 before the pace of increase slowed down to only USD429 579 in 2012. These increases compare to those of only USD1 969 on average per year during the pre-licensing years. Also similar to what was observed in the number of borrowers indicator in the year preceding the licensing year (2009), FIDES also experienced a significant decline in total savings by N$84 959 in that same year, which could still be a reflection of this institution having been preoccupied with the final preparation to be licensed in the following year and hence the less-than-usual efforts in other activities during that year. The observed trending in the same direction by these two variables could be an indicator that savings has been one of the main funding sources for lending and therefore what happened to it affected borrowings as well.

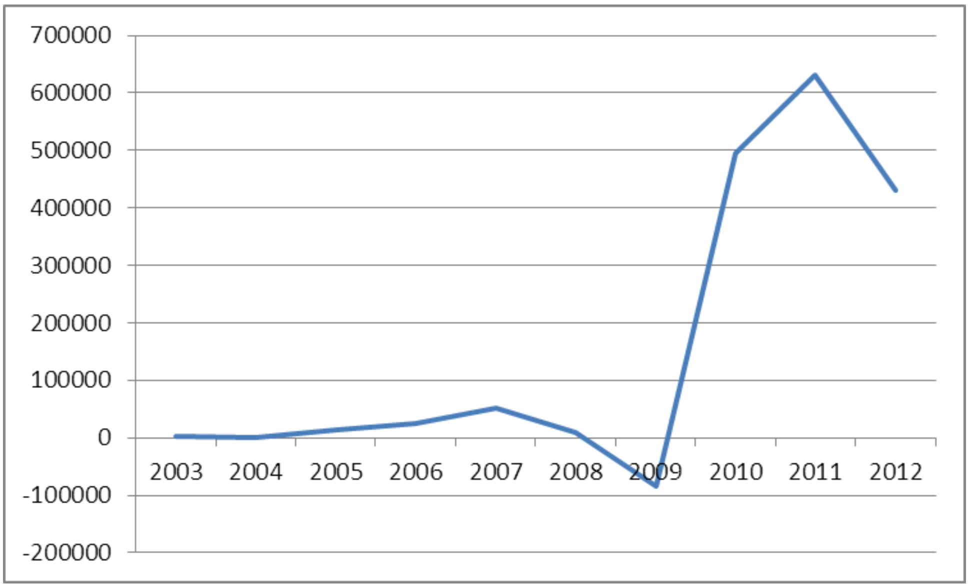

Figure 7.12: Change in total savings

Source: Researcher's calculation from MIX (no date)

Figure 7.13 shows that while FIDES used to take savings prior to its being licensed (mostly obligatory savings), there was a huge increase in the level of savings during the post-licensing period. This huge increase in total saving observed around the post-licensing years is again a structural break, as can be clearly seen in Figure 7.13 below, and shows progress in the total savings indicator, brought about by regulation.

The progress in the savings reflects the fact that as a regulated MFI, FIDES could now freely mobilise savings, including voluntary savings, to the extent possible as opposed to the statutory limitations it faced when it was an unregulated entity and could only mobilise savings to the extent allowed by the regulatory authority.[126] This is evidenced by the number of savers that increased substantially to 51 966 by 2012 compared to only 899 savers on average per year during the period before the license was granted. It is therefore clear that FIDES experienced an upsurge in both total savings and number of savers during the post-licensing period, hence a structural break that can be considered to have been a positive regulatory impact on the scope of access. The structural break is therefore a result of the increased safety and soundness of the institution brought about by regulation that may have encouraged depositors to entrust their savings to FIDES. It is also a result of the removal of

[126] Unregulated entities in Namibia can only mobilise savings to the extent allowed by law.

the limitation on the mobilisation of deposits made possible by regulation after FIDES became a regulated entity. As such, regulation had played a role in the progress of this indicator, and shows the extent of FIDES's contribution to progress in the breadth of access to savings.

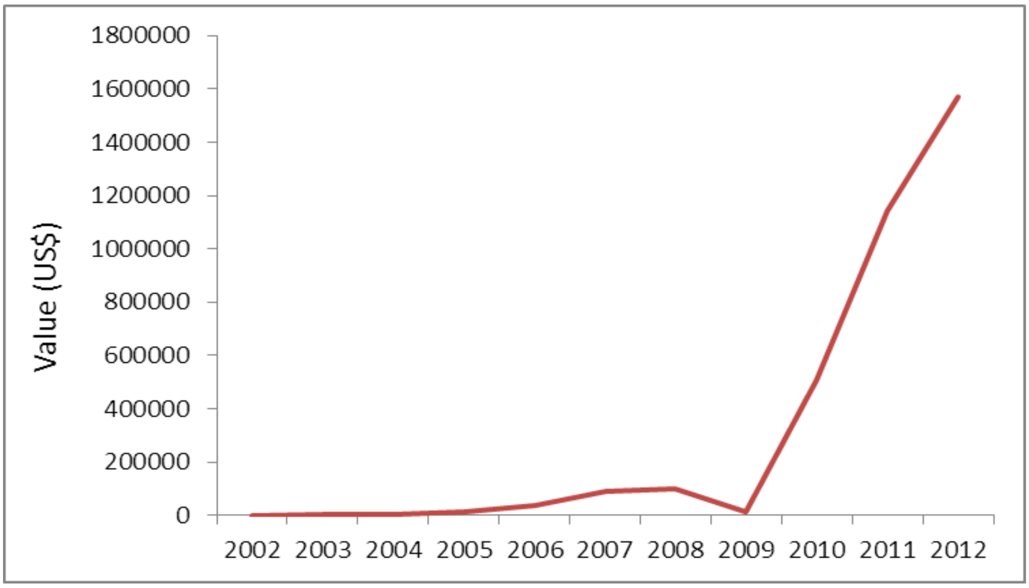

Figure 7.13: Total savings

Source: MIX (no date)

7.4.2.5 Efficiency

Measured by either the operating efficiency or the productivity ratio of the loan officer, the efficiency of an entity's operations is an important aspect to keep track of, given its impact on the performance of its business. For example, Staschen (2010) states that portfolio yields crucially depend on the efficiency of operations. FIDES experienced fluctuations in its operations efficiency ratio (measured as total operating expenses divided by average gross loan portfolio), an indication that it could control its costs better in some periods (i.e. periods of increasing efficiency), while there were also other periods when it was not successful in doing that (i.e. periods of low efficiency).

Regulators would normally also be monitoring the efficiency of regulated entities, measured by the operating expense ratio (i.e. operating expense as percentage of the loan value), because it can indirectly affect the safety and soundness of the entities. According to Staschen (2010), regulation can cause growth of the institution, which leads to larger loan sizes, improved governance, more profit-oriented ownership and more competition, which in turn can lead to increased efficiency of operations. He however also cites the cost of regulatory compliance as a possible downside, as it can push up the operating expense ratio. Figure 7.14 shows a decreasing trend in its operating expense ratio (representing high efficiency) during the bank's fourth and fifth years of operations (2005–2006), but turning into an increasing mode (representing low efficiency) from 2007 to 2010. The highest increase for the period was recorded in 2010, and this could be attributed to the cost of regulatory compliance, given that 2010 was the year in which FIDES was licenced and therefore it needed to comply with related regulatory requirements. However, the general declining trend during the overall post-licensing period, as observed in Figure 7.14 below, can be a reflection of FIDES's response to regulatory pressure for the institution to ensure efficiency in its operations, such as compliance with requirements to have proper information management systems and qualified staff in place, both elements that are efficiency enhancers.

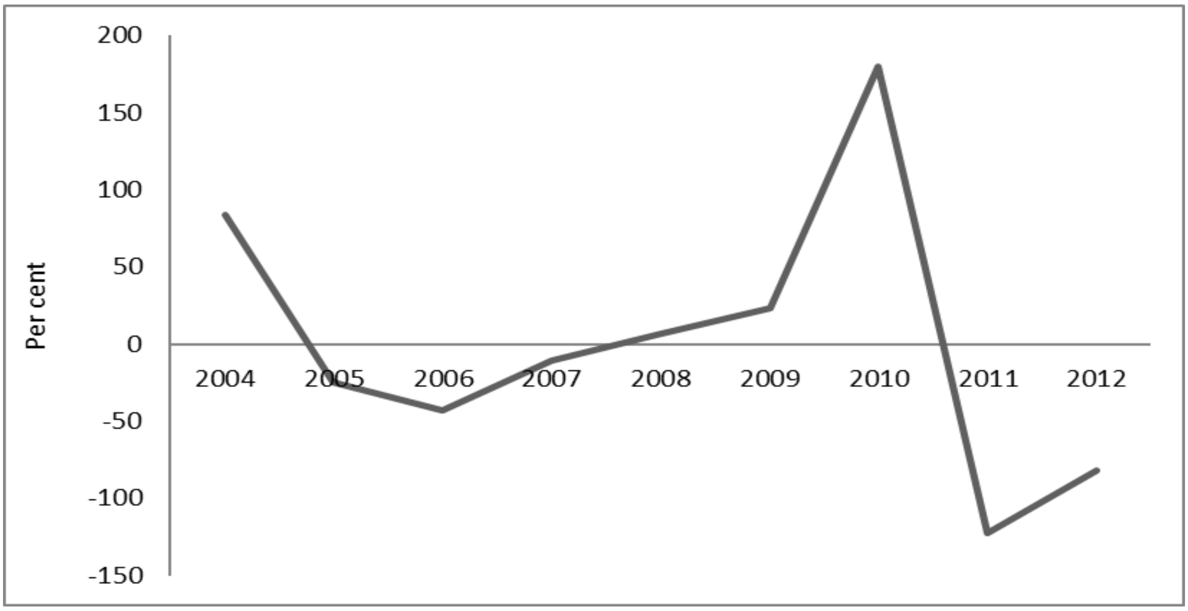

Figure 7.14: Change in FIDES's operating expense ratio

Source: Researcher's calculation from MIX (no date)

In comparison to the Morgan Stanley standard, FIDES registered averages of 82.6 per cent during the period before it was licenced and 156.0 per cent during the post-licencing period. As can be seen in Figure 7.15 below, the highest ratio (264.7 per cent) was recorded in 2010, followed by 142.5 per cent the year after that. The average for the overall period (2003–2012) was therefore 102.9 per cent. The Morgan Stanley rating scale considers a ratio of <20 per cent to be representing the best operating efficiency and anything above 50 per cent as very poor. The ratios recorded by FIDES throughout its period of existence are above 50 per cent (see Figure 7.15 below), and this places it in the ‘very poor’ category. It also implies that FIDES had difficulties in controlling its costs, especially during the period around its treatment year (i.e. during its transformation period). A significant improvement in the ratio (declining ratio) observed after the treatment year (in 2011–2012) could however imply that the MFI was achieving gradual economies of scale and that FIDES’s operating expenses were declining as the business was expanding.

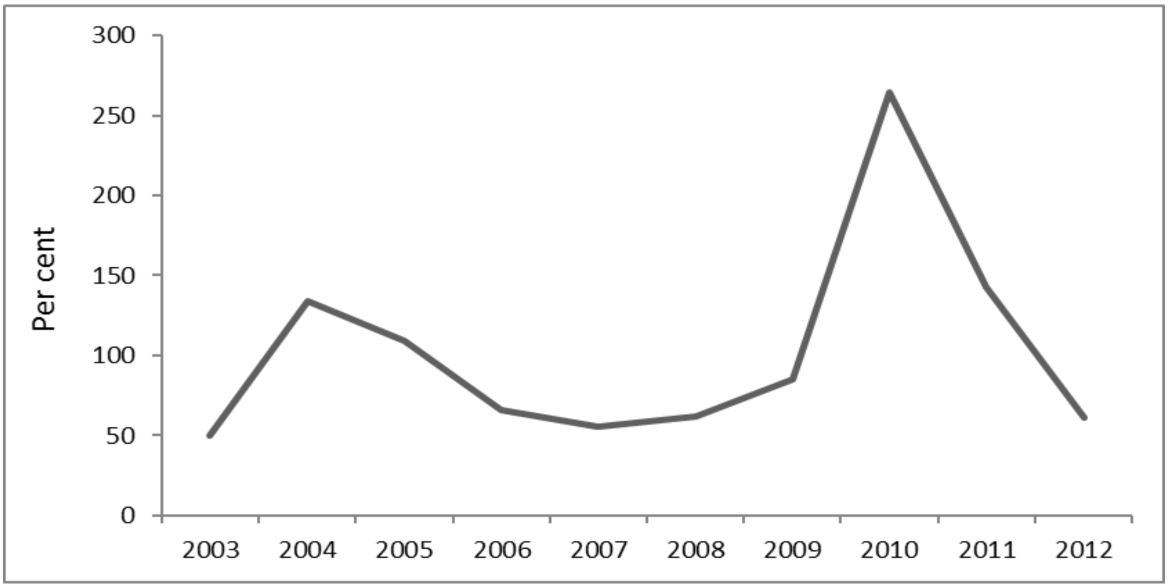

Figure 7.15: FIDES’s operating expense ratio

Source: MIX (no date)

For the period for which data are available (2008–2012), commercial banks in Namibia recorded much lower operating expense ratios relative to FIDES (see Figure 7.16). Their period average stood at 56.8 per cent, compared to 123.6 per cent for FIDES. The operating expense ratio averaged at 56.5 per cent before FIDES came on board (75.0 per cent for FIDES) and 57.1 per cent after FIDES was licensed (156.0 per cent for FIDES). A key observation of this comparison is the fact that while FIDES’s operating expense ratio increased significantly and was the highest in the year it was licensed, that of commercial banks decreased significant, as reflected in Figure 7.16 on changes in their operating expense ratio. In fact, there has been a consistent declining trend in this ratio for commercial banks after 2009, as shown in the same figure. This gives an indication that the banks have been consistently striving to lower their operations expenses in line with regulatory requirements, while FIDES, a microfinance bank, has had to struggle with regulatory compliance, at least for two years before the ratio fell back to the normal pre-licensing period trend in year three of its post-licensing period.

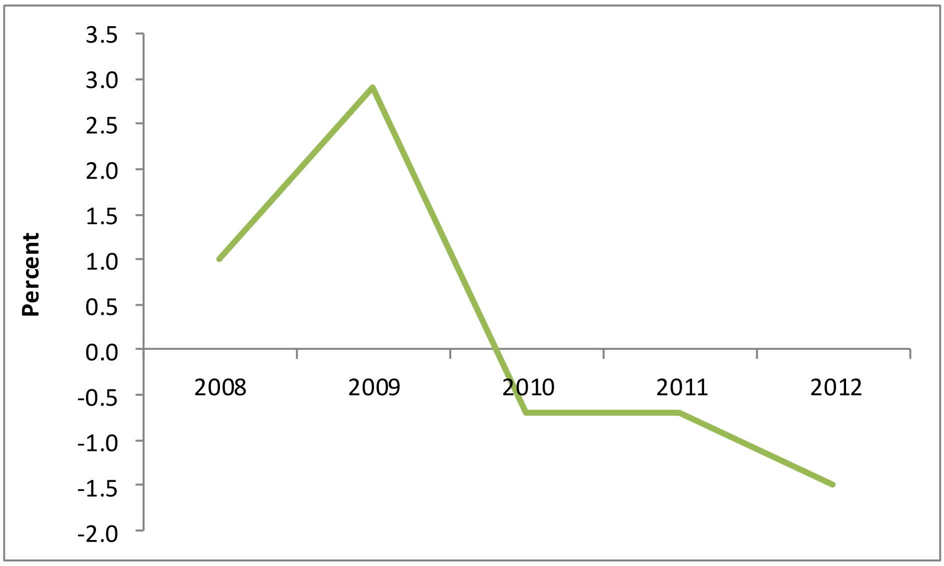

Figure 7.16: Change in operating expense ratio of commercial banks

Source: Researcher's calculations from BoN annual reports 2008–2012 data

7.4.2.6 Liquidity

The liquidity of an organisation, measured through liquidity ratio (liquid assets over deposit liabilities), is an important indicator that shows the extent to which an organisation is able to meet its payment obligations (Oguntoyinbo, 2011). A low liquidity ratio would signal a liquidity problem, i.e. the lack of capacity of the organisation to meet its payment obligations, while a high liquidity could also imply that an organisation is being ineffective in managing its cash (Arvelo et al., 2008). Regulators therefore have a keen interest in monitoring the liquidity levels of regulated institutions. In the case of FIDES, the statutory requirement with which it had to comply was to maintain a ratio of 10 per cent.[127] The Morgan Stanley ranking standard has a scale of >15 per cent being very good and below 3 per cent as poor.

While the data on the liquidity ratio of FIDES were not available, the researcher used those for the liquid ratio (i.e. liquid assets as percentage of total assets) to serve as a basic indicator. FIDES's liquid ratio averaged at 10.6 per cent before it was licenced and at 18.2

[127] The regulator of banks, requires that banking institutions, including FIDES, maintain a liquidity level of 10 per cent.

per cent after it was licenced. This resulted in an overall average of 13.1 per cent over the period 2004–2012 (Figure 7.17). Before the MFI was licenced, its liquidity level fell in the 'good' category, i.e. a level 3 ranking on that scale of 6, with the highest ratio for that period having been recorded in the initial periods of establishment (29.4 in 2004), which might suggest a still-cautious approach taken by the entity as it continued to study the market and settle in and therefore not putting cash into profitable use.

After licencing, the ratio moved into the 'very good' category on the Morgan Stanley ranking (18.2 per cent on average, which is above 15). While the same explanation provided above for the situation before the MFI was licensed is applicable here, and while FIDES had capacity to repay its current liabilities, there seems to have been a situation where FIDES was not able to negotiate with its funding sources (which had been mainly its shareholders and donors) to keep on recapitalising the business in its later years of transformation, as indicated earlier in this chapter. FIDES was also ordered by the regulator at some point to control growth to allow time to develop internal systems commensurate with the expanded business (FIDES, 2011) and this could have resulted in the cautious credit-extension approach taken by the bank, which led to high liquidity levels.

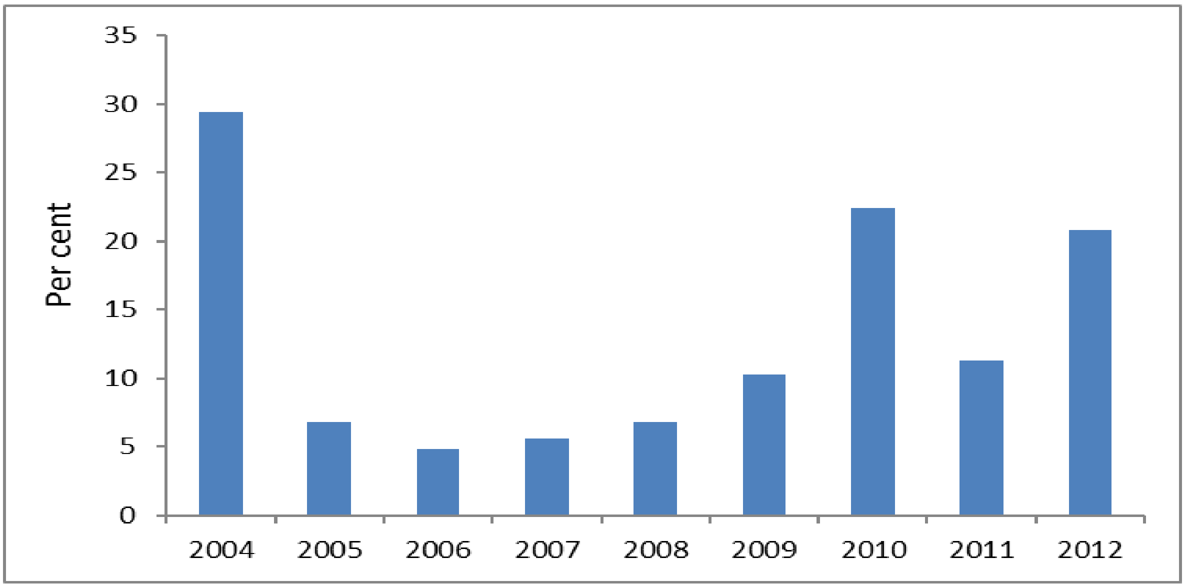

Figure 7.17: FIDES's liquid ratio

Source: MIX (no date)

In comparison, commercial banks in Namibia have also been very liquid. For the same period of review as covered for FIDES for this indicator (i.e. 2004–2012), their liquidity ratio[128] averaged at 10.3 per cent and the trend has been fairly constant at those levels, as can be seen in Figure 7.18 below. The average liquidity ratio before FIDES entered that space was 9.7 per cent and this increased to an average of 11.3 per cent after FIDES came on board. This trend is consistent with the developments in FIDES's ratio discussed above. The average liquidity ratio post-licensing (i.e. 11.3 per cent) is however lower relative to 18.2 per cent for FIDES, which could be explained by the fact that the regulator required FIDES to control growth to allow time to develop internal systems commensurate with its expanded business, as alluded to earlier.

