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Lesotho

DEMAND, SUPPLY, POLICY AND REGULATION

Diagnostic report

2014

ABOUT MAP Lesotho

This Diagnostic report presents a comprehensive analysis of the financial inclusion environment in Lesotho as part of the Making Access Possible (MAP) Lesotho initiative. The implementation of MAP in Lesotho was officially requested in August 2013 by The Government of Lesotho, via the Ministry of Finance. The MAP project is formally hosted by the Ministry of Finance, with the cooperation of the Central Bank of Lesotho. MAP Lesotho is funded by FinMark Trust.

The MAP Diagnostic comprises a comprehensive country context, demand-side, supply-side and regulatory analysis. The supply-side analysis covers the markets for payments, savings, credit and insurance, respectively. Hence the report provides an understanding of access to financial services in a broad context. The demand-side component includes an analysis of access, usage, perceptions and attitudes of financial services by different target groups. The demand-side analysis draws from quantitative data provided by the Lesotho FinScope Consumer Survey 2011 and qualitative research in the form of focus group discussions, immersion visits and key informant interviews[1].

The MAP methodology and process has been developed jointly by UNCDF, FinMark Trust (FMT) and the Centre for Financial Regulation and Inclusion (Cenfri) to foster inclusive financial sector growth.

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[1] For more information on the research methodologies and scope of the qualitative research conducted, please refer to ''Making Access Possible qualitative demand report: Lesotho'', 2014.

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List of Acronyms and Abbreviations

ACH	-	Automated Clearing House
ATM	-	Automated Teller Machine
AML	-	Anti- Money Laundering
BAAC		Bank for Agriculture and Agricultural Cooperatives
CBL	-	Central Bank of Lesotho
CENFRI	-	Centre for Financial Regulation and Inclusion
CET	-	Common External Tariff
CMA	-	Common Monetary Area
CRA	-	Credit Reporting Act
CRB	-	Credit Reference Bureau
CRS	-	Catholic Relief Services
DB	-	Defined Benefit
DC	-	Defined Contribution
DoC	-	Department of Cooperatives
EFT	-	Electronic Funds Transfer
EMV	-	Eurocard, MasterCard, Visa
FIA	-	Financial Institutions Act
FIP	-	Financial and Investment Protocol
FNB	-	First National Bank
FSD	-	Financial Sector Development
FSDS	-	Financial Sector Development Strategy
GDP	-	Gross Domestic Product
GoL	-	Government of Lesotho
ID	-	Identification
ILFS	-	Integrated Labour Force Survey
IMF	-	International Monetary Fund
IT	-	Information Technology
KYC	-	Know Your Customer
LMCH	-	Lesotho Manual Clearing House
LNDC	-	Lesotho National Development Corporation
LPB	-	Lesotho Post Bank
LSW	-	Lesotho Wire
M	-	Maloti
MAP	-	Making Access (to Finance) Possible
MCC	-	Millennium Challenge Corporation
MDP	-	Ministry of Development Planning
MFI	-	Microfinance Institution
MM	-	Mobile Money
MNO	-	Mobile Network Operator
MoAFS	-	Ministry of Agriculture and Food Security
MoCST	-	Ministry of Communication, Science and Technology
MoF	-	Ministry of Finance
MOU	-	Memorandum of Understanding
MSMEs	-	Micro, Small and Medium Enterprises

MTICM	-	Ministry of Trade, Industry, Cooperatives and Marketing
MVA	-	Motor Vehicle Accident
NBFI	-	Non-Bank Financial Institution
NPS	-	National Payment System
NSDP	-	National Strategic Development Plan
NSSA	-	National Social Security Act
OTC	-	Over-the-counter
P2P	-	Person to Person
PAL	-	Payments Association of Lesotho
PAYG	-	Pay As You Go
PODCPF	-	Public Officers Defined Contribution Pension Fund
POS	-	Point of Sale
PPP	-	Public Private Partnerships
PS	-	Permanent Secretary
PSB	-	Payment System Bill
ROSCAs	-	Revolving Savings and Credit Associations
RSCGs	-	Rural Savings and Credit Groups
RTGS	-	Real Time Gross Settlement
RUFIP	-	Rural Financial Intermediation Program
SACCOs	-	Savings and Credit Cooperatives
SADC	-	Southern African Development Community
SARB	-	South African Reserve Bank
SLB	-	Standard Lesotho Bank
SME	-	Small and Medium Sized Enterprises
SUFIL	-	Support for Financial Inclusion in Lesotho
TA	-	Technical Assistance
VSLA	-	Village Savings and Loan Association
WBSI	-	World Savings Bank Institute

Executive Summary

This diagnostic report forms part of a series of documents produced as part of the Making Access to Financial Services Possible (MAP) Lesotho initiative. This report applies the MAP diagnostic and programming framework to support expanding access to financial services. The application of MAP in this report considers the opportunities, challenges and scope for the development of inclusive financial markets in Lesotho. This report includes demand-side, supply-side and regulatory analyses covering payments, savings, credit and insurance. It draws upon a survey of the demand for financial services in Lesotho (FinScope) undertaken in 2011, as well as qualitative demand-side research undertaken in both urban and rural areas.

Participation in MAP Lesotho was approved by the Ministry of Finance in July 2013. The project is governed by a Task Team, consisting of ten members, representing the Central Bank of Lesotho, the Ministry of Finance, and UNDP Lesotho. The bulk of the work for the diagnostic report was carried out in October 2013, and the results were presented to a broad-based stakeholder group in March 2013. The draft MAP diagnostic report was discussed by the Task Team in July 2014 and was updated with feedback and comments by the Task Team.

The general findings of the diagnostic are set out below. Detailed findings on the target market and individual markets for financial services can be found at the end of the respective chapters. Detailed recommendations are contained in Section **Error! Reference source not found.**

MAP puts the demand-side perspective – the customer and his/her needs – at the core of the analysis and recommendations. The adult population is segmented into groups of individuals with similar profiles and needs that could form discrete target markets for financial services. With the target markets in mind, the rest of the analysis then seeks to identify which institutions currently serve which segments of the market through which services, as well as what the potential and gaps are for enhanced provision. The analysis is informed by the realities of the context of the country and ultimately seeks to meet the policy objective of financial inclusion as a tool to improve welfare and poverty alleviation.

Country and Financial Sector Context

Lesotho is small in physical, demographic and economic terms. Total GDP is only M22 billion ($2.5 billion), with a population of 2 million. As a result markets are small and do not benefit from economies of scale, leading to a lack of competitiveness. The country is poor by the standards of Southern Africa, with GDP per capita around $1,300. Poverty is high, with an estimated 50% of the population living in households with incomes below the poverty line.

Lesotho is strongly integrated into the regional economy. It is a member of the Common Monetary Area with South Africa, whose currency circulates in Lesotho and is legal tender alongside the Lesotho Maloti. It is also a member of SACU and SADC. Revenues from SACU are the largest single source of fiscal revenue, but are also a source of fiscal instability, and there are concerns about long-term fiscal sustainability.

Dual economic structure, high outward migration. The economy has a dual structure: a formal economy with jobs in government and industries such as textiles and mining, alongside a heavy reliance on the informal sector and subsistence agriculture. The economy has experienced steady, respectable growth and is reasonably diversified. However, there is a heavy reliance on government and the private sector is weak. There are few large firms, and the medium, small and micro-enterprise sector is not very dynamic. High unemployment and the geographical proximity to South Africa contribute to high outward migration, notably to South Africa, at all skill levels. Historically, many Basotho males have migrated to South Africa as mineworkers, but this is less important now, and outward migration is more diverse.

Strong social fabric. Notwithstanding economic weaknesses, Lesotho has a strong social structure with a great deal of reliance placed on collective institutions such as burial societies and savings clubs. These institutions provide not only financial services, but also social support, and impart a resilience to the society and economy that might otherwise be absent.

Small formal financial sector at the core, large informal periphery. The formal financial sector is dominated by banks and insurance companies. The small size of the market means that there are only a few institutions, which raises competition concerns. However, the formal financial sector is complemented by a range of informal financial institutions such as burial societies and savings clubs, which provide alternative opportunities. In addition, new products and services are being introduced by mobile network operators, who have recently introduced mobile money and payments.

A single financial sector regulator. Whereas the Ministry of Finance is the financial sector policymaker, the regulatory system is based around the Central Bank of Lesotho (CBL). The CBL is responsible for regulating banks and non-bank financial institutions (NBFIs – including credit-only and deposit-taking MFIs, insurers, money lenders, money transfer operators, etc.), as well as the payments system. The primary instrument of regulatory legislation is the Financial Institutions Act (FIA), 2012, which establishes the CBL as the regulator of banks and a wide range of NBFIs. Other important legislation includes the Insurance Act (1976 and 2014), the Credit Reporting Act (2011), and the Payments Systems Act (2014). The only other significant financial sector regulator is the Department of Co-operatives, which is responsible for SACCOs. Some financial services (e.g. pensions and capital markets) are largely unregulated.

Regulatory reform places high demands on capacity. As the financial sector evolves and new institutions and products develop, the regulatory framework needs to be updated and modernised. This requires both institutional capacity and legal reform. The wide span of regulatory responsibility borne by the CBL means that, at times, it suffers from capacity constraints. The process of drafting and passing new legislation is often slow. Furthermore, the quality of drafting of bills is sometimes weak, meaning that even when passed they need immediate amendment, which is again a slow process. New legislation, when passed, needs regulations to give effect to implementation, which can add further delays. The slow process of regulatory reform can hold back innovation, as some new products and services that institutions wish to introduce and that the market appears to demand may not be possible, or alternatively financial services may be provided in a regulatory vacuum.

Financial sector problems. The Lesotho financial sector has had problems in the past, with the collapse or closure of various financial institutions and schemes – largely government owned or initiated – as well as abuse from pyramid schemes. Currently, the banking sector is sound, albeit high cost. Historically the banking sector has been criticised for being unadventurous and not providing sufficient credit; however, in recent years credit has grown rapidly. Outside of the banking sector the quality of financial institutions is more variable, with some threats to financial stability and consumer protection. Regulation and supervision in these areas are patchy, with numerous ongoing reforms. The financial system is generally considered not to be very competitive, and there are gaps, particularly with respect to SMME finance and micro-finance more generally, micro-insurance, and agricultural insurance or credit.

Financial Inclusion Findings

Financial Inclusion is a key policy objective. A strong financial inclusion commitment by government is manifested in various ways. Financial inclusion and access to finance are an explicit component of the National Strategic Development Plan. The Government has been actively collaborating with UNCDF and IFAD to establish the Support for Financial Inclusion in Lesotho (SUFIL) and Rural Financial Intermediation Program (RUFIP) projects. The Financial Sector Development Strategy (FSDS), approved by Cabinet in 2013, has financial inclusion as a major component. The objective of enhancing financial inclusion is to reduce vulnerability and increase income in the wider economy, thereby impacting on poverty reduction, employment and growth and, ultimately, enhancing welfare.

High level of financial inclusion. According to the results of the 2011 FinScope survey, 81% of Basotho adults are financially included. This means that Lesotho has the highest level of financial inclusion of any of the African countries where FinScope surveys have been carried out. This high level of inclusion is driven by very high usage of insurance, primarily funeral insurance (formal as well as informal), which is used by 62% of adults. 38% of adults have a bank account and a further 23% have another form of formal financial service. This means that 61% of Lesotho adults are formally included. A further 20% are only served by informal financial services.

Informal usage is very important. In total, 62.4% of the adult population use informal financial mechanisms, spread across informal savings, insurance and credit.

Fairly broadly served. More than half of those who have an informal product have more than one type of informal product. 53.2% of those with a formal product have a formal product from more than one product market. There is furthermore a very large overlap between usage of formal and informal services, with 40% of adults using both. Total usage (formal, informal and unintermediated[2]) is relatively high in all product markets, with 65% of adults insured, 58% using credit, 67% saving, and 57% using remittances. However, the penetration of formal credit, at around 17% of adults, is noticeably low.

Urban skew. The usage of all of the financial products is higher in urban areas, apart from insurance which has relatively even access between urban and rural areas.

[2] For example, saving at home, borrowing from friends and family, or sending money with a third person.

Segmenting the market

To understand the nature and dynamics of uptake and usage of financial services by different population segments, the population was divided into economic groupings. This was mainly based on primary source of income, and renders six groups. These are shown below along with their size and average income levels:

Group	No. of adults	Average income (maloti per month)
Salaried workers	160,000	2292
Piece job workers	200,000	527
Small business owners	136,000	951
Farmers	140,00	1,392
Private dependents	300,000	750
Government dependents	90,000	776

Given the traditional importance of migrant labour in Lesotho, a seventh group was added, namely non-resident Basotho. Though they are not captured in the FinScope survey, they nevertheless fulfil an important role in supporting dependents in Lesotho. The key findings regarding the financial service needs of these groups were as follows:

- *Salaried workers* are well-served and unlikely to be a priority for financial inclusion. However, their potential to serve as an entry point for productive or asset-based finance for family and friends who cannot meet eligibility requirements can be explored. Their role in supporting the private dependent segment means that they could benefit from enhanced remittance services.
- *Private dependents* are surprisingly well-served. The biggest need is for enhanced access to low-cost, convenient remittance options, domestic as well as cross-border. Furthermore, there is a gap in terms of savings penetration. The qualitative research suggests that many want to leverage and grow their remittance income through productive activities, but the low penetration of formal credit suggests that most people are unable to meet the eligibility requirements.
- *Piece job workers* have a comparatively high usage of friends and family to send and receive money, which suggests that remittances fulfil an important role for them, even if it is not their main income source. This suggests a need for cost-effective, accessible remittance services. Their irregular, low incomes make them unlikely formal credit or insurance clients, but there is scope to increase the reach of savings vehicles to store value in between jobs. Collective vehicles such as burial societies and savings clubs may be best placed to serve their needs given their limited ability to meet formal eligibility requirements.
- *Small business owners* are largely survivalist in nature (making ends meet, rather than running growing businesses). This suggests a larger need for financial services to help them manage their risks, smooth their consumption over time, cost-effectively make payments and send and receive money, than for productive credit. However, the minority of aspirational businesses would benefit from increased access to productive credit.

- *Government dependents*' relatively high usage of financial services is mostly a function of funeral cover, burial society and savings club membership. Furthermore, many tend to borrow informally. Their biggest financial services needs would therefore seem to be well-served informally at the community level – a role that should be acknowledged and leveraged. The main formal financial inclusion gain in this market stems from ensuring access to a low-cost, convenient payment mechanism for receiving grants. Given their widespread role as guardians of orphaned children, there is also a need for accessible targeted savings products (such as for education) and health insurance solutions to strengthen them in this role.
- *Farmers'* average income and level of inclusion suggests that many of them are already fairly enterprising, or at least that there's a sub-set of more commercial farmers with potential for further growth. For them, it would be important to improve access to targeted agricultural finance. Furthermore, the seasonal nature of farming income suggests a need for savings towards not only consumption smoothing, but also farm inputs and assets such as livestock. There is a possible role for low-value input finance for smaller farmers. Their mostly rural nature challenges distribution through traditional channels and highlights the importance of working through agro-business networks or agricultural associations.
- *Non-resident Basotho's* primary need is to save and send money home. For mineworkers, there is an established mechanism to do so through the TEBA recruitment agency. With the mineworker numbers dwindling, however, this is no longer a mainstream solution. It therefore raises questions of informal workers' access to the banking system in South Africa, as well as the scope for alternative cross-border remittance channels. Another important need is for longer-term savings and asset accumulation in Lesotho, on the assumption that migrant workers would want to eventually retire in Lesotho. On the same premise, they would have a need for funeral insurance that would include repatriation of the body. They may also be interested in paying for financial products such as insurance or education endowment policies for their dependents in Lesotho.

Financial Service Markets

Credit

Limited uptake of formal credit. Only 16.6% of adults have credit through formal providers, although most of this is through retailers and just 3.8% (40,000 adults) access credit from banks. Given that the banks dominate the total credit market (by value), this indicates that bank lending is focused on corporates and high net worth individuals, rather than the mass market. Most Basotho accessing credit do so through informal providers or family and friends.

Consumption smoothing the primary use of credit. The primary use of credit amongst Basotho is for "living expenses when you do not have money", i.e. consumption smoothing which is important for the target markets earning irregular or low incomes. The second most frequent use of credit is for education expenses.

Fragmented, underdeveloped formal market. The credit market in Lesotho is fragmented and probably one of the most underdeveloped financial sectors, especially for the low-income market. In the rural areas access to formal credit is almost non-existent, and access depends on informal and community based financial services. In the urban areas, supply of credit is more tailored towards formally employed people. Besides the banks, the main providers of credit are non-bank credit institutions, registered money lenders, NGOs, Savings and Credit Cooperatives, Village Savings and Loan Associations, Rural Savings and Credit Groups, and unregistered money lenders (Machonisas).

Licensed credit institutions are limited to Maseru and target the employed market. However there are a large number of formal moneylenders spread throughout the country. There is only one, small lender providing credit to microenterprises. There is one large financial cooperative, and a number of smaller savings and credit co-operatives, often associated with employee groups, such as teachers. A large proportion of formal personal credit is supplied by retailers.

Concentrated banking sector. Amongst the banks, Standard Lesotho Bank is the oldest and largest player. Given the small size of the Lesotho market, it is unlikely to be appropriate to introduce more players; however, the heavy dominance of one bank in the market is not ideal. The three commercial banks are South-African owned and are guided by parent strategies, and benefit from group technology and infrastructure. Lesotho's banks are highly profitable, but are less efficient than in comparative countries. There is a strong focus on fee income. Most bank credit to households takes the form of personal loans related to salaries, but mortgage finance is also growing. The Lesotho PostBank (LPB), wholly-owned by the Government, is more development-focused but at a competitive disadvantage. It has a formal mandate to promote financial inclusion but has yet to find a sustainable, commercially viable business model.

Recent increase in bank lending. In recent years there has been a rapid increase in bank lending and a reduction in liquidity. This has important implications for the competitive environment, and may help to raise deposit interest rates as banks become more active in attracting deposits. The dramatic increase in lending by the banks has been largely attributed to changes in the regulatory context and policy measures undertaken by the government of Lesotho. Non-performing loans (NPLs) are low, but rising.

Informal credit is small in value but important. Informal loans are small but widely used and obtained from a range of sources. Unregistered money lenders (machonisas) are common. Informal savings groups are widespread and often engage in lending, to earn greater returns on deposits. Despite the low income profile of members, Village Savings and Loan Association (VSLA) repayment rates are good.

A number of factors challenge the credit market. The main barrier to accessing credit on the demand-side is fear of becoming indebted. Awareness and education are not a major barrier. From a supply perspective, payslips are required by formal providers to access credit, and irregular incomes are not appropriately catered for by formal providers. There is a lack of effective regulation and supervision of moneylenders, and inconsistent monitoring across formal provider types. The CBL does not monitor all types of registered credit providers. One of the main regulatory gaps is the current absence of financial sector supervision over Boliba, the largest financial co-operative.

Conclusion: gaps and opportunities. In terms of the potential for improving the availability of credit, aspirational farmers are a potential growth area, but very poorly served and facing a number of access barriers. Formal credit is preferable to informal credit for aspirational farmers, provided products are appropriately designed. Input financing and value chain-based distribution are a potential avenue for low value agricultural credit. There is limited support for SMME credit and further work is needed to understand the exact nature and needs of different sub-groups of SMMEs and the networks that they belong to, in order to effectively target more aspirational groups of entrepreneurs.

Informal providers play a vital role in providing credit for consumption smoothing and risk management, and the informal market is large enough to attract formal providers. However, community based financing has limitations in terms of how far it can expand.

Payments & Remittances

Cash still the preferred payments mechanism. Many bank accounts are used as 'mailbox' accounts, where money is withdrawn in one go immediately after being deposited. Most account-holders have debit cards and use their accounts primarily for ATM withdrawals. The use of POS devices in Lesotho is very low. The usage of cheques as a payments instrument is declining. By contrast, there has been rapid growth in the uptake of mobile money since its introduction in September 2012. Mobile money has become a much more frequently used method of payment than cheques, EFTs or credit cards. Only debit cards, primarily for ATM cash withdrawals, are more frequently used as a payments mechanism.

Regional payments integration. Given Lesotho's high level of trade and financial integration with South Africa, a high level of emigration for employment to South Africa, and a shared currency; cross border payments and remittances constitute a substantial portion of the value and volume of transactions in Lesotho. These cross border remittances represent an important source of household income in Lesotho, especially for rural households. This illustrates the critical importance of mechanisms facilitating these payments for Lesotho consumers. The largest users of remittances are salaried workers (presumably mostly senders) and private dependents (presumably mostly receivers). The majority of remittances are sent via friends and family.

Lesotho is gradually developing and modernising its payments infrastructure. This includes establishing a real-time gross settlement (RTGS) system to handle high-value transactions; an automated cheque clearing house, and electronic funds transfers (EFTs). The SADC Interbank Regional Settlement System (SIRESS) also commenced operation in July 2013 and handles cross-border interbank payments.

Banks are the traditional providers of formal payments services in Lesotho through the provision of cheques and EFTs. All the banks provide payments and cross-border remittance services. The three South African owned banks issue their own Maestro- or VISA-branded debit cards and operate their own ATM machine networks, but the cards are all interoperable. The LPB card system, however, is "closed" and the cards can only be used in LPB ATMs and POS machines. This means that LPB clients receive a lower value service on transaction accounts, thereby putting LPB at a competitive disadvantage to the other three banks.

Banks provide a range of payments instruments and channels, including cheques, debit and credit cards, electronic funds transfers (EFTs), ATMs, Point of Sale (POS) machines and mobile phone payments. Access to bank ATM/debit cards is linked to the opening of a transactional bank account. Typically, opening such accounts requires proof of employment or source of income, and a passport and proof of address to meet KYC requirements. The cost of an entry-level transaction account is high for the majority of Lesotho's citizens.

Mobile money emerging rapidly. Lesotho currently has three e-money providers. The two MNOs (Mobile Network Operators) both offer mobile money (MM) products, whilst FNB has introduced its eWallet. Both MNOs have appointed large agent networks to handle cash-in and cash-out transactions. For most customers, the agent is their primary interface with the MM system. FNB uses its ATMs for cash-out transactions.

The two mobile money providers (Vodacom M-Pesa and Econet EcoCash) allow subscribers to send money deposited in their mobile money account to any other individual, who can then withdraw this as cash from a mobile money agent. No registration or bank account is required to receive money. For regulatory reasons, all e-value balances on the MM system have to be matched exactly by a deposit by the MNO in a trust account at a licensed bank.

MM a cheaper, more accessible alternative to bank accounts. Mobile money costs in Lesotho are comparable with other regional mobile money products, and are substantially cheaper than comparable banking products. The opening of a MM account and registration as a user is fairly straightforward, and facilitated by tiered KYC requirements. Accounts with low-value transaction limits can be opened easily by customers, simply by using a mobile phone handset, on a "self-declaration" basis, without onerous requirements for proof of identity and address. The adoption of "Tiered KYC" requirements for MM money accounts is in sharp contrast to the banks, where "full" KYC is required for all account opening. Hence from this perspective, MM is more accessible than bank products.

Informal remittance channels predominate. The overwhelming majority of remittance senders and receivers use either informal channels or family and friends to send these remittances. However, the high reliance on informal channels has several disadvantages: it is risky, unpredictable, slow and expensive.

High costs for cross-border transfers. The high costs associated with cross border remittances sent via formal channels constitute a substantial portion of the value of the remittances sent. This helps explain the overwhelming preference by Lesotho remitters to send money with family and friends. The launch of a regional switch should substantially reduce the cost of transferring money between countries in the region operating through banks.

Scope for non-bank cross-border transfers. Discussions have been taking place with a view to setting up a new cross border money transfer channel through Capitec Bank in South Africa (cash-in) and Shoprite in Lesotho (cash-out). The initial pilot, which permits a cross-border remittance at a flat cost of R10, is set to become operational in the second half of 2014. The most important formal cross-border remittance channel is the one operated by TEBA, which is the recruitment agency for Lesotho mineworkers working in South Africa.

Several access barriers. Barriers to accessing bank accounts include required documentation, physical proximity and cost. Full KYC requirements are required for all bank accounts with no exemption for low-value accounts. As physical bank infrastructure is situated in urban centres, many clients have to travel to interact with the bank. This entails a further transport cost, which may be substantial for adults residing in rural areas. The high costs associated with transaction accounts constitute a significant barrier to usage amongst the large low-income population of Lesotho.

Cross-border barriers. The potential entrance of two types of alternative cross border money transfer providers in the form of MNOs (with mobile money) and retailers (specifically Shoprite) has significant potential to improve the efficiency and cost of cross border remittances to Lesotho. The main regulatory issues for cross-border remittances arise on the South African side. SARB rules require that all cross-border payments are subject to full FICA controls (which require full KYC verification of the identity of sender and recipient as well as justification of the reason for the transaction), foreign exchange controls and Balance of Payments (BoP) reporting. Furthermore, workers without legal immigration status are prevented from accessing the formal system.

Conclusion: gaps and opportunities. The rapid uptake of mobile money (MM) indicates that it is meeting a previously unmet need. The high reliance on cash transfers despite the high costs of such cash distribution (due to distance, the difficult terrain, and low population density and scattered settlements in rural areas) indicates a significant unmet need for a low cost payments mechanism for low value payments. This is particularly valuable for low income earners with short-term budgets. Increasing the value and use of MM therefore represents a central opportunity to improve the quality of access to finance in Lesotho. MM can also enhance formal cross-border remittances. It furthermore has significant potential through broadening the range of available services over and above person to person (P2P) transfers. These include bill payments, salary payments and welfare payments.

Savings

Savings is widespread amongst Basotho adults. Approximately 50% of adults claim to save through formal or informal savings mechanisms, and a further 7% save at home. Households account for around 40% of the deposit base of the banking system. Formal savings are substantially higher amongst urban dwellers than those in rural areas.

Many people use multiple forms of savings, combining savings with a bank, with a community savings group, and at home. It is estimated that around half of those who save with an informal savings group also save with a bank. Although banks and other formal institutions are often considered to be mainly for the formally employed, they in fact cater for a wide range of customers where savings accounts are concerned. Only a third of those who save in banks are from the salaried target group, with the remaining two-thirds spread across the other groups.

Saving for living expenses rather than long-term purposes. The demand-side research indicates the main motivation for savings to be the need to meet living expenses (i.e. consumption smoothing). Other important motivations for savings are to mitigate risks (funeral expenses, non-medical or medical emergencies), and education or school fees. Savings for investments, capital accumulation or for retirement are less common.

Many options for saving. There are a wide variety of institutions offering savings facilities for households in Lesotho. In the formal/ regulated sector this includes the banks, TEBA, pension funds, and mobile money operators. Community-based institutions include Boliba co-operative, various types of SACCOs, Rural Savings and Credit Groups, Village Savings and Loans Associations, and informal savings clubs. The Financial Institutions Act makes provision for the licensing of various deposit-taking institutions besides commercial banks; these "Type II" financial institutions include large financial co-operatives, deposit-taking MFIs and savings banks. However, regulations governing the licensing, operation and supervision of such institutions have yet to be finalised.

Entry level savings accounts fairly accessible. Interest rates on bank deposits are low. However, as credit grows, competition between banks to mobilise deposits may lead to higher interest rates on deposits. The minimum opening balance requirements on entry-level savings accounts are relatively modest, ranging from M40 – M200. Some savings accounts also come with the added functionality of ATM cards and access to cellphone and internet banking. Bank fees are perceived as being high, but this may not reflect the reality for entry-level accounts.

Cross-border savings. It is likely that significant financial savings are held by Basotho in South Africa. This is driven by higher interest rates on savings deposits in South African banks as compared to Lesotho banks. Savings are also held in South Africa in the form of Ubank/TEBA accounts.

Many people use informal or community-based savings institutions. Estimates suggest that the total informal deposit loan book is about M400 million, which constitutes about 6% of total bank deposits and about 15% of total household financial savings in banks. Most of these groups have both savings and credit functions, acting as local intermediators of deposits. As well as financial services, membership provides communal and social support where members can turn to one another for emotional assistance. Informal savings groups generally require fixed term savings from members, depending on the group cycle. Returns are often good when the savings pool is loaned out, but there are also risks from fraud and non-repayment of loans.

Saving in mobile money accounts offers an alternative to bank accounts. A major advantage of saving with mobile money rather than with banks is the greater distribution network of mobile money agents. Furthermore, accessing mobile money has fewer barriers to entry than bank accounts in terms of reduced know-your-customer (KYC) requirements and no proof of employment or income requirement.

Pensions underdeveloped beyond public sector. The most important pension fund in Lesotho is the Public Officers Defined Contribution Pension Fund (PODCPF), which has around 35,000 members. The private occupational and voluntary pension sector is undeveloped. Relative to other SACU countries, the Lesotho pension sector is the smallest (in relation to GDP). A compulsory national pension fund has been proposed in response to low pension coverage.

Savings limited by low incomes. The primary reason indicated in the demand-side research for not saving is low incomes. Furthermore, many Basotho believe bank fees to be high, even if these fees may not be substantial in practice for entry level savings products. "Doorstep" barriers to banks are also important; many qualitative research respondents

indicated that they are of the opinion that they are not the target market of banks and therefore they do not even investigate savings options at the banks. At the same time, banks have some positive characteristics; they are perceived to be very safe and are trusted.

Some regulatory barriers. Mobile money operators are prevented from offering interest on products. The FSDS recognises that mobile money products can play an essential role in providing low cost options for savings products, and proposes that a new licensing category is introduced into the FIA that specifically accommodates deposit-taking e-money issuers, such as MNOs. The new licensing category would deal with concerns about the encroachment of MM into the banking space, and by providing a definitive regulatory basis for such products it would encourage their rollout and access for the unbanked. Other barriers relate to a non-level playing field between banks and non-banks. This includes regulations relating to agency banking and KYC requirements.

Conclusion: gaps and opportunities. Mobile money represents a low cost, accessible alternative flexible savings product. There is a potential role for banking agents to overcome distributional challenges for rurally based savers. Finally, informal savings group are a powerful savings mechanism and no major consumer protection concerns have arisen in this space.

Insurance

Funeral insurance a major financial inclusion driver. Insurance is the most-consumed financial service in Lesotho for nearly all target groups and contributes significantly to the financial inclusion figures. The high uptake is virtually exclusively driven by funeral insurance. According to FinScope 2011, 62% of the adult population has some form of insurance. Usage is significantly higher in urban areas, where formal penetration is 48.1% as compared to the 31.8% in rural areas. In turn, informal-only usage is much higher in the rural areas (30%) than for urban dwellers (11.4%).

Risk of death ranks highly. Demand-side research indicates that the risk of death is the only significant risk that Basotho insure against, and accounts for the high levels of uptake and usage of both formal and informal funeral insurance. Funeral cover cuts across income bands. Other products are only consumed, in low proportions, by consumers in the higher income bands.

Potential health use case. Though funeral insurance is the only product currently used to any significant extent, it does not mean that other insurance products cannot potentially add value. Research suggests a potential use case for health insurance. Apart from death and health, few other risk events seem significant from the client perspective. There would not seem to be a strong use case for agricultural insurance from the customer's perspective. The same holds for asset insurance.

Small number of formal providers. The insurance industry in Lesotho is small. There are three long-term (life) insurers, two short-term insurers, one composite insurer, and 17 insurance brokers. The ownership of insurance companies in Lesotho is mixed, both local and foreign. The formal insurers offer a range of short-term and life cover, including funeral cover.

Cross-border competition. There is also competition from South African insurers, which is used by both corporates and individuals. Competition from South African insurers restricts the growth of the local industry, but from the consumer's perspective the ability to buy insurance in South Africa is essential to extending product options, as well as in providing a pricing and value-for-money benchmark.

Proliferation of informal providers. Funeral undertakers and burial societies are considered as informal providers, because they are not regulated or supervised as financial service providers. Funeral cover from funeral undertakers, mainly through the provision of funeral services, is prevalent. Funeral undertakers have a wide geographical footprint and better access to the low-income market than the formal insurance market and indications are that they are trusted by clients. There is no formal supervision or regulation of insurance business conducted by funeral undertakers. Over time, consumers have begun demanding the option of cash payouts from funeral undertaker policies, in addition to services. However, the Insurance Act clearly classifies cash payouts dependent on death as life insurance business, for which a licence is required.

Burial societies play important social role. Burial societies offer a functional coping mechanism for many households, but face a number of challenges that affect their functionality. It is therefore common for people to belong to more than one burial society, or to use other coping mechanisms in addition to burial societies, including formal insurance for those who are able to make regular premium payments.

Distribution largely broker and agent-based. The distribution space for short-term insurance is dominated by brokers. For long-term insurance, most of the insurance companies have networks of agents for marketing and sales of insurance policies. However, the distribution space for long-term insurance is changing, with the most recent development being the use of mobile network operators.

Various access barriers. Although Lesotho has relatively high uptake of insurance, there are still challenges for some people in the low-income population segment to access insurance. Irregular incomes make it difficult to make regular premium payments, but high uptake shows that affordability is not a major barrier in practice, as people are willing to prioritise funeral cover in their budgets. It would, however, suggest that there is limited scope for additional insurance beyond funeral cover for the majority of adults. Negative perceptions of formal players are a key usage barrier, mainly related to claims settlement.

Regulatory barriers largely relate to distribution. A microinsurance regulatory framework is currently being developed. The main challenges lie on the distribution side. Insurers and intermediaries are seeking ways to innovate to increase uptake of insurance products by low-income population segments. However, the current distribution framework is not facilitative of alternative distribution channels. Notably, the issue of bancassurance is still under discussion. The likelihood is that such provisions will be dealt with under agency considerations for banks, as will insurance partner-agent arrangements for delivering microinsurance.

Conclusion: gaps & opportunities. Innovation particularly in improved product benefit design and delivery channels by formal insurers can enhance client value and uptake of formal insurance products. Based on the current offering and market opportunity analysis, the

scope for other types of insurance products than funeral insurance is very limited. However, there would seem to be a gap in provision – as well as an in-principle use case – for some kind of health-related insurance across the various segments. Though the majority of households currently access health care from public clinics and hospitals, they incur ancillary expenses and suffer lack of income when sick.

Roadmap Priorities

Financial inclusion drivers

The analysis suggests a number of cross-cutting drivers of financial inclusion:

- *Entrepreneurship, farming important to livelihoods*. The small size of the economy and limited industrial base means that, though most micro businesses are survivalist in nature and most farmers operate on a subsistence basis, entrepreneurship and farming nevertheless fulfil an essential role in generating livelihoods.

- *Strong collective functioning creates social resilience and supports financial inclusion*. Community-based/collective financial services are a preferred way of functioning in society, rather than just a stop-gap measure in the face of formal exclusion.

- *Cultural factors, poor health impact financial decisions*. The cultural prominence of a decent burial, along with strong social structures has led to Lesotho having a very high penetration of funeral insurance, both formal and informal. Furthermore, the impact of poor health is evident on household structures and creates an imperative for targeted financial services (be it savings, credit or insurance) as a coping mechanism.

- *Extensive regional integration impacts livelihoods and financial inclusion profile*. Lesotho has a high degree of financial integration with South Africa and migrant labour has a central impact on household structures and livelihood activities. Those dependent on others for their main income source is the single largest target market segment, whilst many other adults also receive remittances as an additional source of income. Apart from the direct impact of remittances, the large migrant population also creates scope for other financial services targeted at the diaspora.

- *Generally enabling environment, but isolated regulatory provisions impact inclusion*. Though the regulatory framework as a whole does not pose significant access barriers, there are nevertheless a few key constraints, such as that there is no KYC threshold limit for bank accounts (as is the case for mobile money), that there are differential regulations regarding the requirements for banking and mobile agents and that MNOs are not currently allowed to pay interest on deposits.

- *Regulatory hiatus creates uncertainty*. In addition, the implementation of new legislation and the ability of financial institutions to take advantage of new opportunities are being held up by the lack of regulations needed to give effect to the legislation. Even where regulations relating to financial services provision exist, enforcement has been patchy, leading to uncertainty and the persistence of undesirable practices.

- *Small financial sector limits potential for economies of scale*. The number of formal financial institutions is small, there are limited formal non-bank credit providers and almost no provision of productive credit to SMMEs. This results in relatively high use of expensive and short-term informal credit vis-à-vis formal alternatives. This in part reflects the small size of the economy, in absolute terms, which limits the potential for economies of scale.

- *Mobile money particularly relevant in a remittance economy*. The advent of mobile money is an important development that offers the prospect of an increasingly broad range of financial products that overcome traditional distribution challenges. There has been very quick and high initial uptake and a substantial proportion of users are active.

Determining roadmap priorities

Rethinking the role of financial inclusion. Though each target market segment still has a number of financial service needs, the adult population is on the whole already broadly served by financial services. However, the kind of financial services that people use (including high-cost bank accounts, low-value community or home-based savings, high-cost informal loans, funeral cover and informal remittances) are not serving to lift them out of poverty, but are merely helping them to "get by". Dependents, survivalist entrepreneurs, farmers and those who do piece jobs or casual labour make up the lion's share of adults. Their very low and irregular income profiles challenge formal eligibility, especially for credit. Furthermore, the country's geography and topography, combined with poor infrastructure, means that there are substantial access barriers for the two thirds of adults who live in rural communities. This would suggest that the scope for further penetration at scale is limited. The conclusion is that financial access measured in terms of uptake is not the issue in Lesotho. The bigger question is: how can financial services be leveraged or re-engineered to more effectively alleviate poverty and support economic growth?

When filtering the financial inclusion priorities through the lens of actions most likely to meet key target market needs and contribute to poverty alleviation and economic growth, three key roadmap priorities arise:

1. Directly improve household welfare through efficiency gains and risk mitigation
2. Take small steps towards enhanced growth through highly targeted productive credit and inward investment promotion
3. Leverage financial sector intermediation to support investment and growth

1. Directly improve household welfare through efficiency gains and risk mitigation

It is clear from the target market needs analysis that most households can benefit from efficiency gains in the financial services that they engage with. This strategy has three prongs:

a. Lowering transaction costs and enhancing the range of low-cost savings options. There is a need for accessible, low-cost savings options across target markets – for a short-term store of value for remittances received, but also longer-term goal-oriented savings products, e.g. towards education or for health or other emergencies. Facilitating lower-cost, more accessible savings options and transaction accounts can therefore have direct

welfare benefits. However, it must be recognized that such efficiency gains, while not negligible, will not provide a silver bullet out of poverty. It can only be a contributing factor on the gradual path to economic development.

Potential actions in this regard include:

- *Facilitating the continued growth of mobile money.* To come into its own as a store of value, it should be allowed to pay interest. Creating an ecosystem of goods and services that can be purchased directly with mobile money will increase the velocity of mobile money in the system and improve the overall value proposition of the product for consumers.
- *Enhanced non-bank competition to impact on incentive structures*. Increasing competition from MNOs, including allowing them to pay interest on deposits, and stemming from their lower transactions fees may act as this incentive for banks to reduce their fees and pay more attractive interest on deposits.
- *Greater disclosure of fees*. Enhanced transparency/disclosure requirements regarding charges, or a form of industry code on disclosure practices can all serve to bring down user costs.
- *More efficient government payments*. Efficiency gains can be had by converting bulk cash disbursals (such as grant payments) into electronic transactions through the banking sector or mobile money.

b. *Facilitating low-cost domestic and cross-border remittances*. More accessible, cheaper domestic as well as cross-border remittances will represent a direct welfare gain for all of the target market segments – either as senders or receivers. Potential actions in this regard include:

- *Allowing retailer remittances*. Facilitating the retailer cross-border remittance model, and extending it to domestic remittances and outgoing cross-border remittances and formalising the model in regulation for others to adopt if they want is a first step.
- *Advocating for lower first-mile barriers to cross-border remittances*. Another important strategy will be to work with authorities in South Africa to find a way to enable cross-border mobile money payments, to enhance access for informal Basotho workers in South Africa to the South African banking system and to reduce the cost and regulatory requirements of cross-border banking payments.
- *Active banking strategy to capitalise on informal remittance flows.* With the introduction of the new regional switch, SIRESS, the cost of transferring money between countries in the region is substantially reduced. Given that these banks may become increasingly competitive for deposits due to the current trend of rising credit provision, the informal remittances represent a substantial opportunity for the banks to substantially increase their deposits.

c. *Enhancing risk mitigation beyond funeral cover*. Most Basotho adults already have funeral cover. While funeral cover enables decent burials and prevents households from incurring debt or drawing down savings when faced with funeral expenses, it is a sunk expenditure that does not provide a return in terms of the wealth of the family and, hence, does not directly lift people out of poverty. To achieve this objective, the product

suite accessible to the low-income market would need to be broadened to life insurance that can, for example, pay for dependents' education, and coverage for health risks. Consideration should be given to the scope for bundling of funeral cover (with which the market is familiar enough to create a spontaneous demand) with other elements such as life and health in order to ensure uptake. Another important consideration given qualitative demand-side feedback is the need for capacity building, benefit design and better service offerings of existing funeral insurance providers. Lastly, more specific analysis is needed on the parameters to be included in microinsurance regulations.

2. Take small steps towards enhanced growth through highly targeted productive credit and inward investment promotion

Specifically target credit at aspirational SMMEs and cash-generating farmers. The small economic and industrial base means that individual entrepreneurs, farmers and small businesses fulfill an important role in supporting livelihoods, even if the more aspirational among them represent only a small group and most are survivalist in nature. While the bulk of microenterprises and small-scale farmers are unlikely to be viable credit clients, access to productive credit can benefit a small, but important subset of small business owners and farmers.

Leverage the private sector. Sustainable access to productive credit can be pursued through targeted strategies to provide finance to distinct pockets of enterprising entrepreneurs. To do so, at least three strategies can be considered:

- *Targeted market research* on SMMEs and farmers, focusing on specific, promising sub-sectors, to get a more dedicated understanding of their realities and finance needs, as well as the value chain aggregators and other networks with potential to reach them.
- *Tailored product design.* The credit needs of both farmers and SMMEs will tend to be long-term in nature. Other product characteristics will need to be tailored to the consumer. For example: a small business may need an initial repayment holiday in order to allow the business to achieve profitability whilst the repayment terms of agricultural loans should reflect the seasonality of farmers' incomes.
- *Leverage existing channels.* Targeting defined groups of SMMEs and farmers requires a rethink of the role and mechanisms of delivering credit. Potential actions include working through existing networks in key markets.

Explicit strategies to leverage inward investment by migrant workers. Drawing on international experience, a number of strategies can be considered for more effectively leveraging inward productive investment by migrant workers.

3. Leverage financial sector intermediation to support investment and growth

Providing products appropriate to the needs of low income and entry level consumers is likely to become more important for banks, and can support growth by leveraging savings for investment purposes. There are a number of options:

- *Reducing costs* of formal savings and enabling mobile money to play an explicit role in deposit mobilisation.

- *Incentivising higher account balances* through interest rate incentives, or innovative schemes such as embedding free funeral cover based on the deposit value maintained in a bank account.
- *Facilitating access to savings accounts by revisiting eligibility requirements,* such as the introduction of a tiered KYC system in banking similar to what is the case for e-money, revisiting the need for proof of employment or income by banks, or by promoting partnerships between banks and MNOs to utilise mobile money as a lower-cost front end for mobilising savings accounts
- *Targeting groups*. Furthermore, offering tailored group accounts is a way of leveraging the large funds vested in community-based savings and insurance groups for formal intermediation in the economy.
- *Incentivise non-resident Basotho to save and invest in Lesotho*. Another strategy would be to find a way to make it cheaper and more lucrative for migrant workers to save in Lesotho than in South Africa.

- *Selective institutional reforms*: Lesotho Postbank and Boliba Savings and Credit play a small but important role in providing financial services to low-income households, but both face significant problems that jeopardise their future sustainability. For LPB, this means reforming its governance and clarifying its mandate; developing a viable business plan; upgrading and modernising its payments system; moving to a branchless banking platform, and possibly considering an alliance with an MNO. For Boliba, regulation needs to be modernized and supervision made effective, and extensive governance reform undertaken.

The discussion above has shown that a number of key activities – for example to promote mobile money by allowing it to pay interest, or various policies to target migrant workers, can serve more than one of the key public policy objectives to be achieved through the roadmap and are therefore relevant for more than one of the three core roadmap strategies.

1. Project Scope and Objectives

This diagnostic report forms the evidence base for the Making Access to Financial Services Possible (MAP) Lesotho initiative. This report applies the MAP diagnostic and programming framework to support expanding access to financial services for individuals as well as micro and small enterprises. MAP is a multi-country initiative to support financial inclusion through a process of evidence-based country analysis. It is a partnership between the United Nations Capital Development Fund[3] (UNCDF), FinMark Trust[4] and the Centre for Financial Regulation and Inclusion[5] (Cenfri). In each country, it brings together a broad range of stakeholders from within government, private sector and the donor community to create a set of practical actions aimed at extending financial inclusion tailored to that country[6].

Why focus on financial inclusion? Financial inclusion is achieved when consumers across the income spectrum in a country can access and sustainably use financial services that are affordable and appropriate to their needs. The MAP approach pursues financial inclusion not in and of itself, but in support of enhanced welfare and an impact on the real economy, namely those activities that contribute to GDP and economic growth[7]. Economic theory[8] suggests that financial intermediation can fuel real economy impacts at the macroeconomic level by mobilising savings for investment purposes (including capital allocation for business development), reducing transaction costs and increasing efficiency, thereby contributing to employment generation and growth. At the microeconomic or household level, financial inclusion can impact people's welfare directly by reducing their transaction costs, enabling them to more efficiently manage risks, allocating capital for productive use and supporting the accumulation of wealth over time. Financial services can also facilitate access to core services, such as health or education. This can impact growth directly, by triggering service sectors, as well as indirectly, by enhancing productivity.

Why conduct MAP in Lesotho? In August 2013, The Government of Lesotho, via the Ministry of Finance, formally requested the implementation of MAP in Lesotho. This commitment followed a presentation of MAP to the Ministry of Finance, the Ministry of Development Planning and the Central Bank of Lesotho on 31 July 2013. MAP acknowledges and builds on the financial inclusion research conducted in Lesotho to date, including the Support for Financial Inclusion in Lesotho (SUFIL) and RUFIP (Rural Financial Intermediation Project) programmes and, importantly, the Financial Sector Development Strategy (FSDS). The intended outcome of the MAP diagnostic in Lesotho is to facilitate the development of a comprehensive financial inclusion roadmap to align stakeholders and resources around

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[3] **UNCDF** (www.uncdf.org) is the UN's capital investment agency for the world's least developed countries. It creates new opportunities for poor people and their communities by increasing access to microfinance and investment capital. UNCDF focuses on Africa and the poorest countries of Asia, with a special commitment to countries emerging from conflict or crisis. It provides seed capital – grants and loans – and technical support to help microfinance institutions reach more poor households and small businesses, and local governments finance the capital investments – water systems, feeder roads, schools, irrigation schemes – that will improve poor peoples' lives.

[4] **FinMark Trust** (www.finmark.org.za) is an independent non-profit trust whose purpose is 'Making financial markets work for the poor by promoting financial inclusion and regional financial integration'. The trust was established in March 2002 with funding from the UK's Department for International Development (DFID).

[5] **Cenfri** (www.cenfri.org) is a non-profit think-tank based in Cape Town. Cenfri's mission is to support financial sector development and financial inclusion through facilitating better regulation and market provision of financial services. They do this by conducting research, providing advice and developing capacity building programmes for regulators, market players and other parties operating in the low-income market.

[6] For more information on MAP visit any of the partner websites listed in the footnotes above.

[7] It goes both ways, however. As the discussion in Section 2 will show, the real economy and broader country context also impact the scope for financial inclusion by determining the realities within which the target market functions.

[8] See, for example: Calderón & Liu (2002), King & Levine(1993), and Levine (1997)

agreed key priorities. This report forms the evidence base for the stakeholder process towards the development of such a roadmap. The MAP roadmap will not replace the FSDS, but will build on it and focus the menu of FSDS recommendations into a set of key priority activities informed by the target market context and needs.

The MAP project is formally hosted by the Ministry of Finance, with the cooperation of the Central Bank of Lesotho. A MAP Task Team has been formed to oversee the MAP diagnostic and roadmap development process. The MAP Task Team, chaired by the Ministry of Finance, is accountable to the FSDS Implementation Committee.

1.1. Scope and methodology

MAP incorporates a comprehensive analysis of the country context as well as of the demand and supply of financial services and the regulatory environment in order to identify key barriers and opportunities to increased financial inclusion across four core product markets:

	***Credit***
	***Payments***
	***Savings***
	***Insurance***

Table 1: Four core product markets

Source: Authors' own

Customer needs as point of departure. MAP puts the demand-side perspective – the customer and his/her needs – at the core of the analysis and recommendations. The adult population is segmented into groups of individuals with similar profiles and needs that could form discrete target markets for financial services. With the target markets in mind, the rest of the analysis then seeks to identify which institutions currently serve which parts of the market through which services, as well as what the potential and gaps are for enhanced provision. The analysis is informed by the realities of the context of the country and ultimately seeks to meet the policy objective of financial inclusion as a tool to improve welfare and poverty alleviation.

The supply-side analysis was informed through in-country consultations with industry, regulators and other stakeholders, complemented by desktop research and a mystery shopping exercise. The demand-side analysis is based on the FinScope (2011) survey, as well as insights generated by qualitative demand-side research in the form of focus group discussions and individual consumer interviews conducted as input to the study.

1.2. Structure

The document is structured as follows:

- **Section** 2 outlines the country context, including the macroeconomic and socioeconomic context, as well as physical infrastructure. The country context plays an important role in shaping the scope for financial inclusion.
- **Section** 3 analyses the relevance of the regulatory framework in Lesotho for financial inclusion.
- **Section** 4 takes a closer look at the target market, zooming in on the profile and needs of different target market groups and analyzing current levels of usage of financial services.
- **Section** 5 provides an overview the financial service provider landscape in Lesotho across the four product markets and analyses the capital market infrastructure and distribution network.
- **Sections 6** considers each of the four product markets: credit, payments, savings and insurance. For each market, the analysis considers:
    - **Current usage** – the profile of usage in the particular product market
    - **Use cases** - the nature and extent of various use cases for the product (see Box 1 for an explanation)
    - **Providers** – an overview of the types and performance of providers serving the particular product market.
    - **Products** – an overview of the suite of available products in the market and their key features from a financial inclusion point of view.
    - **Barriers to access** – the factors that prevent greater financial inclusion in the particular product market, be it factors relating to the nature of the target market (such as their perceptions and trust – called *usage barriers*) or the features and accessibility of the product suite -called *access barriers*[9].
    - **Regulatory issues** - with a bearing on financial inclusion in the particular market
    - **Gaps and opportunities** – concluding on the key gaps and opportunities for serving target market needs in the particular product market.
- **Section** 7 concludes by identifying the financial inclusion priorities stemming from the target market needs and supply-side analysis and highlighting potential roadmap focus areas to unlock the opportunities.

Box 1. What is a use case?

A "use case" is simply an identified need or application for a particular service among the target market, the reason why a particular product is demanded. For each product market, there will be several use cases. The use cases for a particular product will differ across

[9] **Access barriers** are factors relating to the supply of financial services that preclude certain individuals from using such services. Affordability, availability of the service within easy reach, the eligibility requirements set (which can be the result of regulatory requirements) and the appropriateness of the available products to prospective clients' particular needs are the main access barriers.

Usage barriers refer to factors that cause people not to use financial services even if they technically have access to it. Usage barriers are internal to the individual or society and include perceptions, trust, financial capability and the fear of officialdom.

countries, depending on the context and target market features. For example, “to pay bills” or “to send money to rural family members” can both be a use case for payments, while “to provide for education expenses” can be a use case for either savings or credit.

The use cases identified in Section 6 are intended to focus the discussion on the actual or potential needs expressed in the market and the prospective roles that a particular product could fulfil. The use cases for each product market are identified based on the qualitative and quantitative demand-side research, along with an overview of products on the market and insights from provider interviews.

2. Context

The development of a strategy for Making Access to Finance Possible (MAP) in Lesotho will reflect many general challenges related to low-income countries along with a range of characteristics that are specific to Lesotho itself. While Lesotho shares many of the characteristics of the region within which it is located (Southern Africa), it also has many distinctive economic, physical and demographic characteristics that have important implications for extending financial inclusion.

2.1. Physical context & infrastructure

Small size. Lesotho is a small country in physical, demographic, and economic terms. It has a population of just short of 2 million, a land area of 30,355 km^2, and is completely surrounded by the Republic of South Africa[10] (FAO, 2005). The country has a high elevation and the terrain is largely mountainous[11]. Although distances are not large, the mountainous terrain makes transport and communications difficult. Many people live in areas that are considered "remote" due to inaccessibility. Many people in the rural areas are unable to access markets, schools and even health facilities (South African Foreign Policy Initiative, 2012).

Poor road network. Lesotho's rugged terrain[12] remains a challenge for expansion of maintaining the current road network. The majority of the road infrastructure is found in the lowlands which represents about 25% of the country's total land area (Wade Publications, 2011 and FAO, 2005). Major roads connect all the districts but there are relatively fewer roads that connect villages and towns within the mountain districts that make up 75% of the remaining land area and are home to about a quarter of Lesotho's population (Wade Publications, 2011). The proportion of paved roads improved from 18% in 2006 to 26% as reported in 2011[13] (Bogetić & Fedderke , 2006 and Mail & Guardian, 2011).

Lesotho does not have its own railway line and uses South Africa's railways line which stretches on for 2.6 km into Maseru via the Caledon border (Wade Publications, 2011).

Expanding water and electricity infrastructure. Lesotho is expanding the Lesotho Highlands Water Project (LHWP) initiated in 1986. Based on the first phase of the project, it currently earns about $24 million annually for the sale of water[14] and hydro-electric power to South Africa and produces 80% of the electricity needed domestically (Michigan State University, 2014). The second phase, worth R15.4 billion, was launched in March 2014 and is set to be completed in 2020. When in full operation, it will increase electric power for Lesotho and increase water supplied to South Africa by 50% (Times Live, 2014). Lesotho is aiming for an electrification rate of 35%[15] by 2015 from its current rate of 28% (Lesotho Electricity Authority, 2013). With declining surplus capacity in the Southern Africa Power Pool especially in the winter, Lesotho experiences sporadic outages and load shedding.

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[10] Lesotho is the only country in the world to be completely surrounded by a single other country.
[11] Lesotho has the highest lowest point of any country in the world.
[12] Lesotho has the most rugged terrain in the continent (Wade & Lovegrove, 2011).
[13] Paved roads in Sub Saharan Africa accounted for 19% of total roads (The World Bank (c), 2014)
[14] Water and diamond are Lesotho's most significant natural resources (UNEP Risoe, 2013).
[15] Average Sub Saharan Africa electrification rate stands at 32% (KPMG, 2011)

Land reform. Traditionally, a communal land tenure system applied in Lesotho (refer to Box 2). Among other changes, the 1979 Land Act established a state leasehold tenure that gave title holders of non-agricultural land in urban and rural areas exclusive possession and enjoyment of their plots. A revised Land Act was enacted in 2010. It allowed for persons allotted agricultural land in rural areas to apply for lease titles that serve as proof of ownership. This has allowed landowners to mortgage, sublease, transfer and inherit land, as well as to apply for commercial business licenses (Lesotho Government, 2010). The 2010 Act, together with the establishment of the Land Administration Reform Project (a mass titling project supported by the Millennium Challenge Account), led to more than 60 000 leaseholds being registered by September 2013. This is five times the number of leases that were registered by the end of 2008 (Kadaster International, 2014). Nevertheless, international research suggests that the impact on access to credit where titles are used as collateral is limited (Leduka, 2012). This is confirmed by FinScope (2011), where less than 1% of adults indicated that they have a title deed on their land.

