

# **Productive and Unproductive Debt Spending of Microloans Taken by Urban Borrowers (Johannesburg)**

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A research project submitted to the Gordon Institute of Business Science, University of Pretoria, in partial fulfilment of the requirements for the degree of Master of Business Administration

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## **ABSTRACT**

Edward and Olsen (2006) explored the existence of three paradigms within the microfinance world of India. It was found that microfinance institutions were moving towards the Financial Sustainability paradigm as opposed to Poverty Alleviation and Women Empowerment. Meyer (2002) showed that there are benefits to differential finance products targeted at borrowers from microlenders. This hung primarily on the purpose or usage of the loan. Weller (2007) defined productive spending as money spent on education and home improvement and consumptive spending as money used for purchasing goods, services or cars.

The purpose of this research is to identify whether borrowers of microloans within the Johannesburg region of Gauteng, engaged predominantly in productive debt spending or unproductive debt spending. This information would be useful to bankers to redesign financial products for individuals who spend their loans on productive debt.

It was found in the sample that loans were used predominantly for productive debt. The dominant elements were business and education spending. It was also found that women engaged in more productive debt spending than men. This was driven by a greater portion of females investing in businesses and education for themselves and their family.

## DECLARATION

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in this or any other University.

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Ravindra M Saman

14 November 2007

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## **DEDICATION**

To my parents, Mr M. S. Saman and Mrs. G. Saman, I am grateful for all the sacrifices you have made for me.

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# 1 INTRODUCTION

## 1.1 Context and Significance of Study

As an emerging economy and a country riddled with socio-economic problems and crime, it is my view that through sustainable economic development, much of these problems can be addressed. Access to bank finance offers a means to a better quality of life, but this is restricted to those who can offer security in return. The vast majority will access funds through other means, and of particular interest are micro-lenders.

Consumers that engage micro-lenders, pay the price of borrowing at high interest rates and over longer repayment periods than commercial banks, Hietalahti and Linden (2006). Probably the most successful microlending enterprise is the Grameen Bank of Bangladesh. Meyer (2002) showed that monies from loans were either used for household consumption or cross-funding debt. This research will investigate how borrowers spend their money within two categories. The categories are productive and unproductive debt. The concept of productivity will be defined as return on investment. Essentially if there is a return on investment then that will be classified as productive debt and if there is not then that will be unproductive debt.

Productive and unproductive debt will be subdivided into different categories each. Consumers will be probed to divulge to what extent they invest their loans in educating themselves, educating their children, building onto their house for rental purposes or investing in a business (productive debt) against spending their money on clothing, lending to others not for profit or alcohol (unproductive debt). By capturing race, sex and age amongst other parameters, it will be possible to provide a deeper understanding of spending patterns within these categories.

The data will be collected through a survey and will be localised to the Johannesburg region. Each category will be explored through a question and sub questions which provides added layers of depth to the responses. The questions will be short and as simple as possible. This approach is strategic in reducing interview time and improving accuracy. Meyer (2002) points out that there is a demand for more flexible products within the microfinance industry. The data analysis will be aimed at extracting groups that largely engage in productive debt with the view that these groups may potentially obtain loans at a lower interest rate than others.

If the poor could access finance at manageable interest rates and tailored to their needs, Sharma (2005) shows that there are economic benefits in terms of transformation of the second economy into the primary economy and borrowers are given the chance to improve the quality of their lives.

## 1.2 Definition of Terms

The following definitions are relevant to this research:

Microfinance institutions – Microfinance institutions are defined as entities that serve capital markets in low-income communities (Pollinger J. J., Outhwaite J. and Cordero-Guzmán, 2007).

Productive Debt – Productive debt is defined as money spent on education and home improvement (Weller (2007).

Unproductive Debt – Unproductive debt or consumptive is defined as money used for purchasing goods, services or cars (Weller (2007).

## 2 LITERATURE REVIEW

### 2.1 Microfinance

The United Nations declared 2005 as the International Year for Microcredit. Some of the underlying factors were the positive impacts that microfinance has on asset building and developing economies (Pollinger J. J., Outhwaite J. and Cordero-Guzmán, 2007).

One of the countries that posted many benefits from the microfinance industry is India, but this is not without some discourse on the obvious effects and hidden ramifications. Edward and Olsen (2006) investigated paradigms within the sphere of microfinance and found that there were three dominant paradigms. The three paradigms are the Financial Sustainability paradigm, the Poverty Alleviation paradigm and the Feminist Empowerment paradigm.

According to Edward and Olsen (2006), at the embryonic stages of microfinance, the goals were poverty alleviation and woman empowerment. Woman empowerment was to address gender inequalities and considering that most woman were responsible for the well-being of their households, they were aptly positioned to target poverty within their homes. Monies from Non-Government Organizations (NGOs) were loaned to individual woman within Self Help Groups (SHGs) and the repayment was administered through the SHGs.

