Making Access Possible

Lesotho

Financial Inclusion Country Report

2014

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The Centre for Financial Regulation & Inclusion

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Making financial markets work for the poor

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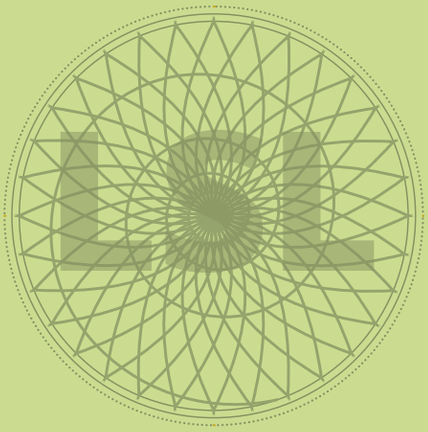
Making Access Possible (MAP) is a multi-country initiative to support financial inclusion through a process of evidence-based country diagnostic and stakeholder dialogue, leading to the development of national financial inclusion roadmaps that identify key drivers of financial inclusion and recommended action. Through its design, MAP seeks to strengthen and focus the domestic development dialogue on financial inclusion. The global project seeks to engage with various other international platforms and entities impacting on financial inclusion, using the evidence gathered at the country level.

At country level, the core MAP partners, collaborate with Government, other key stakeholders and donors to ensure an inclusive, holistic process.

The cover symbol

Through the MAP programme, we hope to effect real change at country level and see the impact of financial inclusion on broader national growth and development. The cover graphic features a plant synonymous with the region, which is the Spiral Aloe. The flower symbolises growth and development while the circle represents inclusive growth. Each flower is an example of the successful growth in a unique environment. By combining the Aloe with the currency symbol of Lesotho we represent the characteristics of the country, linking financial inclusion with successful growth.



ABOUT MAP Lesotho

This Synthesis note summarises the main findings of the Making Access Possible (MAP) Lesotho Diagnostic Report. 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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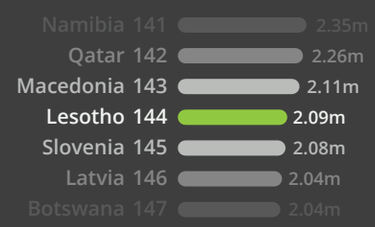
SYNTHESIS REPORT AUTHORED BY CENFRI, based on the diagnostic report

List of Abbreviations and Acronyms

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

Contents

Key facts



Lesotho has a GDP of USD 2.3 billion

GDP per capita is $1,289

With 2.09 million people, Lesotho's population is one of the smallest in SADC

2.3% of adults have a tertiary education

69% of adults are estimated to live in rural areas

69.8% of adults are estimated to have access to a mobile phone

Remittances constitute 22.6% of Lesotho's GNP

Financial Inclusion Priorities

PRIORITY AREAS 1: DIRECTLY IMPROVE HOUSEHOLD WELFARE THROUGH EFFICIENCY GAINS AND RISK MITIGATION

33% of Basotho adults cited bank charges as a primary consideration as to whether to open a bank account

PRIORITY AREA 2: TAKE SMALL STEPS TOWARDS ENHANCED GROWTH THROUGH HIGHLY TARGETED PRODUCTIVE CREDIT AND INWARD INVESTMENT PROMOTION

Only 10.4% of SMMEs and 7.7% of farmers have access to formal credit.

PRIORITY AREA 3: LEVERAGE FINANCIAL SECTOR INTERMEDIATION TO SUPPORT INVESTMENT AND GROWTH

As many as 400,000 Basotho live outside the country, a focused migrant worker policy could leverage this group for increased internal investment.

Breakdown of Financial Access in Lesotho by Product Market

16.6% of adults borrow from a formal institution
419,289 adults are members of burial societies
34.4% of adults save with a formal financial service provider
17% of adults save in cash at home
62% of adults have access to some form of insurance
ATM withdrawals account for **89%** of the total number of formal transactions

Overview of Financial Access in Lesotho

61% of adults reported to use at least one financial service from a formal financial service provider.