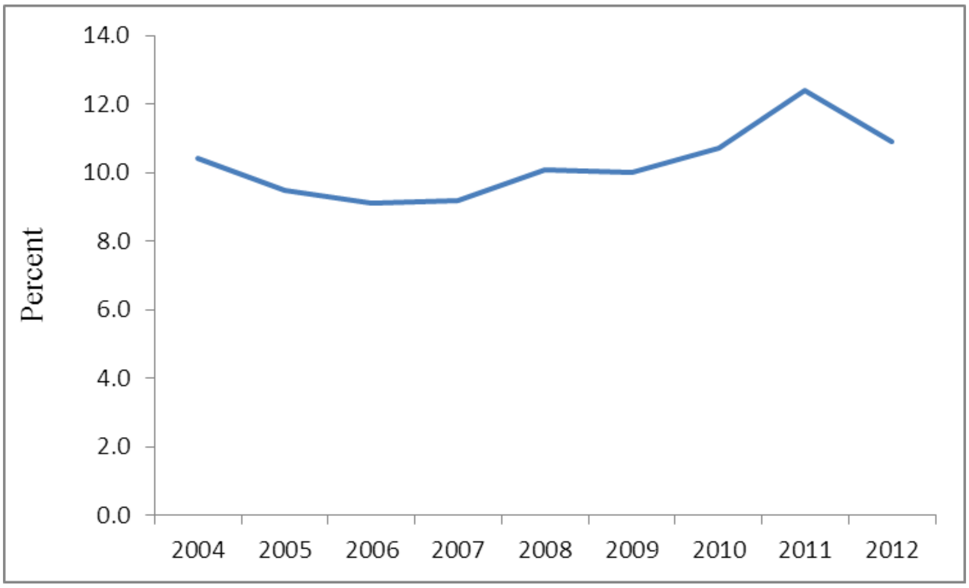

Figure 7.18: Liquidity ratio of commercial banks

Source: BoN annual reports 2004–2012

Table 7.2 below presents a summary of the identified impact of regulation on the performance indicators of FIDES discussed above. Only indicators where impact was observed are listed.

[128] Although this measure of liquidity is not exactly the same as the liquid ratio used in the case of FIDES, they are both still measures of liquidity.

Table 7.2: Summary of the impact of regulation on FIDES's performance

Indicator	Impact
Profitability	Reduced losses (measured by ROA) after licensing, which are attributed to regulatory efforts that aim to ensure that regulated entities strive to achieve at least minimum levels of profitability larger than zero; therefore regulation leading to progress in this indicator.
Capital	Highest ratio in the year of licensing, as shareholders subscribed to additional shares in that year to meet the regulatory requirement of capital adequacy, a situation that continued after that, although at a lesser level, and hence a regulatory effect.
Portfolio quality	Declining PAR>30 during treatment year (an excellent loan portfolio quality), as FIDES needed to comply with regulatory requirements concerning loan-provisioning standards, but very high PAR>30 after treatment year (a deteriorating portfolio quality), reflecting other operational problems experienced around that period.
Breadth of access	Substantial increase in the number of savers after licencing as a result of the increased safety and soundness brought about by regulation, which may have encouraged depositors to entrust their savings to FIDES; therefore, progress of this indicator and FIDES's contribution to progress in the breadth of access to savings in Namibia.
Scope of access	Huge increases in total savings around the post-licensing years, as FIDES could now freely mobilise savings, including voluntary savings, to the extent possible as opposed to the statutory limitations faced before licensing; therefore, a positive regulatory impact on the savings indicator facilitating progress on the scope of access.
Efficiency	Highest ratio during licencing year, which is attributed to the cost of regulatory compliance with related regulatory requirements; therefore, a negative impact of regulation, although it started reducing immediately after that.
Liquidity	Increased liquid ratio just before and around the licencing period (with the highest in the licencing year), reflecting a cautious credit-extension approach taken by FIDES, which is ascribed to the regulator having ordered the bank to control growth to allow time to develop internal systems commensurate with the expanded business.

7.4.3 Evidence from qualitative factors

As indicated in the methodology chapter, the researcher also performed an analysis of the qualitative indicators (i.e. views from other sources and interviews) to complement the assessment of the quantitative indicators in determining what the regulatory impact on FIDES has been. The use of relevant qualitative data from various sources, such as interview evidence and secondary sources, including internal documents, reports, unpublished studies, newspaper articles, etc., is a good complement in this tracing process for the assessment of regulatory objectives (Staschen, 2010), as according to the approach of process tracing, all information that provides evidence about the achievement of any of the regulatory objectives is relevant (Staschen, 2010). Staschen posits that the result is a much more refined picture of various impact channels and regulatory impact than would be possible with the analysis of only performance indicators.

The focus in this section of the thesis is on the governance of the institution, because it is generally acceptable that both sound implementation of good governance practices and sustainable financial performance can lead to viable MFIs (Ayayi, 2011), and regulation can facilitate that process. The qualitative indicators analysed are adapted from the Morgan Stanley Credit Risk Assessment Framework for Microfinance, published in its issue on international corporate governance in 2008, and include looking at the company's strategy and business plan, the quality of senior management and the board, operations procedures and internal controls, human resource policies and management, quality of management information systems and reporting as well as its growth potential. Where possible, the relevance to the regulatory objectives is also established.

In his work on selected Vietnamese MFIs, Ayayi (2011) found the MFIs that scored the highest grades in management and strategy, systems and reporting, and internal and operational controls were the most financially sound. He also found active government involvement through constructive regulation aimed at promoting MFIs to be a good signal for MFI investors and donors. Studying the developments in those aspects over the period of existence of FIDES gave an indication of the extent to which those factors had enabled the management teams at FIDES to evaluate their institution's performance in order to identify and correct weaknesses and position the bank in a favourable situation. It also revealed whether or not regulation had made a difference or had led to improvements in those factors, i.e. whether or not regulation had facilitated a favourable environment for FIDES's operations. The aim was therefore to validate the results of the assessment of performance indicators obtained in the previous section above, thereby broadening the evidence base.

These qualitative indicators were also compared to the Morgan Stanley approach to risk assessment systems, where relevant, to see whether or not FIDES was operating in line with internationally acceptable best practices. Further, as in the case of performance indicators, theoretical expected outcomes for specific factors have been provided where possible. Data to inform this analysis were obtained through the questionnaire, documentary reviews as well as interviews with stakeholders that were involved with the bank, such as employees, board members and regulators.

7.4.3.1 Strategy and business planning

There has been an industry-wide observation that the greatest constraint to the development of microfinance in Africa has been a lack of management capacity (CGAP, 2009). As for any other business venture, good management can lead to viable MFIs (Arvelo *et al*., 2008). According to the Morgan Stanley framework for credit risk assessment, when analysing the strategy and business plan of an MFI, one should look for a clear and achievable strategy that contains elements such as marketing, attraction and retention of customers, products, branch and geographic expansion, human resource needs and technology enhancement (Arvelo *et al*., 2008).

Information from documentary review and interviews revealed that FIDES had clear mission and vision statements that spoke to its existence and intention, and that it had a business strategy and has been planning its operations since the beginning of its existence. The researcher could trace evidence in this regard from documents such as the annual reports that made reference to an action plan for the following year and the MFI having had to change business plans at some point, as dictated by situations at hand (FIDES, 2010; 2011). The bank also reported on having forecasted a loss in the 2012 financial year as well as a continuation of the foreseen growth path to achieve breakeven during the 2013 financial year (FIDES, 2011). Interviewed internal stakeholders further confirmed this when asked about the existence and effectiveness of the strategy and business planning at FIDES, with one of the staff members stating the following:

> *"Yes, it has been in place from day one, it formed the basis of the licence granting by the central bank"* [MFI8/2/(2)]

At the time of licensing, it announced through the media its intention (i.e. its plan) to expand its operations by creating additional branches and hence its client base of micro and small entrepreneurs and employing more staff (3 February 2010 Press Release), which shows that planning was taking place. In addition, from other documents it became clear that the bank had also clearly communicated its plans for market and product development, human resource development and institutional development. For instance, it reported in its 2011 annual report that it had planned to open a new branch in Rundu in 2012, but opted to open in Windhoek so as to enter that market and take advantage of the potential it offered before its competitors could do so. It had also kept its social mission and commitment alive by regularly producing a social performance report as well as keeping track of the progress made by its individual clients and publishing those. All of the above examples exhibit the existence of elements of strategy and planning and therefore of FIDES having had in place tools that were critical to its performance.

The question that arises is whether or not regulation had played any role in the process of ensuring the existence of a strategy and business plan of FIDES. While these tools might have been in existence since the establishment of the entity, it became binding after licensing as a regulatory requirement that regulated entities are to have a viable strategy and plan in place, not only at the time of applying for licence but also after licensing, so as to guide their business operations and be able to conform to regulatory requirements. This requirement was also applicable in the case of FIDES. As indicated earlier in this chapter, the BoN could alter some regulatory requirements such as CAR, etc., based on the business model and/or performance of the entity. For instance, FIDES's CAR was increased to not less than 15 per cent with effect from May 2012, while the bank was also ordered to control its growth and allow time to develop internal systems commensurate with the expanded business (FIDES, 2011). All these are regulatory requirements aimed at safeguarding the soundness and sustainability of the entity, which the regulator needed to enforce, and regulation therefore played a role in directing or guiding the strategy and business plan of FIDES.

7.4.3.2 The quality of senior management and the board

According to the Morgan Stanley framework, the strongest MFIs typically boast of experienced board members and management teams in the financial and development sector and having a cultural understanding of their operating regions. The framework further states that management would ideally demonstrate the ability to set balanced goals and achieve them in a timely and cost-efficient manner without compromising portfolio quality or community reputation.

One of the regulatory requirements of regulated banks in Namibia is to comply with the 'fit and proper' test of management and board members running regulated entities. Under this requirement, regulated entities, including FIDES, are required to prove to the regulator that their management and board members are qualified, both professionally and socially, to hold positions in those respective capacities.

FIDES had a team of skilled people, with university degrees, at both senior management and board level. Most senior managers were microfinance experts who gained experienced over years of service at different management levels in other countries before they came to Namibia. At some point, the bank benefited from a 'donation of services' that ensured payment of salaries of key management (who were international microfinance experts) to ensure efficient management and achievement of the bank's objectives (FIDES, 2011). It can therefore be concluded that regulation played a role in ensuring that FIDES had qualified and experienced staff and management in place to run its business through the 'fit and proper' requirement. However, it is the view of the researcher that the fact that top management were all expatriates (i.e. FIDES had changed three different managing directors during its existence, who were all expatriates) might have been a downside in the form of top management not having a cultural understanding of their operating regions. This actually also came up during interviews with some of its stakeholders, with one stakeholders mentioning, on the question of why FIDES had to stop operating under the same management, that a lack of understanding of the market actually existed as one of the factors that led to its takeover, as quoted below.

> *"FIDES had outside people in management, there were too many foreigners involved who did not understand the Namibian market"* [MFI8/2/(1)]

The extent to which this might have affected the business has however not been measured. The researcher also observed some strength in terms of management's ability to set balanced goals and achieve them in a timely and cost-efficient manner. Examples to this effect are those detected from the documentary review, such as where FIDES reported in 2011 that it had to a large extent reached the volumes it foresaw, such that results achieved in that year were close to the objectives set (FIDES, 2011). It therefore reflects the quality of its senior management and board.

7.4.3.3 Human resource management

Managing human resources is critical to any organisation. This is because the performance of an organisation depends very much on the capacity of its employees. As such, regulators impose a 'fit and proper' requirement on the management, board members and key staff of regulated entities as one of the key pillars to ensure the safety and soundness of regulated entities. This requirement also applied to FIDES when it was licensed. The Morgan Stanley framework of credit risk assessment has identified recruitment, training and retention as pillars of a robust human resource policy (Arvelo *et al*., 2008).

FIDES had human resource policies in place, such as policies to retain and improve employees' productivity, incentives and compensation policies with specific quarterly bonuses for over-achievements by loan officers based on a number of performance indicators, portfolio growth and quality, PAR, etc. [MFI8/2/2]. It also used to conduct capacity-building activities for staff, especially for loan officers, as evidenced the following reported in 2011: "An important capacity building effort has been provided by the management and FIDES support in order to staff the bank rapidly with an important number of sufficiently qualified client officers, thus laying the basis for the now engaged growth path" (FIDES, 2011). Further, an interview with one of the staff members revealed as quoted:

> *"Extensive practical training of loan officers guaranteed promotions to supervisory positions"* [MFI8/2/(2)]

The above indicates FIDES's commitment to human resources. The same staff member also indicated, however, that training for existing and potential middle management was non-existent [MFI6/2/1]. This can be considered to be a weakness, given the need for every organisation, including FIDES, to ensure that all levels of its staff are capacitated to be able to deliver on the business plan, especially so for the case of FIDES, which was operating in a country where microfinance is a relatively new business area. The Morgan Stanley credit risk assessment framework posits that employees at all levels require training once recruited and that employees promoted to middle management roles specifically be trained on managerial skills. It further advocates for continuous training and monitoring and retention of recruited employees. Information on the staff-retention policy of FIDES could not be obtained.

7.4.3.4 The quality of systems and reporting

"The ability of an MFI to maintain robust systems and provide accurate reports affects not only the quality of the information that it provides but also its ability to understand and monitor its own operations" (Arvelo *et al*., 2008). For this reason, organisations normally strive to have good accounting, IT and reporting systems in place. Regulators also have vested interest in ensuring this happens, because robust systems will facilitate their supervisory function over regulated entities. While they may not have this as a specified regulatory requirement, the nature of information and processes they require (such as audited financial statements and having internal audit functions) influences the type of systems regulated institutions would need to have in place. This was the situation that FIDES had to live up to as a regulated entity.

FIDES had quality systems (management information systems, information technology (IT) systems, loan tracking and accounting systems) in place. This has made it possible for the bank to plan for its expansion in outreach and diversification of its product and services, which was discussed earlier in this chapter. An interview with a former staff member who used to be involved with those issues also pointed to the strong support provided by the owner of the IT systems [MFI8/2/2]. The process of data processing and distribution and/or transfer between head office and branches was also effective, as they were connected via a reliable wide area network with a central server at the head office, which ensured the quality and speed of data feed. Further, IT backup was always available [MFI8/2/2]. This situation is consistent with the standards advocated by the Morgan Stanley credit risk assessment framework that points to the need for automation and integration, among others (Arvelo *et al*., 2008).

In terms of reporting, FIDES used to prepare financial statements from the beginning, as evidenced by its ability to submit its data to the Mix Market also for periods before its licencing. This could be a demonstration of some of the requirements and/or expectations of the shareholders and involved donors even before it became a transformed institution. The situation improved further when it became a licensed entity, as FIDES now had to produce and release annual audited financial statements prepared strictly in accordance with the International Financial Reporting Standards.

It also had an internal audit department for which staff were trained and had a good understanding of the MFI's role for internal control and assurance purposes. The internal control and audit system allowed systematic monitoring and mitigation of risks, as the audit plan was 60 per cent field-based, in line with the business model [MFI8/2/2].

A look at the organisational structure clearly indicated the reporting structure of the internal audit function to the board audit committee and administratively to the chief executive officer, which is a good governance practice. An external auditor was appointed every three years to audit the bank's books and at the time of its takeover, Delloite and Touche, an international auditing firm, was its external auditor. These processes ensured good-quality and comprehensive reports, as required by the regulatory authority. FIDES's operation procedures and internal controls were also documented and evaluated every six months by an internal audit unit for validity and adherence, while procedures were further disseminated to staff, who in turn were trained for three months intensively in a classroom setup and thereafter on the job [MFI6/2/1].

7.4.3.5 Growth potential

The Morgan Stanley credit risk assessment framework states that regulatory restrictions and political climate can have a significant influence on an MFI's business (Arvelo *et al*., 2008). It suggests indicators for examining the growth potential of an MFI to include the regulatory and government involvement, number and density of micro-entrepreneurs and behaviour of micro-entrepreneurs towards microloans (Arvelo *et al*., 2008). It explains by citing examples of apex funds specifically created for the microfinance industry as well as priority sector quotas, which could ensure that MFIs are able to attract funding, and a regulatory environment where MFIs face little or no government interference as good government initiatives that can contribute favourably to the development of MFIs (Arvelo *et al*., 2008).

The establishment of FIDES came at a time when government had recognised the importance of MFIs in financing SMEs in Namibia and had resolved to develop the microfinance sector through its Financial Sector Strategy 2011–2021. This was also the time when FIDES was perceived to be the only 'true' MFI in the country. As such, there was great interest in FIDES, which led to positive publicity, i.e. the environment was a conducive one for FIDES in which to operate.

Government through the DBN also created an apex fund to provide wholesale loans to MFIs from which FIDES could have tapped. Further, becoming a regulated MFI was an opportunity for FIDES to extend its microfinance activities in terms of both scope and geographically. It would also facilitate the possibility for FIDES to tap into external credit sources, which would in turn enable it to further expand its outreach. The expansion in terms of creating an additional branch in Windhoek should have been the result of this situation. In addition, having operated in the most populous part of the country, i.e. the far northern region, the demand for microcredit had been enormous, as evidenced by the growth in the number of clients and loans outstanding discussed earlier in this chapter, including in the number of micro-entrepreneurs, which gives an indication of the density of micro-entrepreneurs. The behaviour of micro-entrepreneurs towards microloans was also good, as demonstrated in the good repayment and generally low levels of loan PAR discussed in the section on performance indicators. These all point to the existence of a high growth potential for FIDES.

Table 7.3 below gives a summary of the regulatory impact on the critical qualitative factors discussed above.

Table 7.3: Summary of the impact of regulation on qualitative factors

Indicator	Impact
Business strategy and planning	The bank had an enhanced strategy and business plan that guided business operations due to the need to conform to regulatory requirements.
Quality of senior management and board	The ‘fit and proper’ regulatory requirement enabled FIDES to have qualified and experienced board and management in place.
Quality of systems and reporting	The nature of information and process required by the regulator (such as audited financial statements and having internal audit functions in place) influenced the type of systems FIDES needed to have in place, and these in turn led to comprehensive and quality reporting.
Growth potential	Becoming a regulated MFI was an opportunity for FIDES to extend its microfinance activities in terms of both scope and geographically, and therefore saw the creation of an additional branch in 2012. There was high growth potential, also facilitated by the existing conducive environment created through government’s acknowledgement of the importance of MFIs in financing SMEs and the policy pronouncement to develop the microfinance sector of Namibia.

7.5 CONCLUSION

This chapter presented the analysis of the impact of regulation and supervision on FIDES, an MFI licensed and regulated under normal conventional banking law, through the use of the ROI method under the RIA framework. While the researcher could not perform regression analysis in the process of attributing regulatory impact due to a lack of sufficient data and the absence of an appropriate control case, she applied the use of the structural breaks method and the physical causal approach, which are both acceptable methods of attributing impact, as long as it can be proven that the main happening during the period of review was regulation.

The logic of inference used in quantitative research, as explained in the methodology chapter, was further applied to deduce impact, i.e. it used the same thinking in discussing impact when looking at changes in data/information (i.e. changes in both performance indicators and qualitative factors). Further, benchmarking the outcomes to an international credit risk rating scale for microfinance (i.e. the Morgan Stanley approach) was also performed where possible, and a comparison to developments in the performance indicators of commercial banks together with which the MFI has been regulated under the same law strengthened and complemented the analysis.

The impact assessment process yielded results that showed the existence of regulatory impact on some of the performances indicators of FIDES. It particularly found that regulation has generally had a positive impact on the operations of FIDES, as reflected in improvements in most of its performance indicators (profitability, capital adequacy, liquidity and efficiency) during the post-licensing period, although causality was not too clear in some instances.

