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Innovative Approaches to Delivering Microfinance Services: Credit Indemnity in South Africa

Gerhard Coetzee, Richard Bates and Nthabiseng Mokobori

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Executive Summary

The objective of the study was to document Credit Indemnity's process of transformation. They started as a small short term lender that commenced operations more than a decade before the rest of the South African micro lending industry really started. Today they are part of a listed company and operate on a cash loan and repayment basis out of 118 branches covering the whole country. This study documents the process, its success and hurdles, through the eyes of its management, staff, clients and other stakeholders in the financial industry. It also identifies areas in which the organisation needs to improve.

Credit Indemnity was launched in 1978 in Pietermaritzburg when an estate agent and building contractor purchased it as a concept organisation. Credit Indemnity had developed basic lending procedures but had not, at that stage, developed a client base. The market, which it identified, was not served to any extent by the formal financial services sector. Credit Indemnity based its lending on strict procedures which formed the foundation for its future success. The procedures included essential credit checks and introduced a manual scorecard system to assist in the processing of applications. Loans were disbursed and repaid in cash. The organisation had very little competition to begin with and the business grew primarily from retained earnings. A second branch was opened in 1983 in Durban followed by a third branch in 1987 in Pinetown (all three of these branches were in the KwaZulu Natal province).

Up to 1992 the micro lending industry in South Africa operated in an uncertain legal environment with the Usury Act placing a ceiling on interest rates, which made the achievement of financial self sufficiency in the high risk, small loan business difficult, if not, impossible. In 1992 an exemption to the Usury Act was granted with regard to removing the ceiling on interest rates which could be charged on loans under R6,000[1] (subsequently increased to R10,000 in 1999). This provided impetus for the micro lending industry to expand.

Credit Indemnity opened its fourth branch in Ladysmith in 1993. Between 1993 and 1998 the branch network increased to 23 branches in KwaZulu-Natal. The company remained a family owned business up to 1998 when 35% of it was sold to African Bank Investments Limited (a bank holding company registered on the Johannesburg Securities Exchange) which purchased the balance of Credit Indemnity's shares in 2000.

During the period 1978 to 1998 Credit Indemnity offered only one product, a four month loan at a flat interest rate of 7.5% per month. The interest rate remained the same from 1978 to 1998.

From 1998 to 2002 Credit Indemnity increased its branch network from 23 to 118 branches nation wide. Its loan advances increased from R 169 million in 1998 to R 722 million in 2002. This amounted to a 5 fold increase in the branch network and a 4 fold increase in loan advances. Staffing increased from 173 in 1998 to 1100 in 2002, a 6 fold increase.

Following the takeover of Credit Indemnity by African Bank Investments Limited the primary strategic focus of Credit Indemnity was to achieve profit warranties. At the same time it focused on the expansion of its branch network to increase its market share. During the period 1998 to 2001 the culture of Credit Indemnity was changed from that of being a family owned business to that of a corporate one.

Credit Indemnity increased its product range to include one-month, six-month and twelve-month loans. It also changed its interest rate policy with rates varying according to loan risk and loan term. The majority of its loans, however, continue to be for a period of four months.

[1] One US dollar is equal to R6.50 in December 2003.

Achievements of the model

The immense and quick expansion of branches, staff, clients and portfolio was a major achievement. This expansion did not happen automatically and the following aspects are seen to be central to the successful expansion:

- One of the important contributions to the success of Credit Indemnity is a close-knit and dedicated senior management team. All efforts are made by the members of this team to lead by example and to ensure that they work integrated with the rest of the staff. It is clear from interactions with the staff and management that their efforts indeed are successful.

- Simple product offering well understood by clients and staff. This was standardized at such a level that the product was largely commoditized and training modules, branch structure and operations were standardised. All systems are well documented and practice and procedures throughout the company are similar.

- In addition customer service is of paramount importance and all customers interviewed echoed their satisfaction with the Credit Indemnity service.

- Relative efficient cost structure due to efficient systems and standardized products and systems. This links closely with the standardization or "commoditisation" of their most prominent loan product, the four month loan.

- Credit Indemnity has a good data base that spans five years of transactions and they use it well in terms of the score cards they apply and the continuous profiling of customers during all facets of the loan cycle. Their loan management and management information system, Duzi, was developed internally and contributes to the positive results from applying score cards and profiling methods. Indeed, they also have a dedicated in-house specialist that works on the scoring and profiling systems.

Having transformed from a family owned provincially based organisation to a corporatised nationally spread organisation Credit Indemnity now faces challenges resulting from its rapid growth in a high risk and highly competitive market. It is concerned about the sustainability of the micro credit industry, in its current format in South Africa, maintaining that the market is supply and not demand driven. They are facing these challenges by relying on their core success aspects, and already since the information for this report was collected more positive changes took place.

Challenges for Credit Indemnity

- Challenges in ensuring a good relationship with its owner, African Bank Investment Limited and keeping to its core values and success recipe. It is also important to note that the linkage of an MFI with a significant corporate group provides exciting opportunities.

- Although the current vision and mission chartered a new course for Credit Indemnity, it is important to ensure continued attention to the establishment of a clear mission statement and objectives together with the development of a strategic plan. This will enable Credit Indemnity departments to be in a position to improve their contribution to the organisation's future.

- Credit Indemnity sees the establishment of a savings led loan to informal sector borrowers as an important research and development area. This in itself will prove to be a major challenge, but is seen as an essential step towards expanding the client base and services provided to clients.

- Credit Indemnity maintains that, as a result of the saturation of the micro loan market, the impact of reducing the interest rate will not result in a rapid increase in market share. However, they are of the opinion that the first MFIs that take this step will be market leaders and will be difficult to beat. Recent reports of other leading microlenders reducing interest rates are quite positive in terms of increased portfolios. It shows that clients are becoming more price sensitive in the South African market. Another aspect of interest rates is client affordability. Credit Indemnity believes that, at current rates, loans are becoming unaffordable to borrowers.

- Credit Indemnity currently provides a number of loan products, which vary according to term, interest rate and profile of applicant. It has identified that it needs to diversify its product offering. Current clients have indicated a need for other products. Credit Indemnity considers that offering other products will increase its client base and improve its revenue generation and sustainability. This should be comprehensively addressed. The partnership with ***MicroSave*** and the inherent quality and experience of key Credit Indemnity staff will benefit the institution in this regard.

In South Africa micro lending, as confirmed by Credit Indemnity, still has a poor public image – that of high cost loans are made to poor people. The negative image of "loan sharks" is prevalent. In most arenas of development, access to finance is seen as being a necessity. As a result of this, greater focus can be expected to be directed at the financial services industry by the public and government. Formal banks are well aware of the pressure being placed on them to increase access to financial services for poor people (leading to the financial services charter signed in late 2003).

Credit Indemnity is a leader in the provision of micro loans in South Africa. It has developed technology, policies, procedures and operational skills, which currently place it at the forefront of its industry. With Credit Indemnity's public image and its wish to increase the depth of its outreach it will have to take cognisance of the issues around providing financial services to poor people, while at the same time maintaining financial self-sufficiency. Its policy, procedures and technology are currently geared for a well-defined market, changing this will change operational requirements and the risk profile of its business.

With the addressing of challenges identified above and development of new products according to demand and based on structured planning Credit Indemnity has the potential of remaining a leader in its field. It indeed has the management capacity and commitment to cross new borders. However, the potential conflict between the demands and aspirations of its shareholder, versus the building and positive use if its image in the mind of customers and its own culture and values, should be carefully managed.

Lessons for Mainstream MFIs

Credit Indemnity’s success is based on a focus on a few main areas, leading to their establishment in the market, growth and quick expansion to where they are today. They emphasised a good management team, a simple product offering well understood by clients and staff, a relative efficient cost structure largely due to standardisation and a high reliance on good and automated information systems that is continuously used in loan allocation and management of all facets of the loan cycle.

It is clear that the massive expansion of their portfolio would not have been possible without these aspects being in place, and without continuously improving on these aspects. It is especially the standardisation of their core product that put them in a position to expand, without loosing control. They were also able to live through their quick expansion as they had good and flexible systems that accommodated all the pressures of growth. It must be noted that they work continuously in improving these systems.

Lastly, they also realised that although their core standardised product is a good fit for their core market, they will have to do market research to ensure that they expand their product range and clientele over time. Continued growth cannot happen on the back of the same product, offered over many years. Credit Indemnity has a strong marketing and research department who are working towards the design of new products and delivery systems in the market.

Recommendations for Donors

Until recently, Credit Indemnity had little exposure to donor institutions. Their expansion is self financed and the company is part of a group listed on the Johannesburg Stock Exchange. However, they realised the benefit of receiving technical assistance and actively learned from the lessons of other MFIs. In their quest to improve themselves they started to work with donor funded programmes (like ***MicroSave***).

This represents a bold move by a consumer finance focused institution in South Africa. Credit Indemnity's own in-house research, bolstered by research by the MicroFinance Regulatory Council (2003) in South Africa indicated that their clients do not only use loans for consumption related expenditure. This led them to the investigation of new markets, new products and delivery systems. Unfortunately the donor world still chooses to stereotype consumer finance institutions as not being part of the microfinance world (which is largely seen as enterprise finance).

Donor programmes in microfinance would benefit tremendously from interacting with consumer financiers with established markets, products and systems towards an expansion of products that could include emphasis of savings and enterprise finance. This could result in a wide outreach with respect to enterprise finance as illustrated in this chapter (see section 1.3 and Table 3). The emphasis of donor support in this instance would be on technical support, and exposing the consumer finance institutions to international best practice. On the other hand, the international microfinance world will also benefit from being exposed to the aspects that made Credit Indemnity a successful institution, something that could easily be facilitated by donor institutions.

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1. Introduction

MicroSave is undertaking a series of studies looking at various approaches to provide innovative financial services to the poor. The objective is to learn from the lessons of existing innovative institutions. Learning should both be by the institutions and lessons for the microfinance fraternity. This paper focuses on the experience of Credit Indemnity a microfinance institution in South Africa.