Edward and Olsen (2006) summarised the paradigms in the table bellow.

**Table 1: Summary of Paradigms in Microfinance**

	<b>Financial Sustainability</b>	<b>Poverty Alleviation</b>	<b>Female Empowerment</b>
<b>Underlying development paradigm</b>	neo-liberal market growth	poverty alleviation and community development	feminist critique of capitalism
<b>Target group</b>	entrepreneurial poor	poorest of the poor	poor women
<b>Reason for targeting women</b>	efficiency, high female repayment rates, increase economic activity of women	high levels of female poverty, women responsible for household well-being	gender equality, human rights of women
<b>Definition of empowerment</b>	economic, expansion of individual choice and capacity for self-reliance	community development, well-being and self-sufficiency	transformation of power relations in society
<b>Role of participation</b>	consultation and group formation to decrease costs of service delivery and increase commitment and innovation	development of self-owned and self-managed peoples' organizations for community development	empowerment of woman to articulate their collective interests and organize for change in gender relations

Source: Adapted from Table 1, Edward and Olsen (2006).

Towards the latter part of 1990, the underwriting of the microfinance industry was moving towards greater commercial loans than grant funding. This inherently brought with it the Financial Sustainability paradigm. Edward and Olsen (2006), observe that there are contradictory facets in existence within the mix of paradigms. The Woman Empowerment paradigm seeks to promulgate

cohesion within the SHGs but non-conformance in the external economy. The value is to bring about gender equality and address some of the injustices enforced upon woman, but non-conformance is a trait viewed very seriously within the banking fraternity. This speaks directly to their elements of risk and poses a challenge to the Financial Sustainability paradigm.

What was clear was that the Financial Sustainability paradigm is dominant and the Poverty paradigm is implicit in India (Edward and Olsen, 2006). Pollinger *et al.* (2007) have also explored the question of sustainability in the United States within the microfinance environment. The question of sustainability depended on pricing inefficiencies and the degree to which microfinance institutions (MFIs) understood their costs. Essentially the efficiency of the MFI is masked by subsidies and as such, sustainability is precariously perched on the back of continuous subsidies and grants. Pollinger *et al.* (2007) and Edward and Olsen (2006) share a common thread that self-sufficiency and extracting profits are paramount to sustainability. This may suggest that the borrower will bear this inefficiency in the form of higher interest rates.

Meyer (2002) states that borrowers' of microloans tend to cross-fund debt with other informal loans, as a means to prevent payment defaults. This necessitates a demand for flexible products from microlenders. Using the Grameen bank as an example, Meyer (2002) indicates that the spending plan for the loan, will determine the interest repayment period. To clarify the point, a

loan that is used for agriculture will have a different repayment period as opposed to a loan that is used for a rickshaw business, fundamentally because the return on investment is at differing time periods.

The underlying theme is that microfinance offers individuals the opportunity to escape the clutches of poverty and unscrupulous “loan sharks” who charge exorbitant interest rates. Meyer (2002) does stress that the success stories are due to the complex management structures and total community involvement.

Finally, although Chen (2006) and Weller (2007) have based their studies in the United States, they do offer some insight into the distinction between productive and unproductive or consumptive spending. Weller (2007) defines productive spending as money spent on education and home improvements and consumptive spending as loans that are used for the purchase of goods, services or cars. Chen (2006) states that countries with a higher share of productive public spending have a higher economic growth than those countries that have a lower share of productive spend.

Weller (2007) and Chen (2006) concur that debt rises as a result of poor labour conditions, rising consumer prices and disproportionate increases in household incomes. The consequence is that households borrow to manage the increased cost of living.

Further to the economic conditions, lower income families are disproportionate renters and compounded by their lack of collateral, in terms of owning a house, their need to borrow is more frequent than higher income households. To reiterate the point, borrowing is directed towards education, investment in a home and making ends meet (Weller, 2007).

## **2.2 Education**

### **2.2.1 Investment in Children's Education**

Investment in education has many forms. Parents who pay school fees and ensure that their children attend school, invests in their children's future. Adults that improve their education through skills training and academic institutions also form a part of a resource pool to their children.

Vila (2005) states that the impact of schooling causes a more productive individual in the economy. The other factors that must be borne in mind are the types of education delivered in schools. In South Africa, we have outcome based education as opposed to the classic theoretical schooling (Vambe T. M., 2005). With outcome based education, learners are acquiring skills that could make them functional in the economy from an early age. Although this may encourage an early departure from schooling and address some of the issues around poverty, Vila (2005) also indicates that longer schooling improves the chances of employment.