53% of those formally included have more than one formal product

70% of those formally included have an informal product as well

62% of the adult population use informal financial services

20% of adults make use of informal services only

1 MAP in Lesotho

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[2]. Economic theory[3] 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 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.

The value of MAP. 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. The strong demand-side focus and the segmentation tool employed enables MAP to identify the needs of specific groups of consumers, rather than treating all individuals alike. This creates the opportunity to identify more specifically targeted actions and to prioritise those which will have the largest impact on overall consumer welfare. Furthermore, MAP looks at financial inclusion across all four product markets: credit, savings, payments and insurance; which allows for a holistic analysis of the financial sector, taking into account the inter-linkages between product markets.

2 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 migrant worker population, such as repatriation funeral insurance and cross-border payment of dependants' insurance premiums, retirement or other long-term savings, or cross-border payment of loans.

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.

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: more than 500,000 Basotho 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. 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.

3 The Lesotho consumer

Despite the 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). 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.

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.

Broadly served population. 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. Dependants, 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.

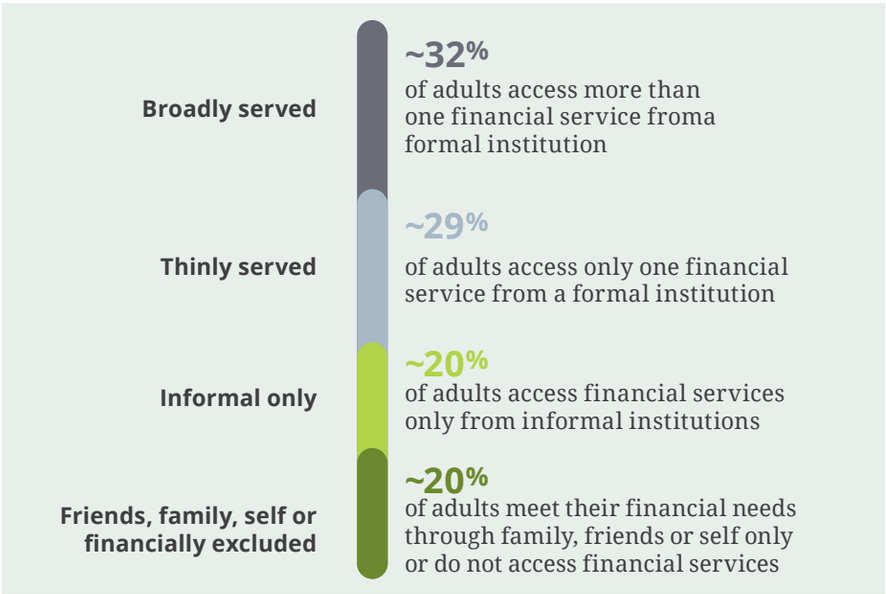


Figure 1: Nature of financial services usage
Source: FinScope, 2011

3.1. Segmenting the market

To understand the nature and dynamics of uptake and usage of financial services by different population segments, the adult population was divided into six target market segments, classified mainly based on primary source of income.

- The salaried workers consist 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.
- Private dependants 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.
- Government dependants 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.
- The small business owners include 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.
- The piece job workers consist of adults that rely on low-wage jobs, that is, piecework or casual labour.
- The farmers represent 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.

The diagram to the right summarises the profile of each segment:

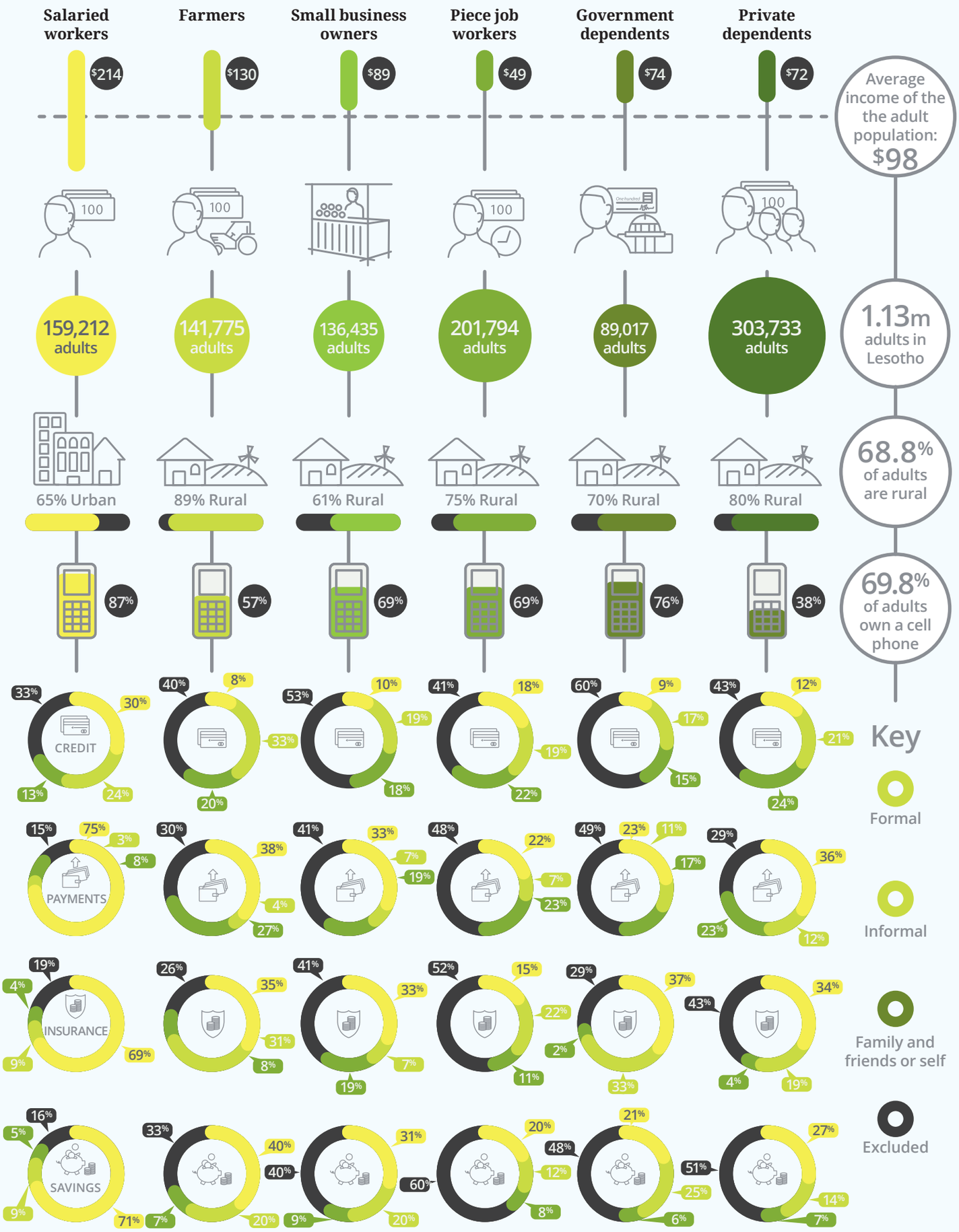


Figure 2: Target markets for financial inclusion in Lesotho
Source: FinScope, 2011

"Small business owners are largely survivalist in nature (making ends meet, rather than running growing businesses)."

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 dependants 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 dependants' 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.

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 dependants in Lesotho.

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 dependants in Lesotho.