The objective of the study was to document Credit Indemnity's process of transformation. They started as a small short term lender that commenced operations more than a decade before the rest of the South African micro lending industry really started. Today they are part of a listed company and operate on a cash loan and repayment basis out of 118 branches covering the whole country. This study documents the process, its success and hurdles, through the eyes of its management, staff, clients and other stakeholders in the financial industry. It also identifies areas in which the organisation needs to improve.

The study of the operations and management systems of Credit Indemnity was required to address, inter alia, outreach and sustainability, governance and management and indeed any innovations that led to their success.

In addition to the foregoing, the study was required to assess the opportunities and constraints in respect of the improvement of products and services offered and the organisational support that would be required to achieve this, funding issues and the potential to replicate Credit Indemnity products and systems outside of South Africa.

The next section starts with the history and context of Credit Indemnity, and reflects the service orientation that embodies one of the key cultures of the organisation. Section three looks at Credit Indemnity's approach to the market, while section four reflects the governance and ownership issues, and also highlights one of the key challenges that need to be dealt with by Credit Indemnity. Sections five and six look at management and measurement of performance, while sections seven and eight cover human resource management and the profitability of the organisation. The last two sections summarise the lessons and remaining challenges for Credit Indemnity.

1.1 Context

1.1.1 Credit Indemnity 1978 to 1998

Credit Indemnity was launched in 1978 in Pietermaritzburg (KwaZulu-Natal Province in South Africa) when an estate agent and building contractor purchased it as a concept organisation. Credit Indemnity had developed basic lending procedures but had not, at that stage, developed a client base. The market, which it identified, was not served to any extent by the formal financial services sector.

Credit Indemnity based its lending on strict procedures which formed the foundation for its future success. The procedures included essential credit checks and introduced a manual scorecard system to assist in the processing of applications.

Loans were disbursed and repaid in cash. The organisation had very little competition to begin with and the business grew primarily from retained earnings. A second branch was opened in 1983 in Durban followed by a third branch in 1987 in Pinetown.

Up to 1992 the micro lending industry in South Africa operated in an uncertain legal environment with the Usury Act placing a ceiling on interest rates, which made the achievement of financial self sufficiency in the high risk, small loan business difficult, if not, impossible. In 1992 an exemption to the Usury Act was granted with regard to removing the ceiling on interest rates which could be charged on loans under R6,000 (subsequently increased to R10,000 in 1999). This provided impetus for the micro lending industry to expand.

Credit Indemnity opened its fourth branch in Ladysmith in 1993. Between 1993 and 1998 the branch network increased to 23 branches in KwaZulu-Natal.

The company remained a family owned business up to 1998 when 35% of it was sold to Nisela. Nisela became Theta Investment Limited, which was itself acquired by African Bank Investments Limited, a bank holding company registered on the Johannesburg Securities Exchange. In 1999 the balance of the company was purchased by Theta.

During the period 1978 to 1998 Credit Indemnity offered only one product, a four month loan at a flat interest rate of 7.5% per month. The interest rate remained the same from 1978 to 1998.

1.1.2 Credit Indemnity 1998 to 2002

From 1998 to 2002 Credit Indemnity increased its branch network from 23 to 118 branches nation wide. Its loan advances increased from R 169 million in 1998 to R 722 million in 2002. This amounted to a 5 fold increase in the branch network and a 4 fold increase in loan advances. Staffing increased from 173 in 1998 to 1100 in 2002, a 6 fold increase.

African Bank Investment Limited has subsidiaries involved in banking, African Bank, insurance, Stangen, and investment, Theta Investment Limited. Theta Investment Limited is currently being absorbed into African Bank, which means that Credit Indemnity will become a subsidiary of the bank. It is estimated that there is currently a 30% to 40% overlap of the Credit Indemnity and African Bank client base.

The main differences between Credit Indemnity and African Bank operations are that Credit Indemnity's loan delivery and collection is principally cash based while that of African Bank is electronic based and African Bank's loan terms are longer. The presence of two organisations within the same group carrying out similar operations raises questions of efficiencies, which could give rise to review and restructuring at some stage.

African Bank Investment Limited (a smaller bank only offering credit services) has entered into a joint venture with Standard Corporate and Merchant Bank Limited, one of the larger South African banks. This linkage is significant in terms of increasing the depth of outreach of the formal banks (direct or indirectly) into the under or unbanked population groups of South Africa.

Following the takeover of Credit Indemnity by Theta Investment Limited the primary strategic focus of Credit Indemnity was to achieve profit warranties. At the same time it focused on the expansion of its branch network to increase its market share. During the period 1998 to 2001 the culture of Credit Indemnity was changed from that of being a family owned business to that of a corporate one.

Credit Indemnity increased its product range to include one-month, six-month and twelve-month loans. It also changed its interest rate policy with rates varying according to loan risk and loan term. The majority of its loans, however, continue to be for a period of four months.

The immense and quick expansion of branches, staff, clients and portfolio was a major achievement. This expansion did not happen automatically and the following aspects are seen to be central to the successful expansion:

- Close knit team of managers that are motivated and work together well at executive level
- Simple product offering well understood by clients and staff. This was standardized at such a level that the product was largely commoditized and training modules, branch structure and operations were standardised. All systems are well documented and practice and procedures throughout the company are similar
- Relative efficient cost structure due to efficient systems and standardized products and systems
- Credit Indemnity has a good data base that spans five years of transactions and they use it well in terms of the score cards they apply and the continuous profiling of customers during all facets of the loan cycle.

Having transformed from a family owned provincially based organisation to a corporatised nationally spread organisation Credit Indemnity now faces challenges resulting from its rapid growth in a high risk and highly competitive market. It is concerned about the sustainability of the micro credit industry, in its current format in South Africa, maintaining that the market is supply and not demand driven. They are facing these challenges by relying on their core success aspects, and already since the information for this report was collected more positive changes took place.

1.2 The economy

South Africa has a well diversified economy where nearly two thirds of activity and contribution takes place in the services sectors. After a declining economic growth rate until the early nineties political changes and prudent financial and economic management led to positive economic growth, slowly increasing growth rates and a generally positive economic outlook. This is especially true when comparing South Africa with other developing countries. After a near collapse of its currency at the end of 2001 it managed to recover and bring back the currency value to a level near to its internationally accepted valuation. Unemployment is still high, structural and also a result of the fact that service orientated economies requires skilled workers, which is in short supply in South Africa. Over the last decade the SMME sector grew tremendously, now contributing nearly 38% to the South African GDP and engaging nearly 50% of the economic active population in South Africa. This area of activity faces many constraints, including the rigid rules and regulations still hindering the creation and operation of SMMEs, and a lack of access to financial services.

Its financial sector is viewed as well developed for a third world country and its commercial banking sector serves the population from 45 banks out of approximately 3600 branches. Nearly the same number of international banks has a presence in South Africa, however, with negligible emphasis on retail financial services. Near to 90% of bank assets and market is concentrated in four big local banks. These banks all have international presence and three of them have a solid presence on the continent. Unfortunately, the conventional commercial banking sector does not offer a broad range of financial products to the poor. Until about eight years ago they provided savings facilities to the poor, but little more. They were most urban based and still show a decline in rural bank branches through a process of closure of branches.

Recently conventional commercial banks started showing an interest in the microfinance market with several acquiring part or full ownership of microfinance entities, or engaging in joint ventures or strategic partnerships. This lead to some lessons learned and in the wake of some failures in the microfinance sector also to apprehension on these portions of their portfolios. At the moment this is an interesting phase in the development of the microfinance portion of the broader financial market. Microfinance focused institutions are continuously trying to broaden their market presence through improvement of systems and technology. Commercial banks are also interested but not entirely convinced on the most appropriate strategies, and in the process, acting in contradicting ways. For example, some commercial banks are increasing their exposure to the microfinance market, while the same banks may be making it more difficult for small savers to open accounts by raising the hurdles in the form of higher account opening and minimum balances and closing branches in poorer areas. The pending financial services charter[2] that will be signed by the commercial banks in 2003 will also serve as a big motivation to enter the "unbanked" market.

1.3 The microfinance "market"

Until 1992 microfinance institutions in South Africa largely consisted of state supported financial retailers or development finance institutions (DFIs) and non-government institutions (NGOs). The DFIs were mostly operating at provincial level, while the NGOs were spread around the country. Both the DFIs and the NGOs declined in importance as the private sector took a foothold in the microfinance sector in South Africa. However, until 1992 they were the important actors and they largely focused on the financing of entrepreneurs. In 1992 the government changed the Usuary Act in South Africa that

[2] The concept of a charter rests on the attempt of the South African government and private sector to ensure more asset accumulation, access to economic opportunities and active participation for black South Africans who had little opportunity under apartheid to accumulate assets and participate in the economy. The first charter signed was in the mining and energy fields, while the financial services charter was signed on 17 November 2002.

opened a window for loans under R6 000 to have no interest rate ceiling (with a few additional rules). This brought a range of players into the market. In the early years these were mostly small operators that provided cash loans (pay day loans) to low income South Africans. These were quickly followed by term loan providers that would provide loans over 6 to 36 months. In the beginning this was a market where little rules applied. Although it opened access to financial services for many South Africans, it also opened up opportunities for exploitation and many low income earners fell victim to unscrupulous practices.

In 1999 the government reacted by creating the Microfinance Regulatory Council and lifting the ceiling to R10 000. The MFRC's task in essence was to establish integrity in the market. In the same period the market started consolidating, several commercial banks entered the scene and specialised microfinance commercial banks were established. Most of the conventional commercial banks structured arms length relationships with their microlender subsidiaries or partners. It became a sizable sector and touched the lives of many people. In the next table, an indication of the client groups (according to living standard measurement categories) is provided. It is clear from the table that in almost all the lower income categories access to conventional commercial bank accounts declined. Note that this is access to formal sector commercial bank accounts.