Borghans and Heijke (2005) largely concur with Vila (2005), but they highlight important influencing factors to schooling and education. Borghans and Heijke (2005) purport that the extraneous influences on education are the size of the class, economic environment of the country, budgetary constraints, skill level of teachers and the curriculum, which are very valid and real concerns within the

South African environment. Despite these concerns, on the whole, Borghans and Heijke (2005) do agree that schooling improves an individuals' chance of employment and furthermore improves that individuals' productivity in the workplace.

Vila (2005) states there are social benefits to schooling and not just pecuniary related benefits. Children who attend school learn societal rules and values and their behaviour becomes more socially acceptable. This has a strong leaning towards lower crime and consequently a benefit to society. Lower crime means a lower cost of safety and a more productive usage of budgetary funds.

Based on the above review, investment in schooling can be classified as a productive investment.

### **2.2.2 Investment in Borrower's Education**

Basic skill improvement has significant advantages to seeking employment, in society and the existing environment for the individual. If basic skills are defined as literacy and number fluency, Addis (2003) claims that the lack of basic skills will lead to labour market exclusion.

He further indicates that the immediate effects of proficient basic skills are, for example the ability to read and comprehend instructions on machinery and it affords the individual a better understanding of loan repayments. This will result in a certain amount of job security and Addis (2003) also points out that individuals that are competent in reading and mathematics, are more likely to be earmarked for further skills improvement by companies.

With business being steeped in the world of information technology, the cost of a poorly skilled workforce is much too high. Consider incorrect order processing, slow throughput due to poor computer literacy and poor communication skills are examples of how skill levels influence productivity of a business. In the world of the small to medium enterprise, Addis (2003) states that improved skills lead to being more competitive.

According to Vila (2005), better educated adults have a positive impact on their families. In general, families are healthier because adults have a better grasp of health risks which ultimately leads to a better quality of life. Therefore investment in skills development of an individual will be seen as productive investment.

## 2.3 Business

### 2.3.1 Investing in a Business

Investing in a small business is a sure way to become economically active and improving an individual's financial status. According to Clarke J., Thorpe R., Anderson L. and Gold J. (2006), the owners of small to medium enterprises (SMEs) learn via "on the job training". Although their learning is contextualised to the immediate environment, through critical reflection, their adaptive style of learning could be moved beyond the immediate and subsequently improve their SME business. This suggests that running a business does have some benefits in terms of business operational skills.

Clarke *et al.* (2006) expanded the concept of SME learning into what is categorised as social learning. The use of networks of SME's and advice from business experts and specialists is of paramount importance to the SME's overall business education. It would appear then that with the help of these bodies, SME success ratios may improve.

Morris and Pitt (1995) undertook a study on a South African township to distinguish entrepreneurial and non-entrepreneurial activity in the informal sector. What was found in Khayelitsha was, despite the poor working conditions, as characterised by the informal sector, these businesses were efficient at generating job opportunities and satisfying basic needs.

A large portion of the owner – managers that were interviewed, were focused on future growth in terms of sales, staff and premises expansion. Although there is belief that business in the informal sector is largely survivalist, the study found that there was an opportunity driven mindset, future orientated outlook and a higher level of business sophistication. These are attributes of entrepreneurship and potential positive contributions to the economy (Morris and Pitt, 1995).

Therefore an investment in a business or SME has gains albeit limited by external factors. Even though stakeholders may have a role to play in order to ensure the success of the SME, this is still a productive way to spend money.

## 2.4 Extending a House

### 2.4.1 Building to rent

Housing the poor and the poorest of poor remains a challenge to governments throughout the world. The private and public financial sector grapples with the idea of providing unsecured loans to the poor, specifically property finance. Jorgensen (2007) investigated the rental environment amongst the poor in Kenya and found that the poor pay the highest premium on rentals.

As a consequence of there being a high demand for housing and a very low supply of housing, the poor are experiencing the effects of economic supply and demand. This presents an opportunity for property owners to rent to the poor but more importantly for the poor to rent to the poor. Jorgensen (2007) showed that rental of rooms within a house is a viable source of income and a mechanism to improve the poverty state of individuals and families. The research further explains that a 5 bedroom house that had 3 to 4 bedrooms rented out was profitable. Access to funds in the formal sector now becomes possible through a structured finance option of “tenant purchase”, where the lender owns the house until the loan is paid off (Jorgensen, 2007).

Jorgensen (2007) does however express that even though this addresses poverty alleviation, this is a very simplistic view because there are other important social and economic factors that must be considered.

