Microfinance Financial Sustainability in Namibia

By Jonathan Adongo

Introduction

In a stable political environment and enabling macro economy, microfinance institutions are important in providing savings, credit, funds transfer and other financial intermediation facilities to low-income households, micro-enterprises and marginal small-scale enterprises.

Effective, long-term provision of these facilities occurs through microfinance institutions that adhere to the key principles of microfinance endorsed by the Consultative Group to Assist the Poorest (CGAP).

The fourth key microfinance principle states that microfinance can pay for itself, and must do so if it is to reach ... large numbers of poor people. This advocates that microfinance institutions should strive towards financial sustainability, which is defined as the development of products and delivery systems that meet client needs, at prices that cover all costs of providing these financial services, independent of external subsidies.

To inform practitioners as they design institutional models and regulators in their efforts to boost the effectiveness of microfinance provision in Namibia this policy brief focuses on presenting the key findings of more detailed reports aimed at empirically identifying factors that influenced the financial sustainability of selected microfinance institutions in Namibia (see Further Reading section).

In that year, microfinance institutions in Namibia included:

Table 1: Microfinance Institutions in Namibia

<table>
<thead>
<tr>
<th>Category</th>
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<tbody>
<tr>
<td>Savings and credit co-operatives: SACCO</td>
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<tr>
<td>Multi-purpose co-operatives providing microfinance: MPCM</td>
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<tr>
<td>Savings and credit associations: SCA</td>
</tr>
<tr>
<td>Micro-lenders</td>
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<tr>
<td>Commercial bank microfinance branches</td>
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<tr>
<td>Non-Governmental Organizations</td>
</tr>
</tbody>
</table>

These were governed by the Division of Co-operative Development (DCD) in the Ministry of Agriculture, Water and Forestry, the Namibia Financial Institutions Supervisory Authority (NAMFISA), the Ministry of Trade and Industry Steering Committee (MTISC), the Ministry of Youth, National Youth Services, Sports and Culture or their own donor agencies.

The residual, break-even, interest rate was used to represent financial sustainability. It is defined as the absolute value of the difference between the maximum, nominal interest ceiling allowed by the Usury Act in Namibia and the break-even interest rate required by the...
Financial Sustainability

Although there has been substantial growth in the microfinance industry over the past few years, all of the selected microfinance institutions were not yet financially sustainable.

Figure 1: Levels of Financial Unsustainability

The lack of financial sustainability, across the board, for microfinance institutions in Namibia can be partly attributed to the fact that interest rates that microfinance institutions require to break-even exceed the ceiling imposed by the Usury Act of 1968.

However, raising or removal of the ceiling is not a clear policy option because it represents a conflict between efforts to protect borrowers from the adverse social impact of overwhelmingly high interest rates and efforts to increase access to financial services.

If it is to be raised or removed, it is important to first pursue alternative ways to reduce the degree of financial unsustainability. This will prevent the collapse of weak microfinance institutions, which typically results when a high influx of competitors accompanies the raising of the interest ceiling.

Potential Factors

Using Limited Dependent Variables (LIMDEP) version 7.0, which is an econometric software, the measure of financial sustainability was regressed on an Analysis of Covariance model consisting of cross-sectional data that captured various features of selected microfinance institutions in Namibia that were thought to potentially affect it using the Ordinary Least Squares statistical parameter estimation technique. These potential factors were:

Table 1: Potential Influencing Factors

<table>
<thead>
<tr>
<th>Factor</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>Support: RISE, NAMFISA, MTISC</td>
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<tr>
<td>Organizational form</td>
<td>proprietary limited, closed corporation, SACC, SCA, MPCM, special-purpose</td>
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<tr>
<td>Repayment flexibility</td>
<td>weekly, monthly, semi-annually</td>
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<tr>
<td>Donor financial support</td>
<td></td>
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<tr>
<td>Group Lending</td>
<td></td>
</tr>
<tr>
<td>Mobilized savings amount</td>
<td></td>
</tr>
<tr>
<td>Disbursed loans amount</td>
<td></td>
</tr>
<tr>
<td>Target group per capita income</td>
<td></td>
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</tbody>
</table>

While co-operatives are closely monitored and supported by RISE or the MTISC, micro-lenders are independent, private, organizations that are only regulated to the extent that NAMFISA requires them to be registered and comply with the Usury Act. Therefore, it is expected that co-operatives supported by RISE or the MTISC will be related to a higher level of financial sustainability, while those supported by NAMFISA will be related to a lower level of financial sustainability.