Box 2. Communal land tenure system

Under the communal land tenure system, all land belongs to the Basotho nation and is held in trust by the King as the head of state. Before the land reform programme, there was no individual ownership of land and chiefs were responsible for allocating and administering land on the king's behalf. They allocated arable land to families to cater for their subsistence but the land would revert to communal use after the crop harvest. With respect to grazing land, all community members were entitled to grazing communally. The chiefs could not allocate individual rights to grazing but they were responsible for opening and closing communal grazing lands in accordance with principles aimed at conserving the areas and enhancing animal productivity (Mosaase, n.d.). Despite having advantages such as promoting equality, the communal land tenure system was seen as an obstacle to commercialization of agriculture, enhanced food security and proper land conservation because there was little incentive to invest in land that had no security of tenure (Lee, 2011; Daemane, 2012).

Widespread cell phone access. According to the International Telecommunications Union[16], mobile teledensity in Lesotho was 86.3 cellular subscriptions per 100 inhabitants in 2013. Within the SACU region, this is higher than Swaziland (71.5) but lags significantly behind Botswana (160.6), Namibia (110) and South Africa (147.5). Cellphone signal coverage is estimated to extend to 81% of the population. FinScope (2011) estimates 69.8% of adults to own or use a cell phone, though this number is expected to have grown since.

2.2. Macroeconomic context

At USD 2.3 billion (2013 estimate), Lesotho's GDP is only 0.7% the size of the South African economy. At the same time, Lesotho has not registered a negative GDP growth rate since 1981; the only country in the SACU region with such a track record. From 2000 to 2012, it registered the second highest growth (4.1%) in the SACU region. Although the World Bank classifies it as a lower-middle income country, it is relatively poor by the standards of SACU

[16] http://www.itu.int/en/ITU-D/Statistics/Pages/stat/default.aspx

countries. Lesotho's GDP per capita of USD 1,289 is the lowest in the SACU region (International Monetary Fund, 2014).

GDP Breakdown. Similar to other SACU countries and as recorded in 2012, Lesotho's services sector is the largest contributor to GDP at 58%[17], followed by industry at 34.6%[18] and lastly the agricultural sector at 7.4%[19] (The World Bank (c), 2014). The main industry sector drivers have been the textile and apparel industry, electricity and water industry, mining industry and building and construction industry (SARC Department, 2013 and Nseera & Bhatia, 2014).

Small private economic base. The private sector is gradually expanding following government initiatives aimed at encouraging private sector development. Although credit extension to the private sector rose from 19.8% of GDP in 2012 to 21.6% in 2013 (Nseera & Bhatia, 2014), the majority of such extension is to private households and not to business enterprises (Central Bank of Lesotho (b), 2012).

Textile industry the main contributor to economic growth and job creation, but now under threat. The textile industry accounts for 40%-60% of exports (Trading Economics, 2014 and Nseera & Bhatia, 2014). It employs 80% of Lesotho's manufacturing workforce and 85% of these are women (Nseera & Bhatia, 2014 and Bennett, 2014). Recently, there has been a declining trend in the industry due to increased competition from Asian producers following the expiration of the Multi-Fibre Arrangement (MFA) in 2005, as a result of the global economic crisis, a strong exchange rate and by withdrawal of the SACU duty rebates for imported raw materials (World Bank, 2014). Investors are also concerned about the loss of duty free access to the USA once the African Growth and Opportunity Act (AGOA) expires in 2015. The Act was the main reason the industry flourished in the first place (SARC Department, 2013) making it the largest sub-Saharan Africa exporter of textile and clothing to the United States (Manoeli, 2012).

Young and flourishing diamond mining industry, but with limited impact on job creation. Lesotho is experiencing strong growth in especially mining activities: the contribution of mining to GDP has risen from 0.1% in 1999 of GDP to 7.8% in 2013 and mining now makes up 22% of total exports. Yet there has been little impact on job creation because of the capital intensive nature of mining as well as its weak linkages with other economic sectors (SARC Department, 2013).The diamond sector employs 2 000 workers and is expected to employ 1 000 more by 2016/17 (International Monetary Fund, 2012).

Small SMME sector. Lesotho does have not a strong documented entrepreneurial sector and most of the developments in trade, including in the textile industry, have been driven by FDI[20].Limited employable skills and poor levels of technological development have resulted in few linkages between foreign companies and local medium and small enterprises (ILO, 2012). Lesotho is ranked 143rd out 185 economies in the overall ease of doing business index and 79th for starting a business specifically (The World Bank (e), 2014). Some of the

[17] Services include value added in wholesale and retail trade (including hotels and restaurants), transport, and government, financial, professional, and personal services such as education, health care, and real estate services. Also included are imputed bank service charges, import duties, and any statistical discrepancies noted by national compilers as well as discrepancies arising from rescaling (The World Bank (c), 2014)

[18] Industry comprises value added in mining, manufacturing (also reported as a separate subgroup), construction, electricity, water, and gas (The World Bank (c), 2014)

[19] Agriculture includes forestry, hunting, and fishing, as well as cultivation of crops and livestock production.

[20] Taiwanese and Indian investors own most textile factories in Lesotho (United States Department of State, 2012).

challenges facing businesses in Lesotho are inadequate supply of infrastructure, restrictive labour regulations, crime, corruption and tax rates[21] (C. Makokera, 2012).

Various government support initiatives for SMMEs. The government of Lesotho has created a number of departments and agencies with a mandate to help develop local entrepreneurs. The parastatal BEDCO (Basotho Enterprises Development Corporation) was established in 1975 as a subsidiary company of the Lesotho National Development Corporation (LNDC). Its mission is to aid the establishment and development of Basotho-owned businesses by offering administrative, planning and marketing support. In 2007, the Ministry of Trade, Industry, Cooperatives and Marketing (MTICM) along with the World Bank, launched the One-stop Business Facilitation Centre (OBFC). It was given the task of reducing the number of procedures necessary for starting a business. The MTICM also houses the Department of Cooperatives, which is, amongst others, given responsibility for entrepreneurship development (UNDP, 2012).

Agricultural sector more important to livelihoods than economic contribution suggests. Despite only contributing 7.4% to GDP, agriculture is the mainstay of rural inhabitants and provides livelihood sustenance (if not the primary source of income) to over 70% of Lesotho's population (Ministry of Natural resources, n.d.). Most farmers are subsistence producers with average plot sizes of less than 1.5 hectares. Commercial farmers involved in market-oriented production account for 10% of total output (FAO/WFP, 2007). Most small-scale farmers lack the labour, capital or access to advanced technologies and support services that they need to improve their farming practices. Severe land degradation, reliance on rain fed farming and poor crop husbandry methods have also contributed to low yields (IFAD, 2008). Lesotho produces only 30% of the nation's food demand and has to import the deficit (Central Bank of Lesotho (c), 2012).

Wool, mohair biggest commercial farming activities. Due to the barren and mountainous terrain, land with agricultural potential makes up only about a quarter of Lesotho's total land. About 9% is arable and the other 16% is suitable for livestock farming (Wade Publications, 2011). Most crops (notably maize) are for subsistence purposes, with livestock farming, and particular wool and mohair production, being the main cash-generating activities. Lesotho produces 14% of the world's mohair and is the second largest producer of mohair in the world (ABSA Agribusiness, 2011). There are an estimated 28,000 wool producers (Matebesi, 2014).

Established public network of shearing sheds. Government, under the auspices of the Livestock Department, operates approximately 100 shearing sheds[22] spread throughout the country. These sheds are estimated to handle shearing of more than half of all sheep and goats in Lesotho. Their day-to-day administration is in the hands of producer groups known as Wool Growers Associations (WGAs). The average goat flock sheared at government woolsheds is 31 head and the average sheep flock 53 head. Both of these are about twice as large as the national average flock per farmer. (International Livestock Research Institute, n.d.).The shearing shed network is therefore a good entry point to reach the more commercial farmers in Lesotho

[21] Lesotho's corporate tax rate is currently 35% and is levied on net income companies obtain while exercising their business activity (United States Department of State, 2012).
[22] Another author mentions 114 government woolsheds (Matebesi, 2014: http://www.merino2014.com/uploads/files/Matebesi-PP-30.04.14.pdf)

2.3. Economic Integration and Trade

SACU receipts an important source of fiscal revenue. Lesotho is a member of both the Southern African Customs Union (SACU) and the Common Monetary Area. These institutions are extremely important in the economic structure of Lesotho. SACU members are Botswana, Lesotho, Namibia, South Africa and Swaziland, and it is the oldest customs union in the world. SACU members impose a Common External Tariff (CET) vis-à-vis the rest of the world, but trade within SACU is largely free of tariffs. Revenues raised from the SACU CET, along with excise duties are paid into a common pool, which is then distributed to members in line with an agreed formula. This formula favours the smaller members of SACU, which receive a disproportionately large share. SACU-related transfers are the largest single source of fiscal revenues for Lesotho, and in 2012/13 accounted for an estimated 44% of government revenues. The SACU revenue distribution formula is currently under review and may be revised, which could have long-term implications for Lesotho.

CMA membership determines monetary policy. The CMA includes all SACU members except Botswana. Under the CMA, the currencies of Lesotho, Namibia and Swaziland are pegged 1:1 with the South African rand, which also circulates as legal tender in those countries in parallel with the domestic currency. Although each country has its own central bank, monetary policy is *de facto* determined by the South African Reserve Bank (SARB). This has meant fairly stable and low inflation in Lesotho in recent years, at an average of 6.3% between 2008 and 2012[23]. There are no controls on capital movements within the CMA, and broadly common exchange controls are imposed vis-à-vis the rest of the world by all CMA members. The exchange rate of the Lesotho loti vis-à-vis international currencies is determined by the exchange rate of the rand, which floats in international markets. Although not a formal monetary union (there is no single currency or single central bank), the CMA is a single monetary zone.

Regional harmonisation initiatives under SADC. Lesotho is also a member of the Southern African Development Community (SADC). SADC is less important than SACU and the CMA for the Lesotho economy. However, there are various regional economic and financial integration initiatives taking place at the level of SADC that are of relevance to Lesotho, notably the Finance and Investment Protocol (FIP) and initiatives around a regional payment system.

Close economic integration with South Africa. As noted above, there is free trade (in goods, but not services) between the two countries. The vast majority of Lesotho's imports are from South Africa. Exports, however, are more diversified. The main export products are textiles and diamonds, which are exported to international markets rather than SACU. As will be discussed below, South Africa is also extremely important as a destination for Basotho migrant workers, both in the mining industry and elsewhere.

2.4. Demography & labour force

Largely rural population. The capital Maseru is by far the largest settlement with an estimated population of around 228,000 in 2006[24]. Other towns are relatively small and the

[23] IMF WEO database, October 2013
[24] 2006 population census data accessed [Online] at http://www.geohive.com/cntry/lesotho.aspx

2006 Census estimated approximately three-quarters of the population to live in rural areas[25]. When only considering the adult population, FinScope (2011) estimates 69% of adults to live in rural areas.

Fairly young female population. The population of Lesotho is relatively young, with 53% of the population aged 24 and under. There are also more women than men. Amongst the resident population, women accounted for 53% of the total at the time of the 2006 Census and men 47% (approximately 8.9 men for every 10 women).

About half of the employed absorbed in the formal sector. The last Integrated Labour Force Survey (ILFS) was carried out in 2008. Out of a total population of 1,461,763, 53.1% (775 897) made up the labour force (economically active population aged 18 and over). A quarter (24.6% or 190,512) of the labour force is unemployed, while 51% of the employed are absorbed in the formal sector, 40% are absorbed by households (engaged in production of goods and services for their own consumption) and 9% by the informal sector (Bureau of Statistics, 2008).

Textile and garment industry the largest formal sector employer, followed by the civil service. The textile industry accounts for the largest share of formal sector employment (Bennet, 2006 and International Finance Corporation, 2010). Although employment dipped from 53,087 in 2004 to 40,364 in 2005, it recovered to 47,040 in 2007. Following closely is the civil service, which accounted for 39,048 formal sector employees in 2007, an increase from 35,609 in 2004 (Bennett, 2014).

Basotho migrant workers are a vital support for domestic livelihoods. According to the Lesotho Bureau of Statistics, there are 135,285 Basotho citizens residing abroad (about 14% of the population) and 134,773 are registered in South Africa (Abadura, et al., 2014). However, the World Bank reported that in 2010, the number of Basotho migrants living or working in South Africa alone was much higher at approximately 428,000, around one fifth of the population (The World bank (b), 2013)[26]. Although Basotho workers in South Africa stay there three to six times longer than migrants from Mozambique or Zimbabwe, they are considered to be very in touch with their native land as approximately 89% of them own a house and send money back home in Lesotho (Pérouse de Montclos, 2005). Each migrant worker is said to support seven to nine relations back in Lesotho (Abadura, et al., 2014) on an average monthly remittance of R320 per household and some studies report that financial transfers make up 80% of rural household income (Pérouse de Montclos, 2005). According the World Bank, remittances make up 22.6% of Lesotho's GNP (The World Bank (c), 2014).

Declining mining migrants. Historically, the main source of employment in South Africa was mine work, and during the 1980s more than 100,000 Basotho mineworkers were employed in South Africa. However, mine employment has since reduced substantially[27], such that by March 2007 the figure was 53 877 and by September 2013 the figure was only 22,000

[25] The 2006 Census reported 24% of the population as urban, 76% as rural.
[26] The divergence may arise from the number of descendants, illegal immigrants, short-term sojourners, and Sesotho speakers with dual citizenship (Pérouse de Montclos, 2005).
[27] Factors such as falling commodity prices, performance of the Rand against major currencies and falling gold price have led to the retrenchment of mine workers (Youthpolicy.org, 2014). Stricter immigration rules mean that only experienced foreign mineworkers can be employed in South Africa (i.e. inexperienced novices can no longer be recruited from Lesotho, and must be South African).

(Bennett, 2014 and TEBA, 2013[28]). This has had an effect on unemployment and especially youth unemployment, which stood at 38% in 2010 (Youthpolicy.org, 2014 and Central Bank of Lesotho, 2012).

"Brain drain" Lesotho is significantly challenged by a skills shortage (SARC Department, 2013). According the International Organisation for Migration (IOM), professionals including teachers, engineers, doctors and nurses continue to migrate to the US, UK and take up South African citizenship in search of better opportunities. Such migration is crippling core sectors such as health. 33% of physicians born in Lesotho are now registered as working abroad (Dixon, n.d.).

Diaspora policies. The government of Lesotho acknowledges the importance of engaging the diaspora in poverty alleviation and wealth creation. Amongst others, the government of Lesotho is working with IOM to develop an overseas employment and diaspora engagement policy and the Lesotho National Development Corporation is conducting investment drives in South Africa to encourage the Basotho diaspora as well as foreign businesses to invest in Lesotho (Dixon, 2014 and Motsoeli, 2014). There is no evidence of specific financial products directed at the Basotho diaspora.

2.5. Socioeconomic context

About half the population lives in absolute poverty. Lesotho is regarded as a lower-middle income country[29]. However, a significant proportion of the population is considered to live in poverty. In the 2002/2003 Household Income Survey, poverty levels were estimated at approximately 57% (58% in rural areas and 40% in urban areas)[30]. FinScope Lesotho (2011) findings show that about 60% of the adult population earn less than M500 (USD 60.60) per month. Figure 1 shows income levels of the adult population based on the findings of FinScope Lesotho (2011).

[28] Source: interview with TEBA
[29] World Bank Classification
[30] IMF (2012) Kingdom of Lesotho: Poverty Reduction Strategy – National Strategic Development Plan

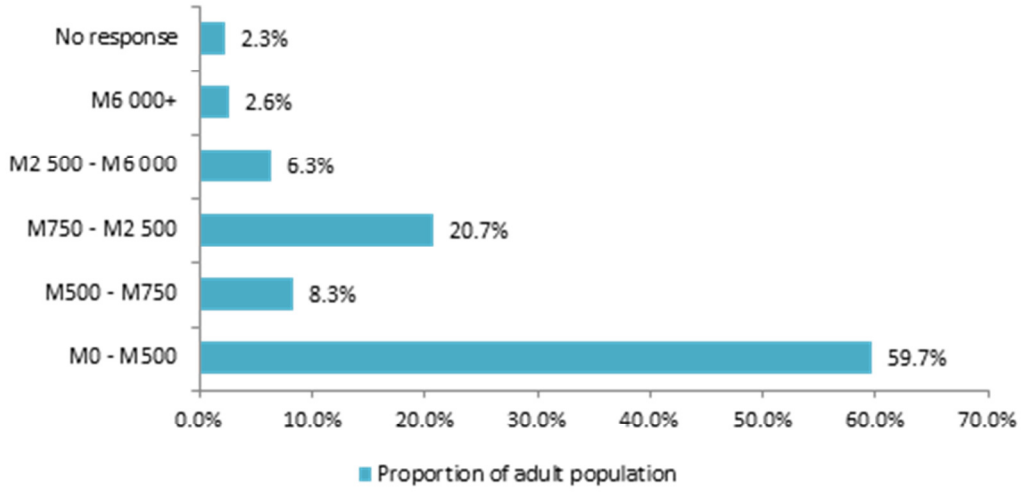

Figure 1: Income levels

Source: FinScope (2011)

The percentage of the population living below USD 1.25 PPP per day has dropped from 48 percent in 1995 to 43 percent in 2010. Lesotho's Human Development Index has fallen steadily from 134th out of 174 countries in 1995 to 160th out of 187 countries in 2011. It is estimated that 352,000 people (approximately 17 percent) of the population is food insecure.

Moderate inequality in regional terms. Inequality is relatively high in Lesotho, with a Gini of 0.54 in 2010, although this is lower than in other countries in the region (Namibia, South Africa and Botswana all have a Gini of over 0.6).

2.6. Healthcare and social welfare

Free and subsidised primary healthcare is available but overburdened. The introduction of the 2003 Health and Social Welfare Policy has resulted in major reforms in the health and social welfare systems. Since then, major strides in health care services have been achieved and it is estimated that 85% of all Basotho have access to healthcare services. However, the healthcare system is overburdened and not easily accessible to especially those in rural areas (United Nations, 2013).

Box 3. Healthcare system overview

Lesotho's health personnel to population ratio is only five physicians and 62 nurses to 100,000 people, a ratio that is far below the 2.5 personnel to 1000 people approved by the UN Millennium Development Goals (Dixon, 2014). Moreover, the fact that most Basotho live in remote rural areas presents a challenge to access. According to the WHO, 75% of urban dwellers are within walking distance of hospitals, while more than 75% of rural dwellers are outside walking distance of a hospital (United Nations, 2013).

The government relies partly on the Christian Health Association of Lesotho (CHAL), an organisation made up of six different church denominations, for the provision of healthcare services. With the support of a 70% government subsidy, the association provides almost

40% of health care services in Lesotho (IRIN, 2011), with the government providing a further 43% directly and the rest accounted for by other NGOs and the private sector[31], as summarised in the table below:

Healthcare service provider	Percentage of services provided	Number of hospitals:	WHO Regional Office for Africa: regional average
Government of Lesotho	43	12	76
CHAL	39	8	72
NGOs	2.9	0	6
Private Sector	15.1	1	30
Total	100	21	184

Figure 2: Provision of Health Care in Lesotho

Source: (United Nations, 2013)

In 2007 government signed a memorandum of understanding with CHAL to provide health care to those Basotho who could not afford the nominal rates being charged at CHAL and government health centres. Patients would receive free drugs and medical services at health centres and subsidized medical care and drugs at hospitals. However, the associated increase in demand meant that both CHAL and government run clinics and hospitals experienced a number of drug shortages and a deterioration in the quality of care offered, and many overburdened government and CHAL health centres took to referring patients to private clinics and pharmacies (IRIN, 2011) Thus this attempt to make healthcare more accessible was challenged by administrative and funding difficulties.

Subsequently, the Government of Lesotho entered into a number of partnerships with development agencies and the private sector to reform the country's health care system (The World Bank (f), 2013). As part of its Public Health Care reform the government worked with a number of donors to deploy outreach-based District Management Health Teams to deliver community health services. (The World Bank (a), 2013). A consortium led by the South African based NetCare was engaged to build the Queen Mamohato hospital in Maseru, which opened in 2011 (Boseley, 2014).

HIV/AIDS is the single biggest burden on Lesotho's social security infrastructure. Lesotho has the third highest HIV/AIDS infection rate in the world (The World Bank (f), 2013). 23% of the adult population is infected and women account for 60% of infected adults (AVERT, 2012).The HIV/AIDS pandemic has placed considerable strain on Lesotho's healthcare and social welfare. The Ministry of Health and Social Welfare (MOHSW) has reported that more than 50% of outpatient attendances are AIDS-related ailments and that more than 60% of inpatients are due to AIDS-related illnesses. (National Aids Commission, 2006). Furthermore, the impact can be seen in the 140 000 orphaned and vulnerable children that are largely the result of HIV/AIDS and HIV/AIDS-related illnesses, and Lesotho's life expectancy at birth, which has diminished from 60 years in 1991 to 49 years in 2012 (BTI, 2014 and The World Bank (g), 2014).

[31] http://unctad.org/en/PublicationsLibrary/ditctncd2012d1_en.pdf

In 2004, the Lesotho government launched voluntary counselling and testing and also made antiretroviral therapy free. The two programmes have not run as smoothly as would be required, but by 2011 35% of adults had been tested and 58% of those needing antiretroviral therapy were receiving it (AVERT, 2012). Despite government efforts to curb the disease, impacts and spread of the virus have been aided by misconceptions held about the illness and adherence to social norms, specifically those that have to deal with gender equality (Government of Lesotho, 2011).

Major strides in social welfare reach. The department of social welfare was established in 1976 and has since been incorporated in the Ministry of Health and Social Welfare. Back then, the government welfare assistance was focused on the distribution of food packages but it has now grown to encompass provision of free primary education, medical assistance and financial relief to the most vulnerable households with children, disabled persons and pensioners. Although the increased scope of the government welfare programme can be taken as a positive signal, most of the programmes are still reliant on external support from NGOs and development agencies (Ministry of Health Lesotho, 2014 and Pellerano, et al., 2014). The table below outlines the different programmes undertaken under the auspices of the Ministry of Health and Social Welfare:

Social Welfare Programme	Description
The Lesotho Child Grant Programme (CGP)	Provides quarterly transfers of M 360 –M 7,501 to poor households with children. The programme is estimated to have impacted 55,000 children and 22,000 households which were selected using a combination of means testing and background checks. As on April 2013, the transfers' value was indexed to number of children representing on average 21% of household monthly consumption. CGP started out as a donor pilot but the government of Lesotho has since taken over a significant fraction of the funding and is contemplating a nation-wide expansion.
Food Emergency Grant	In 2012 and 2013 when the country experienced poor harvests the government added the Food Emergency Grant, a M400 bi-monthly cash payment made to existing CGP beneficiaries. This initiative received funding from the European Union through UNICEF.
Non-contributory Old Age Pension	This programme was launched in 2004 and at the time Lesotho was the only LDC in African to introduce such an initiative. The pension consists of a M150 monthly payment targeted at citizen 70 years and over. As at May 2005 the scheme had 69,046 registered recipients out of 74,000 eligible persons.
Free Education	A free and compulsory primary education policy was adopted in 2000 and reinforced by the Education Act of 2010. The Ministry of Education and Training undertook to progressively assume financial responsibility for books, stationery, maintenance and utility cost at the primary-level. The initiative also included the provision of food assistance, an activity that was spearheaded by the World Food Programme (WFP) and taken over by the government of Lesotho in 2010. The programmes received financial support from the International Development Agency, The African Development Fund, The Development Cooperation of Ireland, UNCF and the World Food Programme.

Social Welfare Programme	Description
Free healthcare	The Government of Lesotho introduced free medical services and drugs at health centres and subsidised medical care and drugs at hospitals in 2008 as explained in Box 3. The period in question saw large-scale investment in healthcare from the US government.

Figure 3: Social welfare programmes

Source: BTI, 2014 and Pellerano et al, 2014

3. Policy and Regulatory Framework

3.1. Policy initiatives for financial inclusion

A number of previous initiatives. In the past, there has been no overarching policy framework on financial sector development in Lesotho. Lesotho has in recent years implemented or attempted to implement a large number of financial sector development initiatives and has received a large amount of technical assistance in connection with these initiatives. Notable recent projects are the SUFIL (Support for Financial Inclusion in Lesotho) project and RUFIP (Rural Financial Intermediation Project) programmes:

- **SUFIL** was a joint program of UNDP, UNCDF and the Government of Lesotho to stimulate financial service providers to offer pro-poor products as well as facilitating access to financial services for women. The three year program (2010-2013) was intended to improve inclusive financial regulatory and policy environment, strengthen the financial infrastructure and improve access to a broader range of financial services. The program also aimed to build technical capacity, implement a consumer education program and establish a microfinance resource for the industry.

  SUFIL has, with FinMark Trust supported the FinScope Study for Lesotho which provides important data on access to finance. As part of the consumer education program, SUFIL has supported "Money Week" which has included a media awareness campaign, capacity building and training. In addition, SUFIL has supported a number of studies, policies and strategies:

  - Inclusive Finance Sector Assessment
  - Inclusive Finance Strategy of Lesotho
  - Mobile money for the Poor: Lesotho Scoping Report
  - Demand and Supply for Micro-insurance in Lesotho
  - Analysis of Draft Insurance Bill
  - Micro, Small and Medium Enterprises Policy for Lesotho

  In the absence of a broad policy view of the financial sector within the Ministry of Finance, the selection of topics has been guided by the SUFIL program. Many of the outputs are useful in promoting financial inclusion, although the quality varies considerably and suffered from not being part of a broader strategy for the financial sector[32]. They also have considerable overreach in terms of the number of new institutions, associations and organisations required and contain limited consideration of implementation constraints.

- **RUFIP** is an International Federation of Agriculture (IFAD) seven-year project started in 2008 with four main components:
  - development of member-based financial institutions,
  - development of formal financial institutions for rural outreach,
  - development of an enabling environment, and
  - programme coordination.

[32] The Financial Sector Development Strategy (FSDS) is now in place and provides strategic direction regarding the development of the sector.

RUFIP's development of member-based financial institutions has supported the establishment of about 25 small financial cooperatives, about 30 Rural Savings and Credit Groups and about 330 informal groups including Village Savings and Lending Associations and Savings and Internal Lending Communities. The program has provided support to Lesotho Postbank (LPB) for rural outreach and contributed to the policy framework through a legal review and support for the new Financial Institutions Act. The impact of RUFIP interventions is discussed further below.

The crucial test of the development of member-based financial institutions is whether they will be sustainable when the program ends. The LPB project has other challenges, stemming from the lack of a clear objective and strategy and the involvement of multiple donors.

Challenges to implementation. In the absence of an overarching plan, co-ordination across the various initiatives has been lacking. A number of cross-cutting problems have become apparent in financial sector development initiatives and related technical assistance (TA) proposals:

- Lack of co-ordination amongst donors, leading to parallel and sometimes contradictory proposals or initiatives;
- Lack of absorptive capacity, inadequate prioritisation as well as a lack of resources to implement reforms, leading to slow progress;
- No systematic processes for reviewing the recommendations of TA providers;
- A focus on the anticipated benefits of new proposals without consideration of costs, and hence no balanced assessment of whether proposals would yield net benefits;
- A tendency to recommend the establishment of new institutions, without determining whether this is relevant or feasible in a small economy;
- Insufficient consideration of the potential benefits of cross-border trade in financial services and regional financial integration.

New strategic direction. The situation is now changing, with financial sector development being included in the National Strategic Development Plan (NSDP) and the preparation of a broad-based Financial Sector Development Strategy (FSDS). The inclusion of the financial sector in the NSDP marks an important first step in developing an overarching framework for financial sector development. The NSDP has six strategic objectives relating to the financial sector:

- Improving access to finance;
- Increasing alternatives for mobilising financial resources;
- Promoting a savings culture;
- Improving financial sector efficiency;
- Bridging the skills gaps in the financial sector and increasing financial literacy; and
- Improving financial stability and soundness.

The NSDP falls under the new Ministry of Development Planning, but with other ministries involved for specific sectoral plans and strategies.

The Financial Sector Development Strategy (FSDS), which was finalized and accepted by Cabinet in late 2013, aims to give effect to the NSDP aspirations regarding financial sector

development. The FSDS includes almost 200 action items to be implemented over a five year period, covering the six strategic objectives of the NSDP, and broken down into a number of detailed areas including:

Financial Inclusion

- Financial Literacy;
- SME Financial Inclusion;
- Legal reforms;
- Increasing Commercial Bank Participation;
- Lesotho PostBank;
- Microfinance Institutions, RSCGs and VSLAs, SACCOs;
- Housing Finance;
- Agricultural Finance;
- Mobile money/e-Money Accounts;
- Micro-Insurance; and
- Credit Information.

Mobilizing Financial Resources and Promoting a Savings Culture

- Consumer Protection;
- Capital Market Development;
- Insurance;
- Cross-Border Competition; and
- Pensions.

Improving Efficiency—The Payments System

- Payment System Regulation and Oversight;
- High Value Payments and Clearing Systems;
- Retail Payments; and
- Cross-Border Remittances.

Financial Stability and Soundness

- Financial Stability;
- Financial sector supervision;
- Financial Safety Net; and
- Strengthening the Legal Framework.

Clearly the FSDS gives a high priority to financial inclusion, in line with the policy priorities of the Government of Lesotho, as already reflected in the SUFIL and RUFIP projects.

An FSDS Implementation Committee has been established under the chairmanship of the Principal Secretary of the Ministry of Finance. It includes the Governor of the CBL and Principal Secretaries from the ministries of Development Planning; Trade, Industry, Co-operatives and Marketing; and Law. The Implementation Committee reports to a Cabinet Sub-Committee, which has ultimate responsibility for ensuring implementation. An FSDS Technical Secretariat is being established in the CBL to act as the FSDS project management team.

3.2. Regulatory Framework

A single financial sector regulator. Whereas the Ministry of Finance is the financial sector policymaker, the regulatory system for the Lesotho financial system is based around the Central Bank of Lesotho (CBL). The CBL is responsible for regulating banks and NBFIs (including credit-only and deposit-taking MFIs, insurers, money lenders, money transfer operators, etc.), as well as the payments system and capital markets. The Lesotho system therefore differs from other systems, which often have two financial sector regulators[33]. The single regulator system is probably appropriate for Lesotho given the small size of the economy and the high costs of establishing new regulatory institutions.

Large-scale reform programme. The CBL derives its authority from the Central Bank of Lesotho Act, 2000, which sets out the general powers and responsibilities of the Bank. However, detailed regulatory responsibilities are set out in a range of other legislation. The following diagram outlines the various pieces of legislation under the ambit of the CBL. The regulatory framework has a number of gaps, but these are gradually being filled, as indicated by the asterisks below:

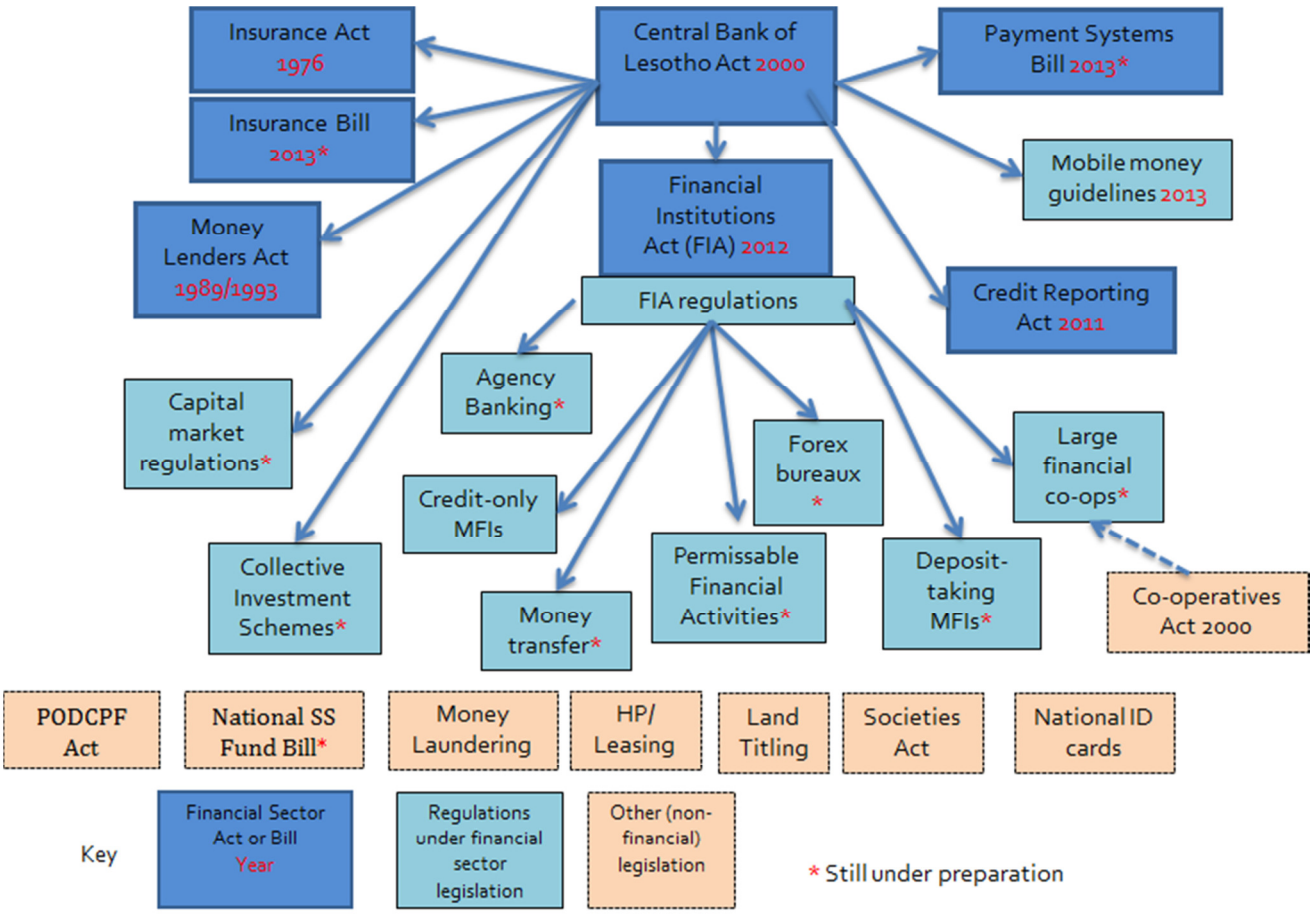

Figure 4: Lesotho Financial Sector Regulatory Framework

Source: Authors' own

[33] There are different types of dual regulatory structures. One approach is to have separate regulators for banks and NBFIs. In the region, this is followed by Botswana, Namibia and Swaziland. A second approach is the so-called "twin peaks" model, whereby the separation is between a prudential regulator and a market conduct regulator; this is the model recently implemented in the UK and currently being implemented by South Africa.

The most far-reaching instrument of CBL legislation is the Financial Institutions Act, 2012. This establishes the CBL as the regulator of banks and a wide range of NBFIs, with the exception of insurers, pensions, investments, capital markets, payment systems and mobile money.

The CBL also derives its powers from other legislation. The Insurance Act 1976 provides for a Commissioner of Insurance, who has subsequently been designated as the CBL Governor. The Credit Reporting Act, 2011, specifies certain powers for the CBL, while the draft Payments Systems Bill directly specifies that the CBL Governor has responsibility for oversight of the payments system. The old Money Lenders Act, 1989, also delegates powers to the Commissioner of Financial Institutions.

As the financial sector evolves and new institutions and products develop, the regulatory framework is being updated and modernised. This requires both institutional capacity and legal reform. The wide span of regulatory responsibility borne by the CBL means that, at times, it suffers from capacity constraints. Furthermore, the process of drafting and passing new legislation is very slow – for example, the new Insurance Bill and the Payments System Bill have taken many years to reach the stage of being presented to Parliament. Furthermore, the quality of drafting of bills is often weak, meaning that even when passed they need immediate amendment, which is again a slow process. Introducing new regulations is easier, as it only requires agreement between the CBL and the Ministry of Finance before being gazetted, but the process of drafting, consultation and refinement can also be lengthy.

Below, more detail is provided on the regulatory framework pertaining to key categories of financial service providers in Lesotho, namely, financial institutions, payment systems, insurers, and member-based financial service providers, as well as other regulation of pertinence to financial inclusion.

3.2.1. Financial Institutions

Tiered financial system. The FIA is relatively new, having been passed in 2012. It replaced an older Act dating back to 1999. Under the FIA, a range of "types" of financial institutions are established, including:

Type	Institution	Main activities	Minimum capital
Type I:	Commercial bank	All conventional banking activities, acceptance of deposits, lending, foreign exchange, payments etc.	M20 million
	Merchant/investment bank	Corporate finance, deposits and lending, forex, advisory	
	Mortgage bank	Deposits, property loans & guarantees, raising foreign loans	
Type II:	Savings bank	Acceptance of savings and fixed deposits; investment in government and other approved securities	M10 million
	Deposit-taking microfinance business	Conducting microfinance business, including acceptance of deposits and lending	

Type	Institution	Main activities	Minimum capital
	Large financial co-operative	Accepting deposits from members and providing credit services on the pledge of savings	
Type III:	Credit institution	Acceptance of call and time deposits; lending	M5 million
	Acceptance house	Granting of acceptance facilities	
	Discount house	Dealing in short-term assets such as T-Bills and NCDs	
	Finance house	Provision of Hire Purchase facilities, leasing/factoring, short and medium term loans	
Type IV:	Foreign exchange bureau	Dealing with currency exchange	n/a
	Money transfer	Provision of money transfer services	
	Credit guarantee facility	Facilitation of access to bank finance through lending to small and medium enterprises	
	Credit-only microfinance institution	Granting of uncollateralised credit services to unbanked communities	

Table 2: Categories of Financial Institution under the FIA

Source: FIA

All of these types of institutions are regulated and supervised by the CBL. In general, the Commissioner of Financial Institutions (i.e. the Governor of the CBL) may exempt financial institutions from provisions of the FIA, except for commercial banks.

No credit interest rate cap. It is noteworthy that the FIA does not contain any interest rate cap. As will be discussed in Section 3.2.5, the only interest rate cap currently in place is under the Money Lenders' Act, but it is not enforced in practice.

Regulations still under development. While the FIA sets out the framework for regulation of financial institutions, including capital requirements, much of the detail is left to the regulations that are promulgated under the Act. Several sets of regulations still need to be finalised and gazetted, including:

- Capital, liquidity and reserve ratios;
- Agency banking;
- Permitted financial activities (for different types of institutions);
- Credit-only and deposit-taking microfinance institutions;
- Large financial co-operatives;
- Foreign exchange bureaus.

The lack of regulations has been a barrier to the establishment of various types of non-bank financial institutions. For instance, non-bank lenders – both the large credit institutions such as Letshego or the small MFI-type lenders such as Moliko Trust – have been prevented from

establishing deposit-taking facilities[34] and the lack of regulations regarding large financial co-operatives is one of the reasons why the largest co-operative (Boliba – see below) is not regulated in practice. Furthermore, while the FIA makes provision for agency banking, it has not been possible for banks to appoint agents without the detailed regulations regarding the conditions and procedures for such appointments. The draft regulations also propose to ease some of the requirements for banking agents; for instance, while the FIA requires potential banking agents to have been established for five years and provide evidence of financial performance over this period, the draft regulations reduce this to two years. The regulations under development are expected to in due course encourage the establishment of agency banking services.

3.2.2. Payments Systems

Payment Systems Act forthcoming. There has up to now been no statutory basis for oversight and regulation of the payments system (including clearing and settlement systems), but a draft Payment Systems Bill has been finalised and is awaiting approval by Parliament. The Act will establish the authority of the CBL to oversee payments, clearing and settlement systems, including the power to licence and regulate.

Interim regulation of mobile money. In principle, mobile money (MM) falls under the regulatory oversight of the CBL. However, there is currently no regulatory framework that explicitly deals with MM. The CBL has permitted MNOs to offer MM services on the basis of a "Letter of No Objection"[35], and has subsequently issued "Mobile Money Guidelines" detailing the conditions under which MM services can be offered.

The Guidelines explicitly recognise the importance of mobile money in enhancing financial inclusion: "Mobile money in Lesotho includes various components that facilitate the delivery of payments to the banked and non-banked population through mobile phones or other similar electronic means"[36].

The MM Guidelines set out the conditions under which the CBL wanted to see mobile money operated, including elements such as KYC rules and requirements for trust accounts. They are designed to be accommodative of MM services, encouraging access and innovation, while providing basic safeguards. The primary safeguard for users is the requirement for all mobile money balances to be backed by trust account balances at a bank. Other regulatory requirements relate to "fit and proper" tests for directors, record keeping and audit trails, system stability and backup etc.

MM to be incorporated under Payment Systems Act. At present the MM Guidelines are issued with reference to Section 6 of the Central Bank of Lesotho Act, which simply states that one of the functions of the CBL is "to promote the efficient operation of the payments system". The legal basis for prescribing the conditions under which MM services can be offered will be strengthened once the Payments Systems Act (PSA) is in force. The PSA provides explicit authority for the CBL to provide oversight of payments systems and "the issuance and use of payment instruments", and to issue regulations for that purpose. Once

[34] The credit institutions must await the gazettement of regulations, whilst MFI lenders must comply with registration and licensing requirements.
[35] This approach is used by many central banks with respect to MM services
[36] Introduction to MM Guidelines

the PSA is in force, the MM Guidelines will therefore be reissued as Regulations. However, it will still not be necessary for a MM system operated by an MNO to be licenced by the CBL, as MM does not fall under the definition of a payments "system" for which a licence is required[37].

Flexible money transfer operator dispensation. With regard to cross-border payments, a Money Transfer Operator (MTO) is classified as a Type IV financial institution under the FIA, and has no statutory capital requirements. There are no formal requirements in place at present for the licensing of MTOs, and approvals are on an "ad hoc" basis by the CBL. Regulations under the FIA for MTOs were gazetted in February 2014 and appear to be accommodative of new entrants. Licensing requirements mainly relate to "fit and proper" tests, the approval of the applicant's business plan and the adequacy of AML/CFT procedures.

3.2.3. Insurers

Outdated insurance legislation. The insurance industry is currently governed by the Insurance Act of 1976 and its 1985 Regulations. It allows composite insurers, provides for cooperative insurance societies to obtain an insurance licence alongside incorporated companies and allows foreign insurers to register in Lesotho as long as they appoint a principal officer in Lesotho. According to Angove & Manje (2012), the CBL and insurance industry have identified a number of weaknesses in the framework, including:

- Capital requirements are in need of revision. The current act specifies paid-up capital of M50,000 or 10% of premium income for life insurance and M100,000 or 20% of premium income for short-term insurance business.
- Licensing requirements do not focus on the effectiveness of governance structures
- Regulations around the licensing and conduct standards of brokers, agents and broker's runners are weak (for example, there is no guidance on the conduct of agents and no monitoring of such conduct).
- Agents must have completed secondary education plus require three months' training in insurance business and there is no provision for alternative distribution channels (for example mobile network operators or retailers).
- Bancassurance is limited to insurance relating to banking activities (notably credit life insurance on for example mortgages or vehicle finance). No other mention is made of credit life insurance and whether it may be compulsory or not.
- The regulator has limited powers of supervision, particularly in terms of gathering information and conducting inspections of brokers, but also in terms of ongoing monitoring and enforcement of insurers
- There is no regulation preventing consumers in Lesotho from purchasing insurance from South African insurers not licensed in Lesotho.
- There is no mention of the funeral cover provided by funeral undertakers.

[37] A payment "system" (which requires a licence) is defined in the Bill as "an interbank payment system, a securities settlement system or a clearing house". However, the CBL is entitled to regulate the issuance and use of "payments instruments", defined as "a cheque, a bill of exchange or a promissory note, electronic money, electronic payments, credit cards and debit cards".

New legislation underway. In response, a new Insurance Bill has been under preparation since 2005 and is now in the final stages of being enacted. The new bill demarcates licensing between long-term and short-term insurers and, amongst others, significantly reforms prudential requirements. Only public companies are allowed to obtain an insurance licence (thereby removing the leeway under the previous dispensation for cooperative societies to obtain an insurance licence). Existing insurers incorporated under the laws of any other country are still allowed. The bill also paves the way for dedicated treatment of funeral policies in regulations.

Provision for microinsurance. The draft insurance bill includes a broad definition of microinsurance, namely, "insurance that is accessed by the low-income population and is provided by a variety of different entities, but run in accordance with generally accepted insurance policies". It is thus a conceptual definition that does not yet provide operational parameters for supervisory and reporting purposes. The CBL has indicated that such parameters will be developed in microinsurance regulations to follow the enactment of the bill. The draft bill indicates the types of products that will fall under microinsurance as "funeral cover, crop insurance, credit life, savings, life, health and miscellaneous".

Funeral undertakers unregulated. Funeral undertakers are registered by the Ministry of Trade and Commerce and, as such, are allowed to provide in-kind funeral services to their clients. Many funeral undertakers in Lesotho however provide standard funeral insurance policies. This means that they technically require an insurance license from the CBL; yet they operate outside of CBL enforcement. This relates to a historic ambiguity under the previous Trading Enterprises Act, the provision relating to activities relating to funeral services was interpreted more widely by funeral undertakers to include funeral cover. The Trading Enterprises Order (1993, amended 1996) and Regulations (1999 and 2011) have since been amended to close this loophole. According to the Ministry of Trade the funeral schemes operated by the funeral undertakers are financial services and should be regulated and supervised by the CBL (Angove & Manje, 2012)

Following the microinsurance diagnostic study (Angove & Manje, 2012), funeral undertakers, led by the Association of Funeral Undertakers, recognised the need for proper regulation in order to be recognised as insurance players and develop their business. They have subsequently been in discussion with relevant institutions including the Central Bank of Lesotho and Ministry of Justice. Although it has not yet been decided what form of regulation would cover funeral undertakers, a number of options are currently being discussed by the relevant institutions.

Pensions. There is no legislation in place dealing with the establishment and regulation of private pension funds; the only relevant legislation is the Act establishing the Public Officers Defined Contribution Pension Fund, and elements of the Income tax Act.

3.2.4. Co-operatives and other group-based financial service providers

No regulation of cooperative financial activities. Besides the CBL, the only other regulator with some direct responsibility for financial institutions is the Director of Co-operatives, which has responsibility for SACCOs and other co-operatives under the Co-operatives Act, 2000. However, the enforcement powers under this Act are limited and in practice SACCOs and other co-operatives are not supervised from a financial institution perspective. Similarly,

there is no financial regulatory framework pertaining to informal savings groups, village savings and loan associations (VSLAs) and burial societies (though they can be legally constituted as Societies).

The main concern relates to the single large financial co-operative, Boliba Multipurpose Co-operative which operates as a savings and credit co-operative even though it is not registered as such. Concerns have been raised regarding the governance and financial soundness of Boliba[38], stemming largely from poor quality regulation and weak supervision. This exposes depositors to risks and Boliba's size is such that it could give rise to systemic financial sector risks. The FIA gives the CBL the power to regulate large financial co-operatives, but the regulations for implementing this part of the Act are not yet finalised. Co-ordination with the Department of Co-operatives with regard to the sharing of regulatory responsibilities for Boliba is also a challenge. According to the consultations, it has now been agreed that the CBL will shortly be taking full regulatory responsibility for Boliba. Such a transition should provide a sounder basis for regulation and supervision in a way that will reduce the risks to Boliba members and the financial sector more generally.

It is proposed[39] that a new Financial Co-operatives Act will be introduced to deal specifically with small financial co-operatives (those that do not fall under the FIA).

3.2.5. Other Legislation

Money Lenders Act. Moneylenders regulated under the Money Lenders Act are subject to "regulatory forbearance", in that the CBL has only enforced its regulatory powers to a limited extent due to limited capacity, thereby effectively allowing them to operate in a virtually unregulated manner. The Money Lenders Act includes a prohibition on advertising and promotion, and a cap of 25% per annum on interest rates on loans. Both of these conditions are ignored by moneylenders and there appears to be no attempt at enforcement[40]. Though this does not give rise to systemic risks, there are concerns about consumer protection and regulatory credibility which may be undermined.

The Money Lenders Act conflicts with the FIA in some instances, and it is the intention of the CBL to have the MLA repealed as soon as possible. For instance, the MLA does not have a minimum capital requirement (unlike the FIA); it has an (unenforced) interest rate cap and a ban on advertising (the FIA has neither); and the MLA does not have "fit and proper" requirements or obligations regarding AML/CFT (the FIA has both). There is uncertainty in the market stemming from the co-existence of credit institutions under both the MLA and the FIA, and from the lack of clarity over when those registered under the MLA will be required to migrate to licensing under the FIA.

Credit Reporting Act. A Credit Reporting Act was passed in 2011 to govern the establishment, registration and operation of credit information bureaus, as well as the obligation of credit providers to report credit information (Credit Reporting Act, 2011). This should have an important impact in terms of both improving the availability of credit –

[38] Such concerns were expressed during consultations with the authorities and are also stated in the FSDS.
[39] As per consultations with CBL, Ministry of Finance, Commissioner of Co-ops. This is also contained in the FSDS.
[40] However, a civil case was bought [in 2011] against [a group of] money lenders challenging the interest rates and fees charged. The case was won by the plaintiffs.

especially bank credit – and protecting consumers from over-indebtedness. One credit information bureau has been licensed, and is expected to commence operations in 2014.

Outside of the ambit of the CBL there are also other pieces of legislation that have an impact on the provision of financial products and services, even if they are not specifically about financial sector regulation. The most notable are:

National Social Security Bill. The draft bill, which was issued in 2012, proposes the establishment of a national social security fund, which would include both short-term risk benefits for workers (such as maternity, employment injury, sickness etc.) and long-term pension savings. It would be compulsory for a wide range of workers and voluntary for others (such as the self-employed and those in the informal sector). In May 2014, Cabinet took a formal decision to proceed with the National Social Security Fund on the basis of the draft Bill. This has implications for both long-term savings and the operation of existing pension funds.

Capital Markets. There is no regulatory structure for oversight of capital markets (shares, bonds, etc.). Draft regulations have been prepared by the CBL (for implementation under the CBL Act), but these are framed around the establishment of a fully-fledged stock market in Lesotho, which would probably not be appropriate at this stage in Lesotho's financial development.

KYC requirements. The regulatory know-your-customer (KYC) requirements applicable to financial institutions and financial transactions are laid out in the Money Laundering, Proceeds of Serious Crime and Terrorist Financing Act (2006). These essentially require financial institutions to verify the identity and physical address of anybody wishing to open an account or enter into a financial transaction. The interpretation of these requirements has varied between financial institutions, but the general requirements are as follows:

Requirement	Documentation
ID	Passport, Driver's licence, Voter's card, Chief's letter
Address	Utility bill, Chief's letter

Table 3: KYC Requirements

Source: Money Laundering, Proceeds of Serious Crime and Terrorist Financing Act (2006)

These requirements are applicable to all accountable institutions[41], but are generally only applied by banks. Insurers, for example, generally do not impose KYC requirements when policies are taken out, though they will often do so when a claim is made.

Identity. Because of the historical lack of a national identity card system in Lesotho, proving identity has never been straightforward. However, it has not been an insurmountable barrier. FinScope 2011 shows that most people have passports, and these are generally accepted as proof of identity, as are driver's licences and voter registration cards. However,

[41] Accountable institutions are defined as legal practitioners, accountants, and financial institutions. It includes estate agents, stockbrokers, financial advisors, casinos, custodians, dealers in gold and precious stones, and company service providers, as well as banks and insurers.

none provide a unique identifier, as passport numbers change on renewal. Some institutions will accept a Chief's letter confirming knowledge of the identity of the applicant.

National identity cards were introduced in the second half of 2013 and, once fully rolled out, will provide each citizen a unique lifetime identity number. The full implementation of the national identity card will improve KYC procedures. Furthermore, national identity cards will make the credit information system to be introduced in 2014 much more effective. By mid-2014, ID cards had been issued to approximately 170,000 people (out of an estimated 1 million eligible people aged 16 and above). It is intended that 80% of the cards will have been issued by March 2016.

Proof of address. KYC requirements also require proof of address. This is less easy to fulfil using formal documentation, which can only be satisfied using a utility bill. Most adults in Lesotho would not have a utility bill, especially with the move to prepaid electricity meters (and hence no billing). Many houses do not have formal addresses (in the sense of street names and numbers), and post is delivered to Post Office boxes. Hence there is strong reliance on Chief's letters as evidence of physical address.

Special dispensation for mobile money. The KYC requirements for mobile money are somewhat different, as a "tiered" KYC system is in operation, as follows:

KYC level	ID requirements	Verification
Least	Name, phone number, physical address	Self-declared
Partial	Name, phone number, physical address, passport number	Self-declared
Full	Name, physical address	Verified against official documents

Table 4: KYC rankings

Source: CBL Mobile Money Guidelines

The key difference is that for the Least and Partial KYC levels, individuals can simply register their details (over the mobile phone system) and do not have to present either themselves or their documentation for official verification. A discussion on the threshold account limits for the various tiers is contained in Section 6.2.

4. Target market analysis

To understand the nature of the demand for financial services in Lesotho, this section provides an overview of the demand-side characteristics of financial inclusion in Lesotho. These characteristics include demographic, employment and income considerations that will influence the demand for and usage of financial services. The section draws heavily on FinScope 2011 findings as well as the qualitative research undertaken as input to the MAP country diagnostic study.

Box 4. Qualitative market research methodology

The total sample for the qualitative research was 106: 51 males and 55 females. Research was conducted in two distinct regions within Lesotho, aiming to access both the urban and the more rural consumer. Consumers were accessed in both Maseru (urban centre) and Butha-Buthe and surrounds (rural centre).

Two different data collection methodologies were employed namely focus group discussions (which were two and a half hours in duration) and one-on-one in-depth interviews/ immersions (which were between an hour and a half and two hours in length). The focus group discussions included 8 to 9 participantss per session and took place in one central venue/location. The in-depth interviews/immersions typically took place at respondents' homes or place of work. Immersive interviews were conducted with respondents representing different economic profiles:

- **Urban trader:** Selling snacks, airtime, shoes, chickens,
- **Rural trader:** Selling snacks, fruit and vegetables, airtime, shoes, chickens, traditional herbs and medicine
- **Livestock farmer with own land**
- **Government grant recipient**
- **Receive remittances**: female headed household with spouse working in South Africa

For a full overview of the findings, see the qualitative research report (KLA, 2014).

The rest of this section is structured as follows:

- Section 4.1 considers the target market context by looking at societal structures, livelihoods and budget and expenditure realities, as well as the evidence regarding financial capability stemming from the demand-side research.
- Section 4.2 provides an overview of the level of financial services usage in Lesotho
- The target market is not one homogeneous group. The MAP approach is set apart from other diagnostic methodologies in that it uses the FinScope survey to segment the adult population into discrete target markets based on their main source of income. Each target market segment can then be profiled in order to conclude on their realities and main financial service needs – against which the supply-side analysis in the rest of the report will then be evaluated. This is the topic of Section 4.3.
- Section 4.4 concludes on the salient demand-side findings.

4.1. Target market context

This section unpacks the insights generated by the qualitative demand-side research into the lives of the target market and the society within which they live.

4.1.1. Societal context

A respectful, resolute and spiritual nation despite hardships. The qualitative research paints a picture of a very respectful and resolute people. Their hardships and struggles have made them humble and respectful of others. HIV/AIDS have ravaged the country to such an extent that almost everyone encountered in the qualitative research to had lived through the loss of a family member. Funerals are a very frequent occurrence and are seen as an inescapable reality.

While they were willing to share the difficulties they faced in the groups, the majority of respondents did not speak openly about HIV/AIDS. This is mostly out of respect for those who have passed on or are living with it, as well as the stigma that still surrounds the disease. This respect stems from the acknowledgement that those around them have suffered equally and no one is immune to life's hardships. A strong belief in God and his benevolence has made many respondents grateful for the little they have even when faced with daily hardships and struggles.

The Basotho people are furthermore highly nationalistic and respondents had deep respect for the king. This pride in their country is reflected in a preference for Lesotho brands.