Some of the economic cost factors are driven by maintenance. A high expectation of a tenant presents a degree of uncertainty in maintenance of a house, according to El-Haram and Horner (2002). This is fundamentally due to the tenancy contract not stipulating the frequency of maintenance or whether preventative or reactive maintenance will be performed. Jorgensen (2007) and El-Haram and Horner (2002) concur that the solution largely lies in the quality of construction of the building. It has in fact become imperative for a superior quality building to be erected for the poor considering their financial position to cope with the burden of maintenance. Other factors that influence the cost of maintenance are improper usage, energy costs and regulatory costs (El-Haram and Horner, 2002).

The literature does suggest that building to rent is a productive means of spending.

#### **2.4.2 Building to accommodate family and guests**

The concept of extended family living is one that pervades all cultures, globally. As a continent, Africa is no exception and more importantly, this is becoming a tool within African countries for nation building (Marx, 2002). In South Africa specifically, the concept is punted in the form of “Ubuntu”. According to Marx (2002), this is a shortened form of *Umntu ngumuntu ngabantu* which means “A human being is a human being only through its relationship with other human

beings". The argument distinguishes that whilst it is commendable to extend hospitality to strangers, there are certainly pressures upon individuals to have a communalistic outlook. The consequence is that there is a loss of individuality and a requirement of conformance.

According to Rapoport (2004), hospitality is most often extended to fathers, mothers, children, nieces and nephews of the main couple or head of the family. This stems from a combination of obligations to younger families, polygamous relationships and community status seeking. Rapoport (2004) claims that, in Gabon, 77% of households comprise of children and grandchildren and the balance are made up of guests. The guests may offer status elevation to the head of the house or additional income to the household.

Amongst these family groups, a decision may be taken to share the household income evenly amongst all adult members of the household. This behaviour inherently favours the lower to no income producing members. For the higher income producing members, this creates internal turmoil within those individuals who are ambitious and seek independence (Rapoport, 2004).

Giannelli and Monfardini (2000) investigated the economics of co-residence and working or studying. Investigating the labour market activity of people who live with their parents and those that make a home for themselves, it was found

that, within countries, individuals who left home early were more successful than those that delayed their departure from their parents' home.

Generally speaking, with increasing age, the probability of finding a job whilst co-residing decreases. This inevitably places a burden on the income producing members of the household. Although, if the co-residence is a mechanism that facilitates gaining an education so as to shape improved economic activity, it is seen as a nest. This is however a function of parental wealth. The house is a cage when there is an increase in the unemployment rate and the cost of housing because individuals cannot find a job and the economic climate makes purchasing a house unaffordable (Giannelli and Monfardini, 2000).

Consequently, this increases the cost of caring for those who are unable to generate income. Rubin (2002) indicates that this informal care giving is likely to negatively impact the GDP because care givers are more likely to leave their employment, amongst other factors.

There is also a cost to business in the form of lost productivity, time off work, unanticipated absence and receiving telephone calls at work. This impacts work load on other members of the workforce team because someone has to perform the work allocated to that staff member. If the individual, mostly

woman, choose to withdraw from the labour force for long time periods, this impacts their future career. Their training and skill levels fall behind the market which makes re-entry difficult (Rubin, 2002).

Rubin (2002) also states that due to household responsibilities, there will be a tendency for individuals not to pursue promotions in the workplace because they want less responsibility. This creates a situation of salary stagnation and the effects are borne within the pension fund contribution, which impacts the individuals' financial standing later on in life.

Although there are social benefits to living in an extended family, the literature does suggest that there are more economic drawbacks. Therefore, building to house family and guests will be viewed as unproductive spending.

## **2.5 Unproductive Spending**

### **2.5.1 Spending on Branded Clothing**

Brand awareness and the vast amount of marketing paraphernalia influence individuals' decisions on purchasing. Clothing is the most accessible form of distinction through branding, because generally speaking, what people wear creates a perception of the individual.

Banister and Hogg (2004) believe that branded clothing is purchased to satisfy or enhance self-esteem. The same argument holds on the contrary that one may not purchase a certain brand because it will not enhance one's self-esteem. Brands also play a role in social acceptance. Banister and Hogg (2004) claim that fashion and style of dressing indicates a person's drive which influences their association with other members of society. People with positive drives will dress in a particular way and will be found amongst individuals who share the same common ground.

Generally, branded items will be found in shopping malls and this attracts other costs. There are travel costs and time consumption. Dholakia (1999) indicates that one of the motives for shopping is to be a performer and spectator. It is a place where individuals will be seen and will be watching. It is also an opportunity to socialise. Dholakia (1999) also states that shopping is a major source of relaxation.

Whilst there seems to be some benefit to these experiences, it is equally clear that the gains are to the emotional self. There are no future financial benefits from these acts and therefore it is not a productive manner of spending money.

### **2.5.2 Spending on Alcohol**

Socialising is part of the human experience and over the years; alcohol has become a socially acceptable drug. For most users of alcohol, the social experience is incomplete without a few drinks.