4 Overview of financial sector institutions

The institutional landscape is illustrated below in Figure 3:

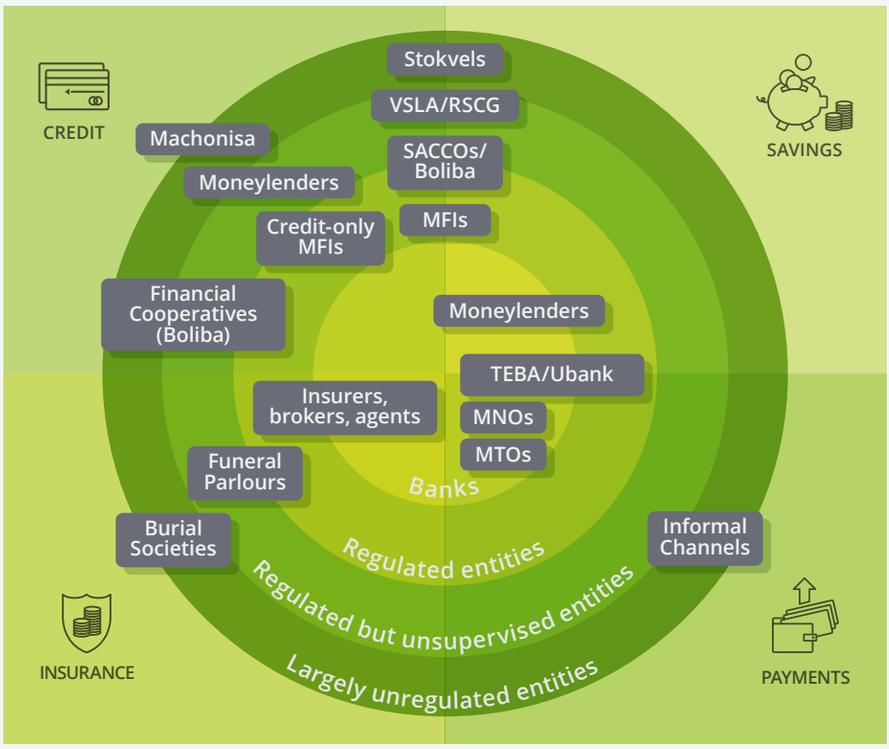


Figure 3: Mapping of Lesotho Financial Sector*

Market dominated by the banks. There are four licensed banks: Standard Lesotho Bank (SLB); Nedbank Lesotho; FNB Lesotho and Lesotho PostBank (LPB). They are the largest players in the financial sector, with combined assets equivalent to 42.3% of GDP. Figure 3 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.

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.

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, 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. The vast majority of remittances are also sent through informal channels such as with friends or family. 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[4]. 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.

** 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.*

5 Financial inclusion priorities

"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 highly 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. Most 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 as well as meet key target market needs, three core 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.

5.1. 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 dependants 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 dependants' 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.

5.2. 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 1). 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 1:
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
- ***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).

BOX 2:
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

BOX 3:
Comparative regional 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 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

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[5]. A dedicated stock-take is needed of the landscape of SMME networks and supply-chains to identify those linkages with most capacity. Box 3 below discusses some examples credit provision through existing networks.

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 4:
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 incentivises 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

5.3. 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 incentivise 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 incentivise 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 dependants 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; moving 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 5:
Comparative international examples:
migrant population-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' migrant 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 migrant worker investment

There are a number of policies that have been developed by countries around the world targeting remittances with the aim of channelling 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.

6 Going forward

Lesotho has made good progress in enabling access to formal financial services to the entire population. Informal, community-based services also play an important role in extending access to financial services to the Basotho, with many adults using formal and informal financial services as complementary products.

MAP has identified three priority areas which will provide the largest marginal gain in welfare through the extension of financial services. Addressing these areas will require a coordinated effort across institutions, product categories and market segments, in order to ensure that the underlying market inefficiencies are adequately addressed and the opportunities capitalised on. It will also require the government to work together with other stakeholders such as the private sector, development partners and sector experts. To assist these stakeholders address the opportunities in harmony, a MAP Roadmap has been developed and discussed by the MAP Task Team. The roadmap details the programme of action necessary to address the identified priority areas.

Endnotes

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.
2. It goes both ways, however. The real economy and broader country context also impact the scope for financial inclusion by determining the realities within which the target market functions.
3. See, for example: Calderón & Liu (2002), King & Levine(1993), and Levine (1997)
4. It still functions as an investment promotion agency and as a provider of industrial properties.
5. The qualitative demand-side research referred to an instance where a savings club is formed among taxi drivers to buy new minibus taxis.

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