Table 1: Some salient features of Living Standard Measurement Categories in South Africa

LSM	Number 16 to 64 years old	Average annual h/h income in R	Any bank account	Any bank account
	1998	2000	1998	2000
1	2,808,000	R 8,952	0%	3%
2	2,621,000	R 10,428	16%	11%
3	3,208,000	R 12,432	18%	17%
4	3,147,000	R 17,628	30%	29%
5	3,831,000	R 25,344	34%	43%
6	3,572,000	R 42,792	44%	62%
7	3,274,000	R 87,540	74%	78%
8	3,259,000	R 157,308	94%	98%

Source: IGI Consumer Scope, 2000.

In the next table, outreach of retail financial institutions focused on the low income market is indicated. Here it is clear that institutions have a sizable outreach. In this table we look at all financial institutions interacting with the poor.

Table 2: Outreach of retail finance for the poor and low-income in South Africa

Retail Institutions	Loans Rand million	Savings Rand million	Number of Outlets	Number of Loan Accounts	Number of Savings Accounts
Public Sector	205	1,774	2,434	63,028	2,650,000
Private Sector	14,259	4,703	9,427	4,497,766	4,711,114
Informal sector	400	1,760	1,150,000		14,750,000
Total	14,864	8,237	1,161,861	4,560,794	22,111,114

Source: Coetzee and Grant, 2000.

It is clear from the table that the private sector in South Africa plays the biggest role in terms of the provision of financial services to the poor. Most of these institutions are listed on the Johannesburg Stock Exchange and the bulk of outreach is from registered commercial banks.[3] However, the biggest component of this private sector outreach is in the form of consumer finance if we analyse the supply side in terms of institutions (and what we know of their financial products and focus).

Further estimates, based on the results of a range of sample surveys, indicate that there may be a considerable leakage of consumer finance to entrepreneurial finance. The next table provides some estimates in this regard. Note that this table represents an estimate of one directional leakages, from

[3] Note that the latest information from the MFRC indicates that registered banks have the biggest presence in the market with up to 80% of advances measured in Rand terms coming from them.

consumer finance to entrepreneurial finance. It gives no estimate or indication of the possible leakage from entrepreneurial finance to consumer finance.

Table 3: Outstanding loans and estimates of loan allocation for enterprise finance			
Loans mostly for	**Loans Rmillion**	**Outlets**	**Loan accounts**
Enterprise finance	343	119	163,069
Leakage at 4 %	565	373	175,909
Leakage at 10 %	1,412	933	439,773
Leakage at 20 %	2,824	1,866	879,545
Source: Coetzee and Grant, 2000			

If the leakage from consumer finance loans to enterprise finance is estimated at about 10 percent outreach increases from approximately 163 069 loan accounts to 439 773 loan accounts.

The point is that the industry became sizable, organised and improved its integrity over the last few years. It is estimated that there are more than 1 300 microfinance institutions in South Africa, and that they use more than 9 000 outlets to reach clients (MFRC Annual Report, 2001). This easily leads to an industry with approximately 30 000 people working in it.

1.4 Regulation
Following the rapid growth of the micro lending industry from 1992 and concern being registered from many quarters regarding questionable practices within the industry the Micro Finance Regulatory Council was established in 1999, in terms of an exemption to the Usury Act, to regulate the industry and ensure that acceptable lending practices prevailed. All micro lenders were acquired to register with the Council.

Money lenders who do not lend more than R10,000 for a maximum period of 36 months, and comply with the Usury Act exemption requirements and are members of the Micro Finance Regulatory Council (MFRC) are exempt from certain provisions of the Usury Act, 1968 (Act No. of 1968).

A lender complying with the Usury Act exemption requirements may charge interest rates greater than those set as the maximum in terms of the Usury Act, as determined from time to time. In addition the lender must comply with required loan information disclosure rules and must not employ loan collection procedures disallowed by the Usury Act exemption.

Credit Indemnity is a member of the MFRC and complies with requirements in terms of the Usury Act exemption.

2. The Model
The general picture that one obtains in encountering Credit Indemnity is that its employees and clients express a feeling of happiness with the company, its policies, management and products. The majority of clients participating in focus group discussions stated that they do not wish to do business with any other MFI.

Staff expressed the opinion that Credit Indemnity is "the best company and are happy to work for it". This message was consist in all Credit Indemnity branches that were visited. The friendliness of Credit Indemnity's staff was apparent at all the branches. Furthermore, the services offered in different branches were uniform which makes it easier for staff and clients.

2.1 Customer Service – paramount
Credit Indemnity is promoting "Superior customer value" which it expects to lead to "Customer satisfaction and delight" which in turn will lead to "Customer loyalty" which should give rise to "Long term profitable relationships".

Credit Indemnity has a policy, which states that customers come first. It informs its customers about all aspects of their loans and educates them about products and opportunities.

Customer service was identified in the staff focus group discussions as the most important aspect, which contributed to the growth of Credit Indemnity. Staff felt that Credit Indemnity offered outstanding customer service. "Staff is helpful, patient, listen to clients' problems and provide advice. Staff is always smiling". Service time is quick with loans being able to be approved and disbursed within an hour, as long as all requirements are met.

Credit Indemnity maintains contact with its clients, even after they have settled their accounts, with follow up calls being made. This is used as a technique to retain clients and make them feel valued by the company. As a result, clients have trust in the company. Trust tends to be mutual.

This focus on clients and client service must be one of the most important lessons from this study. It permeates through the systems and approaches, visible in follow-up and after sales services, even for customers who have serviced and completed their loan repayments.

2.2 Products, Marketing and Clients

"Cash loans to help you" is the advertising phrase used by Credit Indemnity. It has retained a simple product range with a number of loan products being made available. They are differentiated according to loan amount, term and interest rate according to loan risk and client profile.

Table 4 shows the level of risk attached to each client profile and the amount, term, and interest rate pertaining to each client category. The client profiling system used by Credit Indemnity in its credit scorecard approach will be dealt with at a later stage, as it is an important component of its lending policy and procedures.

The interest rates indicated are flat rates, which amounts are added to the loan at its commencement. Under normal circumstances an applicant's loan repayment instalment should not exceed 20% of his/her salary.

Table 4: Loan categories by risk, profile, term, interest rate and loan levels

Risk	Profile	1 Month			4 Month			6 Month			12 Month		
		Min R	Max R	Rate	Min R	Max R	Rate	Min R	Max R	Rate	Min R	Max R	Rate
Low	Diamond & Platinum	-	-	-	200	6,000	7.75%	1,500	6,000	7.5%	1,000	10,000	5.5%
	Gold & Silver	-	-	-	-	-	-	-	-	-	1,000	6,000	5.5%
Medium	Gold & Silver	-	-	-	200	6,000	9.5%	1,500	6,000	9.5%	-	-	-
High	Bronze & Steel	200	700	20%	200	4,000	11.75%	-	-	-	-	-	-
	Tin, Ore, 1st time and New accounts	200	700	20%	200	4,000	11.75%	-	-	-	-	-	-

Information provided by Credit Indemnity showed that its clients used loans for the following purposes:

- Educational purposes (31%)
- Paying the accounts (22%)
- Home improvements / building (13%)
- General use -food, clothes, rent etc (9%)
- Vehicle repairs (6%)
- Funeral (5%)

Other than home improvements, the usage of loans would appear to be primarily for consumptive and emergency purposes.

Credit indemnity has identified that it needs to develop new products to retain existing clients and to obtain new clients. These are planned to involve a savings led product, a weekly and fortnightly loan product with the aim of better servicing the needs of weekly wage earners and a revolving credit product to allow clients to better manage their credit needs on a more flexible basis. This, however, requires extensive changes to be made to the information system (DUZI) to accommodate the process. Credit

Indemnity is also piloting the provision of financial services through retailers. The focus group discussions carried out in this study indicated that clients wished to have access to longer term, lower cost loans.

In general the majority of clients access the standard four month loan of Credit Indemnity. This is the core product and well known amongst clients and staff. In essence it has been standardised to a level where the management called it a commoditised product. This standardisation is across branches and regions and the rules, systems and procedures related to this product is well known, well documented and kept to by staff. This standardisation backbone is another part of the success recipe, as it served CI well during the massive branch expansion phase. Now, with an established client base, branch infrastructure and well trained staff is the company looking to new products and new delivery systems.

Marketing

Credit Indemnity takes an aggressive approach to marketing. It undertakes research to understand the market and to develop appropriate products. The market research, which Credit Indemnity has undertaken has provided a great deal of important information to the organisation. Its market knowledge is impressive and stands it in good stead to take important decisions regarding its future.

As a result of its marketing initiatives Credit Indemnity has established a recognisable brand in the micro lending industry. Marketing and promotion of products are undertaken via advertising in the local press, through pamphlets and the distribution of promotional products and competitions and through direct marketing by field marketers operating in branch areas.

Use is being made of the in house developed management information system (MIS) called DUZI to list clients by employer to enable focused presentations to be made to them. "Field Marketers" are used to make presentations in factories and other places of client employment. These Marketers are dedicated employees who also provide information at street level by distributing loan applications and relevant information. Approximately 20% to 25% of loan applications are facilitated via this process.

There is a substantial amount of competition in the market. Table 5 lists financial institutions, identified in the focus group discussions, operating in the same areas as Credit Indemnity. The ranking of the usage of these financial institutions five years ago, three years ago and this year are indicated by way of a star rating.

Commercial banks are used by Credit Indemnity’s clients to deposit salaries and to hold savings. In addition they are used to access long-term loans, such as mortgage bonds, 32% of Credit Indemnity's clients have home loans from commercial banks.

In respect of MFIs the popularity of, not to mention the legality of, those that take client bank cards and PIN numbers as security for loans has declined. It will be seen, however, that the popularity of those MFIs operating on a similar basis to Credit Indemnity has increased. There are a number of newly established MFIs indicating increasing competition in the sector.

Stokvels (ROSCAs) retain their popularity and would appear to offer greater returns to their members than MFIs in terms of profit sharing and other benefits of membership.

The focus group discussion response indicates that Credit Indemnity faces competition from a number of areas, these being formal banks, other MFIs of various size, retail businesses and traditional ROSCAS. As can be seen from the table a number of competitors are new and a number are well established.

Although the commercial (formal) banking sector has experienced a number of setbacks with the provision of micro finance in the recent past it can be expected to be consolidating its position prior to further development of services. The formal banking sector has a significant strength in that it has a developed savings base.