According to French A. J., Blair A. J. and Booth A. D. (1994), imbibing alcohol can cause subjective wooziness and a degraded level of performance in an individual, which generally is not apparent to the individual. Furthermore, the effects of alcohol are used as an excuse for violence, vandalism and other unsociably accepted behaviour. Probably a more interesting statement by French *et al.* (1994) is that alcohol affects the nerve cells that process sensitive information. This results in behaviour that is not normally associated with that individual.

The impaired function of the person sometimes lends its way into the workplace. Loup (1994) states that the cost of substandard performance by workers, could adversely affect the reputation of a company. This is also linked

to the level of responsibility that the employee has, and the more responsible, the greater the damage. Another vital issue that Loup (1994) points out is the issue of safety. The consequences are dire, a large number of injuries are related to alcohol abuse and in some cases the injuries are fatal. Ultimately this may lead to the person being dismissed.

Alcoholism is more prevalent amongst the lower socioeconomic status groups. In a study done by Stark (2004) it was found that mothers who drank during their pregnancy gave birth to low weight babies. In the case of excessive drinking, babies can be born with foetal alcohol syndrome. Foetal alcohol syndrome presents as defects at birth, some of which are smaller heads, poor coordination and abnormal joints and limbs.

The literature therefore indicates that alcohol is unproductive at best and thus expenditure on this item will be classified as unproductive.

### **2.5.3 Lending money to family and friends**

Within a household, money transactions occur across multiple parties. Parents give money to children, children give money to parents, siblings exchange money and friends give money to friends.

Park (2003) explored the motives behind money exchanges within households. The literature states that 20 to 90 percent of households in developing countries engage in money transfers. The reasons for transfers range from altruism, donors' self interest, exchange for service, repayment of implicit loans to relief of liquidity constraints.

Children gave money to older parents as well as widowed mothers, who were the greatest recipients of transfers. It was found that children make these transfers in order to keep favour with the parents, which ensures bequests from them in the future. This suggests a selfish motivation for their actions. Furthermore, individuals were found to have made transfers if their utility depended on the utility function or consumption of the recipient (Park, 2003).

Park (2003) and Feinerman and Seiler (2002) agree that parents largely give money to children to provide relief of liquidity constraints on them as well as filial services rendered. According to Park (2003), amounts transferred to parents were positively correlated to parental age. The older the parents were, the more money they got from their children.

It is suggested that the expectancy of transfers from family or relatives may have caused individuals to alter working habits. Individuals were expected to have reduced working hours and consequently earned less pay because of the

subsidies that the transfers were providing. There was no evidence in support of this theory and the conclusion was that private transfers have little to no effect on labour supply. However, there was a positive correlation between parental receipts and bequeathable wealth. The greater the bequeathable wealth the greater the transfer received by the parent (Park, 2003).

Feinerman and Seiler (2002) researched the dominance between parental transactions based on altruism versus parental transactions based on tangible and intangible exchange. The result was that there was no overwhelming dominant motive but both altruism and exchange existed simultaneously as motives for transfers. Although they did find that as a parents' love for a child increases, so did the amount of the transfer and vice versa.

Through research in Colombia, Cox and Jimenez (1998) found that private transfers were a form of risk pooling and smoothing of household income fluctuations. Families would engage in marital arrangements across different villages from different regions. This provided some sort of insurance to households during times of drought or hardship which was largely a factor of geographic positioning of the villages.

It was also found that higher earning households had lower transfer transactions whilst lower earning households had higher transactions.

Households that experienced unemployment were also exposed to a higher probability of transfer receipt (Cox and Jimenez, 1998).

Although the literature does suggest social benefits to private transfers, there does not seem to be sufficient evidence that supports either economic productivity or unproductive spending. If anything, the dominant theme underlying the motives is a combination of altruism and donor selfishness.

## 2.6 Conclusion

Edward and Olsen (2006) showed the existence of three paradigms within the microfinance world of India. The lesson of importance, amongst others, is that the dominant paradigm was the Financial Sustainability paradigm. The target group were the entrepreneurial poor and women specifically displayed efficiency and high repayment rates.

Pollinger *et al.* (2007) largely concurs with Edward and Olsen (2006) that sustainability is the corner stone of effective microfinance. One of the ways of attaining sustainability is to target entrepreneurship, which points to the Financial Sustainability paradigm. Successful entrepreneurs will get themselves out of poverty which reiterates the point by Edward and Olsen (2006), that poverty alleviation is implicit.

Monies are not always borrowed for productive purposes. People engage microlenders to finance education, home renovations and consumption. Weller (2007) as well as Chen (2006) defined productive spending as money that was used for education and investment and consumptive spending (which we will consider as unproductive spending) as money spent on cars, services and goods.