Regulation has also facilitated FIDES's significant contribution to Namibia's efforts to enhance access to financial services to poor and low-income people, as reflected in substantial increases in the number of savers and borrowers, especially in the rural areas of the northern regions where the majority of its operations were based. This performance was attributed to the increased safety and soundness brought about by regulation that had encouraged depositors to entrust their savings to FIDES, and therefore the institution having contributed to progress in the breadth of access to savings in Namibia. Further, as a licenced entity, FIDES could now also freely mobilise savings, including voluntary savings, to the extent possible, as opposed to the statutory limitations faced before licensing. This led to the observed huge increases in total savings around the post-licensing years and therefore regulation having facilitated progress in the 'scope of access' sub-indicator. It can therefore be concluded from the available analysed data that regulation generally had a positive impact on FIDES, as measured by the observed improvements in most of its performance indicators.

The analysis, however, also showed that FIDES experienced some operational challenges in the later years of its post-licensing era, especially when it opened a branch in the capital city where the setup was completely different from the rural and semi-urban areas in which it used to operate.

While the above findings are a good indicator of what has transpired at FIDES as a result of being regulated under normal banking law, they have to be interpreted bearing in mind the limited quantitative evidence that is inherent in a small sample (or in a single case study in the case of this thesis), which rendered causality not to be too clear in some instances. This was however minimised by the analysis of other qualitative factors analysed as well as the presented evidence from interviewees.

Chapter 8 below performs an ex-ante impact assessment of the envisaged amended BIA that has made provision for regulating MFIs in Namibia, on the microfinance sector, as a second stage of the RIA of this study.

CHAPTER 8

ASSESSING THE POTENTIAL IMPACT OF THE ENVISAGED MFI REGULATORY FRAMEWORK ON MFIs

8.1 INTRODUCTION

This chapter reports on the assessment of the potential regulatory impact of the draft amended BIA, i.e. the envisaged amended BIA that has made provision for regulating MFIs in Namibia, on the microfinance sector. This was therefore an evaluation of the regulatory impact at a macro level and constitutes the ex-ante RIA part of the thesis. It is a second stage of the RIA of this thesis and complements the case study assessment undertaken in Chapter 7 in addressing the research objective of assessing the potential impact of regulation and supervision on the microfinance sector of Namibia.

In 2013, Namibia, through its central bank, decided to create a window for regulating and supervising DMFIs by amending the BIA, Act No. 2 of 1998, as amended. The amendment bill was yet to be promulgated at the time of preparing this research. The assessment here therefore is ex-ante (i.e. a regulatory appraisal), which, according to Staschen (2010) is possible to undertake through the use of the 'logic of inference' approach. King, Keohane and Verba (1994: 4), cited by Staschen (2010), posit that the logic of inference used in quantitative research can and should also be used in determining qualitative evidence. The researcher therefore used this approach of thinking in determining the impact through the RIA framework, and specifically through the use of the ROI methodology developed specifically for financial inclusion regulatory assessment by Staschen (2010), as explained under the methodology chapter (Chapter 4).

To form a basis for the impact assessment, the analysis was preceded by an investigation to first understand the rationale of Namibia providing for microfinance regulation and an examination of the proposed provisions and requirements of the envisaged amended act as it pertains to microfinance banking business and the institutions involved (i.e. MFIs) as well as its characteristics and intended objectives. Information/data used in the overall analysis of the study are from the policy documents that informed the regulatory provision for microfinance, the draft amendment bill itself and its draft determinations as well as the fieldwork results collected through interviews and surveys.

The rest of the chapter is organised such that the next section (Section 8.2) provides the background and rationale for the regulatory intervention, followed by an identification of the characteristics and intended objectives of the Namibian microfinance regulatory framework in Section 8.3. In Section 8.4 the assessment of the potential impact of the envisaged regulatory framework for DMFIs is discussed based on the evaluation of the expected achievements of the intended regulatory objectives through the use of identified indicators, while Section 8.5 reports on a cost-benefit analysis through an identification of regulatory costs and relating those to the benefits identified in Section 8.4. Section 8.6 presents the chapter conclusions.

8.2 BACKGROUND AND RATIONALE FOR THE REGULATORY INTERVENTION THROUGH THE ENVISAGED AMENDED BIA

Given that a large part of the Namibian population, especially the poor and SMEs, does not have access to financial services, the country has resolved to develop its microfinance sector, especially the deposit-taking microfinance industry, based on the recognition that MFIs have the potential to address the needs of those groups of the population. Hence, the regulatory provision for microfinance has been designed to provide the necessary legal framework for the operation and development of the deposit-taking microfinance industry, as outlined in the following policy statement[129]:

> The Bank of Namibia (BoN) seeks to increase access to finance for micro and small enterprises (“MSEs”) and low income individuals in Namibia through the development and deepening of the Namibian formal financial system by creating an enabling legal, regulatory, and supervisory framework for microfinance. [UP/RD/2/1: 1]

Policy makers believe that providing an enabling legal environment through this window will complement other efforts of developing the overall microfinance banking sector in Namibia, which was underdeveloped, i.e. there was only one operating microfinance bank in Namibia (as discussed in Chapter 7) at the time of undertaking this research. Regulators have therefore considered this legal framework as providing an opportunity for existing credit-only microlending institutions desiring to grow their business activities into deposit-taking and other related services [UP/PD/2/1]. In fact, the year 2014 saw a provisional banking

[129] The statement was a brief by BoN to the international experts, First Initiatives, who were engaged to assist with drafting the regulatory framework for DMFIs in 2011.

licence[130] granted to one of the microlending institutions (Letshego Ltd) wanting to enter that space, albeit also under the normal commercial banking law. Should Letshego succeed in meeting the prescribed regulatory requirements by the stipulated time period, it will be an important and necessary addition to the deposit-taking microfinance banking industry. This process was taking place before the coming into place of the envisaged amended act, but it could be argued it is being done in anticipation of the implementation of the new amendment act with microfinance-specific provisions that will be applicable to all DMFIs. While it is sometimes argued that regulation is in some way supposed to follow the market, which in the case of Namibia is clearly lacking, it could be argued that under certain circumstances, regulation may also create a market by attracting new players, which in the case of Namibia seems to be one of the key objectives for creating the microfinance regulatory window.

The provision for MFI regulation is in a way an acknowledgement of the special nature of MFIs and microfinance banks in particular, for which the law (BIA) for conventional banking institutions was applicable at the time of drafting this study. The effective uptake of this new opportunity, however, will only be observed after the coming into effect of the amended act and its regulations/determinations, given that there could be other factors investors would consider in deciding to invest in the microfinance banking sector apart from regulation. This however does not prevent an appraisal of the likely impact of the envisaged act on the sector, hence this study.

8.3 CHARACTERISTICS AND INTENDED OBJECTIVES OF THE ENVISAGED REGULATORY FRAMEWORK FOR DMFIs

As discussed under Section 8.2 above, the main objective for providing a regulatory window for DMFIs in Namibia is to facilitate the expansion of access to finance. The policy statement specifically states: “In the context of Namibia, the objective of the proposed regulatory framework is to permit prospective and existing MFIs engaged in microlending to mobilise deposits” [UP/PD/2/2: 4]. It also aims to prevent regulatory arbitrage and exclude entrants into the microfinance space who do not have the desired social objectives [UP/PD/2/1]. As such, and with the intention to facilitate the attainment of this objective, the regulatory framework has made specific provisions for MFIs, some of which are differentiated from those for conventional banking, while some have remained the same to a certain extent, as

[130] A provisional license allows the institution to prepare itself to fully meet the requirements of the regulator within a stipulated period (i.e. within six months). The researcher was however informed that this period had been extended on the request of the applicant to allow more time for preparation.

will be evident in subsequent sections. It is important to mention at the onset that while the act has (or policy makers have) defined the objectives of the MFI regulatory framework, it has in most cases only defined standards and has left the regulator to set the specific rules, i.e. the draft determinations by the BoN to this effect have set out specific rules and/or provisions.

When studying the provisions proposed in the draft determinations, it becomes clear that the main characteristics of the envisaged microfinance regulatory framework hinges on the purpose for developing it in the first place. They are clearly an acknowledgement of the special nature of the microfinance business in most cases, as is evidenced by the following extract from the statement of policy in the draft determinations: “These Determinations set out the specialised regulatory requirements for microfinance banking institutions” [UP/D/1/1: 4]. It is clear from this statement that Namibia has considered DMFIs as special institutions that require special regulatory treatment. The regulatory framework has therefore made a distinction in the regulatory requirements for MFIs relative to those applicable to conventional banks. This is in line with what is advocated by literature, as discussed in the literature review chapter of this thesis. Following below is an exposé of the main/key provisions of the draft DMFI regulatory framework and how they differ from those for conventional banks to serve as background for the regulatory appraisal in subsequent sections.

8.3.1 The main regulatory provisions for MFIs under the envisaged amended BIA

This section provides a highlight of the key provisions of the proposed deposit-taking microfinance regulatory framework and how they differ from the regulation of normal banks. Key to the provisions in the proposed act for microfinance business is the definition of ‘microcredit’.

CGAP (2009) indicates that there is no universal definition for microcredit and suggests that it be defined taking into account specific country socio-economic conditions and the existing legal structure. Further, MIX suggests defining microfinance lenders with average outstanding loan portfolio not exceeding 250 per cent of their country’s per capita gross national income (CGAP, 2009). In line with that, the envisaged legal framework has defined microcredit for Namibia and has prescribed the lending methodology and target market. Accordingly, a microloan in Namibia has been determined to be a loan not exceeding N$200 000, which is extended on a group-lending basis to low-income people with no collateral or security provisions, which allows for short-term and more frequent repayments than conventional monthly repayments, while an MFI is one for which the average outstanding microloan balance does not exceed N$10 000[131] [UP/D/1/1].

Based on the specific policy objective of facilitating the expansion of access to finance, and the desire to prevent regulatory arbitrage by excluding entrants into the microfinance space who do not have the desired social objectives, the envisaged legal framework for DMFIs has also made a clear distinction between the micro-lending business and the microfinance banking business. It is believed that this distinction "will provide for a trade-off between maintaining the focus on the excluded portion of society, while allowing for flexibility and avoiding concern of enforceability" [UP/PD/2/1: 3]. Policy makers also believe that by defining the scope of microfinance banking business, a distinction from conventional banking business is made as well as parameters set within which such institutions are to operate [UP/PD/2/1].

Specific prudential and non-prudential provisions have also been proposed. It is worth noting that while MFIs will be subject to both prudential and non-prudential regulatory requirements, the researcher has observed that the main special provisions are those relating to prudential requirements, while the applicable non-prudential requirements are largely the same as those for normal banks. The nature and characteristics of these provisions are discussed below.

8.3.1.1 Prudential requirements

Prudential guidelines address issues pertaining to minimum capital requirements, capital adequacy, permissible activities, asset classification and loan loss provisioning, exposure to single borrowers, loan file documentation, and liquid and reserve requirements. A highlight of the key special prudential provisions of the proposed legal framework and how they differ from the regulation of normal banks is presented in the table below.

[131] This is less than what term lenders, discussed in Chapter 5, had at the time of this research (i.e. N$13 000).

Table 8.1: Key special prudential provisions of the DMFI regulatory framework

Provision[132]	**Requirement for DMFIs**	**Difference to normal banks**
Minimum capital requirements *[Section 28 (b)]*	To be relatively lower than for conventional banks (amount not yet specified), although the bill also indicates that this will depend on the business model of the applicant	Lower (the requirement for commercial banks is N$10 million)
Capital adequacy requirement *[Section 13.3 (c)]*	A CAR for DMFIs is set at a higher ratio of 12%	Higher (the requirement for traditional banks is 10%)
Asset classification and loan loss provisioning *[Section 11.3]*	A range of 1% to 100% and classified into categories (pass or acceptance, watch or special mention, substandard, doubtful, loss). Provisioning is made based on the frequency of loan repayment (i.e. less than a month or a month and more, etc.) and subject to the number of days a loan is outstanding. See Table 8.2 below for details.	Stricter (more frequent and over very short-term periods than in the case of conventional banks, in terms of both days and minimum provisions)
Limit on exposure to borrowers *[Section 12.1 (ii)]*	• Total exposures to any person or a group of related persons of not more than 1% of an MFI's capital funds • Aggregate of all large exposures[133] not to exceed 200% of DMFIs' capital funds	Significantly lower (30% in the case of normal banks)
Liquid assets requirements *[Section 12.1 (a)]*	15% of the average daily amount of deposits and short-term liabilities to the public for the preceding month	Higher (the requirement for banks is 10%).

Source: UP/D/1/1, UP/PD/2/1 and UP/PD/2/2

Table 8.1 above shows that a higher CAR of 12 per cent has been prescribed for DMFIs, compared to the 10 per cent for conventional banks on the following justification:[134]

[132] The sections indicated are from the draft implementing determinations for the envisaged amended act.
[133] An exposure that individually equals or exceeds 1 per cent of the microfinance banking institutions capital funds.
[134] Justification for each proposed requirement has been provided in the unpublished policy documents coded BONUP/P/2/1.

> DMFIs have fewer options to raise additional capital, especially during infancy years of operations, since it may be overwhelmed with inexperienced management and systems, while they generally also have relatively higher administrative costs, uncollateralised loan facilities and less diversified loan portfolios, making them more prone to contagion effects and rapid deterioration of loan quality and hence the precautionary higher ratio requirement [UP/PD/2/1:3].

It is further argued that licensing and regulation of this new type of banks would also prove to be a challenging new experience for both the regulator and practitioners, therefore requiring a conservative approach [UP/PD/2/1]. The high minimum capital adequacy requirement ratio for MFIs is actually in line with what is advocated in literature. CGAP (2009) and BIS (2010) are of the view that DMFIs should be subject to slightly higher minimum CAR compared to the conventional banks, especially as they have fewer options to raise additional capital compared to banks. It argues that capital standards should not be lowered to encourage entry of MFIs to the banking landscape because the viability and sustainability of such institutions need to be ensured, as it remains an important ingredient for maintaining the financial inclusion objective.

Under the envisaged regulatory framework, the regulator will have flexibility to tailor the minimum capital requirement for individual DMFIs, taking into account their business model, i.e. taking into account the estimated costs of setting up business infrastructure and other facilities [UP/PD/2/2]. Critique obtained through the fieldwork was that the high minimum capital requirement, such as that currently in existence under the conventional banking regulatory framework, was a barrier to entry and an impediment for entities to access the mainstream banking environment, as it discouraged investors from entering. Liquidity requirements are expected to be higher than for normal banks, i.e. 15 per cent of the average daily amount of deposits and short-term liabilities to the public for the preceding month compared to 10 per cent applicable to commercial banks.

It can also be seen from Table 8.2 below that DMFIs are being subject to stricter asset classification and loan-provisioning requirements than conventional banks, in terms of both days and minimum provisions. Provisioning is more frequent and is over more short-term periods than in the case of conventional banks. For example, the classification of watch or special mention is applicable to loans that are overdue for the period 1 to 15 days for loans with a repayment frequency of less than a month and 1 to 30 days for those with a repayment frequency of a month or longer, while for commercial banks it is applicable for overdue loans falling within the period 90 to 119 days. Substandard loans for DMFIs are those falling within the overdue period of 16 to 30 days and 31 to 60 days for loans with a repayment frequency of less than a month and a month or longer, respectively, while for conventional banks substandard loans are those that are 120 to 209 days in arrears. The same stricter requirements for DMFIs are observed for the other categories of doubt and loss. Furthermore, the researcher observed from the draft implementing determinations that for loans rescheduled or restructured once, the classification of microfinance loans is set at two levels more severe than for normal loans, while those rescheduled or restructured twice are to be classified as a loss [UP/D/1/1].

Table 8.2: Loan-provisioning classifications: DMFIs vs conventional banks

Number of days overdue	Classification	Minimum provision
Loans with a frequency of repayment of less than a month		
Repayments up to date and loan is performing in accordance with contractual terms	Pass/Acceptable	1%
Repayments overdue 1–15 days	Watch/Special mention	10%
Repayments overdue 16–30 days	Substandard	25%
Repayments overdue 31–45 days	Doubtful	50%
Repayments overdue more than 45 days	Loss	100%
Loans with a frequency of repayment of a month or longer		
Repayments up to date and loan is performing in accordance with contractual terms	Pass/Acceptable	1%
Repayments overdue 1–30 days	Watch/Special mention	10%
Repayments overdue 31–60 days	Substandard	25%
Repayments overdue 61–90 days	Doubtful	50%
Repayments overdue more than 90 days	Loss	100%
Commercial banks		
Up to 89 days in arrears	Pass /Acceptable	1%
90–119 days in arrears	Special mention	2%
120–209 days in arrears	Substandard	10%
210–389 days in arrears	Doubtful	50%
390 or more days in arrears	Loss	100%
CGAP recommendation		
General provision		1%
1–30 days in arrears		10%
31–90 days in arrears		25%
91–180 days in arrears		50%
Over 180 days in arrears		100%
Over 1 year in arrears	Write off	

Source: UP/D/1/1 for DMFIS and UP/RD/2/1 for commercial banks and CGAP

The consideration for the stricter requirements have been the characteristics of the microfinance business such as the shorter repayment periods associated with the microcredit of MFIs, the fact that loans are unsecured as well as non-performance of accounts and rescheduling, which are all different from that of conventional banking business [UP/PD/2/1]. Further, the stricter requirement for loan loss provisioning is said to have taken into account the fact that microloan portfolios can deteriorate much faster than a typical loan portfolio, given that microloans are usually unsecured [UP/PD/2/1]. For this same reason, CGAP (2009) actually recommends more aggressive provisioning schedules than for normal bank loans, as can be seen in Table 8.2 above. The same table, however, also shows that provisioning requirements for DMFIs in Namibia are generally also stricter than those recommended by CGAP. The researcher observed that the policy intention of Namibia is that the number of categories of special provisioning can be determined at the BoN's discretion to best suit the DMFI market as it develops and is therefore not necessarily prescribed in the law, while different provisioning schedules could also be developed for micro-enterprise loans with different types of repayment periods and risk profiles. If implemented, this approach will be beneficial to the DMFI industry, in that appropriate provisioning levels are going to be applicable at relevant stages of the development of the industry going forward.

With regards to the single borrowers exposure limit, a significantly lower limit of 1 per cent to single person or group of related persons has been set for DMFIs relative to the 30 per cent for traditional banks. The policy consideration here has been stated to have been the fact that DMFIs typically have a portfolio of small loans, influenced by geographical and sectoral concentrations, and that it will therefore not be viable to subject them to the same requirement as banks, as it would increase their concentration risk [UP/PD/2/1]. This is in line with that advocated by CGAP (2009) and the Basel Committee Guidelines for Supervising MFIs. In addition, to set operational parameters for DMFIs, sections 8 and 9 of the draft implementing determinations of the envisaged amended act, relating to microfinance banking institutions, has specified the permissible and prohibited activities. Accordingly, DMFIs are only permitted to engage in activities listed in Table 8.3 below, while the same table also lists specified prohibited activities.

Table 8.3: Permissible and prohibited activities

Permissible activities	Prohibited activities
Acceptance of deposits	Opening and operating demand cheque accounts
Provision of loans, of which at least 70% of the total number of loans must be microloans	Engaging directly or indirectly for its own account or on a commission basis, in trade, merchandise, mining, fisheries, commerce, industry or agriculture, except in the course of the satisfaction of debts due to it for the purpose of carrying on its business
Provision of domestic and international remittances and funds transfers	Insurance underwriting
Provision of insurance services as an agent	Acquiring or holding, directly or indirectly, in the aggregate, any part of share capital of, or making any capital investment or otherwise having any interest in enterprises engaged in trade, commerce, industry or agriculture in excess of 25% of its core capital, except in the course of the satisfaction of debts due to it, but in such a case all shares and interests shall be disposed of at the earliest reasonable opportunity
Maintenance and operation of accounts with banking institutions	Underwriting and placement of securities
Receipt of interest as may be agreed between the microfinance banking institutions and their clients	Engaging in trust operations
Any other activities as the bank may from time to time determine in terms of the act	Taking deposits and lending in foreign exchange
	Purchasing a non-performing or low-quality loan from any of the directors, officers or affiliates of the institution or their related interests
	Dealing in derivatives
	Any other activities as the bank may determine in terms of the act

Source: UP/D/1/1

CGAP (2012) supports the principle of having limitations on permitted activities and regulation clearly defining what is permitted. It argues that newly licensed MFIs may lack experience to manage a full range of banking activities and associated risks.