Table 5: Financial sector trend analysis (discussions at three branch areas)

Financial Institutions	This Year	3 years Ago	5 Years Ago	Comments
Commercial Banks:				
ABSA	***	**	*	Due to alleged fraud cases that were occurring within the bank some couple of years ago many people lost trust in the system. But as these cases were resolved people started using the bank again mainly for savings.
Standard Bank	***	***	***	Many people use this bank for saving purposes. This is the second most popular bank after FNB among many people since it has been operating for a while as compared to other commercial banks.
First National Bank	*****	*****	*****	This is the most popular bank around and it has been operating for a while and has built trust among the people in the area. They have a lot of clients depositing their salaries.
NBS	***	**	***	They did not know about the operations of NBS but stated that they have noticed that many people are using this bank.
Nedbank	**	****	*****	Previously, many people were using it because it was new, now Nedbank has been closing some of its branches around the area (where the focus group discussions took place).
MFIs:				
Consumer Credit	**	***	*****	This institution was very popular five years ago because it used to give out a lot of cheap loans. And the competition around the area was not tough as compared to a couple of years later.
Microsure	***	**		This is a new institution around the area. Clients allege that they take people's bank cards.
Louhen Consultants	*	***	*****	Due to competition around the area their popularity has declined dramatically. According to clients many people have stopped using this institution because it retains people's bank cards.
Bridge Holdings	***	***	***	This institution has been steady throughout and they operate more or less like CI. They share clients with CI because they normally call CI for clients' references.
Anchor Finance	*****	*****	*****	This institution has been steady throughout and it is regarded as the main competitor to CI. They also share the clients with CI and they normally call CI for clients' references
Thuthukani Financial Services	**			It is not very popular and gives out very small loans. Participants argued that their impression is that this institution is targeting the 'underprivileged' people
Finaid	*			Just started in the areas where FGDs took place, and gives small loans. Many people are not aware of it.
Others				
Furniture shops	*			Many people were not aware that furniture shops offer loans. People have just started using them lately.
Clothing shops	**			Many people think clothing shops impose higher interest rates.
Stokvels	*****	*****	*****	Stokvels are very popular among many people. CI staff stated that this institution is their major competitor because clients usually take loans from CI to pay their debts in stokvels. The latter basically helps members with groceries at the end of the year. The interest rates are high compared to MFI's , however members are happy because they share the profits and all benefits at the end of the year.

Legend: Level of use of organisation:

*	**	***	****	*****
Very low	Low	Intermediate	High	Very high

Client exit interviews conducted by Credit Indemnity indicated that 30% (n=483) made use of competitors with 63% of them stating that competitors were used because of their service. It should be noted however, that 89% of the people interviewed rated Credit Indemnity as good/excellent.

To maintain contact with clients and to provide relevant information Credit Indemnity producers a monthly newsletter titled "Impempe" (The whistle). The newsletter contains basic financial information, competitions and profiles of clients.

The interaction with Credit Indemnity staff and clients by the research team indicated a high awareness amongst them of its products, policy and procedures. This would indicate that its communication and information distribution systems are achieving a high level of success.

2.3 Loan delivery and collection

Applications for loans can be made via various methods, these being direct application at a branch or remote application by telephone, fax or internet. For applications not made at a branch, final approval requires the applicant to be physically present at the branch concerned.

For an applicant to obtain a loan he/she must:

- be at least 18 years of age.
- must have a South African identity document and be a permanent resident of South Africa and must be able to provide details of a physical home address.
- be easily contactable via their own, a relative’s and/or an employer’s telephone.
- be permanently employed, and be able to present a payslip.
- have been employed for more than six months with the current employer otherwise they must be able to show that they have been employed for at least 12 months with a previous employer.
- provide details of close relatives, who are employed and are contactable as well as personal, banking and trade references.

If an applicant is not permanently employed and is self-employed or a temporary worker, he/she may not be advanced a loan. If an applicant is a contract worker he/she must be able to show that the remaining term of the contract is 1.5 times longer than the requested loan term.

Once an applicant has met the requirements for a loan, a loan can be approved and disbursed within an hour. Loans are disbursed in cash. The overall loan approval rate is currently 33%, which is a reduction from the previous rate of 40%. Credit Indemnity ascribes this fall to the current weak economic conditions prevailing in South Africa.

Loan approval is based on the use of the Credit Indemnity’s scorecard system. For "first-time applicants" the application approval is based on a matrix comprising scoring information from a credit bureau and information based on an applicant’s information provided in respect of demographics in respect of age, gender and income and stability factors in respect of address and the ability to contact the client by telephone.

The information provided by the scorecard gives the Credit Indemnity official an indication of whether a loan can be granted or not. The outcome indicates definite rejection or approval with a central area indicating that the official requires taking a decision with regard to the size of loan and the rejection or approval thereof.

For "repeat loans" a different scorecard is utilised. This scorecard utilises behavioural information obtained from the clients past performance. A client is required to have a minimum of six months performance. The scoring for this scorecard is adjusted monthly according to the latest client information. Clients are rated in respect of risk categories. These categories determine the amount, which can be advanced to the client, the maximum term and the interest rate to be charged as well as the procedures to be adopted if the client falls into repayment arrears at any stage.

As at the end of Credit Indemnity's 2002 financial year the loan portfolio amounted to R265 million. Table 6 indicates an increasing loan portfolio for the period 2000 to 2002. Table 6 also shows loan balances by product and the proportion of the various products in the portfolio for the financial years 2000, 2001 and 2002. The 4 month loan is the most important product with 70% to 80% of the loans been made in this category.

A 12-month loan was introduced in 2001. It would appear that increasing use is being made of this product.

Table 6: Loan balances by loan product for period 2000 to 2002.

Financial year	Loan Period months – Value					Grand Total
	1	2	4	6	12	
Sep-2000	R 8,199	R 2,685,983	R 113,085,032	R 32,648,112		R 148,427,326
Sep-2001		R 253,121	R 187,170,605	R 18,083,413	R 16,051,361	R 221,558,501
Sep-2002	R 1,211,462	R 3,810	R 196,024,455	R 35,082,128	R 32,607,629	R 264,929,484
Total	R 1,219,661	R 2,942,914	R 496,280,092	R 85,813,653	R 48,658,990	R 634,915,310
	Loan Period – percent of portfolio					
	1	2	4	6	12	
Sep-2000	0.01%	1.81%	76.19%	22.00%		R 148,427,326
Sep-2001	0.00%	0.11%	84.48%	8.16%	7.24%	R 221,558,501
Sep-2002	0.46%	0.00%	73.99%	13.24%	12.31%	R 264,929,484

Since 1997, 830,784 loan applications have been received by Credit Indemnity. Of these 405,085 were approved. Of the latter 51% are still active and 29% have become dormant, that is, there has not been a transaction for a month or more on the respective loans

Credit Indemnity does not believe that a reduction in interest rates will have a rapid response from borrowers as they believe that the credit market is inelastic. The organisation sees the introduction of cheaper products and better service as a solution to the retention of clients.

Credit Indemnity clients may apply for repeat loans on the following conditions:

- On completion of repayment of a previous loan
- Prior to the completion of repayment of a previous loan and making use of portion of the new loan to repay outstanding instalments of the previous loan
- Prior to the completion of the repayment of a previous loan without impacting that loan. In respect of additional loans a client may not exceed a total loan amount of R10,000 in terms of the Usury Act.

In the case of a client taking out a new loan prior to the completion of repayment of a previous loan he/she may use a system called "Deduct Last Payment" (DLP). This enables a client to pay off the remaining instalments, up to the previous three instalments, of a previous loan. This basically means that a client will be including the revolving portion of a previous loan into a new loan. This option is offered to clients qualifying for repeat loans, who are experiencing repayment difficulties - this could be interpreted as rescheduling. Further to the DLP procedure, clients may reschedule loan repayments if they can provide proof that they have experienced an income shock or that they have a satisfactory reason for non-payment.

Table 7 indicates the monetary value of loans disbursed from 1998 to 2002. Loans outstanding at the financial year end have increased from R38 million in 1998 to R248 million in 2002. The outstanding loans include those, which are current and past due up to 210 days.

Table 7: Annual value of loan applications

Total in Rand	**1998 x 1000**	**1999 x 1000**	**2000 x 1000**	**2001 x 1000**	**2002 x 1000**
First time loans disbursed	-	-	86,502	103,970	108,301
Total loans disbursed	169,191	213,406	388,435	579,368	721,808
Loans outstanding FY end	38,320	47,059	126,129	195,811	246,708

Table 8 shows that the average loan size has remained relatively constant at approximately R1,200 per loan. The average loan term is four months.

Table 8: Average loan size and loan term.					
	1998	**1999**	**2000**	**2001**	**2002**
Average loan size	-	-	R1,158	R1,209	R1,266
Average loan term (months)	4	4	4	4	4

Table 9 details interest rates charged by Credit Indemnity. The table utilises example loan amounts to indicate the total repayments and periodic repayments required. Credit Indemnity utilises a flat interest rate to calculate loan instalments. Loan interest rates, varying from 5.5% to 20% per month, are advertised as "low". The annual percentage rate (APR) varies between 106% and 240%. The effective annual interest rate on a 12-month loan is 175.5%.

Prior to 2001 Credit Indemnity charged a flat monthly rate of 7.5% on all loans. The rate was increased in 2001 and 2002 to meet revenue requirements.

Table 9: Flat interest rate, periodic payments and annual percentage rate for loan products						
	Low Risk			Medium	High Risk	
Loan amount	R 1,000	R 1,500	R 200	R 200	R 200	R 200
No. payments in loan agreement	12	6	4	4	4	1
Flat periodic interest rate	5.50%	7.50%	7.75%	9.50%	11.75%	20.00%
Total repayment	R 1,660	R 2,175	R 262	R 276	R 294	R 240
Periodic repayment	R 138.33	R 362.50	R 65.50	R 69.00	R 73.50	R 240.00
APR	105.70%	141.30%	141.00%	171.10%	208.90%	240.00%
Monthly interest rate	8.81%	11.78%	11.75%	14.26%	17.41%	20.00%

A discount of 2.5% per month pro rata on the capital advance on early repayment of a loan is given. Interest on overdue amounts is charged at a rate of 10.31% per month – this applies to all loan types. This charge was introduced in 2001.

