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Fact Sheet

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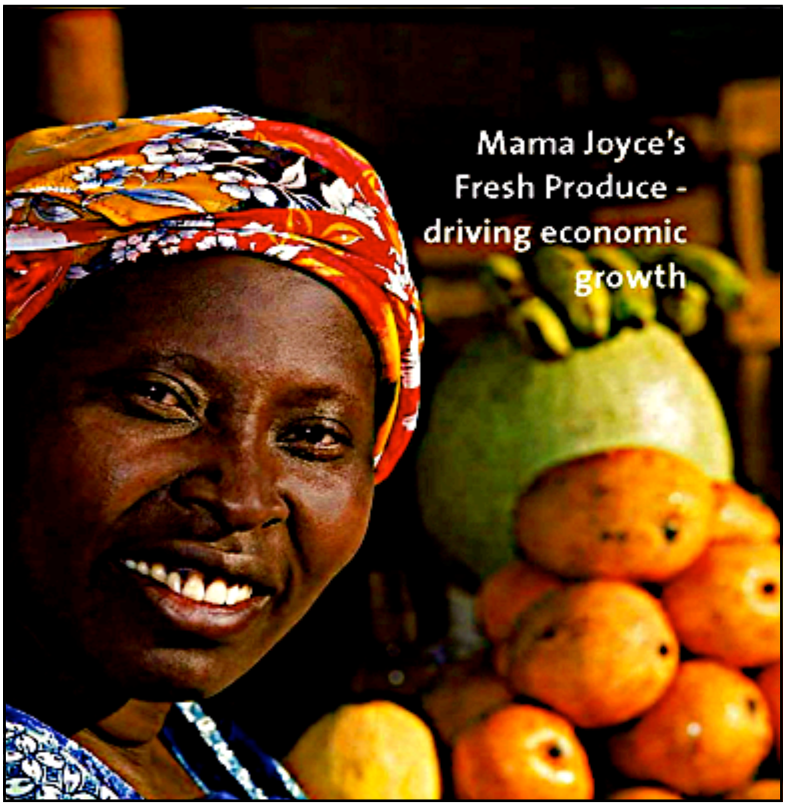


ABSA – Fostering entrepreneurship at the base of the pyramid

Encouraging and nurturing entrepreneurship arguably form a crucial part of any economic development strategy for an emerging country such as South Africa. Given the immense challenges the country faces in terms of poverty alleviation and unemployment, small entrepreneurs, especially in the so-called « informal » economy, provide income, jobs, and essential services in lower income segments at the base of the pyramid (BOP). In South Africa, as in other emerging markets, government, private sector and civil societies can achieve very encouraging results in helping people in the lower income segments to lift themselves out of poverty. This may especially be true when, as we will argue in this factsheet, an integrated, holistic and well thought strategy is adopted.

It has perhaps become something of a cliché to present South Africa's economic structures as a unique and peculiar mix of formal and informal, sometimes also referred to as « first world » vs « third world » economic sectors. Undeniably, there is a uniqueness in South Africa's juxtaposition of a strong, diversified formal sector and a huge «underbelly» of around 40% of the working-age population who do not hold formal employment and fall outside formal structures. This represents more than a human cost : the economic opportunity loss represented by so much wasted skill and talent is staggering. South Africa is fortunate, though, to have a very strong cluster of dynamic, innovative and committed firms who see opportunities in this situation and find solutions which are both profitable, sustainable and socially responsible.

This factsheet will look at how ABSA, one of South Africa's largest banking groups, is developing and testing a range of products aimed at micro- and small entrepreneurs at the Base of the Pyramid. Its focus is to provide finance for productive rather than consumption purposes and asset accumulation. To this end, it has established AMEF (ABSA Micro Enterprise Finance), as a fully fledged business cluster within its retail banking division. Established in June 2007, the unit has already achieved measurable successes and despite global and local challenges, ABSA's approach has a potential impact far beyond South Africa's borders.

"Innovation distinguishes between a leader and a follower."
Steve Jobs, CEO, Apple

1. Corporate Id

Amalgamated Banks of South Africa (ABSA) is one of four large banking groups in the country. It was created in its current form in 1991, as a result of the merger of banking and building societies Volkskas, Allied and United. Volkskas especially played an important role in the economic upliftment of the Afrikaner community in the decades between 1930 and 1980, contributing to give ABSA with a crucial experience base in catering for the needs of first-time and lower income customers.