As a form of productive spending, Borghans and Heijke (2005) and Vila (2005) have shown that education has benefits to society from a behavioural point of view as well as economic gains. Socially responsible individuals have a lower propensity to commit crime. Addis (2003) expands the debate to the economic impacts of education and claims that higher skilled workers are less likely to suffer labour market exclusion and are more likely to have a long term career.

Alternatively, individuals who choose to invest in a business or expand their homes for rental purposes engage in productive spending. Clark *et al.* (2006) showed that running a business develops operational skills. This was supported by Morris and Pitt (1995) who found that businesses within the informal sector displayed entrepreneurial attributes and had potential to positively impact the economy. Jorgensen (2007) argued that rental income does offer some financial relief from the burden of poverty. Through this rental income, the owner may enter the formal lending sector using the rental income as a mechanism to leverage.

According to Giannelli and Monfardini (2000) and Rubin (2002), if money is used to renovate homes for the purpose of accommodating family and friends, it is classified as consumptive spending because there are more economic drawbacks than benefits. Unproductive spending also encompasses purchasing of branded clothing, as argued by Banister and Hogg (2004) and Dholakia (1999) and buying alcohol. French *et al.* (1994) and Loup (1994)

demonstrated that alcohol affects behaviour unfavourably and jeopardises responsible working ethos, respectively.

Finally, lending money to family and friends could not be categorised as productive or unproductive spending because the nature of the cash disbursement by the recipient will inform the classification.

### **3 RESEARCH QUESTIONS**

This is an exploratory research with a view to explore the concepts of productive and unproductive debt spending within the microlending environment of Johannesburg. The questions were borne out of the literature review but were also expanded to include open ended questions in an effort to capture a wide range of responses.

The data gathered will indicate to the researcher where the monies are being spent. This information may be useful in revisiting the existing lending models of commercial banks and present an opportunity to attract new business for these banks.



**3.1 Will the loan be used for existing debt?**

3.1.1 Why was this debt incurred?

**3.2 Will you lend this money to someone else?**

3.2.1 Why does that person need the money?

**3.3 Will you use this money to build onto your home?**

3.3.1 Is this for rental?

3.3.2 Is this for your family?

**3.4 Will you use the money in your business?**

3.4.1 Is your business to buy and sell goods/items?

3.4.2 Is your business manufacturing?

3.4.3 Other, please specify?

**3.5 Will you use the money for education?**

3.5.1 Will the funds be for your own education?

3.5.2 Will the funds be for your family's education?

**3.6 If NO to all of the above, what will the money be used for?**

## **4 RESEARCH METHODOLOGY**

This chapter describes the data gathering methodology. It begins with a description of the type of data that was gathered and progresses to the techniques used in the data analysis. Finally this chapter ends with a discussion around ethics of research. This was done to ensure the data collected was reliable and valid.

### **4.1 Research Design**

The sample design was cluster sampling. This is a probability sampling technique and as a result, the data was subjected to statistical methods of analysis, Zikmund (2003). According to Zikmund (2003), in pure cluster sampling, the clusters are chosen at random, for the purpose of convenience, the clusters were specifically chosen to control costs and facilitate easy data gathering. Within each cluster, the units (the borrowers) were chosen randomly.

### **4.2 Population**

The population consisted of individuals who borrowed money from microlenders within the Johannesburg region of Gauteng. The target was both genders and all race groups that engaged microlenders.

### **4.3 Sampling Frame**

Some of the companies that were targeted as data gathering centres were African Bank, Capitec, SA Microloans and other smaller microloan outlets. These companies were contacted and permission was requested to allow researchers to gather data, unfortunately permission was denied and so the research gatherers interviewed respondents on the street. Data was also gathered at taxi ranks located in the Johannesburg region.

### **4.4 Sampling Method**

The data gathering was done through a random sampling method using a questionnaire. Questionnaires were primarily filled in by the research helpers outside microfinance premises and at taxi ranks. The data gathering was done at various locations around Johannesburg city centre. Due to the potential literacy issues, the questions were short. Most responses were limited to yes or no.

The questionnaire had 7 sections (see Appendix). The first section dealt with demographic information as well as employment status and loan amount data. The following 6 sections extracted loan spending information. The first 5 out of 6 sections were specifically on existing debt, lending to someone else, building onto a home, investing in a business and investing in education. The final

section was added as a qualitative question and captured the loan spending pattern of respondents who answered NO to all of the previous 5 sections.