Based on principal-agent theory, it is expected that organization form has an effect on the behavior of microfinance managers.
Based on its effect on the effective rate of interest, which in turn has an effect on the break-even interest rate, a more frequent repayment schedule is expected to be related to a higher level of financial sustainability, even though, from a demand-side perspective, it is argued that this results in an unattractive lending product.

Donor involvement in providing start-up funds for the loan portfolio of microfinance institutions in Namibia was a feature of the original RISE supported pilot projects for establishing microfinance in Namibia. Although, this approach has been abandoned in their more recent pilot projects in northern Namibia, it is interesting to include this factor as a post-mortem assessment.

Group lending is expected to be related to a higher level of financial sustainability because the peer pressure that group members exert on each other should lead to lower default rates on the number of loans disbursed.

On one hand, the amount of savings mobilized is expected to be related to a lower level of financial sustainability because it increases interest expenses, which is a major cost item. On the other hand, it is expected to be related to a higher level of financial sustainability because savings provide credit information that can be used to assess the eligibility of a borrower at a reduced cost to the lending process.

The amount of loans disbursed is expected to be related to a higher level of financial sustainability because it represents a lower per unit cost of lending.

A higher level of target group per capita income is expected to be related to a higher level of financial sustainability because this is associated with more borrowing for productive purposes as opposed to consumption and lower default rates.

**Key Findings**

From all the factors that could potentially influence the financial sustainability among the selected microfinance institutions in Namibia, there is evidence that MPCMs are related to a lower level of financial sustainability. This can be attributed to the fact that they are currently the only category of microfinance institutions, for which data was available, that were providing both financial and non-financial services and did not separate the costs of providing non-financial from those of providing financial services in their reporting to the Registrar of Co-operatives.

Evidence also exists that donor involvement in providing start-up funds for the loan portfolio is related to a higher level of financial sustainability. This finding implies that donor support can give a false impression of financial sustainability and can be attributed to the formula used to calculate financial sustainability, which does not differentiate the sources of funds used to cover costs, even though the definition of financial sustainability emphasizes independence from donors or government.

In addition, evidence exists that group lending is related to a lower level of financial sustainability. This implies that group lending service delivery strategies can be complemented by the adoption of credit and risk management tools aimed at reducing default rates and other technological innovations aimed at reducing operational costs in the microfinance industry.

Finally, there is no evidence that a lower target group per capita income is related to a lower level of financial sustainability. This implies that the microfinance solution can be used to improve the livelihoods of the marginalized members of society.

**Usury Rate**

Microfinance institutions in Namibia should adopt operational, financial and technological innovations to achieve financial sustainability, before the interest rate ceiling imposed by the Usury Rate Act of 1968 is raised or removed. This should prevent widespread collapse of weak microfinance institutions, which will have an adverse effect on the society.
Recommendations

1. Multi-purpose co-operatives providing microfinance should separate the cost of providing financial and non-financial services in their reporting to the Registrar of Co-operatives.

2. Donors and Government should formulate and implement a clear-cut strategy to wean microfinance institutions off subsidies in the provision of financial services to prevent the creation of a false impression of financial sustainability in the industry.

3. Microfinance institutions should adopt operational, financial and technological innovations such as small business credit scoring tools to increase the number or size of loans disbursed without compromising the integrity of the loan portfolio and to reduce default rates.

4. Regulators and practitioners should ensure that information reported to and by them is reliable by engaging an external audit partner. This will allow them to effectively monitor progress by microfinance institutions in Namibia towards attaining financial sustainability.

Further Reading


Downloadable at www.nepru.org.na

Funded by:
FinMark Trust
www.finmarktrust.org.za