Extended households. Households are typically large, driven mainly by the practice of adopting the children of deceased family members. Respondents will often have both their biological children and adopted children to look after. Older respondents often find themselves having to look after grandchildren due in most part to the untimely death of their adult children. Adopted children are viewed no differently than biological children and are treated equally with regard to school, food, shelter and clothing. Even though looking after others' children adds strain to household budgets, it was clear from the qualitative research that nobody shirks this responsibility.

Migrant labour impacts household structure, gender roles. In addition to the high mortality rate of the adult population, employment opportunities also impact on the overall structure of households and families. Historically, the male population of Lesotho sought work across the border at the mines and farms in South Africa. While this trend is not as prevalent as it once was, there is still a 'migrant worker' population within Lesotho itself. As work opportunities are limited in one area, respondents move to another area in search of jobs, leaving behind their children in the care of parents, spouses or siblings. Often fathers are absent from home, leaving the care of the children solely to their wives. Thus, though Lesotho is a patriarchal society with deeply entrenched gender roles, women are taking a leading role within the family and financial decision making.

Strong social ties provide a safety net. Another key qualitative finding – also borne out in usage figures in the FinScope survey – is that the Basotho people are highly reliant on each other at community-level. Faced with mounting hardships, consumers acknowledge that together they have a better chance of up-lifting one another than alone. Burial societies and

collective savings groups often form the back-bone of the community. They fulfil a not only a financial role, but also a vital social support role. The following focus group quotes illustrate:

R: It gives you a sense of belonging

R: We are able to survive because of these organisations

R: We boost each other

R: For an example the furniture that I bought in Johannesburg I didn't buy it with my own money only I went to the organisation and told them what I want to buy, when I bought the furniture they were the first ones to see my furniture

R: When I wanted to buy stock they helped as well

R: If you want to start a small business that's where you must go those people will understand your language rather than going to the bank

Maseru, male, age 25-40, income M3001 – M5000

Sophisticated collective financial functioning. There is a wide variety of burial and savings societies and many operate at a complex and intricate level, reflecting how entrenched the practice has become in Lesotho. Collective bodies meet a wide variety of financial as well as social needs of consumers. The following quotes illustrate:

R: I am in a society where we contribute R10 every day and in June we buy our children winter clothes and then carry on again in July and in December we buy groceries, and the second one is where we contribute weekly and another is where we pay a R100 fee and then contribute R50 monthly and we can take loans from that money and pay it back in three months so this is what helps us survive.

Maseru, female, age 41 – 55, income 0 – 3000, credit users.

R: Yes, and then also the one with the dishes.

M: How does that one work?

R: Buy each other dishes, pots for when we have funerals, so when a funeral occurs we all take our pots and dishes to be used at the funeral.

Maseru, female, age 41 – 55, income 0 – 3000, credit users.

R: We have a society that I am a part where I work (at the market), we are four ladies and we each contribute R400 every Friday for one person every week till we have all received the money and do it again the next month.

M: You rotate?

R: Yes and with this money we are able to keep our stock afloat and pay our children's school fees.

Maseru, female, age 41 – 55, income 0 – 3000, credit users.

R: There is a savings group I know of where all the members are taxi owners and they save up to assist each other buy a taxi. They bought each other quantum taxis.

Maseru, male, age 25-40, higher income, credit users, all banked

4.1.2. Connectivity and documentation

High access to cellphones, passports across income bands: Although people in the higher income bands have significant higher access to cellphone (95%), access to cellphone seems to be reasonably high across income bands but lowest for people in the lower income bands. Furthermore passports, the main source of identification for KYC purposes, are fairly widespread even among the poorest groups. Verification of identity through proof of residence is, however, problematic: only 35% of people living in urban areas and 12% in rural areas indicated having proof of identity and proof of residence.

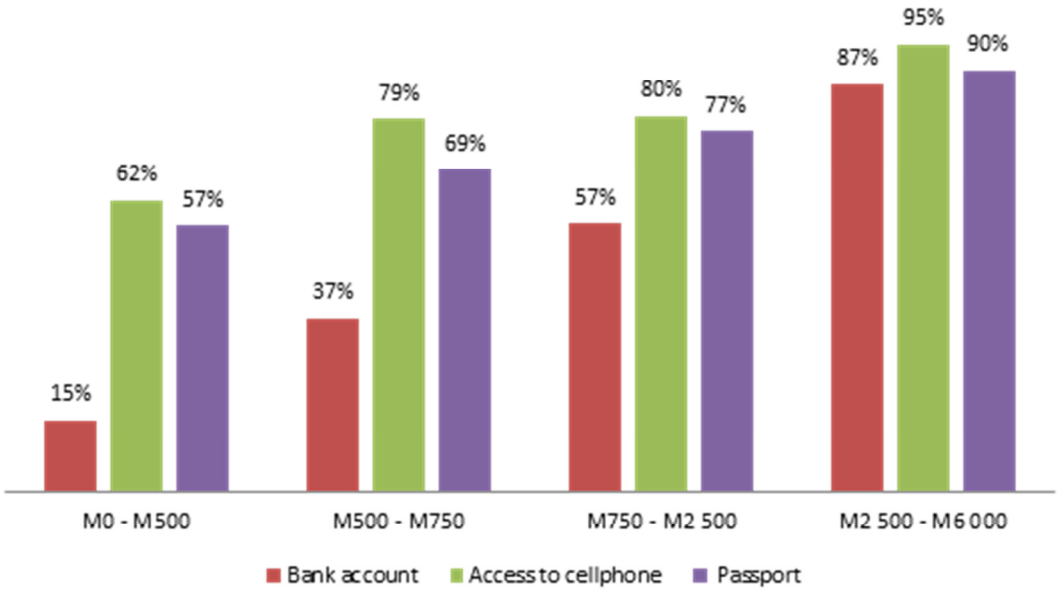

Figure 5: Access to financial infrastructure and support services by income level

Source: FinScope 2011

4.1.3. Livelihoods and budget realities

Small budgets imply limited room for advancement. The qualitative research confirms the picture painted by the low income profile of the Lesotho adult population: for the most, life is a struggle and a lack of income is at the core of respondents' personal and family challenges. Most respondents have to spread their limited income over a large household; some respondents have up to 6 children; respondents' households consist of up to 4 to 8 members. While educating their children is a priority for most, there are some limited mentions that when income is insufficient the older children are pulled out of school.

Not only is constrained income hindering their ability to pay for basic necessities for the family such as food and school fees; it is also the key obstacle they face in achieving their goals and aspirations. For those involved in informal trade or owners of micro enterprises, lack of money means they are often unable to inject a cash investment into their business in order to facilitate expansion and growth. Ultimately, without access to an adequate investment most microenterprises will remain too small and underdeveloped to properly support respondents and their family.

Low incomes cause many to resort to informal credit. Many respondents are severely over-indebted, resulting in emotional and financial stress as the following examples from an older low income female group in Butha-Buthe illustrates:

> R: I'd say they affect our lives in that it gives us a lot of stress and as women we get sick of stress because you'd be able to pay this and not pay that one. Some even go to our work places and insults you, they don't even listen and at times you just had a funeral, they just humiliate you regardless.
>
> R: We have become crooks as women because if we took a loan and were not able to pay we use a different road home if we know we might meet the people we owe. We end up being not trustful.
>
> R: I even suffer from heart disease because of debts. I'm now sick. Even our documents are no longer with us, they took them. At times when you wake up at night and you wonder whether you'll finish all those debts. And when the husband is around and doesn't know since we make them secretly you just get heart attack.
>
> *Butha-Buthe, women, age 41-55, income 0-2000*

Limited formal employment implies various household income sources. Formal employment is mostly limited, with the majority of respondents engaged in informal methods of earning an income (in line with the low formal employment rate indicated in Section 2) and most households having more than one income source. Especially older women are more likely to be running small micro enterprises than being formally employed. Respondents had stalls at local market places selling fruit, snacks, airtime, poultry, etc. Women have started these small businesses out of necessity to make money to survive. Men are more likely to be engaged in casual labour or piece jobs.

4.1.4. Financial capability[42]

Relatively high awareness. Respondents are generally aware of some of the products offered by formal financial institutions. They are able to describe in basic terms what a transactional account or a loan is and what it entails from a customer's perspective.

Respondents have a good understanding of how interest on loans work and how repayments are calculated. The theory behind short-term loans and the practical implications thereof is something most consumers are intimately familiar with from their dealings with informal money lenders and through their collective savings societies.

Some had quite a sophisticated understanding of the practices of formal financial institutions, as the following quote illustrates:

> I don't have a consistent guaranteed salary at the end of each month. I am a bit of a high risk for any bank, for a bank to be aimed at me I would have to be employed at a government department, although I might actually need their services to start my business. They need security from me and

[42] Financial capability is the knowledge, skills, attitude and behaviour that enables effective management of a person's finances as well as interaction with financial services.

unfortunately I do not have.

Maseru, male, age 25-40, higher income, credit users, banked

In addition, respondents understand that banks charge certain fees on their transactional and savings accounts. However most respondents do not know what those fees and charges are for. As the amounts of those fees can vary from month to month, this often adds to the confusion respondents have around bank charges.

Awareness of the various banks and other financial institutions is quite high. Respondents were aware of all the banks operating in Lesotho i.e. Nedbank, FNB and Standard Lesotho Bank. To a lesser extent Lesotho Post Bank and Boliba were also mentioned. Boliba, in respondents' opinions, straddled two positions: that of a bank as well as that of a co-operative. It began as a co-operative for saving and loan purposes and has since evolved to offer a bank accounts and investment products. Interestingly, some respondents were sceptical or cautious of Post Bank. Its status as a government owned enterprise seems to impact this sentiment. Awareness of insurance products is mainly limited to funeral policies and education policies.

S*ophisticated engagement with collective financial vehicles*. Respondents are generally confident in their dealings with informal financial channels and have a strong grasp of financial matters when dealing with societies and informal money lenders. The practice of charging interest on loans from savings societies in order to increase the funds of the society illustrates quite sophisticated financial awareness:

R: We contribute money at the end of each month, and loan it out to each other within the society and whoever loans money will pay it back at the end of the month. Our target for the end of the year is to each have about R6000 and then start again in the beginning of the year.

Maseru, female, age 41 – 55, income 0 – 3000, credit users. All but 1 have bank accounts

R: I also have one where we share money at the end of the year. We also borrow from the same and payback with interest.

M: How much is the interest?

R4: It's 20%. We do this so that we can be able to pay school fees for our children from the returns.

Butha-Buthe, women, age 41-55, income 0-2000

R: Yes, but a member can borrow the money on behalf of someone else, yet he will be liable for paying if the other person from the outside fails to pay. The whole point is to make interest for this money.

Maseru, male, age 25-40, higher income, credit users, banked

R; When you don't have anything you understand that you are supposed to bring something every month so if I don't have that R100 this month the next time I come I should have R20 extra

R; They charge you interest

M; Okay and what do they do with the interest money?

R; It goes into the society

R; It increases the money bag

Maseru, female, age 41 – 55, income 0 – 3000

Limited confidence with formal financial terminology and processes. The confidence in dealing with informal financial services does not extend to respondents' dealings with the formal financial institutions and the products they offer. This lack of confidence stems mainly from the fact that banks and insurance companies make use of financial jargon and technical terms most respondents are unfamiliar with. This lack of understanding and confusion manifested itself when banked respondents described their feelings around bank charges. Many feel the bank charges are unfair, the purpose behind the charges lacks transparency and therefore it can be viewed as theft on the part of the banks. The following quote illustrates:

"I used to keep my money in a bank account. But then when I went to withdraw it, there was less than when I first deposited the money. I asked them why and they told me about these charges, but I didn't understand why they took so much"

Butha-Buthe, Female, Aged 33 years, Police officer and Informal Money lender

4.2. Take-up of financial services

This section outlines usage of financial services in Lesotho in broad terms. The analysis makes use of the access strand framework in FinScope. The box below explains the access strand tool as applied in the Lesotho context

Box 5: Explanation of revised access strand (adapted to Lesotho)

An access strand is a tool used to illustrate take-up of financial products or services across the formality[43] of the source or provider. It does so based on the idea that the goal of financial inclusion initiatives is to increase formal financial inclusion. MAP adapted the standard access strand categorisation employed by FinScope to define the following distinct sections or groups of adults in Lesotho:

- *Financially excluded:* This group consist of individuals who do not have regulated or unregulated financial products or services. However, this group can be split into individuals who demonstrate no financially activity, and those who illustrate financial activity through the use of financial mechanisms other than regulated or unregulated financial products or services. This financial activity includes saving at home or with family or friends, borrowing from family or someone you know, sending money to someone via family or friends, or using a savings or borrowing mechanism in response to having experienced an insurable event (ex-post financial mitigation)[44].

[43] As explained earlier in this document, for the purposes of the revised access strand we refer to formal providers as regulated and to semi-formal and informal providers as unregulated.

[44] This last category is captured as financially excluded in the insurance access strand regardless of the formality of the saving or borrowing activity employed. The use of regulated or unregulated saving or borrowing to mitigate risk would still reflect as regulated or unregulated use of saving or borrowing in the saving or borrowing strand, and overall financial access would therefore still reflect the true extend of regulated and unregulated uptake.

Those who are financially included (see below) may still make use of such "unintermediated" financial activities, but this group represents those who do not have any other regulated or unregulated financial services.

- *Financially included through unregulated/informal financial products and services:* This group is comprised of individuals who are financially included through the take-up of financial products or services from entities that are unregistered and not supervised for the provision of financial services (or any other aspect of their activities), but have no formal products or services. It also contains individuals who are financially included through the take-up of financial products or services from institutions that are registered with a public authority but that are not subject to supervision in their provision of financial services.
- *Financially included through regulated/formal financial products and services:* This group is made up of individuals who are financially included through the take-up of financial products or services from institutions that are both regulated and supervised for the provision of financial services. It includes individuals who, apart from their formal financial service, also have informal services or who rely on family and friends.
- The regulated component is furthermore disaggregated into those who have a *bank account* and those who do not have a bank account, but have *another formal financial service*. The former may also have other financial services, but the latter excludes all with a bank account.

As explained above, the access strands do not show overlaps between these categories, so that an individual with both a regulated and unregulated financial product is not distinguishable from the access strand and would only appear under regulated take-up. Similarly, a person with no regulated product but who has an unregulated product and who (for example) saves with a family member, would only appear under the unregulated take-up.

The access strand can further be used to illustrate take-up across particular product groups (credit, savings, insurance or payments). Particular financial products, services, mechanisms and activities that have been included for each category of the product group access strands are listed under each product group below:

Credit strand

- *Regulated/formal take-up:* This relates to uptake of formal credit. In Lesotho, the main sources are commercial banks, financial cooperatives, licensed microfinance institutions, licensed money lenders, (non-bank) financial institutions and stores. Arguably, some of these could be regared as 'semi-formal' as they are registered but not currently supervised.
- *Unregulated/informal take-up only:* Those without a regulated service who borrowed money from an employer, savings group, informal savings group, unlicensed money lenders ('machonisa'), community-based organisations, burial societies, multi-purpose societies or a registered institution which is not being supervised for the provision of financial services. This includes registered Rotating Savings and Credit Groups (RSCGs) under the RUFIP project.
- *Borrowing with family or friends only:* Those without regulated or unregulated services who borrowed money from family or friends that you have to pay back. Received money from family or friends that you did not have to pay back.

Savings strand

- *Regulated take-up:* Saving with or having a savings account with a commercial bank, formal (non-bank) financial institution or a co-operative.
- *Unregulated take-up:* Those without a formal savings account who belong to a savings group or have savings with a savings group, money donations group, or another institution that is not

supervised for the provision of financial services. This includes Village Loan and Savings Associations (VSLAs), RSCGs, etc.

- *Saving with family*, friends or self: Saving within the household, family or community who keep it safe for you, saving in a secret place at home, saving in kind.

Insurance strand

- *Regulated/formal take-up:* Any formal insurance product with an insurance company.
- *Unregulated/informal take-up:* Without a formal product, but belonging to a burial society or funeral parlour schemes (which are unregulated in Lesotho).
- *Self-mitigation:* Without either of the above, but use of risk mitigation strategies (savings and credit) other than insurance to cope with risks and financial shock; belonging to an informal savings group or multi-purpose society may have risk mitigation elements (e.g. against funeral expenses) but is not included as an insurance activity within the FinScope framework.

Remittances strand

- *Regulated/formal take-up:* Having sent or received remittances in the last 12 months via bank transfer (or paying into a bank account), ATM, the Post Office, Western Union, MoneyGram, etc, or using somebody else's bank account for remittances.
- *Unregulated/informal take-up:* Not making use of regulated services, but have sent or received remittances in the last 12 month through an unregulated money transfer facility, including informal channels such as bus or taxi drivers.
- *Sending money with family or friends:* None of the above, but have sent or received remittances in the last 12 months directly via friends or family.

High financial inclusion in regional terms. Among the 15 African countries in which FinScope surveys have been undertaken, Lesotho has the lowest financial exclusion figure, with only 19.1% of the adult population being financially excluded. 38% of adult have a bank account and a further 23% have another form of formal financial service. This means that 61% of Lesotho adults are formally included. A further 20% are only served by informal financial services.

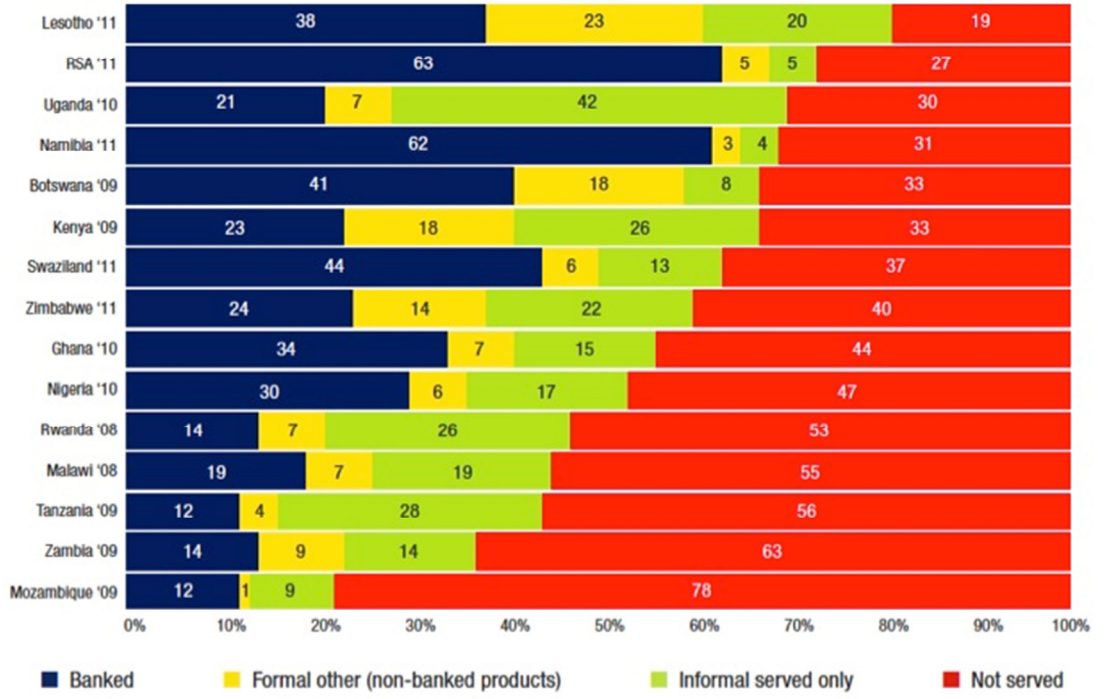

Figure 6: The Lesotho Access Strand: Country comparisons

Source: FinScope 2011

Access to banking is relatively low in Lesotho – with only 38% of adults being banked, the lowest figure in SACU. The limited access to banking is particularly evident in the rural areas, where 29.5% are banked (compared to 57.9% in urban areas).

High informal usage, especially community-based. The access strand[45] masks the fact that there is substantial overlap between usage of formal and informal products. When looking at total uptake of informal financial services, we see that 62.4% of the adult population use informal financial mechanisms. In total, 29% of adults (329,839 individuals) save through informal groups or mechanisms, almost 33% (369,642 individuals) borrow from informal sources and 37% (419,289) belong to a burial society. 11% of adults (124,800 individuals) make use of informal remittance services.

Usage across product markets

The figure below considers the percentage of adults served in each of the four product markets:

[45] The access strand shows mutually exclusive usage. The proportion indicated under "non-bank formal" are only those who have non-bank services but no bank account. Similarly, the informal category are only those with informal financial services only. Many of those who have a bank account or another formal financial service will also have an informal service.

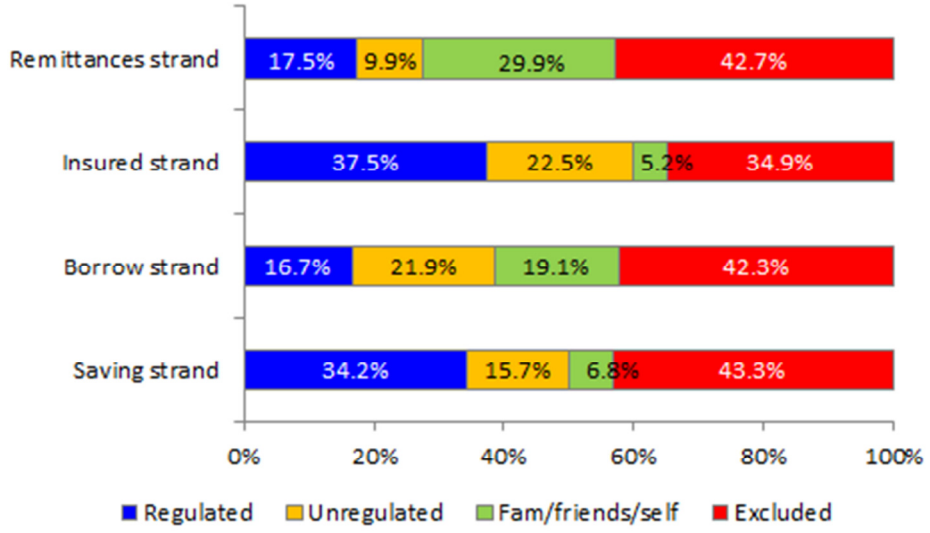

Figure 7: Access strand by product market

Source: FinScope 2011

Urban skew. The diagram does not indicate the rural-urban spread of uptake across product markets. The penetration of insurance is fairly similar in rural and urban areas. For the other product markets, however, urban uptake is significantly above rural usage.

Formal credit particularly low. Compared to the other product markets, the penetration of formal credit, at 16.7% of adults, is particularly low. Just more than a third of adults have a formal savings account. About 37% make use of formal payment mechanisms (transaction account or remittance service) and about the same proportion have a formal insurance product.

About 30% rely on self or others for remittances. Given the prominence of migrant labour to the Lesotho economy, remittances fulfil an important role. The remittances strand shows that 29.9% of adults only rely on family/friends or another person to send and receive money. 17.5% remit via formal channels and about 10% use only informal remittance channels (e.g. via a cross-border minibus taxi driver). Note that mobile money was only introduced in Lesotho after the 2011 FinScope survey and is therefore not reflected in the uptake figures.

Fairly broadly served

Many use more than one type of informal product. 52.3% of those who have an informal product (368,396 individuals) have more than one type of informal product (insurance, credit, savings or remittances). Almost 60% of all informal product users belong to burial societies.

Half of formal users broadly served. 352,009 individuals (31% of adults; 53.2% of the formally served) have a formal financial service across more than one product market. This means that 53.2% of those with a formal product have a formal product from more than one product market.

Large overlap between formal and informal usage. 457,307 individuals have both a formal and an informal financial service. This represents 40% of all adults, 69% of formal users and 65% of informal users.

The picture painted by considering the overlaps above is one of a society that, even when formally served, still makes use of informal and community-based financial services. Furthermore, more than half of those that use formal products use more than one type of formal product. Likewise, more than half of informal users have more than one type of informal product. This confirms the social role fulfilled by community-based mechanisms, plus suggests that financial inclusion in Lesotho is not just driven by a single anchor product.

4.3. Segmenting the market

To understand the nature and dynamics of uptake and usage of financial services by different population segments, the population was divided into economic groupings. The main parameter used in deriving the market segments was income sources, based on FinScope data. The analysis renders six groups:

- Salaried workers;
- Piece job workers;
- Small business owners;
- Farmers;
- Private dependents; and
- Government dependents.

Given the traditional importance of migrant labour in Lesotho, we add a seventh group, namely *non-resident Basotho*. Though they are not captured in the FinScope survey, they nevertheless fulfil an important role in supporting dependents in Lesotho.

The diagram below shows the size of each segment and plots the various segments in terms of their geographical as well as income spread:

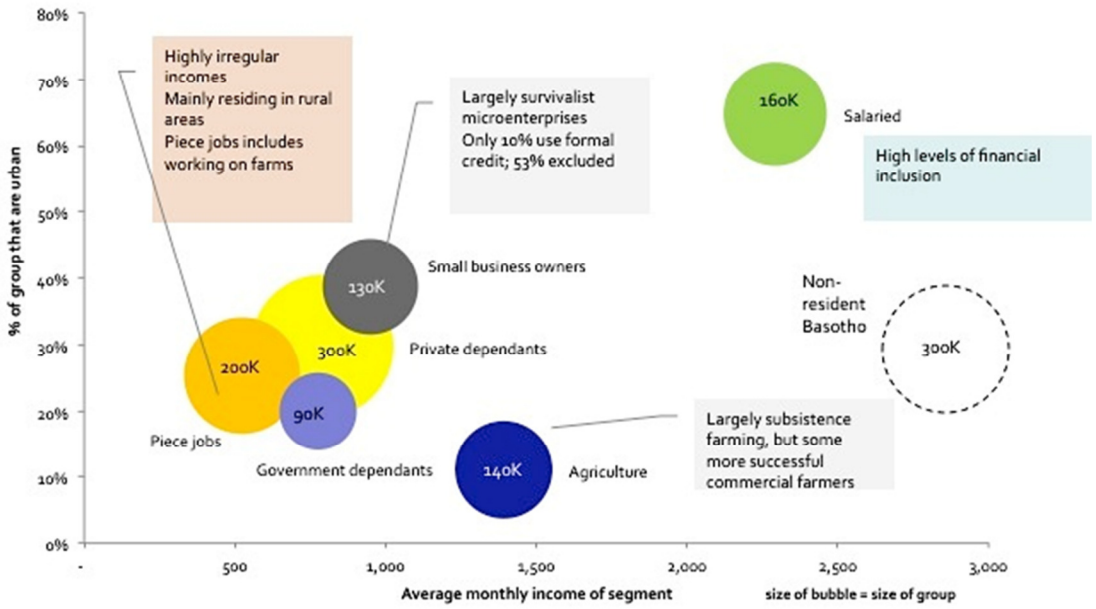

Figure 8: Target groups by average income and size[46]

Source: FinScope 2011

The usage profile is as follows across the segments:

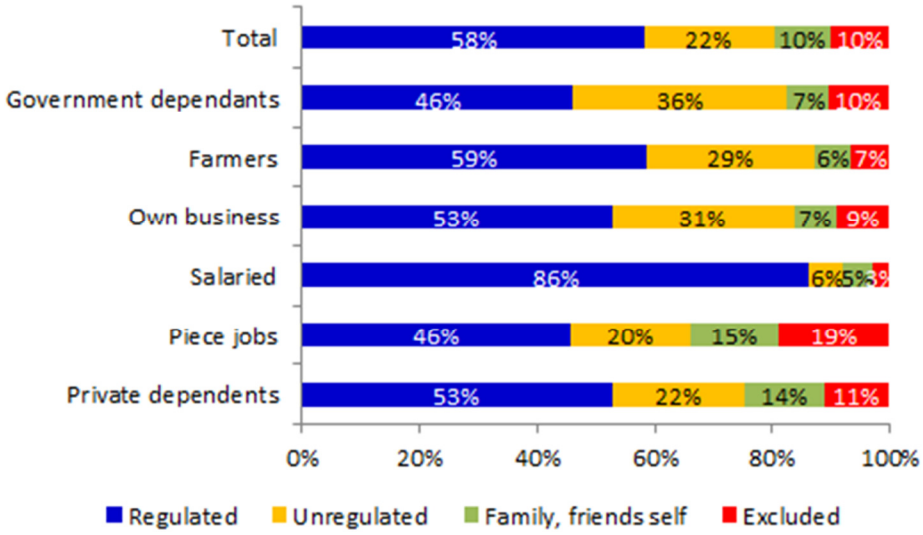

Figure 9: Access strand across target market segments[47]

Source: FinScope 2011

[46] Note that there is a significant discrepancy between the income profiles reflected here and that recorded in the 2008 Integrated Labour Force Survey. Given the more recent nature of the FinScope 2011 survey, FinScope figures have been adopted. However, it is always difficult to reliably gauge income levels through a demand-side survey and the average incomes had to be calculated from income bracket data. Income figures should therefore be considered indicative only.

[47] Note that this figure includes a differential category of individuals that 'access' financial services through family, friends or self only and hence the exclusion figure is lower than in Figure 6 which does not include this category. Strictly, individuals in this category can also be considered as excluded from using financial services intermediated through a third party.

Below, we unpack the profile, usage patterns and key needs of each segment:

4.3.1. Salaried workers

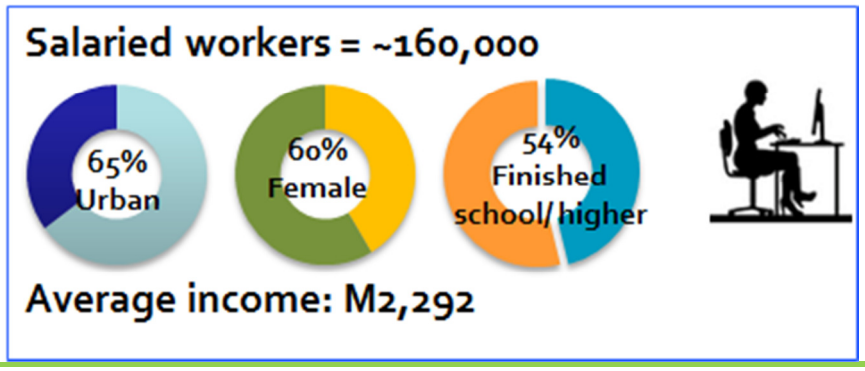

Figure 10: Salaried workers key indicators

Source: FinScope 2011

The salaried worker segment consists of adults that are formally employed with a regular monthly salary; this includes those employed in the private sector as well as the public sector. Salaried workers constitute only 14% of the adult population. At M2,292, this group has the highest average income of all groups. The qualitative research revealed that some use surplus income to engage in small businesses, including informal money lending activities. The majority of salaried workers (65%) reside in urban areas. 54% have finished their school education or attained college or university education. 60% of salaried workers are female, making this group slightly more male than the population average.

High usage of all but credit. 86% of salaried workers are formally included and only 3% are excluded. They have the following financial service usage profile:

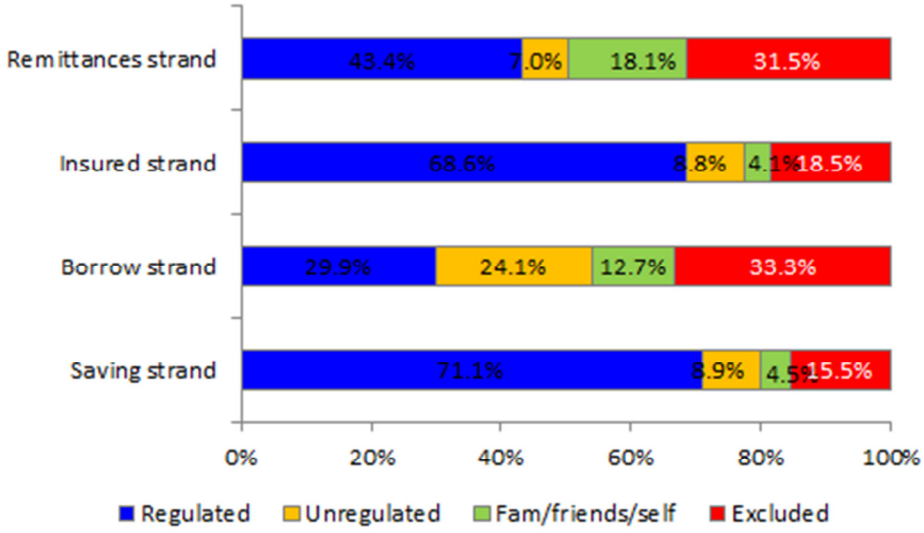

Figure 11: Access strands for salaried workers

Source: FinScope 2011

Salaried workers have high uptake of formal savings accounts, payment services and insurance. Their regular income and ability to provide a pay slip puts them in a good position to access personal loans that they could then also leverage for productive purposes. Yet only about 30% of them report having a formal loan. Another 24% borrow from informal entities and a further 13% borrow only from family and friends.

Key financial service needs: salaried workers

Salaried workers are well-served and not likely to be a priority for financial inclusion. However, their potential to serve as an entry point for productive or asset-based finance for family and friends who cannot meet eligibility requirements can be explored. Their role in supporting the private dependent segment means that they could benefit from enhanced remittance services.

4.3.2. Private dependents

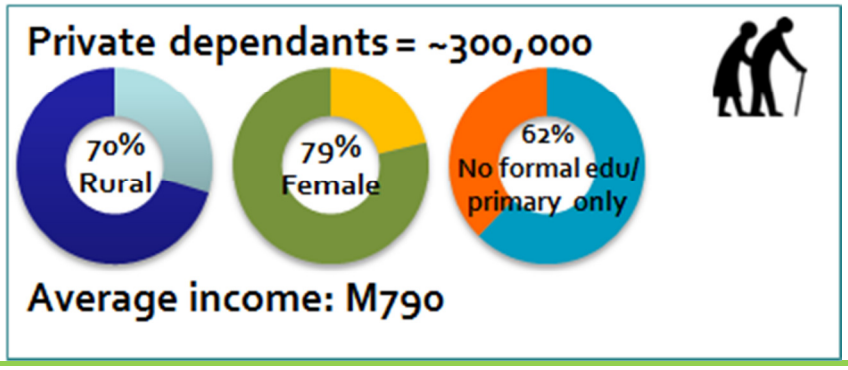

Figure 12: Private dependents key indicators

Source: FinScope 2011

Private dependents consist of adults and young people that receive income from spouses, parents, guardians or other household members. These include those who receive money from Basotho working in South Africa and other countries. Private dependents constitute 26.8% of the adult population, making them the single largest target market segment (with the exception probably of non-resident Basotho). At M790 per month, their average income is low, but still above that of government dependents and those earning an income from piece jobs.

The majority (79%) is female. Qualitative data indicates that this would include those who are widowed; with migrant husbands; or single female heads of households. A large number of private dependents (39%) are aged between 18-24 years, which may include students. Furthermore, 70% of private dependents reside in rural areas and the majority (62%) has either non formal education or only attained primary education. The qualitative research furthermore suggests that, although this group is reliant upon an external income source such as a relative either inside Lesotho or outside, they are still an economically active group. Despite relying on others for their main income source, many dependents, especially females, engage in survivalist activities such as small businesses or subsistence farming (livestock or crop).

Active financial services uptake. Their usage profile confirms that private dependents are not economically marginalized: 53% of them are formally included (lower only than farmers and salaried workers) and only about 11% are fully excluded. Their usage profile across the product market is as follows:

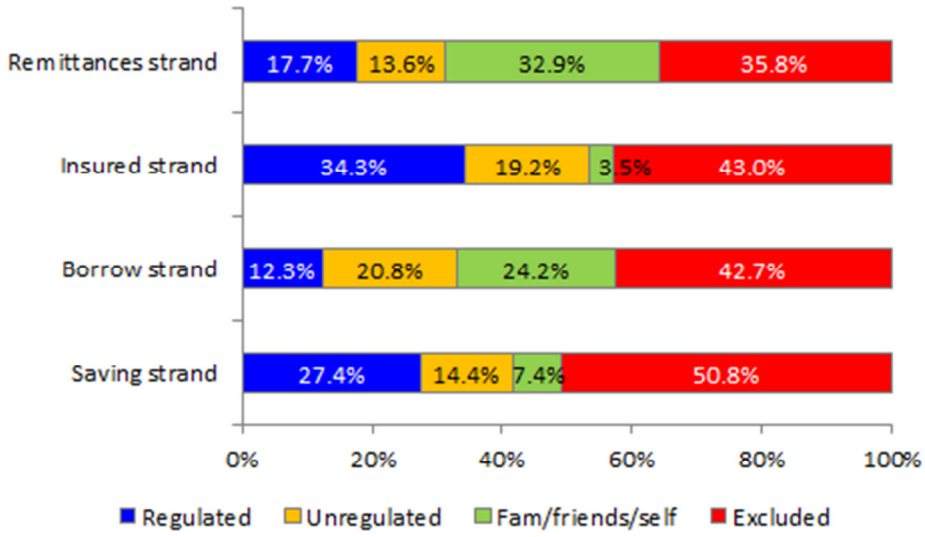

Figure 13: Access strands for private dependents

Source: FinScope 2011

More borrow than save. It is notable that, after those with piece jobs, the private dependents is the segment that is second least likely to save in some way, with almost 51% not engaged in any type of saving, even at home. Also notable is their low uptake of formal credit, though a substantial proportion borrows from other sources. Insurance penetration is fairly high in line with the overall pervasiveness of funeral cover in Lesotho.

Rely on remittances. As would be expected, private dependents are better served by remittance services than the adult population average. Only salaried workers are less excluded where the use of remittances is concerned. As indicated above, however, the bulk of that uptake is informal or through family and friends.

Key financial service needs: private dependents

Private dependents are surprisingly well-served. The biggest need would be for enhanced access to low-cost, convenient remittance options, domestic as well as cross-border. Furthermore, there is a gap in terms of savings penetration. The qualitative research suggests that many want to leverage and grow their remittance income through productive activities, but the low penetration of formal credit suggests that most are unable to meet the eligibility requirements for formal credit.

4.3.3. Government dependents

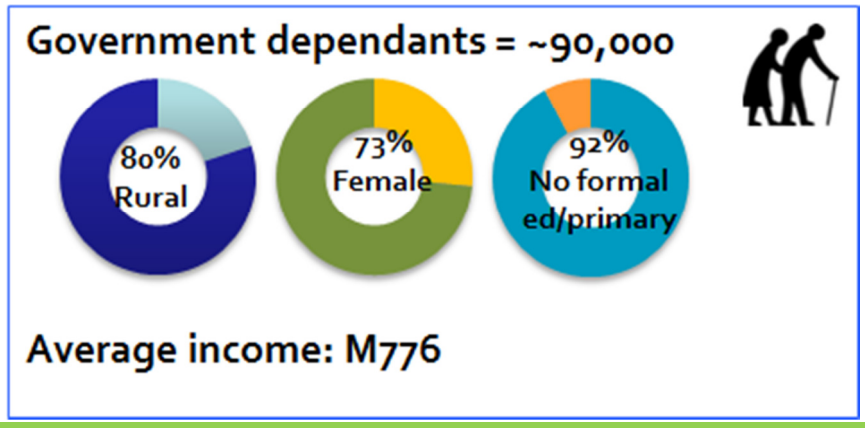

Figure 14: Government dependents: key indicators

Source: FinScope 2011

Government dependents represent adults that reported receiving a government pension or grant as their main income source. Specifically, this included those that receive child or foster care grants, disability grants and old age pensions, with the latter being the biggest sub-group. At about 90,000 individuals (8% of adults), it is the smallest target market segment and the majority of people in this economic group are aged 65 years and above. Most (92%) have either no formal education or only primary education. Not surprisingly, this is the group with the second lowest average income.

80% of government dependents reside in rural areas. Although government dependents receive most of their income from the Government, as with private dependents, many also engage in some survivalist activities, notably subsistence farming. Qualitative data also revealed that this group plays a large role in bringing up orphaned grandchildren due to the effects of HIV/AIDS. Like private dependents, the majority (73%) are female.

Relatively high inclusion. 46% of government dependents is formally included and only 10% is fully excluded. They exhibit the following usage profile across the four product markets:

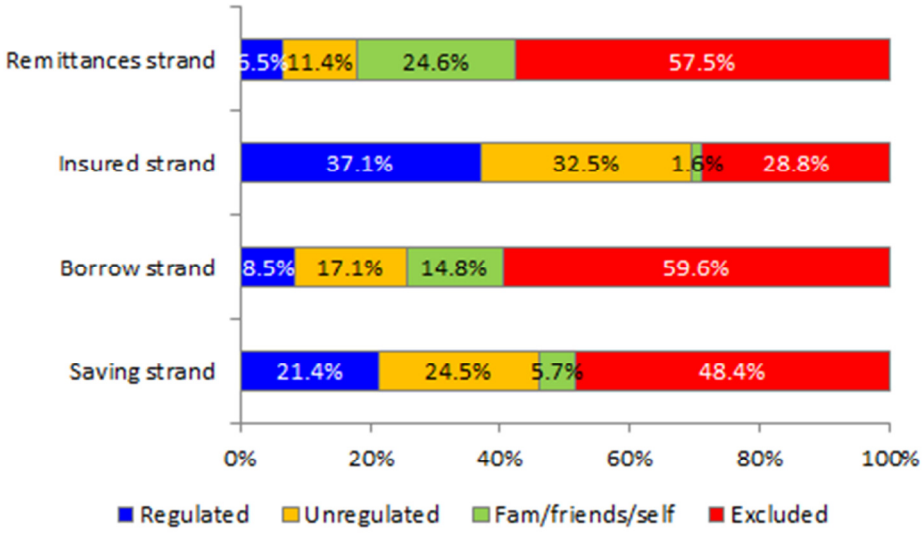

Figure 15: Access strands for government dependents

Source: FinScope 2011

As with the private dependents, formal borrowing has limited penetration for government dependents. They also largely do not use formal remittances and savings products and formal usage is largely driven by funeral cover, which would make sense given their age profile. In addition to those with formal insurance, about one in every three government dependents belong to a burial society. About a quarter of government dependents furthermore do not have a savings account, but belong to a savings group.

Key financial service needs: government dependents

Their relatively high usage is mostly a function of funeral cover, burial society and savings club membership. Furthermore, many tend to borrow informally and in the community. Government dependents' biggest financial services needs would therefore seem to be well-served informally/at community level – a role that should be acknowledged and leveraged.

The main formal financial inclusion gain in this market could be had by ensuring access to a low-cost, convenient payment mechanism for receiving grants. Given their widespread role as guardians of orphaned children, there is also a need for accessible targeted savings products (such as for education) and health insurance solutions to strengthen them in this role.

4.3.4. Small business owners

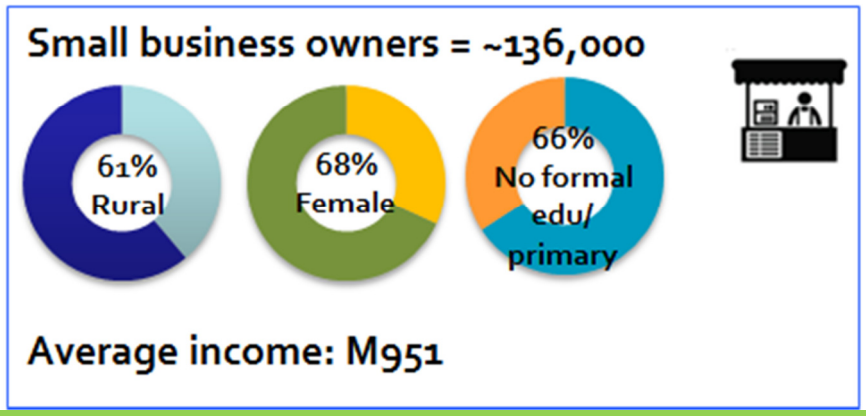

Figure 16: Small business owners: key indicators

Source: FinScope 2011

The small business owner segment includes all adults who are self-employed or own and operate an enterprise as their main source of income. This would include street vendors or hawkers. At 12% of adults, it is the second smallest segment in Lesotho, representing slightly fewer adults than those that derive their main income from farming activities. They have the third highest average monthly income after salaried individuals and farmers. The 45-54 years range is the largest age group.

The majority of small business owners (61%) resides in rural areas and is female (68%). Most (66%) have no formal education. The responses provided suggest that these are mainly unlicensed enterprises, ranging from micro to small in size and largely survivalist in nature. The qualitative research confirms that this is quite a heterogeneous group mostly engaged in individual survivalist business activities: in urban areas such business owners will include those that sell shoes, airtime, snacks, chickens and groceries, while in the rural areas business owners will include those selling agricultural produce such as vegetables and fruits, traditional herbs and medicine, groceries, chickens and livestock.[48]

Box 6. Small business out of necessity to survive

Most are unlikely to be viable formal credit clients. Their survivalist nature suggests a larger need for financial services to help them manage their risks, smooth their consumption over time, cost-effectively make payments and send and receive money, than for productive credit.

For those that are viable, there is a lack of formal credit provision. In the absence of access to formal credit, they have a need for savings towards business capital finance.

Financial functioning beyond formal services most important. 53% of small business owners is formally included and only 9% is fully excluded. They are the group with the second-highest usage of unregulated financial services (after government dependents) and also use

[48] MAP demand qualitative results

unintermediated services across product areas. This shows a need for financial functioning that is not currently met by formal financial services.

Integrated business and household finances. The qualitative research furthermore shows that business owners make their financial decisions at the household or individual level, rather than separating business and household finances. The business's needs are part and parcel of the household budget needs and realities. For example: an illness or funeral in the family may impact on the availability of money for stock or the ability of the individual to conduct the business.

Borrowing has lowest total penetration. Intuitively, one would expect entrepreneurs to require finance to boost their businesses. However, credit is the product with the lowest formal as well as overall penetration among the small business owners in Lesotho, as indicated in the diagram below. When they do borrow, they tend to turn to friends and family or informal money lenders. Access to formal SMME credit is limited:

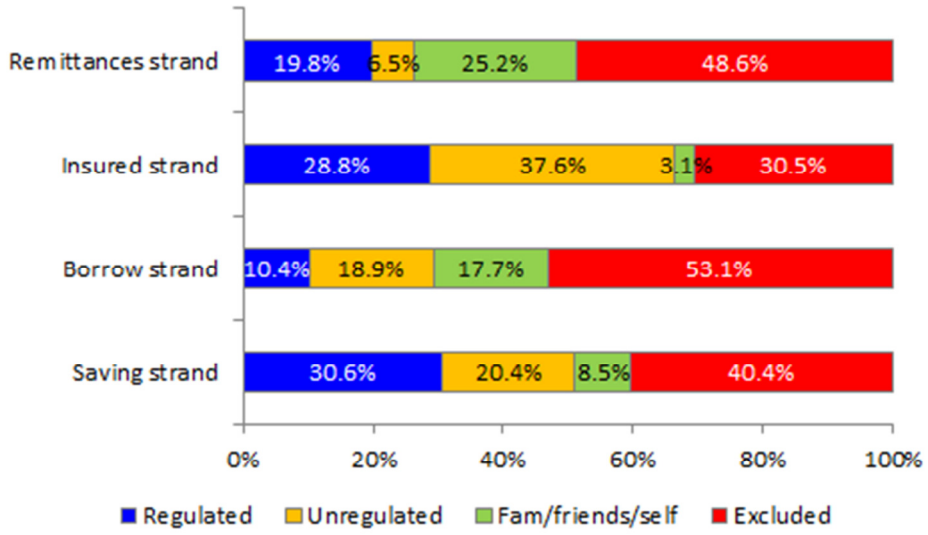

Figure 17: Access strand for small business owners

Source: FinScope 2011

If we take usage of informal and unintermediated services as an indication of demand for a particular service that is not met by formal financial services (be it due to access barriers or client preference), the access strands below suggest a relatively larger "latent demand" for remittances and insurance among small business owners than for credit. This seems to confirm the fact that most businesses are micro and survivalist in nature and integrated with the finances of the household: the individual or household's needs for risk mitigation or to send and receive money trumps the need for credit to grow the business.

For those with more aspirational businesses, lack of access to finance however becomes a key constraint, as the following focus group quote illustrates:

"The space at the back is too small to raise more chickens (currently keeps 100)… so I would have to buy land somewhere else and that is a lot of money. And then I would have to have

security there so people don't try and steal my chickens."

Maseru, Female, Aged 32, Poultry Trader

Key financial service needs: small business owners

Their survivalist nature suggests a larger need for financial services to help them manage their risks, smooth their consumption over time, cost-effectively make payments and send and receive money, than for productive credit.

4.3.5. Piece job workers

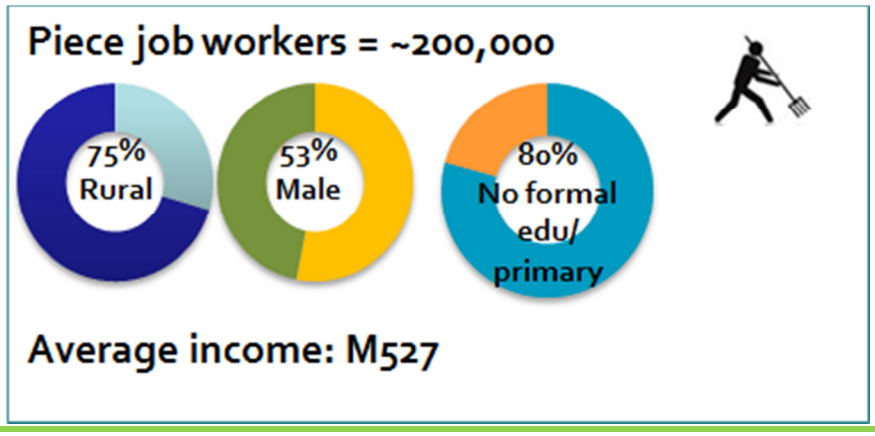

Figure 18: Piece job workers: key indicators

Source: FinScope 2011

This segment consists of adults that rely on low-wage jobs, that is, piecework or casual labour. This group makes up the second largest economic group by number (17.8% of adults), and they are relatively young (with the 25-34 year category being the single biggest age group) and significantly more male than the population average. The income from piece jobs is not only small but highly irregular. It was clear from the qualitative research that they often go without a job and income and are in some cases willing to travel large distances in pursuit of employment opportunities. This makes them the segment with the lowest average monthly income, at just M527. Qualitative data also suggests that this group includes men that previously had jobs in South Africa, notably in the mining sector, and upon returning to Lesotho as older men were unable to secure jobs with regular income streams.

Box 7: Illustration of piece jobs: farm labour

Boss Sehololo, male, works, as a gardener and farm labourer, on smallholdings of local Butha-Buthe farmers and residents. He used to work on the Katse dam doing construction jobs. But since 2000 has been doing odd jobs in Butha-Buthe: "It's not every day that people need me, so you find that you go 3 days without a single job." During a busy month he can earn just under M1,000. While he lives alone he supports his two orphaned

nephews by sending them between M150 and M200 a month.

Most excluded segment. Piece job workers reveal the highest level of financial exclusion (19% totally excluded; 46% formally included) and is the group that is most poorly networked with informal groups such as savings and burial societies. This could be due to the fact that societies are most popular among females, while this group has a male skew, but could also be indicative of their economically marginalized position. The access strands across product markets are as follows:

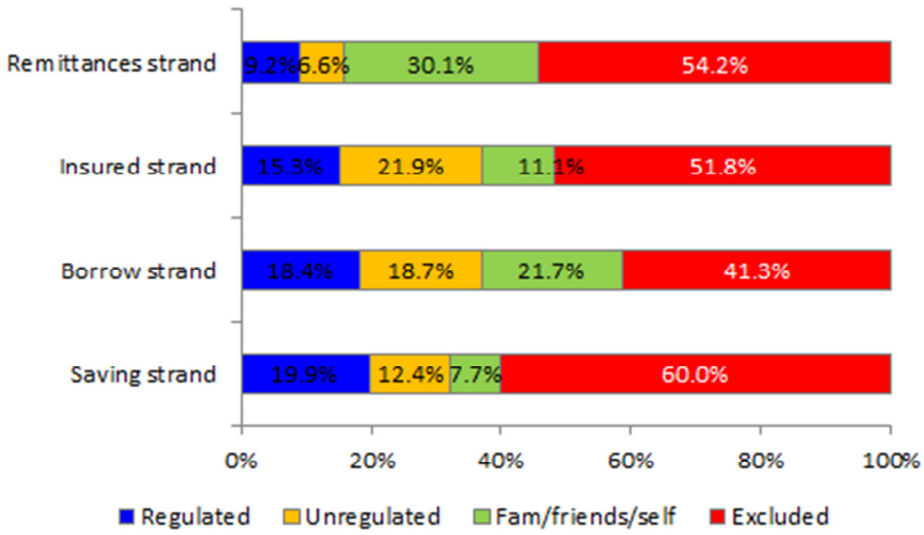

Figure 19: Access strands for piece job workers

Source: FinScope 2011

It is clear that they have limited engagement with formal financial services across the spectrum and are, overall, most likely to borrow.

Key financial service needs: piece job workers

Their comparatively high usage of friends and family to send and receive money suggests that remittances fulfil an important role for them, even if it is not their main income source. This suggests a need for cost-effective, accessible remittance services.

Their irregular, low incomes make them unlikely formal credit or insurance clients, but there is scope to increase the reach of savings vehicles to store value in between jobs. Collective vehicles such as burial societies and savings clubs may be best placed to serve their needs given their limited ability to meet formal eligibility requirements.

4.3.6. Farmers and agriculture related enterprises

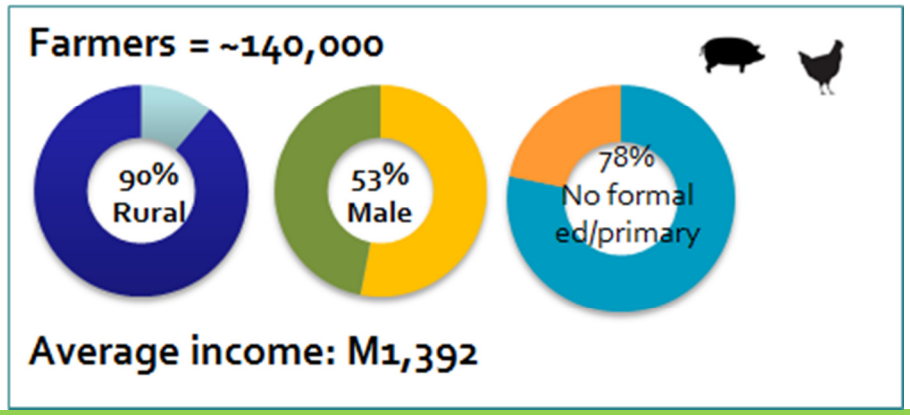

Figure 20: Farmers: key indicators

Source: FinScope 2011

This segment represents adults that rely on income from agricultural related activities, mainly small-scale farmers, but also including adults that rent out livestock or equipment for farming purposes. As the discussion in Section 2 showed, small scale farming in Lesotho is constrained by a number of factors, which includes size of cultivation area and mountainous terrain. As a result, many small-scale farmers engage in little more than subsistence farming. Yet this group has the second-highest average monthly income after salaried workers, suggesting at least a subset of more aspirational, larger-scale farmers.

Those with farming activities as main income source constitute 12.5% of the adult population and are mainly in the age range of 45-54 years. As would be expected, 90% of adults engaged in farming reside in rural areas. They are also more likely to be male than the population average. The majority (78%) have either no formal education or only primary education.

Relatively well served, but low formal credit and remittances. 59% of farmers are formally included, another 29% have informal financial services and only 7% are totally excluded even when considering turning to family and friends or own mechanisms. When considering their usage by product market (as per Figure 21 below), it is apparent that their total usage is mainly driven by insurance and savings. As with small business owners, farmers (who are essentially also small businesses) rarely use formal credit. Where they do have borrowing needs, they turn to informal moneylenders or family and friends.

This would suggest a very similar conclusion to that for the small business owners, namely that financial decisions regarding the farming activities are taken within the household context, which means that they tend to use informal and formal savings and insurance vehicle to smooth consumption and manage the impact of risk, and that most farmers do not have the option of formal, targeted agricultural credit. It is furthermore noticeable that remittances are equally important to farmers than to most of the other segments. While only 8% use formal remittances channels, an additional 42% remit in some way through informal or unintermediated channels.