In 2005, ABSA became the first large South African banking group to be exposed to significant international ownership, when the UK-based Barclays Bank purchased a 58.8 % stake in the group for 5.5 billion USD. At the time, this constituted the largest single foreign investment in South African history. [1]

ABSA is currently positioning itself in emerging markets, both locally and on the rest of the African continent, having taken majority stakes in banks in Angola, Mozambique and Tanzania, all three of which present promising market opportunities. [2]

2. Background : The operating environment for South African banks

South Africa, especially compared to many other emerging markets, is generally considered to have a solid and sophisticated banking system, which has been in place for well over a century. The banking sector has been instrumental in the economic development and industrialisation of the country.

Currently, four main banking groups share the bulk of the retail market : ABSA, FirstRand (parent of First National Bank), Nedcor, and Stanbic Group (Standard Bank) hold some 90% of banking assets.[3] Historically these banks were geared towards the financial needs of the formal economy. Over the last two decades, however, these banks have started tapping into the business potential presented by customers in the lower income segments, and have developed products specifically aimed at this market, both in the retail sector and enterprise finance. This development has been given further momentum after the advent of majority rule in 1994, with the issues of poverty relief and the reduction of inequality becoming national priorities.

There is an impressive body of laws regulating the banking industry in South Africa : in fact no less than 232 pieces of legislation govern the sector, and provide the general framework in which banks are allowed to operate, provide credit, and service their customers. [4]

Beyond the regulatory framework, at least two additional local factors are influencing decisions and strategy in the banking sector : these are the Accelerated and Shared Growth Initiative for South Africa (AsgiSA), a government-promoted national economic initiative, and the Financial Services Charter, which commits the banking sector to a certain number of targets in terms of empowerment and providing access to lower income segments.

AsgiSA, launched in February 2006, specifically states the promotion of small enterprise as an essential part of its objective to reduce poverty and unemployment by half by the year 2014. [5]

The Financial services charter completes the picture. Adopted in 2002, one of its main features is committing the financial services industry to provide access to a range of financial services to lower income segments. [6]

3. The Business case

ABSA's interest in micro enterprise finance stems from a mix of commercial and strategic factors.

Key figures at 30 June 2008 :

- Market capitalisation : R 55.8 billion
- Number of customers : 9.3 million
- Number of employees : 40,000
- Outlets (points of presence) : 1176

The commercial factor is straightforward : there is a market space to be filled, and ABSA's experience with entry-level customers provides it with the kind of in-house expertise to develop innovative products geared towards the needs of this segment. In fact according to ABSA's own estimates, 4.6 million of its 9.3 million clients fall into the lower income segments, with an income per household of under R 3800 per month. Over a quarter of them (27%) earn less than R 900 rand per household.[7] ABSA has an obvious interest in the increased prosperity of these customers. Furthermore, through its Barclays Bank connection, ABSA also can count on a higher level of access to international capital markets and global experience.

Strategically, by developing specific products aimed at this market, ABSA crucially contributes to integrating the second economy into the first one. In a growing emerging market such as South Africa, this market constitutes the basis for future growth. Furthermore, in terms of its product mix, micro enterprise finance serves to complete the range of existing savings, insurance, transmission and lending products to the employed, and helps open the market for these products to self-employed entrepreneurs.[8] In addition, micro-entrepreneurs may not be the poorest of all South Africans, but they certainly have the potential, if given a proper chance to prosper, to provide vital employment opportunities to the lowest income segments. An additional external factor is the opportunity created by the National Credit Act, which provides banks with state-sanctioned guidelines with regards to lending rules[9], but also aims to protect consumers by committing lenders to transparency rules. Furthermore, the strategy fits neatly within the stated aims of AsgiSA, especially its poverty-reduction target.

1. REED John, "Barclays plans integration after Absa bank deal", Financial Times, London, 9 May 2005
2 www.absa.co.za,
3 BRIAN METCALFE & TOM WINTERBOER, Strategic and emerging issues in South African banking, 2007 edition, PriceWaterhouseCoopers , Johannesburg, 2007, p8
4 Ibid., p 9
5 http://www.info.gov.za/asgisa/asgisa.htm
6 http://www.irmsa.org.za/FinancialServicesCharter.pdf
7 Nishid DOSA, ABSA Micro Enterprise Finance : a Business Against Poverty Initiative at the Base of the Pyramid ?, BOP Learning Lab, Bellville, October 12th, 2008
8 Nishid DOSA, ABSA Micro Enterprise Finance : a Business Against Poverty Initiative at the Base of the Pyramid ?, BOP Learning Lab, Bellville, October 12th, 2008.