Loan collection

Loan repayment is done in cash, at either a Credit Indemnity branch, a Post Office branch or a First National Bank branch.

Individual Credit Indemnity branches manage the collection of loans advanced by a particular branch, using the services of branch Credit Controllers, up to the stage where a loan reaches 90 days in arrears. If a client misses a repayment by one day, a process is instituted to telephone him/her to remind them of the repayment. All communication with a client and agreed actions are logged on the information system.

Currently arrears accounts are classified as follows:

- Past due - 2 to 30 days in arrears.
- 2^{nd} line - 31 to 60 days in arrears.
- 3^{rd} line - over 60 days in arrears (due for hand over).
- S58 - consent to judgment.
- Bad debt (or accounts that have been handed over to David Lewis Associates).

Credit Controllers are provided with guidance in the policy and procedures manual on how to manage loan collection and how to conduct a telephone call to ensure maximum repayment. Telephone calling, in the case of arrears accounts, is based on contacting new accounts in arrears first thereafter clients who are longer in arrears.

Following a period of seven days from a loan falling into arrears a reminder letter is sent to the borrower. If the necessary repayment instalment is not received a process of further telephone calls and letters is instituted. Once a loan reaches the stage of greater than 90 days in arrears it is handed over to Credit Indemnity's central collection department, David Lewis Associates (DLA). This is an important feature in the collection process. Although DLA is a collection "department" of Credit Indemnity it is perceived by the client as an external collection agent and therefore has an impact on the client's reaction.

Credit Indemnity uses a number of external collection agencies and distributes the arrears accounts according to the deemed appropriate collection methodology that should be used. If external agencies fail to collect the debt within approximately 4 months the accounts are handed over to facilitating agents who are smaller debt collectors located closer to the client base.

Credit Indemnity's loan book status as at August 2002 is shown in the following table. It will be seen that 68% of the book is current. Portfolio at risk (PAR) is 31.71%.[4]

Table 10. Credit Indemnity loan book status as at August 2002.

Loan status	Percentage
Current	68.29
Past Due	9.11
2nd Line	3.60
3rd Line	1.90
Section 58	2.58
DLA Amount	12.61
DLA - Legal	1.92
Portfolio at risk	31.71

The definition of loan status categories in the above table is as follows:
- Current, past due, 2nd and 3rd as per previous definitions.
- Section 58 – consent to judgement to secure repayment and avoid legal costs.
- DLA - collection being undertaken by David Lewis Associates.
- DLA - Legal - legal action being taken by David Lewis Associates.

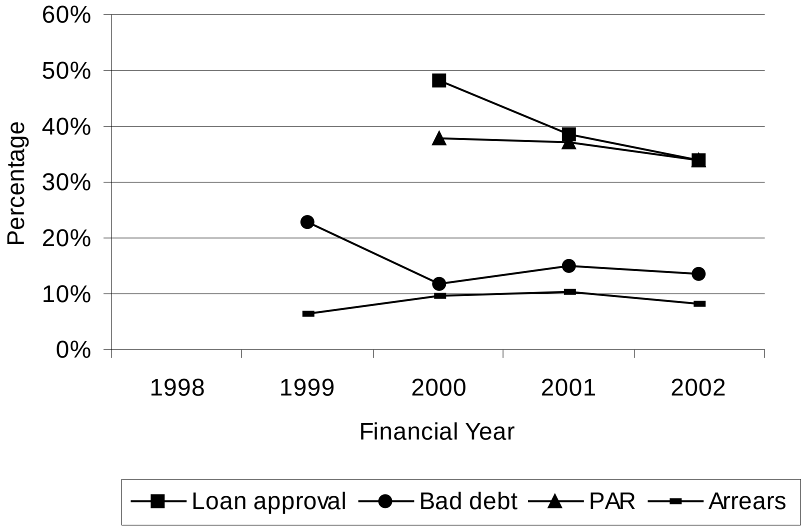
Credit Indemnity is currently introducing a new system for the analysis of the repayment status of its loans. This is in the form of a client profiling system for debt collections based on the probability of recovering a debt. The system relies on a client's past transactional history to establish the profile of a debtor. In early usage of the system it has been indicated that higher levels of debt recovery are being achieved.

The arrears rate increased from 1999 to 2001 and then declined in 2002. The portfolio at risk has decreased for the period 2000 to 2002. Comparative figures for the period 1998 to 1999 are not available. The bad debt as a percentage of the loan book declined from 1999 to 2000 and appears to have settled around 14%.

Figure 2 shows the trends in bad debts, arrears and portfolio at risk compared to the first time loan approval rate. The indication is that with improved borrower selection the quality of the loan book is improving. With this, however, goes a relative decrease in the volume of business and a consequential increasing cost structure.

[4] This has decreased to 28% as of August 2003.

Figure 2: Comparison of loan approval, bad debt, portfolio at risk and arrears rates.



2.4 Risk management and internal auditing

Credit Indemnity faces risk in terms of its provision of credit (loans). The quality of its loan portfolio has been presented, and it is apparent that Credit Indemnity is fully aware of controlling risk in this area. It has developed stringent procedures to manage its credit risk and these are applied rigorously.

The highly structured credit risk management system involves borrower selection according to its scorecard system and thereafter, a strict follow-up procedure on clients falling into arrears. This is a major strength of Credit Indemnity's management procedures.

As described earlier, Credit Indemnity employs a decentralised system of loan approval with decisions being made at branch level. A "scorecard" system is employed, which utilises credit bureau information and internal scores derived from information provided on the application form and from prior loan performance, where applicable.

The management of delinquency and defaults has been described in detail in earlier sections. The success of the procedures being applied, have enabled Credit Indemnity to provide cash loans without requiring security.

In terms of Credit Indemnity's financial status and its liquidity risk, its balance sheets indicate that it does not face a liquidity problem. Credit Indemnity is not in an over borrowed position; in fact the contrary is the case, with the organisation probably being able to leverage more funds. As a result of Credit Indemnity principally utilising retained funds for its lending operation it does not face interest rate risk. The organisation, also, does not face foreign exchange risk.

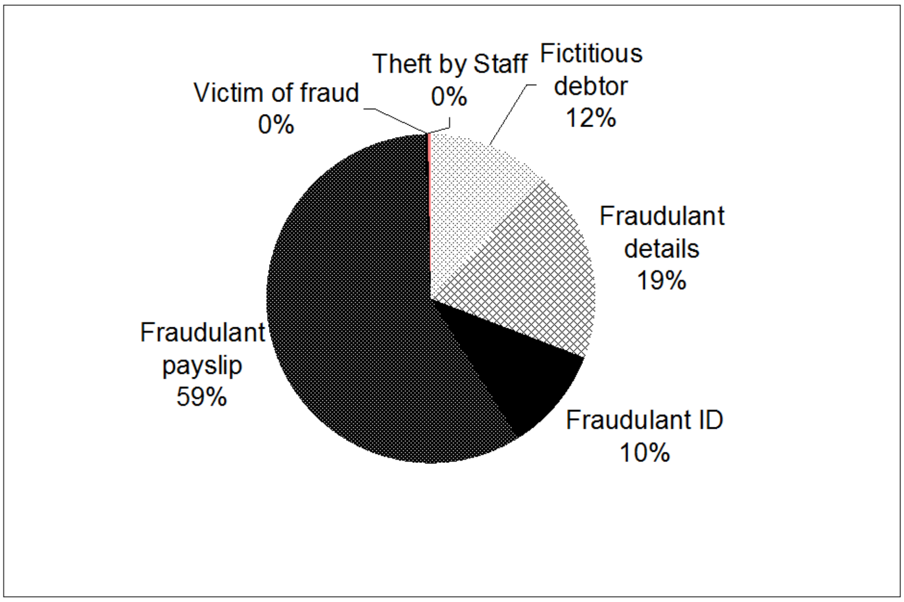
In respect of operating risk management, the issue of internal auditing and fraud will be dealt with in the next section. Credit Indemnity has developed policy and procedures, which provide standards for all operations, which should limit fraud.

Credit Indemnity undergoes an annual external audit to verify its financial status and adherence to its policy and procedures. With respect to risk management, Credit Indemnity has an effective accounting and administration system.

Internal auditing

Credit Indemnity's Internal Audit Department operates "to ensure that there are adequate controls in place and that these controls are tested on an ongoing basis". By controls are meant policy and procedures that identify misstatement, errors and fraud.

Figure 4: Nature of fraud identified in loan applications



The Internal Audit Department undertakes and manages fraud investigations. For the 2001 and 2002 financial years fraud write-offs accounted for approximately 1.2%, respectively, of the total Credit Indemnity write-offs for those periods. Figure 4, indicates areas in which fraudulent information is provided or loss occurs. Theft by staff is indicated as less than 1%.

2.5 Ownership, governance and leadership

Credit Indemnity commenced as a family owned business in 1978 and was subsequently purchased by Theta Investment Limited in 2000. Theta Investment is part of African Bank Investments Limited.

African Bank Investments Limited (ABIL) is a registered bank holding company listed on the Johannesburg Securities Exchange (JSE) under the Speciality and Other Finance sector. African Bank Investments Limited specialises in the provision of liquidity through credit to emerging market clients in South Africa.

African Bank Investments Limited "specialises in the provision of liquidity through credit to the emerging market clients in South Africa" (The Investors' Guide, June/August 2002).

ABIL is represented by over 300 branches (African Bank and Credit Indemnity branches) throughout South Africa. It is the largest bank in the microfinance market providing personal credit. ABIL has the ability to provide numerous services through its subsidiaries and associated companies.

The principal shareholders of African Bank Investments Limited are Standard Bank Nominees (49.1%) and Nedcor Bank Nominees (16.6%). The latter two principal shareholders are two of the four commercial banks in South Africa that controls 90% of the banking assets in the country. As at 30th September 2001 ABIL's capital employed was R5376 million and it made a pre-tax profit of R1138 million for the 2000/01 financial year.