In line with expectations by literature, loan file documentation required are proposed to be lesser than for normal banks, i.e. they exclude certain documentation viewed impractical for DMFIs to obtain from their clients. This is therefore a less strict requirement and is in line with that for which CGAP (2012: 30) advocates: “given the size of microloans and nature of the borrowers, loan documentation requirements need to be lighter for microcredit than for conventional banks”.

The above discussions show that in general, stricter prudential regulatory requirements have been imposed on DMFIs compared to normal banks, except for the minimum capital requirement, limit on exposure to single borrowers and loan file documentation.

8.3.1.2 Non-prudential requirements

Non-prudential requirements include those relating to licensing, reporting and institutional transparency and consumer protection, i.e. they are to direct the business conduct of the DMFIs. As alluded to earlier, the applicable non-prudential requirements for DMFIs have been largely left to be the same as those for normal banks, but with a slight modification, as evidenced below.

According to the envisaged amended BIA, potential DMFIs are to be required to pay an application fee at the time of lodging an application for licensing, and if a license is granted, an annual fee will be applicable [UD/L/1/1]. The process of licensing involves considerable quality checking, including the validity and authenticity of information submitted by the applicant, financial status and history of the applicant, the integrity of the applicant and competence to conduct microfinance banking business; whether proposed directors and officers are fit and proper; as well as whether granting the license would be in the economic interest of Namibia (Banking Institutions Bill, 2015). The Basel Committee on Banking Supervision recommends the need to tailor the licensing criteria to the type and size of the MFIs instead of applying the criteria used for normal banks. It is also of the view that ‘ownerless’ NGOs should be prohibited from taking deposits unless they convert their legal forms to companies. The committee argues that NGOs lack shareholders to inject additional capital in MFIs when a need arises (BIS, 2010). It is not clear from the bill and its draft implementing determinations how Namibia intends to address this issue. What is clear, though, is that under the existing BIA, Koshi Yomuti, the case study discussed in Chapter 7, needed to convert to FIDES before it was licensed, and this requirement gives a hint that this may still be the case going forward.

In terms of ownership of MFIs, the draft amended act has placed a restriction on foreign shareholding of DMFIs to not more than 55 per cent, as per Section 32(1) (a) and (b). By implication, foreign DMFIs wanting to enter the Namibian market will have to incorporate local shareholding of 45 per cent. Given the nature of the microfinance business of not being a very profitable business, it may prove to be a challenging requirement for MFIs in terms of finding local investors to meet this requirement.

With regard to the reporting requirements, the key principle adopted by Namibia is to minimise the cost burden on DMFIs in terms of reporting detailed submissions and the frequency thereof [UP/PD/2/1]. For instance, the reporting requirements for DMFIs is such that they are to submit all returns relating to portfolio quality and loan loss provisioning on a monthly basis, but not later than the 21st day of each month for the prior month, while they must also submit all returns relating to liquidity, capital, asset quality, asset concentration and any other returns issued in accordance with the envisaged determinations or as the central bank may specify in a notice issued under Section 3 of the act [UP/D/1/1]. The monthly reporting is also as per the status quo for commercial banks. Views obtained from surveyed MFIs (both term lenders and FIDES), however, indicated that they would prefer reporting on a quarterly basis, which then implies that the monthly reporting is considered to be a burden by MFIs. Based on the same principle of the need to apply a differentiated supervision approach between conventional banks and MFIs referred to earlier, and the need to still ensure that microfinance banking institutions conduct their business in a prudent manner, the researcher suggests an approach whereby, based on the risk involved, only certain information deemed critical and that requires regular monitoring is collected on a monthly basis, while information not so critical is collected on a quarterly basis, i.e. the risk involved should determine what is critical and what is not.

From the above discussions, it can be concluded that the main emphasis of the regulatory provision for MFIs under the framework of the envisaged amended BIA is on prudential regulation and systemic regulation.[135] This is a clear indication that the objective of these requirements is to ensure that DMFIs conduct their business activities in a prudent manner and implement effective risk-management practices to safeguard the interests of depositors, which is typical of financial regulation. The differentiation of some of the requirements from normal commercial bank regulation discussed above is in line with what literature advocates. There were no differences observed in other aspects such as the publication of the financial statements and branch requirements, i.e. the requirements for conventional banks and DMFIs are the same.

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[135] Systemic regulation differs from prudential regulation in that it addresses risks that are of systemic nature to the financial system.

8.4 ASSESSING THE POTENTIAL IMPACT OF THE ENVISAGED REGULATORY FRAMEWORK ON MFIs

This section reports on the assessment of the envisaged regulatory window for DMFIs with the aim of determining its potential impact on the microfinance sector (or MFIs) once it becomes effective. This was done through an analysis of the provisions of the draft amended act and its draft implementing determinations (regulations), discussed in Section 8.3 above, and a hypothesis of the likely impact they would have on the achievement of the regulatory objectives, i.e. an ex-ante impact assessment. An ex-ante regulatory assessment is an appraisal of a proposed new or revised regulation that intends to provide information to policy makers on the (likely) impact of such regulation on the target audience (which is the DMFIs in the case of this thesis) and hence the provision of microfinance in Namibia. It therefore intends to inform the process of policy making.

As discussed under the introduction section of this chapter, the regulatory appraisal of the new regulatory framework for MFIs was also done within the RIA framework. Specifically, the ROI was selected to be the suitable analytical method under the RIA umbrella, which is a method specifically tailored for conducting impact assessments for financial inclusion regulation, including microfinance regulation (Staschen *et al*., 2012). The method was developed based on the public interest theory, which stipulates that financial regulation should only be imposed if there is an obvious economic rationale for it, i.e. "a ROI assessment provides a pragmatic framework through which to conduct an examination of the consequences of a policy or regulatory choice(s) and assess the positive and negative impacts of existing or potential regulatory measures" (Staschen *et al*., 2012: 1). The ROI also advocates the need for regulatory impact to be measured against a benchmark with a clear causal link to the rationale for regulation (Staschen, 2010).

As also explained under the methodology chapter, the ROI methodology has three components, namely the rational component, which explains why regulation is necessary (which for this study has been explained under Section 8.2); the objectives of regulation component, which is to explain what outcome regulation intends to achieve (which have also been identified under the same section for this study); and the indicators component, which are to measure the extent to which the objectives are achieved (as explained under the methodology chapter) and which is the main subject matter of the current section. The researcher therefore followed this approach and used the regulatory objectives as a benchmark for measuring the potential impact of the regulation, as will be observed in subsequent sections.

The main goal was to produce valid inferences about the regulatory impact of introducing the new regulatory provisions for microfinance under the proposed amended BIA, which then became the main exogenous or causal variable in this study. It can be regarded as a vector of regulatory provisions specified in the envisaged amended BIA and of changes in supervisory practices towards DMFIs in Namibia. The outcome of this process was then used as indicators of impact for the achievement of the regulatory objectives and ultimately for the likelihood of the envisaged amended act facilitating the development of the microfinance sector in Namibia. The counterfactual for this is the likely development of the sector and achievement of regulatory objectives without the introduction of the new amended regulatory framework, and not the status quo before the new regulatory provision.

Typically, impact analyses investigate the changes created in target groups and related agents by an intervention (Nghiem, 2012). The researcher therefore aimed to investigate potential changes to be brought about by the envisaged amended BIA No. 2 of 1998, as amended, on the MFIs and therefore on the microfinance sector of Namibia.

8.4.1 The new regulatory framework and its potential impact on regulatory objectives

The model developed by Staschen (2010), which was applied in the impact analysis of this study, identified five public interest objectives for microfinance regulation as well as indicators (quantitative and qualitative) for measuring each of the objectives, as discussed under the methodology chapter. The identified objectives are (1) the promotion of the safety and soundness of MFIs, (2) guarding against systemic risk, (3) establishing a competitive market, (4) protecting consumers and (5) improving access. As can be seen from this list, the two main policy objectives for providing a regulatory framework for MFIs in Namibia stated under the introductory section of this chapter (i.e. the promotion of the safety and soundness of MFIs and enhancing of access to finance), clearly fall within this list of objectives. Some other provisions of the envisaged amended act also link to the other three regulatory objectives of guarding against systemic risk, establishing a competitive market and protecting consumers, as will be evident in the ensuing sections.

The sub-sections below (8.4.1.1 – 8.4.1.5) assess the potential regulatory impact of the envisaged regulatory provisions on the above-listed objectives (i.e. the likelihood of achieving these objectives) by analysing the expected performance of the relevant indicators for each of the objectives (as discussed under each of the objectives). The main assessment criterion is whether regulation would lead to progress in the indicators and hence the achievement of the objectives or not. In other words, the potential impact of the draft amended BIA is being assessed in terms of the possibility of it attaining the said public interest objectives. The importance of this within the context of this study was the need to determine whether that process would ultimately lead to the development of the microfinance sector of Namibia. As stated above, the counterfactual is not the situation before the treatment, i.e. the status quo, but the likely development of the sector without the introduction of the new regulatory window.

Following below is an analysis of the impact indicators for each of the regulatory objectives in relation to the provisions of the envisaged act and its implementing determinations discussed earlier. This exercise is an exposition of the expected results for each of the regulatory objectives based on the theory relating to microfinance legal frameworks and the views discussed in the literature review section of Chapter 4. The process followed was that of identifying legislative provisions that could affect the specific regulatory objective, relating those to theory and experiences of other countries and determining what should be expected for Namibia.

8.4.1.1 Objective 1: The promotion of the safety and soundness of MFIs

The need to ensure safety and soundness of MFIs stems from the fact that failure of institutions can have devastating consequences for their clients, the stability of the financial sector and the economy as a whole. The promotion of safety and soundness of financial institutions, including MFIs, is therefore a necessary regulatory objective pursued by financial regulators. The envisaged amended BIA states that it aims, among others, to provide for the control, supervision and regulation of banking institutions and microfinance banking institutions and to protect the interest of persons making deposits with those institutions (Banking Institutions Bill, 2015). In essence, this provision relates to the regulatory objective of promoting the safety and soundness of MFIs.

Staschen (2010) has identified indicators for measuring whether or not the objective of promoting the safety and soundness of MFIs is achieved. These include determining the impact of regulation on the performance indicators of MFIs such as on profitability, portfolio quality, capital and liquidity ratios. In a situation of an already existing regulatory framework, the assessment is to be based on the performance of these indicators, but in the current situation where the regulatory framework is yet to come into effect and potential regulated institutions are yet to enter the regulatory space (i.e. in the case of this ex-ante impact assessment), there is no data for measuring the impact, i.e. the performance of the indicators. However, it is still possible to infer the likely implications of the regulatory provisions on the performance indicators, taking theory and empirical evidence by related previous studies into consideration. The premise for this evaluation is that regulation that leads to better performance in the indicators is good for the MFIs and the microfinance sector. Furthermore, Staschen (2010) posits that institutional changes that would possibly stem from certain regulatory requirements, including those related to the ownership and governance of MFIs as well as those that would avail credit information to inform MFIs' credit-allocation decisions, are also valuable indicators for the future performance of MFIs. This appraisal process therefore also seeks to trace the existence and/or the likelihood of those institutions coming into existence.

The provision by the draft amended act for the BoN to regulate DMFIs will prescribe good standards of practice by the regulated institutions and ensure the protection of clients' deposits. Having operational rules and guidelines on good standards of practice in place (such as those on the minimum capital requirements, minimum performance standards and reporting requirements highlighted in Section 8.3) under which DMFIs are to operate is likely to enhance the chances of achieving good profitability, portfolio quality and capital and liquidity ratios of the DMFIs, which is good for the sustainability of these much-needed institutions. The experience of Uganda, as found by Okumu (2007), points to financial regulation having positively affected the sustainability of MFIs in the short-run and positively influenced both their sustainability and their outreach in the long run, although in the short run their outreach was negatively influenced.

Further, the observed relatively high capital levels, strict provisioning and high liquidity requirements of this proposed DMFI regulatory framework should also help reduce the probability of failure by DMFIs and thereby enhance financial stability. This view was echoed by some of the stakeholders interviewed, as illustrated by a quoted response below on the question of whether or not they were aware of the objectives of the envisaged amended act and whether or not they thought that its implementation would meet the intended objectives:

> *"There are two things to regulation. When you have regulation there is a certain degree of confidence created."* [PM/2/3/(1)]

Other provisions of the envisaged act that could also have a bearing on the regulatory objective of promoting the safety and soundness of financial institutions are those pertaining to the ownership and governance of MFIs. Section 11(1) (d) of the envisaged act requires that before authorisation is granted to operate microfinance banking business, the integrity and competence of potential owners or experience in relation to that type of business be proven, while Section 11(1) (f) requires that the 'fit and proper' test be applied to potential management teams and board members of the DMFIs. This provision should ensure that DMFIs are owned, managed and strategically guided by qualified and skilled individuals and/or teams, which in turn should contribute to the safety and soundness of the DMFIs and hence to the achievement of the regulatory objective.

Although not stemming from the regulatory provisions of the envisaged act, it is also worth to take note of the envisaged initiative that is being investigated concurrently with the draft amended act under the framework of the country's Financial Sector Strategy 2011–2021, which should also bring change to the country's financial sector environment and contribute to the enhancement of safety and soundness of financial institutions, including MFIs. Investigations of the viability of setting up a deposit insurance scheme for Namibia were at an advance stage at the time of drafting this thesis. If found feasible and implemented, this, together with the already existing lender of last resort facility and the recently enhanced credit bureau system for availing credit information to inform the credit-allocation decision-making process of lenders, should also help facilitate the attainment of the objective of promoting the safety and soundness of financial institutions in Namibia.

It is however also important to caution that regulation does not guarantee non-failure of institutions, as even regulated institutions can fail. The collapse of Finansol (a failed Colombia MFI) discussed earlier in Chapter 3 of this thesis is a good example. This is, at times, a result of non-enforceability of the law that can be due to, among other reasons, a lack of regulatory capacity on the side of regulators, which creates lax in compliance on the side of regulated entities. It follows therefore that chances of DMFIs' failure would be reduced and financial stability enhanced if the regulatory requirements of the envisaged act would be enforced effectively. In other words, if effectively enforced, the new regulation will lead to progress in the above discussed indicators[136] and hence to the achievement of the regulatory objective of promoting the safety and soundness of the MFIs.

A question that arises is whether or not the achievement of the safety and soundness of MFIs that would contribute to the development of the microfinance sector would still be possible in the absence of the new regulatory framework for DMFIs, i.e. a counterfactual to the above situation. It is acknowledged that without this new regulatory window for DMFIs, those MFIs wanting to enter the deposit-taking arena would be regulated under the current BIA together with conventional banking institutions, as has been the case with FIDES discussed in Chapter 7, and that it is a fundamental principle of any financial regulation to ensure the safety and soundness of financial institutions, including MFIs, as this is actually one of the key reasons for financial regulation. However, the researcher argues that by differentiating MFIs from normal banks, as observed in Section 8.3 above, the new regulatory framework is providing a relatively conducive regulatory environment for MFIs. It is also creating an opportunity for MFI tailored and focused supervisory attention, thereby widening the probability of ensuring their safety and soundness.

8.4.1.2 Objective 2: Guarding against systemic risk

Under this objective, the focus is on reducing (if not eliminating) the systemic risk. Systemic risk in the financial sector refers to risk at the level of the entire financial system (Gauthier & Souissi, 2012). When the risk materialises, the fear is that it can have serious consequences for the financial sector as a whole.

The recent financial crisis is a good example of a failing financial system and therefore a reflection of systemic risk having existed. It has highlighted the need for a better assessment of systemic risk (Gauthier & Souissi, 2012). Countries therefore strive to have mechanisms and facilities such as a deposit insurance system and lender of last resort in place to ensure that this risk is mitigated. A deposit insurance system would reduce depositors’ incentives to run on an institution, while the lender of last resort facility would reduce contagion risk through the credit channel (Staschen, 2010). Staschen’s 2010 analytical model, applied in this thesis, identified these facilities as indirect indicators that can be used to assess the probability of future systemic events in addition to assessing the safety and soundness of

[136] These indicators are achieving good profitability, portfolio quality and capital and liquidity ratios of the DMFIs, and the institutional changes stemming from regulatory requirements related to the ownership and governance of MFIs as well as those that would avail credit information to inform MFIs’ credit-allocation decisions.

financial institutions alluded to above. He also posits that sound financial institutions are actually the best defence against contagion (i.e. against systemic risk). As such, the conclusion reached for the regulatory objective of promoting the safety and soundness of MFIs above, which pointed to the likelihood of the envisaged amended act enhancing its achievement, is also applicable to the objective of guarding against systemic risk, which the envisaged act expects to achieve.

The situation in Namibia is such that there has been only one bank failure event, but this did not culminate in systemic events despite the existence of links of the failed institution to other financial institutions. While literature argues that MFIs are normally too small such that their failure may not cause systemic risk concerns, it is also important to note that for MFIs the risk might not be systemic, but their failure may lead to devastating consequences for their clients. This is because, as Nghiem (2012) argues, the poor only have limited resources to draw on in order to cope with and recover from shocks. The fact that the country has a lender of last resort facility in place already and has undertaken an investigation into the feasibility of setting up a deposit insurance system under the NFSS framework, as mentioned earlier, is a step in the right direction. Once the deposit insurance scheme is established, the two facilities/schemes should ensure that the country is better prepared for possible future events, thereby facilitating the attainment of the regulatory objective of guarding against systemic risk. This would especially be the case if the country continues to enjoy the macro-economic stability it has been enjoying, as noted in Chapter 2 of this thesis.

What was not yet clear at the stage of writing this thesis, though, was whether or not the above-mentioned facilities would also be available to DMFIs once in place. The policy document refers to ‘banks’ and it is not clear whether deposit-taking microfinance banks are also included. The researcher advocates for the facilities to also cater for the DMFIs for the reason highlighted above, i.e. that their failure may lead to devastating consequences for microsavers, even if that possibly does not lead to systemic risk.

A counterfactual to this finding is whether or not it would still be possible to achieve the objective of guarding against systemic risk in the absence of the new regulatory window for MFIs. The researcher argues that without the proposed regulatory framework, most MFIs would probably still experience the entry barrier, as seem to have been the case, and would therefore not enter the deposit-taking industry. This would have a negative impact on the policy objective of developing the microfinance sector, but it would avoid the possibility of MFIs creating any systemic risk, as they will not be able to enter that space in the first place, given the entry barrier. The status quo at the time of writing this research, i.e. not having DMFIs and/or a DMFI industry as part of the Namibian financial system, would remain.

8.4.1.3 Objective 3: Establishing a competitive market

Competition is considered an important aspect in any market. This is because it is likely to benefit customers in many respects, including lower prices in terms of fees and interest rates charged. The aspect of competition particularly becomes important in the case of Namibia, whose ultimate regulatory goal for providing a regulatory window for DMFIs is the enhancement of access to finance, given that affordability is one of the important elements when it comes to ensuring access to finance (AfDB, 2014). In this regard, the structure of the market matters and information on the number and volume of loans and savings accounts, number of branches and the concentration ratio of the market are good indicators (Staschen, 2010) of the level of competition. Given that the impact evaluation here concerns a newly proposed regulatory framework and hence the absence of data to measure aspects of market structure and saturation, the assessment of the likely impact was done indirectly by considering possible institutional changes and other requirements that might be brought about by the provisions of the new regulatory framework.

In order for regulation to achieve the objective of establishing a competitive market, it is important that it guards against provisions that would increase barriers to entry. Indicators in this respect have been identified by Staschen (2010) to include licensing conditions and procedures as well as openness to foreign participation. The draft amended act has placed a restriction on foreign shareholding of DMFIs to not more than 55 per cent, as per Section 32 (1) (a) and (b). By implication, foreign DMFIs wanting to enter the Namibian market will have to ensure incorporation of local shareholding of 45 per cent. This provision may be an entry barrier for foreign participation, as the requirement to give up such a significant shareholding may not sit well with foreign investors. This may in turn lead to fewer MFIs entering the sector, thereby reducing the level of competition. This shareholding provision may therefore reduce the degree to which the regulatory objective of establishing a competitive market can be achieved. On the other hand, the following provision of the draft amended BIA in Section 79(1) is a good start in this regard, as the central bank will have an opportunity to review this in the interest of facilitating a competitive environment:

> An agreement relating to the restricting of competition entered into by a banking institution or microfinance banking institution or its affiliate or associate must, unless the

parties to such agreement are of the same corporate group, be submitted by the parties to the Bank of Namibia for its approval.