According to Zikmund (2003), the standard deviation can be estimated by dividing the range of data by 6. The equation to calculate sample size is,

$$n = (Z*S/E)^2 \quad (1)$$

Where,

n – sample size

Z – standardized value corresponding to a confidence interval

E – acceptable magnitude of error

S – estimation of the population standard deviation

In the Micro Lending Industry Overview February 2007 statistics, the number of loans issued was stated to be 4.8 million (Heymans, 2007). Using this data, the population was estimated to be 4.8 million. For a confidence level of 95%, the corresponding Z score is 1.96 (Zikmund, 2003). The error E, was estimated to be 2.5% of the population.

Table 2 shows the sample size calculations using equation 1.

**Table 2: Sample size calculation**

Population (P)	S = P/6	Z @ 95%	E @ 2.5%	n
4 800 000	800 000	1.96	120 000	171

It was therefore concluded that at a confidence level of 95%, a sample size of 263 was statistically significant considering it was greater than 171.

#### **4.5 Sampling Technique**

The questionnaire was reviewed and amended to include open ended questions to probe a deeper understanding of the dissemination of the loans.

The data collectors were interviewed and those that spoke multiple South African languages were chosen. They were then briefed on the approach that was adopted. The data collectors informed the respondents that no information pertaining to their personal profile was recorded and as such anonymity was guaranteed which gained the respondents trust. They were further told that the questionnaire will take 1 – 2 minutes of their time to complete and that the research was for an academic thesis.

#### **4.6 Sample Exclusions**

Incomplete questionnaires were removed from the data analysis. All other questionnaires were included.

#### **4.7 Assumptions**

All loans were spent across the 6 categories listed in the questionnaire.

#### **4.8 Limitations**

The research was localised to the Johannesburg region only which inherently excludes rural borrowers. Some respondents could not accurately remember the interest that they paid on their loans. The interest rate could have been inferred if the researcher had information on the repayment amount and repayment term.



## 4.9 Data Analysis

### 4.9.1 Data Coding

The qualitative as well as section 1 raw data received was coded as listed in the table below.

**Table 3: Data coding**

<b>Coding</b>	
<b>Race Coding</b>	
Black	B
White	W
Coloured	C
Indian	I
<b>Age Group Coding</b>	
<25	1
25 -35	2
>35	3
<b>Employment Coding</b>	
Employed	E
Unemployed	U
<b>Qualitative Coding</b>	
Personal Needs	1
Funeral Expenses	2
Car Expenses	3
Other	4

Personal Needs encompassed groceries, furniture, clothing accounts, alcohol debts, parties, transport and marriage. Car Expenses included servicing and buy a car whilst “Other” related to purchasing of shares and business

registration fees. The coding process facilitated graph plotting and a deeper analysis of the sample.

#### **4.9.2 General Analysis**

A comparison of the total sample responses was done under the following:

- Race
- Gender
- Age
- Employment status

#### **4.9.3 Unproductive debt Spending**

Responses to questions 1, 3.2 and 6 were compared under gender and age for the entire sample. A deeper analysis was done for Black Males within the various age groups as well as Black Females. There was insufficient data from other race groups to do a racial comparison. There was insufficient data for borrowers who lent money to someone else to perform an analysis.

#### **4.9.4 Productive debt Spending**

Responses to questions 3.1, 4 and 5 were compared under gender and age for the entire sample. A deeper analysis was done for Black males within the

various age groups as well as Black females. There was insufficient data from other race groups to do a racial comparison. There was insufficient data for borrowers who lent money to someone else to perform an analysis.

#### **4.10 Ethics of Research**

According to Zikmund (2003), obligations and rights of researchers, field workers and respondents are as a result of society and individuals. Privacy refers to the choice by a respondent to answer questions and confidentiality refers to the obligation on the part of the researcher not to reveal the identity of the respondent.

Floridi (2005) used the concept of an infosphere. The infosphere is the environment in which information was exchanged. Some of the inputs in the environment are honesty, informational privacy and expectations of the respondent.

In return for honesty, respondents expect confidentiality and anonymity. A lack of openness leads respondents to believe that the researcher is being deceptive. By explaining the purpose of the research clearly, the researcher may gain informed consent from the interviewee in which case he/she waives his/her right to privacy (Zikmund, 2003).

Taking this forward, the field workers will be open to questions from the respondents and will strive to make the respondent understand the nature and aim of the research. Furthermore the respondent will be assured of their anonymity which is supported by the lack of identity details in the questionnaire.

## 5 PRESENTATION OF RESULTS

### 5.1 Description of Sample

A total of 263 questionnaires were completed and formed part of the valid data set. Incomplete surveys were discarded from the valid data set. The respondents spanned all four race groups, both genders and all age groups that engaged microlenders in the Johannesburg region of South Africa.

Table 4 below shows a breakdown of responses to the survey questions. The numbers indicate the count of Yes responses to the questionnaire.

