DTI Logo **ILO Logo**

Seminar Monograph

Financing Transformation from Below: The Role of Cooperative Banking

Contents

1. **Background**

2. **Problem Statement**

3. **Financing Transformation from Below- The Role of Cooperative Banking**

   Sharda Naidoo, Managing Director, Cooperative Banks Development Agency

4. **The Challenges and Opportunities for Stokvels To Become Cooperatives**

   Andrew Lukhele, Leader and Founding Member of Stokvel Movement

5. **The Cooperative Banking System in Germany**

   Sabine Fitzner, Head of the DGRV South Africa Office

6. **Summary of Main Discussion Points**

1. Background

On 9th June 2009 the International Labour Organisation and the Department of Trade and Industry hosted a seminar entitled: *Financing Transformation from Below-The Role of Cooperative Banking*. This was the fifth seminar in the cooperative series to be hosted by the ILO and DTI.

The seminar drew in cooperators, policy experts, sector stakeholders and academics into a common space to think about cooperative development as part of an approach to addressing wider development challenges facing the country.

The seminar series on cooperatives is intended to achieve the following:

- Provide a platform for in depth debate about key policy and development issues facing cooperatives in South Africa;
- Generate new ideas, innovative thinking and insights about the role of cooperatives, the cooperative sector and cooperative economy;
- Identify opportunities and challenges facing cooperative development in South Africa;
- Provide a learning and sharing space for cooperative practitioners, policy actors, support ngos, and mass organisations;
- Generate knowledge about cooperative practices and experiences at the frontline of change;
- Enhance the capacity for knowledge based leadership around cooperative development in South Africa.

2. Problem Statement

Cooperatives have been providing financial services in poor communities since 1980. Through the credit union movement cooperatives became a crucial institution for savings and loans to support education costs, housing development and consumption needs. Alongside the South African Credit Cooperative League (SACCOL) credit unions, the 1990s witnessed the emergence of village cooperative banks and financials services cooperative linked to the sugar industry. The institutional success rate of these experiences has been chequered and in some instances disastrous. As part of formalising this sector a Cooperatives Banks Act was passed with an enabling role for a Cooperative Banks Development Agency (CBDA). What is the CBDA and how will it assist in setting up cooperative banks? How will this link with poverty reduction and development? Is there a role for stokvels and burial societies in the emergent cooperative banking sub-sector? What are the challenges and opportunities? What can we learn from international experiences? What is the role of the state? What is the role of the cooperative movement?

3. Financing Transformation from Below- The Role of Cooperative Banking

Sharda Naidoo, MD, Cooperative Banks Development Agency

3.1 Introduction

The use of the term transformation in the South African context poses complex and profound challenges. At minimum, a holistic view of transformation would encompass change at social, psychological, educational and economic levels. It is therefore difficult to imagine that cooperative banking or any other form of financial service option could tackle the multiple levels and dimensions of transformation. Perhaps the most tangible aspect of transformation is that of attempting to impact on incomes and management of resources at the household level. In view of this, the discussion in this paper will thus be limited to the role that co-operative banking can play in reducing poverty.

We start by considering some of the key facets of poverty. The view taken here is that poverty is a multi-dimensional phenomenon that covers a range of impacts and consequences. This is explored in the first section. We then go on to consider one of the key challenges that can cause households to regress into poverty frequently, i.e. risk. Risks are endemic to the lives of poor households. Its link to capital formation or the constraints thereof are key to understanding poverty reduction. We examine capital formation with the use of the sustainable livelihoods framework. This leads into a discussion about risk and capital formation. From this perspective we consider what role financial services can play in poverty reduction. And finally we consider the specificities of co-operative financial services and explore the roles such institutional options can play in enabling poor people to work their way out of poverty.

The background to the linkage between poverty and financial services stems from the microfinance revolution. Since the advent of that revolution in the 1980s, increasing access to financial services as a tool for poverty reduction has received increasing attention. Numerous strategies and types of projects attempted to tackle poverty. Microfinance targeted the poor directly and this led to sustainable financial institutions, which attracted very substantial resources and attention from donors and governments. Having started with credit for poor people operating enterprises, financial services for the poor evolved as it was learnt that the poor also needed savings, hence the progression from micro-credit to microfinance.

In some cases, poverty is considered solely as the inability to generate sufficient income. The impact of financial services can and sometimes has been reduced to credit only as an investment which will simply reduce poverty through injections into the businesses of the poor (e.g. Micro Credit Summit, 1997). We attempt to take a broader view here and consider whether credit itself can increase the incomes of the poor **sustainably**. More simply can every injection of credit into a business run by a poor person increase

income? We would prefer to assert here that the issues need to be examined more rigorously to ensure robust solutions.

3.2 Understanding Poverty

In order to cast some light on the linkage between financial services and poverty, we start by examining some aspects of poverty through two lenses: 'The Voices of the Poor' and the sustainable livelihoods framework. We next ask how we should view 'financial services'. To focus the issues, we then examine some of the evidence from a range of studies on access to financial services and poverty. In our attempt to examine the issues in more depth, we consider the views of the poor from 'Moving out of Poverty' (World Bank, 2009) which is a follow up to 'Voices of the Poor'.