With regard to the counterfactual of whether or not the attainment of a competitive market objective would be achieved without the introduction of the new regulatory window, the researcher argues that the achievement of the competitive regulatory objective would still be possible, given the existence of the Competition Regulatory Authority in Namibia that watches over anti-competitive activities and conduct.

8.4.1.4 Objective 4: Protecting consumers

Microfinance customers are typically vulnerable to exploitation and unfair treatment by lenders, as noted under the literature review chapter. This is because of their normally low level of financial literacy. What makes it even worse is the fact that the loss of savings can severely impact the welfare of clients of MFIs, given that they cannot afford to lose any of their hard-earned income (Nghiem, 2012). This necessitates the aspect of market conduct regulation.

As indicated above, one of the aims for amending the BIA stipulated in the draft bill is to protect the interest of persons making deposits with banking institutions and microfinance banking institutions (Banking Institutions Bill, 2015). Measured in three core principles of transparency, fair treatment and effective recourse, consumer protection is therefore one of the explicitly stated regulatory objectives of the new act. Staschen (2010) has identified indicators (both quantitative and qualitative) to measure the achievement of the consumer protection objective. Quantitative indicators include the number and type of consumer grievances reported and redress mechanisms employed, while qualitative indicators are those relating to views from customer satisfaction surveys, possible changes in the consumer protection regime as well as consumer empowerment and financial literacy that measure the capacity of consumers to process availed information.

The policy document [UP/PD/2/1] on which the implementing determinations of the draft amended BIA has been based states that DMFIs will be subject to non-prudential requirements like banks, mainly aimed at regulating market conduct. In this regard, DMFIs will be required to be transparent and to disclose information needed by clients to make informed decisions. This includes those relating to reporting and institutional transparency, consumer protection through contracts, fees and charges, etc. [UP/PD/2/1]. If effectively enforced, these requirements should lead to the achievement of the objective of consumer protection. In addition, plans by the sector's development strategy to create a comprehensive consumer protection framework for the financial sector in Namibia, which encompasses a financial adjudicating function and which is to be applicable to all financial institutions, including MFIs, together with the already ongoing financial literacy campaigns spearheaded by a national body (the Financial Literacy Initiatives Secretariat) discussed earlier in Chapter 2, also stand to contribute to the achievement of the consumer protection regulatory objective.

In terms of consumer empowerment, the consumer protection framework envisaged by the NFSS 2011–2021 is expected to put in place guidelines for lodging consumer complaints to the financial adjudicator and this should make it easier for consumers to execute their rights. All of the above, together with the work on the deposit insurance scheme discussed under the objectives of safety and soundness of MFIs and guarding against systemic risk, are positive developments that would enhance the achievement of the consumer protection regulatory objective in the country. This outcome would also be conducive to the development of the DMFI sector, as consumers will deal confidently with their service providers.

For the counterfactual of whether or not the attainment of the consumer protection objective would be achieved without the introduction of the new regulatory window, the researcher argues that the objective would still be achieved in the absence of the new regulatory framework, given that most of the initiatives in that regard are being implemented as part of the broader financial sector development plan and will not necessarily come because of the envisaged new legislation. Therefore, regardless of under which framework the MFIs are to be regulated, being financial institutions means that they will have to adhere to the financial consumer protection requirements envisaged by the financial sector.

8.4.1.5 Objective 5: Improving access

Given the lack of access to finance in many countries, especially in the developing world, access to finance has become an important consideration even in the regulatory sphere. It is believed, as discussed under literature review chapter, that providing an enabling legal environment could facilitate access to finance, as MFIs will be able to mobilise deposits (i.e. external source of funds) and to better serve their potential clients. It is also generally acknowledged that microfinance itself can play a role in enhancing access to finance.

Against this background, enhancing access to finance becomes an important aspect to consider in the regulation of microfinance. In the case of Namibia, improving access to finance has been the main consideration for providing a regulatory framework for DMFIs through the amended BIA (i.e. it is a regulatory objective), as indicated earlier in this chapter.

In quoting Schreiner (2002), Staschen (2010) states that access has various dimensions: depth, breadth, scope and length. He elaborates that for microfinance, the depth of access measures whether or not MFIs are reaching poorer clients, the breadth of access refers to the number of clients reached and financial products sold, the scope of access refers to the range and characteristics of the products offered by the MFIs, while the length of access relates to the self-sustainability of MFIs for long-term survival. Also important in the process of enhancing access to finance is the quality of access aspect, information on which can be obtained from customers through surveys on customer perception of and satisfaction with the products offered (Staschen, 2010). All of these are then also the indicators that can be used to measure the impact of regulation on the objective of improving access to finance (Staschen 2010). In the case of this study, in which the RIA was an appraisal of a yet-to-be-implemented act and hence the unavailability of data on the indicators, the likely impact was measured in terms of whether or not the regulatory provisions under that act are likely to lead to progress in the access indicators. A positive regulatory impact would be reflected in the improvement of these indicators and vice versa.

Informed by literature, the researcher identified certain provisions of the envisaged regulatory framework that can have an impact on the objective of improving access to finance, and these are discussed below. In Section 8.3 of this chapter, in which the various provisions of the envisaged amendment BIA were discussed, it was observed that lower minimum capital requirements for the DMFIs relative to normal banks is anticipated, in line with what is advocated by literature as being appropriate given the often less sophisticated operations of DMFIs and the smaller loan sizes and hence their typical smaller total assets. The lower minimum capital requirement can serve as an incentive in terms of making entry affordable to potential DMFIs. This is especially so if it would be pitched at an appropriate level that would be supportive of the setup of basic operations and start-up losses of these entities (Staschen, 2010). This process should therefore lead to the growth and development of the deposit-taking microfinance industry and ultimately the microfinance sector in Namibia.

The researcher has however observed from documentary review that reasons to amend the act include developing new regulations on shareholder limits and foreign ownership so as to encourage local participation and ownership of banking institutions, including deposit-taking microfinance banks [UP/PD/2/2]. While this is good for this country that has foreign dominance in those respects, shareholder limits and foreign ownership restrictions could pose problems for MFIs that want to transform into DMFIs from a status such as credit-only microlender (i.e. term-lending MFIs) and NGO. For instance, this will mean that credit-only term-lending institutions that may currently be owned by single owners (be it local or foreign) would now have to give up some of their shareholding as required and this may not sit well with some of the investors. This could therefore be a barrier to entry. In the case of the existing NGO-owned MFIs that may be harbouring the idea of upgrading to DMFIs, this requirement could also be a setback, as they would typically wish to hold a significant ownership stake in the transformed DMFI so as to be able to maintain their social mission of serving the poor.

It may also prove difficult for NGO-MFI applicants to attract additional and suitable potential shareholders, given their limited track record in the for-profit-making arena. This may therefore be a barrier to entering the industry, and has the potential of delaying the growth and development of the industry and the microfinance sector in general, as well as the achievement of the regulatory objective of improving access to finance. Ways should therefore be found to mitigate and/or compensate for this potential barrier. For instance, policy makers and/or regulatory authorities could consider allowing for and setting a transition period for shareholder diversification by DMFIs.

Another provision of the law that can be used to get an indication of whether or not there will be progress in the access indicators and hence the achievement of the regulatory objective of improving access to finance is that related to the ‘fit and proper’ test of potential shareholders. Section 26(8) of the envisaged amended BIA requires that shareholders (i.e. those holding 5 per cent or more shares in a banking institution) be ‘fit and proper’ persons in accordance with specific criteria to be determined by the regulator. Should the existence of the envisaged act be able to lure more entrants with the genuine intention and ultimately the commitment to participate in the process of enhancing access to finance for the poor, it would succeed in facilitating the achievement of the regulatory objective of improving access to finance through achieving progress in the depth and breadth dimensions of access. The envisaged act would however have failed in achieving this objective should that condition not hold.

With regard to the dimension of the length of access that refers to the self-sustainability of the MFIs for long-term survival so as to be able to serve the target market (Staschen, 2010), the envisaged amended act is likely to enhance the length of access, given it aims to ensure the safety and soundness of the potential DMFIs. The link to the length of access indicators lies in the fact that a safe and sound MFI depicts the possibility of its self-sustainability and hence an indicator of the length of access (Staschen, 2010) as self-sustainable MFIs would provide financial services to their target clients on a continuous basis. The findings under the regulatory objective of ensuring the safety and soundness of the DMFIs discussed above pointed towards positive progress in its measurement indicators and hence the likelihood of its achievement. Further, the bill will allow access to deposit mobilisation by the potential entrants (i.e. microlenders who are not able to do that now), hence increasing their funding sources, and that should lead to their growth, thereby enhancing the length of access. There is therefore a likelihood of the act facilitating the achievement of the regulatory objective of improving access to finance.

In addition to availability and affordability of financial products and services, the quality of products and services is an important element of access. Staschen (2010) identified customer perceptions of and satisfaction with the supply of products normally obtained from customer surveys as indicators in this regard. In other words, these would normally provide information that will give an indication of the quality of products and services.

Namibia has been conducting a FinScope survey[137] every four years, starting in 2004, with the latest one having been conducted in 2011. The survey has been collecting information on the satisfaction of consumers, and if the practice is maintained, the FinScope Survey should continue to provide information on the perceptions of and satisfaction of customers, although the time intervals between the surveys may need to be reduced to ensure that cases of unsatisfactory products and services are addressed quickly. This should therefore assist the country in ensuring the quality of products and services offered by MFIs, and will hence facilitate achievement of the access goal.

For the counterfactual of whether or not the attainment of the enhancing access to finance objective would be achieved without the introduction of the new regulatory window, the researcher argues that it would be difficult to achieve. As discussed in the previous section, the idea of providing an enabling environment through developing a regulatory framework

[137] The FinScope Survey collects information on customer usage of financial products and services as well as the satisfaction level towards these.

specifically for MFIs was informed by the fact that access to finance was a problem, especially for SMEs. The country realised that the business model of MFIs (where non-traditional collateral methods are used as risk-mitigation measures and non-conventional approaches for appraising loan applications are applied, as discussed under the literature review chapter) is better suited to serve the poor and SMEs and that there was a lack of this breed of institutions in Namibia. Further, the status quo where only one DMFI had been in existence is a sign of the existence of some entry-prohibiting factors, which may need addressing, as can be illustrated by the quoted interviewee responses below.

> *"The sector is stagnant because there is no recognition, no incentives and no support; and for as long as there is that missing link, we will remain small"* [Exp/2/2/(2)]

> *"There is no enabling regulatory framework, and no dedicated legislation for microfinance to support growth of the sector"* [Reg1/2/(1)]

The new regulatory framework seems to be striving to address these inhibiting factors through its provisions highlighted above and the creation of a differentiated legal framework for DMFIs. It follows therefore that without the proposed new legislation, the Namibian microfinance sector would not be able to develop and a lack of access to finance for the targeted groups would continue to be a problem, at least in the short to medium term.

8.5 EVIDENCE FROM A COST-BENEFIT ANALYSIS

As stated in the methodology chapter, the cost-benefit analysis is a widely used tool in financial regulation analysis that not only identifies the costs and benefits incurred during the process of regulation, but also how they are distributed between different stakeholders (Carrasco, 2006). The cost-benefit analysis approach therefore complemented the analysis of the ROI above in the manner explained below.

While the ROI approach allowed for the assessment of the benefits of regulation (i.e. the progress in the achievement of the regulatory objectives), as discussed under Section 8.4 above, it did not make specific reference to the costs caused by regulation. According to Staschen (2010), the process of regulation incurs costs for market participants, i.e. the regulator, regulated institutions and the wider economy. Costs also change the behaviour of market participants and therefore would impact the achievement of regulatory objectives

(Staschen, 2010). Therefore, to provide a complete picture of the RIA, the researcher also performed a cost analysis to identify the likely major costs to be incurred by those stakeholders. As in the case of the ROI, the cost analysis was done by examining relevant regulatory provisions of the envisaged amended BIA and relating those to theory and empirical experience of other countries, where possible.

Stakeholder views were further sourced through the survey and interviews to corroborate the findings. Views on the likely regulatory and supervisory costs were sourced from the regulators, while those on the costs of regulatory compliance were obtained from the potential DMFIs and other relevant stakeholders. In the context of this study, and in line with the approach taken by Staschen (2010), the aim of doing this was not to derive a figure for the net social benefit of the regulation, but to list major costs created by specific regulatory provisions. The identified costs were then compared with the benefits derived from the ROI approach (i.e. the likely attainment of objectives) and therefore a cost-benefit analysis was carried out in that manner. While there were some limitations in the process of identifying the costs, the researcher is confident that the study has been able to draw some conclusions, as evidenced in the next section.

8.5.1 The costs of regulation

In line with literature (Staschen, 2010), the researcher identified the likely costs of regulation to include institutional costs (relating to the expenditure of the regulator), compliance costs (incurred by regulated institutions in complying with regulatory requirements) and structural or indirect costs that arise as a result of market failures resulting from regulation. These are discussed below in the context of the current study.

8.5.1.1 Costs to regulated MFIs

From the regulatory provisions of the envisaged amended BIA and its draft implementing determinations discussed under Section 8.3, the provisions relating to licensing, minimum capital requirement, CAR, liquid asset requirements, loan portfolio management and reporting requirements are likely to result in costs to the potential regulated MFIs, as discussed below.

MFIs that decide to obtain a license will have to incur licensing costs initially as well as other related costs, such as administrative expenses (i.e. ongoing costs) and transformation costs of designing and setting up new systems as may be required (i.e. start-up costs), followed by an annual licensing fee for the period of their existence (i.e. ongoing costs). The flip side to the licensing cost, however, is that after obtaining a license, the MFIs will have an opportunity to increase their funding source through mobilising deposits, an advantage which is not applicable to unlicensed non-deposit-taking MFIs, whose business is restricted to lending; hence a potential regulatory benefit in that regard.

In addition, in order to obtain a license, potential MFIs will have to meet the required minimum capital requirement (i.e. start-up cost). While this is envisaged to be lower relative to that of conventional banks under this new regulatory framework (which is an advantage of having the envisaged differentiated regulatory approach for MFIs created by the new regulatory framework), the cost will still be real for the MFIs. This is because even for those MFIs that might have sufficient funds such that they may not feel the burden of having to put down the required minimum capital, it will still be a cost in the sense that the money could have continued being used in their normal business processes, if it was not a requirement to set it aside for that purpose. Other MFIs may have to increase their capital levels and this can be a potential entry barrier should they not succeed in raising the required funds. In addition, MFIs will have to incur the opportunity cost of holding liquid non-interest earning assets in compliance with the statutory liquidity requirements (i.e. an ongoing cost).

Requiring compliance with minimum capital, CAR and liquidity ratios is, however, advantageous to both the MFIs and the financial system in that higher capital levels and liquidity will reduce the probability of institutions failing, thereby enhancing their financial soundness and the stability of the system.

Further, in terms of the regulatory provisions related to reporting, licensed MFIs would be required to submit prudential reports to the BoN on a monthly basis (i.e. ongoing costs). The cost of reporting naturally manifest itself in the form of time spent to prepare the reports and hence shifting from other business-related activities during preparations as well as the effort required (Staschen, 2010). The process may also involve updating and/or improving systems such as information management systems so as to adhere to specific reporting requirements. Regulated MFIs will also be required to have audited financial statements and to publish them, and will hence incur costs in terms of audit fees. In addition, the supervisory on-site inspections would also add costs to the regulated MFIs in terms of time spent on related activities to enable supervisors to perform their duty as required. All of the above will be additional and ongoing costs, which potential DMFIs will have to incur[138] and which may result in a considerable expense for them. The benefit, however, may be the fact that regulated MFIs will have proper records and accounts in place, which will enable them to better monitor their own activities and performance.

Moreover, as part of the 'fit and proper' requirement of the regulation, MFIs will likely incur high costs related to recruiting relevant qualified management staff to comply with this requirement. Having to comply with prudent standards and reporting requirements will also lead to increased staff training costs. While these costs, especially training cots, may be incurred by microlenders already now, the scale and number of people that would require to be trained may differ, as the DMFIs will now be banks that will operate at a much larger scale than microlenders. Both of these costs will however benefit the regulated institutions, as they will have skilled managers and staff in their employ to drive the business operations, which may result in the good performance of the MFIs, and which will be good for the sector as a whole. The downside, however, would be the fact that these together with all other costs discussed above would normally end up being borne by the customers through increased fees and interest rates.

8.5.1.2 Costs to the regulator

Regulation and supervision also involves costs for the regulator, starting with the planning and preparation for the legal framework itself (i.e. the process of establishing the regulatory framework) to the actual supervisory process (Chiumya, 2006). In order to execute its role as regulator and supervisor of new entrants (i.e. DMFIs), the BoN will incur personnel training costs relating to on-site and off-site inspections. It will also incur training costs for staff, especially as staff will still be inexperienced in regulating MFIs, which will be a new function for them,[139] hence the need to capacitate its staff in this relatively new field of supervising MFIs (i.e. an additional cost to the regulator). A positive side of having to pass the regulatory framework and licence MFIs, however, is that it would facilitate and make it easier to collect data on them and monitor developments so as to enhance the achievement of the intended policy objectives of having safe and sound MFIs and developing the microfinance sector.

[138] Microlenders, who are the potential entrants to the DMFI industry, are not required by their supervisory authority (NAMFISA) to have audited financial statements and publish them. They are only required to furnish NAMFISA with quarterly returns and annual compliance returns. Therefore, this will be an additional cost to those that will enter.

[139] While the BoN has had an opportunity to regulate FIDES, the case study discussed in Chapter 7, this was done under the framework of the conventional banking institutions law, hence the limited experience.

8.5.1.3 Other structural or indirect costs

The indirect costs that would result from the above discussed costs to the regulator and MFIs caused by regulation are those to be incurred by customers. MFIs are likely to pass on their costs to customers in the form of increased fees and charges. However, the positive side is that the regulatory provisions of requiring MFIs to be transparent and disclose information, including the terms and costs of products and services they offer, as well as to publish financial statements would ensure that consumers have access to more information and make informed decisions.

In summary, the above discussions have shown that regulation is likely to result in costs for the regulator, regulated MFIs and clients of MFIs. It has also shown that for every cost identified there is an accompanying benefit. This finding, together with the extent to which regulatory objectives are likely to be achieved (i.e. most of the intended regulatory objectives would be met), as discussed in the previous section, suggests that the benefits of introducing the envisaged regulatory framework would exceed the costs.

8.6 CONCLUSION

This chapter analysed the potential impact of the proposed new regulatory framework under the draft amended BIA, which provides for microfinance regulation, on the microfinance sector in Namibia. The analysis was done within the ROI regulatory assessment framework and this was therefore the second stage of addressing the research objective of assessing the impact of regulating and supervising the microfinance sector at a macro level, following that done in Chapter 7. Typical of ex-ante RIAs, this was a process-tracing analysis, benchmarked on the regulatory objectives of the new framework that are identified based on the public interest theory.

It found a greater probability of the envisaged act achieving its regulatory objectives, as most of the provisions have demonstrated the likelihood of leading to an improvement in the indicators that measured the objectives through the ROI process. The chapter also identified the possible regulatory costs to the regulator, regulated MFIs and clients of MFIs. These were compared to the benefits obtained from the ROI process so as to strengthen and enhance the validity of the results, i.e. a cost-benefit analysis approach was applied. The general outcome suggested that the benefits of introducing the envisaged regulatory framework would exceed the costs. This implies that the proposed microfinance regulatory framework would lead to the achievement of regulatory objectives and therefore to the facilitation of the development of the microfinance sector in Namibia.

On the question of whether or not the achievement of the regulatory goals that would contribute to the development of the microfinance sector would still be possible in the absence of the new regulatory framework (i.e. the counterfactual to the above situation), the researcher argued that by differentiating MFIs from normal banks, as observed in Section 8.3 of this chapter, the new regulatory framework is providing a relatively conducive regulatory environment for MFIs. It is also creating an opportunity for a microfinance-tailored and focused supervisory attention, thereby widening the probability of ensuring the safety and soundness of MFIs. In other words, there is a better chance of developing the microfinance sector with the proposed new regulatory window.