The reasons for entering this market can be summarized as follows :

- **The local developmental context**
- **The financial sector's commitments in terms of the financial services charter, and its obligations under the National Credit Act**
- **The potential returns from micro enterprise finance combined with its beneficial impact on the lower income segments.**

4. Challenges

- **Poverty**

Poverty levels in South Africa remain alarmingly high, and there is some controversy about how much real progress has been made in the past decade in the fight against poverty. While some studies focus on the emergence of a strong black middle class and its growing purchasing power, others argue that poverty has actually worsened at the lower income segments. [10]

Whatever the statistics tell us, poverty remains a big obstacle in order to gain access to banking services. For banks, the potential return provided by a large number of small deposits does not necessarily cover the cost of managing and administering these accounts. And for people earning very low incomes, the cost of holding a bank account can be seen as prohibitive. This is, however, a short term view. In the long run, banks which position themselves in the lower income segments build up a loyal customer base, which is likely to grow more wealthy over time.

- **Selling an expensive product to a low-income market**

One of the key obstacles on bringing micro-enterprise finance to the lower income segments is that in order to mitigate the risk factor, lenders need to charge the highest rates to those who can least afford it. In South Africa, whereas interbank rates fluctuate around the 12% mark and home loans around 18% per annum, micro enterprise finance loans can reach levels of 80% on an annual basis, going down to around 48% as the customer's credit history is established. [11] It is a challenge to explain to a first-time borrower why, from a banking point of view, the price of money will be several times higher than for more established customers. There is also a potential image risk : no respectable bank wants to be seen as a « loan-shark » profiting from the poor. [12]

This hurdle is possibly the biggest single challenge for a bank operating in an emerging market and in microfinance. In order to get around this, it is important to ensure that the trust-building steps between bank and customer are cleared in quick succession : loans should be structured in such a way that a credit record can be built within a few months, and lenders should reward creditworthiness with better conditions of access as quickly as possible. This is important both for lenders and borrowers. Another crucial matter is the need for transparency : the terms of such agreements should be made clear from the onset to customers. This is where the building of a network of local credit counsellors, who are trusted figures and know the markets in which they operate, becomes an essential condition of success. And the obligation for the lender to provide transparent and complete information to the borrower is explicitly outlined in the National Credit Act.

The bottom line is that for micro entreprise finance to work, it needs to be profitable. If lenders see it as a lucrative business to be in, the microfinance industry will attract more investors, increasing the offering. Greater competition is also likely to push lending rates down, to the benefit of self-employed micro-entrepreneurs.

- **The global financial crisis and aversion to risk**

The ongoing and unprecedented crisis in the global banking system will inevitably have an impact on South Africa. So far, the country's banks, partly thanks to comparatively limited foreign ownership and exchange controls, have had little exposure to the subprime related assets which have caused so much mayhem in the international markets.[13] As a result of these factors, local banks have been insulated enough from the crisis to avoid the spectacular collapses and massive government rescue packages of the type which have recently occurred in the United States and Europe. And thankfully for ABSA, its UK-based parent company Barclays has emerged as one of the stronger banks in this time of turmoil. Even so, in the current environment banks will be under huge pressure not to take any undue levels of risk, most certainly when it comes to lending to people who cannot afford it. Banks expanding their business into lower income segment markets will now find it even harder to find the right balance between innovation and prudence.

5. The Response

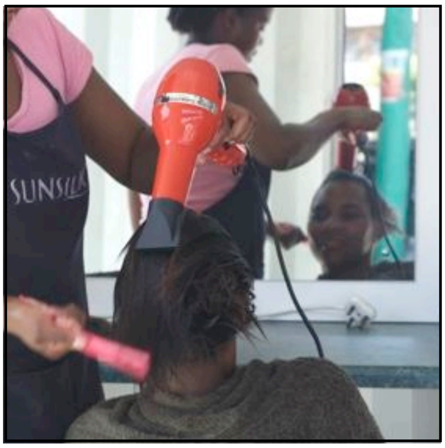
Mindful of the very particular parameters of the South African context, ABSA came up with a carefully calibrated micro-enterprise offering, which an initial focus on loan products for businesses with an estimated annual turnover of between R 15,000 and R 500,000. This targets ventures which are informal, typically operate from homes, where the owner has at least some high school education, and often employs one or two people. These products are the Yanda loan, Group loan, the Retail Enterprise loan and most recently the Hawker loan, currently in design stage. They are being developed and managed by the AMEF unit.