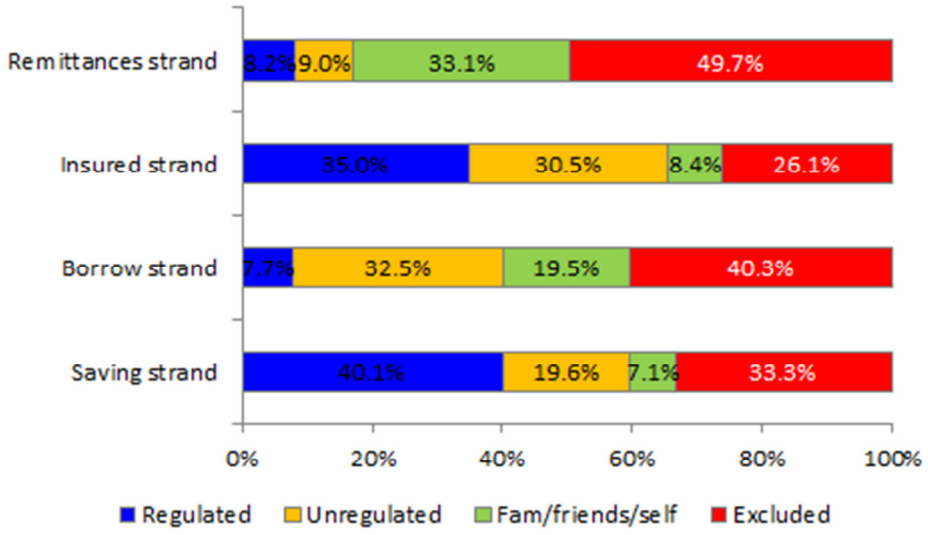

Figure 21: Access strands for farmers

Source: FinScope 2011

Key financial service needs: farmers

The average income and level of inclusion of farmers in Lesotho suggest that many of them are already fairly enterprising or, if this does not hold across the board, at least that there's a sub-set of more commercial farmers with potential for further growth. For them, it would be important to achieve access to targeted agricultural finance.

Furthermore, the seasonal nature of farming income, along with the signal sent by existing relatively high usage of savings vehicles, suggest a strong need for savings towards not only consumption smoothing, but also farm inputs and assets such as livestock. Possible role of low-value input finance for smaller farmers.

Their mostly rural nature challenges distribution through traditional channels and highlights the importance of working through agro-business networks or agricultural associations.

4.3.7. Non-resident Basotho

This group is important, given the history of Lesotho migrant labour in South Africa, the more recent growth of expatriate professionals and the generally important cross-border economy. Although there is considerable uncertainty over the size of this group – with estimates of the number of non-resident Basotho ranging from 126,000 to 428,000 – they are likely to be the single largest group. Their earnings in South Africa are likely to be relatively high compared to Lesotho salaries, and they are important sources of remittance income for Lesotho households.

Key financial service needs: Non-resident Basotho

Their primary need is to save and send money home. For mineworkers, there is an established mechanism to do so through the TEBA recruitment agency (see the discussion in

Section 6.2). With the mineworker numbers dwindling, however, this is no longer a mainstream solution. It therefore raises questions of informal workers' access to the banking system in South Africa, as well as the scope for alternative cross-border remittance channels (see the discussion in Section 6.2).

Another important need is for longer-term savings and asset accumulation in Lesotho, on the assumption that migrant workers would want to eventually retire in Lesotho. On the same premise, they would have a need for funeral insurance that would include repatriation of the body. They may also be interested in paying for insurance or for example education endowment policies for their dependents in Lesotho.

4.4. Conclusion

Strong social structures. This section has shown a nation that is used to economic hardship, but not "broken" by it. Instead, they have come to rely on each other. Collective financial vehicles to save and insure are entrenched in the fabric of society and fulfil an important role that does not seem to warrant a formalisation drive.

Regional integration drives target market features. The economic linkage with South Africa is historically another key driver of social and economic dynamics, with female-headed households who supplement remittance income with entrepreneurial activities, returning migrants who engage in farming and piece jobs, and cross-border traders who capitalise on the close proximity of border towns and the pegged exchange rate. Remittances are an integral part of respondents' lives. Money is sent and received all over the country as well as cross-border, with many using informal channels such as taxi drivers or hand-delivery. Others are depositing into a third party's account.

Behaviour driven by perceptions. The qualitative demand side research has highlighted that perceptions within the market are as much a barrier to take-up of formal products as accessibility. They do not see themselves as the target market for formal financial institutions and do not deem themselves to be eligible as clients.

Informality often by choice rather than necessity. Formal penetration of especially individual loan and remittance products is relatively limited. Generally Lesotho respondents are financially savvy and familiar with most financial terms and the basics of how products work. Their inventiveness and creativity in the informal sector must not be underestimated. Therefore key barriers to financial access is not linked to knowledge and skill but rather to affordability (which is driven as much by perceptions as by reality), perceptions around eligibility and the fact that up to this point the informal channels they use and engage with have offered them what they need.

Key opportunities for supply response. The target market needs and realities suggest some opportunities relating to product features and eligibility:

- There are opportunities for the banks to take to market a flexible loan offering tailored to the market's needs i.e. flexible payment terms, smaller loan amounts, less stringent

eligibility criteria, etc. This would require higher interest rates, but informal usage show tolerance for short-term loans at high interest.

- There is a need for products designed taking the economic realities of the target market into account, most notably the irregularity of income for many respondents, and the fact that many need constant access to their savings.
- Many do not feel they can afford formal products or solutions and therefore some do not even try applying for accounts. There is thus a need for transparent pricing that is widely marketed.
- Respondents tend to operate collectively in the informal financial sphere, but formal institutions and products are designed for the individual. There are opportunities for formal institutions to offer products and solutions designed for a collective, for example society accounts or family group savings or insurance products.
- Eligibility is a major barrier to financial inclusion; being self-employed has specific implications for financial access. A self-employed respondent is unable to provide pay-slips or employment letters, which excludes him/her from applying for certain financial products.
- There is an opportunity to educate respondents about the benefits of using mobile money channels, as the use of cell phones is extensive and wide-spread. Currently many respondents are unaware of how mobile money solutions work and how affordable these are.

The profiles and usage patterns of the different target groups provide opportunities for improving their welfare by addressing access barriers with regard to the financial services they need most. These needs will be recapped again in Section 7 as basis for determining the financial inclusion roadmap priorities for Lesotho.

5. Overview of the Financial Sector

This chapter provides an overview of the Lesotho financial sector in terms of the types and numbers of players as well as the distribution network. Further detail is provided in Section 6 below, relating to the specific product and service segments of savings, credit, payments and insurance.

5.1. Institutional Overview

In developing the financial sector, Lesotho has to balance financial sector efficiency, competition and the desire to extend financial services to the whole population with the desire to develop national institutions. The small size of the country and the economy sometimes means that economies of scale cannot be achieved, and the interests of consumers are best served by access to cross-border financial services. Small size also means that the fixed costs of establishing new institutions pose a relatively high burden, and have to be weighed against the potential benefits.

This section provides an institutional overview of the Lesotho financial sector. Further details of products and services are provided in the supply-side review in Chapter 4 under the separate headings of savings, credit, payments and insurance.

Figure 22 below maps Lesotho's financial institutions across two parameters – products provided and the level of regulation that the entities are subject to. Each quadrant represents one of the four main financial product categories – credit, savings, insurance and payments. Each ring represents the level of regulation the providers are subject to, with the innermost ring representing all those providers that are formally regulated and supervised. The outermost ring represents those providers that are completely informal and not subject to any regulation, whilst the middle ring represents those providers that are subject to institutional regulation, but are unsupervised in practice for the provision of financial services.

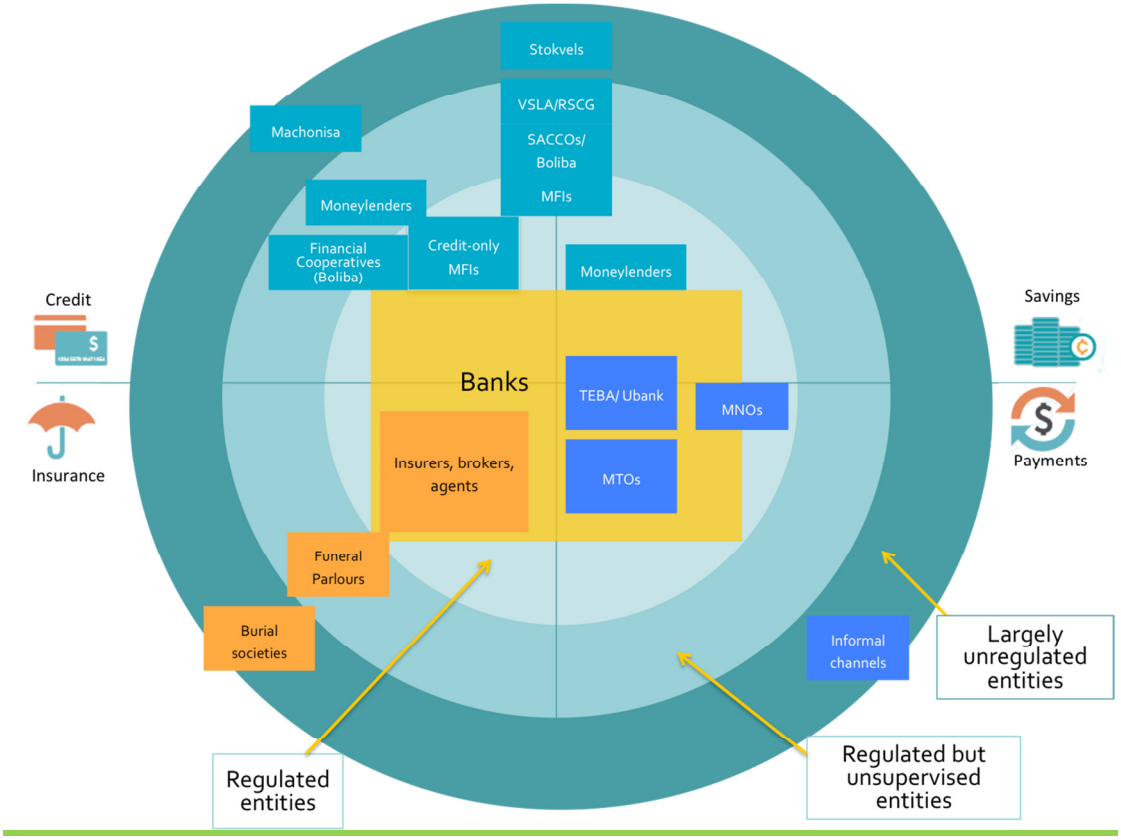

Figure 22: Mapping of Lesotho Financial Sector[49]

Source: Author's own

Small size of market defines provider landscape. The small size of Lesotho's population and economy is a key determinant of the nature of financial sector market development within the country. The small market size limits both the number and variety of providers in the sector, with the majority remaining very small in size but with a few dominating the environment.

Market dominated by the banks. The four licensed banks: Standard Lesotho Bank (SLB); Nedbank Lesotho; FNB Lesotho and Lesotho PostBank (LPB) are the largest players in the financial sector, with their combined assets equivalent to 42.3% of GDP. Figure 22 illustrates the relative lack of major formal non-bank credit, savings and payments providers. There are 8 credit-only MFIs, but only Letshego has reached any substantial size as well as 154 formal moneylenders but each of these remain relatively small. Lesotho also has a large number of savings and credit co-operatives (SACCOs) registered under the Co-operatives Act but only one large financial co-operative, Boliba Savings and Credit.

[49] In this diagram, supervised, the innermost circle, refers to entities whose financial services market actions are actively monitored by the supervisor. Regulated but unsupervised refers to entities for which scope is provided through regulation to be supervised and may have a formal license but are not actively monitored, due to a lack of supervisory capacity or conflicts between entities as to who is responsible for supervision. Unregulated entities are not formally registered or licensed and fall outside the scope of regulation, either because they operate illegally or because they are not covered under existing regulation.

Insurers have achieved substantial penetration. Though there are only a limited number of insurers, FinScope (2011) indicates that 37% of adults have formal insurance. This is very high compared to peer countries, as the insurance analysis in Section 6.4 will show.

Heavy reliance on cash. The Lesotho economy remains strongly cash based – ATM withdrawals account for 89% of the volume of total transactions and 62% of the value in the country, indicating that cash is overwhelmingly the transaction mechanism of choice for Basotho, despite the associated costs and risks related to transport and theft.

Rapid growth in mobile money usage since introduction. Nearly 450,000 Basotho's have subscribed to mobile money with one of the two mobile money providers: Econet (EcoCash) and Vodacom (M-Pesa), despite the product only first being introduced in September 2012. The rapid uptake suggests a latent demand for a cheap, safe payments product with a good distributional reach.

Variety of informal providers. The main informal institutions are burial societies, informal lenders (called machonisa) and savings groups. Funeral undertakers registered with the Ministry of Trade and Commerce, but not regulated for insurance purposes, are also important players. Given the remoteness of many rural communities in Lesotho (as discussed in Section 5.2), accessing formal financial services is both difficult and expensive, increasing the importance of informal providers to supply credit, a safe place to save and earn a return and to pool risk, such as through burial societies. An indication of the importance of informal provision of financial services is that in total 62.4% of Basotho adults access financial services from informal providers.

History of failures of public financial institutions. The financial sector has experienced a number of problems of fraud, insolvency and mismanagement over the years, which may have contributed to a low level of trust in formal financial institutions. The state owned Lesotho Bank had to be liquidated and sold in the late 1990s due to prolonged and excessive losses. The Lesotho Agriculture Development Bank was closed in 2000 for similar reasons. The Lesotho National Development Corporation (LNDC) also had to cease operations as a provider of finance due to losses[50]. More recently, the Government established the "Block Farming" loan guarantee scheme in 2006, whereby bank loans to farmers consolidating their land into larger farming "blocks" were fully guaranteed by the Government. However, virtually none of the loans were repaid and the cost to Government ran into hundreds of millions of maloti.

In the private sector, a large-scale pyramid scheme grew out of a funeral services company (MKM) in 2007/8. Several hundred thousand Basotho were enticed to "invest" by promised returns of up to 60%, and most of them lost their money when the inevitable collapse came.

5.2. Distribution Channels

A variety of distribution networks are in place for the delivery of financial services in Lesotho. Distribution channels are classified here between traditional distribution channels, which include formal banking infrastructure such as branches, ATMs and POS devices as well as insurance agents and brokers, and alternative distribution channels such as mobile money

[50] It still functions as an investment promotion agency and as a provider of industrial properties.

through MNOs and money transfers and insurance sales through retailers. As noted above (in Section 5.1), the banks form the core of the financial system and hence have traditionally been the primary distributors of financial products. However, there are also a number of important emerging non-bank channels effectively serving low-income households.

5.2.1. Traditional distribution channels

Lesotho relatively poorly served by bank branch infrastructure. Although banks remain the core of the Lesotho financial system, the country is not particularly well served by bank access points. In comparison with other SADC countries, Lesotho ranks 9th out of 12 countries for bank branches per 100,000 people (as shown in Figure 23 below). Although the country is ranked more highly in terms of branches per 1,000sq km (3rd) and ATMs per 1,000sq km (3rd), this is more a reflection of the small geographical size of the country rather than the population's requirements and suggests that the physical bank infrastructure is concentrated in the major urban centres only.

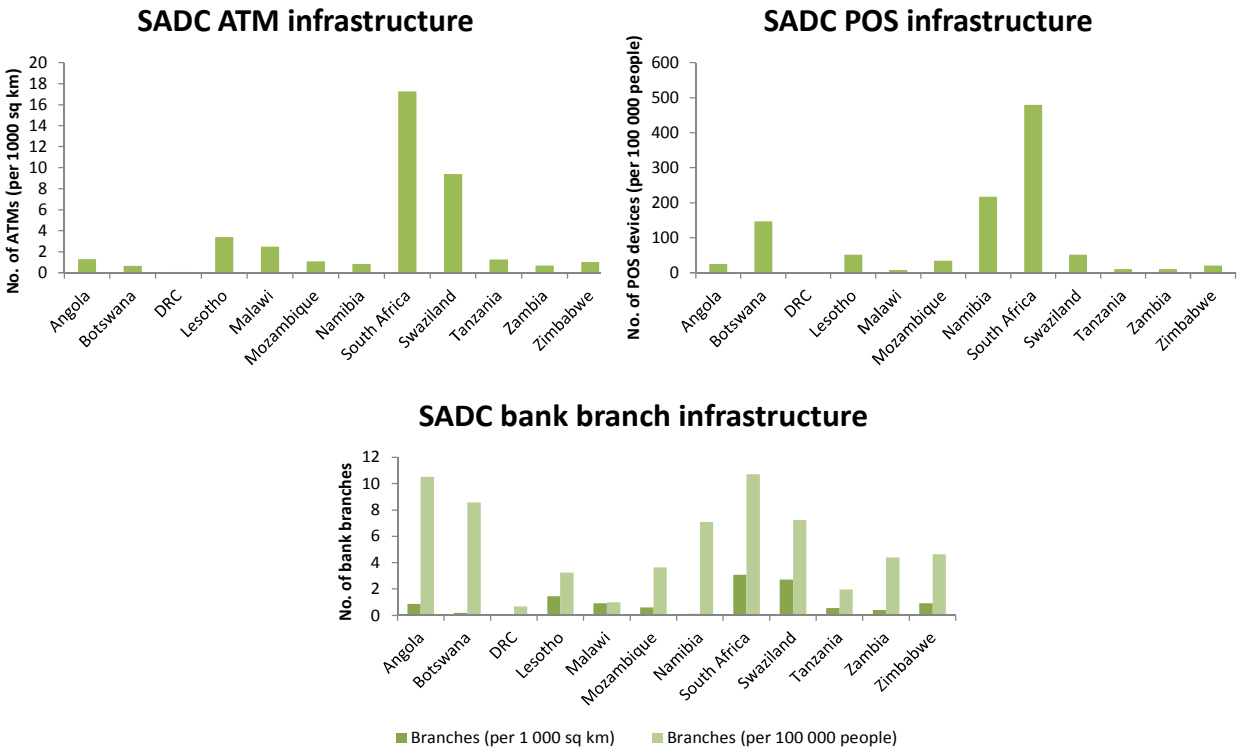

Figure 23: Lesotho traditional distribution channels, SADC comparison

Source: Red Flank, 2013

Formal banking infrastructure is primarily situated in urban areas which, given that two-thirds of the population resides in rural areas, may be difficult and expensive to access for most Basotho. Figure 24 below, shows that just 24% of Basotho live within 30 minutes travel time of a bank branch and 55% live more than an hour away, including 23% having to travel for at least 3 hours to access a bank branch.

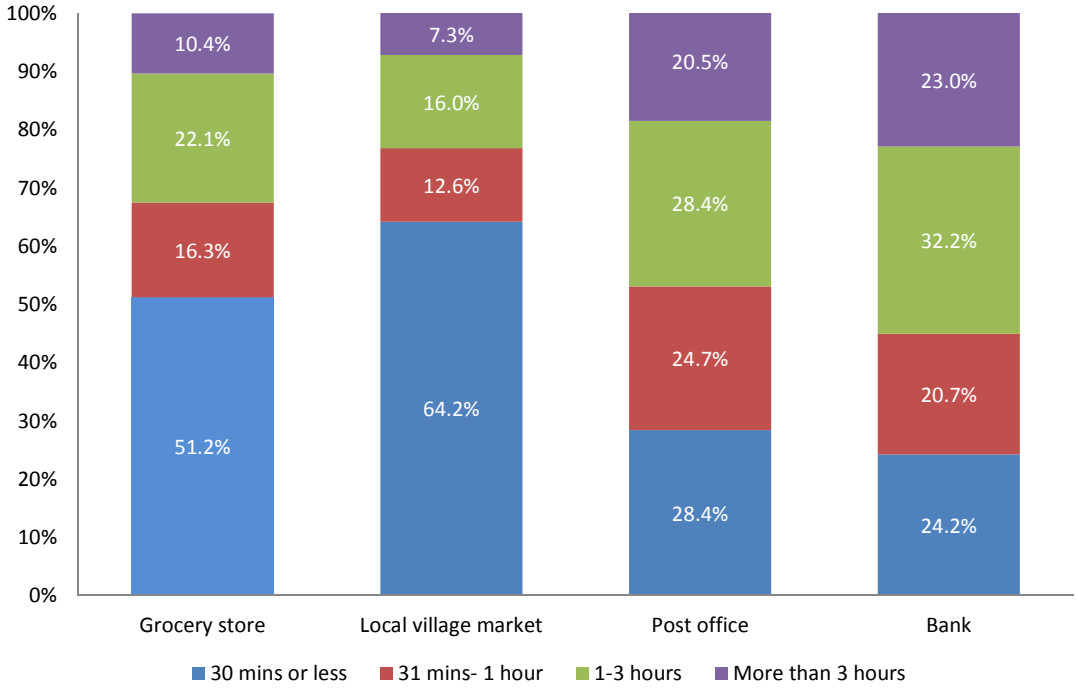

Figure 24: Travel time for Lesotho adults to key infrastructure

Source: FinScope, 2011

Limited potential for significant bank branch expansion. SLB has the largest branch network (as indicated in Table 5 below), which stems from its history as the former government-owned Lesotho Bank. The next largest is LPB, whose branches are mainly linked to Post Offices. It is unlikely that there will be a significant expansion in the network of fully-fledged bank branches. Despite the majority of Basotho living outside of urban areas it is unlikely that it will be viable for banks to open branches outside of urban areas as bank branches are expensive and have high fixed costs that are difficult to cover profitably, particularly given the low population density in rural communities.

Bank	Number of Branches
SLB	17
FNB	6
Nedbank	9
LPB	13
Total	**45**

Table 5: Bank branches, 2013

Source: Consultations with banks, 2013

Banks focusing on technology as growth distribution channel. Increasingly technology is being viewed as the avenue for distributional growth due to the lower costs of providing banking services via cellphone or internet banking, as well as their wider reach due to the fact that there is no requirement for a consumer to interact directly with physical bank

infrastructure when using these channels. The rapid growth in the number of POS devices in particular is a feature of the technology focus of Lesotho banks. FNB, in particular, has led the way in this regard and, as shown in Table 6 below, has the largest number of POS devices in operation despite being only the 3rd largest bank in terms of market size. The number of ATMs has also recently increased significantly, rising 23% in 2013. However, banks report that the expansion of the ATM network is inhibited by the need to get CBL approval and pay a fee for installing new ATMs, as well as power supply problems. There may also be scope to increase outreach through the use of banking agents. Some of the banks indicated in consultations (2013) that they are keen to use banking agents but are awaiting the finalisation of applicable regulations

	ATMs	POS	Debit cards	Credit cards
SLB	73	307	242,418	9,133
FNB	42	393	59,251	112
Nedbank	24	68	1,524	179
LPB	2	35	8,556	-
TOTAL	**141**	**803**	**311,749**	**9,424**
TOTAL - Dec 2012	**115**	**474**	**261,784**	**8,201**

Table 6: Numbers of ATMs, POS machines and cards, per bank, December 2013

Source: CBL, 2013

5.2.2. Alternative distribution channels

Mobile money offers major advantages as a financial services distribution channel. Lesotho has experienced a rapid uptake of mobile money since its introduction in September 2011. As primarily a payments mechanism, mobile money can help facilitate other financial services such as loan repayments and insurance premiums, but can also act as a savings mechanism. Mobile money has a number of advantages as a distribution channel, including:

- *Easily accessible*. FinScope (2011) indicated that more than two-thirds (70%) of the adults population own and use a mobile phone (and this figure has likely risen further in the interim), meaning that most Basotho can easily access mobile money.
- *Affordable*. The cost of conducting payments through mobile money is substantially cheaper than through most other channels.

Broad distribution. Possibly the greatest advantage of mobile money is its wide distribution network. As mobile money is serviced by agents rather than physical branches (like with banks) there are far more touch points at which mobile money customers can access services. Both mobile money providers (Econet and Vodacom) have appointed agent networks to handle cash-in and cash-out transactions for their mobile money offerings. Agent networks comprise both agents and super-agents, with the latter acting as the intermediary between the agent and the MM operator. As at June 2014, Vodacom had 1,322 agents and 28 super-agents, while Econet had 809 agents and 43 super-agents (CBL, 2014). Furthermore, Figure 25 below shows that these agents are fairly broadly spread around the

country, indicating that most rural communities will be within relative proximity to a mobile money agent.

Figure 25: Lesotho mobile money agent locations

Source: CBL

Retailers an important alternative distributor of financial services. Figure 24 above, shows that more than twice as many Basotho adults are within half an hour's travel time of a grocery store than a bank branch, illustrating the greater reach of retailers. Furthermore, many individuals may feel intimidated or uncomfortable to transact in a bank and interact with bank staff and are more willing to access financial services from a trusted retailer that is well-known to them (Eighty20, Forthcoming). A challenge is that many of these retailers, particularly those situated rurally are non-franchise retailers and hence do not explicitly connect into an existing network that can be leveraged to allow customers to access financial services. International experience has shown that technological innovations, such as Flash[51], offer the potential to create these networks to allow even remote shops to offer financial services. These retailers can also act as mobile money agents.

Distributing financial services through retailers can also be highly beneficial to the retailers themselves as it provides an alternative source of revenue and can reduce the retailer's cash management costs if a cash-out service is provided. Furthermore, providing the service will provide greater reason for more customers to frequent the store and therefore opens up

[51] South African based payment system s provider for local mom and pop stores.

the opportunity for increased profits through cross-selling. For example, a significant amount of money transfer funds sent through retailers is also spent in retailers (Eighty20, 2013).

Shoprite piloting cross border remittances. Shoprite is already in the process of implementing a pilot cross border remittance product from South Africa to Lesotho which will provide remittances more affordably than existing channels. Recipients can collect their remittance at any Shoprite branch. With authorisation from the Central Banks of both South Africa and Lesotho secured, the retailer intends to begin piloting the project in the second half of 2014.

Agricultural value chains represent an important potential distribution channel. Lesotho has a large number of adults engaged in farming activities and, as the analysis in Section 4 showed, many would benefit from improved access to credit, savings and insurance products. The rural nature of farmers, however, can make them difficult to reach for most formal providers. Exploiting aggregation points in the value chains of specific agricultural products is a viable channel through which to provide financial services products. An example would be to distribute financial products through the Government woolsheds to the 28,000 wool producers in Lesotho (Matebesi, 2014). Repayments of loans, insurance premiums or savings contributions could all be deducted at this point of the value chain, where the farmers receive their payment for the wool.

Postal services a potentially viable alternative distribution channel of financial services. Apart from its links with Lesotho PostBank, the Lesotho post office can itself act as an alternative distribution channel for financial services. It already acts as a mobile money agent for Econet and with 47 branches (Lesotho Post, 2014), has significant reach throughout the country.

6. Product market analysis

6.1. Credit

Credit, when allocated efficiently, can be a core driver of economic growth and development. The disbursal of credit allows the intermediation of otherwise unproductive deposits, thereby earning a return on those deposits as well as supplying capital to projects and enterprises. Credit is supplied on both a personal and business basis and is used for purposes such as building businesses, funding education, funding larger assets and preventing people from falling into poverty after a shock. However, it can also trap people in a cycle of debt that causes severe hardship. Therefore, the balance between enhancing access to credit and consumer protection is fundamental to the development of the credit market, and requires a comprehensive view of the market from both the consumer and provider's perspectives.

The following section discusses the credit market in Lesotho. The section provides an overview of current uptake, usage, types of products and providers of credit. The section also discusses accessibility barriers, regulatory issues and opportunities for improving uptake and value to the identified target groups.

6.1.1. Current usage

Limited uptake of formal credit. Figure 26 below shows that only 16.6% of adults (190,000) have credit through formal providers, although most of these are through retailers and just 3.8% (40,000 adults) access credit from banks. Given that the banks dominate the total credit market (by value), this is a clear indication that bank lending is focused primarily on corporates and high worth individuals, rather than the mass market.

Bank credit strongly skewed towards urban inhabitants. According to Figure 26, 7.3% (25,000) of urban adults access credit from banks whereas only 2.2% (15,000) of rural dwellers access credit from banks. This may also indicate the focus by banks on higher net worth individuals who are more likely to reside in urban areas, but may also point to difficulties of access for the much larger rural population.

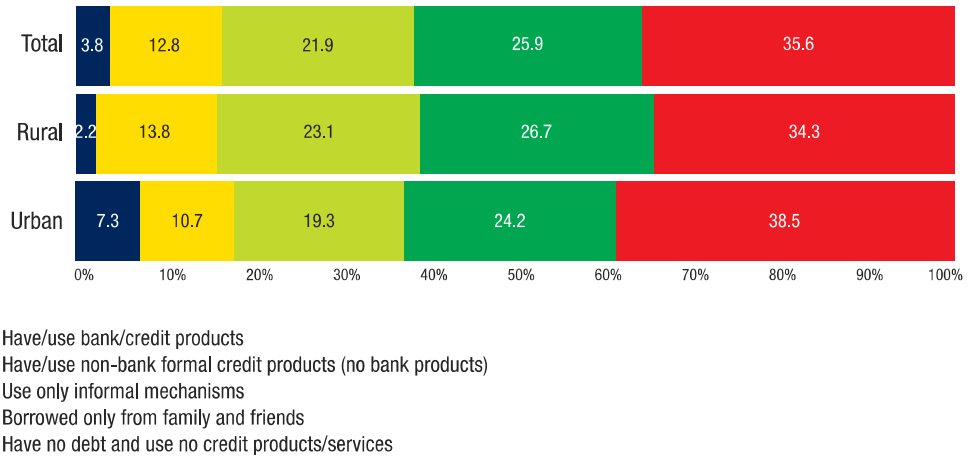

Figure 26: Credit access strand (rural & urban split)

Source: FinScope, 2011

Most Basotho accessing credit do so through informal providers or family and friends. Although only a relatively small proportion of adults access credit through formal channels, the large number of adults that access credit through other channels indicates that this is not due to a lack of demand for credit. Figure 26 indicates that 21.9% (250,000 adults) access informal credit only and a further 25.9% (215,000) access credit from family and friends only.

Salaried employees dominate formal credit: The most prevalent users of formal credit amongst Lesotho's target markets are the salaried employees. As illustrated in Figure 27 below, 30% (45,000 adults) of salaried employees access credit from regulated providers and account for 25% of total regulated users, despite making up just 14% of the total population. Salaried workers, as the target market with the highest average income and the most regular income, constitute the target market with the greatest access to formal credit providers.

Farmers have the lowest credit uptake from regulated providers but highest from unregulated. Just 7.7% (10,000 adults) of the agriculture target market currently access credit through regulated providers. This is likely largely due to seasonality and irregularity of income for farmers, particularly small-scale farmers, which could classify them as risky clients. However, it may also indicate that credit products are inappropriately designed for the farmers as FinScope (2011) indicates that farmers are the target market with the second highest average income levels and hence would be more likely to be able to repay loans, provide the product was structured appropriate to their constraints regarding infrequency and irregularity of income. The low uptake of regulated credit by farmers is not driven by a lack of demand for credit. This is illustrated by the fact that this target market has the highest uptake of unregulated credit (32.5%) and has the lowest proportion of members (after salaried workers) not accessing any form of credit.

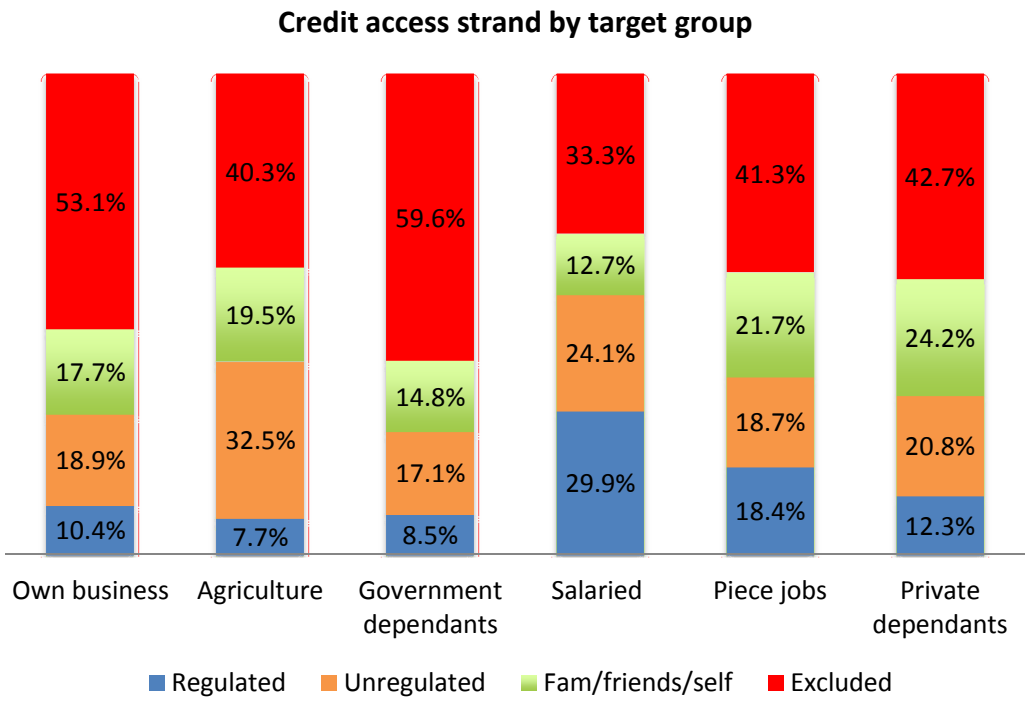

Figure 27: Credit access stand by target group

Source: FinScope, 2011

Low uptake of credit by business owners. Those who are self-employed, which includes SMMEs, are the second most excluded target market (53.1% excluded).

High uptake of unregulated credit. FinScope (2011) indicates that in total, 33% of Lesotho adults borrow from unregulated sources; 10% of adults borrow from an informal moneylender and 16% from informal savings groups. 21.9% of Basotho adults borrow only from unregulated providers. Credit provided by unregulated providers is an important source of finance for many Basotho.

Unregulated credit uptake consistent across target markets. Apart from the farmers (whose higher usage may be due to restricted access to regulated credit), the uptake of unregulated credit is relatively consistent across the target markets, indicating that all spheres and stratas of Lesotho society access credit from unregulated lenders.

Majority of Basotho borrow from family and friends. FinScope (2011) indicates that more than half (52%) of all Lesotho adults borrow from family and friends, with 19% only borrowing from family and friends. This indicates an underlying demand for credit products amongst Lesotho adults that is not currently being met by the formal providers, due to accessibility barriers, or the informal providers, due to the high costs.

6.1.2. Use cases

This section outlines the use cases for credit uptake by Basotho consumers, as identified through the qualitative and quantitative demand-side research. The use cases demonstrate the needs of the consumer market. The supply-picture painted by the following sub-sections

can then be compared to these target market needs to determine the gaps and opportunities in the provision of credit in Lesotho.

The figure below indicates the main reasons for taking out credit indicated by the FinScope (2011) survey:

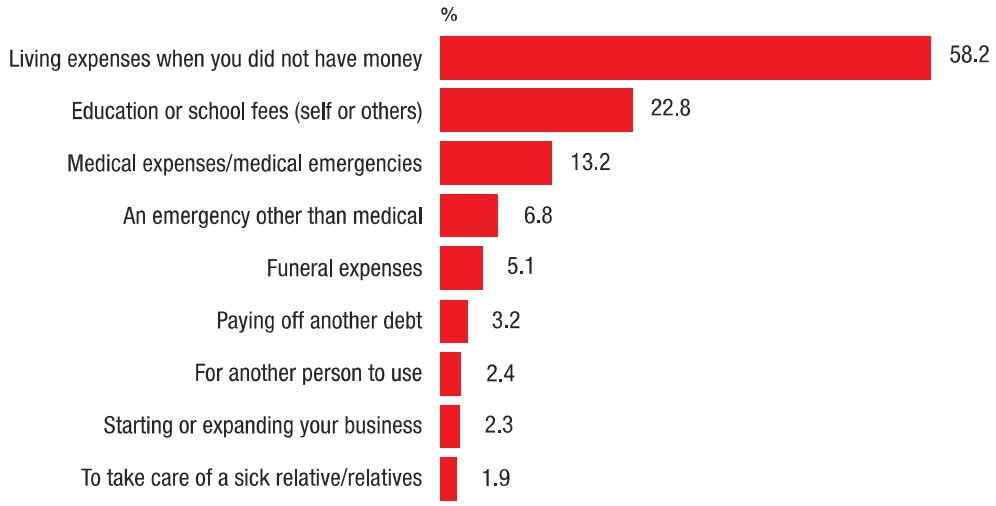

Figure 28: Reasons for taking credit (% of all those with credit)

Source: FinScope, 2011

Six main use cases are apparent:

Consumption smoothing the primary use of credit. According to FinScope (2011), as shown in Figure 28 above, the primary use of credit amongst Basotho (58.2% of adults with credit) is for "living expenses when you do not have money." Consumption smoothing would be an imperative for the target markets earning irregular or low income (all but the salaried workers) as they may require credit to cover living expenses during periods of poor income and/or when there is a long period of time between income payments. This is confirmed by the qualitative demand-side research

Educational expenses. 22.8% of Basotho with credit use it to pay for education or school fees (FinScope, 2011). The qualitative demand-side research indicated that education is seen as a key enabler to the future success of individuals' children and is a priority for people across target markets. Hence some adults may need to access finance to afford the costs associated with education (KLA, 2014).

Risk management. Using credit to address risks that arise for individuals is common in Lesotho. Figure 28 shows that 13.2% of adults with credit use it for medical expenses and emergencies, 6.8% use credit for non-medical emergencies and 5.1% use credit for funeral expenses.

Servicing existing loans. Figure 28 shows that 3.2% of Lesotho adults with credit use it to pay off another loan. The FGDs also indicated that some Basotho access credit to pay off pre-existing debt. Accessing credit to service existing loans can be considered a symptom of over-indebtedness.

Owners of different types of businesses will have different credit needs. Business enterprises can be differentiated between aspirational enterprises which are run by 'entrepreneurs of aspiration' and survivalist enterprises run by 'entrepreneurs out of desperation' with the primary goal to make ends meet while looking for a wage job (International Finance Corporation (IFC), 2013). Access to credit is important for businesses wanting to grow, such as aspirational entrepreneurs, as they will frequently need to finance large fixed costs up front and purchase major assets. In contrast, survivalist micro-enterprises which constitute the majority of Lesotho businesses, often do not have the skills, ideas or desire to grow the business to enable them to repay debt incurred. Results from SMME FinScope surveys in other SADC countries indicate that credit may drive these types of businesses into over-indebtedness, rather than improve livelihoods. Small amounts of trade credit or risk mitigation mechanisms such as funeral, property and health insurance are more likely to be needed by these SMMEs

Funding agricultural inputs. In a similar way that businesses can be segmented into aspirational and survivalist SMMEs with different credit service needs, different types of farmers may also require different credit needs. Cash-generating farmers would likely require larger capital investment in farming implements, the purchase of additional livestock or even more land, whereas subsistence farmers would be primarily focused on their own survival and simply farming as a way to feed themselves, possibly selling a small surplus in order to pay for non-food necessities and therefore they would struggle to repay credit and it could drive them into a spiral of debt.

6.1.3. Providers

The credit market in Lesotho is fragmented and probably one of the most underdeveloped financial sectors, especially for the low-income market. In the rural areas access to formal credit is almost non-existent and has paved the way for the promotion by non-government organizations of community based financial services. However, as is apparent from the credit access strand discussed above, these still do not reach the majority of rural inhabitants. In the urban areas, supply of credit is more tailored towards formally employed people.

The following table provides a summary of the major suppliers of credit on which data are available.

Institutional type	Number of institutions	Regulation and supervision	Lending model	Range of services	Targeted market
Commercial banks	4	Central Bank of Lesotho	Commercial	Savings and credit	Mainly formally employed
Money lenders	70	Central Bank of Lesotho	Commercial	Credit only	All population segments
NGO	1	None at present Future: Central Bank of Lesotho	Commercial (non-profit)	Credit only	Informally employed (microenterprises)

Institutional type	Number of institutions	Regulation and supervision	Lending model	Range of services	Targeted market
Savings and Credit Cooperatives	141	Commissioner of Cooperatives Future (large co-ops): CBL	Member services	Savings and credit	Informally employed (microenterprises, rural and urban households)
Village Savings and Loan Associations	Figures unavailable	Registered as societies with Ministry of Justice Not regulated or supervised as financial institutions	Community based	Savings and Credit	Informally employed (microenterprises and rural households)
Rural Savings and Credit Groups	Figures unavailable	Registered as societies with Ministry of Justice Not regulated or supervised as financial institutions	Community based	Savings and credit	Informally employed (microenterprises and rural households)
Machonisas	Figures unavailable	None	Commercial	Credit	

Table 7: Providers of credit

Source: Authors' own, based on consultations and review of available data

Below, each category is discussed in more detail.

6.1.3.1. Commercial banks[52]

SLB the oldest and largest player. The fact that the size of each bank's market share (as shown in Table 8 below) is correlated with the length of time it has been established in the market suggests that perceptions around brands and the building up of trust over time may be important in capturing Lesotho's bank customers. Notably, Standard Lesotho Bank's large market share derives from the fact that it took over the operations of the former government-owned Lesotho Bank in 1999.

[52] Note that part of the discussion here is applicable more broadly than just in the credit market. As the credit market is discussed first, it also sets the baseline information applicable for a particular institutional type, such as banks, in other product markets.

	Est.	Assets (M mn)	Loans (M mn)	Deposits (M mn)
Standard Lesotho Bank	1995	5,190,630	2,502,566	3,900,561
NedBank	1997	2,289,254	791,289	1,556,164
FNB	2004	940,126	333,964	668,133
Lesotho Postbank	2005	286,899	12,554	245,792
Total		8,706,909	3,640,373	6,370,650

Table 8: Commercial Bank Details as of December 2012

Source: CBL, 2013

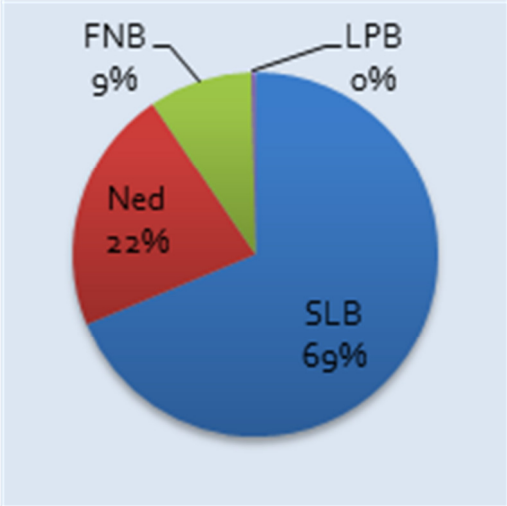

Figure 29: Market share of total loans between Lesotho's banks

Source: CBL, 2013

A highly concentrated market. Figure 29 above, illustrates the market share of credit provision (by value) across the three banks. The figure clearly shows that SLB is the primary provider of credit by value amongst the banks and that, together with Nedbank, it accounts for more than 90% of market share. The Herfindahl-Hirschman Index (HHI) is 5,283 for the bank credit market, making it a highly concentrated market[53]. Given the small size of the Lesotho market, it is unlikely to be appropriate to introduce more players, however the heavy dominance of one bank in the market is not ideal.

South-African owned banks guided by parent strategies, benefit from group technology and infrastructure. The three largest banks: SLB, Nedbank and FNB are all majority owned subsidiaries of major South African banks. The majority of the shares (80%) in SLB are owned by SBSA; the GoL retains a small shareholding (9.4%), with the remaining 10.6% held by an investment group. Both Nedbank and FNB are wholly owned subsidiaries of their South African parents The South African owned banks tend to be motivated by their parents' strategy and are bound by the group's performance targets. This has the impact of making

[53] The U.S. Department of Justice & FTC in its Horizontal Merger Guidelines (2010) consider a market with an HHI below 1,500 is considered unconcentrated, between 1,500 and 2,500 is defined as moderately concentrated and a market above 2,500 is defined as highly concentrated. [NB this is in the US context and is not necessarily applicable to other countries]

these banks relatively conservative and with the ability to earn safe returns on cash invested with their parent bank, rather than lending it out. This is evidenced by the historically high liquidity held by the sector (as discussed below) and the low levels of consumer lending (as illustrated in section 6.1.1). The Lesotho subsidiaries are also guided by group-wide policies and have restricted scope for local innovation. However, the close link with South Africa allows these banks to piggy-back on the technology and infrastructure of their parent organisations, which improves the efficiency of their operations and the value offered to consumers through the introduction of technology and products developed by the group, such as internet and cellphone banking.

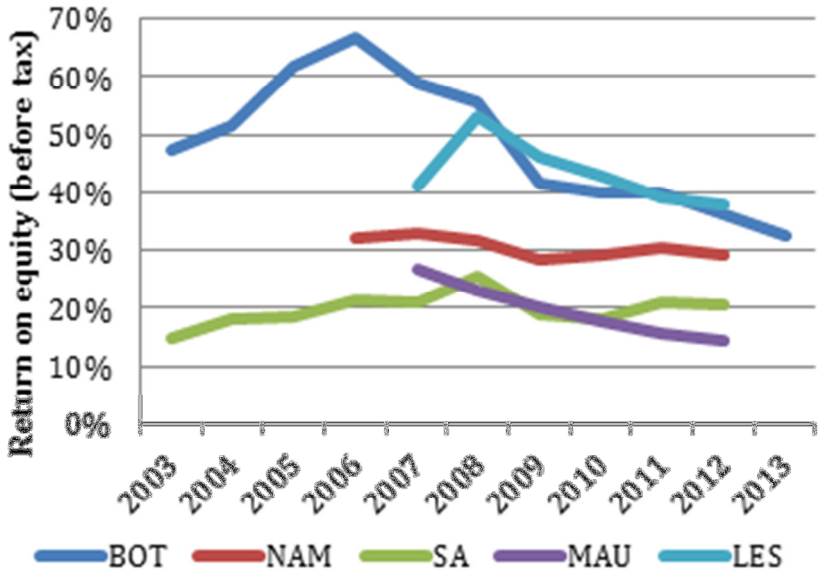

Figure 30: Comparative return on equity (RoE) of the bank sector across selected SADC countries – Botswana, Namibia, South Africa, Mauritius and Lesotho

Source: Econsult Botswana, 2014, based on central bank data

Lesotho's banks highly profitable. Figure 30 above shows that Lesotho's banks are amongst the most profitable in the region. In 2012, Lesotho's banking sector earned the highest return on equity (RoE) across each of the five regional comparisons included in the figure. It is of particular relevance that the RoE of Lesotho's banks was nearly twice as high as South Africa's in 2012. Given that the three largest Lesotho banks are fully or partially-owned subsidiaries of South African banks, this suggests that the banks may, if duly incentivised, have sufficient scope in their budgets to consider innovative initiatives that may increase long term returns, even if such initiatives lead to reduced profits in the short term.

Lesotho's banks less efficient than in comparative countries. Figure 31 below shows that the cost-to-asset ratio of Lesotho's banks is substantially higher than the banks of other countries within the SADC region. This indicates inefficiencies in Lesotho's banking sector. Whilst this may be partly attributed to the lack of economies of scale in Lesotho due to the small size of the market, it also supports the conclusion that there is latitude in Lesotho banks' budgets.

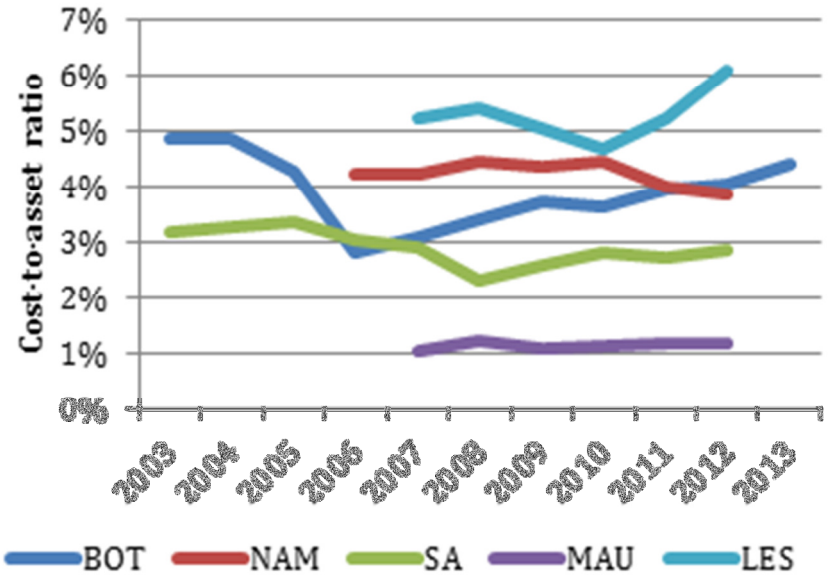

Figure 31: Cost-to-asset ratio of banks in 5 selected SADC countries

Source: Econsult Botswana, 2014

Strong focus on fee income amongst Lesotho's banks. Figure 32 further illustrates the strong reliance that Lesotho's banks have on non-interest income, with nearly 45% of total revenue derived from non-interest income in 2012, the second highest of the 5 countries compared. Only South African banks earn a greater proportion of revenue from non-interest income than Lesotho's banks. It is likely that Lesotho's banks' model is influenced by their South Africa parents' model and hence the similar focus on non-interest income[54]. However, this translates to relatively higher bank fees being charged to consumers, which is particularly detrimental to lower income clients for whom such fees may constitute a significant portion of their income. The high transaction fees charged by Lesotho's banks are further discussed below in Section 6.2.3.2.

[54] South Africa's banking sector was criticized by the South African competition commission for the anti-competitive pricing of fees resulting in excessively high bank fees (Competition Commission South Africa, 2008).

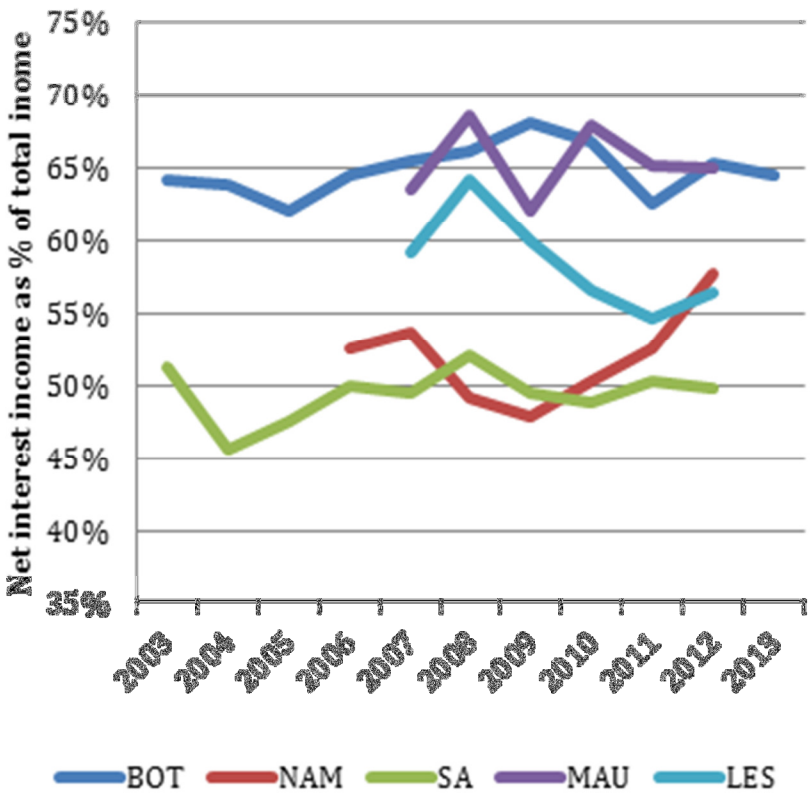

Figure 32: Net interest income as % of total income across the banks in 5 SADC countries

Source: Econsult Botswana, 2014

LPB more development-focused but at a competitive disadvantage. LPB is wholly owned by the Government of Lesotho and therefore has a different set of constraints and incentives to the other three banks. LPB was established with the objective of providing banking and financial services to the unbanked and lower-income groups, initially making use of the facilities of the Lesotho Post Office. LPB remains the smallest of the four banks and is at a competitive disadvantage to the other three, without links to a South African partner. One implication of this is that LPB does not offer interoperable debit and credit cards (as discussed below in Section 6.2). LPB also offers a narrower range of products than the other banks, and has traditionally concentrated on savings products. It has recently moved into loans but the number and value of loan accounts is relatively small.

Rapid increase in lending and reduction in liquidity amongst banks in recent years. Lesotho's banks have conventionally been highly liquid, and have historically had a relatively low ratio of loans to deposits. The figure below shows that the banks' loan-to-deposit ratio was 42% in the 2nd quarter of 2011 with M2.6 billion in total bank loans. Indeed, the banks have been widely criticised during consultations with various Lesotho stakeholders (2013) for insufficient financial intermediation, and for preferring to hold deposits with their South African parent companies rather than lending in Lesotho. However, the situation has been changing and this impression may now be outdated. Until the end of 2011, the deposits of Lesotho banks in SA exceeded their lending in Lesotho. But in 2012 and 2013 lending increased sharply and deposits were withdrawn from South Africa. In early 2012, loans and advances replaced deposits with other banks as the largest asset of Lesotho banks. By mid-2013 the ratio of deposits in SA to Lesotho credit was only 55%. Over the same period, the loan-to-deposit ratio had risen from 42% to 67% (as shown in the figure below) with M4.4 billion in total bank loans. Hence Lesotho banks have become more "normalised", in that

most deposits are now lent out, and liquidity is approaching normal business levels rather than being substantially in excess.

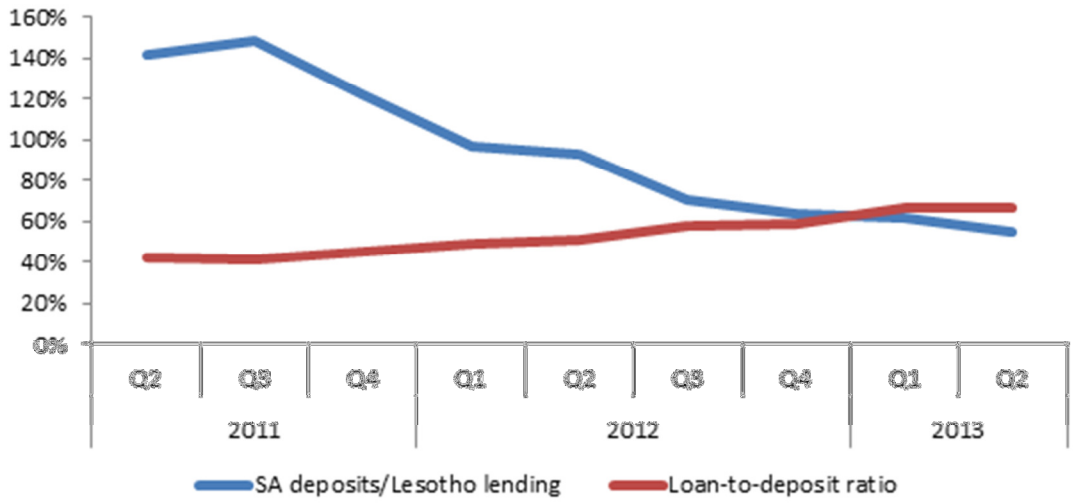

Figure 33: Key Ratios - Lesotho banks

Source: CBL, 2013

Reduction in liquidity has important implications for competitive environment. Because of the historical excess liquidity, the banks have not had to compete for deposits. However, as excess liquidity is declining, this situation will change. In order to continue expanding their profitable lending business, banks will need to mobilise additional deposits (or alternatively raise wholesale funding, in Lesotho or in South Africa). This may provide an environment where conditions for savers/depositors will improve.