Our starting point in understanding poverty is drawn from 'The Voices of the Poor' a study done by the World Bank using 23 research teams across the globe. This study provides perspectives on poverty through interactions with poor people in order to arrive at a universal understanding and definition of poverty. In citing this study we hope to highlight the importance of a holistic understanding of poverty through 'the eyes of the poor'. Following this review of definitions of poverty, we unpack and discuss the sustainable livelihoods framework[1] as it provides a comprehensive overview of the factors which impact on poverty and at the same time leads us towards pathways out of poverty.

The definitions of poverty which arose from the inquiry termed, 'Voices of the Poor'[2] show that there is no one simple concept which can define poverty. One of the first insights is that poverty is a 'multidimensional social phenomenon'. It is a condition which manifests in a lack of a series of basic resources and abilities which includes food, skills and productive assets. Key to this notion is that poverty is both a static and dynamic concept. Poor people lack the necessities for maintenance of material well-being, which includes food, clothing and housing. A further profound insight is that of psychological deprivation. Poor people are not heard in society and they lack independence. This becomes manifest in the inability of the poor to maintain social norms; perform necessary rituals, and the combination of these factors impacts on their ability to maintain their cultural identity.

[1] Our use of the sustainable livelihoods framework is intended to show the categories of assets that could be considered in enabling people to work their way out of poverty. We are not advocating that the sustainable livelihoods approach holds any advantages over other approaches to poverty reduction or eradication.

[2] Narayan, D. et Al (1999): Can Anyone Hear Us? Voices From 47 Countries, Voices of the Poor, Volume1, World Bank

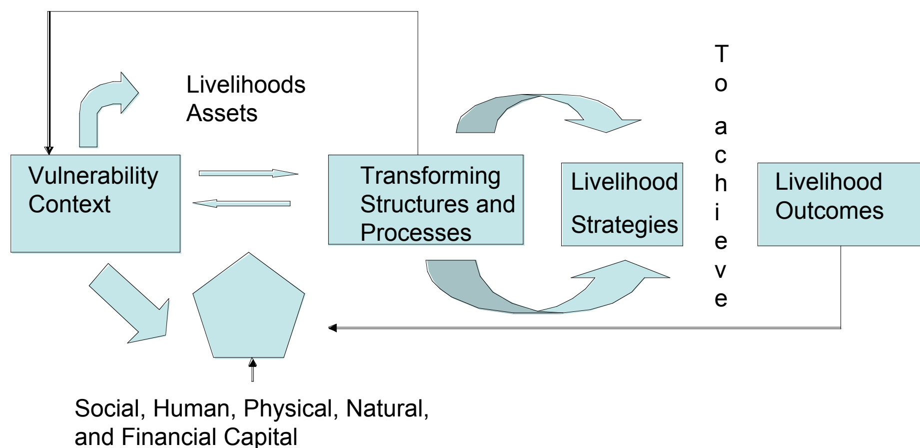
At a practical level, poor people often live in locations which lack basic infrastructure. This brings with it many burdens which compound poverty. Lack of clean water can lead to diseases. Lack of transport makes it harder and possibly more expensive to seek or to get to work. Lack of energy means that time is spent foraging for fuel (instead of more productive activity) or spending on more expensive or dangerous fuel such as paraffin. If poor people run businesses and lack telecommunications, they have to go to their suppliers to purchase or to order.

Key Facets of Poverty

- Multidimensional social phenomenon
- Lacking necessities for material well-being
- Psychological deprivation – voice, independence, cultural identity
- Absence of infrastructure
- Lacking combined physical, human, social, and environmental

The linkages among factors thus show that a combination of assets are lacking in the lives of the poor. These include physical assets, human assets, social assets, financial assets and environmental assets. This combination of assets or forms of *capital* as it is termed in the sustainable livelihoods framework, links poverty, vulnerability and risk.

The Sustainable Livelihoods (S L) framework illustrated below shows the connectivity between the vulnerability context and processes towards sustainable livelihoods.



Source: Sustainable Livelihoods Guidance Sheets, DFID, 2001

As the schematic above illustrates the lack or presence of key forms of capital or assets (social, physical, natural, human and financial) is the set of connectors between risk and

livelihoods. In this context, a livelihood consists of capabilities, assets, and activities required for living. 'A livelihood is sustainable when it can cope and recover from stresses and shocks and can maintain or enhance its capabilities, now and in the future while not undermining the natural resource bases'. (Sustainable Livelihoods Guidance Sheets, DFID, 2001)

When we juxtapose the complexities of poverty as they emerge from the Voices of the Poor with the range of risks that the poor face in conjunction with their limited asset base, we can begin to appreciate some of the depth and breadth of the processes of poverty eradication. The two boxes above, labelled transforming structures and processes and livelihoods strategies have embedded strata of functions and changes which are necessary for placing poor households on pathways towards sustainable livelihoods.

As the SL illustrates, financial assets are one of a group of assets the interplay of which enables people to cope sustainably and enhance their capabilities. As is fairly obvious financial assets may enable households to acquire human or physical assets though it is a matter of time before human capital can effectively enhance capabilities. If we view financial services in the context of the Voices of the Poor, we have to ask what survival strategies are being used that credit could enhance? Secondly, would there be sufficient know-how to invest competitively in business. The majority of studies have not really questioned the capacity (skill) of the enterprise owners when assessing whether increasing access to microfinance or financial services reduce poverty.