- **Yanda Loan**

Yanda is the entry-level AMEF product aimed at start-up micro enterprises, typically in high-density urban environments. Its main feature is its simplicity and accessibility: applicants do not need to have a credit history to apply. Their businesses also don't need to operate from fixed premises. Initial amounts start at R 400 and can grow up to R 8000, following a graduation principle, after the applicant has built a credit history and an understanding of debt management.

- **Group Loans**

This formula is in some ways inspired from existing stokvel models (traditional collective savings and loan schemes) and the Grameen model in Bangladesh.[14] It is aimed predominantly at a rural market, and at women entrepreneurs. Groups typically consist of 5 individuals, and loans start at R 1000 and to reach a maximum of R 10000



9 http://www.absa.co.za/absacoza/generated/files/6cc3e3d8bf5f2110VgnVCM1000003511060aRCRD/National%20Credit%20Act.pdf
10 South African Institute of Race Relations
11 ABSA, Yanda Loan Brochure,
12 "Doing good by doing very nicely indeed – in support of profiting from the poor", The Economist, June 26th, 2008
13 BONORCHIS Renée, Fears remain over SA banks, Business Day, October 24th, 2008

following the same graduating principle as for the Yanda loan. The amounts are collateralised by a deposit of 40% collectively held in an ABSA account by the individuals.

- **Retail Enterprise Loans**

These loans are aimed at micro-enterprises that have been in operation at fixed premises for at least one year. Loans vary from R 2500 to R 15000 over a period of 3 to 8 months, and are granted on the basis of an on-site assessment of the business by a loan officer. These loan officers are trained to provide financial advice and assist micro-entrepreneurs in keeping accounts and eventually producing balance sheets, a crucial step towards formalising informal businesses.

- **Hawker Loans**

The latest product in AMEF's mix is the hawker loan, which is currently being piloted. These loans will range from R 400 to R 25 000 are designed to cater for stock turn cycles. Loan officers will monitor loan repayments and manage the relationship with customers, whose credit scoring will be supplemented by key partners such as wholesalers and purchase points.

AMEF has a stated double bottom-line objective of both achieving profitability and contributing to sustainable economic development within the communities where they operate.[15] In order to offer a suitable proposition to customers, one of the characteristics of its business model is to operate outside of the retail branch infrastructure, and act rather through "points of presence", an approach ABSA calls the "channel strategy". The channel strategy consists of establishing a service centre within the communities served, often in the form of prefabricated buildings, similar to shipping containers. The service centres are manned by independent, local experts called Community Finance Officers (CFO's), who offer financial services, advisory and business support services. Just as importantly, these service centres double as community billboards and matchmakers for micro-entreprises. At the time of writing, 15 such centres had been established, mainly in Gauteng and in Durban.

In addition to the channel strategy, ABSA is rolling out a franchise model, in which an independent entrepreneur owns and manages an ABSA kiosk combining a range of services. This model will be expanded aggressively in 2009. The franchise model helps ABSA to control costs and shares the risk between ABSA and the franchisee. ABSA provides the necessary equipment, capital and expertise, while the franchisors bring crucial local knowledge.

With this product mix, ABSA intends to achieve a series of key objectives :

Engage with self-employed entrepreneurs
Deliver in terms of profitability
Building an appropriate operational model, including a focus on innovation in terms of cost, culture and customer relationships with the stated aim of expanding the model into the rest of Africa

Conclusion

Micro enterprise finance has the potential to make a real, sustainable impact in the fight against poverty. Proper access to credit and finance is the necessary fuel to ensure the sustainability of BOP business initiatives. One of the most obvious applications is for the support of micro-franchises, which are a common form of accessing the BOP in a large variety of sectors, such as retail, mobile telephony, food and beverages. The examples of Massmart, Vodacom and Danone spring to mind immediately.

Some of the early lessons learned so far by ABSA include the fact that micro-entreprise finance will not just sell itself. It needs broad, cross-divisional internal support right up to the executive management to the bank, and the success of the model will also be enhanced by the building of a solid network of external relationships and partnerships. This implies an integrated, well thought through model with partnerships with governement at all three levels, international organisations including the IFC (the World bank's investment arm) community leaders, as well as local and international expertise.

15 ABSA Micro Enterprise Finance – ABSA factsheet, 2008, p1

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