2.6 Vision, mission and objectives.

Since 2002 Credit Indemnity revised its mission as follows:

- "To be the leading Micro finance institution providing innovative financial products on a sustainable basis and contribute to the socio-economic development of sub-Saharan Africa".

In place of a mission statement Credit Indemnity has adopted a "Company Cultural Statement" as follows:

- "To achieve our vision by creating a working environment based on trust, responsibility and accountability which promotes passion, loyalty, commitment and teamwork, and that enable talent, innovation and initiative to flourish".

The primary goal of Credit Indemnity is to achieve the profit and revenue targets set by African Bank Investments Ltd.

Following a strategic planning meeting held in October 2002 Credit Indemnity identified that strategic change needs to be made in the following areas:

- ***Product pricing.*** It was noted that prices need to be reduced significantly to allow the company to become the price leader on the back of a cheap, efficient infrastructure with a clean well managed and assessed book.
- ***Savings.*** Deposits need to be taken to provide stability to the client base and provide the basis of offering more products and access in the informally employed and unbanked portion of the South African market.
- ***Product range.*** The range of loan products needs to be broadened on a demand led basis founded on a clear insight and understanding of the target market.
- ***Delivery channels.*** New delivery channels need to be sourced that will allow products to reach more clients in a convenient and cost effective manner.
- ***Improved IT system.*** The Credit Indemnity IT system needs to become more flexible and able to rapidly deliver new products and other features as well as provide the required management information and back office functionality.
- ***Costing.*** A better understanding of costs is needed to ensure that Credit Indemnity is able to price aggressively, cost products accurately and better understand the dynamics of the business.
- ***Market knowledge.*** The analysis of the business needs to be stepped up to ensure that Credit Indemnity fully comprehends the dynamics of the industry and the business model which will allow it to strategise with more insight and with a better feel of the consequences of various courses of action.
- ***Gearing***. Credit Indemnity's balance sheet needs to be adjusted with cheaper sources of capital being sourced to better gear the assets.

2.7 Management

Credit Indemnity's Executive Committee comprises the Chief Executive Officer, six departmental heads and seven middle level managers. The Executive Committee / Management has three members with post graduate qualifications, mostly in economics, finance and law.

The Executive Committee is large, with representation of a number of people from the same departments on the committee. The departmental structure of Credit Indemnity is shown in figure 5. Credit Indemnity is divided into six departments. Currently the post of head of Finance and Risk is vacant.

The management of branches falls under the Operations Department. For administrative purposes Credit Indemnity has divided its operations in South Africa into three regions and 18 areas. A total of 118 branches fall into these areas.

Each department is required to develop its own mission and objectives, which should support the achievement of the organisation's mission and objectives. At this stage not all departments have finalised this exercise. On review of departmental mission statements, which were available, it was felt that there is an element of overlap, in certain instances, of their apparent operational areas.

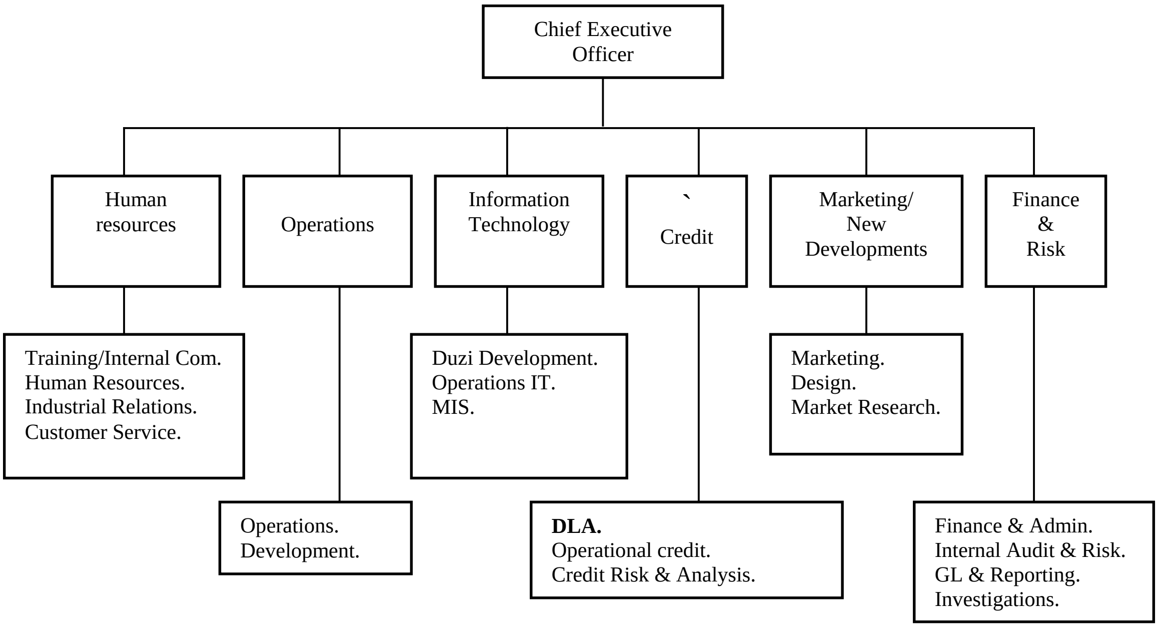


Figure 5: Departmental structure of Credit Indemnity

One of the important contributions to the success of Credit Indemnity is a close-knit and dedicated senior management team. All efforts are made by the members of this team to lead by example and to ensure that they work integrated with the rest of the staff. It is clear from interactions with the staff and management that their efforts indeed are successful.

2.8 Information Systems

Credit Indemnity's Information Systems consists of a loan management system, an accounting system, a management information system (MIS) and an in-house communication system - the Credit Indemnity intraweb.

2.8.1 Loan Management and Management Information System

Credit Indemnity has developed a wide area network (WAN) information systems programme named "Duzi". With the use of this system Credit Indemnity has been able to develop a decentralised loan management approach. Loan assessment, loan disbursement and the collection of outstanding loans are all performed at branch level using Duzi.

Duzi has formed the backbone of a highly successful loan administration process. Without this system Credit Indemnity would probably not have achieved the success, which it has. Duzi is designed for the efficient processing of multiple individual transactions relating, usually, to a single client.

Currently the system caters for the retention of transactional history but does not retain historic performance data, which is essential for analytical purposes. This is being addressed with information being restored to provide data for the newly commissioned management information system.

The information system has a high-level of connectivity. Approximately 1,000 PCs are connected to it. Telkom, the national telephone service provider, provides the network for the connectivity. With regard to disaster recovery, provision is made for the main server going down with a triangulated connection between it and a backup server. Disaster recovery procedures are tested regularly.

Direct linkage is made with a credit bureau so that online credit checks can be undertaken. This is important with regard to the rapid approval of loans. The Credit Indemnity intraweb operates within the system.

2.8.2 Accounting system

Credit Indemnity uses Accpac for its accounting. Approximately 2 million transactions are recorded in the system annually. It was stated that it may be necessary to upgrade the accounting system to one which will be able to handle the volume of work more efficiently. There is currently no interface between Accpac and Duzi. Manual transfer of necessary data is done with the use of Microsoft Excel spreadsheets. The Finance and Risk Department is introducing Activity Based Costing (ABC) to enable focus to be directed at efficiencies and improved control of costs. Credit Indemnity has undergone training by ***MicroSave*** to undertake this task.

2.8.3 Intraweb

The Credit Indemnity intraweb makes provision for staff access to the policy and procedures manual and other necessary information. It also makes provision for two-way communication between staff and management within the organisation.

The system promotes rapid and uniform communication within Credit Indemnity. Access to the standardised procedures is important in terms of the overall operational efficiency of Credit Indemnity. Staff knowledge of policy, procedure and products was found to be high in the organisation. Communication would appear to be effective and is leading to the efficient operation of the organisation.

2.9 Human Resources

Credit Indemnity has a staff complement of 1,100 members. A gender breakdown of the staff was not obtained but interaction at head office and at a number of branches indicated that there was a high percentage of female employees.

Currently an in-house job grading system is being used with a total of 79 salary brackets. The Human Resources Department is investigating implementing a new job grading and performance system.

Complementing the “intraweb” communication system is a monthly staff newsletter, "Thetha Nathi" (speak to us). The newsletter covers a large amount of business and social information of interest to staff members. This newsletter serves to instil a sense of belonging and team spirit in the staff.

3. Analysing performance

3.1 Outreach: Breadth and Depth

Credit Indemnity classifies its client base according to the South African “Living Standards Measurement” (LSM) matrix, developed by the advertising industry to classify households, not individuals, according to 29 variables for marketing purposes (SA Advertising Research Foundation (SAARF), 2002). The measurement is used by marketing organisations to identify target groups and encompasses 10 categories, LSM1, being primarily low income rural households, to LSM10, being primarily high income urban households. SAARF state that 90% of marketers focus on LSM groups 5 to 8.

Credit Indemnity statistics indicate that 80% of its clients are in the LSM groups 3 to 7 with a household income range of R1,000 to R6,400 per month. The top four groups targeted by Credit Indemnity are primarily urban, have good levels of education and have access to utilities and consumer durables while the lower group is primarily rural, does have some access to utilities, but has minimal ownership of consumer durables.

For the period 1997 to 2002 loans were advanced to 405,085 clients in LSM groups 3 to 7. These LSM groups represent a total population of 17 million people. It is estimated that Credit Indemnity’s penetration of these LSM groups is approximately 2.4%.