The dramatic increase in lending by the banks has been largely attributed to changes in the regulatory context and policy measures undertaken by the government of Lesotho. Most notably, recent legislation permits the use of land as an economic asset, for example as collateral by borrowers (The Land Act, 2010). Furthermore, women are permitted to enter into contracts without husbands' consent, giving them the right to access credit and acquire immovable property in their own name (CBL, 2012). Thus far, 60,000 title deeds have been issued by GoL .However, Figure 34 below indicates that this credit growth has largely been due to lending to households, which accounted for two-thirds of total credit growth over this period and, as illustrated Figure 35 in Section 6.1.4.1 below, is mostly in the form of unsecured personal loans. Credit extension to private businesses has also been growing steadily, and increased by 51% over this 21-month period.

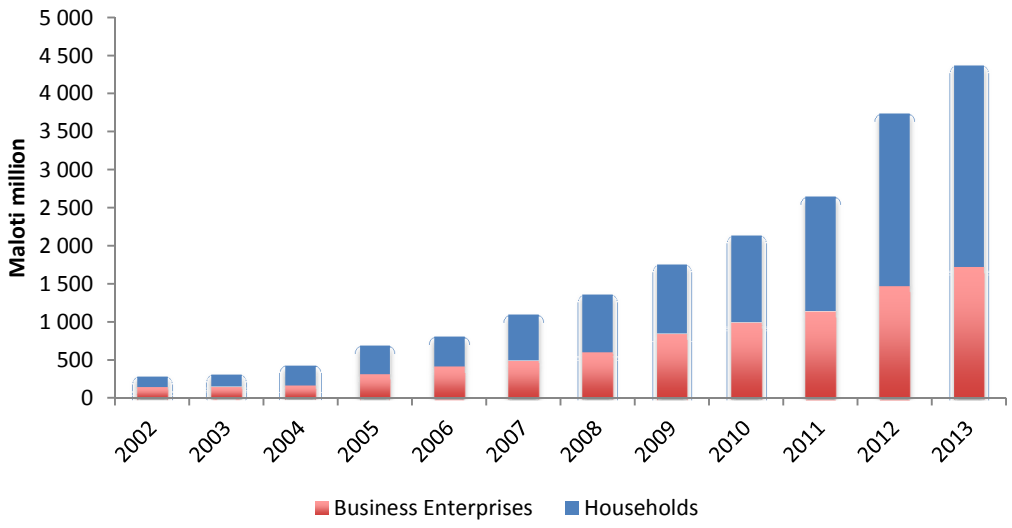

Figure 34: Private sector credit to businesses and households

Source: CBL, 2013

NPLs low, but rising. CBL (2013) revealed that Non Performing Loans (NPLs) increased from 2.5% to 3.5% between Q2 and Q3 in 2013. Although this signals an increase in debt stress, the overall level of NPLs remains relatively low. Nevertheless, it will be important to closely observe the NPL rate, in order to determine whether the rapid growth in credit, particularly in personal loans, in recent years is leading to a build-up of debt distress amongst household borrowers.

6.1.3.2. Formal moneylenders (credit-only institutions)

There are two types of moneylending institutions operating in Lesotho:

- Credit institutions (licensed under the Financial Institutions Act as Type III institutions)
- Formal moneylenders (licensed under the Money Lenders Act)

Credit institutions limited to Maseru, target the employed market. There are six licensed credit institutions, all based in Maseru: Blessings, Thusong, Netloans, Alimela Thuto, Lesana and Letshego. Lestshego, the largest of these, is a subsidiary of the Botswana-based Letshego Holdings, which is listed on the Botswana Stock Exchange. Letshego also has subsidiaries in Kenya, Mozambique, Namibia, Rwanda, South Sudan, Swaziland, Tanzania, Uganda and Zambia. Letshego was established in Lesotho in September 2012, and its focus is on the provision of unsecured credit to employees of government and other approved firms. Letshego is licensed as a credit-only MFI by the CBL, but is considering becoming a deposit-taker once the relevant licensing criteria and regulations are finalised.

Large number of formal moneylenders spread throughout the country. As at December 2012, the CBL had licensed approximately 135 institutions under the Money Lenders Act, spread throughout the country. These include a mixture of individual and corporate entities. Each licensed entity has to have an authorized address (hence physical premises). The 2011 CBL annual report indicated that non-compliance with the law is very high among moneylenders.

6.1.3.3. Credit-only Micro-finance Institutions (MFIs)

Only one, small lender focused on providing credit to microenterprises. Established in 2007 as an initiative of the South African National Union of Mineworkers, Moliko Micro Credit Trust is the only Type IV credit-only MFI under the FIA. It has the mandate of assisting and developing micro enterprises run by young people to access financial services. Moliko Trust currently has a relatively small outstanding portfolio of M2 million with an average loan size of about M1,500 stretched over 1,500 clients. The organisation provides subsidised credit to entrepreneurs. Moliko Trust has a fairly broad footprint operating in seven out of the ten districts. Business activities supported by Moliko Trust include sales of agricultural inputs, other retail shops, hawkers (clothes) and carpentry. However, the MFI is not fully financially sustainable; current revenue only covers 75% of the operational costs[55].

Room for growth but constrained by access to funding. The management of Moliko Trust sees an expansion opportunity up to a lending portfolio of M5 million, due to a perceived mismatch between current supply and demand for credit. However, the inability to secure additional funding has been a major constraint to achieving this growth.

6.1.3.4. Financial co-operatives

One large financial cooperative. Although there are several savings and credit co-operatives operating in Lesotho these organisations' operations are very small. There is only one large financial cooperative as provided for under Type II institutions in the FIA: Boliba. It offers traditional banking services using the banking platforms of other banks. It is only permitted by law to provide loans to members. Members are required to provide a passport and to deposit M50 in a transacting account and M50 in a membership account on joining the co-operative. Boliba has 39 000 members and a total loan book of around M55 million. Boliba operates four branches: two in Maseru, one in Morelewe and Mohales' Hoek. The co-operative is marketed through brochures, advertisements and group presentations.

Boliba faces a range of problems and has been criticised by the regulator – the Department of Co-operatives - for various infringements of the Co-operatives Act, including lending to non-members. There have also been issues around its conduct as a financial institution, including provisioning for bad debts, financial record keeping, insider lending and "fit and proper" status for directors. Questions have been raised about its solvency, on the basis of proper financial provisioning, as well as its governance. There have been allegations of fraud by senior officials. However, the powers of the regulator to intervene are limited, and forceful action has not been taken, with the result that depositors' funds are at risk. There have also been tensions between the DoC and the CBL, especially since the latter has gained the responsibility of regulating LFCs under the FIA, although this has not yet been operationalized (Department of Co-operative Development, 2011).

Nevertheless, Boliba is popular among its members, who are mostly drawn from the lower income groups in Maseru and other urban centres. It is seen as a distinctly "Basotho" institution, and many members like the old style passbooks rather than electronic, card-based accounts. However, due to poor financial record keeping there are sometimes

[55] Figure provided by Management, requiring verification

discrepancies between passbook records of accounts and those on Boliba's own system (Boliba, 2013).

6.1.3.5. Retailers

A large proportion of formal personal credit supplied by retailers. Retail credit is offered mostly by clothing stores, like Jet, Truworths, Edgars and PEP, and furniture stores like Lewis Stores. In specific cases, local grocery stores or general dealers offer regular customers credit to buy groceries and other household items. In addition, some hardware and building material stores will offer credit on such things as bricks, cement and other building supplies. FinScope (2011) indicates that 13% (145,000) of Lesotho adults have bought good on credit at a store within the last 12 months and 14% (155,000 adults) have 'got goods in advance from a shop/store and had to pay back later' within the last 12 months[56].

6.1.3.6. Informal providers

Informal loans small but not insignificant. The qualitative demand-side research (KLA, 2014) indicated that the average informal loan size was about M600. On this basis, the total value of informal credit is estimated at about between M200 and M250 million, equivalent to 5-7% of total bank loans[57].

Informal lending in Lesotho is broadly conducted by two types of lenders: Informal moneylenders (or machonisas) and informal savings groups (including the VSLAs and rotating savings and credit groups – RSCGs).

Machonisas widely used. FinScope 2011 shows that 10% (120,000) of Basotho adults borrow from moneylenders. The qualitative demand-side analysis revealed that the use of mashonisas or informal moneylenders is entrenched in Basotho society. According to the results from focus group discussions, access and usage of credit from machonisas surpasses all other channels (both formal and informal). While there are good reasons why Basotho use this form of credit including ease of access and availability, it also signals absence of competing formal credit products addressing the credit needs of especially those in the low-income population segments.

Machonisas play a dichotomous role in Basotho society as they are seen as a beneficial, helpful 'friend' but are also resented for being expensive places to borrow and being a contributing factor for respondents' endless cycle of debt. They also use aggressive and sometimes violent tactics to get their money back from defaulting customers. The most common occurrences are of moneylenders sending their employees to customers' homes to confiscate household appliances specified as surety when the loan was first taken out. Others mention instances when moneylenders would threaten or actually use violence to compel customers to pay up.

> *"They come to your house and take your fridge or your kettle when you don't have the money to pay". Butha-Buthe, Female, aged 25-40 (KLA, 2014).*

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[56] Note that there are likely to be large overlaps between these two groups.

[57] This is an estimate calculated by extrapolating the average loan size calculated in a limited sample through qualitative research to the entire population of informal lenders as calculated from FinScope, 2011

Informal savings groups target lending to earn greater returns on deposits. Informal savings groups (most of which operate as accumulative savings and credit associations (ASCAs))[58] are also an important source of informal credit. FinScope (2011) indicates that 16% (180,000) of Lesotho adults access credit from an informal savings group. Many offer loans to both members and non-members but members receive a preferential interest rate (10% per month on average) whereas non-members are charged between 15% and 20% per month (KLA, 2014). Most of these groups encourage the practice of lending out deposited funds in order to increase their capital growth. A number of initiatives, funded by donors, have encouraged the formation and management of informal savings groups. These include, but are not restricted to, CARE Lesotho's VSLAs and the RSCGs supported under RUFIP.

Despite low income profile of members, VSLA repayment rates are good. Although the VSLAs are generally primarily savings focused, they also constitute an important source of loan funding for members. The maximum amount loaned out is three times the amount saved by a member. Although the VSLA membership has low and irregular income, repayments rates were good. If a group member experiences challenges in repaying the loan, the other members will assist in raising funds. Money from the saving fund is also used to pay back the outstanding loans on the death of a member. CARE also attempted to link the VSLAs with banks but the partnership could not materialize. One such attempt was with LPB, but LPB considered VSLAs as too risky for credit provision. This experience illustrates the reluctance of formal financial institutions to work with informal groups.

High portfolio at risk for RUFIP informal SACCOs and RSCGs. IFAD's RUFIP programme has also supported capacity building of SACCOs and RSCGs in Lesotho. Thus far, RUFIP has worked with 30 SACCOs with 776 members and supported 32 RSCGs (Rural savings and Credit Groups) with 579 members. The groups have a total outstanding loan book of M250,000. However, these groups report a portfolio at risk proportion of 47%, posing a substantial challenge for sustainability of these groups and questioning how functional groups actually are.

6.1.4. Products

6.1.4.1. Personal loans

Personal loans the predominant form of loan type in Lesotho. The majority of loans extended to individuals are in the form of personal loans. The top three use cases discussed in section 6.4.2, consumption smoothing, educational loans and risk management, all use personal loans.

[58] ASCAs are member-based entities whereby members contribute an agreed amount of savings, which may then be lent out to members and sometimes non-members.

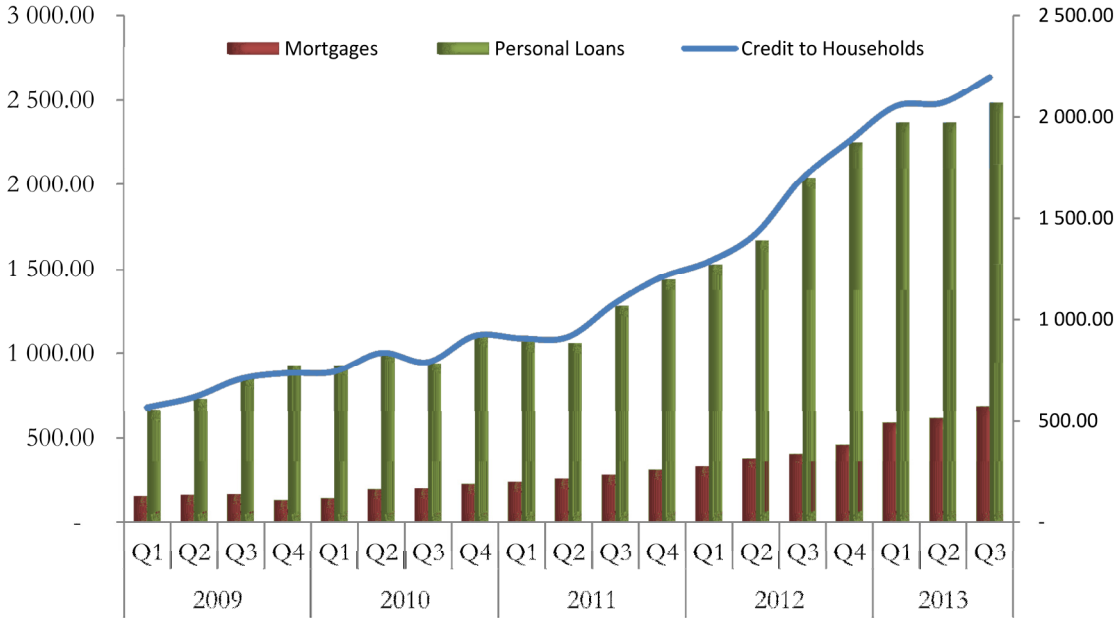


Figure 35: Trends of credit extension, mortgages, personal loans and households

Source: CBL, 2013[59]

Personal loans the driving force behind rapid rise in credit extension. Figure 35 above, shows the trends in time between 2009 and 2013 of credit to households, as well as the proportion of credit provided for personal loans versus the proportion provided for mortgages. As discussed above in section 6.4.3, there has been a rapid increase in credit to households since 2011 and this figure illustrates that this rise has been primarily driven by increasing personal loans, which are mostly unsecured, which account for close to 80% of the banks' total household credit and has more than doubled since the beginning of 2011. This finding also questions how significant the role that the new Land Act has played in increasing credit provision. The fact that the increased lending is driven by increasing personal loans suggest that the Legal Capacity of Married Persons Act 2006, which is intended to achieve equality between spouses married in community of property, may have been a more significant driver of the rise in credit provision and possibly combined with a shifting of bank policy to the extension of personal lending, as the banks' South African parents engaged in a similar growth strategy of unsecured personal loans in South Africa.

Wide range of Boliba loan sizes. The loans start from M4 000, with a maximum loan of M2.5 million having been granted.

Informal products have both pros and cons vis-à-vis formal products. Informal credit has a number of features that places it at an advantage over credit from regulated providers:

- *Informal credit is quick*. This is particularly important in emergencies, which was highlighted as one of the top three use cases of credit by Basotho, as the money may be required immediately and formal providers typically require a lengthy application and approval process.

[59] Note: no y-axis title indicated in original CBL report.

> "An advantage of an informal money lender is you can go there tonight and come back with the money. With the formal money lender it can take up to 6 weeks or more, let me make an example of FNB, they can't process the loan in the country, and it has to be done in Johannesburg at the head office."
>
> *Maseru, Male, 25-40 years (KLA, 2014).*

- *Informal credit is proximal*. For geographically remote communities, accessing the distribution points of formal providers may be time-consuming, difficult and costly.
- *Informal credit offers more flexible repayment terms*. Some machonisas offer loanees the flexibility to renegotiate loans. Some will take personal circumstances into account, such as allowing a seasonal worker to pay back after only a few months (KLA, 2014).
- *Informal credit has no eligibility barriers*. Unlike formal credit providers, no proof of income, ID or proof of address is required to access formal credit. Most Machonisas are willing to loan money regardless of employment status (KLA, 2014)

However, customers also face associated risks when accessing credit from informal sources:

- ID documents and ATM cards may be withheld until the loan is repaid
- Intimidation may be used against individuals with outstanding loans

Furthermore, the interest rates charged by informal moneylenders are substantially higher than those charged by formal providers and hence loanees run the risk of being drag into a spiral of increasing debt if they cannot quickly pay off their loans. Focus group discussions indicated that interest rates charged by informal money lenders are on average 20% per month, but can range from 15% to as high as 30% per month.

6.1.4.2. Asset-based finance

Mortgages constitute a significant and growing minority of banks' household lending. Figure 53 above, shows that mortgages constitute only about 20% of banks' personal lending but they have more than doubled since 2011. This suggests that whilst personal mortgages remain very low within the country, likely due to the previous land ownership and collateral restrictions, the 2010 Land Act has increased the opportunities for Basotho households to use their land as collateral and therefore increasingly access mortgages.

Retailer credit the most widely used formal credit. As indicated in the provider discussion above, retail credit accounts for most credit customers in Lesotho. Retailer credit is primarily accessed by the formally employed as a salary slip is usually required for access. For those who qualify access is considered easy (KLA, 2014).

6.1.4.3. SMME loans

Moliko Trust provides small loans at low interest. As mentioned, the only financial services provider focused specifically on SMME funding is Moliko Trust. It offers subsidised funding to small enterprises (at a 3% flat rate per month plus 1% for credit life insurance). Its impact

remains fairly small given the small size of its loan book (M2 million). Moliko Trust focuses on micro enterprises, providing only very low value loans ranging between M500 and M5,000 and averaging about M1,500. Given the small value of these loans, it is likely that a large portion of its clients can be classified as survivalist SMMEs rather than aspirational. The term of the loans is also short: 3-12 months. The loans are provided on a group basis, with groups ranging between 10-15 members who live in the same community. The groups must be registered with the law office and must have bank accounts.

SBL introducing targeted SMME lending. SBL indicated in consultations (2013) that it offers an unsecured short-term loan targeting micro enterprises. It is fairly a new product perceived by the Bank as a product for the 'microentrepreneur trading on the street'. Loan amounts start from as low as M500 and vary according to the size of enterprise (SBL, 2013). SBL has also opened a branch in Maseru to deal with the specific needs of SMMEs. The branch offers specialised SMME accounts, business loans, vehicle and asset finance, investments and other SME financial solutions. SLB has reduced opening requirements, the length of application forms and reduced the time it takes to open an account and to access business loans for SMMEs (Mpaki, 2013).

6.1.4.4. Agricultural loans

Aspirational farmers have different credit requirements to survivalist farmers. A similar distinction can be made amongst farmers as is made between SMMEs, differentiating between aspirational farmers with the capacity and desire to expand their production for commercial purposes and survivalist farmers whose intention is simply to grow sufficient food to feed themselves and their family and sell sufficient surplus to meet other necessary expenses. Credit is therefore mostly beneficial to aspirational farmers who likely require loans and asset based finance to invest in major farming inputs to grow their production. Survivalist farmers, with small farms and no desire to grow, have limited need for credit, although may also benefit from low value input financing given the seasonality of agricultural income.

Limited credit extended to agricultural sector. Figure 36 below shows that although the amount of formal credit extended to the agricultural sector grew 49% from M12.3 million in September 2012 to M18.3 million in September 2013, the absolute value of formal credit extended to the sector is still very low and remains the least among the nine sectors of the economy, accounting for just 1% of non-household formal credit. According to FinScope (2011) about 11,000 farmers have formal credit which equates to an average loan size of M1,700. This indicates that the majority of loans to the agricultural sector is low in value and hence may not be ideal for aspirational farmers which are need substantial capital investment to grow production.

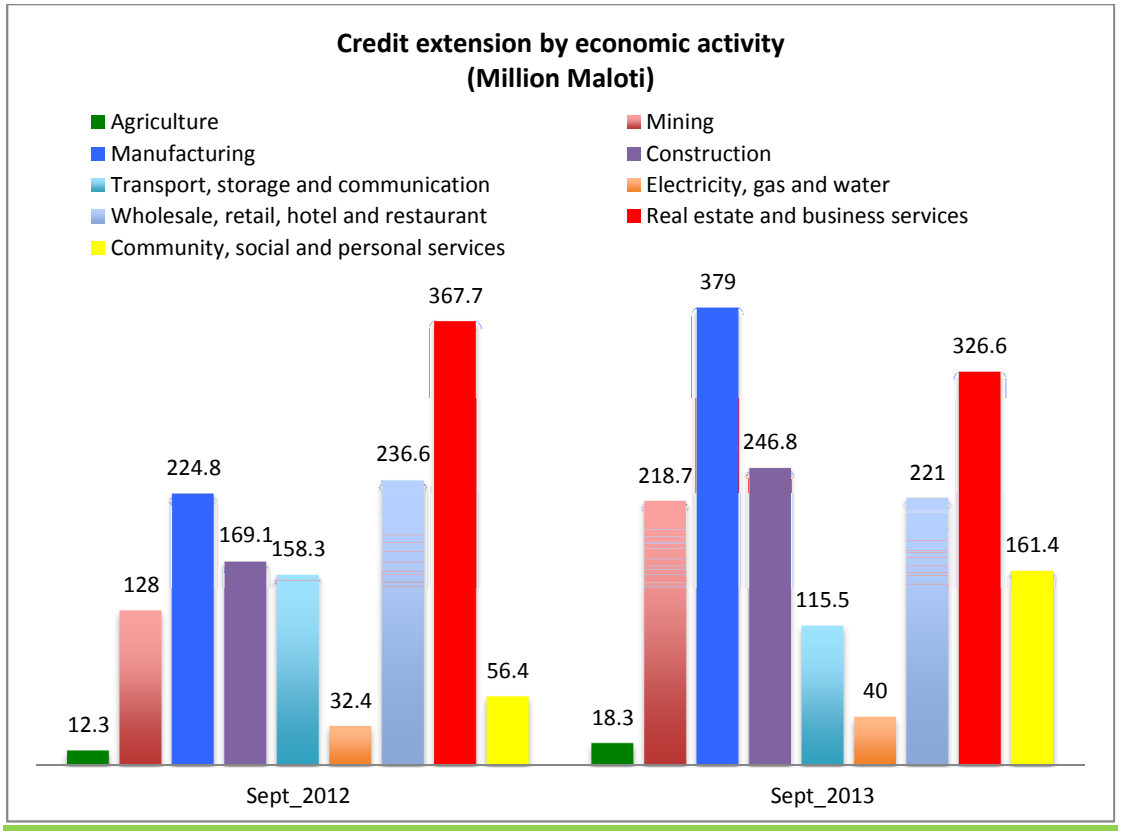


Figure 36: Credit extension by economic activity (2012-2013)

Source: CBL, 2013

Low credit extension partly due to distributional and product design difficulties for providers. The low levels of formal credit extension to farmers in Lesotho may be due to the practical difficulties for formal credit provider to reach many of them due to their remote locations and the associated cost to assess their credit-worthiness and viability of their agricultural activities. Formal credit providers would also require specialized skills such as agricultural loan officers, which only becomes feasible with a large enough scale of agricultural lending. Products also need to be designed to suit the specific needs of the farmers e.g. crop farmers would likely need substantial capital during ploughing season but only earn returns, and therefore be able to repay, months later when the crop is harvested. Given that the average income of farmers is the second highest amongst the target groups and that 20% of farmers (30,000 adults) can be classified as aspirational, an inability to repay the credit is likely not the major constraint.

6.1.5. Accessibility barriers

Fear of credit the main barrier to accessing credit. Figure 37 below, shows the main reasons why Basotho adults without credit do not have it according to FinScope, 2011. A fear of debts (66% of adults without credit) and concerns about their ability to repay the loan (42% of adults without credit) are the overwhelmingly most commonly cited reasons for not accessing credit.

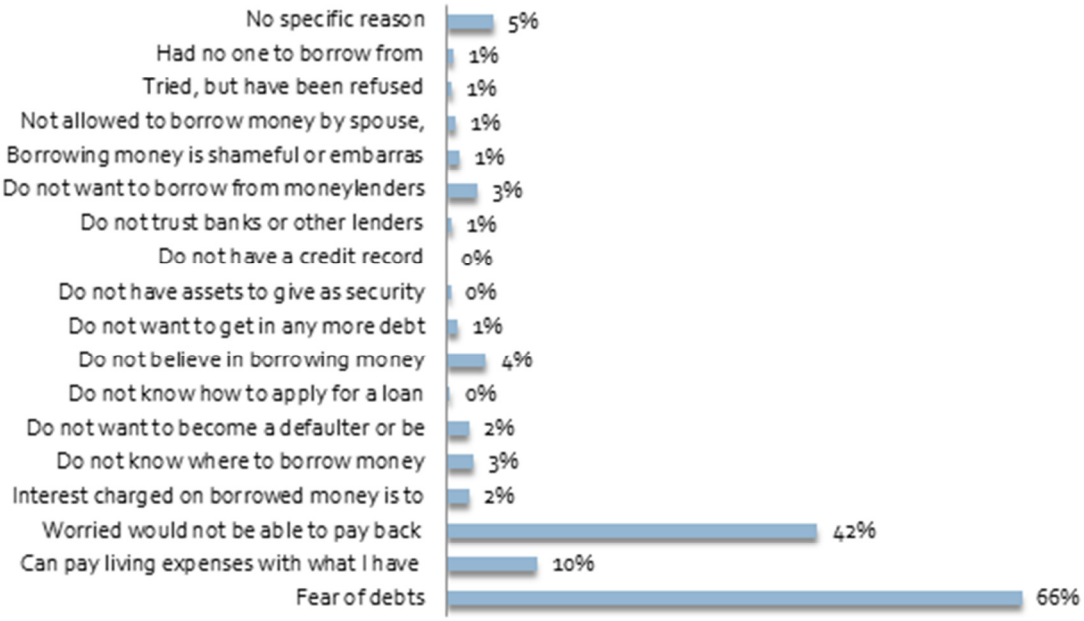


Figure 37: Reasons for not getting credit

Source: FinScope, 2011

Awareness and education not a major barrier. Figure 37 indicates that awareness and understanding of credit and how to access it is not a major barrier. Less than 1% of adults without credit indicated that they do not know how to apply for a loan and only 3% of adults without credit indicated that they do not know where to borrow money from.

Payslips required by formal providers to access credit. A payslip is an almost universal requirement when accessing credit from regulated credit providers, including both banks and retailers. Given that only 14% are salaried workers, this is a major barrier to accessing credit for the rest of the population. Banks also consider applicants' income levels to determine eligibility for credit products and there is a perception amongst most Basotho adults that they earn too little to qualify:

> "I would ask the bank for a loan if I could. But I know the outcome already. My salary is too little. They would refuse to give me the money."
>
> *Butha-Buthe, Male, 41-55 years. KLA, 2014.*

Unpredictability of interest rates a barrier to formal credit. Qualitative research participants were of the view that interest rates on formal loans are not fixed (unlike rates of informal providers) and fluctuate from month to month. This creates uncertainty for borrowers and given their already fluctuating incomes makes their ability to repay each month highly unpredictable (KLA, 2014).

Irregular income not appropriately catered for by formal providers. Many Basotho earn irregular income from activities such as farming, piece work or via remittances from family

or friends. However, most formal products have relatively inflexible repayment terms, making them unfeasible for a large portion of the Basotho population.

Doorstep barriers significant for formal credit providers, particularly banks. Many focus group discussion participants did not regard themselves as part of the target market for banks. They perceive banks as aimed at the higher income salary workers such as civil servants only.

6.1.6. Regulatory issues

The consultations and research suggest the following regulatory issues in the credit market:

Lack of effective regulation and supervision of moneylenders. Licensed moneylenders are not effectively supervised by the CBL and there are many unlicensed, unsupervised credit providers. The CBL is proposing to have the Money Lenders Act repealed, in which case licensed moneylenders would have to apply for licensing under the FIA (either Type III credit institutions or Type IV credit-only microfinance institutions) while formation of an Apex Institution is envisaged to register the very small lenders that may not qualify under Type IV of the FIA.

Inconsistent monitoring across formal provider types: CBL does not monitor all types of formal credit in Lesotho; this makes it difficult to identify need and growth areas. For instance, many chain stores and retail shops offer credit facilities to consumers, which is not captured or monitored. However, the establishment of the credit bureau, which is in advanced stages, can potentially cover the required monitoring mechanisms for this type of credit.

Current absence of supervision over Boliba. Boliba currently falls under the authority of the Department of Cooperatives (DoC), but is not prudentially supervised. According to consultations, agreement has been reached through a Memorandum of Understanding that the responsibility for supervising Boliba will be shared between the DoC and the CBL, with the CBL supervising prudential requirements and the DOC supervising market conduct requirements. The CBL will have to draw up a list of necessary reforms to Boliba's governance and operations, which will need to be implemented fairly quickly if it is to be re-established as a sound financial institution where risks to depositors' funds are minimised.

6.1.7. Gaps and opportunities

Aspirational farmers a potential growth area, but very poorly served. The farmers constitute a substantial target market, making up 13% of the total adult population in the country and are the target market with the second highest average income. Whilst the majority of these farmers are small, poor and can be classified as survivalist in nature, approximately 30,000 Basotho farmers can be called aspirational, with potential capacity to grow. Many of these, however, require access to credit to fund expensive up-front and input costs. Currently just 10,000 farmers have access to formal sources of credit and the average size of these loans is small, approximately M1,700[60]. This show that at least 20,000 aspirational farmers (it may

[60] This is calculated by dividing the total credit supplied to the agricultural sector (CBL, 2013) by the total number of farmers with credit (FinScope, 2011).

well be more as the small size of the loans suggests that some of this credit may be going to survivalist farmers) have no access to formal credit and even those that do, likely require additional credit. The demand for additional credit by this target market is clearly illustrated by the high uptake of informal credit, which is higher than for any other target market.

Formal credit preferable to informal credit for aspirational farmers, provided products are appropriately designed. The advantages of formal credit for farmers include the substantially lower cost of formal credit as well as the longer terms of the loans. Formal credit, therefore allows farmers to take a long-term view when planning their growth, without being strangled by credit if they cannot repay immediately due to a sub-standard season. However, formal products also need to be appropriately designed for farmers' needs, being flexible enough to allow for the seasonal nature of income earned by farmers.

Input financing and outgrower schemes a potential avenue for low value agricultural credit. Credit can be disseminated through agriculture value chains in which there is one or a small number of sales aggregation points. This allows credit providers to supply low value credit to both aspirational and survivalist farmers, either in the form of an actual loan or in the form of agricultural inputs, and then to automatically deduct the credit repayments at the point of sale. An example would be the government woolsheds.

Limited support for SMME credit. According to FinScope (2011) there are about 15,000 aspirational business owners in Lesotho[61], a similar number to those which have credit from regulated providers. However, this includes all forms of personal credit as well, such as consumptive credit from retailers. There is only one enterprise-focused credit provider, Moliko Trust, with a loan book of just M2 million and only offering low value loans over a short term. There is also limited SMME credit provided by the banks. This would suggest that there may be a role for additional SMME focused credit with appropriate training, guidance and mentoring aspects attached to the credit in order to aid the growth of aspirational SMMEs. This is not an issue unique to Lesotho. A 2010 IFC and McKinsey study estimated that there is a credit gap in excess of USD 2 trillion for a population of 420-510 million SMMEs in emerging markets globally. This SMME credit gap has been revised upwards to USD 3.2 to 3.9 trillion in emerging markets globally in subsequent analyses (IFC, 2013).

Informal providers play a vital role in providing credit for consumption smoothing and risk management. The value of informal lending indicates that there may be an incentive for smaller formal credit providers to target this market with lower cost formal loans. The fact that there is no *de facto* credit interest rate cap in Lesotho would facilitate such a move. However, given the relative preference for informal mechanisms given their greater flexibility, as discussed in Section 2 and the distributional challenges of reaching rural communities, it may prove challenging for formal providers to enter this market. Informal providers are situated within communities and are willing to lend to all income levels due to the high interest rates charged. Furthermore credit from these providers is provided immediately, with no wait for application and approval processes as is typical of formal providers. These characteristics make informal credit providers preferable suppliers of credit for consumption smoothing and risk management to a large proportion of the population.

[61] Aspirational business owners are defined as business owners earning a monthly income in excess of M2,000. This is used as an indicative proxy to differentiate between business owners that may be large enough to grow further and those that are simply too small and are only concerned with earning enough to survive.

This questions the traditional emphasis on formalisation, but also raises consumer protection considerations for regulators.

> "I think one of the main reasons people chose to be part of these savings groups is being able to get the money as a lump sum, free from the banks administration. We all know financial institutions will want so many documents from you when you go lend money from them and with this savings group it's much similar."
>
> *Maseru, Male, 25-40 years (KLA, 2014).*

Informal market large enough to attract formal providers. Although relatively small in comparison to total bank credit, the total loan book of the informal credit market is large enough to be a significant potential source of growth, particularly for smaller formal credit providers. The lower interest rates charged by formal providers would be of benefit to those individuals currently accessing credit from informal providers. However, given the level of trust in community-provided financial services and the distributional challenges of reaching rural communities, significantly penetrating this informal market, as opposed to just targeting specific groups such as high income farmers as discussed above, may be difficult for formal providers. This may support a case for banking agents.

*Limitations of community based financing***.** With the right financial and technical resources, community-based savings groups could play a vital role in offering rural based households access to productive credit and financial safety nets at rates below those offered by machonisas. However, community based financing mechanisms such as SACCOs, VSLAs and other RSCGs seem to have challenges in terms of achieving scale, outreach, performance and sustainability, with many only able to survive whilst supported by NGOs such as CARE or the RUFIP programme.

Rising household debt levels but still limited evidence of widespread over-indebtedness. FinScope (2011) indicated that just 3% of adults with credit borrow to pay off an existing loan, a frequently used measure for over-indebtedness. However, since the completion of that survey credit, particularly in the form of personal loans, has increased substantially. Significantly the banks' NPL ratio rose from 2.5% in the second quarter of 2012 to 3.5% in the following quarter. Whilst the absolute level of NPLs is still low, that is a substantial increase over a short period and hence may need to be carefully monitored by the CBL. The qualitative research conducted however found only limited cases significant indebtedness with about 40% of participants indicating outstanding debt obligations and debt repayments for these individuals estimated at 20% of household income (KLA, 2014).

6.2. Payments

This section provides an overview of the market for transaction banking, remittances and e-money[62] in Lesotho. Remittances are defined as "the sending and receiving of money between people in one place to people in another, using formal and/or informal means".

6.2.1. Current usage

Preference for cash amongst Lesotho adults. According to FinScope (2011) 54% of Lesotho adults prefer to carry cash rather than bank cards. 89% of adults pay for food with cash, 90% pay for clothes with cash and the majority of adults (59%) even pay for household goods/ appliances with cash. This strong preference for cash is supported by the qualitative findings (KLA, 2014). The qualitative research also indicated that informally employed adults typically receive their salary/ wages in cash.

Indications that many bank transaction accounts used as 'mailbox' accounts. 30% of Lesotho adults have bank accounts with transactional capability[63] (FinScope, 2011). FinScope (2011) further indicates that at least 82% of these accounts are linked to an ATM card. ATM withdrawals account for the majority of transactions in terms of both volume (89% of the total) and value (62%) (CBL, 2013). This suggests that most account-holders use their accounts primarily for ATM withdrawals and anecdotal evidence suggests that many account holders immediately withdraw their entire salary from the account when it is deposited. This is further supported by closer examination of the ATM withdrawal data. Adults with ATM cards make on average just 2 withdrawals a month but the average value of each withdrawal is M736. The value is compared to an average income for the entire population of M1,051. Furthermore, a third (33%) of the ATM holders earn a monthly income of less than M750 and 60% of this group earn a monthly income of less than M2,000 (FinScope, 2011). FinScope (2011) also indicates that just 5% of bank account holders have transferred money to someone else's account within the last 3 months. In contrast, 85% of bank account holders indicated that they had withdrawn cash within the same period.

Low usage of POS devices despite roll-out. The use of POS devices in Lesotho is very low, with anecdotal evidence suggesting that people prefer to withdraw cash and spend this in shops, rather than use their debit cards, even where POS machines are available. This is supported by data from the CBL (2013) and FinScope (2011). Slightly more than 500,000 POS transactions took place during the entire year of 2012. This corresponds to just 0.16 POS transactions per card holder per month. Further to this, FinScope (2011) indicates that less than 1% of Lesotho adults have access to a credit card.

Significant minority of Basotho bank in South Africa. FinScope (2011) indicates that nearly 10% (30,000 adults) of Basotho with a bank account have an account registered in South Africa. About a third of this group has accounts in both Lesotho and South Africa, but the remainder only has a South African bank account. In some cases this may due to South African banks being more accessible for Basotho living close to the border, but is also likely due to lower bank fees with South African banks. Furthermore, for regular receivers of remittances from South Africa it would be substantially easier to receive these remittances

[62] For consistency purposes, mobile money is used to refer to value stored in mobile form, whilst e money is money stored in any electronic form, including mobile money but also prepaid cards, e wallets etc.
[63] This includes basic savings accounts as these also have some transactional capability.

as they would be classified as domestic remittances and therefore not subject to the full cross-border regulatory requirements.

Very low usage of internet and cell phone banking. FinScope (2011) indicates that less than 0.5% of people with bank accounts indicated that they had used internet or cellphone banking within the previous 3 months. Although this has likely increased since the completion of that survey, usage of the channels which are typically cheaper to administer and more convenient and accessible for individuals remains very low.

Usage of cheques declining. Cheques are one of the oldest forms of payments instrument and are still used for some larger transactions; while they account for only 4% of the volume of transactions, they account for 28% of the value. Nevertheless, in Lesotho, as elsewhere, cheques are in decline. Between 2011 and 2012, the number of cheques issued fell by 17%, and the total value by 14%. The cheque business is being eroded at both ends of the value spectrum: higher value transactions are moving to the real-time high value payment system (Lesotho Wire), while lower value payments are moving to electronic channels.

Rapid growth in the uptake of mobile money. Since the introduction of mobile money in September 2012, the growth in the number of users and usage has been substantial. As at June 2014, Econet's Ecocash had signed up around 157,723 customers by the end of 2013 – representing 31% of its cellphone subscriber base. After twelve months of operation, Vodacom M-Pesa had signed up 421,851 customers – representing 33% of its cellphone subscriber base (CBL, 2014). Uptake has been far faster than original expectations, and was partially driven by the fact that Vodacom had offered generous incentives (in the form of an airtime bonus) for signing up. However, the majority of mobile money subscribers do not use the system; both networks estimate that between one-third and one-quarter of MM customers are active. This suggests that between 145,000 and 190,000 Basotho actively use mobile money, constituting 12-17% of the adult population. These figures reflect significant penetration, but also substantial room for further growth.

Figure 38 below, shows the growth path of mobile money since its introduction into the Lesotho market.

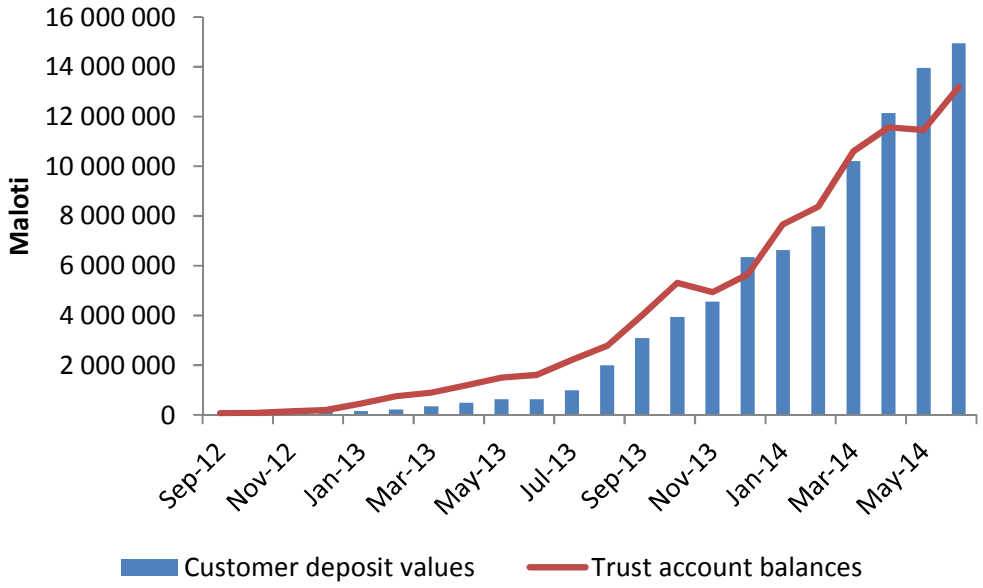


Figure 38: Mobile money customer deposit values and trust account balances

Source: CBL, 2014

Transaction	Number	Value (Maloti mn)
Customer deposits	474,701	65.5
Airtime purchases	670,132	12.9
MM transfers	62,810	20.6
Customer withdrawals	117,544	38.1

Table 9: Mobile money Transactions, January-June 2014

Source: CBL, 2014

Mobile money more frequently used than alternatives. Table 9 above, shows that, although the value of transactions through mobile money is relatively low, the number of transactions is substantial with the largest number used for airtime purchases. Figure 39, below, shows that Mobile money is a much more frequently used method of payment than cheques, EFTs or credit cards. Only debit cards, primarily for ATM cash withdrawals, are more frequently used as a payments mechanism.

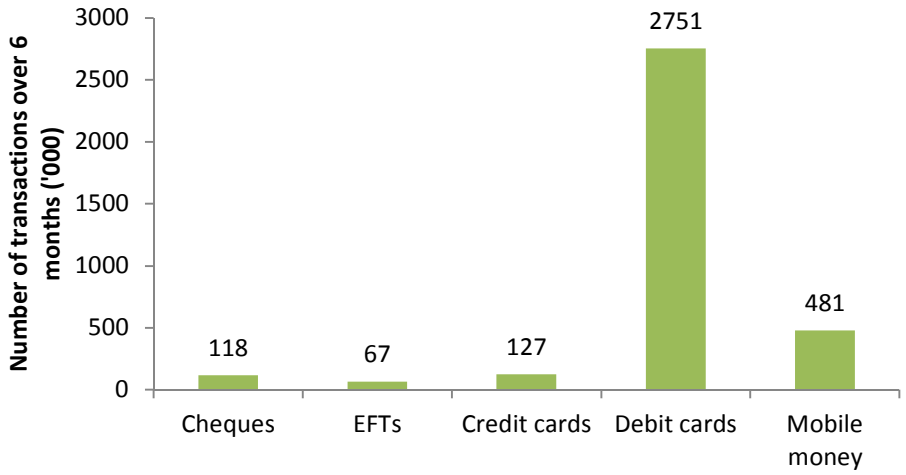


Figure 39: Number of transactions in 6 months (July-December 2013) by payments mechanism[64]

Source: CBL, 2014

Average value of mobile money transaction lower than other payment platforms. Figure 40 below, illustrates that the average value of all types of transactions conducted via mobile money is lower than all other payments mechanisms. This indicates that mobile money is serving an otherwise unserved niche for low value payments, most likely because the fees related to alternative payment mechanisms render lower value payments unfeasible. This is particularly relevant for money transfers, where the average value of mobile money transfers is M416 compared to M6,937 via EFT and M9,355 via cheque. Figure 40 also shows that the average value of airtime purchases through mobile money is just M12. The ability to purchase such low values of airtime, and the same would apply for other services paid through mobile money such as pre-paid electricity, is particularly valuable to low income users who lack the ability to budget for long periods. It allows them to purchase only as much as they need immediately, without paying a fee for each transaction. The following quote illustrates the inability to budget over a long period expressed by many respondents:

M: "So you are able to see your profits weekly right? So you can add that to a month or you only focus on weekly profits?

R: A month is just too long.

M: So you only stick to weekly?

R: Yes and I am able to go on with life"

Butha-Buthe, female, aged 27 years, rural trader, KLA (2014)

[64] Note that this figure compares data which is available. The figures for Cheques, EFTs, Credit cards and Debit cards are derived from the total number of transactions in 2012 divided by two in order to compare with the Mobile money data which reflects the number of transaction during the second six months of 2013.

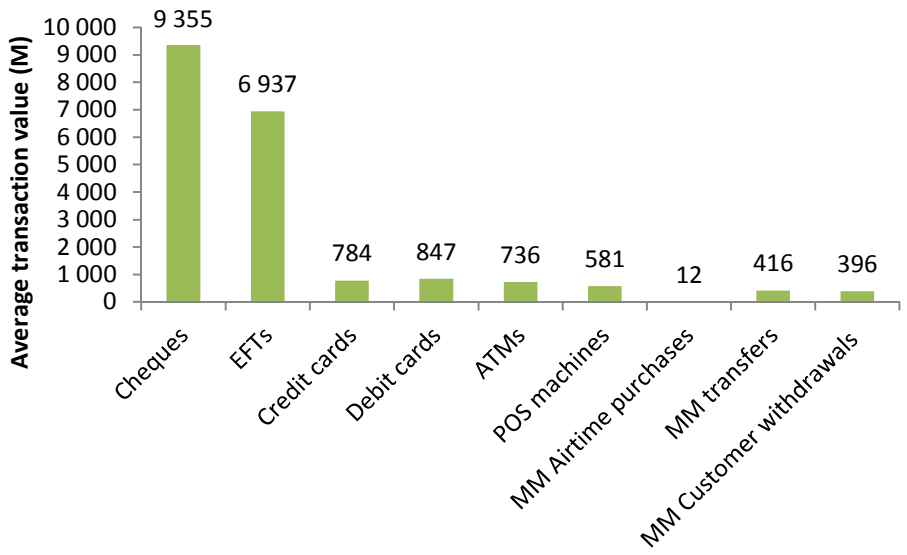


Figure 40: Average transaction value across payments platforms

Source: CBL, 2014

Heavy reliance on cross border remittances as an income source. Given Lesotho's high level of trade integration with South Africa, a high level of emigration for employment to South Africa, and a shared currency (as discussed in Section 2.3) cross border payments and remittances constitute a substantial portion of the value and volume of transactions in Lesotho. These cross border remittances represent an important source of household income in Lesotho, especially for rural households. FinScope (2011) indicates that more than 200,000 adults (17.7% of the adult population) receive remittances from outside of the country (as shown Table 10 below). In total, nearly 60% (650,000) of Lesotho adults either send or receive remittances. This illustrates the critical importance of mechanisms facilitating these payments for Lesotho consumers.

Remittances (including cash transactions)	Total	% of adult population
Total send in Lesotho	187,622	16.6%
Total send outside Lesotho	52,784	4.7%
Total receive from inside Lesotho	408,912	36.1%
Total receive from outside Lesotho	200,462	17.7%
Total remittance sent or received	648,652	57.3%

Table 10: Use of Remittances

Source: FinScope 2011

Cross border remittances constitute a substantial portion of GDP. According to a report on South Africa-SADC remittances prepared for FinMark Trust in 2012 (Truen and Chisadza, 2012), the South Africa-Lesotho remittance channel – with a total estimated value of R1.75

billion - was the second largest in SADC, after the SA-Zimbabwe channel. By this measure, total remittances were equivalent to around 9% of Lesotho's GDP. However, this may be a considerable under-estimate. The World Bank migration database presents a higher figure, US$549 million in 2011, equivalent to around M4 billion – almost 20% of GDP. Balance of payments data show that in 2011, labour income from abroad totalled M5.7 billion, equivalent to 33% of GDP[65].

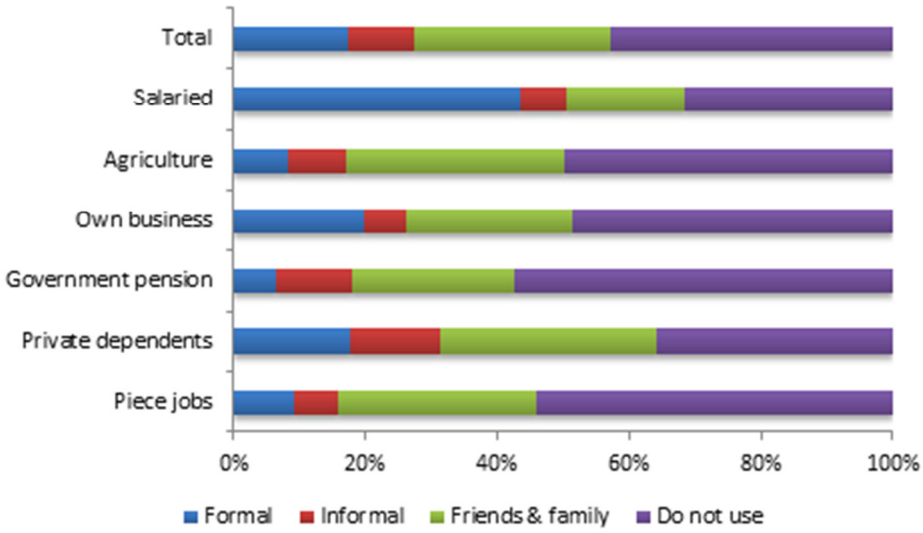


Figure 41: Remittance access strands across target markets

Source: FinScope, 2011

Salaried workers and private dependents biggest users of remittances. Figure 41 above shows that the largest users of remittances are the salaried workers (presumably mostly senders) and the private dependents (presumably mostly receivers). The salaried workers are also the only target market with a relatively higher usage of formal channels than informal and family and friends

Majority of remittances sent via friends and family. Figure 41, above, shows that the largest portion of remittance users (50% of remittance users) send or receive remittances via family or friends only. The usage of the informal sector in remitting money is relatively lower (20% of those who send or receive remittances), compared to the formal bank channel – bank transfer (30%). Family and friends is the preferred method for sending and receiving remittances across all the target markets, apart from the salaried workers. Relying on family and friends to remit has the drawback that remittances may be slow and only sent infrequently, namely when a friend or family member is travelling to the residence of the remittance receiver. This may be a particular disadvantage in cases where remittance receivers need to respond to an emergency. The high reliance on formal and informal channels may be expensive or, particularly in the case of formal channels, may have inadequate distributional touch points.

[65] This refers to the foreign earnings of Lesotho citizens, which will not all be remitted home.

6.2.2. Use cases

This section outlines the major reasons why Basotho use payments mechanisms, detailing the primary uses that individuals have for payments.

Remittances (P2P). Remittances include domestic transfers, such as intra-family money transfers from urban to rural areas, as well as cross-border transfers, such as the remittance of wages earned in South Africa to family members in Lesotho. Remittances are important to all the target markets but particularly to salaried workers (which constitute the main senders) and private dependents (which constitute the main receivers).

Bill payments (P2B, B2B, P2P). Bill payments constitute the payment by a person or a business to business or another person in return for a good or service. Bill payments encompass the purchase of goods, such as clothes, groceries, agricultural or business inputs, airtime, utilities or appliances and services including financial services, such as insurance premiums, loan repayments and contributions to community organisations like ASCAs, VSLAs and burial societies. All the target markets are required to make payments and hence this use case is important to all. This use case may, however, be particularly important to businesses owners who may have to make and receive multiple bill payments each day.

Salary payments (B2P, G2P, P2P). Salary payments constitute the payment of individual employees by their employer, either a person, business or the government. As salary payments constitute a bulk payment disbursal, it is important that employers are able to use efficient and cost effective channels to conduct these payments. From the individual receiver's perspective it is imperative that they receive salaries on a consistent, timely and reliable basis. The target markets most affected by salary payments are the salaried workers any business owners that have employees.

Welfare payments (G2P, NGO2P). Welfare payments constitute the payment of grants[66] to grant recipients and other social security payments by the Government. As with salary payments, grants also constitute a bulk payment disbursal by the state, but the recipients have a considerably different profile that will affect the payments mechanisms used. In Lesotho, grants are paid in cash as it is deemed that most grant recipient do not have access to other payments mechanisms. The use of cash makes the overall cost of distributing grants substantially more expensive for the government, which in-turn means that the value of the grant itself is less and it is only cost effective to distribute the grants quarterly, rather than monthly. The Government dependents are the primary target market affected by grant payments.

6.2.3. Providers

This section considers the providers of payments services and products to Lesotho consumers, whilst also examining the underlying payments infrastructure which enables payments in the country.

[66] A specific sum of money allocated by a government to purposes necessary for the protection of an individual's social welfare, such as replacing basic income lost due to disability or providing basic monetary support to the poverty stricken for child support.

6.2.3.1. Payments infrastructure

Lesotho is gradually developing and modernising its payments infrastructure. A real-time gross settlement (RTGS) system, known as Lesotho Wire, was established in 2006. This handles high-value transactions, comprising customer payments as well as inter-bank transactions, and is operated by the CBL. It is intended for payments of M100,000 and above, and hence is not primarily intended as a retail payments system.

Cheques are cleared through the Automated Clearing House (ACH); however, this requires the physical exchange of cheques for payment to be final. A new system is currently being installed, to reduce cheque clearing times and improve accuracy. The Maseru Image ACH (MIACH) will be a fully automated, truncated system meaning that payments will be made against cheque images and there will be no requirement for the physical exchange of cheques. Although this is somewhat controversial given the declining usage of cheques and the high cost of the system, the investment is justified on the basis of the high costs of the present system that involves physically moving cheques around the country.

EFTs were introduced in late 2011 and are processed outside of the country by Bankserv in South Africa, on a contract that runs until 2015. The new ECH will have the facility to add an EFT module and hence it is likely that EFTs will be processed domestically from then.

New regional payment system. A relatively new development with regard to cross-border payments is the SADC Interbank Regional Settlement System (SIRESS), which commenced operation in July 2013. SIRESS is hosted by the SARB and members include the other CMA central banks as well as commercial banks in the region. SIRESS is a regionally-integrated RTGS, and obviates the need for cross-border cheque payments within the CMA. SIRESS is part of the SADC Payments System Project, which itself falls under the SADC Financial Integration Protocol (FIP).

6.2.3.2. Banks

Banks are the traditional providers of formal payments services in Lesotho through the provision of cheques and EFTs. All the banks provide payment and cross-border remittance services.

Interoperability. The three South African owned banks issue their own debit cards and operate their own ATM machine networks. However, the cards are all Maestro- or VISA-branded and are EMV-compliant. Hence these cards are interoperable (i.e., can be used in any of the banks' ATMs or POS machines, as well as outside of the country). The LPB card system, however, is "closed" and the cards are not EMV-compliant. Hence these cards are not interoperable and can only be used in LPB ATMs and POS machines. This means that LPB clients receive a lower value service on transaction accounts, thereby putting LPB at a competitive disadvantage to the other three banks.

6.2.3.3. E-money providers

Lesotho currently has three e-money providers. The two MNOs (Mobile Network Operators) both offer mobile money products, whilst FNB has introduced its eWallet. The introduction

of mobile money is a relatively recent development in Lesotho. EcoNet introduced its EcoCash product in September 2012, while Vodacom started m-pesa operations in July 2013.

Substantial agent networks deliver mobile money services to consumers. Both networks have appointed large agent networks to handle cash-in and cash-out transactions. There are currently 2,131 mobile money agents across the two providers. International experience shows that the quality of the agent network is a crucial factor in determining the success of MM rollout, acceptance and usage. For most customers, the agent is their primary interface with the MM system. Quality depends on:

- *Agent liquidity:* having sufficient e-value float (for cash-in) and cash (for cash-out).
- *Agent proximity:* number and geographical spread.
- *Agent reliability and honesty:* understanding of products and services, as well as not committing fraud or theft.

6.2.3.4. Retailers

Money Transfers set to be introduced through retailers. Discussions have been taking place with a view to setting up a new cross border money transfer channel through Capitec Bank in South Africa (cash-in) and Shoprite in Lesotho (cash-out), although this is not yet in operation. The initial pilot, which permits a cross-border remittance at a flat cost of R10, is set to become operational in the second half of 2014. In-store testing and training[67] already commenced in early May, whilst SARB approval was pending. Following the receipt of SARB approval in mid-June, Shoprite intends to commence the Live Pilot in the second half of 2014. The pilot phase is a full live offer to be used by customers to prove the value and feasibility of the service; it is scheduled to be reviewed by CBL after 12 months. The cross-border money transfers from South Africa to Lesotho are sponsored by Capitec Bank (the same bank that currently sponsors Shoprite's South African domestic money transfers). However, as Capitec is not a registered bank in Lesotho, SBL will act as the sponsoring bank for domestic Shoprite money transfers in Lesotho. Once approval has been received from CBL this service will commence. According to consultations, Shoprite (with SBL) intends to introduce cross border money transfers from Lesotho to South Africa in 2015.