Important to note, however, is the fact that in the end what is key would be the degree to which regulatory requirements are going to be enforced. In this regard, it is hoped that supervisors would have sufficient capacity to effectively supervise the new breed of unique institutions that will enter the industry. The experience picked up so far with the regulation of FIDES discussed in Chapter 7 should assist in going forward, but more experience and skills will need to be developed during the process, especially as FIDES had been regulated under normal conventional banking law and therefore supervisors did not really need to differentiate the two types of institutions when supervising. There will be a need to learn lessons from other countries that have been involved with regulating and supervising MFIs as well, while still keeping in mind the unique environment of the country.

The researcher is also of the view that while necessary, regulation alone will not be sufficient to attract relevant players, given the structural weaknesses of the Namibian economy, discussed in Chapter 2, relating to the size of the market, geographical setup, physical infrastructure, etc. Broader policy and reform initiatives, including additional incentives, might be required to spur the development of the country’s microfinance sector.

The next and last chapter of this study presents the key findings, conclusions, policy implications, limitations of the study and suggests a possible direction for further research.

CHAPTER 9

KEY FINDINGS, CONCLUSIONS, POLICY IMPLICATIONS, LIMITATIONS AND DIRECTION FOR FURTHER RESEARCH

9.1 INTRODUCTION

This study has been conducted on the background that while the emergence of the microfinance industry four decades ago has been considered as presenting an opportunity to extend financial services to the excluded majority in developing countries, this has come with associated challenges. This is especially so because the earlier role of MFIs of 'credit-extension only', which has historically evolved informally, has transformed into a much wider role, such that MFIs are now also providing additional services in the form of savings, money transfers, etc. This changing role has come with greater responsibility and accountability, given the risks involved, including the possibility of loss of savers' money. It has also sparked an increasing interest internationally, in terms of whether or not MFIs should be regulated and supervised, and if they should, how that should be done to avoid any undesirable impact.

Furthermore, the observed increasing pressure for regulating MFIs has originated from the belief that there is a need for transformation of MFIs into regulated financial intermediaries and that regulation would allow them to evolve into such institutions, especially the ones that aim to take deposits, as discussed in this thesis. The belief is that this would result in increased loanable funds of MFIs, which implies that regulating MFIs would lead to increased outreach and thereby increased access to finance, an argument that Namibia has aligned itself with as the rationale for introducing the proposed microfinance regulatory framework.

However, some views in literature caution of the potential trade-offs of regulation in that complying with regulation and supervision can be costly and that this may curtail MFIs' outreach, which may lead to the exclusion of some potential borrowers. The above views confirm the complexity involved in deciding whether MFIs should be regulated and how this should be done to ensure that they still play the expected role of providing access to finance for the poor, low-income earners and SMEs. As a result, there has been differing views, both for and against the regulation of these institutions. This is where RIAs on microfinance become important and hence the assessment on Namibia done in this study, reported in chapters 7 and 8, which aimed to empirically determine the potential impact of regulation on the microfinance sector. This was the primary research objective of the study. To facilitate the process of the RIA, the researcher had to first obtain and develop an understanding of both the microfinance sector to which the envisaged regulation will apply as well as the existing legal and regulatory framework for the financial sector (including the microfinance sub-sector), discussed in chapters 5 and 6, so as to determine the changes, if any, that would be brought about by the new regulatory framework.

This final chapter is organised in a manner that the next section (9.2) provides a summary of key findings of the study as they relate to the research objectives, also highlighting their implications for theory. A consideration of policy implications resulting from the research follows in Section 9.3, while Section 9.4 highlights the study limitations and proposes further research areas on the basis of the identified limitations. Section 9.5 concludes the thesis.

9.2 SUMMARY OF KEY FINDINGS AND IMPLICATIONS FOR THEORY

9.2.1 Understanding the microfinance sector in Namibia

The researcher found that Namibia's microfinance sector was relatively small and undeveloped. With the exception of the one microfinance deposit-taking bank, an NGO-owned Namibia Housing Action Group and a few SACCOs, credit-only microlenders (mainly pay-day lenders but also a small number of term-lending institutions) dominate the sector. Moreover, most of the microlending institutions are urban-based and serve the salaried segment of the population, which is a limiting factor to outreach. It also became clear from the fieldwork results that the largest part of microlending in Namibia was consumption lending, while fully fledged MFIs that can offer comprehensive packages of microcredit, microsavings, money transfer and micro-insurance were very few. This situation does not augur well with the generally accepted role of microfinance that points to poverty alleviation, as the unemployed and self-employed are excluded. The scope of microfinance programmes and activities in Namibia has therefore not adequately addressed the problem faced by the poor, low-income people and SMEs to access finance in the country. A need was therefore identified to develop an industry of MFIs that will offer comprehensive packages of microcredit, microsavings, micro-insurance, money transfers services, etc. for these groups of the population.

The study also found weaknesses and constraints to the growth of the Namibian microfinance sector. Identified weaknesses include the absence of an enabling legal framework to spur the development of the sector, the limitations to entry exerted by the legal framework (where DMFIs were regulated under the same law with conventional banks), the interest rates limitations of the Usury Act and its Exemption Notice, under which microlenders were being regulated, as well as the lack of skills in the country to drive and manage microfinance, which called for the need to build capacity in this area.

An apparent lack of a national definition for microfinance and hence confusion around what should be considered as microfinance and/or MFIs was also observed. The researcher is of the view that any regulatory framework aimed at regulating the microfinance sector should first and foremost recognise the need for defining the sector, as this will assist in facilitating the process of determining whether or not interventions are appropriately targeted and intended regulatory objectives of the country are achieved.

The fieldwork findings also pointed to the fact that the MFIs in Namibia stretched over a diverse spectrum and that different regulators and supervisors regulate and supervise them under different acts, a situation which stakeholders believed to have caused uncoordinated microfinance activities. The researcher found that this was not unique to Namibia, as the microfinance sectors of most countries were fragmented and uncoordinated.

The country was however in the process of introducing a regulatory framework for DMFIs through amending the BIA, Act No. 2 of 1998, as amended, as well as developing a microlending bill to address some of the above-mentioned weaknesses. The introduction of the microfinance regulatory window, for instance, was being done following the realisation of the need to develop the microfinance industry to address the lack of access to finance by individuals and SMEs, i.e. policy makers have considered that regulation would create an environment that would entice investors to invest in the microfinance sector. The outcome of this policy initiative will either confirm or refute this thinking.

9.2.2 Understanding the regulatory and supervisory environment for MFIs in Namibia

From the analysis of this study, a picture emerged of the existence of a financial sector regulatory framework with emphasis on both prudential and non-prudential regulation, supported by two regulatory authorities (the BoN and NAMFISA) that had the necessary instruments to collect information about the sector and enforce regulatory provisions. There was a clear distinction between the regulation and supervision of the banking sector and that of the NBFIs in Namibia for which each of the two financial sector regulatory authorities were respectively responsible. It was also clear that the system was still evolving, especially in as far as the regulation of the new and special areas of mobile banking and microfinance is concerned. There had been only one DMFI that had been regulated under the conventional banking law (the BIA No. 2 of 1998, as amended) together with normal commercial banks, as indicated earlier. The basis for regulating credit-only micro-lenders was the Usury Act No. 73 of 1968 and the Exemption Notices issued by government, which allowed lenders registered with NAMFISA to charge interest rates and other fees over and above the usury limit. As this is not a law that established microlending institutions, a gap in terms of the authority effectively enforcing regulatory power had been identified and was being addressed through the development of an envisaged Microlending Act, for which a bill was in place.

Through the survey and stakeholder interviews, the need was identified for regulating MFIs for various reasons, but mainly for consumer protection purposes, especially in the case of deposit-taking and savings-mobilising MFIs, and also to bring order in the sector and enhance the sustainability of the institutions. This process however also raised concerns about a lack of dedicated legislation for microfinance activity in Namibia, which was perceived to have led to the fragmented treatment of MFIs and was viewed as the cause for a lack of understanding of what microfinance was and who an MFI in Namibia was. As such, stakeholders called for a coordinated approach to the microfinance sector in the country as well as a clear definition of MFIs to address the seemingly current state of confusion.

The researcher also identified the need for capacity building in microfinance regulatory and supervisory skills, given that this was an area that was relatively new to the country.

9.2.3 Determining the existing and potential impact of regulation on the Namibian microfinance sector

The assessment of the impact of regulation on MFIs in Namibia was done at both a micro level using a case study of a regulated MFI (i.e. ex-post assessment) and a macro level by appraising the likely impact of the anticipated microfinance regulatory framework (created through amending the existing banking legislation) on the sector (i.e. an ex-ante assessment). The researcher used the ROI methodology, which is grounded in public interest theory of regulation for assessing regulatory change, in the analysis of impact. The method aided in assessing regulatory impact through an evaluation of changes in quantitative indicators and qualitative factors for identified regulatory objectives. The main findings are summarised below.

9.2.3.1 The impact of the existing regulation on an MFI (i.e. an MFI regulated under conventional banking law

The researcher evaluated the experience of a regulated MFI (FIDES) as a case study through an application of the ROI approach of RIA and assessed the impact through an evaluation of changes in this MFI's performance indicators and qualitative information.

The analytical process found that regulation has generally had a positive impact on the operations of the regulated MFI. This was reflected in improvements in most of its performance indicators (profitability, portfolio quality, liquidity) during the post-licensing period, relative to the pre-licensing period. Regulation had also facilitated FIDES's significant contribution to Namibia's efforts to enhance access to financial services to poor and low-income people, as reflected in substantial increases in the number of savers and borrowers, especially in the rural areas of the northern regions, where the majority of its operations were based. This therefore presents evidence that the regulatory objectives (i.e. the intention for regulating FIDES in the first place) had been generally achieved. While these findings cannot be generalised, they present important lessons for policy making in the area of microfinance in Namibia going forward.

As with any research, the above findings are not without weaknesses. A key weakness of this assessment is the limited available data. The analytical process of the impact of regulation and supervision demands availability of sufficient data. In the case of FIDES, while data for its existing period were available, the period that the institution had been in operation and hence the period covered in the analysis is relatively short (2002–2013), and this rendered the use of regression analysis impossible. This weakness was however mitigated by using another rigorous methodology that follows a very systematic approach, i.e. the ROI method (as presented under the methodology chapter of this study), which ensured a solid evidence base on which other research can build going forward.

9.2.3.2 The potential impact of the envisaged microfinance regulatory framework on the microfinance sector

The researcher also analysed the potential impact of the anticipated new microfinance regulatory framework, created under the proposed Banking Institutions Amendment Bill, on the microfinance sector in Namibia. This was a second stage of addressing the research objective of assessing the impact of regulating and supervising MFIs on the microfinance sector, following that performed on the case study.

The analytical process, also done within the ROI regulatory impact assessment framework, involved an analysis of the relevant provisions of the proposed microfinance regulatory framework in terms of whether or not they would facilitate the achievement of the intended regulatory objectives, taking into account relevant theory and lessons from other countries. Qualitative information collected through interviews strengthened the evidence.

The impact assessment process identified some specific provisions of the envisaged MFI regulatory framework that are likely to yield undesirable outcomes of the regulation for the sector. These include the provision on shareholder limits and foreign ownership introduced to encourage local participation and ownership of banking institutions, which may prove to be an entry barrier for foreign investors that can bring the much needed technical skills to this relatively new sector that still needs to build capacity. The overall finding of the analysis, however, pointed towards a greater probability of the anticipated microfinance legal framework achieving its intended regulatory objectives, as most of the provisions have demonstrated the likelihood of leading to an improvement in the relevant indicators for each of the objectives. These were considered to be the potential benefits of Namibia introducing the new regulatory framework for microfinance to create a conducive environment for regulating MFIs. The accompanying proposed lower minimum capital requirement at licensing and other incentives, such as the ability to mobilise deposits, should reduce barriers to entry for MFIs and encourage them to enter the industry, and are likely to lead to an increased number of entrants in the industry. This, together with the set regulatory standards that will ensure the soundness and safety of the MFIs, should positively impact the regulatory objective of enhancing access to finance going forward, and hence the achievement of the initial policy intention for which the regulatory framework was introduced.

A further analysis of the expected regulatory costs revealed specific possible costs to the regulator, regulated MFIs and clients of MFIs. These include supervisory costs and regulatory compliance costs. A comparison of the identified costs to the benefits obtained from the ROI process (i.e. to the likelihood of achieving the regulatory objectives), however, suggested that the benefits of introducing the envisaged regulatory framework would exceed the costs. This implies that the proposed microfinance regulatory framework will lead to the achievement of intended regulatory objectives and therefore should facilitate the development of the microfinance sector in Namibia going forward. It also confirms the general assumption in literature that recognising the uniqueness of MFIs and treating them as such can have a positive impact on these institutions and the clients they serve.

As a counterfactual to the above, the researcher posed a question of whether or not the achievement of the regulatory goals that would contribute to the development of the microfinance sector would still be possible in the absence of the new regulatory framework. It was argued that by differentiating MFIs from conventional banks, as observed in the studied provisions, the new regulatory framework will provide a relatively conducive regulatory environment for MFIs. It will also create an opportunity for microfinance-tailored and focused supervisory attention and therefore widen the probability of ensuring their safety and soundness. In other words, there is a better chance of developing the microfinance sector with the proposed new regulatory window than without.

The above findings are however not free from weaknesses. One weakness of this ex-ante regulatory assessment is the fact that it did not perform an appraisal of different options normally performed under the RIA framework. Under this framework, the quality of the assessment is believed to be enhanced through conducting an ex-ante regulatory appraisal of different options, such as a comparison of having a dedicated microfinance legislation, integrating microfinance under the general banking law, etc., with the do nothing option (i.e. with an option where policy makers decide not to undertake a regulatory reform), and then choose the most relevant option with the highest net benefit (Staschen, 2010). According to Staschen (2010), the selection of the best option would also involve consideration of a number of issues, including the supervisory capacity needed to implement regulatory changes, etc. Doing this would have given an indication of the superiority of the alternative regulatory approaches, which would be more successful in facilitating the attainment of the intended regulatory objectives. This aspect was however outside the scope of this study, which followed the ROI approach of the RIA methodology.

In addition, another weakness identified of this ex-ante impact assessment is the fact that estimating future impact proved to be more challenging than the measurement of past impact under the ex-post impact assessment scenario, which was performed on the regulated MFI case study in this study. This is because the appraisal is on a proposed new regulatory framework and hence the unavailability of data to validate evidence. This possibly renders an ex-ante RIA less accurate than an ex-post RIA, which uses actual data. Having followed a rigorous regulatory impact approach such as the ROI, which is grounded in public interest theory, of regulation for assessing regulatory change, as explained in the methodology chapter, has however enabled the above findings to offer a good foundation upon which further research can be built.

9.3 IMPLICATIONS OF THE STUDY FINDINGS FOR POLICY

The above findings from the assessment of the impact of regulation and supervision on the MFI sector pointed to a general positive impact of regulation on microfinance in Namibia. There are however other pertinent findings in this study that are relevant for achieving the intended policy and regulatory objective of developing the country's microfinance sector to enhance access to finance, and that should therefore have policy makers in Namibia thinking in terms of how to address them going forward. These are those cases that pointed towards the likelihood of undesirable outcomes of the regulation (i.e. some of the provisions of the envisaged microfinance regulatory framework were found to be potential hindrances to the attainment of the regulatory objectives) as well as other issues that emanated from the fieldwork. These are discussed below.

9.3.1 Shareholder limits and foreign ownership

The provision on shareholder limits and foreign ownership introduced by the new microfinance regulatory framework to encourage local participation and ownership of banking institutions, including deposit-taking microfinance banks, was found to be a potential entry barrier. The draft amended act has placed a restriction on foreign shareholding of DMFIs to not more than 55 per cent as per Section 32 (1) (a) and (b). By implication, foreign DMFIs wanting to enter the Namibian market will have to ensure incorporation of local shareholding of 45 per cent. While this provision is good for this country that has foreign dominance in those respects, shareholder limits and foreign ownership restrictions could pose problems for MFIs that want to transform into DMFIs from a status such as credit-only microlender (i.e. term-lending MFIs) and NGO. For instance, this will mean that credit-only term-lending institutions that may currently be owned by single owners (be it local or foreign) would now have to give up some of their shareholding as required and some investors may not be comfortable with such a requirement.

In the case of the existing NGO-owned MFIs that may be harbouring the idea of upgrading to DMFIs, these requirements could also be a setback, as they would typically wish to hold a significant ownership stake in the transformed DMFI so as to be able to maintain their social mission of serving the poor. It may also prove difficult for NGO-MFI applicants to attract additional and suitable potential shareholders, given their limited track record in the for-profit-making arena. This may therefore be a barrier to entering the industry, leading to fewer MFIs entering the sector and reducing the level of competition. This may further limit the achievement of the regulatory objective of promoting competition and/or establishing a competitive market. While there is a possibility of this being mitigated by the provision of the draft amended BIA in Section 79(1), as cited in Chapter 8, and the central bank will therefore have an opportunity to review such agreement in the interest of facilitating a competitive environment, policy makers still need to be aware of this potential risk.

For regulation to achieve the objective of establishing a competitive market, it is important that it guards against provisions that would increase barriers to entry. Ways should therefore be found to mitigate and/or compensate for this potential barrier, which could delay the growth and development of the deposit-taking industry and the microfinance sector in general, and in turn the achievement of the regulatory objective of improving access to finance. For instance, policy makers and/or regulatory authorities may consider allowing for a transition period for shareholder diversification by DMFIs. This will allow them to set up shop while luring in potential investors.

Other issues for policy makers to consider in the process of striving to achieve their policy objective of developing the microfinance sector of Namibia through the provision of an enabling regulatory framework are those that emanated from the fieldwork, as summarised below.

9.3.2 To have dedicated legislation for microfinance or not

While stakeholders saw the need for regulating MFIs for various reasons discussed in Chapter 6, which addressed the research objective of understanding the current regulatory and supervisory framework for microfinance in Namibia, they raised concerns about a lack of dedicated legislation for microfinance activity in Namibia and the fragmented treatment of

MFIs, which they saw as the cause for a lack of understanding about microfinance in Namibia is. In their view, this could be the reason why the country does not have a national common definition of what microfinance is and who the MFIs are. They therefore called for dedicated legislation for the sector so as to ensure a coordinated approach towards microfinance.

The researcher did not find the lack of dedicated microfinance legislation to be a unique situation to Namibia, as many other countries around the globe are without dedicated legislation for microfinance, while the microfinance sectors of many are also fragmented and uncoordinated. Literature revealed that the binding constraint to the growth of microfinance in most countries has not necessarily been a lack of a dedicated legislation, but a shortage of licensable MFIs. As pointed out earlier, what is necessary for Namibia therefore is to have legislation for well-defined institutions and under which MFIs can thrive, as well as an enabling regulatory framework attractive to new entrants.

Regulators have to consider many issues when creating and reforming policies and depending on the circumstances of the country, a choice can be made between creating microfinance-specific legislation or amending existing legislation to make provision for MFI regulation (CGAP, 2010). An important first step in this decision process, before the complex task of creating a new legislation is engaged, is for the country to determine whether and how the existing sector regulation is a barrier to the achievement of the country’s intended objective (CGAP, 2010), which in the case of Namibia is the provision of financial services to the poor and SMEs. It should also be determined whether there is existence of a critical mass of qualifying institutions and which actors are likely to respond to the new legislation, as without this the creation of new and dedicated legislation would not necessarily lead to the achievement of that objective. As literature revealed, several countries have built technically sound new regulatory windows for microfinance, but have seen little response (CGAP, 2010). These are all important aspects that Namibia has to consider in its quest to create an effective microfinance regulatory framework.

The amended BIA providing for the regulation of DMFIs and the Microlending Bill that was being worked on by NAMFISA at the time of preparing this research, should go a long way in enhancing the regulatory and supervisory framework for the microfinance sector in Namibia once they become effective. It is however not yet known to what extent there would be harmonisation between these two pieces of legislation, especially in terms of defining what a microloan is and hence who an MFI is, as currently the definition for a microloan differs between the two bills. Harmonising common aspects of microfinance, such as the definition of microcredit, MFI, etc., is important, as this will help address some of the above-cited concerns raised by the sector stakeholders engaged by the researcher.