3.3 Financial Services and Poverty

While financial services for the poor or financial sector development[3] are often defined simply as access to credit and savings (and in a few cases insurance), a DfID Policy Paper (2004) usefully explores a range of ways in which the financial sector may develop:

- the efficiency and competitiveness of the sector may improve;
- the range of financial services that are available may increase;
- the diversity of institutions which operate in the financial sector may increase;
- the amount of money that is intermediated through the financial sector may increase;
- the extent to which capital is allocated by private sector financial institutions to private sector enterprises, responding to market signals (rather than government directed lending by state owned banks), may increase;
- the regulation and stability of the financial sector may improve; and
- of particular important from a poverty reduction perspective, more of the population may gain access to financial services.

[3] The use of the terms microfinance and financial sector development in this context are intended to include savings and credit co-operatives and voluntary savings and lending at community level.

Hence there is no single definition of FSD, and there are different aspects and measures of FSD. This range of options is useful in that it broadens the range of issues that could be important for clients.

Gibb, S (2008) conducted research in Bolivia using a group receiving loans and a control group to assess whether microfinance impacts on education, poverty and empowerment. Using a comparative approach that allowed for comparisons between the independent control group and the loan group, the study which conducted more than 100 interviews, found that while the ownership of goods (especially household appliances and other household goods) increased in the loan group, the benefits of micro credit on family educational attainment levels and empowerment are questionable. If the impact of micro-credit on income alone were to be considered then the MFIs in Bolivia that provide loans are impacting positively. We could also ask whether it is appropriate to expect that a financial service would alter social relations or status, i.e. empower women or increase educational levels. If however, the study found that people invest more in household goods than in education that could suggest that they do not yet understand asset building. On the other hand it could also be that they do not value education or that empowerment would separate women from their social group and this may not be preferred.

Wright (1999) raises questions of impact by asking whether microfinance reduces poverty or raises income. Examining evidence from a broad range of studies Wright concludes that the poor use the profits from their enterprises to diversify their sources of income, thereby suggesting two things. First, it would seem that insecure income is one of the biggest risks that they face. Second, that using increased income to increase consumption is not the first choice by poor people. It would thus seem that the poor would rather use increased income to invest in other sources of income as a strategy to reduce risk and increase income simultaneously.

In seeking to assess direction for their development investments, SIDA conducted a study asking "Is microfinance a good poverty alleviation strategy?" (2004). The literature review on impact assessment found some impact on the poverty level of households, especially on female borrowers, schooling, nutrition, health, fertility and women empowerment. The evidence suggested that:

- Microfinance has a higher impact for households closer to the poverty line, rather than the poorest of the poor.
- There is clear support for the vulnerability of households being reduced through consumption and smoothing income and work patterns.
- Large proportions of microfinance loans are being used for consumption-smoothing purposes raising questions about long-term improvement for the participating households.
- There is a general lack of sustainable and cost-effective microfinance programmes that are necessary for the long-term contribution to income expansion and poverty reduction.
- If the economic growth in the economy is sluggish, microfinance programmes might result in redistribution, rather than an increase in income and employment.

Thus, microfinance is better used as an instrument along with other policies for poverty alleviation rather than a poverty reduction strategy in isolation.

A close set of correlates to the findings of the SIDA study appear to have influenced direction in the approach of the Inter-American Development Bank, IDB (2006), 'The Bank's current approach recognizes that reducing poverty requires complementary actions in multiple sectors, and that in order to expand the economic opportunities and the productive potential of the poor, both their productive capital (human, physical, and financial) and their market environment opportunities must be improved. The financial sector offers multiple instruments to improve the efficiency of capital allocation in the economy, and to help households manage their exposure to economic risk, including transaction banking, credit, savings, and insurance.'

Based on the Voices of the Poor and the evidence cited from the four studies above, there are a number of important aspects of financial services that emerge:

- Financial services, at minimum credit and savings, are important foundations in the processes of risk reduction and asset building for poor people;
- Given the fragility of income and circumstances, viewing the costs and benefits of financial services in totality would therefore be very important if the financial services are driven by goals related to poverty relief; and
- Thirdly it would be essential to construct financial products that are demand-driven and will meet the service needs of the people they are intended to serve.

These sets of requirements[4] are indeed a tall order in the light of the SIDA study comment that cost-effective and sustainable financial services are in short supply.

New insights into the value of financial services to poor people emerge from the World Bank's new study, "Moving Out Of Poverty" (www.worldbank.org, 2009). That study followed a similar methodology to the Voices of the Poor. In the case of the Moving Out of Poverty, studies were conducted in 15 very poor countries and 60 communities were consulted in attempting to seek pathways out of poverty. A number of over-arching themes emerged from the study. Of these there are two which pertain to financial services:

- Tiny loans usually provided under micro-credit schemes do not seem to lift large numbers of poor people out of poverty. Poor people need credit which

[4] One of the most controversial aspects that comes into focus here are the interest rates charged by MFIs. In the early days of the development of microfinance, it was assumed that the poor would rather have access to the credit rather than avoid the high prices. This was clearly a measure of how important access to the services is to poor people. In more recent debates (e.g. Compartamos), questions are being raised about the balance between sustainability through external investment (therefore driven by returns) and the mission to serve the poor.

enables them to go beyond meeting immediate consumption needs and build permanent assets.
- Credit is more likely to be used productively when it is combined with improved local infrastructure particularly rural roads and with help in connecting to and producing for markets.
- Co-operative financial services are useful in that they help people to cope and survive but the resources from this are insufficient to help people to move out of poverty.