6.2.3.5. TEBA

TEBA a major remittance channel for South African-based mineworkers. The most important formal cross-border remittance channel is the one operated by TEBA, which is the recruitment agency for Lesotho mineworkers working in South Africa. These mineworkers are required by law to save (or "defer") 30% of their pay, which is then sent back to Lesotho at the end of their contract. This money is remitted through Ubank (formerly TEBA Bank) in South Africa, and paid out by TEBA in Lesotho. In addition, to deferred pay, there are a variety of other voluntary and contractual savings channels for mineworkers and their families. Mineworkers are largely paid through their Ubank accounts. A portion can be set aside in a linked account and withdrawn by a spouse or other relative in Lesotho. Mineworkers at the end of their contracts typically keep any accumulated savings in their Ubank account and withdraw these funds on returning to Lesotho, rather than travelling

[67] In-store testing does not entail cross border settlement, nor allow customers to do transactions. Only Shoprite staff conduct low value test transactions on a daily basis.

with large amounts of cash. In addition, pensions may be paid through this channel, as well as "Industry Generated Funds" such as retrenchment payments, death benefits, long service awards, occupational diseases and injuries compensation monies (TEBA, 2013).

Total payments through Ubank accounts and TEBA Lesotho are substantial. In 2012 the payments were made up as follows:

Type of payment	Amount (R million)
Deferred pay	370.4
Cash remittances	65.1
Ubank withdrawals	1,316.8
Total	1,752.4

Table 11: Ubank/TEBA transfers from South Africa to Lesotho

Source: TEBA, 2013

The total payments of R1.752 billion were equivalent to around 8.5% of 2012 GDP. Most of these funds are withdrawn as cash at the TEBA office in Maseru, although amounts over R10,000 are paid by cheque.

6.2.3.6. Informal providers

Large portion of remittances sent through non-formal channels. FinScope (2011) indicates that the overwhelming majority of remittance senders and receivers use either informal channels or family and friends to send these remittances (see Section 6.2.1.) Truen and Chisadza (2012) estimated that 80% of the funds remitted across the border from South Africa was sent informally. In addition to travelling friends and family, informal channels typically entail taxi or bus drivers transporting cash door-to-door. A major advantage of sending money through this channel is that it can be delivered directly to the recipient. This is particularly important in Lesotho, as the geography of the country means that many rural communities (the majority of private dependents reside in rural areas) face substantial challenges in accessing the distribution infrastructure of formal remittance providers.

Sending remittances through informal channels entails several drawbacks for the consumer. The high reliance on informal channels has several disadvantages: it is risky, unpredictable, slow and expensive. As the money is sent with taxi or bus drivers with no paperwork or guarantee, there is a significant risk that the remittance will not reach the receiver and the sender will have no recourse. Informal channels are also expensive, estimated at R10-R30 per R100 sent according to research done in South Africa (Truen and Chisdza, 2012).

6.2.4. Products

The channels or product categories through which retail payments (transaction and remittance) services are provided in Lesotho can be broadly divided into three main groupings. The first is banking transaction facilities, including cheques, cards, ATMs etc. The second relates to a relatively new field, transactions using the e-money channel. The third relates to money transfers, including both domestic and cross-border remittance products.

There are some overlaps between these channels (e.g. banks provide money transfer and remittance facilities); however, the conceptual distinctions are still useful.

These three product categories are shown in the diagram below. For completeness, the diagram also includes a relatively minor channel – money orders through the Post Office – as well as the channels used for high value (non-retail) payments. All of the major channels are described in more detail in the text below.

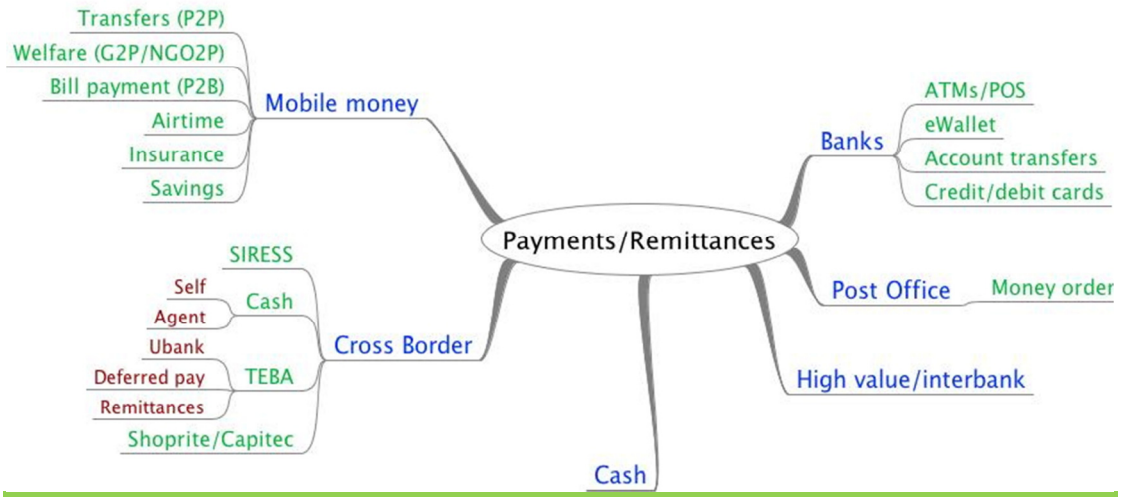


Figure 42: Payments landscape in Lesotho

Source: Authors' own

6.2.4.1. Banks' transaction facilities

Banks provide a range of payments instruments and channels, including:

i. Cheques
ii. Debit cards
iii. Credit cards
iv. Electronic funds transfers (EFTs)
v. ATMs and Point of Sale (POS) machines
vi. Mobile phone payments

Eligibility requirements. Access to bank ATM/debit cards is linked to the opening of a transactional bank account. At SLB, the largest bank, the Personal Current Account provides a Maestro-branded debit card linked to the account, which can be used in the bank's ATMs and POS machines. Opening this entry level account requires proof of employment or source of income, and a passport and proof of address to meet KYC requirements. LPB will open transactional accounts with a debit card (for use only in LPB ATMs and POS machines) without an employment requirement, although it does require some evidence of the source of income as well as proof of address (a chief's letter will suffice). It also allows a driving license to be presented as proof of identity, instead of a passport.

Cost structure. Table 12 below, shows the relative cost of Lesotho's banks to neighbouring Swaziland's and South Africa's banks for the same hypothetical monthly transaction profile.

	Assumed transaction profile[68]	Lesotho (M)	Swaziland (E)	South Africa (R)
Monthly service fee		8.53	12.93	3.00
Debit orders	1	14.48	18.96	3.67
Debit order bounce		n/a	314.08	10.33
ATM withdrawals--on us (w/d: R100 each)	3.1	4.83	4.67	5.00
Statements requested – ATM	1.2	2.74	4.16	3.67
Statements requested – Counter	0.11	20.15	11.18	11.17
Deposit (R500) – counter	0.31	13.70	21.23	12.50
Estimated monthly cost[69]	**-**	**47.73**	**59.14**	**31.67**

Table 12: Average bank charges for entry level transaction account in Lesotho, Swaziland and South Africa

Source: Mystery shopping, 2014; Genesis, 2005; 2014,

Although relatively more affordable than Swaziland's banks, the cost of an entry level transaction account is high for the majority of Lesotho's citizens. This will be discussed further in the section on access barriers below.

6.2.4.2. E-money

E-money used for remittance payments (P2P), salary payments (B2P) and bill payments (P2B). All three of Lesotho's e-money providers, the two mobile money providers (Vodacom M-Pesa and Econet EcoCash) and FNB (eWallet), allow subscribers to send money deposited in their mobile money account or wallet to any other individual, who can then withdraw this as cash, either from a mobile money agent (for mobile money) or from an FNB ATM (for the eWallet). No registration or bank account is required to receive money. These products also allow subscribers to pay bills directly from their phone to registered merchants, including certain lenders and insurers. The mobile money providers are also able to facilitate bulk payment disbursals, such as salary payments for businesses.

Both mobile money operators offer similar products. Essentially, customers make a cash deposit onto the MM system, on which they are then credited with a MM balance (electronic or e-money). This can then be used in various ways, including:

- Mobile money transfer (MMT), person to person (P2P)
- Payment for products and services, specifically:
    - DSTV

[68] This banking profile is based on the postulated Southern African profile for low income bank customers (Genesis, 2005) . The profile estimates the usage of a low income user that is using the account to a limited extent, although more frequently than simply as a 'mailbox'

[69] Estimate is based on the weighted average according to the market share of the four operating banks in Lesotho and Swaziland, and the average costs of the three banks operating in South Africa which also operate in both Lesotho and Swaziland (i.e. FNB, Nedbank and Standard Bank).

- Lesotho Electricity Corporation (LEC)
- Insurance/burial society

- Airtime purchase
- Cash withdrawals

In principle, other services can be provided, such as payment of pensions and other social welfare allowances (by Government or NGOs), or payment of wages (by employers).

Box 8. Mobile money transaction flows

The MM ecosystem in terms of the structure and flow of transactions is as shown in the diagram below. The flow of funds can be classified under deposits (A), payments/transfers (C), and withdrawals (D). The funds held in MM accounts are shown under (B), and represent the total value of mobile money in issue at any time. Over any given time period, MM balances will increase (or decrease) by the differences between deposits (A) and withdrawals (D). The total value of MM balances at any point in time represents the value of funds "in transit" plus any "savings" held on the system.

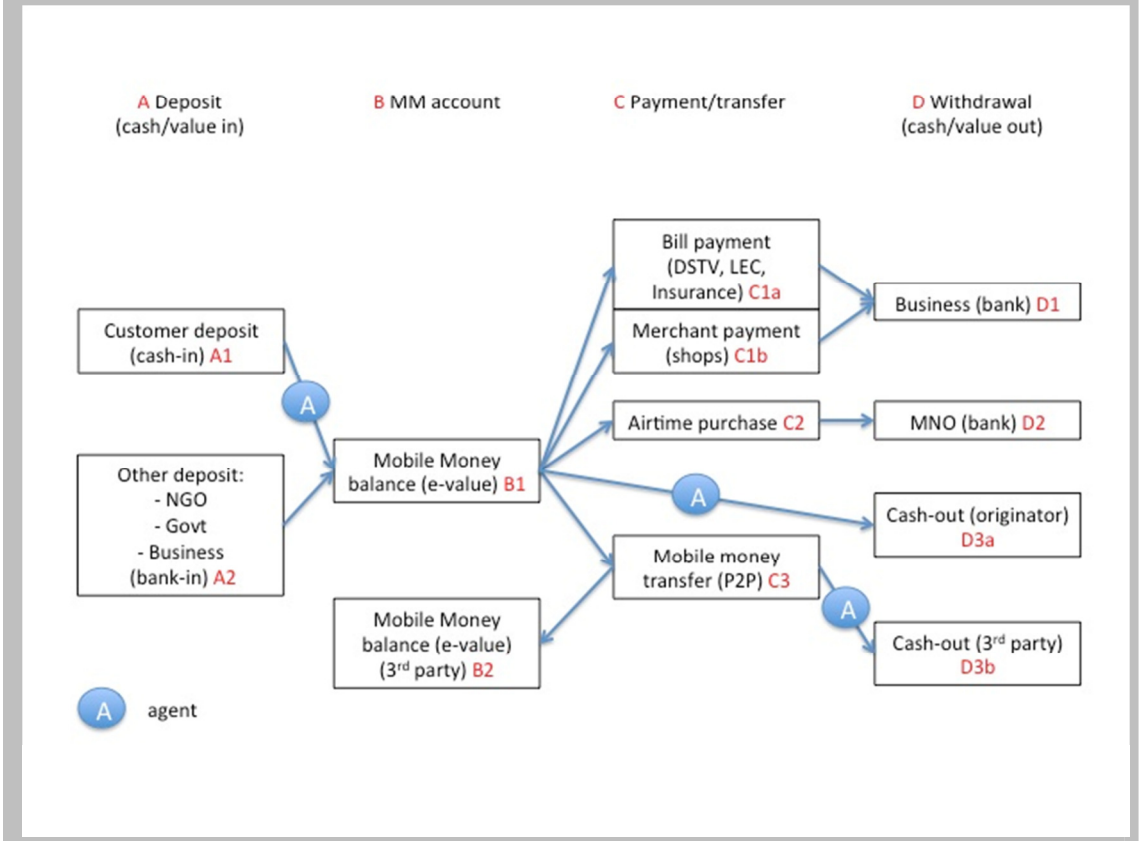


Figure 43: Mobile money Transactions Flow

Source: Authors' own

Float held in trust account. For regulatory reasons, all e-value balances on the MM system have to be matched exactly by a deposit by the MNO in a trust account at a licensed bank; essentially this ensures that MM customers are protected by ensuring that there is always

"bank money" backing the "e-money" in their MM accounts. The value in the trust accounts should therefore be exactly balanced by the total value in MM accounts. At present both MM operators use SLB for their trust accounts.

Cost structure. Fees for various types of MM transactions are shown below in table 22.

Transaction	**Network**	
	m-pesa	**Ecocash**
Deposit	free	free
Send money to registered customer on same network	1.00-7.59	2.00-15.00
Send money to unregistered customer	2.50-18.98	4.00-18.00
Cash withdrawal – registered customer	1.50-11.39	2.00-15.00
Merchant payment	1.00-7.59	0.00-5.00
Bill payment	1.00-7.59	1.00-10.00
Airtime purchase	free	free

Table 13: Mobile money Fees

Source: Vodacom Lesotho and EcoNet Lesotho, 2013

Mobile money costs in Lesotho comparable with other regional mobile money products. The cost of money transfers via mobile money is typically tiered based on the amount that is being sent. The cost of mobile money transfers in Lesotho is comparable to similar products provided in the region, as shown in Table 14. With two mobile money providers operating in Lesotho, competition may play an important role in helping to drive the rollout of the product and ensure that consumers receive appropriate value. This is already exemplified by the incentives Vodacom offered to new subscribers.

	Cost to *send* mobile money to a registered user (M)[70]
Econet Lesotho	2.00 – 15.00
Vodacom Lesotho	1.00 – 7.59
MTN Swaziland	3.00 – 5.00
MTN South Africa	0.00
Vodacom South Africa	2.45
Safaricom Kenya[71]	0.37 – 4.03
Vodacom Mozambique[72]	0.99 – 8.28

Table 14: Relative telephony and mobile money sending charges across selected MNOs in the region

Source: Respective MNO websites, 2014

Mobile money products substantially cheaper than comparable banking products. The advent of mobile money opens up a new low-cost transaction channel for payments and remittances. Table 15, below, compares the costs of running a basic transactions account between the MM operators and FNB (which is the only bank that offers full cellphone-based

[70] The costs of sending mobile money are generally tiered based on the value sent. Also note that this is the cost of sending money from one account to another, fees are also usually levied on withdrawals and may also be levied on deposits.
[71] Based on the exchange rate as at 1 March 2014 of 0.122 (Oanda, 2014)
[72] Based on the exchange rate as at 1 March 2014 of 0.3310 (Oanda, 2014)

banking capability). Note, however, that the two products – bank account and MM account – are not fully comparable. For instance, the MM account does not come with an ATM card, and MM has – at present – more restricted use in retail outlets; at the same time, MM has a much more extensive network of "touch points" (through agents). The key observation is that for all of the listed transactions, MM is cheaper than the bank. For instance, a monthly bundle of transactions comprising one cash withdrawal, one merchant payment, one bill payment and one transfer to another cellphone would cost M6.75 using m-pesa, M15 using EcoCash and M36 using FNB. If the cost of cash deposits is factored in, the difference is even greater.

	Mobile money		FNB
Transaction	**EcoCash**	**m-pesa**	**Transmission**
Monthly fee	0.00	0.00	10.00
Cash deposit - M500	0.00	0.00	25.00
Cash withdrawal - M250 (agent/ATM)	3.00	2.25	4.80
Merchant payment/POS - M100	2.00	1.50	3.40
Bill payment - M100	5.00	1.50	7.30
Money transfer to another phone - M250	5.00-6.00	1.50-3.75	10.50

Table 15: Payments and Remittances comparisons

Source: EcoNet Lesotho, Vodacom Lesotho and FNB, 2013

Simplicity of mobile money accounts a boon for users. The opening of a MM account and registration as a user is fairly straightforward. The procedures depend on the level of access (in terms of the value of transactions) required by the user. An important element of the MM Guidelines that encourages access is the provision for tiered KYC requirements that facilitate the opening of MM accounts (as shown in Table 16 below). This tiering enables MM accounts with low-value transaction limits to be opened easily by customers, without imposing onerous requirements for proof of identity and address. Essentially, accounts in the "Least KYC" category below can be opened simply by using a mobile phone handset, on a "self-declaration" basis. Therefore, even customers without ready access to proof of identity (such as a passport) or an address (which would apply to the majority of households in Lesotho) can open a MM account. The adoption of "Tiered KYC" requirements for MM money accounts in is sharp contrast to the banks, where "full" KYC is required for all account opening. Hence from this perspective, MM is more accessible than bank products.

KYC level	KYC requirements	Mobile payment transaction limit
Least	Self-declared: Name, phone number, physical address	Daily: M2,500 Monthly: M7,500
Partial	Self-declared: Name, phone number, physical address, passport number	Daily: M5,000 Monthly: M15,000
Full	Verified against official documents: Name, physical address	Daily: M7,500 Monthly: M20,000

Table 16: Mobile money KYC Limits

Source: CBL MM Guidelines, Appendix 9

6.2.4.3. Cross border Money transfers

Cross border money transfers expensive through all channels. Data supplied by the World Bank (2013)[73] shows that sending a USD 200 remittance from South Africa to Lesotho costs on average USD 35, representing 17.5% of the total amount. This cost is extremely high if compared with other countries with similar migration patterns and remittance volume flows, and is above the global average of 9.1% and also above the average cost for the Sub-Saharan African region of 12.2%. For low value remittances to low income dependents this also constitutes a substantial foregone income and therefore reducing the value of remittances. Informal channels are equally expensive with Truen and Chisadza (2012) estimating that sending remittances via taxis or busses costs 10-30% of the total value of the remittance value. This helps explain the overwhelming preference by Lesotho remitters to send money with family and friends.

SIRESS to reduce the cost of cross border flows through banks. The launch of a regional switch substantially reduces the cost of transferring money between countries in the region operating through the switch from the existing system of SWIFT transfers and correspondent banking. Payments through the SIRESS switch cost R4.76 each and this cost can be reduced even further to individual consumers if banks send batches of individual money transfers through the system as one transaction.

6.2.5. Accessibility barriers

Required documentation a barrier to accessing bank accounts for most Basotho. The requirement for proof of income and/or proof of employment to access bank accounts restricts access to a minority of the population, primarily the salaried workers. FinScope (2011) shows that this target market has much higher access to bank accounts than the other target markets. Furthermore, full KYC requirements are required for all bank accounts with no exemption for low value accounts. This creates a substantial barrier for most Basotho. Although ID cards are now being distributed and passports are prevalent, most Lesotho adults do not have proof of address and hence must prove this by providing a letter signed by their chief, which may be both difficult and costly to obtain and opens them up to exploitation.

Proximity. As physical bank infrastructure is situated in urban centres, many clients have to travel to interact with the bank which entails a further transport cost, which may be substantial for adults residing in rural areas. FinScope (2011) indicates that 55% of Lesotho adults live more than an hour's travel away from a bank branch, including 23% which have to travel in excess of three hours to reach a bank branch. The farmers are the target market worst affected, with 85% of farmers forced to travel more than 1 hour to reach the nearest bank (FinScope, 2011).

Expense a major barrier to the use of transaction accounts and formal remittance products. The high costs associated with transaction accounts, as discussed in Section 6.2.4.1 constitute a significant barrier to usage amongst the large low income population of Lesotho. Given that the average monthly income of Basotho adults is M1,051 (FinScope, 2011), the monthly cost of an entry level transaction bank account would constitute 5% of

[73] World Bank, Remittance Price Worldwide

total individual income. The following qualitative demand-side research quote explains the affordability barrier:

> "I used to keep my money in a bank account. But then when I went to withdraw it, there was less than when I first deposited the money. I asked them why and they told me about these charges, but I didn't understand why they took so much"
>
> *Butha-Buthe, Female, Aged 33 years, KLA, 2014.*

Usage decisions are made on the basis of cost. Table 12 shows the relative expense of bank accounts in Lesotho. Figure 44 below, shows that cost is a major driver of behaviour. The most frequently cited consideration when opening an account (by 33% of adults) is bank charges.

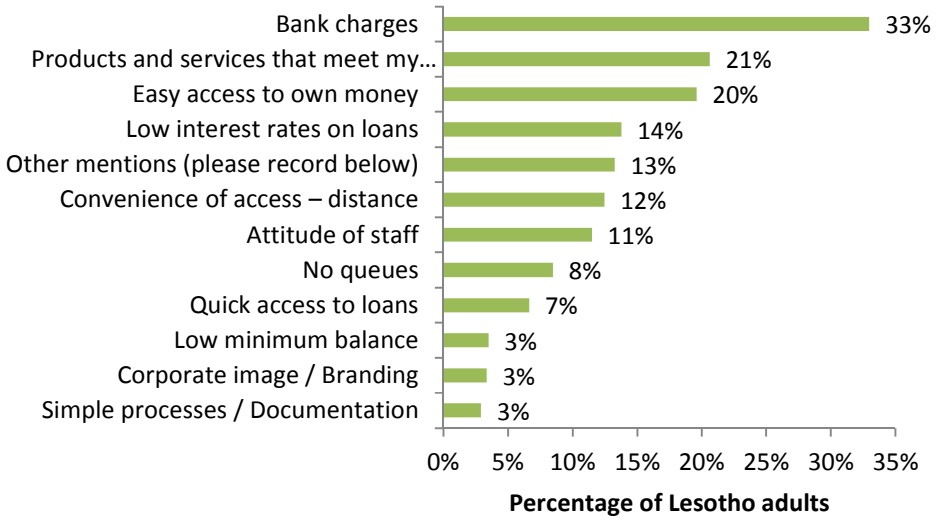


Figure 44: What do you look for when opening an account?

Source: FinScope, 2011

Expensive cross-border transfers. The high costs associated with cross border remittances sent via formal channels constitute a substantial portion of the value of the remittance sent and hence foregone income for the large population of Basotho reliant on remittances.

Lack of awareness and education an inhibiting factor to uptake of mobile money. The key barrier to take-up of mobile money, according to qualitative research, is awareness of the channel and education around how it works and what is required from users (KLA, 2014).

6.2.6. Regulatory Issues

Regulatory vacuum to be filled. The regulatory vacuum arising from the absence of payments legislation should be largely addressed once the Payments Systems Act comes into force, as this will provide the legal basis for the regulation of mobile money.

Lack of KYC exemption for low value bank accounts a barrier to consumers as well as creating a non-level playing field for providers. As discussed above, the full KYC requirements represent an onerous compliance burden for many Basotho. Furthermore, the lack of a tiered KYC regime sets the banks at a disadvantage to the mobile money providers in supplying low cost, low value transaction products which are subject to tiered KYC reporting requirements.

Mobile money guidelines opens space for MNOs to earn interest on float but not to pay interest to subscribers. In the early stages of MM in Lesotho, the Guidelines prohibited the payment of interest by banks on the MNO's Trust Account balances. This is common practice in various counties, but does not seem to be well founded. The argument is that the trust account balances represent funds held "in trust" for customers, and so why should the MNO make a profit from these? However, this approach simply shifts profits from MNOs to banks, and does not help customers in any way; indeed, if anything it leads to higher charges for MM services. The more recent version of the MM Guidelines has removed this prohibition, thus opening up the possibility for the interest earned on MM Trust Accounts to be used to offset system operating costs (and hence supporting lower charges), or in due course to pay interest on MM accounts. However, the mobile money providers are still prohibited from paying interest on subscribers' accounts.

Existing mobile money guidelines restrict direct oversight of agents by the CBL. The CBL, through the mobile money Guidelines, does not attempt to regulate the recruitment and appointment of agents, treating this as a business issue for the MM operator. Instead, the Guidelines simply lay out a set of responsibilities and obligations that the agent (through the MNO) has to meet. This creates an environment enabling of the development of agent networks by the MNOs and therefore the growth of mobile money, but can also lead to consumer protection risks.

Potential for regulatory conflict in supervision of mobile money. Given that MNOs are primarily regulated – as providers of telecoms services – by the Lesotho Communications Authority (LCA), while MM services offered by MNOs are regulated by the CBL, there is the potential for regulatory overlap or conflict. In order to clarify the regulatory scope of each organisation, a Memorandum of Understanding is being drawn up between the LCA and the CBL in respect of MM services offered by MNOs.

Agency requirements for ancillary services. Another regulatory issue that has arisen for MM involves the sale of insurance products by MM providers. In particular, Econet has been selling its "Ecosure" product to MM customers. The product is underwritten by LNIC; however, there is an issue of whether EcoNet requires an insurance agent's license to sell this product. The issue is under discussion between EcoNet, LNIC and the CBL.

Potential for alternative providers needs regulatory clarity. The entrance of two types of alternative cross border money transfer providers in the form of MNOs (with mobile money) and retailers (specifically Shoprite) has significant potential to improve the efficiency and cost of cross border remittances for Lesotho remitters. While retailer transfers are set to be piloted in the 2nd half of 2014, the MNOs do not yet offer cross-border services. As noted in Chapter 3, any firm offering cross-border payments services must obtain a Money Transfer Operator licence from the CBL. This applies even if the entity is simply a receiving channel (such as TEBA or Shoprite). However, this does not appear to be a major obstacle in practice.

For cross-border MM payments, a further concern from the CBL is that payment inflows received from South Africa would need to be matched in real time by receipt of funds into MM trust accounts – i.e. subscribers should not be able to convert mobile money value to cash prior to the corresponding money being paid into the trust accounts. With SIRESS, this should be achievable.

South African regulations a potential barrier to cross border mobile money transfers. The main regulatory issues for cross-border remittances arise on the South African side. South African rules (from the SARB) require that all cross-border payments are subject to full FICA controls (which require full KYC verification of the identity of sender and recipient as well as justification of the reason for the transaction[74]), foreign exchange controls and Balance of Payments (BoP) reporting. In addition, non-citizens sending cross-border funds must demonstrate the legality of their immigration status in South Africa (valid work or residence permit).This contrasts with domestic mobile money transactions in Lesotho, where tiered KYC is operative, with less rigid KYC requirements for low value transactions. Similarly, within South Africa, there are relaxed FICA requirements applicable to low value bank accounts and domestic mobile money transactions. Furthermore, the MNO would need to obtain an ADLA (authorised dealer with limited authority) or banking license from the SARB either directly or through partnership, in order to conduct cross-border business. Whilst this is possible, it would be practically challenging and would likely require negotiation and lobbying of the South African authorities.

Full KYC requirements required for cross border transfers via retailers. A similar obstacle applies to the proposed Capitec-Shoprite channel. In South Africa, customers can make money transfers to 3rd parties via Shoprite stores, with Capitec Bank acting as the banking partner of record. Domestic transactions benefit from the low-value FICA exemption. However, cross-border transactions do not benefit from this exemption. Besides requiring full KYC, for cross-border transactions all reporting and disclosures must be made by bank (i.e. Capitec) staff, and cannot be done by agents (i.e. Shoprite staff) on their behalf, unlike with domestic transactions.

6.2.7. Gaps and Opportunities

Mobile money represents a major opportunity to increase financial access in Lesotho. Despite only being introduced in September 2012, mobile money already has a similar number of subscribers (450,000-500,000) to the number of bank account holders in Lesotho. This rapid uptake indicates that mobile money is meeting a previously unmet need. The high reliance on cash transfers[75] despite the high costs of such cash distribution (due to distance, the difficult terrain, and low population density and scattered settlements in rural areas) indicates a significant unmet need for a low cost payments mechanism for low value payments. The lower average transaction values of mobile money compared to all other payments platforms indicates that the product may be meeting this specific need for low cost, low value transactions. This is particularly valuable for low income earners with short-term budgets. Increasing the value and use of mobile money, therefore represents a central opportunity to improve the quality of access to finance in Lesotho.

[74] Financial Intelligence Centre Act (FICA), which provides the basis for Anti-Money Laundering (AML) controls in South Africa.
[75] For remittance purposes (e.g., between household members in urban/rural areas); for payment of social welfare benefits (e.g. pensions, orphan support payments, food basket payments etc.) by the government and NGOs; and for the payment of wages and allowances for those working in rural areas.

Mobile money has the potential to meet all of the use cases cited in Section 6.2.2 and in this way improve the value to customers and deepen penetration:

Scope for MM to enhance formal cross-border remittances. Domestic money transfers are already made through mobile money, however, given the distributional advantages mobile money, there is substantial scope to increase the use of mobile money for domestic remittance flows. Although there are gaps in coverage, the number of mobile money agents (2,131 in June 2014) far exceeds the number of bank branches, and many MM agents operate in settlements that do not have bank branches. Cross-border remittances through mobile money are not legally permitted, but this also represents a significant opportunity given the volume and value of cross border remittances and the benefits of mobile money. Sending remittances via mobile money can substantially reduce the costs for the receivers, primarily the private dependents target market, to access the remittance as the broader network of mobile money agents (compared to other formal providers) reduces their travel costs. Electronic payment of remittances also limits the risks associated with informal remittance channels and ensures that remittances can be sent at any time and be received almost instantly.

Broadening the range of services that MM is used for. Apart from P2P payments, mobile money has significant potential on at least three fronts:

- *Bill payments.* The paying of bills forms the second core function of mobile money as it allows users to pay for goods and services such as airtime and electricity directly from their mobile money. Increasing the available goods and services that can be purchased directly from a mobile money account will increase the value of the service to users and thereby encourage usage as well as increase revenue for the MNOs from merchant discounts.
- *Salary payments*. Both mobile money providers offer bulk payment disbursals for customers such as businesses. Paying salaries through mobile money enables the safety of paying workers' salaries into accounts, as opposed to paying in cash, without requiring them to have a bank account, which they may struggle to access.
- *Welfare payments.* Distributing grants via mobile money would substantially reduce the distribution costs to government, thereby potentially allowing higher grant pay-outs and more regular grant pay-outs to State dependents. Furthermore, using MM for G2P or NGO2P payments could provide immediate scale that would encourage more general rollout and usage of MM services.

Although there are potential cost savings and efficiency gains, there are nevertheless logistical and other challenges to overcome before MM can be used for a wide range of payments and transfers, especially bulk payments (such as pension and other social welfare payments):

- *Distributing funds to large numbers of recipients on the same day causes cash stress*. Some locations may have insufficient cash to meet the demand for MM cash-outs. One NGO has already tried to deliver welfare payments to households for food purchases during which the MNO had to arrange for special cash deliveries to agents to ensure sufficient liquidity (which means that MM is not achieving the objective or reducing the need to physically transport cash around the country).

- *Limited number of potential mobile money agents in rural communities.* A related problem is that in many smaller settlements, there are very few candidates to be MM agents, and that even when there are agents, such communities are "cash poor" and there is little merchant capacity to provide cash-out services. MNOs require agents to undergo a due diligence process, and existing businesses need to provide books of account etc. Where there is no proper record keeping, or where merchants are unwilling to formalise their business accounts to the extent necessary, it may be difficult to identify potential MM agents. And even when there are agents, it is likely that they would not have sufficient cash to provide cash-out services when those are concentrated around specific dates (such as pension payment dates; dates for payments of wages/allowances; or month end when family members resident elsewhere get paid and are more likely to send remittances).

  One potential solution to these problems would be to stagger the dates on which people are paid (i.e. through the month rather than all on or around the same date – this would be more feasible for welfare payments than for employment-related payments). Another would be to encourage the rollout of merchant acceptance of mobile money for payments purposes – therefore bypassing the need for cash, at least partially. A third would be to encourage the use of MM accounts for savings purposes (discussed in more details in Section 6.3).

- *Distributing welfare grants by mobile money constrained by low mobile phone ownership amongst target market*. A further constraint to distributing welfare grants via mobile money is the relatively low uptake of mobile phones by the government dependents. This is the target market that are receiving these grants but just 38% had or used a mobile phone in 2011, compared to a population-wide average of 70% (FinScope, 2011). The level of penetration has almost certainly risen in the interim, however this indicates that a large portion of the group receiving the welfare payments would not be able to access them if distributed by mobile money. Distributing grants via mobile money should, therefore be considered a longer term initiative. Increased consumer education and awareness of mobile phone usage and particularly mobile money may help to overcome this deficit.

Box 9: Mobile money Agent Liquidity

The issue of agent liquidity is one of the most important areas to be addressed in making a MM system work effectively*. Resolving the liquidity issue requires a full understanding of the role of the agent in a MM* system.

An agent is the main touch-point for the MM customer for both cash-in and cash-out transactions. For cash-in, the customer pays money to the agent, and in turn receives e-value credited to their mobile money account. This e-value can then be used for purchases (e.g. airtime), bill payment or transfer to another individual. At the time of the transaction, the agent receives cash, and transfers e-value from their own (the agent's) account to the customers MM account. The total value of the agent's assets is unchanged, but he/she has exchanged e-value for cash. Similarly, the total value of the customer's assets is unchanged, but he/she has exchanged cash for e-value. The total value of MM in circulation is unchanged, but more of the e-value is held by the customer and less by the agent. Hence the MNO's mobile money liabilities (i.e. e-value) and assets (trust account balance) are unchanged.

The next step is for the agent to use the cash to purchase more e-value (sometimes referred to as float) from the MNO. This can be done directly, or more commonly via a super-agent. At this point the

amount of MM in circulation will increase; initially, the MNO issues new e-value in exchange for cash, and then the cash is deposited in the trust account at the bank. Hence the MNO's assets and liabilities only change when the agent transacts with the MNO, not when the customer transacts with the agent.

A similar process, but in reverse, takes place with a cash-out transaction, i.e. when a customer exchanges MM (perhaps received from another family member) for cash at an agent.

It is evident that for the system to function effectively, agents must at all times have sufficient liquidity in terms of both cash and e-value (float) to meet customer needs. If the agent has insufficient float, they will not be able to handle cash-in transactions, and if they have insufficient cash they will be unable to handle cash-out transactions.

Having sufficient liquidity, in turn, requires the agent to have sufficient value to invest in the business (and hold in the form of float and cash), and the means to exchange float for cash, and vice versa, when holdings become imbalanced. The smaller the total value that the agent invests in the business, the smaller the value of transactions they will be able to handle, and the greater the chance that they will run out of float and/or cash (and the more frequently they will need to rebalance).

In the case of an agent that has approximately equal flows of cash-in and cash-out transactions, the balancing of cash and float will largely take care of itself. However, for most agents this will not be the case; instead there will tend to be more cash-in transactions (perhaps for an agent in town) or more cash-out transactions (perhaps for an agent in a rural area). Thus there will be a tendency for either cash or float to increase, and the agent will need to trade this cash or float at a super-agent in order to re-balance. Hence ready access to super-agents is also a pre-requisite for an efficient mobile money agency network.

In many cases, MM agents will have other businesses, which can help with cash management. For instance, a rural store that receives cash from the sale of merchandise, and has to deal with the logistics of banking this cash when the nearest bank is some distance away, might be happy to use this cash in a MM agency, where a cash-out bias would be an advantage. The store owner would then be periodically banking MM float rather than cash.

In urban areas, it should be relatively easy for agents to access super-agents and rebalance cash and float as necessary. The real problem arises in rural areas, especially smaller and more remote settlements, where cash takings may be small, and the ability to finance cash-out transactions limited.

Source: Authors' own

Opportunity for increased role of banks in providing cross-border remittance products. The relatively limited use of formal channels to send and receive remittances, with other channels preferred, can be partly attributed to the high costs of formal channels. However, formal channels have the benefits of being quicker, safer and more reliable than other channels. Therefore, by reducing the costs of remittance products, banks could incentivise remittance senders to use them as their primary channel. With the introduction of the new regional switch, SIRESS, the cost of transferring money between countries in the region is also substantially reduced. Truen and Chisadza (2012) estimate that M1.8bn flows from South Africa to Lesotho annually, this constitutes 28% of total current bank deposits and of which an estimated 80% flows through non-formal channels. Given that these banks may become increasingly competitive for deposits due to the rising credit provision (as discussed in Section 6.1 above), these remittances represent a substantial opportunity for the banks to substantially increase their deposits. If 50% of the SA-Lesotho remittances currently flowing

through informal channels were to shift to the banks, this would raise banks' overall deposits by more than 10%. Although developing such products would require close cooperation with their South African counterparts, the three largest banks are all majority owned subsidiaries of major South African banks.

Potential role for retailers to provide remittances. Shoprite is already in the process of rolling out money transfers and these represent an important alternative formal channel for consumers. The success of money transfers offered by retailers in South Africa, suggests that retailers could play an important role as remittance providers in Lesotho.

6.3. Savings

6.3.1. Current usage

Savings is widespread amongst Basotho adults. Approximately 50% of adults claim to save through formal or informal savings mechanisms, and a further 7% save at home, as shown in Figure 45 below. Savings is the second most widely used type of financial product or service used by Basotho (after insurance).

Households account for substantial portion of total deposits. Households account for around 40% of the deposit base of the banking system: household deposits total M2,482 million, out of a total deposit base of M6,239 million. Household deposits have also been growing rapidly, having increased by 13% in the year to June 2013.

Formal savings substantially higher amongst urban dwellers. The uptake of savings is higher in the urban than the rural areas (66% versus 52% of adults respectively). The discrepancy is primarily driven by substantially higher rates of saving with formal institutions in urban areas (51%) than rural areas (25%). Total informal savings (25% of urban dwellers, 31% of rural) and total saving at home (17% urban, 14% rural) are both relatively similar across the two areas. The discrepancy in formal uptake, therefore, suggests urban dwellers may have easier access to formal savings products. This is likely due to a combination of a greater proportion of salaried workers (which have greater access to formal institutions) residing in urban areas and the easier physical access that urban dwellers have to formal products as formal institutions are situated within urban areas.

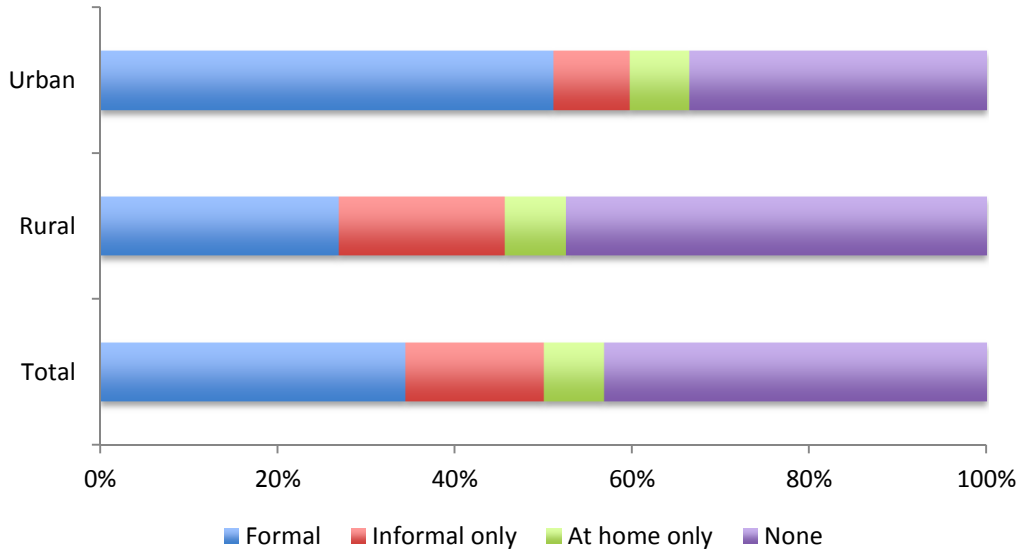


Figure 45: Savings mechanisms/products (% of adults using)

Source: FinScope, 2011

Multiple forms of savings used. Many people use multiple forms of savings, combining savings with a bank, savings with a community savings group, and savings at home. FinScope (2011) estimates that 45% of savers save in more than one form of savings category. For

example, it is estimated that around half of those who save with an informal savings group also save with a bank.

Taking into account multiple uses, formal types of savings still dominate. However, use of informal savings institutions is almost as important in terms of the number of adults served.

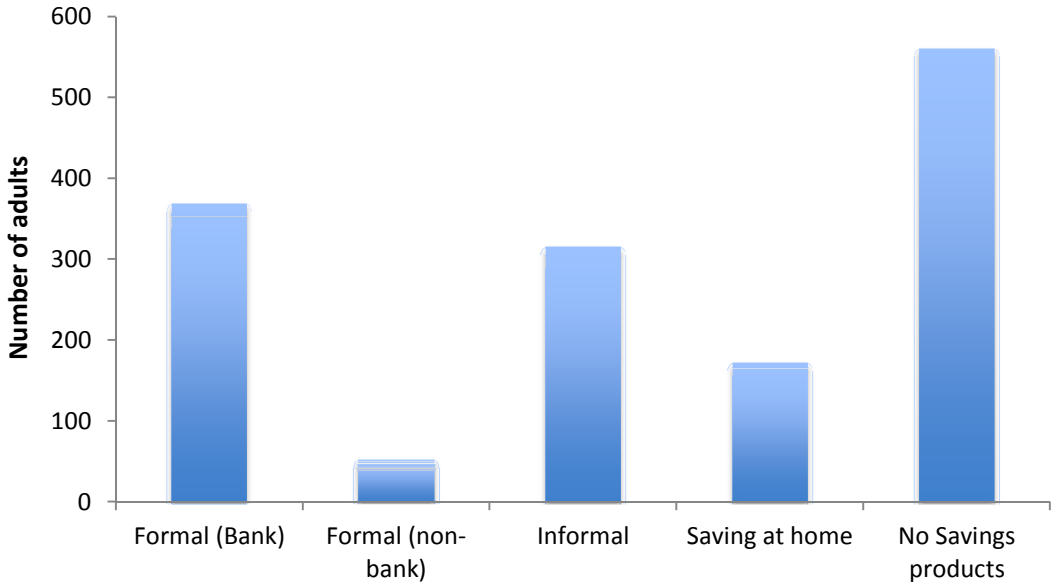


Figure 46: Use of savings institutions (including overlaps)

Source: FinScope 2011

Higher income groups save more. The level of savings varies considerably across target markets. However, there appears to be a clear relationship between savings and income levels. Over 80% of salaried workers, the target market with the highest income level, save. Comparatively, only 40% of piece job workers, the target market with the lowest income level, save. For the other target markets, the proportion of adults who save is also correlated to the average income level of the target group as shown in Figure 47 below. The primary implication of this finding is that the lower income earners may simply be too poor to save.

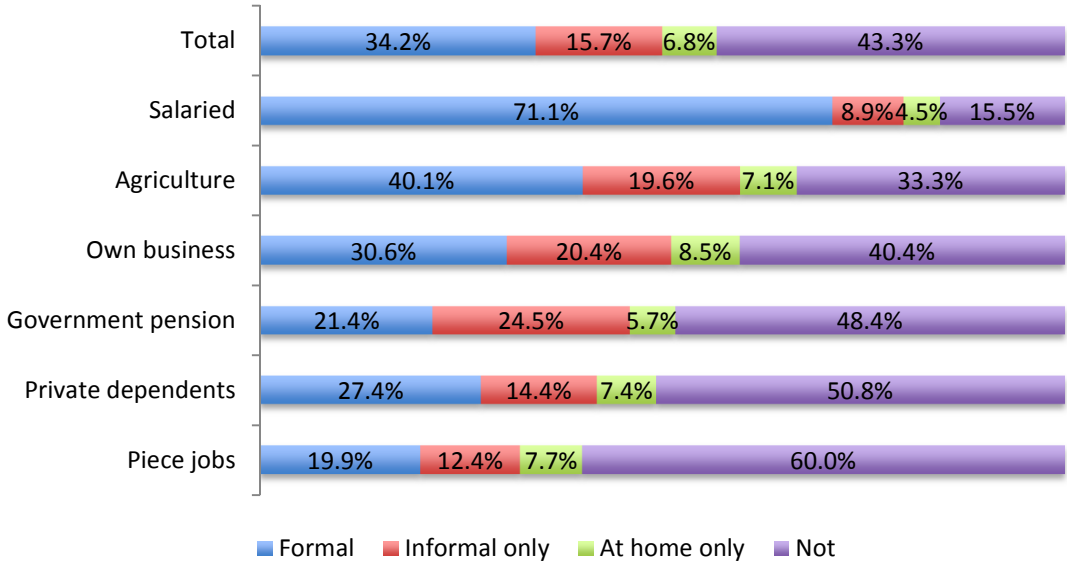


Figure 47: Use of savings channels by target groups

Source: FinScope 2011

All target markets saving with both banks and through informal channels. Although banks and other formal institutions are often considered to be mainly for the formally employed, they in fact cater for a wide range of customers. Only a third of those who save in banks are from the salaried target group, with the remaining two-thirds spread across the other groups, as shown in Figure 48 below. In particular, private dependents make up over 20% of the customer base of banks.

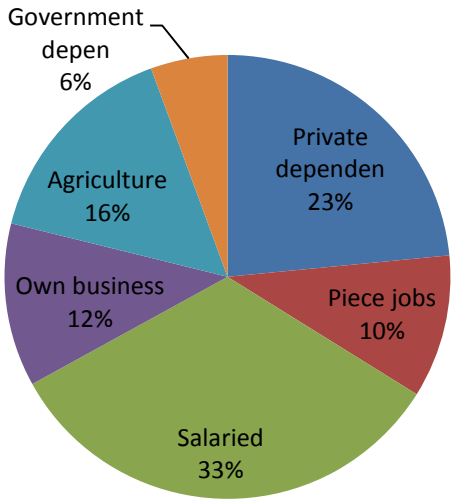


Figure 48: Breakdown of bank clients between target markets

Source: FinScope, 2011

Figure 49 below, shows that the proportion of a target market saving with a bank is strongly correlated with income, whilst the proportion of a target market saving with an informal

savings group is weakly correlated with income. The figure indicates that the wealthier target groups do not only save more with banks, but also with savings groups. This indicates that barriers to entry to the informal savings groups, in the form of joining fees and compulsory monthly contributions may exclude some of the lower income earners from saving even with informal groups.

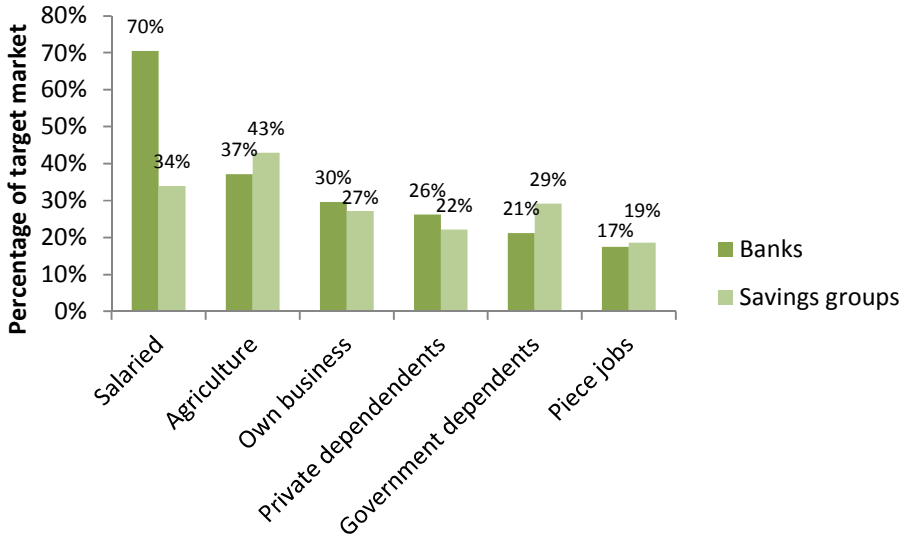


Figure 49: Proportion of target markets saving with banks and savings groups

Source: FinScope, 2011

6.3.2. Use Cases

Savings are defined in the FinScope survey as "safeguarding and accumulating wealth for future use". By implication this refers to financial savings, which is somewhat narrower than the economic definition of savings that would include the direct accumulation of physical assets (such as housing, cattle etc.).

There may be a number of different motivations for savings, which can be classified into the following five categories:

- Consumption smoothing
- Risk mitigation
- Education
- Capital accumulation
- Retirement

The FinScope 2011 survey results describe the relative importance of the various use cases for Basotho adults:

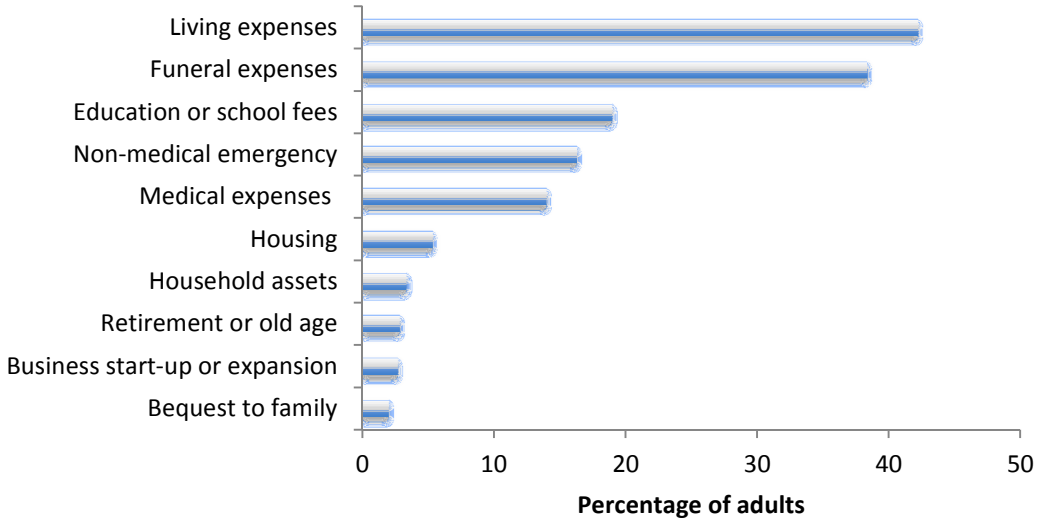


Figure 50: Reasons for saving for Basotho adults who save

Source: FinScope, 2011

Consumption smoothing. Figure 50 above, shows that the greatest use of savings is to meet living expenses. 42% of Basotho who save indicate that they save in order to cover their living expenses i.e. smoothing their consumption between income receipts. This is a particularly important function in Lesotho given the large proportion of adults that earn their income from infrequent and/or irregular sources such as farming, piece work, remittances and even government grants which are only distributed once every three months.

Risk mitigation. The use of savings to mitigate risks is a commonly cited purpose of saving in Lesotho. 38% of Basotho who save indicate they save for funeral expenses, whilst 16% save for a non-medical emergency and 14% for medical expenses (FinScope, 2011). Using savings to mitigate risk would be used across all target markets.

Education. According to FinScope (2011), 19% of Lesotho adults that save, save for education or school fees. Education may be considered by many Basotho as a vital investment to improve the situation of their children and by extension themselves:

> "My dream is to see my kids educated and get good jobs."
>
> *Maseru, female, 25-40 years. KLA (2014)*

However, saving for education is likely higher amongst higher income target markets which are more likely to be able to afford to save for this purpose:

> "I have 6 children, but because I am struggling in my business (fruit and snack stall in the

market) only the younger ones go to school."

Maseru, Female, Aged 41-55 years. KLA (2014)

Capital accumulation. Saving invested in a business, a home or an asset can all be considered as investments or capital accumulation. Figure 50 above, shows that 5% of savers invest in buying or building a dwelling, whilst 3% save for household goods. 3% of Basotho savers also save to invest in their business.

Retirement. Long term savings for retirement can be considered lifetime consumption smoothing as savers save their surplus from when they are earning an income to support them when they are no longer earning an income. FinScope (2011) indicated that 3% of savers save for retirement and old age.

6.3.3. Providers

There are a wide variety of institutions offering savings facilities for households in Lesotho. These are classified below into two categories: formal/regulated institutions and community-based organisations.

The approximate reach of the various types of savings providers is as follows:

Type of institution	Approx. no of customers	Source/comment
Formal/Regulated institutions		
SLB	285,000	SLB, 2013
FNB	125,000	FNB, 2103
Nedbank	55,000	Nedbank, 2103
LPB	72,000	LPB, 2013
All banks	537,000	FinScope 2011
All banks (savings accounts only)	368,000	FinScope 2011
Pension funds	45,000	Estimate, based on data from PODCPF, 2013
TEBA	22,000	Current number of mineworkers in SA
Mobile money	500,000	Total MM subscribers, Feb. 2014 (CBL)
Community-based institutions		
Boliba	39,000	Boliba, 2013
RUFIP SACCOs	525	RUFIP data, 2013
Other SACCOs	n/a	

Type of institution	Approx. no of customers	Source/comment
RUFIP RSCGs	433	RUFIP data, 2013
Other NGO-supported groups (RSCGs, VSLAs etc.)	2,276	RUFIP data, 2013
Informal groups	304,500	FinScope 2011

Table 17: Product / institution characteristics

Each of these groupings is discussed further below

6.3.3.1. Formal / Regulated Institutions

Banks the primary formal providers of savings products. Banks have the largest number of savers amongst Lesotho's savings providers with FinScope (2011) estimating that more than 350,000 adults save with banks. SLB accounts for more than half (53%) of total bank clients The banks also account for the largest proportion of deposits among savings providers with total deposits of M6.4bn, equivalent to about 25% of total GDP. SLB accounts for 60% of the market share of deposits.

LPB has a greater focus on low income and rural consumers. LPB was initially established primarily as a savings bank and retains this focus. The bank has the largest share of low income savings and the greatest outreach to rural areas amongst the four banks, aided by the wide existing network of post office branches (de Klerk, 2014). The difference in the profile of depositors across the four banks is clearly illustrated below in Figure 51, which shows that LPB, followed by FNB, have the lowest average deposit value per customer. This indicates that these institutions have relatively lower-income consumers which save relatively smaller amounts. In contrast, Nedbank's average deposit per customer is more than 8 times higher than LPB's suggesting a restricted focus on corporates and high net worth individuals.

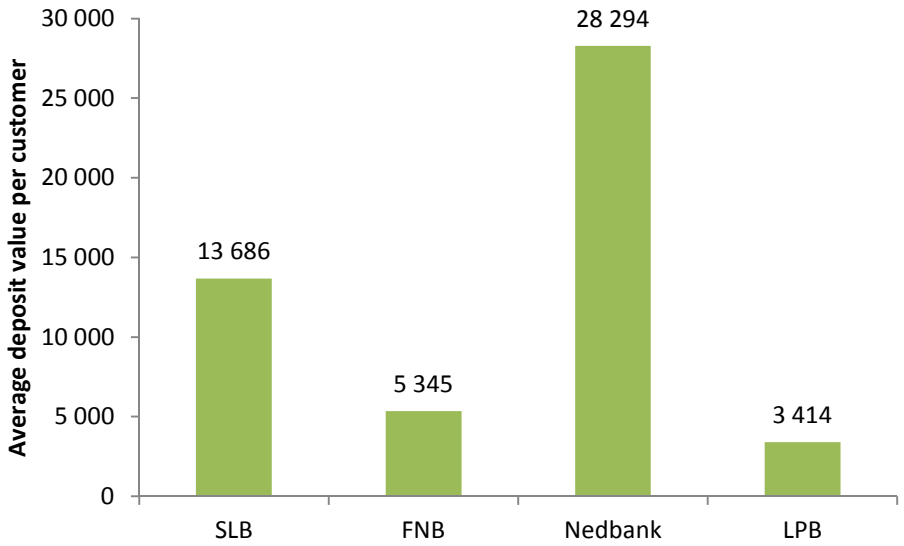


Figure 51: Average deposit value per customer across the banks

Source: Consultations with the banks, 2013

Public pension fund a major long-term savings vehicle in Lesotho. Pensions are an important vehicle for savings, particularly long-term savings in order to meet the "retirement income" objective of savings noted above. The most important pension fund in Lesotho is the Public Officers Defined Contribution Pension Fund (PODCPF), which was established in 2008, and has its own Act. The PODCPF is a contributory, defined contribution fund, covering most government employees, with both employer and employee contributions. The PODCPF has around 35,000 members, and around M2.5 billion in assets[76]. A second pension fund covers a range of statutory bodies (parastatal employees), and there is a range of private occupational funds.