9.3.3 To prudentially or non-prudentially regulate MFIs

The other relevant issue identified relates to whether to prudentially regulate Namibian MFIs or not, on which the general argument from stakeholders pointed towards a differentiated approach. The majority of stakeholders argued that whether to prudentially or non-prudentially regulate should depend on the activities of the MFIs, such that DMFIs would need to be regulated to ensure their soundness and stability, while in the case of credit-only MFIs, it would suffice to only regulate their market conduct (i.e. non-prudential regulation is enough for those type of MFIs).

The above views are broadly in line with the arguments in literature. As such, what is important for Namibia is to weigh the costs against the benefits of supervising and regulating some MFIs as well as the risk involved and to identify and set levels of those to be regulated and how to regulate them, i.e. regulation should be aligned to the risk posed by MFIs. This process should also take into consideration the challenge of the complex nature of regulating and supervising microfinance prudentially and the cost involved, so as not to waste scarce supervisory resources and to avoid unnecessary compliance burdens for MFIs, which could result in the unintended consequence of constraining the development of the sector.

The above arguments are of great importance for Namibia to take into consideration, particularly given the objective to grow the sector and the fact that regulation of MFIs is a relatively new aspect for which the country still needs to strengthen its capacity in supervising and regulating such institutions.

9.3.4 To regulate microfinance activity or microfinance providers

Another aspect that is relevant for policy makers to consider is that of whether to regulate microfinance activity or microfinance providers. While the case of deposit-taking microfinance banks is clear in that they need to be prudentially regulated, the question that arises especially with the other categories of microfinance providers, and which relates to the issues of achieving a coordinated approach as well as the need to have a level playing field called for by stakeholders, is what exactly to regulate. CGAP (2012) is of the view that to advance the promotion of a level playing field for access to finance, similar activities should be subject as much as possible to similar regulation, regardless of the institutions conducting the activity. This implies that regulating the activity or following an activity-based regulatory approach is better than distinguishing regulation based on the type of institution. According to CGAP (2012), this is important not only for creating a level playing field, but also to foster competition and reduce the risk of regulatory arbitrage. The researcher views this as an important aspect for Namibia going forward, if it is to achieve the regulatory objective of developing a real microfinance sector.

CGAP (2012: 18) however argues that “the ability to regulate activities similarly will depend on both the specific regulatory issue being addressed as well as how the different institutions are regulated (i.e. under one or many laws)”. This aspect is also relevant for Namibia to consider and address, given its current setup where MFIs are regulated and supervised by two different regulators (DMFIs by the BoN and credit-only MFIs by NAMFISA) under two different laws. The country needs to determine whether there could be a possibility of following the activity-based regulatory approach and how that is to be implemented.

9.3.5 Enforcing regulation and supervision

Notwithstanding the above highlighted issues, it is important to note the fact that ultimately, what is key would be the degree to which regulatory requirements are going to be enforced. In this regard, it is hoped that supervisors would have sufficient capacity to effectively supervise the new breed of unique institutions that will enter the industry. The experience noted with the regulation of FIDES should assist going forward, but more experience and skills will need to be gained during the process, especially as FIDES has been regulated under normal conventional banking law. There will also be a need to learn lessons from other countries that have been involved with regulating and supervising MFIs, while still keeping in mind the unique environment of the country.

The researcher is further of the view that while necessary, regulation alone will not be sufficient to attract relevant players to the sector, and that broader policy and reform initiatives, including additional incentives, might be required to spur the development of the country’s microfinance sector.

9.4 LIMITATIONS OF THE STUDY AND SUGGESTED FURTHER RESEARCH

A key limitation of the study is the fact that the case study MFI (i.e. FIDES) discussed in Chapter 7 had been the only regulated DMFI in Namibia at the time of conducting the research. Questions that arise could be why FIDES was the only regulated MFI, and whether or not it self-selected into that situation, which then creates selection bias. The problem with selection bias is that if found existing, the appropriateness to attributing the outcomes of the impact assessment to regulation would be questionable. In this regard, the researcher argues that FIDES found itself as the only regulated DMFI due to structural factors, in that it was the only DMFI that had the capacity to enter the industry at the time. This is evidenced by the findings of an unpublished study that investigated the viability of second-tier banks in Namibia, which was undertaken by the BoN in 2005 [UP/P/4/1], which revealed a lack of capacity in potential second-tier bank entrants surveyed.[140] A further review was undertaken by the same institution in 2009, this time focusing on the capacity of some identified MFIs that were considered to be potential candidates for second-tier banks [UP/P/4/2]. These were the big three MFIs in Namibia identified by the rural microfinance technical committee in the country, namely Koshi Yomuti (which later became FIDES), Project Hope and the Shark Dwellers Federation of Namibia, all of which were donor-sponsored MFIs. The operations of these institutions were reviewed against the key findings of the 2005 study, with the aim to evaluate and determine their potential candidacy for consideration as second-tier banks. The findings of the review supported those of the earlier study and concluded that the demand for second-tier bank status in Namibia remained very low [UP/P/4/2].

With the above background in mind, FIDES might have self-selected, but the problem of it not being representative of its group may not be applicable in this case, given that there was no one else in the first place (i.e. there were no obvious NGOs who were likely second-tier bank candidates to enter, as found by the review study). As such, while FIDES's potential self-selection status might not have benefitted from the ideal random selection approach, it is

[140] The study defined second-tier banks as small banks that would be subject to less stringent prudential requirements than conventional banks, allowed to conduct a limited range of banking activities, allowed to accept deposits from the public and extend credit, serving the poor and informal SMEs as their target clients, providing services and products which are suitable for their target clientele and will not insist on conventional form of collateral but will consider alternative forms of collateral which the poor are able to provide [UP/P/4/1].

considered relevant under the circumstances in which FIDES was finding itself as well as in the context of this study.

Notwithstanding the above explanation, the following research ideas are proposed based on identified weaknesses of the thesis under sections 9.2.1 and 9.2.2 above:

The key weakness identified in the findings of the ex-post assessment of the regulated MFI (FIDES) relates to the fact that the analytical process of the impact of regulation and supervision on FIDES has lacked sufficient data for undertaking regression analysis, while from the ex-ante regulatory impact appraisal of the envisaged microfinance regulatory framework, the key weakness pointed to the fact that estimation of future impact is more challenging than the measurement of past impact. This could be an area for further research in the sense that as the new microfinance regulatory framework comes into effect, an ex-post impact assessment could be undertaken after some years of MFIs having been regulated.

Conducting an ex-post regulatory impact study after the implementation of the envisaged act and after having a number of institutions entering the industry should strengthen the evidence of regulatory impact on MFIs in Namibia by enabling a comparison of results to the current study. This could be combined with an appraisal of different options normally performed under the RIA (i.e. the options of having a dedicated microfinance legislation, integrating microfinance under the general banking law, do nothing option, etc.) referred to earlier as another weakness of the ex-ante appraisal by this study, which did not consider options to determine the superiority of alternative approaches and choose the most relevant options that would be more successful in facilitating the attainment of intended regulatory objectives. Further research in this area at the right time would prove to be beneficial to the country, as it will add more evidence for policy making as the country continues to strive to develop an effective, appropriate and enabling regulatory environment for microfinance.

9.5 CONCLUDING REMARKS

The aim of this study was to assess the potential impact that regulation would have on the MFIs in Namibia. Through an application of the ROI methodology, a review of relevant literature, lessons from the experience of other countries and collected quantitative and qualitative information from stakeholders (MFIs, regulators, users of MFIs services, policy and law makers and experts in the field) and the MIX database, an analysis of an RIA was performed at two levels, i.e. an ex-post level using a case study of a DMFI that has been regulated under conventional banking law and an ex-ante level of the likely impact of the new draft microfinance regulatory framework envisaged to be implemented in due course. The researcher believes that some useful conclusions and arguments have been made to answer the relevant research questions of the study and support the analysis, as evidenced by the key findings presented above.

The application of the ROI methodology to the case of Namibia has therefore contributed to the growing literature on RIA, and provided important insights for the future regulation of microfinance, not only in Namibia, but also in other similar countries around the world.

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APPENDICES

Appendix A: The questionnaire

Dear Participant,

My name is Emma Haiyambo, a PhD student at Stellenbosch University, South Africa. Thank you for your time to help me fulfil my study requirements by completing this questionnaire.

The purpose of this survey is to understand the Namibian microfinance industry and the impact regulation has and/or might have going forward on the microfinance institutions (MFIs) and/or industry as a whole. The information being collected is purely for research purposes and ethical issues will be upheld at all times in the dissemination of results.

If the space provided is insufficient for your response to any of the questions, please use a separate sheet of paper(s) and attach it to the questionnaire.

Kindly return the questionnaire to me by …….

Yours faithfully,

Emma Haiyambo
E-mail: haiyamboe@iway.na , Cell 081 293 0490

SURVEY ON MICROFINANCE IN NAMIBIA 2014

A. Details of the institution

1. Name of institution …………………..…………………………………………………
2. Physical address of head office…...……………..…………………………..…………
3. PO Box……………………….…………………………………………….……........

4. Tel……………………………..…………………………………………………
5. Fax……………………………..…………………………………………………
6. E-mail………………………….…………………………………….……………
7. Date of creation/formation…………………………..………………………………
8. Is your organisation registered? Yes ( ) No ( )
9. If yes, is it registered as a:

Society ( )
Cooperative ( )
Limited company ( )
Sole proprietorship/partnership ( )
NGO ( )
Other (please specify)…………………………………………………….……………

10. Date registered…………………………………………………………………………
11. With which agency is your organisation registered? …………………..……………
12. If your institution is not solely dedicated to the provision of microfinance services, what is the % of portfolio dedicated to microfinance?……………………………………………
13. In which areas does your organisation operate? Please provide both for current, previous and future (i.e. planned for next 3 years)

Period	Current /Previous/Future	City/Town/Village	Region	Number of branches

B. Regulation of microfinance institutions

14. Does the agency with which you are registered require any reporting?
    Yes ( ) No ( )
15. If your answer in 14 is 'yes', what information are you required to report and to whom? Please also indicate frequency (daily, weekly, monthly, yearly, etc.).

Required		To whom	Frequency
Financial statements	( )		
Audited accounts	( )		
Cash flow projections	( )		
Donor inflows/statements	( )		
Operation manuals	( )		
Other (please specify):……………..			

16. Is your organisation currently supervised by any agency for the delivery of financial services? Yes ( ) No ( )

17. If yes in 16 above, which agency?

Bank of Namibia ( )

NAMFISA ( )

Registrar of co-operatives ( )

Other (please specify)……………………………………………………………..

18. When was the last time the supervising agency contacted you?

Last month ( )

Last quarter ( )

Within the last six months ( )

Last year ( )

Other (please specify)…………………………………………………………….

19. When was the last time the supervising agency visited you?

Last month ( )

Last quarter ( )

Within the last six months ( )

Last year ( )

Other (please specify)…………………………………………………………….

20. When was the last time the supervising agency asked you for information?

Last month ( )

Last quarter ( )

Within the last six months ( )

Last year ( )

Other (please specify)…………………………………………………………

21. What information was requested? Please select from the list below.

Financial statements ( )

Audited accounts ( )

Cash flow projections ( )

Donor inflows/statements ( )

Organisational operations manuals ( )

Other (please specify)…………………………………………………………..

22. Do you think the microfinance industry should be regulated?

Yes ( ) No ( )

23. Please explain your answer in 22 above…………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

If your answer was 'no' to question 22 above, please go to question 32, and if yes proceed to question 24.

24. Who do you think should regulate microfinance institutions in Namibia?

Ministry of Finance ( )

Bank of Namibia ( )

NAMFISA ( )

Registrar of cooperatives ( )

Registrar of corporations ( )

Donors ( )

Other (please specify)…………………………………………………………..

25. How often would you prefer the regulator to visit you?

Monthly ( )

Quarterly ( )

Yearly ( )

Other…………………………………………………………………………..

26. In your view, what information should the regulator request from you?

Financial statements ( )

Audited accounts ( )

Cash flow projections ( )

Donor inflows/investments ( )

Organisational operation manuals ( )

Other (please specify)……………………………………………………………..

27. How often do you prefer reporting to the regulator?

Monthly ( )

Quarterly ( )

Half yearly (2x a year) ( )

Yearly ( )

Other (please specify)……………………………………………………………..

28. From your institution's experience, what are the major regulatory and supervisory related obstacles for providing financial services in Namibia?

………………………………………………………………………………………

………………………………………………………………………………………

………………………………………………………………………………………

29. Does your institution face any major non regulatory and non-supervisory obstacles in the provision of financial services? …………………………..……………………

………………………………………………………………………………………

………………………………………………………………………………………

30. What do you think are the likely benefits to the following of the having the microfinance industry regulated?

Government/Regulators………………………………………………………………………

…………………………………………………………………………………………….

…………………………………………………………………………………………

Microfinance institutions……………………………………………………………

…………………………………………………………………………………………

Clients……………………………………………………………………………………

……………..………………………………………………………………………………

Investors…………………………………………………………………………………

…………………………………………………………………………………………..…

31. Do you have any intentions to license your organisation after the enactment of the amended Banking Institutions Act which is now providing for the regulation of microfinance institutions? Yes ( ) No ( )

Please provide reasons for your answer……………………………………………………

…………………………………………………………………………………………………

C. Ownership and governance

32. Who owns your organisation?

NGO	( )
Members	( )
Company	( )
Individuals	( )
Other	( )

33. Has there been any change in ownership from the establishment of your organisation?

Yes ( ) No ( )

If yes, please explain………………………………………………………………………

34. What are your funding sources? Please indicate percentages.

Donor funds	( ) ………………%…
Deposits	( ) ………………%…
Commercial loans	( ) ………………%…
Government	( ) ………………%…
Equity	( ) ………………%…
Other (please specify)	( ) ……………………………

D. Management and staffing

35. What percentage of staff in your organisation is dedicated to the provision of the following:

Financial services……………………………..…………%…….

Social services……………………………………………%…….

Other services (please specify)…………………… ………%……

36. Institution size. Please provide information since the creation of your institution.

	2013	2012	2011	2010	2009	2008	2007	2006	2005	……
Total number of staff										
Number of loan officers										
Number of borrowers										
Total number of loans outstanding										
Total value of loans outstanding										
PAR										
Repayment rate										
Total assets										
Number of savers										
Value of savings										
Profit/loss										
Shareholders/members' equity										
Liabilities										
Retained earnings										

37. What is the total number of loans disbursed to date?………………………………..

E. Profile of your clients

38. Please provide the number of active clients

Total ………………………

Repeat clients ……………

New clients ……………

39. Clientele (percentage of total):

Female …………………….%.

Urban …………………….%.

40. How do you select your clients?

Poverty levels ( )

Gender ( )

Locality ( )

Interest in the programme ( )

Prior experience in business ( )

Other (please describe)……………………………………………………………..

41. What source of information do you use to select clients?

Financial statements ( )

Credit histories ( )

Village/community leaders ( )

Friends/relatives ( )

Employers/business people ( )

Credit group selection of eligible members ( )

Other (please specify)……………………………………………………………..

F. Services offered

42. What loan products does your institution offer?

Consumption loans ( )

Loans to repay existing loans ( )

Trade/commercial loans ( )

Agricultural loans ( )

Manufacturing loans ( )

Housing loans ( )

Other (please specify)………………………………………………………………

43. Does your institution provide any other financial services apart from loans?

Savings ( )

Money transmission ( )

Insurance ( )

Other (please specify)………………………………………………………………

44. Does your institution provide any training prior to lending?

Yes ( ) Duration………………… No ( )

Loan Characteristics

45. Which is your lending methodology?

Group ( ) Average group size: min.…….. max.…… average……

Individual ( )

Other (please specify)…………………………………………………………….

46. How long does it take a client to obtain their first loan after joining?

min …….. max ….…. average ……..

47. Do you require collateral? Yes ( ) No ( )

48. If 'yes' in 47 above, which from the list below do you accept as collateral?

Forced savings ( )
Vehicles ( )
Land ( )
Animals ( )
Household goods/furniture ( )
Personal guarantees ( )
Group guarantees ( )
Other (please specify)…………………………..……………………………….

49. If you answered 'no' in 47, how does your organisation mitigate risk?

……………………………..…………………………………………………………….

50. Is there a waiting period between repayment and the disbursement of a subsequent loan?

Yes ( ) Duration: min……max…… aver…….. No ( )

51. Loan activity: Please provide the current situation of your loan book

	Number	**Outstanding balances**
Total		
Individual		
Group		

52. Loan characteristics

	Minimum	**Maximum**	**Average**
Loan size			
Annual interest rates (for 2013)			
Loan terms (duration in days, months or years)			
Repayment frequency			

53. Do you give loans to:

Staff ( )

Board ( )

Their relatives ( )

54. Current loans extended by your institution with late repayment (at least 30 days late)

	Number	**Balance**
Total		
Individual		
Group		

55. When is a loan considered as delinquent? ....

…………………………………………………………………………………………

……………………………………………………………...…………………….

56. Does your organisation penalise for early payment or prepayment of loans?

Yes ( ) No ( )

Deposit characteristics

57. Are clients required to make forced savings? Yes ( ) No ( )

58. How much is a client required to save before a loan is disbursed? .... N$.................

59. Deposit accounts

	Number	**Balance**
Compulsory		
Voluntary		

60. Annual interest rate on deposit accounts

Minimum………………… Maximum………………… Average……….……….

61. Where are clients' savings kept? …………………………………………………...

62. Can a client withdraw from forced savings? Yes ( ) No ( )

63. If yes in 62 above, under what circumstances?

Family emergency ( )

Invest in business ( )

No specific reason ( )

Other (please specify)………………………………………………………………

64. Are savings/deposits used for onward lending? Yes ( ) No ( )

G. Performance indicators

65. Please also provide information on the variables listed below since the establishment of your institution up to 2013. ***(Where available, monthly data for each year will be very useful for this exercise and will be appreciated).***

SUB-INDICATOR	PERIOD (in years)														
	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	…..
Return on assets (%)															
Return on equity (%)															
Debt to equity ratio (%)															
Capital/ asset ratio (%)															
PAR > 30 days / gross portfolio (%)															
Write-off ratio (%)															
Risk coverage															

ratio (%)															
Number of borrowers															
Average loan size															
Share of small loans (%)															
Share of group borrowers (%)															
Portfolio yield (%)															
Total savings															
Savings to loans ratio (%)															
Number of savers															
Average savings per saver															
Average savings per saver to average loan size (%)															
Operating expense ratio (%)															
Financial expense ratio (%)															
Cost per borrower															
Liquidity ratio (%)															
Liquid ratio (%)															

NOTE: DEFINITIONS OF THE ABOVE VARIABLES:

VARIABLE	DEFINITION
Return on assets (%) -------------------------	Profit (loss) from operations after tax/ average assets
Return on equity (%) ------------------------	Profit (loss) from operations after tax/ average equity
Debt to equity ratio (%) ---------------------	Total liabilities / total equity
Capital/ asset ratio (%) ----------------------	Total equity/ total assets
PAR > 30 days / gross portfolio (%) -------	Value of outstanding loan balance with payments past due > 30 days (end of period)/ value of outstanding loans (end of period)
Write-off ratio (%) -------------------------	Write-offs for the 12 months period / average gross loan portfolio
Risk coverage ratio (%) ---------------------	Loan loss reserve/ PAR > 30 days
Number of borrowers -----------------------	Number of active loan clients (end of period)
Average loan size -------------------------	Gross loan portfolio / Number of active borrowers (end of year)
Share of small loans (%) --------------------	Number of loans with a disbursed loan amount < value be determined / number of loans
Share of group borrowers (%) -------------	Number of active borrowers receiving loans as members of a group / number of active borrowers (end of pe
Portfolio yield (%) -------------------------	Interest and fee income from loans / average gross loan portfolio
Total savings -------------------------	Total short-term deposits (end of period)
Savings to loans ratio (%) ------------------	Total savings / gross loan portfolio (end of period)
Number of savers -------------------------	Total number of clients with savings (end of period)
Average savings per saver ------------------	Total savings / number of savers (end of period)
Average savings per saver to average loan size (%)	(Total savings / number of savers) / (gross loan portfolio / number of active borrowers)
Operating expense ratio (%) ---------------	Operating expense / average gross loan portfolio

	(end of period)
Financial expense ratio (%) -----------------	Financial expense / average total assets (end of period)
Cost per borrower -------------------------	Operating expense / average number of active borrowers
Liquidity ratio (%) -------------------------	Liquid assets net of LIF / deposit liabilities
Liquid ratio (%) -------------------------	(Cash and near cash + deposits in banks + short term investments) / total assets

H. Respondent details

In order to enable the researcher to follow up on some of the responses, kindly complete the section below. This is optional and entirely for research purposes only.