The other key insights from the study are also important in this context in that access to opportunities and democratic practices are high among the needs of the poor to move upwards along the ladder of life.

3.4 Co-operative Financial Institutions

The focus on democratic practices is pretty much at the heart of financial co-operatives. It is a precondition for growing community owned and managed financial services. In this way, the potential for financial cooperatives building social capital is enhanced. In South Africa, saving jointly through stokvels or mgalelos is commonplace. Such practice lends credence to the thinking that the poor cannot afford not to save. It is one of their few safety nets in the face of multiple risks in the presence of strong social bonds.

Another advantage that financial co-operatives bring to communities and other groups is that financial literacy is built in the process of understanding and operating an institution. This can have multiple positive consequences as people can make significant changes once they understand the 'Consumption or Asset Building paradigm' and acquire the means to put this into practice.

In the institutional context, operating a financial co-operative, also enhances members knowledge of financial products. In fact the very ethos of community managed savings and lending operations, is that members can construct products which meet their needs and are not available from existing institutions. Clearly, there are other risks which arise in the context of product development and the use of loans from self-managed financial services. The use of sound learning tools to enable community managed financial services to manage product viability would be a very useful input.

The very practice of building and owning a financial institution is an act of empowerment in itself. It builds financial, human and social capital.

While there are numerous advantages to co-operative financial services, some caution should be exercised in viewing them as any form of panacea to economic ills. It is important to remember that some form of natural, physical or human capital is at the core of generating increasing incomes. Access to such capital is particularly important in the South African context where the majority were deprived of skilling opportunities and access to land among other resources.

Another area where caution has to be exercised in the practice of community level financial services is the viability of investments which members may seek to fund. In the absence of proper risk assessment, community savings could be in danger. This is also important for sustaining the institution and maintaining local integrity.

It is easily conceivable that communities could manage savings and lending groups. Long standing relations of neighborliness and social cohesions contribute to the potential that exists. The possibilities that all of these could lead to meeting the prudential and other requirements to become banks needs to tempered. This does not mean the banks are not possible, but rather that appropriate learning and support is needed to enable the maintenance of sound practices.

In summary, sustainable and efficient financial services are important for poor people. However, we need to be cautious in ascribing poverty effects by increasing access to financial services. At the same time we do need to acknowledge the importance of financial services in the following ways:

- As a means of risk reduction through safe saving facilities
- Promotion of food security through consumption smoothing
- Ability to increase spending on health care and education
- Increase in self-confidence (for women) through operating a business, and
- Life-style improvements through increased income.

References

Deepa Narayan: Voices of Poor, World Bank 2000

Financial Sector Team (2004): The Importance of Financial Sector Development for Growth and Poverty Reduction, Department for International Development

Gibb, Sarah: Microfinance's Impact on Education, Poverty, and Empowerment: A Case Study from the Bolivian Altiplano, Institute for Advanced Development Studies, Development Research Working Paper Series No. 04/2008, April 2008

Inter-American Development Bank: Financial Services and Poverty Reduction in Latin America and the Caribbean, 2006

Jalilian, H and Kirkpatrick, C.: Financial Development and Poverty Reduction in Developing Countries, IDPM, University of Manchester, November 2001, Finance and development research programme working paper series paper no 30

Swain R. B.: Is microfinance a good poverty alleviation strategy? , Evidence from Impact Assessment, Sida 2004

World Bank: Overview of Moving out of Poverty, 2009

Wright Graham A.N.: The Impact of Microfinance Services: Increasing Income or Reducing Poverty? MicroSave March 1999,

4.The Challenges and Opportunities for Stokvels To Become Cooperatives

Andrew Lukhele, Leader and Founding Member of Stokvel Movement

4.1 Introduction

What was to be the long – awaited National Economic Development and Labour Council Consultative Conference on co – operatives took place in March 2005 with the aim of raising the profile and understanding of co – operative enterprises.

The former DTI minister told delegates at the conference:

"While formal co – operatives have until now been predominantly in the agricultural sector, we all know of people who are involved in projects or stokvels, which in their own way are co – operatives.

"Our challenge is to grow this concept in our country, integrate it into existing mainstream economic activities and use co – operatives as means to tackle some of the challenges that are facing our country".

There are stokvel groups that seem to be in the process of evolving from simpler savings mobilization structures to more complex types, which are oriented towards income generation and are taking up some of the functions of normal banks. Interest rates seem to have stayed steady or fallen in some of the localities, but at an average of 20 to 30% are prevailing for a loan period of five or six months.

The money in the stokvel is loaned out on a monthly basis to members of the stokvel, who agree to pay it back at the end of the month at a premium of 30% per month. In other words, if they borrow R100.00 they have to pay back R130.00 at the end of the month. They can then borrow money again the following month on the same basis.