Lesotho pension sector smaller than regional contemporaries. Previous estimates[77] suggest that there are perhaps 150 pension funds with 40-45,000 members and around M3.5 billion in assets. Relative to other SACU countries, this makes the Lesotho pension sector the smallest (in relation to GDP). However, in some companies, employees are simply enrolled in the pension funds of their South African parent, and the extent of this is unknown. Pension fund coverage is probably in the region of 35% of those in formal employment. However, this overall figure masks a major divergence between coverage in the public (government/parastatal) sector, where it is very high, and in the private sector, where it is probably very low.

Compulsory national pension fund proposed in response to low pension coverage. Consultations with the Ministry of Labour and Employment (2013) indicated that, in response to low pension coverage in the private sector, particularly amongst the lower paid, Government has, with the assistance of the ILO, recently proposed the establishment of a national, statutory, contributory pension scheme, as part of a broader social security reform. It is particularly aimed at employees of the many textile and garment firms in Lesotho. In principle, all those in formal employment would be compelled to join the new scheme.

[76] Information obtained directly from the PODCPF
[77] As contained in an unpublished report by the IMF in 2009

However, it is not yet decided whether this will apply to members of the PODCPF, nor has there been any evaluation of the likely impact on other existing pension funds. The ILO considers that membership of the new scheme needs to be as broad as possible, in order to achieve scale and efficiency, but this would probably be a death-knell for existing occupational pension schemes. Given that the majority (around 75%) of the employed / working population is engaged in informal employment or subsistence agriculture, the mandatory membership component of the new scheme would reach a relatively small proportion of the labour force. There is a suggestion that membership of the new scheme would be available on a voluntary basis for those in the informal sector, but the policy will need to consider how this can work on a flexible and cost-effective basis. These plans remain at a relatively early stage of development and as such no details have been defined yet.

Type II institutions a prospective class of deposit takers. The FIA makes provision for the licensing of various deposit-taking institutions besides commercial banks. These "Type II" financial institutions include large financial co-operatives, deposit-taking MFIs and savings banks, with a capital requirement of M10 million. However, regulations governing the licensing, operation and supervision of such institutions have yet to be finalised, and hence there are currently no institutions in these categories. No proposals have been made for the establishment of savings banks. However, it is understood that several lending-only institutions are keen on extending to deposit-taking operations, including Letshego and Moliko Trust.

Boliba classified as a type II institution but not registered. One financial institution falls into the category of large financial co-operative – Boliba Multipurpose Co-operative. Boliba operates a substantial savings and credit co-operative, although it is not technically registered as such. Boliba has total deposits of around M83 million, and has three branches and one agency.

South African banks effectively a savings provider for Lesotho citizens. Given the close economic relationships between Lesotho and South Africa, and the high level of cross-border migration to South Africa, it is likely that significant financial savings are held by Basotho in South Africa. This is driven by higher interest rates on savings deposits in South African banks as compared to Lesotho banks, which provide an incentive to save across the border[78]. It is difficult to obtain firm information on the extent of cross border savings. Anecdotally, it is reported that many Basotho resident in Maseru and other border areas have South African bank accounts. Furthermore, many Basotho have legal residence in South Africa, and also hold bank accounts there[79]. FinScope indicates that about 10% of bank account holders have South African accounts, either exclusively or in complement to a Lesotho account.

TEBA acts as a saving vehicle as wages are accumulated. As reported in the Payments & Remittances section, the value of cross-border remittances through Ubank/TEBA is very high. These remittances represent savings accumulated in South Africa and paid across to Lesotho. On the (arbitrary) assumption that savings are accumulated over a 12 month

[78] One of the banks noted that it paid 0.5% on a particular deposit product, while across the border in Ladybrand the same product earned 3% interest.

[79] It was reported that many Basotho have South African citizenship and passports/ID cards, even though this is illegal under Lesotho citizenship rules. One consequence is that some pensioners are reported to collect pensions in both Lesotho and South Africa.

period, and fully remitted to Lesotho at the end of that period, the average level of Basotho savings in Ubank would be half of the level of annual remittances, or around M875 million.

6.3.3.2. Community-based organisations

Informal savings relatively low in value but significant. The qualitative demand-side research (KLA, 2014) indicated that the average informal monthly savings contribution across the sample is about M450 per month. Extrapolating this amount to all savers would render an estimated total informal deposit book of about M400 million[80]. This constitutes about 6% of total bank deposits and about 15% of total household financial savings in banks.

Variety of community based savings groups. There are a large number of community-based savings associations in Lesotho. These include rural savings and credit groups and SACCOs established under the auspices of RUFIP and various NGOs. Most of these groups have both savings and credit functions, acting as local intermediators of deposits.

Require monthly contributions Most of these informal groups require a joining fee and a specified monthly contribution from each member. Qualitative demand-side research indicated that even if money is tight, respondents tend not to miss paying their contributions and would rather cut out other expenses (KLA, 2014). However, this requirement may act as a barrier to very low income individuals and those earning irregular income, hence the higher uptake amongst higher income groups as illustrated in Section 6.3.1.

Groups also act as social support structures. Aside from the financial benefits of saving with the community-based organisations, qualitative market research indicated that membership to the societies provides communal and social support where members can turn to one another for emotional assistance (KLA, 2014).

Many groups have a limited life-span. Indications from qualitative research is that the average society has a life-span of only two or three years. With the society's funds being kept by the treasurer or rotated amongst members, there is a risk of the money being stolen. Similarly the group runs the risk of non-repayment of the money it lends out to members (KLA, 2014).

Box 10. How do VSLAs work in Lesotho?

According to the consultations, loan officers run a nine month training programme for groups on group leadership, saving, loans, repayment and sharing out of funds. Members are required to save monthly with the VSLA and amounts saved depend on levels of affordability for individual members. Savings are distributed among members at the end of the loan cycle (approximately one year). The maximum amount loaned is three times the amount saved. Although the target market has low and uncertain income, repayments rates were good. If a group member experiences challenges in repaying the loan, the other members will assist in raising funds. Money from the saving fund is also

[80] Calculation for the total market for savings was based on the number adults reporting being a member of an informal savings club in FinScope and multiplied it by the average savings per month multiplied by 6 (to take account of the accumulation of savings. Most informal savings groups have a savings period of one year and hence the average total deposits for the entire year will be the value of deposits after 6 months). Note that the resulting estimates are indicative only.

used to pay back the outstanding loans on the death of a member.

Besides the savings and lending activities, groups contribute M10 to M30 per month to a social fund. The social fund is used to assist members in emergencies (e.g. if house burns down or for funerals). At the end of the loan cycle the social fund is closed and the remaining funds used for charity and community upliftment projects.

Linkages with banks did not work well for VSLAs. CARE attempted to work with Postbank, but was unable to get the partnership working before the project was phased out. Postbank was reluctant to work with VSLAs because they were considered too risky. Other challenges included bank charges being too expensive for VSLA groups and a lack of banking infrastructure in the more rural areas. Money is therefore stored in a savings box where keys are given to three members. Although there is a risk to the security of funds there have been few instances of theft. There was once a case of theft of funds when the three key- holders conspired and once case of attempted theft.

6.3.4. Products

6.3.4.1. Flexible savings

The majority of bank savers save in short-term flexible savings accounts and many may also use these like a transaction account.

Low interest returns. Deposit interest rates on flexible savings accounts are generally low – less than 1.0% p.a. - offering little reward to those who have surplus funds for discretionary savings. This compares with 3-4% for similar accounts in South Africa.

Increased bank credit may lead to higher interest paid on deposits due to competition. One of the reasons for the low deposit interest rates in Lesotho is that banks have conventionally been very liquid. With low loan-to-deposit ratios, there has been no real incentive to mobilise additional savings, through paying competitive interest rates that would attract additional deposits. This contrasts with South African banks, which conventionally have a liquidity shortage, and hence an incentive to mobilise deposits and pay higher interest rates. However, as discussed in section 6.1, bank credit has grown rapidly in recent years. Should this trend continue, Lesotho banks may soon be in a situation where they need to mobilise additional savings in order to continue increasing their (profitable) lending business. This could fundamentally change the savings environment, as banks will need to compete for deposits.

Opening balance requirements fairly low. The minimum opening balance requirements on entry-level Lesotho savings accounts are relatively modest, ranging from M40 – M200. Some savings accounts also come with the added functionality of ATM cards and access to cellphone and internet banking, although this varies between banks.

Some bank's fees similar to mobile money on savings accounts. Despite bank fees being perceived as high in the qualitative research, analysis of the fees related to entry level savings accounts, as shown in Table 18 below, indicates that fees on these accounts are not very high at all banks. Saving in mobile money accounts, with zero deposit or service fees

and lower withdrawal fees yields a better return than the 'average' bank account for low cost savings, with a 10% better return despite not paying interest. However, two of the banks – SLB and FNB (only SLB is illustrated in Table 18) – do not charge either deposit or service fees on their entry level savings accounts. This means that the return on these accounts will be almost identical to saving in a mobile money account, with SLB actually providing a marginally higher return in the example used in Table 18 below. The low interest rate earned on bank accounts and absence of interest on mobile money accounts, however, means that saving through either channel results in a loss in the real value of the savings due to inflation.

	Entry level bank savings account		Mobile money	
	Weighted average[81]	Standard Lesotho Bank	Vodacom m-pesa	EcoNet EcoCash
Monthly deposit	M50	M50	M50	M50
Interest earned (p.a.)	0.22%	0.25%	0	0
Total deposits during the year	**600.00**	**600.00**	**600.00**	**600.00**
Less total annual deposit fees (1 deposit each month)	(27.80)	0.00	0.00	0.00
Annual interest compounded monthly	0.64	0.81	0.00	0.00
Less total annual service fee (monthly charge x 12)	(37.99)	0.00	0.00	0.00
Less withdrawal fee	(6.31)	(4.60)	(5.06)	(5.00)
Nominal value of savings at yearend	**528.55**	**596.21**	**594.94**	**595.00**
Real value of savings at year end adjusting for inflation (less 6.3%)	**495.25**	**558.65**	**557.46**	**557.52**
Percentage of initial deposits left at the end of 12 months	**82.5%**	**93.1%**	**92.9%**	**92.9%**
Percentage of initial deposits (not adjusting for inflation) at the end of 12 months	88.1%	99.4%	99.2%	99.2%

Table 18: Estimated value of savings of monthly savings in banks and mobile money after 12 months of contributing E50

Source: Mystery shopping, 2013 and Supply side consultations, 2013

[81] This is calculated on the average weighted average costs across the four banks' entry level savings accounts based on the market share of consumers

Mobile money has non-expense benefits over bank accounts. A major advantage of saving with mobile money rather than with banks is the greater distribution network of mobile money agents. For regular low value savings contributions, travel costs from a rural are to access banking infrastructure may constitute a major proportion of the value of the savings. Furthermore, accessing mobile money has fewer barriers to entry than bank accounts in terms of reduced KYC requirements and no proof of employment or income requirement.

Cash widely used for saving. Although not strictly a product, cash is one of the most widely used savings instruments in Lesotho. In total, 17% of adults (175, 000 adults) in Lesotho save at home in cash (FinScope, 2011). In particular, saving in the form of cash is convenient, has no entry barriers or no transactions costs, and is very liquid. However, it is also risky (vulnerable to loss and theft), earns no return, and the liquidity that is useful can also be a drawback, as it can easily be depleted. In an environment where inflation is an issue, cash also loses real value quickly. Many of those that only save at home may do so as they do not have access to alternative savings products as even informal savings groups require an initial joining fee and a regular, usually monthly, contribution which may exclude the lowest income earners and irregular income earners such as the farmers, piece job workers and private dependents.

6.3.4.2. Fixed term savings

Pension savings have relatively high returns, benefit from tax benefits and act as a commitment device. The long-term nature of pensions means that they can be managed and invested so as to earn higher returns (compared to, say, bank savings deposits). In Lesotho, as in other countries, pension contributions are also exempt from income tax, although pension income is taxable. Furthermore, as contributing to a pension fund is often a contractual commitment (as part of an employment contract), it is effectively a form of non-discretionary savings, and therefore acts as a commitment device "forcing" people to save. Savers value the commitment device offered by inflexible savings products such as pensions which tie them into savings and ensure that the lump sum is not spent. A number of studies, including Kast et al. (2012), Goss et al. (2011) and Militzer (2014), find that people find it difficult to save by themselves due to self-control problems. Where there is easy access to savings it is difficult to build up amounts over time as there are always competing priorities. Despite the in-principle attraction of pensions, low incomes and limited formal employment means that the reach of pension products is limited in Lesotho.

Fixed bank savings products. Apart from short-term, flexible savings accounts, the banks also offer longer-term, fixed term savings such as fixed deposits. However, these products are not widely used. FinScope (2011) indicates that just 1% of adults have a fixed deposit and less than 0.5% of adults have a notice deposit/call account.

Boliba offers long term savings products to members. Boliba has approximately 39,000 account holders. There are three classes of membership: Class A – founder, voting members; Class B – non-voting members; and Class C – "entry level" members. Full membership requires a contribution of M10,000, while Class C "members" – the majority – require a contribution of M50. Boliba offers both ordinary savings accounts and investment accounts (fixed deposits).

Informal savings group require fixed term savings from members. Different informal savings groups may have different structures and serve different needs. However, the qualitative research indicates that there are two primary structures, both of which effectively constitute an informal fixed term savings product:

- Rotational savings societies, in which all members contribute each round (usually a month) to a central pool which is then given to a different member each round.

- Accumulated savings societies, the more common form of informal savings groups, operate with members contributing throughout a defined period, such as each month for a period of a year. This money is then distributed equally to members at the end of the period. Frequently the central pool is loaned out, as discussed in section 6.1, in order to earn a return on members' savings. VSLAs fall within this category.

6.3.5. Accessibility barriers

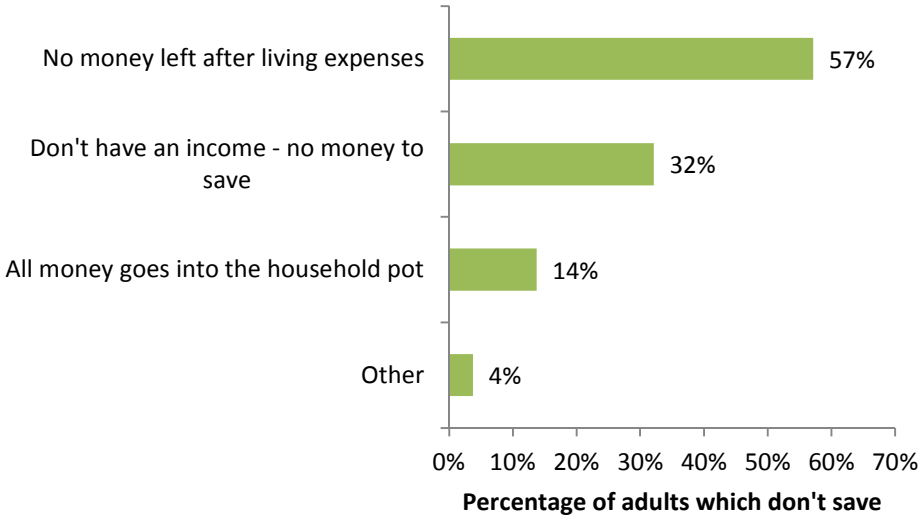


Figure 52: Reasons adults do not save in Lesotho

Source: FinScope, 2011

Lack of excess income the primary reason for Lesotho adults not to save. Figure 48 above, shows that the primary reasons for not saving amongst Lesotho adults that do not save is not having insufficient excess income after living expenses, or having no income at all.

Perception of high bank fees. The qualitative demand-side research revealed that many Basotho believe bank fees to be high, even though analysis in Section 6.1.4. above indicated that these fees may not be substantial in practice for entry level savings products. There is a belief amongst many Basotho that bank charges eat into one's capital, thereby depleting one's cash reserves. In contrast, monthly contributions to informal savings groups are not viewed in the same light as these contributions directly contribute to members' payouts at the end of the period (KLA, 2014).

"The main reason why we have all kinds of savings group is to avoid having to seek

help from financial institutions, because banks always have some type of interest when you borrow money from them. When I join these savings groups, and need to borrow money, yes I will pay interest but at the end of the year I know that I will also benefit from the interest that I have paid back into our savings. Some savings help us because at the end of the month we buy groceries with that money which has accumulated interested and there are also those savings groups where we share the money amongst each member."

Maseru, Male, 25-40 years (KLA, 2014).

Doorstep barriers to banks highlighted in qualitative market research. Most qualitative respondents indicated that they are of the opinion that they are not the target market of banks and therefore they do not even investigate savings options at the banks (KLA, 2014). At the same time, banks have some positive characteristics. In particular, they are perceived to be very safe (FinScope (2011) indicates that 84% of Lesotho adults trust banks with their money), and suitable if the objective is to save a large amount of money (FinScope (2011) indicates that 86% of Lesotho adults would put a large sum of money they received into a bank, compared to just 1% who would put it into an informal savings club).

6.3.6. Regulatory Issues

The following regulatory issues impact on the market for savings:

Mobile money operators restricted from offering interest on products. The current mobile money Guidelines issued by the CBL state that it would not be permissible for a MM operator to offer interest and hence are therefore unable to offer a savings wallet as part of their suite of products, even though technically it is quite straightforward and there is nothing that prevents e-money from earning interest. This does not restrict subscribers from using the current mobile money products as zero interest savings accounts. However, The Lesotho Financial Sector Development Strategy (FSDS) recognises that mobile money products can play an essential role in extending financial inclusion and providing low cost options for savings products that will help to fill the gap left by the banks and other formal institutions. The FSDS, which has been accepted by the CBL, addresses this by proposing that a new licensing category is introduced into the FIA that specifically accommodates deposit-taking e-money issuers; this would be suitable for non-banks – including MNOs – and would allow the provision of card- or phone-based savings products. The new licensing category would deal with concerns about the encroachment of MM into the banking space, and by providing a definitive regulatory basis for such products it would encourage their rollout and access for the unbanked.

Proposed agency banking regulations may be overly stringent and create a non-level playing field. Agency banking offers a potentially attractive mechanism for banks to extend their services – including savings – to more remote and less sparsely populated areas. However, the agency banking regulations being proposed under the FIA impose quite strict requirements on banking agents, which may preclude the rollout of agency banking. Some banks consider that the more stringent conditions applied to the appointment of agents by banks as compared to the appointment of mobile money agents is creating a non-level

playing field, to the disadvantage of banks. This issue applies to transaction banking as well as saving.

Stricter KYC requirements for banks than mobile money. A related concern is that stricter KYC requirements are applied to banks than to MM operators. For instance, the MM guidelines provide for tiered-KYC which allows low value accounts and transactions to be carried out without requiring proof of ID or address; however, this is not possible for banks, which have to implement full KYC requirements for all accounts. The KYC requirements to access bank accounts are also a significant barrier to many Basotho and hence the lack of an exemption for low value accounts for low income earners excludes many from accessing banks' products. This is relevant for the savings market, as well as for the payment and credit market insofar as bank services are concerned.

Regulatory oversight of Boliba to shift from the DoC to the CBL. The movement of Boliba to regulation under the FIA and the associated transfer of regulatory oversight from the DoC to the CBL should help to stabilise Boliba and reduce the risks to depositors. However, it requires appropriate regulations to be developed by the CBL, and a careful transition plan.

6.3.7. Gaps and Opportunities

Mobile money represents a low cost, accessible alternative flexible savings product. With zero deposit and monthly service fees, mobile money is a cheap alternative to saving with a bank. There are also many more mobile money agents than banking infrastructure, making mobile money more accessible to many Basotho than banks. This is particularly relevant for those residing in the rural areas, for whom the cost of travelling to access the relevant banking infrastructure in urban areas to make regular savings deposits may constitute a substantial portion of the value of their savings. Furthermore, the tiered KYC requirements for mobile money make it more accessible to those that are unable to meet these requirements in order to save in a bank. Saving with mobile money eliminates the risks associated with saving in cash at home, as people excluded from saving with a bank would frequently be forced to do. Mobile money can improve the efficiencies of low value savings for all target markets, except the salaried workers which already have access to bank savings products, particularly those residing in rural areas.

Potential role for banking agents to overcome distributional challenges. One of the primary challenges to extending bank savings products to rural areas is the absence of physical bank infrastructure in remote areas. The introduction of banking agents may help overcome this distributional issue for rurally based savers.

Larger deposit balances can benefit both banks and consumers. As indicated in section 6.2, many of those individuals with bank accounts may use them as mailbox accounts. This means that the deposit balances are low over time and not used to accumulate savings. The international GAFIS (2013) study looked at banks across five developing countries and found that banks make a substantial loss on dormant accounts or accounts with a low balance. The rapid growth in bank credit (as discussed in section 6.1) adds to the imperative for Lesotho's banks to raise greater deposits. Incentivising clients to maintain higher deposit balances would therefore be of significant benefit to the banks.

Long-term goal oriented savings induce an important commitment device. Long term savings products explicitly targeted at specific goals represent a powerful commitment device for savers, potentially helping to induce greater usage and uptake of savings. Education was identified in section 6.3.2 above as the third most widely cited savings need, which represents the ideal basis for a goal-oriented savings product. For example, the education product may allow irregular deposits throughout the year but only permit withdrawals in January, when school fees are due. Similar products may be valuable for small business owners or farmers saving for start-up capital or additional capital investment.

Informal savings group a powerful savings mechanism. Savings group fundamentally work on a medium to longer-term goal-oriented basis with the groups typically saving up for a year with one pay out at the end of the year to pay for school fees, groceries , livestock or business stock.

> "This helps because at times there are certain things you would like to do but with the salary you get it makes it impossible for you to achieve these things, and if you save on your own it will take you much longer for you to get these things. So when it's your turn to get the money it's easier for one to fulfil their prolonged needs. For example if you have always wanted to buy a fridge but couldn't afford to such groups make it easier for you to meet those needs."
>
> *Maseru, Male, 25-40 years (KLA, 2014).*

Given the distributional challenges facing formal providers to reach many rural areas, savings groups represent an effective mechanism for many Basotho to save, even despite some of the challenges facing these groups. The strength of the collective society mentality in Lesotho is reflected in the success of many such savings groups and particularly in the widespread use of burial societies. Conversely, many of the NGO and government supported community savings groups, particularly through RUFIP, have struggled to survive, indicating that government and donors may be better equipped to play a less direct, more facilitative role when engaging with savings groups.

The table below summarises the opportunities and challenges to be overcome for the various types of savings products in Lesotho:

Institution / Product	Main target group	Pros	Cons
Banks • Interest-bearing savings accounts	• All	• Safe/secure • ATM/POS debit card (some) • Interest earning	• Branches inconvenient (location/queues) • Monthly fees (some) • Transaction fees • Entry criteria (KYC) • Low interest rates (cf. SA) • Non-interoperable debit card (LPB)
Boliba • Interest-bearing savings accounts	• Low-income salaried • Piece jobs • Dependents	• Perceptions "ours" - member-based, Basotho-owned • Passbook-based	• Risk of loss of funds • Governance • Restrictions on new membership

Institution / Product	Main target group	Pros	Cons
			• No debit cards • Monthly fees • Low interest rates • Limited outreach (few branches, no ATMs/POS)
Mobile money • De facto savings accounts (no interest)	• All	• Tiered KYC (easy account opening) • No monthly fees • Low transaction fees • Convenience (phone) • Agent network	• No interest paid • Agent liquidity
SACCOs • Interest-bearing savings accounts • Profit sharing	• Salaried	• Member-based • Any surpluses recycled to members • Linked to employment (some)	• Poor management • Poor supervision • Fail to meet regulatory requirements • Loss-making? • Risk of fraud

Table 19: Characteristics of savings institutions and products

Source: Authors' own

6.4. Insurance

Insurance, and in particular funeral cover, is the most-consumed financial service in Lesotho for nearly all of the target groups and contributes significantly to the financial inclusion figures in Lesotho. The following section discusses the insurance market in Lesotho; providing an overview of the main insurance needs among the population, current usage, as well as of the product and provider landscape. The section also discusses access barriers and opportunities for improving uptake and value to consumers.

6.4.1. Current usage

High uptake largely driven by funeral insurance. According to FinScope 2011, 62% of the adult population has some form of insurance. 99.5% of all those with insurance cover (formal or informal) have funeral cover. Total uptake of other types of insurance is very limited: only 1% of adults have medical or injury insurance and only 2% have life insurance and pensions, respectively. Most of them also have funeral cover. Usage is significantly higher in urban areas, where formal penetration is 48.1% as compared to the 31.8% in rural areas. In turn, informal-only usage is much higher in the rural areas (30%) than for urban dwellers (11.4%).

Informal provision fulfils an important role. Formal insurance reaches 37% of adults and a further 25% has only informal cover from burial societies. Note that it is not possible to distinguish cover from funeral undertakers (most of which is informal in the sense of not being underwritten by a licensed insurer) from the FinScope usage figures. It is probable that such cover was reported under formal insurance uptake by survey respondents. It is not included in informal cover, as the survey question relating to informal cover only covered burial societies and limited other instances such as an agreement with a church.

Almost all target market segments well-served. FinScope 2011 shows that usage patterns vary across the target groups. Not surprisingly, salaried workers stand out, with almost 70% having formal insurance. However, it is notable that formal insurance penetration is remarkably high even among those without formal employment. This is largely accounted for by the popularity of funeral insurance, as explained above. Piece job workers have the lowest consumption level, at 15% formal usage and 52% excluded. This is largely due to low but also irregular income, which makes it difficult for them to meet regular payment demands for premiums.

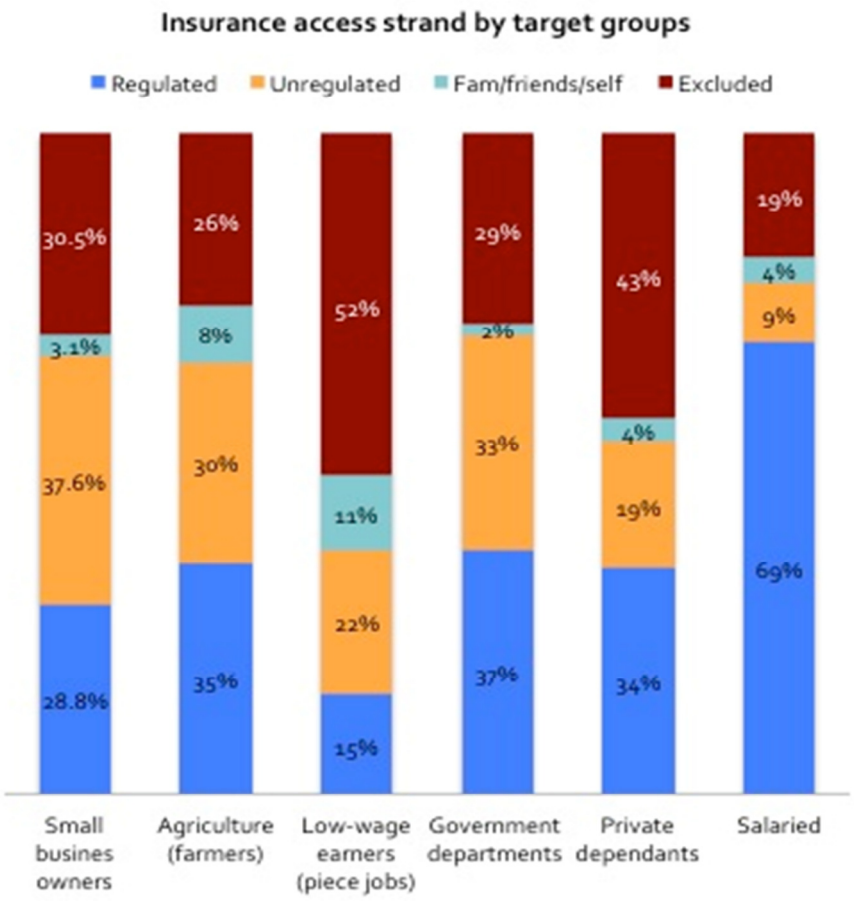


Figure 53: Usage of insurance

Source: FinScope 2011

In addition to taking out funeral cover, the qualitative research showed that borrowing from machonisas and (licensed) moneylenders for funerals is common among respondents. They tend to use more than one strategy to cope with death, indicating that their current level of cover may not be sufficient to cover their full risk exposure.

6.4.2. Use cases

The qualitative and quantitative demand-side research provides insight into the use cases for insurance.

Risk of death the only significant current use case. Death is the risk that qualitative respondents worried about most, and accounts for the high levels of uptake and usage of both formal and informal funeral insurance. Figure 54 shows that funeral cover cuts across income bands. Other products are only consumed, in low proportions, by consumers in the higher income bands. This was confirmed by the qualitative demand-side research.

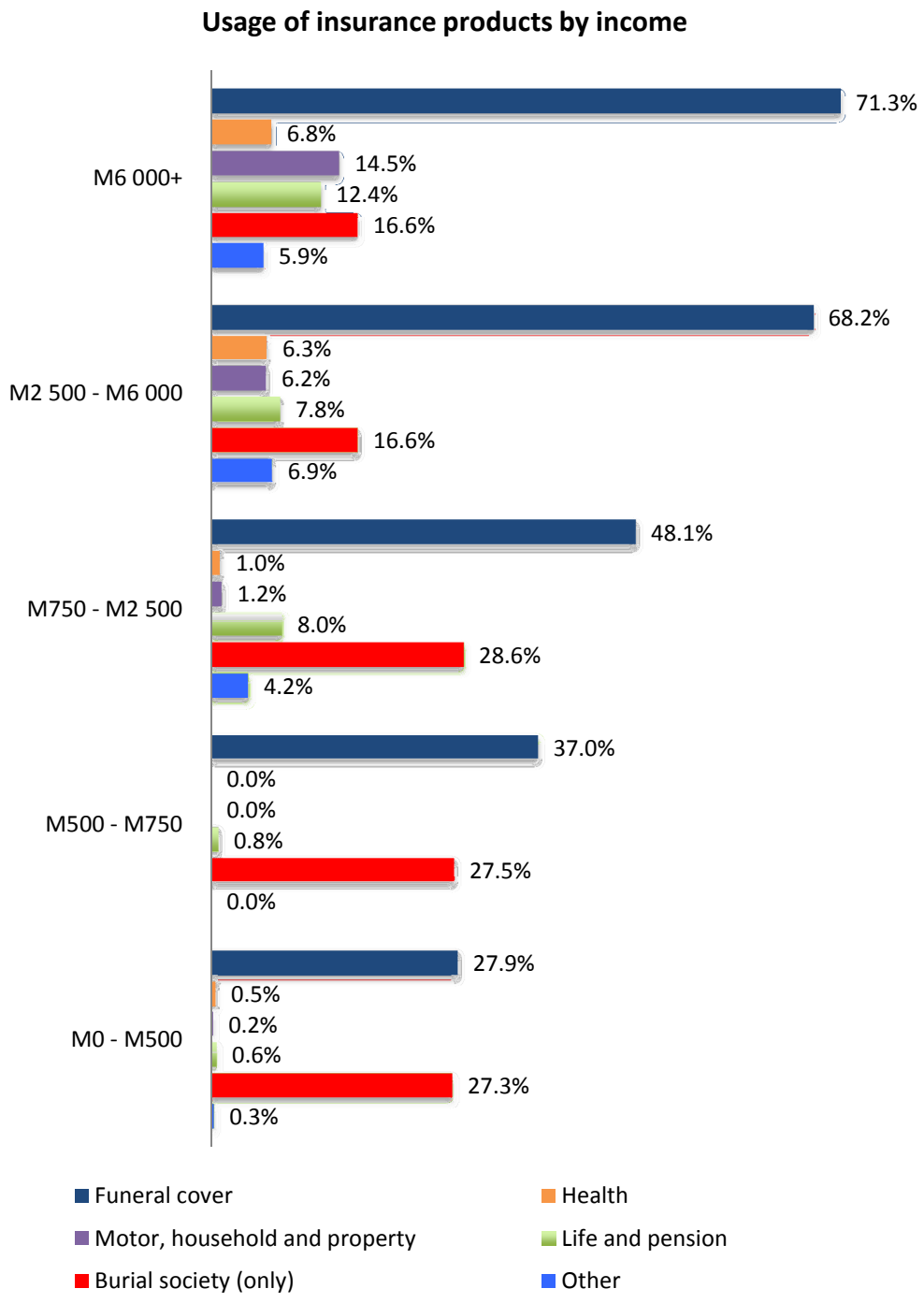


Figure 54: Usage of insurance products by income

Source: FinScope 2011

Albeit based on a small sample, the qualitative demand-side research suggests that people are willing to spend a substantial proportion of their income towards funeral insurance. Respondents with insurance spent between 9% and 27% of their monthly income on premiums.

Potential health use case. Though funeral insurance is the only product currently used to any significant extent, it does not mean that other insurance products cannot potentially add value. Most notably, 25% of adults in the FinScope survey indicated that they had incurred expenses due to an illness in the family over the past twelve months. Of them, 43% turned to family and friends for help, 19% used savings, 20% borrowed money and 8% sold something to cover the cost. Nobody claimed insurance. This indicates a clear potential use case for health insurance.

Limited further use cases. Apart from death and health, few other risk events seem significant from the client perspective. In line with the low formal employment rate, just 8% of FinScope respondents indicated loss of job in the household as having occurred in the past twelve months and less than 5% each had experienced death/illness of livestock or poor rainfall or drought. There would therefore not seem to be a strong use case for agricultural insurance from the customer's perspective. The same holds for asset insurance: only 1% indicated that they had lost their home and less than one percent experienced fire and destruction of household property over the past year.

6.4.3. Providers and products

Limited number of formal players. The insurance industry in Lesotho is small. There are three long-term (life) insurers, namely, Metropolitan Lesotho, Lesotho National Life Assurance Company (LNLAC) and Medi-Life, two short-term insurers, namely Lesotho National General Insurance Company (LNGAC), Zenith Horizon and one composite insurer, Alliance Insurance. There are 17 licensed insurance brokers operating in both non-life and general insurance business classes[82].

The ownership of insurance companies in Lesotho is mixed; with both local and foreign investments. The following table provides an overview of the various insurers:

Company	Ownership	Business strategy	Financial strength
Metropolitan life	88% owned by Metropolitan Life Limited (SA) and 12% owned by a local company.	Retail; targeting individual coverage, comprises approximately 60% of the Company's business. Corporate; targeting large businesses and focuses on pensions and profit funds, which comprises the remaining 40% of the business	Leading market share in long-term insurance business (in both gross written premiums and assets) Financially stable with adequate liquidity
Medi-Life	51% Medi-Life Limited and 49% by GetMed Limited	Largely focuses on medical aid coverage for students studying in South Africa. Recently planning to add funeral insurance cover	Difficult to assess at the moment; company just getting started after a failed business partnership with a South African company.

[82] CBL, Annual Supervision report, 2011

Lesotho National Insurance Company	Government owns 12% of *LNLAC (subject to verification)*	Retail and corporate	Fairly stable; but requiring more aggregation in business strategy; currently only holding 11% of market share
Lesotho National General Insurance Company	Government owns 20% of LNIG *(subject to verification)*	Mainly focuses on corporate business using brokers	Financially stable, still leading market share
Alliance	80% owned by local investors comprised of companies and natural persons.	Licensed for both short-term and long-term insurance	Financially stable, still leading market share
Zenith Horizon	Owned 100% by local investor	Licensed for only short-term insurance business and plans to focus on small and medium enterprise sector (particularly the transport sector)	Difficult to assess at the moment; company just getting started with underwriting only commencing in the last quarter of 2013.

Table 20: Ownership and financial stability of insurance companies

Source: Consultations, published company information

Numerous providers of informal cover. The formal insurers offer a range of short-term and life cover, including funeral cover. Funeral undertakers and burial societies are considered as informal providers, because they are not regulated or supervised as financial service providers. However, in the discussions with funeral undertakers, it was evident that they consider themselves to be in the formal sector. The insurance landscape is summarised below:

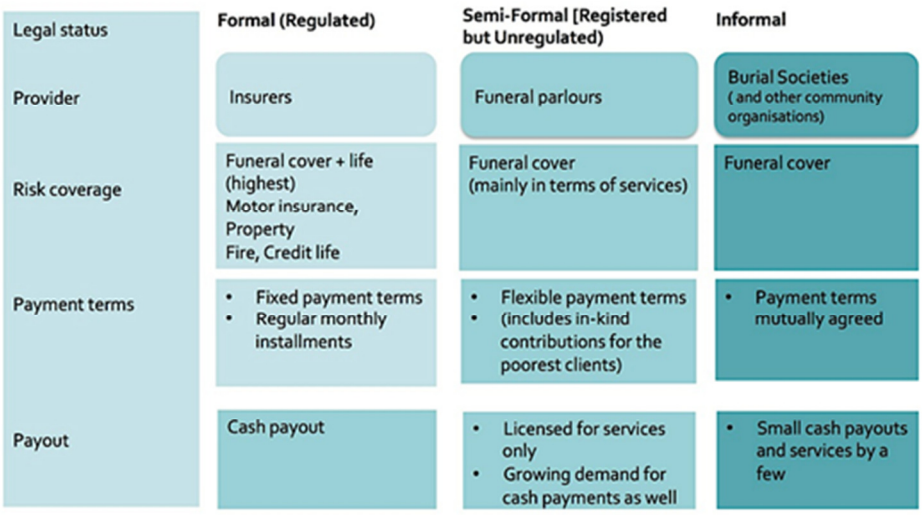


Figure 55: Summary of insurance landscape

Source: Authors' own

The following sub-sections discuss the insurance landscape in detail, providing an overview of the different types of providers, their product suite and their performance.

6.4.3.1. Long-term insurance

Formal players

The table below provides a summary of the four long-term market players:

Institution	Year of establishment	Market penetration, profile[83]	Products
Metropolitan Life Lesotho	Over 40 years ago	– 40,000 clients and over 100,000 active policies – Market leader in long-term business. – Mainly uses in-house agents (more than 240) and brokers for distribution – Branches in Maseru, Teya-Teyaneng, Mafeteng, Larebe and Quting **2012 Performance figures** – Net premiums = M490 million – Gross premiums =M494 million – Value of claims=M260 million	Investment policies Risk management (life and funeral cover) Health (Cash back plan) Retirement (pension, life annuities)
Lesotho National Insurance Group: **Lesotho National Life Assurance Company (LNLAC)**	1973	– The oldest insurance company; initially fully owned by the government. – The long-term insurance company under the group, namely Lesotho National Life Assurance Company (LNLAC) is currently second in terms of market share. – LNLAC operates in Maseru and has branches overseeing the Northern and Southern region with an agent network of 60 agents	
Alliance (composite insurer)	1993	– Fairly new market entrant – Started focusing on long-term insurance business in 2004. While the least market share for long-term insurance, Alliance's short-term insurance business has been growing rapidly and currently ranks second to LNGIC (see short-term insurance discussion below) – Has license for composite insurance but is in the process of separating into long-term and short-term businesses – 7 branches in Hlotse, Maseru, Butha-Buthe, Maputsoe, Ty and Mohale's	Life and funeral cover Life annuities

[83] Figures provided as available from the listed industry players and CBL

Institution	Year of establishment	Market penetration, profile[83]	Products
		hoek **2012 Performance figures (combined long-term and short-term insurance)** – Net premiums = M113 million – Gross premiums =M186 million	
Medi-Life	Re-establish operations in 2014	– One of the newest market entrants, Medi-Life primarily plans to focus on medical insurance for Basotho students studying in South Africa. – Initially launched this product in the early 2000s through a partnership with a South African company. However, the partnership failed and Medi-Life seeks to re-launch operations in 2014 with additional products providing funeral cover. – No in-house underwriting capacity and relies heavily on a South African company.	Medical insurance for students in South Africa

Table 21: Summary of long-term market players

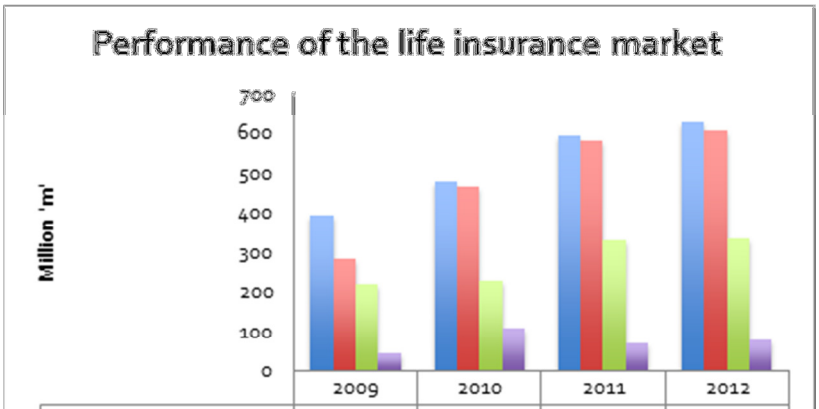
Source: Annual reports and industry consultations; CBL

Long-term insurance also receives competition from South African insurers. One of the current trends is the transfer of employee benefits business to South African insurers by most of the corporates. Individual consumers also purchase insurance from South African insurers. Competition from South African insurers therefore poses a risk to the growth of the local industry and the CBL is working with the insurers to address this issue and increase premium volumes. However, from the consumer's perspective the ability to buy insurance in South Africa is essential to extending product options, as well as in providing a pricing and value-for-money benchmark.

Performance

Size. The long-term insurance industry is larger than the short term insurance industry in terms of premium income. The size of Lesotho's life insurance industry falls behind that of Botswana and Namibia, but ahead of Swaziland – the three Southern African countries with similar population sizes. The following table shows the size of the life insurance market in Lesotho[84]:

[84] Financial statistics provided by the Insurance Division of CBL



	2009	2010	2011	2012
Gross premium	394	479	594	625.1
Net premium	282	466	581.4	606.3
Claims incurred	219	225	328	333.9
Underwriting profit/loss	43	106	70	76.6

Table 22: Performance indicators for the life insurance market85

Source: CBL

Market shares. In terms of market share, Metropolitan life has by far the largest share, which is summarized below for 2010-2011[86]. Over the two years in question, the market shares stayed fairly constant:

COMPANY	% ASSETS		% GROSS PREMIUMS	
	2011	**2010**	**2011**	**2010**
Metropolitan Lesotho	84.2	84.6	72.3	72.3
LNLAC	10.3	10.4	19.1	19.3
Alliance	5.5	5.0	8.6	8.4
TOTAL	**100**	**100**	**100**	**100**

Table 23: Market Share by insurance company

Source: CBL

Metropolitan's market share has since grown further, to 75% of gross premium as at March 2013:

[85] Financial statistics provided by the Insurance Division of CBL
[86] No 2012 statistics available.

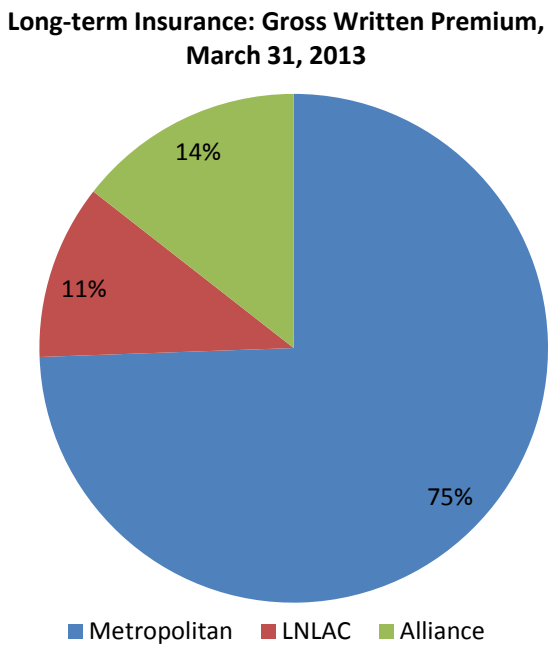


Figure 56: Market share of long-term business by Gross written premium (March 2013)

Source: CBL

Metropolitan attributes its achievements to its rigorous sales strategy and wide distribution network.

Claims ratio. The claims ratio for life insurance business over the last four years (2009-2012) ranges from 47% to 60%. Internationally, claims ratios of 60% and up are regarded as good client value[87]. The qualitative research suggests a high level of client dissatisfaction and suggests that some claims - particularly from low-income earners - either go unpaid or take long to be paid.

[87] For a discussion of microinsurance key performance indicators, see Wipf, J. & Garand, D., 2010. Performance indicators for microinsurance: a handbook for practitioners. Second edition. Available at: www.microinsurancenetwork.org/.../KPI_MI_Handbook_v2_EN.pdf

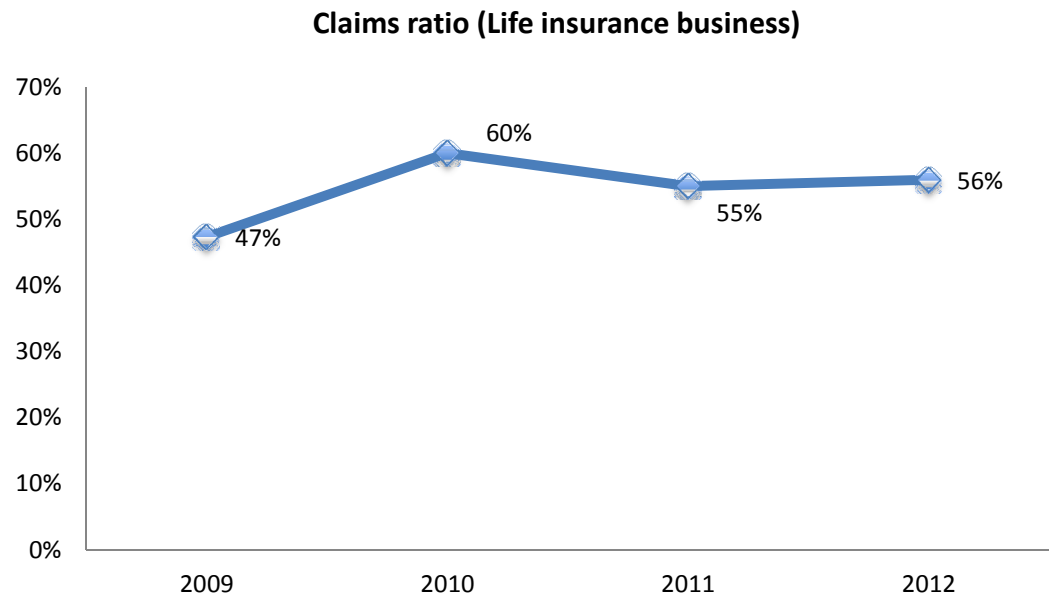


Figure 57: Claims ratio for life insurance business

Source: CBL

Informal players

Funeral undertakers

In-kind cover. Funeral cover from funeral undertakers, mainly through the provision of funeral services, is prevalent in Lesotho[88]. Funeral undertakers have a wide footprint across Lesotho and better access to the low-income market than the formal insurance market. Under their registration from the Ministry of Trade and Commerce, funeral undertakers are only allowed to provide funeral services, no cash payouts, and the insurance premiums charged are justified as "advance payments". There is no formal supervision or regulation of insurance business conducted by funeral undertakers. Over time, consumers have begun demanding the option of cash pay-outs from funeral undertaker policies, in additional to services. Some funeral undertakers feel this is an add-on that they can easily provide. However, the Insurance Act clearly classifies cash payouts dependent on death as life insurance business, for which a licence is required.

Valued place in provider landscape. Qualitative demand-side research undertaken for the 2012 Microinsurance Diagnostic speaks to the value that Basotho attach to these services and suggests that they have more trust in funeral undertakers than formal insurers. In terms of client value, funeral undertakers offer easy access, affordable prices, and flexible payment terms as well as guaranteed services to their clients. Respondents rarely cited instances where funeral undertakers refused or delayed to process a claim. In rural areas, funeral undertakers were praised for the way they accommodate the poorest members of the communities through flexible payments (even accepting in-kind payments) (Angove & Manje, 2012).

Largely group-based distribution. According to consultations, funeral undertakers, particularly the larger ones, have a wide distribution network that extends to government

[88] According to consultations with the Association of Funeral Undertakers, there are about seven to nine large undertakers and a number of smaller ones.

departments, factory workers, church groups and other types of groupings that aggregate clients (for example associations).

Burial societies

Burial societies are an insurance or risk pooling mechanism where members pool their funds to contribute towards the cost of the funeral of a family member. Cover usually extends to the member, spouse, dependent children and up to four parents. One society encountered in the qualitative research provided cover for one grandchild. These societies are prevalent in Lesotho (reaching a total of 37% of all adults) and seem to offer a functional coping mechanism for many households, especially those that cannot afford the services of funeral undertakers and formal insurers. The registration process of burial societies is discussed below.

Box 11 Structure and registration of Burial Societies

Meetings of the society are held once a month where contributions are collected and other matters pertaining to the burial society are discussed. The management structure usually consists of a chairperson, treasurer and secretary. The members draw up a constitution and decide on the operations, administration, contributions and benefits of the society.

Burial societies may elect to register the society with the Law Office under the Societies Act (1966). Registration with the Law Office involves submitting a written document detailing the name, location and list of members of the society, as well as the constitution of the society and paying a nominal annual service fee. Registration with the Law Office enables the society to open a group bank account in the name of the society. The burial society may also register with the local chief. Registering with the chief allows the society to become recognised in the area and means that the chief can act as arbitrator when there are disputes. For example one of the burial societies interviewed indicated that the chief assisted when previous members left the group without repaying all the money they had borrowed.

Source: Microinsurance diagnostic study (Angove & Manje, 2012)

There are two main types of burial societies, namely *funded societies* and *collecting societies*. In funded societies, members are expected to make agreed regular monthly contributions and a fixed amount is paid when a death occurs. Under collecting societies, a fixed amount is collected from group members when death occurs. The table below provides additional information on the structure and operations of burial societies. Some burial societies also make loans to members, usually if funeral expenses exceed the payout and reportedly at an interest rate of 10% (Angove & Manje, 2012).

Type of burial society	Description	Key observations
Funded societies	– Regulator monthly contributions from all members typically ranging from M20-100. – Membership size range from 10 -70 – Payout ranges from M2, 000-5,000 – Usually provide other types of	– Dropouts less likely to affect the payout of the agreed amount, as long as the pool is well managed – Leader can potentially misuse resources

	support, including labour, tent, chairs	– Small group seems to have had more stability and cohesion
Collecting societies	– Everyone expected to contribute the agreed amount when event happens – Contributions range from M5- 50. – Payouts range from M 500-5,000 – Labour from other members is available and a few groups are able to provide other types of support such as tent, chairs etc.	– Not all members contribute on a timely basis – All members receive the agreed payout

Table 24: Structure and operations of burial societies

Source: Focus group discussions as input to Angove & Manje (2012) as well as KLA (2014)

Although burial societies serve an important role in risk mitigation for death, there are a number of challenges that affect their functionality. Burial societies face the risk of running out of funds and the inability to pay claims when a death occurs. This seems to be prevalent especially where funds are misused (in the case of funded societies) and where there are significant numbers of drop outs (in the case of the collecting societies)[89]. Furthermore, although burial societies function as risk pools, the contributions are not professionally calculated and should a large number of deaths occur in a short period, funds may be insufficient. The increase in funeral costs exerts more pressure on payouts from burial societies, such that payouts are generally insufficient to fully cover funeral costs. It is therefore common for people to belong to more than one burial society, or to use other coping mechanisms, including formal insurance for those who are able to make regular premium payments.

Products

Prominence of individual life. Life insurance business consists of both corporate and retail business. Corporate life business focuses on employee benefits: managing pension and provident funds, group life cover (death and some disability) and funeral cover to the workforce through employers. Retail business consists of individual and group life business (outside of employee benefits). Individual life business seems to dominate the long-term insurance business. In 2011, 50% of life insurance business came from individual life policies.

[89] Views expressed in the focus group discussions conducted for the Microinsurance Diagnostic study 2012.

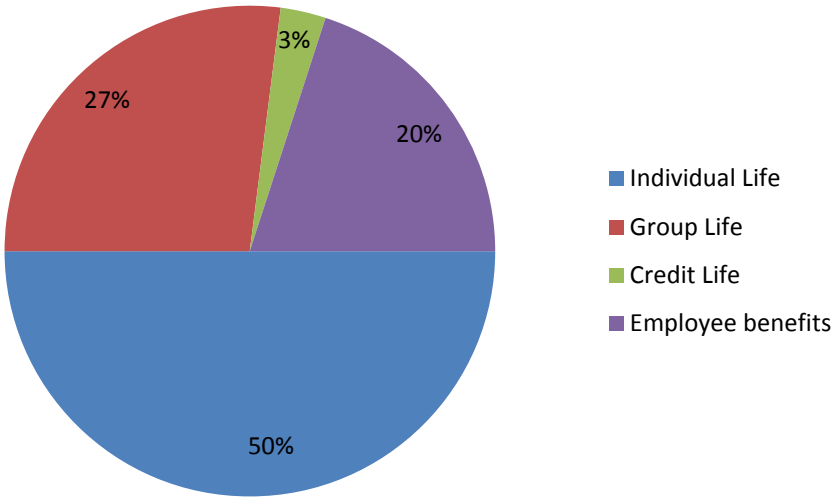


Figure 58: Product portfolio mix, long-term insurance business

Source: CBL

Endowment products not aimed at entry-level market. There are a few saving products (endowments), but they are not relevant to the entry-level market.

Limited health insurance product suite. Two insurers provide health insurance cover. Metropolitan offers hospital cash plans targeting the formally employed market and MediLife provides medical cover to Basotho students studying in South Africa. There is thus no domestic provision of comprehensive medical aid or insurance in Lesotho.

Negligible credit life. Credit life constitutes the smallest share of long-term insurance premiums and is provided mainly on the banks' home and personal loan books. Moliko Trust, the only MFI, has failed to secure a partnership with any insurer for credit life.