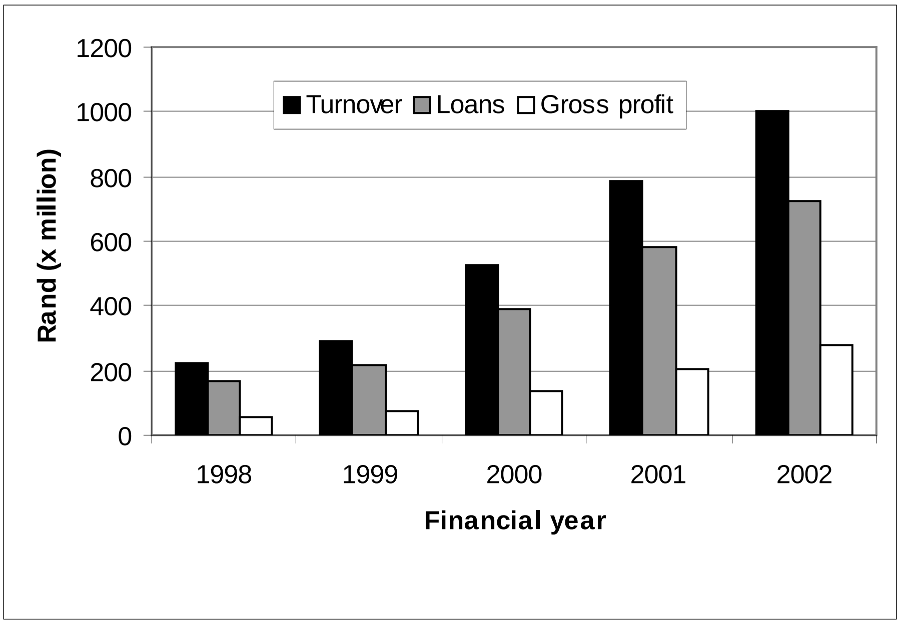
With regard to depth of outreach LSM groups 1 and 2 account for only 8% of Credit Indemnity’s lending activities. In terms of the groups, which are served by Credit Indemnity, increasing lending in LSM groups 1 to 4 would lead to increasing depth of outreach. It will be seen in following sections that Credit Indemnity's current loan policies and collection methodology, where clients are required to have telephonic contact and meet other specific requirements for borrower selection probably restricts increases in depth of its penetration into the market.

The client profile indicates that Credit Indemnity is not currently serving the poorest population groups to any great extent. Notwithstanding this, Credit Indemnity see that there is potential in providing products to the "informal" market which comprises people seen as being "not economically active" and "unemployed" in terms of the formal economy. A key product for entry into this market is seen as savings, which could then lead to the provision of loan products.

3.2 Financial performance and indicators

In this section the financial performance of Credit Indemnity is discussed. Figure 7 shows that there has been an increasing volume of loans, turnover and gross profit for the period 1998 to 2002. Gross turnover reached R1 billion in 2002.

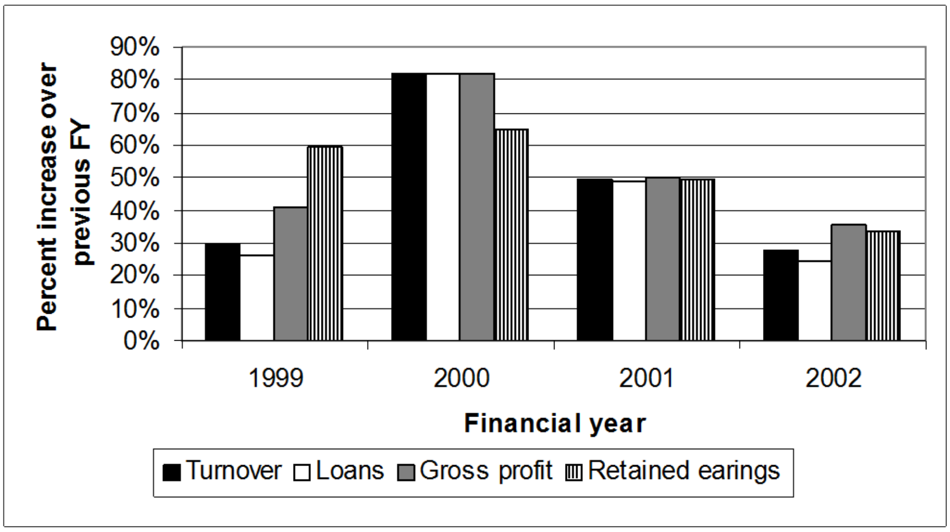
Figure 7: Growth in turnover, sales (loans) and gross profit for financial years 1998 to 2002.



Although there has been an increase in total loans, turnover and gross profit for the period being reviewed the relative annual rate of increase from 2000 decreased. The decrease has been in line with the percentage change in retained earnings, which has also declined in relative terms.

Credit Indemnity identified that its past growth has relied on the opening of new branches to obtain volume. With an apparent saturation in the market, a slowdown in the opening of new branches, a decline in the rate of application approval and a low level of retention of clients the growth in business could be expected to be impacted.

Figure 8: Annual increase in turnover, loans, gross profit and retained earnings for the period 1999 to 2002.



Analysing Credit Indemnity's income and expenditure statements and some of the financial ratios based on these (annexure 3) the following is shown:

- The handover of debts for collection by external collection agents is shown to be increasing. The recovery of bad debt by collection agents appears to be constant at 13% of the value of the amount, which has been handed over to them.

- A significant increase was seen in the interest received on overdue loan repayments. A major increase took place in 2001 with a further, although lesser percentage, taking place in 2002. This resulted from a change in policy regarding the charging of interest on overdue accounts.

- From 2001 Credit Indemnity commenced paying dividends with these rising from R13 million in 2001 to R30 million in 2002. The payment of these dividends has affected the level of retained earnings. Figure 8, graphically indicates the decline in the percentage contribution to retained earnings.

- The leverage of Credit Indemnity is increasing due to an increase in borrowings. Credit Indemnity has not made great use of external funding sources. It has relied mainly on the generation of surpluses and has thereby increased its retained earnings for expansion of its business activities. Credit Indemnity's situation with regard to leverage is more or less average in regard to micro finance institutions. It is noted that in the formal banking industry this can go up to a ratio of 10:1. Given that there is a high degree of risk and lack of security, it cannot be expected that Credit Indemnity could go to this level but there would appear to be an opportunity for increased use of external funding sources.

- Credit Indemnity is both operationally and financially self-sufficient.

- Analysis of Credit Indemnity financial statements show that the company is utilising cash resources faster than the company can generate them. In order to sustain the current utilisation of cash resources the company will have to increase its borrowings or reduce its advances, which will limit the expansion of the business in terms of new revenue generation. The company will consequently not be able to maintain its previous rate of expansion with its current resources.

3.3 Other operational indicators

Table 11 shows the growth in Credit Indemnity branches from 23 in 1998 to 118 in 2002. Staff numbers went from 173 in 1998 to 1,100 in 2002. The staff complement at branches varies according to the level of activity.

Of the 1100 employees approximately 500 are involved in the various levels of credit control. As has been shown this is a vital activity and is an area where Credit Indemnity has shown proficiency. Contact is maintained with clients via telephone.

Staff receive incentives for the number of loans that are advanced and for the number of collections which are made. These incentives are based on targets, which are set from time to time.

The establishment of new branches has decreased significantly in relative terms, see table 11, and this is seen as a major cause of the relative decline in loan volumes. Credit Indemnity believes that the market for micro finance is highly saturated, it strategically embarked on the rapid establishment of a branch structure to capture market share, but now finds its growth potential diminished as it attempts to capture clients in established markets. The cost of the infrastructure is now catching up, see the increasing costs per Rand and per loan advanced shown in table 12 where the average cost per unit of money lent has increased from R0.14 to R0.18, a 29% increase, over the period 1998 to 2002 and the average cost per loan made over the period 2000 to 2002 has increased from R172 to R224, a 30% increase. The relative rate of increase in the staff complement has not declined to the extent of the revenue generation.

Table 11: Growth in number of branches and staff

	1998	**1999**	**2000**	**2001**	**2002**
Number of branches	23	52	74	103	118
Percent increase branches		126%	42%	39%	13%
Number of staff	173	237	645	906	1,100
Percent increase staff		37%	172%	40%	21%

Table 12: Financial efficiency of Credit Indemnity 1998 to 2001

	1998	**1999**	**2000**	**2001**	**2002**
Cost per unit of money lent	R 0.14	R 0.17	R 0.15	R 0.16	R 0.18
Cost per loan made			R 171.64	R 194.33	R 223.85

Credit Indemnity recognises that the client base is becoming wary of credit due to high cost, bad experiences and a general decline in employment in the target groups. The increase in the number of loans advanced in 2001 from 2000 was 43%, the increase from 2001 to 2002 was only 19%. The impact of this decline on the profitability of Credit Indemnity was countered by an increase in interest rates in 2001 and 2002. If the trend is not reversed the financial results for 2003 could be affected negatively.

4. Explaining Success

4.1 Clients perceptions of the MFI and its services

"The experience has to be good" is the client satisfaction level that Credit Indemnity strives to achieve. Clients participating in the focus group discussions indicated a general satisfaction with the service they received from Credit Indemnity. They felt that they had reasonable access to credit with loans being advanced to all people who had proof of earnings. They felt that Credit Indemnity operated differently to other MFIs in that it targeted everyone who was employed, regardless of the type of work.

Customer care/service was viewed as being good, with clients stating that Credit Indemnity staff are patient, listen and are helpful. Clients noted that they could apply for a second loan after paying the second instalment on the first loan. In addition they indicated that a client with a good profile and repayment history could access more than one loan concurrently. They believed that interest rates were comparatively low and application procedures were streamlined.

They felt that Credit Indemnity communicated efficiently with its clients through a monthly newsletter, which accompanied monthly statements. Clients argued that this showed professionalism on the part of Credit Indemnity. Clients stated that service is "instant" and the company policies are non discriminatory. Clients felt that the loan repayment period was reasonable and affordable with it being able to be extended from four to six or twelve months for good customers, if they required larger loans. Clients indicated that Credit Indemnity ensures that borrowers can afford to repay their loans.

Repayment is strictly on a cash basis and is over the counter at any Credit Indemnity branch, Post Office or First National Bank. The fact that Credit Indemnity relies on clients going to their branches to make their monthly payments shows that Credit Indemnity trusts its clients. As a result, clients have also built up trust in the company. Clients also mentioned that they trusted and preferred Credit Indemnity to other micro lending institutions as it did not invade their privacy by taking their bank cards.