In December the total amount of money in the pool, the capital and the interest earned, shared out with all the members on a pro rata basis relative to the amount of capital each member has paid in.

There are many possibilities here, one being that this stokvel can have more people, other than their own members, who wish to, and can borrow the increasing amount of capital from the stokvel each month. If these people have the real means of repaying all the money each month, plus interest, this stokvel becomes a real money lender.

4.2 Stokvels and Regulation

In 1994, the South African Government drew from the international experience which shows that it is possible to upgrade informal arrangements and link them to formal institutions. And this implies building upon, not supplanting, the existing arrangements.

A proposal suggesting a multi – level approach to the prudential regulation of stokvels was presented to the Executive Committee of NASASA in 1991.

Dr Nico F. Marais, researcher from the Department of Bank Supervision, South African Reserve Bank who is the author of the paper, accepts sole responsibility for the views expressed in the paper. He argues that the views do not necessarily coincide with those held by the South African Reserve Bank.

In that paper Dr. Marais argues that stokvels, as informal financial arrangements have a large potential to provide efficient financial services if they were to function within a proper statutory framework conducive to their particular environment and development. Such a statutory framework should take cognizance of the risks involved in these financial arrangements. This will in turn result in a multi – level approach to the regulation of stokvels, ranging from the most basic form of self – regulation to sophisticated regulatory intervention.

It is argued in Marais' paper that should informal financial arrangements be upgraded and treated in a proper fashion, there would, firstly be a significant provision of financial services to the rapid growing informal sector. Secondly, the upgrading process would result in the establishment of a broad base of sound informal institutions with great potential to advance to more formal financial structures such as friendly societies, mutual building societies, and co – operative banks, thereby creating a strong link to the formal financial system.

For any approach to help stokvels to graduate into becoming co – operatives must consider the following factors:

1. The mobilization of savings in stokvels takes place amongst small groups of individuals well – known to each other. They are unable to transfer funds over long distances or even meet demands outside their close environment.

2. Many stokvels do not have the expertise to take account of the inflationary impact on their contributions. Savings are not necessarily invested in inflation – hedged instruments which result, in the erosion of saving over time. This results in those members receiving the first pool of contributions being better off than those members which are only rewarded after several years of contribution.

3. They often do not have access to training facilities, or legal assistance in the case of a dispute.

4. The gap between formal and informal banking is large and the step-by-step development to more formal structures (to satisfy larger financial needs of the community) is unknown and difficult.

5. The assistance that stokvels receive from formal institutions is rather limited.

6. Stokvels are treated as homogeneous institutions. Although they may use similar funding mechanisms, their activities and the nature of their risks might differ considerably.

7. Fraud and default are significant problems which may cause members to face financial disaster.

8. All members contributing to a stokvel have an equal right to the pooled funds. In turn, each will receive payment from the savings pool. A major problem is the lengthy time lapse between these payments. Once such a payment could provide start – up capital but it is a problem to obtain working capital on a continuous basis.

4.3 Self-regulation in Stokvels

The Reserve Bank's interest in stokvels was motivated by their ambition to incorporate them under the Co – operative Banks Act. Their incorporation under the Co – operative Banks Act is aimed, not to replace the self – regulation that these institutions already enjoy, but to enhance the concept to the benefit of stokvels.

NASASA was identified as the self – regulation organization (SRO) to establish contact with stokvels. They should be convinced to register with the SRO which implies a "carrot" rather than a "stick" approach.

The SRO is expected to offer continuous educational courses to increase business skills, marketing techniques, provide legal advice and assistance, etc.

With better operations, there will be a large improvement in the public image of stokvels. The formal banking sector will be more able and willing to utilize the group lending concept in the case where stokvels are known to be efficient and well – run informal financial arrangements.

Acting as the regulator of stokvels in terms of a proposed Co – operative Banks Act does imply that there should be a formal and close working relationship between the SRO and the Registrar of Deposit – taking institutions or co – operatives. In theory, the Registrar will be responsible for stokvels, which in practice, turns out to be the responsibility f the SRO.

There are two major advantages to this approach. Firstly, stokvels will benefit fro educational and legal assistance. Greater sophistication in informal finance will have a profound impact on the availability of finance in the informal sector. Certain stokvels will therefore have a greater potential and ability to develop towards the establishment of co-operative banks in South Africa.

4.4 Major Lessons

1. Self-regulation has not been successful, partly because of the capacity and funding problems, but mainly due to a conflict of interests and the lack of oversight by the Registrar of Banks in that the self – regulatory bodies were left to their own devices.

2. A stokvel will not necessarily become a co – operative.

3. The establishment process of formal stokvels needs to be conducted at a pace set by the community or group concerned to ensure effective ownership and control.

4. Stokvels should not be forced to render services for which they do not have the necessary level of expertise.

5. The development of the stokvel sector will require substantial financial commitment, skills and resources.

6. Almost all community – based savings clubs re linked to commercial banks in some way, none of them, except the conventional stokvels, can operate without this link.

As the government department at the national level with the overall responsibility for co – operative development and administration, the DTI has the responsibility of guiding the upgrading of stokvels to the co – operative level.