Funeral most prevalent product. The main retail life products on the market are funeral cover (usually cover for the whole family). Funeral insurance policies are mainly distributed though groups of co-workers, burial societies and church groups. The table below compares the offering of funeral cover by insurance companies, funeral undertakers and burial societies:

Aspect	Insurance companies	Funeral undertakers	Burial societies
Risk pooling	Standard; upfront premiums	Standard; upfront premiums	Upfront premiums or contributions when death occurs
Lives covered	Principal policyholder, spouse, children (limited and unlimited), parents and extended family members	Principal policyholder, spouse, children, parents and extended family	Principal policyholder, spouse, unmarried children, parents and extended family

		members	members
Benefits	Cash pay-out M3000 –M20, 000	Funeral services equivalent to M2, 500 - M20, 000	Cash pay-out M1, 000 – M5, 000 Some societies also provide tents, chairs and cooking utensils
Premium	M20-350	M15-200	M4-100[90]
Mode of premium payment	Mainly deducted from salaries or debit orders New: mobile payments	Deductions from salaries or debit orders Cash payment at branches Flexible in-kind payment for poorest customers	Cash contributions at meeting either on monthly basis or when the risk occurs
Pay-out	Cash	Services (legally) Cash	Cash and services
Underwriting	No medical questions or medical tests	No medical questions or medical tests	Not applicable
Waiting periods	Applicable, usually 3-6 months for non- accidental deaths	Applicable, usually 3-6 months for non-accidental deaths	Not applicable for most burial societies A few burial societies apply 3-6 months
Grace period	Maximum two premiums in a row	Maximum three contributions in row	Maximum three contributions in a row
Claims process	Notification requirements : • Identity document (passport) of deceased and claimant, Documentation proving relationship between deceased and policyholder (marriage certificate, birth certificate), • Mortuary letter, • Police report for accidental death. Timeline: Promise of 24-48 hours upon receipt of all documents	Notification requirements: • Passport or voter's card • Chief's letter of deceased and claimant • Death certificate • Proof of payment for last three contributions. Timeline: Arrange service within 2-4 days	Notification requirements: • A special meeting of the burial society is called. • Some societies require a death certificate from the district office or letter from the mortuary. Timeline: Instant pay-out Assist in funeral arrangements

Table 25: Product comparison: formal and informal funeral cover

Source: Angove & Manje (2012)

[90] M4 was the minimum contribution indicated in the focus group discussions for 2012 microinsurance diagnostic study

It is clear that the only main difference between funeral undertaker cover and insurance policies is the fact that mostly an in-kind payment is provided, as well as that the terms and premium payment options are slightly more flexible. Benefits offered are similar. Burial societies, in contrast, offer much lower benefits. Yet they provide additional social support and are most flexible. The table below provides additional insights on the pros and cons that have emerged from qualitative studies: [91]

Form of insurance	Pros	Cons
Insurance from insurance companies	• Preference for cash pay-out; money can be used for funeral expenses and other expenses including aftermath expenses.	• Entry premiums out of reach for some people
Insurance from funeral undertakers	• Guaranteed good funeral service and quality of coffin. • Funeral undertakers are reliable when it comes to providing the agreed services • Notification requirements are more flexible • Payment terms are flexible; occasionally they accept in-kind payment	• No cash pay-out; would prefer they had both cash pay-out and services
Informal insurance through burial societies	• Guaranteed social support • Guaranteed material support such as tents, chairs and cooking utensils • Contributions based on affordability	• Mismanagement of resources can affect pay-out • No guarantee that all members will contribute, particularly in burial societies that require contributions when death occurs • Pay-outs in some societies are very small

Table 26: Comparisons of formal and informal insurance cover

Source: Focus group discussions conducted as input to Angove & Manje (2012)

6.4.3.2. Short-term Insurance Industry

The size of Lesotho's short-term insurance industry falls behind that of Botswana, Namibia and Swaziland – the three Southern African countries with similar population sizes[92].

The Lesotho National General Insurance Company (LNGIC) was historically the only short-term insurer in Lesotho. A second player, Alliance, entered in 1993 and another new player is now in the process of setting up. The following table provides a summary overview of the three players in the short-term insurance market:

Institution	Year of establishment	Market penetration, profile	Products
Alliance	1993	– Fairly new market entrant – Has license for long-term and short insurance	Largely mortgage life

[91] Microinsurance diagnostic study, 2012
[92] Microinsurance diagnostic study, 2012

Institution	Year of establishment	Market penetration, profile	Products
		– Have 7 branches in Hlotse, Maseru, Butha-Buthe, Maputsoe, Ty and Mohale's hoek **2012 Performance figures (combined long-term and short-term insurance)** – Net premiums = M113 million – Total policy value = M90 million – Gross premiums =M186 million	
Lesotho National Insurance Group: **Lesotho National General Insurance Company (LNGIC)**	1977	– Oldest insurance company – Currently market leader for short-term insurance.	Motor vehicle Household property
Zenith Horizon	2013	– Newly established company – Unable to provide financial performance information	Workers compensation Motor vehicle Property

Table 27: Formal players in the short-term insurance industry

Source: Information supplied by insurers

Financial performance

Market shares. Between 2010 and 2011[93], short-term insurance recorded an increase in net premiums, from M119 million to M164 million. The following table shows the financial statistics of the short-term insurance market[94]. Alliance increased its market share vis-à-vis LNGIC in both gross premiums and assets in the two years. As at March 31, 2013[95], Alliance was in the lead in terms of gross written premiums (see figure below):

COMPANY	% ASSETS		% GROSS PREMIUMS	
	2011	2010	2011	2010
LNGIC	61.2	70.2	52.8	65.1
Alliance	38.8	29.8	47.2	34.9
TOTAL	**100**	**100**	**100**	**100**

Table 28: Performance indicators for short-term insurance market

Source: CBL

[93] 2012 figures not available
[94] Financial statistics provided by the Insurance Division of CBL
[95] Latest financial figures provided by CBL

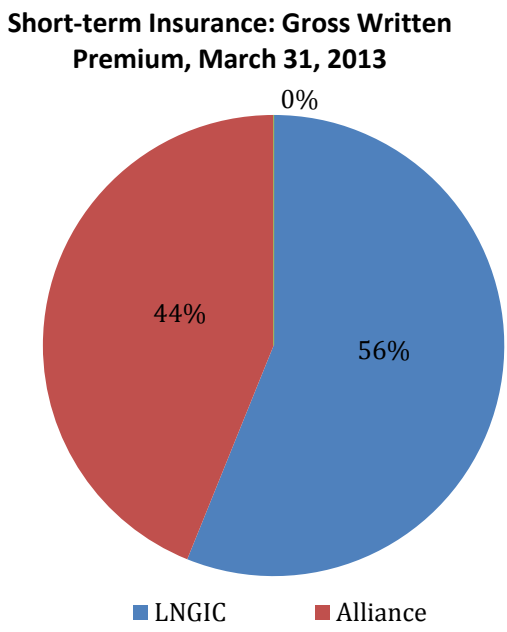
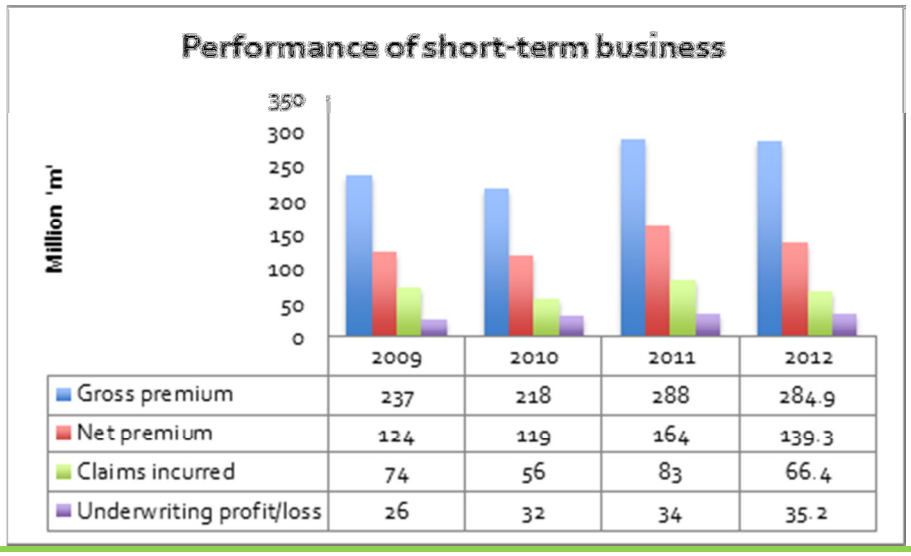


Figure 59: Market share of short-term insurers (March 2013)

Source: CBL

Under long-term insurance, Metropolitan Lesotho accounts for 84.2% of total assets while LNLAC and Alliance account for 10.3% and 5.5% respectively. In short-term, LNGIC accounted for 65.8 % of total assets while Alliance held 34.2 %. The overall performance is summarised below:



	2009	2010	2011	2012
Gross premium	237	218	288	284.9
Net premium	124	119	164	139.3
Claims incurred	74	56	83	66.4
Underwriting profit/loss	26	32	34	35.2

Figure 60: Financial performance of short-term insurance business

Source: CBL, 2013

Like their long-term counterparts, short-term insurers in Lesotho also face competition from South African insurers. CBL noted that sometimes this competition adversely affects the performance of local insurers.

Products

Licensed insurers in Lesotho can provide the following products fire, motor, marine, accident, employer' s liability insurance or any type of insurance excluding life insurance business. The main driver of short-term business is commercial business. Motor insurance constitutes the largest product line by premium volume, while aviation insurance is ranked second. General accident insurance is ranked third, followed by fire insurance and motor vehicle accident (MVA) insurance. Engineering, Personal Accidents and Workmen's Compensation rank last. The figure below shows the distribution of the product portfolio mix:

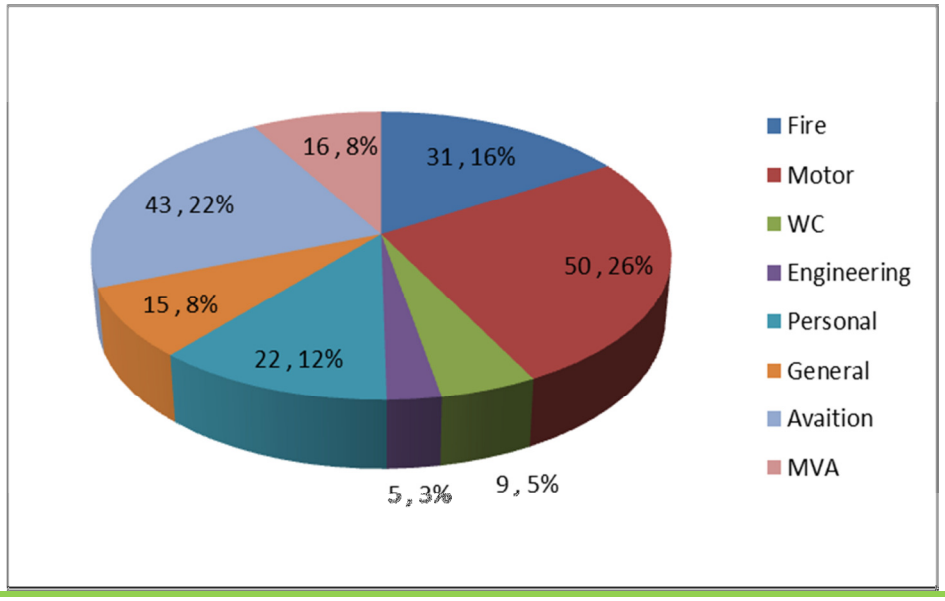


Figure 61: Product portfolio mix for short-term insurance 2011

Source: CBL

Worker's compensation insurance is compulsory in Lesotho, but this is not enforced and not all employers have cover. Personal accident cover is purchased by employers to provide additional cover above the group disability cover to higher salaried employees. Short-term cover for individuals is mainly through compulsory motor and household cover for items with outstanding bank loans. Most short-term insurance cover is not targeted at the low–income households. However, the new market entrant, Zenith Horizon will target small and medium enterprises and seeks to focus on taxi drivers for motor and personal accident cover.

6.4.3.3. Distribution

The distribution space for short-term insurance is dominated by brokers. For long-term insurance, most of the insurance companies have networks of agents for marketing and sales of insurance policies. However, over time the distribution space for long-term insurance is changing. The most recent developments in this space include the use of mobile network operators. LNLAC is currently in partnership with Econet to distribute EcoSURE, a

funeral insurance product. Vodacom is also advanced in discussions with insurance companies on distribution opportunities.

There is still some uncertainty around the scope for bancassurance within the regulatory framework. Standard Bank Lesotho had entered into a distribution arrangement for a funeral policy for its clients, but was stopped by CBL until such a time when the provisions are in place.

6.4.4. Barriers to access

Although Lesotho has relatively high uptake of insurance, there are still challenges for some people in the low-income population segment to access insurance. The 2012 Microinsurance Diagnostic highlighted the following access barriers based on FinScope 2011 data:

Access barriers:

- *Eligibility not a major constraint*: 77% of the low to lower middle income market[96] have a passport.
- *Usage suggests that affordability is not a big barrier in practice*: 57% of adults earn less than M500 per month. This means that payment of any premium comes at a substantial opportunity cost. This was confirmed by the qualitative demand-side research. Respondents highlighted that irregular incomes make it difficult to make regular premium payments, leading to policy lapses and, hence, loss of cover and a sense of all their premium contributions thus far going to waste. Nevertheless, high uptake shows that affordability is not a major barrier in practice, as people are willing to prioritise funeral cover in their budgets. Burial society contributions start from M10 per month and are therefore regarded by respondents as particularly affordable. It would, however, suggest that there is limited scope for additional insurance beyond funeral cover for the majority of adults.
- *Product features*: formal insurance typically requires debit order premium deductions. This is problematic for the low-income market; only 15% of those earning less than M500 per month have a bank account. However, this figure rises to 58% for those earning between M500 and M6,000 per month.

Usage barriers:

Negative perceptions. In addition to the access barriers noted above, the qualitative demand study highlighted negative perceptions of formal players as a key usage barrier. Insurance companies were seen by some as 'thieves', 'crooks' and 'con men'. The sentiments were mainly related to claims settlement – respondents felt that insurance companies either delay or avoid paying claims and that, even where payments have been made, pay-outs seem to depart from what was agreed. The following quote illustrates:

> R: I started with [company A], used to contribute M70 per month. When my husband died I struggled a lot and failed to get the money so I incurred some debts to bury my husband.

[96] Defined as those earning between M500 and M6,000 per month.

M: They did not give you money?

R: No. They were supposed to give me five thousand and I was told they would give me M200 and when I did not get it one month I would go back home. I took it until I stopped going without getting the whole amount because of a painful heart. My husband had left me and [company A] was causing me to run around so I stopped collecting it. I have joined a woman's society where you pay M300 and the monthly contribution is M60. When there is a death in the family, a member gets ten thousand and also the society helps us in that we borrow money and return it at ten percent interest which belongs to the member, at the end of the year we share the interest.

Butha-Buthe, women, age 41-55, income M0-2000

As a result, many respondents with a formal policy also belong to a burial society as a way of ensuring that they get at least something if the insurance company does not pay out.

6.4.5. Regulatory issues

Capacity. Currently CBL was has two staff looking into microinsurance developments. They acknowledge limited exposure to microinsurance and have expressed the need for training to effectively monitor and supervise microinsurance business in Lesotho.

Consumer protection framework. Understanding of insurance as a risk management tool is relatively good among Basotho; this presents one of the growth opportunities. However, qualitative market research conducted for Angove & Manje (2012) highlighted consumer protection concerns stemming from inadequate market conduct during the sales process[97]. One of the critical consumer protection aspects highlighted is the provision of clear product information. The CBL has furthermore noted that the industry has not been improving customer care and claims management.

Formulation of microinsurance regulations. The CBL has already recognized the value of formulating microinsurance regulations. The plight of the funeral undertakers and emerging market developments in the distribution space, in particular the role of banks and mobile network operators, are among the topics to be addressed. The draft Insurance Act of 2013 includes a broad definition of microinsurance, which still needs further qualification for supervision and reporting purposes. Another important consideration is whether there is also need to create a new licensing category for micro-insurers under which the business conducted by funeral undertakers and large burial societies can be regulated. The consultations suggest that funeral undertakers are not in favour or underwriting partnerships with insurance companies[98]. Should regulation demand this, funeral undertakers are looking into establishing an insurance house that will undertake the underwriting for them. The Association of Funeral Undertakers has already commenced engagement with relevant institutions on the topic.

[97] Many respondents complained regarding the conduct and practice of insurance agents. Instances of mis selling were reported, as well as inadequate disclosure at point of sale.

[98] They see insurers as having rigid models that do not effectively serve the target groups. They also worry that insurers will make inroads into their business share.

Currently no regulatory space for alternative distribution or bancassurance. Insurers and intermediaries are seeking ways to innovate to increase uptake of insurance products by low-income population segments. However, the current distribution framework is not facilitative of alternative distribution channels, resulting in some pilots being stopped by CBL[99]. Notably, the issue of bancassurance and distribution provisions for banks is still under discussion. The likelihood is that such provisions will be dealt with under agency considerations for banks, as will insurance partner-agent arrangements for delivering microinsurance.

Policy harmonisation. There is a need for policy harmonisation and coordination across CBL departments, particularly for the supervisory and regulatory provisions that relate to bancassurance, retail payments and insurance distribution.

6.4.6. Gaps and opportunities

Scope for further growth in funeral insurance. Innovation particularly in improved product benefit design and delivery channels by formal insurers as well as the creation of a regulatory environment for services provided by funeral undertakers can potentially enhance client value and uptake of formal insurance products.

Limited potential beyond funeral. Based on the current offering and market opportunity analysis, the scope for other types of insurance products apart from funeral insurance, including asset and agricultural insurance, is very limited. However, there would seem to be a gap in provision – as well as an in principle use case – for some kind of health-related insurance across the various segments. Though the majority of households currently access health care from public clinics and hospitals, they incur ancillary expenses and suffer lack of income when sick.

Scope for life insurance. Funeral cover does not deal with the broader financial impact of a death on the family, especially if the loss is of a breadwinner. However, the low income profiles of all segments but the salaried workers suggest that affordability is a significant hurdle to expanded life cover beyond funeral.

Capacity to design and deliver more valuable products. Reliance on outside expertise for product development has affected the ability of most of the insurance companies to respond swiftly and effectively to market needs.

Simplicity and clarity in product information. Most of the insurance companies are still using conventional approaches to information packaging. Following the microinsurance diagnostic study and microinsurance best practice training[100] conducted for all insurers and funeral undertakers, some providers are already making improvements in this area.

Improving claims processes. Market research conducted as input to Angove & Manje (2012) suggests that funeral undertakers have a better record with consumers when it comes to claims processes than insurers. They are less strict and often pursue other quick ways of confirming risk occurrence. This helps them process claims swiftly. Insurance companies, on

[99] One pilot stopped by CBL was the distribution of insurance through banks, largely owing to absence of regulatory guidelines outlining rules and role allocation between banks and insurers.
[100] Microinsurance Best Practice Training workshop, organized by SUFIL, November 2012

the other hand, are seen to have a record of poor information flow, delayed claims payments and invalid claims.

The table below summarises the relevance of various types of products for the various target market segments:

	Products	Salaried	Low-wage earners	Small business owners	farmers	Government dependants	Private dependants	Migrant workers	Providers
	Funeral insurance (formal)	✔	✔	✔	✔	✔	✔		Insurance companies
	Life insurance	✔	✔	✔	✔	✔	✔	✔	
	Investment products	✔						✔	
	Agriculture insurance				?				
	Funeral insurance (Parlours)	✔	✔	✔	✔	✔	✔		Funeral parlours
	Health insurance/ medical aid	✔	✔	✔	✔	✔	✔	✔	Insurance companies

Table 29: Insurance product relevance to target groups

Source: Authors' own, based on consultations

7. Synthesis

This section synthesises the findings across the context, regulatory, target market and supply-side analyses in order to ascertain the product, provider, channel and regulatory imperatives for financial inclusion that will achieve the biggest ultimate impact on the real economy and consumer welfare in Lesotho.

- It starts off by summarising the key findings regarding the underlying drivers of and constraints to financial inclusion in Lesotho.
- It then concludes on the key target market needs in order to determine the priority imperatives for the Lesotho financial inclusion roadmap.
- Finally, it positions these key imperatives vis-à-vis the existing financial inclusion recommendations as adopted in the FSDS.

7.1. Cross-cutting drivers of financial inclusion

Entrepreneurship, farming important to livelihoods. The small size of the economy and limited industrial base means that, though most micro businesses are survivalist in nature and most farmers operate on a subsistence basis, entrepreneurship and farming nevertheless fulfil an essential role in generating livelihoods.

Strong collective functioning creates social resilience and supports financial inclusion. Community-based/collective financial services are a preferred way of functioning in society, rather than just a stop-gap measure in the face of formal exclusion. They not only extend the access frontier, but also fulfil an important social support role. There is limited indication of consumer protection concerns among small, community-based unregulated providers. Where consumer protection concerns have arisen, it is in larger financial service cooperatives or burial societies where the link to community-based self-management is broken. This contrasts to negative perceptions of formal financial institutions in light of high charges, as well as a history of failed state financial institutions.

Cultural factors, poor health impact financial decisions. The cultural prominence of a decent burial, along with strong social structures has led to Lesotho having a very high penetration of funeral insurance, both formal and informal. Furthermore, the impact of poor health, largely due to high HIV/AIDS prevalence, is evident on household structures and creates unconventional intergenerational financial responsibilities (with grandparents for example looking after grandchildren, rather than being looked after by their own children). The health situation creates an imperative for targeted financial services (be it savings, credit or insurance) as a coping mechanism, as well as for low-cost payment mechanisms in order to send money to those affected.

Extensive regional integration impacts livelihoods and financial inclusion profile. The close link with South Africa makes it unsurprising that Lesotho has a high degree of financial integration with South Africa. This includes: sharing a currency, exchange rate and monetary policy; partially integrated capital markets and payments systems; a banking system that is closely integrated with that of South Africa; a high level of cross-border remittances (largely inward); and cross-border trade in financial services. Migrant labour has a central impact on household structures and livelihood activities. Those dependent on others for their main income source is the single largest target market segment, whilst many other adults also

receive remittances as an additional source of income. Apart from the direct impact of remittances, the large migrant population also creates scope for other financial services targeted at the diaspora, such as repatriation funeral insurance and cross-border payment of dependents' insurance premiums, retirement or other long-term savings, or cross-border payment of loans.

Generally enabling environment, but isolated regulatory provisions impact inclusion. A number of policy and regulatory dots are being connected to fill historical gaps. This includes the preparation of the FSDS, the 2012 Financial Institutions Act, the Credit Reporting Act, the new Payment Systems Act and the new Insurance Act (the latter two both forthcoming). Though the regulatory framework as a whole does not pose significant access barriers, there are nevertheless a few key constraints. Most notable is the fact that there is no KYC threshold limit for bank accounts (as is the case for mobile money), that there are differential regulations regarding the requirements for banking and mobile agents and that MNOs are not currently allowed to pay interest on deposits. This creates a non-level playing field between these institutions.

Regulatory hiatus creates uncertainty. In addition, the implementation of new legislation and the ability of financial institutions to take advantage of new opportunities are being held up by the lack of regulations needed to give effect to the legislation. Furthermore, the weakness of regulation for financial services provision by cooperatives has led to prudential concerns, and consumer protection concerns have arisen with regard to moneylenders under the old Money Lenders Act. More generally, even where regulations relating to financial services provision exist, enforcement has been patchy, leading to uncertainty and the persistence of undesirable practices.

Small financial sector limits potential for economies of scale. The number of formal financial institutions is small, there are limited formal non-bank credit providers and no providers of productive credit to SMMEs. This results in relatively high use of expensive and short-term informal credit vis-à-vis formal alternatives. This in part reflects the small size of the economy, in absolute terms, which limits the potential for economies of scale. It is also striking that bank lending is – or at least was until recently – quite limited. Historically, banks have exhibited low loan-to-deposit ratios, with the largest balance sheet asset being deposits with South African parent companies. Banks have therefore been perceived as unadventurous, and ineffective at intermediating savings mobilised in Lesotho into lending to local firms and households. However, this is now changing.

Mobile money particularly relevant in a remittance economy. The advent of mobile money is an important development that offers the prospect of an increasingly broad range of financial products that overcome traditional distribution challenges related to the topography of the country and the size of the financial sector footprint. There has been very quick and high initial uptake and a substantial proportion of users are active. Importantly, this offers a means of overcoming the very high costs of using physical channels, such as bank branch networks, to deliver financial services cost-effectively to the rural population.

7.2. Priority target market needs

Broadly served population. Despite the context, regulatory and supply-side challenges outlined above, the FinScope 2011 survey showed that Lesotho has a very high level of

access – the highest among all 15 countries in which FinScope surveys had been conducted by 2011. Only 19% of Lesotho adults are not financially served (compared to 27% in South Africa, 31% in Namibia, 33% in Botswana and 37% in Swaziland). In contrast with many other countries, people are furthermore fairly broadly served, that is, they tend to have more than one financial service. Apart from bank accounts, this is driven by the fairly widespread usage of insurance products, notably burial society membership and funeral undertaker cover, as well as the penetration of savings clubs and informal remittances. 70% of those who are formally included have an informal product as well, 53% of those who are formally included have more than one type of formal product and 52% of the informally included have more than one type of informal service. The biggest gaps in formal penetration are in credit and remittances.

Socio-economic and physical conditions limit scope for absolute increase in number of formally included. Dependents, survivalist entrepreneurs, farmers and those who do piece jobs or casual labour make up the lion's share of adults. Their very low and irregular income profiles challenge formal eligibility, especially for credit. Furthermore, the country's geography and topography, combined with poor infrastructure, means that there are substantial access barriers for the two thirds of adults who live in rural communities. This would suggest that the scope for further penetration at scale is limited.

Remaining needs differ by target market .The table below summarises the key financial services needs for the various target markets arising from the demand-side analysis:

Segment	Size (rounded)	Main realities and needs
Salaried workers	160,000	• Well-served, not financial inclusion priority segment • Role as remittance senders and potential to serve as an entry point for productive or asset-based finance

Private dependents	300,000	• The largest group, they are the ones being supported by those working in the formal sector or cross-border and are the conduit for those outside to integrate their foreign earnings into the local economy. Main financial inclusion needs:
		  ○ Enhanced access to low-cost, convenient remittance options, domestic as well as cross-border.
		  ○ Savings gap
		  ○ Accessible formal credit to enhance remittance income with entrepreneurial activity

Government dependents	90,000	• Well-served by funeral cover, burial society and savings club membership; many already borrow informally and in the community • May benefit from low-cost, convenient payment mechanism for receiving grants • Need for accessible targeted savings products (such as for education) and health insurance solutions to strengthen them in their role as guardians of orphaned children.

Segment	Size (rounded)	Main realities and needs
Small business owners	136,000	• Lack of access to finance is not their main constraint, as most are survivalist in nature. Yet "paving your own way" is the only option for many and has real economy impact. The qualitative research suggests that many Basotho also beyond this segment engage in entrepreneurial activities as ancillary income source. • Need for insurance beyond funeral cover and savings to manage risks, smooth their consumption over time, as well as to support business growth[101] • Would also benefit from cost-effective payments and remittance solutions to facilitate their day to day functioning • Most are unlikely to be viable formal credit clients, but there is a lack of formal credit provision for the 10-15,000 aspirational small business owners. In the absence of access to formal credit, they have a need for savings towards business capital finance.
Piece job workers	200,000	• Though a large group, their economically marginalized position challenges formal inclusion and means that they may be best placed in household context, where another household member may be involved in entrepreneurial activities or may be sending them remittances • Informal/unintermediated usage demonstrates need for cost-effective, accessible remittance services. • Unlikely to qualify as formal credit clients and collective vehicles such as burial societies and savings clubs may be best placed to serve their needs, given their limited ability to meet formal eligibility requirements and given that the majority reside rurally. • Scope for savings vehicles to store value in between jobs.
Farmers	140,000	• Relatively high average income suggests that at least a subset are larger-scale farmers with a need for access to targeted agricultural finance and risk solutions • Possible role of low-value input finance for smaller farmers • Need for savings towards not only consumption smoothing, but also farm inputs and assets such as livestock. • Need for alternative distribution as rural nature challenges distribution through traditional channels.
Non-resident	Estimated up to 400,000	• Likely to be the largest group, with substantial role in supporting residents

[101] The results of the SMME FinScope surveys conducted in Malawi, Mozambique and Zimbabwe suggest that savings are a more important and widely used mechanism of financing a business than credit.

Segment	Size (rounded)	Main realities and needs
Basotho	or more	• Primary need to save and send money home – need for enhanced financial access in sending country • Need for longer-term savings and asset accumulation towards retirement. • Need for funeral insurance including repatriation of the body. • Potential value in insurance and endowment mechanisms designed and marketed for them to pay for premiums cross-border on behalf of dependents. • Can be leveraged for productive investments in Lesotho. The gap in access to productive credit is apparent from the fact that Moliko was set up by the National Union of Mineworkers in South Africa.

Table 30: Summary of target market needs

Source: Authors' own, based on KLA (2014)

7.3. Roadmap imperatives

"*The financial access box has been ticked*". The picture painted in the discussion above is one of a poor, but not indigent population, largely thanks to social support structures and remittances. Self-provision through collective structures generally works well at community level, but where government or donors have implemented subsidised development credit programmes or formed collective savings and credit groups, sustainability has often been lacking. Though each target market segment still has a number of financial service needs, the adult population is on the whole already broadly served by financial services. However, the kind of financial services that people use (including high-cost bank accounts, low-value community or home-based savings, high-cost informal loans, funeral cover and informal remittances) are not serving to lift them out of poverty, but are merely helping them to "get by".

Rethinking the role of financial inclusion. The conclusion is that financial access measured in terms of uptake is not the issue in Lesotho. Thus the focus should not be on how to extend the reach of financial services. The bigger question is: how can financial services be leveraged or re-engineered to more effectively alleviate poverty and support economic growth? This calls for a very targeted roadmap that focuses on the "biggest marginal gain" activities from a consumer needs and welfare perspective.

"*Don't fix what isn't broken*". The summary of target market needs above has shown that these "biggest marginal gain" areas do not relate to the formalisation of savings clubs or burial societies. The priority segments are already well served by collective mechanisms and community-based structures are working, with a level of efficiency that, given the level of income generated from the real economy, migrant income and farming, allows for a minimum level of household welfare. Thus a formalisation drive outside of large-scale financial cooperatives would be misplaced as a financial inclusion roadmap priority (though ongoing monitoring to pick up on potential consumer protection concerns when they arise is of course advisable). Neither should it be a priority to form further village-level groups through external intervention.

When filtering the financial inclusion priorities through the lens of actions most likely to contribute to poverty alleviation and economic growth, three key roadmap priorities arise:

1. Directly improve household welfare through efficiency gains and risk mitigation
2. Take small steps towards enhanced growth through highly targeted productive credit and inward investment promotion
3. Leverage financial sector intermediation to support investment and growth

Below, each is unpacked in turn.

1. Directly improve household welfare through efficiency gains and risk mitigation

It is clear from the target market needs discussion above that most households can benefit from efficiency gains in the financial services that they engage with. This strategy has three prongs:

a. Lowering transaction costs and enhancing the range of low-cost savings options. The analysis shows that high charges in the banking sector lead to negative customer perceptions and use of bank accounts merely as "mailbox accounts", rather than as a transaction or savings tool. The target market analysis indicates a need for accessible, low-cost savings options across target markets – for a short-term store of value for remittances received, but also longer-term goal-orientated savings products, e.g. towards education or for health or other emergencies. Facilitating lower-cost, more accessible savings options and transaction accounts can therefore have direct welfare benefits. However, it must be recognized that such efficiency gains, while not negligible, will not provide a silver bullet out of poverty. It can only be a contributing factor on the gradual path to economic development.

Potential actions in this regard include:

- *Facilitating the continued growth of mobile money.* Uptake of mobile money has been swift and significant since its introduction as it allows low cost payments and money transfers. To come into its own as a store of value, it should be allowed to pay interest. Furthermore, explicitly educating customers through the sales process on how to use the product may help people overcome any aversion to new technology, whilst creating an ecosystem of goods and services that can be purchased directly with mobile money will increase the velocity of mobile money in the system and improve the overall value proposition of the product for consumers.
- *Enhanced non-bank competition to impact on incentive structures*. Lesotho's banks are both relatively high cost and highly profitable. The high profits are driven by high fees as well as high lending-deposit spreads, which in turn are driven mainly by a relatively low cost of deposits. This suggests that there is scope for Lesotho's banks, if incentivised, to pay higher interest on deposits and reduce fees. While this would reduce income, bank profitability would still remain high by international standards. Increasing competition from MNOs, including allowing them to pay interest on deposits, and stemming from their lower transactions fees may act as this incentive for banks to reduce their fees.

- *Greater disclosure of fees*. In addition to the above strategy, more explicit monitoring and benchmarking of fee structures by the regulator, enhanced transparency/disclosure requirements regarding charges, or a form of industry code on disclosure practices can all serve to bring down user costs. This also includes a greater focus on targeted marketing by the banks. For example, despite being widely perceived as high cost, the entry level savings products offered by SBL and FNB actually offer marginally better value than mobile money products for low value savings.
- *More efficient government payments*. Efficiency gains can be had by converting bulk cash disbursals (such as grant payments) into electronic transactions through the banking sector or mobile money. While doing so will face many challenges, notably the lack of access to cell phones by government dependents and agent liquidity constraints in rural areas, this is an option to leverage state resources for household efficiency gains that is at least worth exploring.

b. *Facilitating low-cost domestic and cross-border remittances*. More accessible, cheaper domestic as well as cross-border remittances will represent a direct welfare gain for all of the target market segments – either as senders or receivers. Potential actions in this regard include:

- *Allowing retailer remittances*. Facilitating the retailer remittance model, set to be piloted in the 2nd half of 2014, and extending it to domestic remittances and outgoing cross-border remittances and formalising the model in regulation for others to adopt if they want is a first step. Evidence from South Africa indicates that many individuals prefer sending remittances through retailers due to greater accessibility, in terms of longer opening hours, and the elimination of 'doorstep' barriers (Eighty20, Forthcoming).
- *Advocating for lower first-mile barriers to cross-border remittances*. Another important strategy will be to work with authorities in South Africa to find a way to enable cross-border mobile money payments, to enhance access for informal Basotho workers in South Africa to the South African banking system and to reduce the cost and regulatory requirements of cross-border banking payments.
- *Active banking strategy to capitalise on informal remittance flows.* With the introduction of the new regional switch, SIRESS, the cost of transferring money between countries in the region is substantially reduced. The estimated value of informal cross border remittance flows from South Africa to Lesotho annually constitutes 22% of total current bank deposits. Given that these banks may become increasingly competitive for deposits due to the current trend of rising credit provision, the informal remittances represent a substantial opportunity for the banks to substantially increase their deposits.

c. *Enhancing risk mitigation beyond funeral cover*. Most Basotho adults already have funeral cover. While funeral cover enables decent burials and prevents households from incurring debt or drawing down savings when faced with funeral expenses, it is a sunk expenditure that does not provide a return in terms of the wealth of the family and, hence, does not directly lift people out of poverty. To achieve this objective, the product suite accessible to the low-income market would need to be broadened to life insurance that can, for example, pay for dependents' education. Most notably, the context and demand-side analysis suggests vulnerability to especially health risks for which there are

currently limited, if any, insurance solutions. Given the dearth of current health insurance options and the severe accessibility challenges, extending the reach of health insurance will be very challenging and may not be a feasible first-order priority. It would require out of the box thinking regarding cover other than comprehensive inpatient cover (including the so-called hospital cash plan cover already introduced in Lesotho), as well as regarding distribution on a group basis. Consideration should be given to the scope for bundling of funeral cover (with which the market is familiar enough to create a spontaneous demand) with other elements such as life and health in order to ensure uptake. Another important consideration given qualitative demand-side feedback is the need for capacity building, benefit design and better service offerings of existing funeral insurance providers. Lastly, more specific analysis is needed on the parameters to be included in microinsurance regulations.

2. Take small steps towards enhanced growth through highly targeted productive credit and inward investment promotion

Specifically target credit at aspirational SMMEs and cash-generating farmers. As discussed, the small economic and industrial base means that individual entrepreneurs, farmers and small businesses fulfil an important role in supporting livelihoods, even if the more aspirational among them represent only a small group and most are survivalist in nature. Simply providing access to finance is unlikely to grow SMMEs and farmers at scale or position them as growth points for the economy at large. This would in the first instance require a conducive trading and enabling environment, as well as support structures regarding business fundamentals (as for example already pursued through BEDCO). The effective provision of other financial services, including savings, payments and insurance, to SMMEs is also critical to their development (see Box 12). Neither would the bulk of microenterprises and small-scale farmers be viable credit clients. Nevertheless, access to productive credit can benefit a small, but important subset of small business owners and farmers.

Box 12. Comparative international examples: a holistic take on SMME-targeted financial services

Credit is not the only financial service that can add value to entrepreneurs and farmers if specifically tailored to their needs:

Access to savings important for SMME development

Dupas and Robinson (2011) conducted a field experiment in which a randomly selected sample of small informal business owners in a village in rural western Kenya received access to an interest-free savings account in order to test whether limited access to formal savings services impedes business growth. The research found that having an account had a substantial positive impact on levels of productive investments among market vendors and within six months led to higher income levels, determined through a proxy of expenditures. The authors found suggestive evidence that the account made market women less vulnerable to health shocks. The data indicated that over the period of the study, market women in the control group were forced to draw down their working capital in response to health shocks, whereas women in the treatment group did not have to reduce their business investment levels and were better able to smooth their labour supply over illness. This finding indicates that limited access to savings services can indeed impede business growth.

The benefits of a full-service approach

ICICI Bank in India credits at least part of its success in serving SMME clients to its "beyond-lending" approach. By offering products and services to SMME clients that meet their full range of financial services needs, ICICI Bank has been able to increase its total SMME client base to nearly 1 million enterprises, of which only 5% are lending clients.

Using technology-enabled low-cost alternative channels and applications has enabled the bank to serve SMMEs' day-to-day business and transactional needs more efficiently with low turnaround times. Most of the bank's SMME revenues now come from deposit and other non-lending products, whilst lending revenues are also growing rapidly as deposit-only SMME clients begin to take loans (IFC, 2010).

Leverage the private sector. Historical experience suggests that government-subsidised programmes are not the way to achieve sustainable access to productive credit. Rather, targeted private sector strategies are needed to provide finance to distinct pockets of enterprising entrepreneurs. Banks are already extending more credit; the imperative now is to capitalize on the growth in the credit market and multiply it through the economy. This should be done by identifying specific viable sub-sets of productive credit clients at a sectoral basis. To do so, at least three strategies can be considered:

- *Targeted market research.* The qualitative and quantitative demand-side analysis conducted for this report did not allow scope for specific research on the profile and needs of specific sub-sets of aspirational entrepreneurs and farmers to inform product design, distribution strategies or the policy response. This calls for targeted market research on SMMEs and farmers, focusing on specific, promising sub-sectors, to get a more dedicated understanding of their realities and finance needs, as well as the value chain aggregators and other networks with potential to reach them. This does not need to entail a fully-fledged FinScope small business survey, but can be tailored to obtain information most useful to inform the roadmap.
- *Tailored product design.* The credit needs of both farmers and SMMEs will tend to be long-term in nature. Should they move from their current tendency to use informal credit to formal credit sources, they will benefit not just from the reduced cost of credit but also the longer-term nature of loans. The fact that there is no de facto credit interest rate cap in Lesotho facilitates the design of formal products to the SMME market, as players can price for the higher risk associated while still competing favourably with informal interest rates. However, these products should also be designed to meet the specific needs of the consumer. For example: a small business may need an initial repayment holiday in order to allow the business to achieve profitability whilst the repayment terms of agricultural loans should reflect the seasonality of farmers' incomes. At least one bank, SBL, has started to develop products specifically targeted at the SMME market and has opened a specific SMME-dedicated branch in Maseru to service this market's needs.

Box 13. Comparative international examples: tailored SMME and farmer products

A focused SMME payments provider

Zoona is a Zambian payments service provider focusing specifically on servicing the needs of small businesses. Unlike more generic, population-wide electronic payments products such as the standard mobile money product, Zoona is able to focus on servicing the exact needs of small

businesses. Zoona has partnered with Airtel, a large MNO in Zambia that offers mobile money, to provide electronic payment solutions for small businesses, thereby helping to manage SMME's cash management problems and reducing the cost of transactions as physically transporting cash can be both time consuming and expensive.

Zoona is also able to conduct data analytics on data collected from interactions with their clients, allowing them to better tailor their existing products and develop new products to better meet clients' needs. Finally, Zoona aids clients to access finance, facilitating accessible and affordable working capital loans for SMMEs that would otherwise have no formal access.

Flexible input credit

The government-owned BAAC (Bank for Agriculture and Agricultural Cooperatives) in Thailand has launched a credit card for rice farmers that provides interest-free credit for up to 5 months to farmers wishing to buy agricultural inputs. The interest free period takes account of the long lag between farmers' demand for input credit and their return on investment.

Sources: http://www.zoona.co.za/; Microfinance Services Pty Ltd and Cenfri, 2013

- *Leverage existing channels.* Targeting defined groups of SMMEs and farmers requires a rethink of the role and mechanisms of delivering credit. Potential actions include working through existing networks in key markets. For example: targeting the estimated 28,000 wool producers through agricultural associations such as the Lesotho National Wool and Mohair Growers' Association, to name just one example. Where relevant, government could leverage its involvement in value chains to incentivise private financial institutions to engage (for example by tendering access to the government wool shed system).

  Where SMMEs are concerned, the scope for distribution of credit through sectoral networks should be investigated, even if their reach is limited. This could include relevant associations, for example cross-border traders or taxi drivers[102]. A dedicated stock-take is needed of the landscape of SMME networks and supply-chains to identify those linkages with most capacity. Box 14 below discusses some examples credit provision through existing networks.

Box 14: Comparative international example: SMME and agricultural financing initiatives

Nedbank and SEDCO partnership in Swaziland aimed at improving access to credit for SMMEs

Nedbank Swaziland has partnered with SEDCO (Small Enterprises Development Company Limited), the government-funded, apex training and small business development organisation in order to increase its loans to SMMEs. The arrangement is such that SEDCO, after working with SMMEs in terms of training them and helping them to develop a business plan, will pass on the most promising candidates to Nedbank. However, these SMMEs must still comply with Nedbank's full requirements and risk assessment.

Providing finance to Swaziland's cotton farmers

The Swazi cotton board, through the cotton ginnery provides seeds, chemicals and fertiliser on

[102] The qualitative demand-side research referred to an instance where a savings club is formed among taxi drivers to buy new minibus taxis.

credit and then automatically deduct the costs of these inputs when the cotton is sold back to the ginnery. The interest rate charged is 7.5% on the value of the inputs. The lack of economies of scale of growing cotton make it an ideal crop for low income Swazi farmers who can grow cotton profitably on less than 1ha. This means that these farmers are unlikely to be able to afford the capital outlay upfront and hence makes this scheme potentially crucial to their ongoing operations. There are currently about 3,000 cotton farmers in Swaziland.

Source: Thom, et al., 2014: forthcoming

Explicit strategies to leverage inward investment by migrant workers. In addition to SMMEs and farmers, migrant workers can be targeted for productive investments in Lesotho. The Moliko Trust example, established by the South African National Union of Mineworkers (NUM), is indicative of a demand for productive credit in Lesotho expressed by migrant workers in South Africa. Drawing on international experience, a number of strategies can be considered for more effectively leveraging inward productive investment by migrant workers, for example: designing and marketing cross-border financial products where the investment is made in Lesotho, but the loans are repaid in South Africa; utilising cross-border channels such as TEBA to distribute loans; and enhancing access to low-cost cross-border payment channels to facilitate cross-border investments.

Box 15: Comparative international example: Diaspora Term Life Cover with Chase Bank Kenya

Chase Bank in Kenya has combined a number of the potential strategies discussed in this section into one product. The bank offers free term life insurance to the accountholders of the Chase Bank Diaspora Account targeted specifically at Kenyans living outside the country. The account incentivizes higher account balances by offering tiered cover as indicated below:

- A minimum balance of US $2,500 secures you a free benefit of Kshs.500,000
- A minimum balance of US $5,000 secures you a free benefit of Kshs.1,000,000
- A minimum balance of US $7,500 secures you a free benefit of Kshs.2,000,000
- A minimum balance of US $10,000 secures you a free benefit of Kshs.5,000,000

The bank also offers accountholders the opportunity to purchase cover for family members residing in Kenya.

Source: Chase Bank Kenya, 2014

3. Leverage financial sector intermediation to support investment and growth

Financial sector intermediation can support growth by leveraging savings for investment purposes. Current industry trends suggest that banks may soon place greater emphasis on mobilising deposits for on-lending purposes. Providing products appropriate to the needs of low income and entry level consumers may be less profitable for the bank in the short term, but can result in long term gains. There are a number of options:

- *Reducing costs*. Greater formal savings can be supported through the strategies set out under strategy one above for reducing the cost of formal savings and enabling mobile money to play an explicit role in deposit mobilisation.

- *Incentivising higher account balances*. Given the high costs to banks of dormant and low balance accounts, incentivising higher account balances is in banks' interest. Tiered accounts with interest rate incentives for higher balances are already in place. Due to the historically high liquidity of Lesotho's banks there was little competition to mobilise deposits, however as bank credit provision has risen sharply in recent years, this may change and offering a better price for customer's deposits should help incentivize them to maintain higher balances. Another potential strategy is to embed free funeral cover based on the deposit value maintained in a bank account (thereby using the fact that funeral cover is such a strong anchor product in Lesotho as a "carrot" to incentivize savings).
- *Facilitating access to savings accounts by revisiting eligibility requirements*. For regulators, this means considering the introduction of a tiered KYC system in the banking sphere similar to what is the case for e-money, while for banks it means revisiting the need for proof of employment or income often required or by promoting partnerships between banks and MNOs to utilise mobile money as a lower-cost front end for mobilising savings accounts
- *Targeting groups*. Furthermore, offering tailored group accounts is a way of leveraging the large funds vested in community-based savings and insurance groups for formal intermediation in the economy.
- *Incentivise non-resident Basotho to save and invest in Lesotho*. A final strategy, which aligns with that recommended in strategy two above, would be to find a way to make it cheaper and more lucrative for migrant workers to save in Lesotho than in South Africa. Potential strategies that could be considered include designing migrant workers savings accounts that offer a higher interest rate than such workers would be able to earn in South Africa, and then marketing it directly to migrant worker populations in South Africa, targeting areas with a high Basotho worker concentration or large employers. The same would hold for insurance products targeting migrant workers (for example including cover for body repatriation, or focusing on providing cover for dependents in Lesotho).

  Government has a number of options to incentivise private sector innovation in this regard, including creating a database of foreign workers to which financial service providers can gain access for marketing purposes, or by offering regulatory incentives or concessions to banks that offer such products.

  At the front end, a low-cost remittance channel is needed that migrant workers can easily access in South Africa and that allows them to deposit money straight into their Lesotho bank accounts. This would require engagement of South African counterparts through the relevant platforms under the SADC Financial Integration Protocol (refer to strategy one above).

- *Selective institutional reforms*: Lesotho Postbank and Boliba Savings and Credit. LPB has a very large customer base and is important for savings mobilization, but plays a very limited role in credit provision. Furthermore its payments cards are not integrated with those of the rest of the financial system, thereby reducing its attractiveness to customers. It has been continuously unprofitable and dependent upon government subsidies, and has suffered from weak governance and direction. However, efforts to reform and revive LPB are worthwhile. This means reforming its governance and

clarifying its mandate; developing a viable business plan; upgrading and modernising its payments system; moviong to a branchless banking platform, and possibly considering an alliance with an MNO.

Boliba has an important customer base among urban low income populations. However it has governance problems, has been subject to suspected fraud, and has weak supervision. It may be technically insolvent once proper provisioning is applied, and depositors funds at risk. To resolve these problems, supervision should be transferred from the DoC to the CBL (as per the legal requirements of the FIA), and a forensic audit should be undertaken. Boliba needs extensive governance reform, and may need recapitalisation.

Box 16. International comparative examples: diaspora-focused policies

Broader than simply a financial services focus

Any policy to target migrant workers as a mechanism to extend financial inclusion through the inward remittances, investments and deposits needs to take an holistic view of the needs of emigrants beyond simply financial services. Fundamentally, in order to "get something out of" emigrants, they would require some benefits in return. Potential policies in this regard can fall into various categories:

- *Symbolic nation-building*, which may comprise a broad range of initiatives and programmes to increase emigrants' sense of belonging to a transnational community of co-nationals, and to boost the profile of the state within this community.
- *Institution-building policies* in order to furnish the state with technologies – systems and institutions – to 'govern' diaspora populations. A first step for many states is the implementation of surveillance which would entail compiling some form of database of all emigrants and then to collect statistics on which to base strategic orientations towards emigrants.
- *Extending Rights* such as allowing emigrants to maintain a dual nationality, vote or even run for office (Gamlen, 2006). Lesotho, for example, does not currently allow dual citizenship which places emigrants in a difficult position in choosing their citizenship (Petlane, 2013).

Various ways to target diaspora investment

There are a number of policies that have been developed by countries around the world targeting remittances with the aim of channeling them into investments. Examples include:

- Rewarding remitters such as duty free allowances in the Philippines and free passport issuance in Pakistan
- Offering preferential interest rates in India and Pakistan
- Allowing small-minimum-deposit foreign-currency bank accounts in Nigeria and Ghana
- Issuing foreign currency denominated bonds to expatriates
- 'Matching fund' programmes such as *Tres Por Uno* implemented by Mexico, under which every peso remitted by migrants is matched by three from local and federal governments at home.

In addition to these programmes, many countries have developed a specific focus on incorporating expats as investors into their broader FDI and development strategies. Turkey has experimented with expatriate seeded venture capital funds (Faist, 2004), while China, Taiwan and India have created special economic zones to attract expatriate investments. Another approach, as used in India, is the establishment of high level 'investor relations' offices that allow expatriates

to bypass bureaucratic red tape associated with large-scale investment.

Source: Gamlen, 2006

The discussion above has shown that a number of key activities – for example to promote mobile money by allowing it to pay interest, or various policies to target migrant workers, can serve more than one of the key public policy objectives to be achieved through the roadmap and are therefore relevant for more than one of the three core roadmap strategies.

7.4. Positioning the MAP roadmap in the financial inclusion policy framework

The Lesotho Financial Sector Development Strategy (FSDS) was adopted in December 2013. It builds on and integrates the proposals across more than 25 recent or ongoing projects as well as the National Strategic Development Plan (NSDP). The FSDS includes almost 200 action items to be implemented over a five year period, covering the six strategic objectives of the NSDP, and broken down into a number of detailed areas. While the FSDS provides overall strategic direction and consensus on the menu of potential activities, there is a need to narrow down the recommendations into a list of concrete activities that can be implemented according to a defined implementation timeline. As the discussion above has shown, MAP applies a demand-side lens to focus the FSDS recommendations into a set of key roadmap priorities to achieve client impact at scale.

Below, we link the suggested MAP roadmap priorities to the key financial inclusion-relevant NSDP strategy components and FSDS recommendations. Based on the MAP findings, we assign roadmap priorities to the FSDS recommendations using a traffic-light system. The green lines reflect NSDP and FSDS aspects that, though important, do not require specific roadmap priority. Yellow lines represent secondary or supporting roadmap activities. Red lines are core roadmap priorities. The MAP roadmap process will then flesh out and assign specific action steps to each of the priority areas.

NSDP strategic areas	FSDS recommendation elements	Roadmap priority
Improving access to finance	Financial Literacy	
	SME Financial Inclusion	Targeted sectoral SMME credit
	Legal reforms	
	Increasing Commercial Bank Participation	
	Lesotho Post Bank	Develop viable business strategy, improve governance and clarify mandate
	Microfinance Institutions,	Leverage collective functioning for enhanced formal intermediation through an emphasis on group

NSDP strategic areas	FSDS recommendation elements	Roadmap priority
	RSCGs and VSLAs, SACCOs	accounts. Undertake forensic audit of Boliba and transfer regulation and supervision to CBL.
	Housing Finance	
	Agricultural Finance	Targeted financial services for farmers
	Mobile money/e-Money Accounts	Reduce transaction costs and enhance formal savings options
	Micro-Insurance	Limited direct MI priority, as current collective vehicles function well.
	Credit Information	Backbone-level to enable agricultural finance, SMME credit
Increasing alternatives for mobilising financial resources; and Promoting a savings culture	Consumer Protection	A client value perspective on consumer protection underlies each of the MAP priorities
	Capital Market Development	
	Insurance	Consider options beyond funeral insurance.
	Cross-Border Competition	Promote savings accounts targeted at migrants
	Pensions	Consider long-term savings options for migrant workers and families as sub-activity to enhanced financial intermediation priority.
Improving financial sector efficiency	Payment System Regulation and Oversight	Back-bone level support for all three financial inclusion priorities
	High Value Payments and Clearing Systems	
	Retail Payments	Reduce transaction costs, increase formal remittance options and promote savings accounts targeted at migrants
	Cross-Border Remittances	
Bridging the skills gaps in the financial sector and increasing financial literacy		
Improving financial stability and soundness	Financial Stability	
	Financial sector supervision	
	Financial Safety Net	

NSDP strategic areas	FSDS recommendation elements	Roadmap priority
	Strengthening the Legal Framework	

Table 31: Comparison of recommendations to FSDS elements

Source: Authors' own

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Appendix 1: Meeting list

Institution Name	Institution Representatives
Ministry of Finance	Mr M N Khethisa (Principal Secretary) Ms Maseeiso Lekholoane (Private Sector Development Director) Ms Florence Mohasoa Senior Financial Institutions Officer Ms Reitumetse Elias Manager Private Sector Support
Central Bank of Lesotho	Dr Adelaide Matlanyane (Governor) Dr M P Makhetha (First Deputy Governor) Ms Gail M Makenete (Second Deputy Governor) Mr Mokotjo Mphaka (Director of Supervision) Mr Seabata Ntelo (Director of Operations) Mrs Ntee Bereng (Head of Non –Bank Supervision) Ms. Thakane Tau Portfolio Manager Insurance Ms Itumeleng Letsolo (National Payments Systems Division)
Rural Financial Intermediation Programme (IFAD)	Mr. Sekoala Molapo Manager Ms. Monehela Tau (Monitoring & Evaluation and Knowledge Management Officer)
Lesotho National Insurance Group	Mr. Tumelo Kepa (Assistant General Manager)
Alliance Insurance	Mr. Angus Yeats (CEO)
Lesotho Communications Authority	Mr Monahela Posholi (CEO) Mr. Hlompho Sefako Director Licensing, Compliance and Consumer Affairs Mr. Motsamai Mochebelele Director, Economics and Market Develoment
Standard Lesotho Bank	Mr. Mpho Vumbukani (CEO) Mr Phetise Baholo (Manager, Financial Accounting and Reporting)
First National Bank	Ms Limakatso Taleng Mojakhomo Acting Head, Business and Commercial Mr. Kevin Brooks Head of Vehicle and Asset Finance Mr. Willem Nel Head Retail Mr. Themba Sopeng Business Credit Manager
Nedbank	Mr. Fusi Notoane Managing Director Mr Pheta Setlojoane (Head of Compliance)
Lesotho Post Bank	Ms. Refiloe Lehohla (Acting General Manager) Ms Mamahapela Mokuoane Business Development Manager

Institution Name	Institution Representatives
	Mr. George Moqasa Product Development Officer
Boliba	Mr. Lesole Mokheseng (General Manager)
Blessings Financial Services	Ms Mamakamane Makamane CEO
Vodacom	Ms. Nthatisi Qheku (Specialist: m-pesa Partnerships)
Medilife	Dr. Molotsi Monyamane Director Mr. R.V. Lechesa Principal Officer
Zenith Horizen	Ms. Smangela Molumeli Director
ETL	Mr. Kuleile Thekiso (Chief Officer: Econet Services)
AON	Mr. Daniel Gudu Operations Manager
Moliko Trust	Mr. Alter Muchipisi Project Manager
Ministry of Trade, Industry, Co-operatives & Marketing	Mr Moahloli Mphaka (Principal Secretary) Ms Maphamoli Elizabeth Lekoetje (& Commissioner of Cooperatives)
Setebale Gap Funeral Parlour	Ms. Aliciah Motsoane (CEO)
National Funeral Directors of Lesotho	Mr. Reentseng Motobako General Secretary
Private Agro Dealer	Ms Nthabiseng Maieane The Manager/Director
Ministry of Social Welfare	Ms. Limakatso Chisepo Principal Secretary
Metropolitan Lesotho	Ms. Mamphono Khaketla Chief Financial Officer
World Food Programme Catholic Relief Services CARE Lesotho	Mr. Rui Possolo (Head of Programme and Logistics, WFP) Mr. Sempe Lerotholi Livelihood Project Manager Mr. Khoase Litseo Technical Field Officer Ms. Malintle Matlakeng Project Coordinator
UNDP	Ms. Alka Bhatia (Economic Advisor & Head of Strategy Policy Unit) Ms. Mabulara Tsuene (Financial Inclusion Specialist)
Ministry of Agriculture	Ms Mapalesa Mothokho Director of Crops
TEBA Limited	Mr Kikine Kikine (Regional Manager Lesotho)