Clients noted that there are different incentives for clients who have good repayment records, as well as for those clients who introduced new customers to the company. Credit Indemnity also has monthly competitions where customers can win prizes in the form of cash, discounts on interest, electrical appliances, groceries and cell phones. Clients said that Credit Indemnity tries to retain its clients by keeping in touch, even when a client has paid off his/her loan.

The response of clients to the focus group discussions indicated that there is a good understanding of Credit Indemnity's policy and procedures. Discussants did, however, identify the following areas in which they suggested improvements could be made:

- During peak periods, the queues at branches are very long. The number of employees should be increased.
- Clients suggested that Credit Indemnity should try to diversify its products by introducing new products such as bursaries, housing and business loans. Furthermore, interest on such loans should be lowered and the repayment period extended.
- Another recommendation was that instead of paying out loans in cash to clients, Credit Indemnity should provide an option of bank transfers into clients' bank accounts. This is mainly for security reasons.
- Some clients complained that they are not informed of potential changes in interest rates or new developments. The suggested solution to this problem is the strengthening of communication at some branches.

4.2 Achievements and challenges

Credit Indemnity commenced operations from a small foundation developing systems and procedures to manage micro loans. The systems and procedures it developed were advanced in terms of Credit Indemnity's timing of entry and operation in the market, namely the period 1978 to 1998. The foundation, which was laid, provided a platform from which significant expansion could be launched. In 1998 the family owned business focus was changed to a corporate approach, with the purchase of the organisation by the African Bank Investment Limited Group. The change of ownership resulted in the introduction of a strong, focused entrepreneurial management team, which was able to build on the business principles, which had been established.

Credit Indemnity has been able to provide unsecured loans to a segment of the South African population, which has had difficulty in accessing loans, to charge interest rates adequate to establish a financially self-sufficient organisation and to attract commercial investment to the organisation. Their success in attaining this vast outreach in a reasonable short space of time is attributed to four key areas:

- Management – a close knit dedicated team of managers that are motivated and work together well at executive level
- Simple product offering well understood by clients and staff. This instalment based loan product was standardized at such a level that the product was largely commoditized and training modules, branch structure and operations were standardised. All systems is well documented and practice and procedures throughout the company are similar
- Relative efficient cost structure due to efficient systems and standardized products and systems
- Credit Indemnity has a good database that spans five years of transactions and they use it well in terms of the score cards they apply and the continuous profiling of customers during all facets of the loan cycle. The Duzi system they developed is central to the successful mining and analysis of their data.

In addition and strengthening these four main areas they have invested in market research and interaction with clients, incentivised staff and management towards performance to improve portfolio quality and to expand the portfolio at the same time and provided high levels of customer service and satisfaction.

The key driving element was to earn a profit from the organisation's activities. Currently the primary goal of Credit Indemnity is to achieve the profit and revenue targets set by African Bank Investments Ltd.

Credit Indemnity focused on a section of the market, which has constraints in terms of being bankable but are employed, have cash flows and can provide "behavioural" security. Establishing itself at an early stage in the market proved to be advantageous. The market is large and provides opportunity for increased breadth of outreach. The market is, however, attracting many other providers of financial services.

In terms of the timing of its development Credit Indemnity has been innovative and applied "best practice" to its operations. By ensuring that operational procedures were standardised and applied rigorously it has ensured positive revenue generation. This has established it as a leader in the provision of micro credit in South Africa. Further, Credit Indemnity is expanding its product range successfully. Evidence of this is the recent national prize it won for its lending activities to micro and small enterprises.

Credit Indemnity exhibits two separate and different phases in its development. These are:

- 1978 to 1997. The company was established, expanded in KwaZulu-Natal and reached a stage of maturity, when it was purchased by African Bank Investments Limited.
- 1998 to 2002. Credit Indemnity was well established at the beginning of the cycle and entered a period of rapid growth with the rollout of a nationwide branch network. This period coincided with the rapid development of the micro credit sector as a whole in South Africa with the market reaching a point of saturation in the latter part of the period. This has brought Credit Indemnity to a position where it will have to undertake a review of its mission, objectives, products and operating efficiencies and re-strategise to go forward into its next phase.

With an apparent saturation in the market, a slowdown in the opening of new branches, a decline in the rate of application approval and a low level of retention of clients the growth in business is being impacted.

Credit Indemnity is now faced with identifying how it will reposition itself. In terms of the micro finance industry Credit Indemnity is probably in a favourable position compared to a majority of micro finance organisations. It has achieved financial self-sufficiency, an objective which MFIs aim for, but it now faces a question regarding its sustainability as a result of changing market conditions and increasing competition.

The following are challenges, which Credit Indemnity faces:

- Challenges in ensuring a good relationship with its owner, African Bank Investment Limited and keeping to its core values and success recipe. It is also important to note that the linkage of an MFI with a significant corporate group provides exciting opportunities.

- Although the current vision and mission chartered a new course for Credit Indemnity, it is important to ensure continued attention to the establishment of a clear mission statement and objectives together with the development of a strategic plan. This will enable Credit Indemnity departments to be in a position to improve their contribution to the organisation's future.

- Linked to the adoption of a mission statement and objectives a clear strategic plan requires developing. Credit Indemnity's management recently held a workshop where strategic issues were identified. The workshop recognised that there are "several broad areas of strategic change that need to occur". This should be expanded to clear strategy forward

- Credit Indemnity sees the establishment of a savings system as a source of lower cost funds for lending. This in itself will prove to be a major challenge, but is sen as an essential step towards expanding the services provided to clients.

- Credit Indemnity maintains that, as a result of the saturation of the micro loan market, the impact of reducing the interest rate will not result in a rapid increase in market share. However, they are of the opinion that the first MFIs that take this step will be market leaders and will be difficult to beat. Recent reports of other leading microlenders reducing interest rates are quite positive in terms of increased portfolios. It shows that clients are becoming more price sensitive. Another aspect of interest rates is client affordability. Credit Indemnity believes that, at current rates, loans are becoming unaffordable to borrowers.

- Credit Indemnity currently provides a number of loan products, which vary according to term, interest rate and profile of applicant. It has identified that it needs to diversify its product offering. Current clients have indicated a need for other products. Credit Indemnity considers that offering other products will increase its client base and improve its revenue generation and sustainability. This should be comprehensively addressed. The partnership with MicroSave-Africa and the inherent quality and experience of key Credit Indemnity staff will benefit the institution in this regard.

5. Conclusion and the future

5.1 Strengths and weaknesses of the model

In South Africa micro lending, as confirmed by Credit Indemnity, still has a poor public image. High cost loans are made to poor people. The negative image of "loan sharks" is prevalent. In most arenas of development, access to finance is seen as being a necessity. As a result of this, greater focus can be expected to be directed at the financial services industry by the public and government. Formal banks are well aware of the pressure being placed on them to increase access to financial services for poor people (leading to the financial services charter signed in late 2003).

Credit Indemnity is a leader in the provision of micro loans in South Africa. It has developed technology, policies, procedures and operational skills, which currently place it at the forefront of its industry. With Credit Indemnity's public image and its wish to increase the depth of its outreach it will have to take cognisance of the issues around providing financial services to poor people, while at the same time maintaining financial self-sufficiency. Its policy, procedures and technology are currently geared for a well-defined market, changing this will change operational requirements and the risk profile of its business.

With the addressing of challenges identified above and the introduction of deposit taking (savings) and development of new products according to demand and based on structured planning Credit Indemnity has the potential of remaining a leader in its field. It indeed has the management capacity and commitment to cross new borders. However, the potential conflict between the demands and aspirations of its shareholder, versus the building and positive use if its image in the mind of customers and its own culture and values, should be carefully managed.

With regard to expansion within South Africa and across its borders, if Credit Indemnity can resolve the challenges it faces, it will have the potential to partner other forward looking organisations which have a sound business focus. If, however, it is unable to address the challenges positively, its replication outside South Africa could be questioned.

5.2 Lessons for Mainstream MFIs

Credit Indemnity's success is based on a focus on a few main areas, leading to their establishment in the market, growth and quick expansion to where they are today. They emphasised a good management team, a simple product offering well understood by clients and staff, a relative efficient cost structure largely due to standardisation and a high reliance on good and automated information systems that is continuously used in loan allocation and management of all facets of the loan cycle.

It is clear that the massive expansion of their portfolio would not have been possible without these aspects being in place, and without continuously improving on these aspects. It is especially the standardisation of their core product that put them in a position to expand, without loosing control. They were also able to live through their quick expansion as they had good and flexible systems that accommodated all the pressures of growth. It must be noted that they work continuously in improving these systems.

Lastly, they also realised that although their core standardised product is a good fit for their core market, they will have to do market research to ensure that they expand their product range and clientele over time. Continued growth cannot happen on the back of the same product, offered over many years. Credit Indemnity has a strong marketing and research department who are working towards the design of new products and delivery systems in the market.

5.3 Recommendations for Donors

Credit Indemnity has little exposure to donor institutions. Their expansion is self financed and the company is part of a big group listed on the Johannesburg Stock Exchange. However, they realised the benefit of receiving technical assistance and actively pursued to learn from the lessons of other MFIs. In their quest to improve themselves they started to work with donor funded programmes (like MicroSave).

This represents a bold move by a consumer finance focused institution in South Africa. Credit Indemnity's own in-house research, bolstered by research by the MicroFinance Regulatory Council (2003) in South Africa indicated that their clients do not only use loans for consumption related expenditure. This led them to the investigation of new markets, new products and delivery systems. Unfortunately the donor world still chooses to stereotype consumer finance institutions as not being part of the microfinance world (which is largely seen as enterprise finance).

Donor programmes in microfinance would benefit tremendously from interacting with consumer financiers with established markets, products and systems towards an expansion of products that could include savings and enterprise finance. This could result in a wide outreach with respect to enterprise finance as illustrated in this chapter (see section 1.3 and Table 3). The emphasis of donor support in this instance would be on technical support, and exposing the consumer finance institutions to international best practice. On the other hand, the international microfinance world will also benefit from being exposed to the aspects that made Credit Indemnity a successful institution, something that could easily be facilitated by donor institutions.

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