Few years ago, the former DTI Minister, Mr. Mandisi Mpahlwa was quoted as saying "co-ordination is the single most urgent and important issue that has to be dealt with". He said that establishing communication between government departments had been difficult because they "work in silence" (Sowetan, 11 July 2006).

5.The Cooperative Banking System in Germany

Sabine Fitzner, Head of the DGRV South Africa Office

5.1 The cooperative banking system in Germany

Cooperatives are the largest business organisation in Germany in terms of membership. Every fifth German is a member of a cooperative. More than 18 million members are united in our cooperatives.Within the German cooperative movement, the largest group in terms of members (16.2 million) and clients (approx. 30 million customers) are the 1,197 People's Banks and Raiffeisen Banks (Volksbanken and Raiffeisenbanken). Together with the 2 Cooperative Central Banks they form a banking-network of 13,586 branches with a balance-sheet total of 998 billion euros. As universal banks, they offer both to members and non-members alike, the whole range of state of art of banking services.

The cooperative banking group is decentrally organised. All institutions at local level are autonomous. All cooperative banks and financial institutions at regional and national level (e.g. DZ BANK AG – Deutsche Zentral-Genossenschaftsbank, German Cooperative Central Bank) have been established by the primary cooperative banks. Their role is to support the local level (principle of subsidiarity).The German cooperative banking system is organised in three tiers. Its strong basis is the network of the 1,197 cooperative banks with their branches (volume of business approx. 668 billion € in 2008, 9.34 billion € paid-in member capital) which include not only the Volksbanken and Raiffeisenbanken but also several cooperative banks which focus on certain professions such as public servants, clerical workers, and members of medical professions. The group also includes some 178 Raiffeisen cooperatives with commodity transactions (multipurpose cooperatives) which are involved in banking and commodity transactions under one roof. Today, the average balance-sheet total of a cooperative bank is approx. 513 Mio. €. This figure has increased significantly over time, due to mergers in the sector and the general increase in business (1970: 7,100 coop. banks - 40 Mio € average balance-sheet total, 1990: 3,340 coop banks – 298 Mio. € average balance-sheet total). Market shares today range from 20 % (loans) to 25.5 % (deposits).

The second tier of the cooperative banking system consists of one regional central bank (WGZ BANK – Westdeutsche Genossenschafts-Zentralbank, West German Cooperative Central Bank) and the regional offices of the national DZ BANK AG. The regional level balances amongst other surplus liquidity of local cooperative banks and serves as a source of liquidity (refinancing) and handles international trade operations.
Primary cooperative banks and WGZ BANK are also the main shareholders of DZ BANK AG, representing the third and top-tier of the cooperative banking system, which also includes a number of institutions which offer special financial or other specialised services. The balance-sheet total of the so-called cooperative “Finanzverbund” (integrated finance facility), including cooperative mortgage banks, Bausparkasse

Schwäbisch Hall (the biggest cooperative building society in Europe), R+V Versicherung (insurance company) and Union Investment (Asset Management) surpassed 998 billion € by the end of 2008. All primary enterprises of the cooperative banking system are members of regional cooperative auditing associations and of the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e.V. (BVR) as their national federation. By Law all cooperatives in Germany are obliged to be audited every year and the audit mandate was delegated to the national and regional cooperative auditing federations. Thus all cooperative banks are subject to statutory compulsory audits by these federations. The audit is not only for the proper compilation of the annual accounts, but a comprehensive management audit as well. The co-operative audit is a service audit, effective for the future. It is not merely a stock-taking of the past. The auditing federation has the right and the obligation to point out serious shortcomings in the economic position, in organisation and management. It will make recommendations accordingly and at a later date evaluate and control whether the recommendations have been put in place.

Other major tasks of the federations are the provision of advice to cooperatives, particularly in business management, legal and fiscal questions and the organisation of activities in human resource development. Training for cooperative managers and staff (especially bank managers) as well as cooperative auditors is carried out at highest professional level with modern training tools and methods at the Academy of German Cooperatives at Montabaur Castle (ADG).

5.2 The history of Cooperative banks in Germany

Cooperatives have a long and successful tradition, dating back to the 19th century. The founders Friedrich Wilhelm Raiffeisen and Hermann Schulze-Delitzsch helped to establish the first cooperative bank more than 150 years ago. These banks were established as a means to reduce poverty and over-indebtedness among small farmers and craftsmen and –women in rural and urban areas. The peasants, farmers and craftsmen were affected by deep social and economic changes. Free trade and competition were generally propagated. In the agricultural sector farmers had to change production structures from subsistence farming to production for the market. Previous methods of cultivation had to be changed. Following these developments, the importance of money and capital increased. As no real rural financial services were available, farmers had to borrow money from scrupulous, profiteering moneylenders. The former dependence on feudal landlords often was replaced by dependence on these moneylenders.

Similar development took place in towns. Craftsmen and retailers were in need of money and loans in order to expand their production and to satisfy the growing demand of the general public. However, in order to obtain loans the necessary collateral or securities were not available. Existing banks invested in the expanding industrial sector.
In this situation, in principle similar to the situation in developing countries today, it soon became obvious that broad sections of the society would have to be given access to an organised financial system permitting them to borrow money to finance their businesses. As a result the cooperative idea was developed. Craftsmen, small and medium enterprises

and traders as well as farmers established their own cooperative banks. The state merely provided the legal framework.