Name of respondent……………………………………………………………….

Position……………………………………………………………………………

Tel/fax………………………………………………………………………......

E-mail……………………………………………………………………………

THANKS FOR YOUR TIME!

Note: The questionnaire was adapted from Chiumya (2006), who did a similar study on Zambia, as it was found to fit the aim and objectives of this study.

Appendix B: Additional qualitative questions sent to staff of FIDES to provide an indication of what the situation was at the bank

Qualitative indicator	Remark
Management and strategy • Quality of senior management and board	
• Qualifications of management and board	
• Training of middle management & potential middle managers	
• Promotions	
Strategy and business plan • Business plan in place with clear-cut policy required to deliver on their promises.	
• Detailed operational plan covering the activities of each branch, market development and branch replication, product development, regulatory compliance, human resource development, institutional development and industry support	
• Financial projections in place relating to portfolio growth, product diversification and capital structure strategies, challenges, strategy development, financial model and competitors?	
• Does the plan also provides an analysis of the institution's resources and capabilities, business system, financial plan, assumption and risks?	
Quality and support from shareholders and network • Donors and their role	
• Other networking groups/bodies	
Human resources management • Human resource policies in place	
• Policies to retain and to improve employees' productivity	
• Incentives/compensation policies	
• Use of part-time staff	
• Skilled staff in place	
• Capacity building activities	
Systems and reporting: **Quality of management information system** • Management information (effective?)	

Qualitative indicator	**Remark**
• Information technology systems (IT management information system)	
• Loan tracking and accounting systems	
Quality and speed of data feed • Process of data processing and distribution/transfer between head office and branches	
• Also is it manual or computer assisted?	
Quality of reports and distribution/analysis of reports • Quality of financial statements released	
• Are they automated or manually produced?	
• Are financial statements audited?	
• How often auditors are replaced	
Operations procedures and internal controls • Formalised and updated	
• Procedures disseminated to staff	
• Has internal audit department?	
• Internal auditors trained and has a good understanding of the MFI's role	
• Internal audit team's autonomy to apply/define its internal controls	
• An internal control and audit system that allows systematic monitoring and mitigation of risks	

Noted: The questions/statements were adapted from Ayayi (2011)

Appendix C: The interview guide

1. What is your understanding of microfinance?
2. Can you define it in the context of Namibia?
3. Is there a difference between microfinance and traditional banking?
4. Should microfinance institutions be regulated?
5. What do you mean by regulation?
6. Who should regulate microfinance institutions and why?
7. Are there any risks to be addressed by regulation and/or benefits to be derived from regulating microfinance institutions?
8. Is there a need to distinguish between different types of MFIs for regulation depending on their objective (e.g. poverty alleviation, profit maximisation, etc.)?
9. What role do you think microfinance play in the Namibian economy?

Note: The interview guide draws extensively from Chiumya (2006) who did a similar study on Zambia

Appendix D: List of interviewees

INTERVIEWEE	TITLE	DATE	INSTITUTION/ORGANISATION
Mr Festus Nghifenua	Director: Economic Policy Advisory Services	15 Apr 2015	Ministry of Finance
Mr Penda Ithindi	Director: Economic Policy Advisory Services	*	Ministry of Finance
Mr Romeo Nel	Director: Banking Supervision Department	9 Jan 2015	Bank of Namibia
Mr Urbans Karumendu	Deputy Director: Macro-Prudential Analysis	*	Bank of Namibia
Mr Imanuel Hawanga	Principal Examiner (Banking Supervision)	2 Apr 2015	Bank of Namibia
Ms Rachelle Metzler	Manager: Microlending and Credit Agreements	14 Jan 2015	NAMFISA
Mr Philip Shiimi	CEO	23 Jan 2015	NAMFISA
Mr Christopher Engelbrecht	Financial Sector Programme (Subject Matter Expert)	12 Nov 2014	GIZ
Mr Tom Newton	Managing Partner (& Director at FIDES)	28 May 2015	Grant Thornton *(also FIDES)*
Ms Hileni Kaifanua	Financial Manager	*	FIDES
Mr Iaan Lyenar	Chairperson	10 Nov 2014	Bankers Associations of Namibia
Mr Ronald Weber	Chairperson	4 Nov 2014	The Micro Lenders Association of Namibia
Mr Patrick Gardiner	General Manager	16 Jun 2015	PostFin
Ms Mecky Heita	Financial Manager	5 Nov 2014	Kongalend
Mr Ismael Gei-Khoibeb	Financial Manager	12 Oct 2015	Old Mutual Finance
Mr Wilfried Luyanga	Project Coordinator	10 Mar 2014	Project Hope Namibia
Mr Heinrich Amushila	Regional Coordinator	11 Nov 2014	NHAG/ SDFN

Mr Ruben Isak	Senior Cooperative Business Analyst: Division of Cooperative Development & Regulations	7 Aug 2015	Ministry of Agriculture, Water and Forestry
Mr Pintile Davids	Director	10 Jul 2015	RISE Namibia
Mr Michael Gawaseb	Director	14 Oct 2015	Namibia Consumer Trust
Hon. Tom Alweendo	Chairperson *(Also Minister of Economic Planning & Director General of the NPC)*	16 Oct 2015	Cabinet Committee on Trade & Economic Development *(& National Planning Commission)*
Hon. Veikko Nekundi	Chairperson	*	Parliamentary Standing Committee on Constitution and Legal Aspects

Note: * represents those who responded to interview questions in writing due to unavailability for a face-to-face interview.

Appendix E: List of coded unpublished documents

Code	Author	Title	Date
UP/PD/2/1	Bank of Namibia	Policy considerations for the regulatory framework for deposit-taking microfinance institutions	16 June 2011
UP/PD/2/2	Supervision Department, Bank of Namibia	Supervision and regulation of deposit-taking microfinance institutions	15 October 2010
UP/RD/2/1	Supervision Department, Bank of Namibia	Recommendations for the reform of Namibia's legal and supervisory framework to better accommodate microfinance	19 April 2011
UP/RD/1/2	Bank of Namibia	Financial sector achievements over the past 25 years: Banking sector	November 2015
UP/D/1/1	Bank of Namibia	Determinations under the Banking Institutions Act (Act No. 2 of 1998)	December 2012
UP/P/4/1	Supervision Department, Bank of Namibia	Viability of second tier banks in Namibia	June 2005
UP/P/4/2	Research Department, Bank of Namibia	Review of the viability of second tier banks in Namibia	June 2005
UP/P/4/3	NAMFISA	Briefing paper: Microlending industry in Namibia	July 2013
UP/P/4/4	GENESIS for NAMFISA	Determining an optimum interest rate regime for microlenders in Namibia	27 March 2015
UD/L/2/1	Bank of Namibia	Banking Institutions Bill 2015 (Draft)	2015
UD/L/2/2	Republic of Namibia	Microlending Bill	undated

Note: The explanation of codes in the table above are as follows:

UP = Unpublished

PD = Policy document

RD = Report Document

D = Determinations

P = Paper

UD = Unpublished document

L = Legislation

First level 1 or 2 = One or two document (s) in that category per institution

Second level 1 or 2 = Number allocate to the document

Appendix F: List of codes allocated to interviewees

First level codes	Description
Reg	Regulator
MFI	MFI
PM	Policy Maker
MLA	Association of microlenders
BAN	Bankers Association
LM	Law makers
Exp	Expert
Int	Interest group

Note:

(a) Regulators are further divided into Reg1, Reg2 and Reg3 to indicate interviewees belonged to three different regulating authorities.

(b) MFIs are further divided into MFI6 up to MFI10 to indicate that the 6 interviewees belonged to 5 MFIs. The number of interviewees per each of the MFIs are as follows:

- MFI6 = 1
- MFI7 =1
- MFI8 = 2
- MFI9 = 1
- MFI10 = 1

Appendix G: FIDES's performance indictors

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Profitability											
Return on assets (%)	N/A	2.47%	-44.77%	-33.84%	-12.25%	-7.34%	-20.29%	-30.70%	-194.74%	-82.88%	-43.48%
Return on equity (%)	N/A	5.61%	-95.30%	-73.91%	-31.84%	-19.47%	-58.62%	-143.59%	-360.19%	-314.06%	-448.88%
Debt to equity ratio (%)	2.22	1.1	1.15	1.2	1.9	1.53	2.52	5.56	0.8	8.66	9.89
Capital ratios											
Capital/ asset ratio (%)	31.03%	47.61%	46.54%	45.49%	34.45%	39.53%	28.45%	15.25%	55.54%	10.36%	9.18%
Portfolio quality (Portfolio at risk)											
PAR > 30 days / gross portfolio (%)	0.00%	0.09%	1.36%	1.26%	0.68%	2.80%	3.33%	3.17%	1.37%	4.00%	40.23%
Write-off ratio (%)	N/A	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	1.82%	N/A	N/A	N/A
Risk coverage ratio (%)	N/A	117.62%	N/A	N/A	N/A	79.18%	96.27%	116.48%	N/A	N/A	48.35%
Access (to loans and to savings)											
Number of borrowers	181	391	423	1,096	2,001	3,208	3,231	2,731	5313	10698	12,684
Portfolio yield (%)	N/A	N/A	50.21%	53.68%	49.89%	50.65%	40.10%	53.02%		15.27%	35.12%
Total savings	178	2,723	2,477	15,336	39,688	90,263	98,923	13,964	510,040	1,140,121	1,569,700
Savings to loans ratio (%)	3.09%	9.23%	7.35%	13.39%	15.46%	20.68%	27.59%	3.44%	48.84%	41.23%	40.58%
Number of savers	31	107	99	518	1,337	2,436	2,611	49	N/A	N/A	51,966
Average savings per saver	N/A	37	25	30	30	37	38	285	N/A	N/A	30
Efficiency											
Operating expense ratio (%)	N/A	50.10%	133.92%	109.47%	66.14%	55.26%	61.57%	84.88%	N/A	142.51%	60.88%
Financial expense ratio (%)	N/A	0.30%	0.56%	0.55%	0.50%	2.65%	2.76%	4.81%	0.80%	3.72%	7.40%
Cost per borrower	N/A	N/A	104	107	79	74	76	109	N/A	N/A	N/A
Liquidity											
Liquid ratio (%)	N/A	N/A	29.39%	6.79%	4.82%	5.57%	6.76%	10.27%	22.42%	11.28%	20.80%

Source: Mix (no date)

Note: N/A stands for not available

Appendix H: Morgan Stanley's credit risk analysis and rating methodology of microfinance institutions

Rating factors	Indicator definition	Grades					
		6	5	4	3	2	1
Loan portfolio	**A1:** PAR = (outstanding loans with arrears over 30 days + restructured loans)/gross loan portfolio	<3%	<6%	<9%	<12%	<15%	Above 15%
	A2: Write-offs = total loan written off over the last twelve months/ average loan portfolio	<2%	<3.5 %	<5%	<7%	<10%	Above 10%
	A3: Size of portfolio = gross loan portfolio	>30 0M	>25 0M	>10 0M	>50M	>10%	Less than 10M
	A4: Loan loss reserves = loss reserves/PAR30	>85 %	>75 %	>65 %	>60%	>55%	Below 55%
Profitability, sustainability, operating efficiency	**B1**: Sustainability = operating income/(financial expenses + loan loss provisions + loan write-offs + operating expenses)	>12 0%	>11 5%	>11 0%	>100 %	>90%	Below 90%
	B2: Return on average assets (ROAA) = net income/average assets	>3%	>2%	>1%	>0%	>-2%	Below -2%
	B3: Operating efficiency = total operating expenses/average gross loan portfolio	<20 %	<25 %	<30 %	<40%	<50%	Above 50%
	B4: Productivity = number of borrowers/total headcount	>20 0	>19 0	>17 0	>145	>130	Below 130
Asset and liability management	**C1:** Leverage = total liabilities/net worth+ subordinated debt)	<5x	<6x	<7x	<8x	<9x	Above 9x
	C2: Foreign currency exposure = (foreign currency debt)/(total financial debt)	<15 %	<20 %	<35 %	<50%	65%	Above 65%
	C3: Liquidity = (cash + short-term investment)/(gross loan portfolio)	>15 %	>12 %	>9%	>6%	>3%	Below 3%

Rating factors	Indicator definition	
Management and strategy	**D1:** Quality of senior management and board	
	D2: Strategy and business plan (including competitive landscape)	
	D3: Quality and support from shareholders and network	
	D4: Human resource management	
Systems and reporting	**E1:** Quality of management information systems (MISs)	
	E2: Quality and speed of data feed	
	E3: Quality of reports and distribution/analysis of reports	
Internal and operational controls	**F1:** Operational procedures	
	F2: Internal controls	
Growth potential	**G1:** Regulatory environment and government involvement	
	G2: Number and density of micro-entrepreneurs	
	G3: Behaviour of micro-entrepreneurs towards micro loans	

Source: Adapted from Ayayi (2011)

Appendix I: Regulations and determinations issued under primary banking laws

Legislation for regulated and supervised banking institutions	Regulations/Determinations/Circulars/Guidelines
Bank of Namibia Act (Act No. 15 of 1997)	**Regulations:** • Directive on the Minimum Reserve Requirement • Credit Bureau Regulations
Banking Institutions Act (Act No. 2 of 1998) (amendments to this act have been drafted and are awaiting Parliamentary approval)	**Regulations:** • Regulations on fees **Determinations:** • Determination on the Application for Registration as a Controlling Company • Determination on Minimum Liquid Assets • Determination on the Imposition of Administrative Fines • Determination on Branches of Foreign Banking Institutions • Appointment, Duties and Responsibilities of Independent Auditors • Determination on Consolidated Supervision • Limits on exposures to single borrowers, large exposures and concentration risk • Measurement and calculation of capital charges for credit risk, operational risk and market risk • Minimum liquid assets • Public Disclosures for Banking Institutions • Internal Capital Adequacy Assessment Process • Interest Rate Risk in the Banking Book • Minimum Local Assets • Localisation of Core Banking Systems • Country Risk Management • Limits on Interbank Placements • Asset Classification, Suspension of Interest and Provisioning • Minimum Insurance for Banks • Fraud and Other Economic Crime • Compulsory Suspension of Cheque Account Facilities by Banks • Disclosure of Bank Charges, Fees and Commission • Appointment, Duties and Responsibilities of Directors and Principal Officers of Banks • Fees Payable in terms of Section 64(6) of BIA
Payment System Management Act (Act No. 18 of 2003)	**Determinations:** • Determination on Core Banking Systems • Determination on payment instruments • E-money Determination- gazetted • Determination on Access • Determination on Conduct of Card Transactions • Determination on the Efficiency of the National Payment System

	• Determination of CDF and BBA • Determination on the Reduction of the Item Limit for Domestic Cheque Payments within the Namibian National Payment System (PSD-2) **Correction notice:** • Determination on the Reduction of the Item Limit for Domestic Cheque Payments within the Namibian National Payment System (PSD-2 **Circular and Guidelines** • Guidelines for Electronic Money Issuers & Other Payment Instrument Issuers • Guidelines for an Efficient EFT Debit Order System • E-Money Circular • Starter Pack - Access and Participation in Clearing and Settlement **Directives:** • Card Directive 16 April 2008 • Directive on reduction of cheque clearing cycle to 5 days • Directive on the conduct of EFT transactions • Early square off Directive Final • Sort at Source Directive • PSDIR 7-Routing of three debit card bins

Source: BoN (no date)

Appendix J: Guidance on applying the Basel Core Principles to depository microfinance

Principle	Description	Differentiation
1	Objectives, independence, powers, transparency and cooperation	Applies equally to supervisors of banks and ODTIs engaged in microfinance.
2	Permissible activities	Should be tailored to ODTIs engaged in microfinance in a manner that is commensurate with the type and size of their transactions, which may differ from banks.
3	Licensing criteria	Should be tailored to ODTIs engaged in microfinance in a manner that is commensurate with the type and size of their transactions, which may differ from banks.
4	Transfer of significant ownership	Applies equally to banks and ODTIs engaged in microfinance
5	Major acquisitions	Applies equally to banks and ODTIs engaged in microfinance, with isolated situations warranting a tailored approach.
6	Capital adequacy	Should be tailored to (a) the nature of microfinance risks for all institution types, and (b) the size and constituents of capital of ODTIs engaged in microfinance.
7	Risk-management process	Requires specialised knowledge and supervisory methodologies for both banks and ODTIs engaged in microfinance.
8	Credit risk	Should be tailored in banks and ODTIs engaged in microfinance to the specificities of microlending. Supervisors should take into account the context in which microlending occurs, i.e. as a business line within a large diversified bank versus a specialised microfinance organisation in which microloans comprise a significant proportion of total assets. Specialised knowledge of labour-intensive microlending methodologies is imperative for supervisory efficacy.
9	Problem assets, provisions and reserves	Should be tailored in banks and ODTIs engaged in microfinance to the unique risks of microlending compared to other loan types, particularly with respect to loan-provisioning and classification requirements.
10	Large exposure limits	Should be tailored in banks and ODTIs engaged in microfinance to manage the risks in geographic or sector concentrations often observed in microloan portfolios
11	Exposures to related parties	Should be tailored to ODTIs engaged in microfinance. Where governance is weak, supervisors may enhance restrictions or prohibitions on related party transactions. Conversely, member-owned institutions that are very widely held may warrant flexible treatment for loans to non-management members.
12	Country and transfer risks	Applies equally to banks and ODTIs engaged in microfinance
13	Market risks	Should be tailored to ODTIs engaged in microfinance with respect to their foreign currency borrowings.
14	Liquidity risk	Should be tailored in banks and ODTIs engaged in microfinance to take into account the unique features of microfinance assets and funding liabilities.

Principle	Description	Differentiation
15	Operational risk	Requires a deep understanding of the distinctive risks and trends in microfinance operations – including outsourcing and decentralised and labour-intensive credit methodology – in order to adequately evaluate risk management and internal controls in banks and ODTIs engaged in microfinance. Supervisory tools and analyses may differ for ODTIs compared to those used for banks.
16	Interest rate risk in the banking book	Should be tailored in banks and ODTIs engaged in microfinance to take into account the unique features of microfinance assets and funding liabilities.
17	Internal control and audit	Should be tailored in banks and ODTIs engaged in microfinance to take into account that microlending methodologies may require different organisational arrangements and controls from those of conventional retail banking. Supervisory tools and analyses may differ for ODTIs from those used for banks.
18	Abuse of financial services	Should be tailored to the risks posed by low-value or low-risk microfinance operations undertaken by banks and ODTIs, particularly low-value savings products.
19	Supervisory approach	Requires specialised knowledge and supervisory methodologies for both banks and ODTIs engaged in microfinance. Cost and feasibility considerations may allow for alternative supervisory arrangements to cover numerous small institutions that pose low systemic risk, without undermining the supervisor's ability to gather information and monitor different markets.
20	Supervisory techniques	Requires specialised knowledge and supervisory methodologies for both banks and ODTIs engaged in microfinance.
21	Supervisory reporting	Should be tailored to ODTIs engaged in microfinance in a manner that is commensurate with the type and size of their transactions, which may differ from banks.
22	Accounting and disclosure	Should be tailored so that disclosure requirements for small ODTIs engaged in microfinance are based on supervisory cost-benefit considerations.
23	Corrective and remedial powers of supervisors	Requires specialised tools to deal with weaknesses in banks and ODTIs engaged in microfinance, as some corrective measures typically used in commercial or conventional retail banking will be less effective or inadequate for microfinance institutions or activities.
24	Consolidated supervision	Applies equally to banks and ODTIs engaged in microfinance.
25	Home-host relationships	Applies equally to banks and ODTIs engaged in microfinance.

Source: Adapted from Basel Committee on Banking Supervision (2010)