Capital was built up through contributions of the members. Non-members were not entitled to obtain loans. One of the main elements was the introduction of the joint liability, i.e. all members of the cooperative were jointly responsible for the cooperatives liability. Cooperative banks in the rural areas also started to provide other services to their members such as purchasing of agricultural inputs and implements and marketing of agricultural products. This type of "universal cooperative" can still be found today. The basic idea of these cooperatives was and is that people such as farmers, craftsmen and traders decide to join forces for specific economic purposes and run a business jointly, solving problems fairly and effectively as required by the market situation. Activities, previously performed individually by each member unit at high costs were transferred to the cooperative, thus cutting costs and increasing productivity for each member.

The basic mandate of cooperatives is to generate services to be provided to their members and to ensure sound business results in order to be able to promote their members' interests in the longer term on a sustainable basis. As we have seen, the history of cooperative banks began with the idea of providing loans which otherwise could not have been obtained. This was achieved through mutual assistance organised on the basis of solidarity. Full autonomous, a conducive legal framework and the absence of any negative or promotional interference by any authorities was and still is a prerequisite for the success of the movement. At an early stage already the necessity for supporting facilities was recognised by the founders. A central bank was founded by and for the cooperatives themselves for clearing and liquidity management purposes.

5.3 Savings and Credit cooperatives in the South African context, prerequisites and lessons learnt

Cooperative savings and credit institutions are not completely foreign institutions in South Africa as the examples of stokvels and burial societies show. Genuine aspects of a cooperative banking system such as group-association, group-cooperation and group-responsibility are basic traditions of African societies and are applied in traditional savings and credit schemes. These traditional elements should be recalled to construct modern cooperative savings and credit societies. Cooperative banks should not be imposed on the people. To be successful they must be built on and based upon these traditional elements known to the people.

At the base of the cooperative banking system are the local financial services cooperatives. They are specially geared to the financial needs of their members: small and medium-sized enterprises, craftsmen, farmers, members of other professions and private individuals. The board of directors is responsible for running the business of the cooperative bank subject to the restrictions imposed by the Banking Act, the Cooperative Act, The Cooperative Banks Act and the statutes of the particular cooperative. A supervisory committee should be established within the cooperative to supervise the work

of the management in all aspects of administration and performance. The supervisory committee's duty is to check how the management runs the affairs of the cooperative. The general meeting is required to pass resolutions relating to the annual financial statements, the distribution of surpluses or the covering of any losses, the election of members of the board of directors and the supervisory committee, the ratification of the acts of the management and the supervisory board. It sets the limits on the size of loans, amends the statutes etc. At the general meeting, each member has only one vote; irrespective of how many shares s/he may hold in the cooperative and also irrespectively of how high his/her credit balance may be.

The success achieved by the cooperative banks is attributed to the respect of the cooperative constitution, the decentralised form of their system and interaction of different levels. In addition to this well-functioning internal control mechanism as well as the compulsory co-operative auditing plays a significant role in stabilizing the cooperative banking sector.

The fact that they maintain close contact with local people and businesses makes them an integral part of the middle- and lower class community. Members are given the exclusive democratic right to influence their bank's decisions as to what services the bank should offer, which actually is the main difference to other banks. As a result, the members develop strong identification with their bank.

The members not only provide the cooperative banks with capital through their membership shares, which are liable for the debts of the bank, but also provide the bank with business. They make much more intense use of the offered banking services than "mere clients" do. Members are more aware of the range of services offered; they have a special sense of loyalty to their bank and are convinced of its competence.

Every cooperative bank is legally independent. This gives flexibility in its decisions, actions and reactions to the local market, so business decisions can be made without delay and the members' financial needs can be addressed properly. The competitive edge of being "the bank around the corner" will contribute to give the cooperative banks the position in the markets.

Another very important factor contributing to the competitiveness of the cooperative banks is the fact that they belong to a decentralised organisation. However, policy and decision making does not go from the top to the bottom: In cooperative banks policies and decisions are made democratically by the members together and this has the advantage that decisions have the backing of all members.

Cooperatives should establish federations or unions of cooperatives to serve and advise affiliated cooperatives. This is necessary because members with insufficient knowledge of legal, fiscal and business matters often run the cooperatives. As a result, newly emerging cooperatives need additional assistance and advice. The federations as higher level organisations can take over such tasks, which the lower level organisations are unable to fulfil at similar cost and of similar quality.

Every cooperative bank must be audited, either by private auditing companies or by specialised cooperative institutions. This guarantees an effective system of auditing that is in the interest of the cooperative itself, of its members and the general public. Cooperative banks should belong to security mechanisms and if they do not exist, strive for introducing their own system. In this way no depositor or customer of a cooperative bank will suffer a deficit or loss.

Savings first

Credit is sometimes seen as the most important financing service which is missing in rural areas. However, friends, relatives, moneylenders and own savings mainly satisfy actual financial needs. For this reason and for the fact that rural areas are not yet completely monetarised, it is recommended to start with savings first before credits are offered. Such an approach is proposed because of several considerations:
Particularly in rural areas qualified people are scarce who can secure the proper administration of credits/loans. These people have to be trained. The saving component is easier to manage than credit and can therefore be an appropriate way to train "financial management". The same applies to the supervisory or control body which can only fulfil its task if properly prepared.

The social commitment can best be achieved if the members are first contributing to the development of their cooperative. By allowing this process of growth to take place the cooperative will be regarded as an institution developed by the members to satisfy their particular needs and interests. The common perception that credits are government money or donations from international aid organisations (and therefore have not to be paid back) can be best overcome by starting with own contributions of the group and by developing a responsibility for these funds. The self-management of shares and savings is the best way to do so.

Regular savings show everybody how tough it is to put money aside from little available capital. This experience might reduce the willingness to apply for credit without necessity and increase the sensitivity for the value of money.

Another learning experience is that it is sometimes financially more favourable to postpone the desired expenditure until the required money has been saved rather than taking a credit and paying interest. Instead of paying interest it is better to gain interest.

Credit

The constraints for developing the micro business are not limited to a lack of access to credit. Other limiting factors are (vocational) training, management skills, organisation and accounting tools and marketing knowledge.

Cooperatives are an adequate way to eliminate all these deficits. A multi-purpose cooperative can offer all these necessities for a sound development of businesses in rural areas. Thus, the population is not made to believe that all their problems can be solved with money. Compared with the actual credit offer by other financial services this way has two major advantages:

The costs can be reduced because credit is only offered and disbursed where the demand has been expressed before by the members/beneficiaries themselves. Loans will be applied for as they are needed and not because they are available; there is no institution looking for clients but clients organising their own services.

Cooperative members are not made to believe that credit is finally solving their business problems. As mentioned above credit is sometimes the less hampering factor for young entrepreneurs. Money cannot replace missing markets, skills or the lack of management ability.

The credit applicant should receive support to determine the real deficits in his/her business. This task could be fulfilled by cooperatives. If the credit offer would not simply come from outside as the panacea for all problems but would be the result of an analysis of the deficits, the credit demand should be delayed until the other limiting factors are solved or at least are in the process to be solved. Credit/loan applications should be demand and not be supply driven. In cooperatives all members are known personally and their loan repayment capacity can be judged much better. The social pressure in groups will also favour the loan repayment rates.

6. Summary of Main Discussion Points

The deliberations at this seminar raised the following important points:

- Where do we start? South Africa has over 7 million people who do not have access to financial services. We need a vision, as part of a national plan, to mobilise individuals, households, communities and collectives into a vibrant cooperative sector as part of nation building and national transformation. Such a vision should not be presented in a populist way but should tap into traditions of activism, volunteerism and sentiments of nation building. Such a vision should have a multi-class appeal and needs to be articulated at various levels of the society to give impetus to building a cooperative banking system. Central to such a vision is addressing the savings gap in this society and how this relates to advancing reconstruction and development.

- Cooperative banking should not merely be seen as ameliorative and poverty reducing. Cooperative banking can be linked directly to structural transformation. While individuals and households are important it is necessary to also think in terms of collectives and sectors as key drivers for building cooperative banking. The German case shows the importance of linking cooperative banking to the development of a modern agricultural sector. This has also placed the cooperative banking system at the centre of structural transformation. In other places in the world trade unions are also important for supporting cooperative banking systems. In Ireland every village community and town has a credit union which promotes local development. Building a cooperative banking system in post-apartheid South Africa needs to be thought about in more strategic ways beyond a narrow poverty reduction approach.

- Both for poverty reduction and structural transformation cooperative banking has to be grounded in an education and literacy approach. Members of cooperative banks have to be empowered with knowledge about how to manage financial resources, how to think about alternatives for consumption, the importance of production, the advantages of saving and so on. At a systemic level this contributes to managing threats and risks but more importantly it engenders conditions to support transformation.

- The role of the state is important in supporting and enabling cooperative banking. However, the state should not control cooperative banks. The current legislation places a ceiling on the size of cooperative banks in terms of asset size. Such limits would have to be engaged with over time. South Africa needs a diversified financial system. Alongside the commercial banks and state financing institutions like IDC and the Land Bank, there is a need for a cooperative banking system. Such a system needs to be regulated by the state

but not constrained. The state must not limit the growth of cooperative banks in South Africa. The global financial crisis has also exposed the risks associated with commercial banks and globalised financial systems. A cooperative banking system is a nationally based system and does not have the risks of a commercial banking system.

- It is necessary to find a link between stokvels and an emerging cooperative banking system. Stokvels do not have to convert into cooperatives but can become members of cooperative banks. More thought needs to be given on how stokvels can be linked with cooperative banks as members.

- Establishing cooperative banks cannot be achieved without education, training and institutional capacity building. At minimum cooperative banks require proper policies, member education and training, proper watchdog structures including audits, management capacity and efficient decisionmaking. Information and communication technology are also crucial for enhancing the efficiencies of cooperative banks.

- A great deal of grass roots mobilisation is needed to build sustainable cooperative banks. Mobilising strategies have to be developed based on education and awareness raising. Inclusive practices are required in rural and urban communities to ensure broad support. Cooperative banking must be built through a common bond and this bond must educate, build commitment and even manage 'delinquency' vis-à-vis debts. In this sense cooperative banking is also a peoples movement.