**Table 4: Breakdown of survey responses**

Questions from the Questionnaire		Yes Responses
<b>Q1</b>	Will you use this loan for existing debt?	<b>26</b>
<b>Q2</b>	Will you lend this money to someone else?	<b>4</b>
<b>Q3</b>	Will you use the money to build onto your home?	<b>76</b>
<b>Q4</b>	Will you use this money in your business?	<b>55</b>
<b>Q5</b>	Will you use this money for education?	<b>67</b>
<b>Q6</b>	Other uses for the loan.	<b>55</b>
<b>Total Yes responses</b>		<b>263</b>

Table 5 indicates the differences in loan amounts borrowed across gender profiles.

**Table 5: Breakdown of survey response by Loan Amount**

<b>Loan Amount Analysis</b>	
<b>Total Loan Value</b>	
R4 448 000	
<b>Loans taken by Males</b>	
Minimum	R 100
Maximum	R 100,000
Average	R 17,202
<b>Loans taken by Females</b>	
Minimum	R 400
Maximum	R 150,000
Average	R 26,143

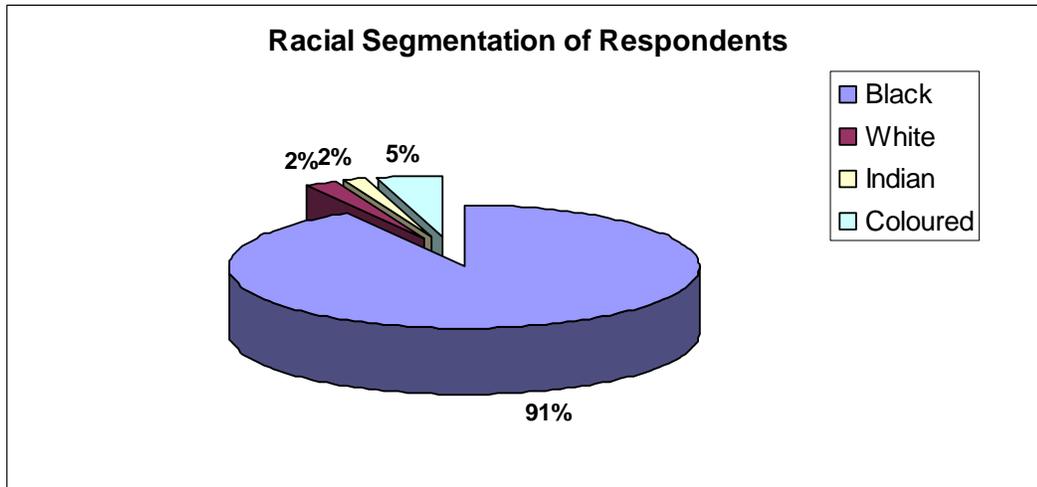


Figure 1: Racial segmentation of respondents

Figure 1 is a graphical representation of ethnic responses to the survey. Clearly a higher proportion of respondents were black.

Figure 2 shows the gender segmentation of the sample and the female component was higher than the male component.

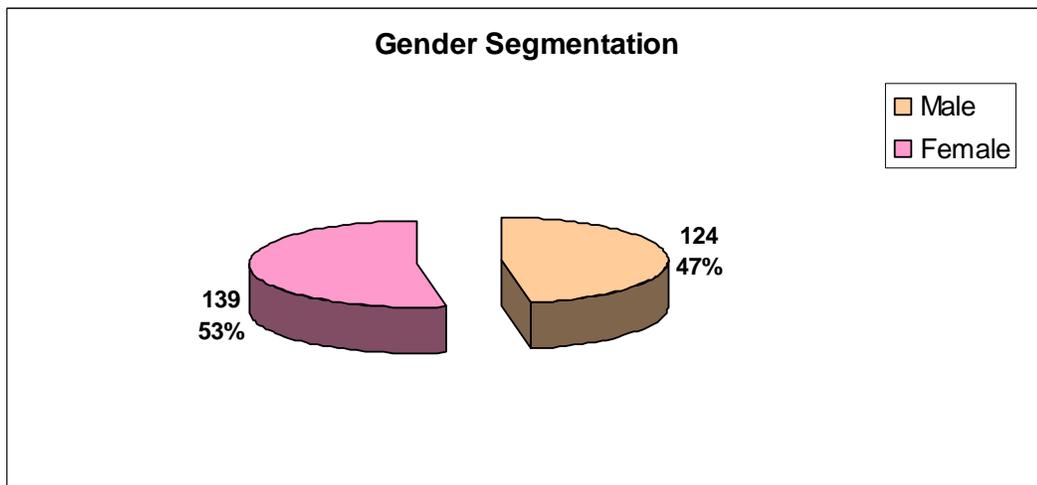


Figure 2: Gender segmentation of respondents

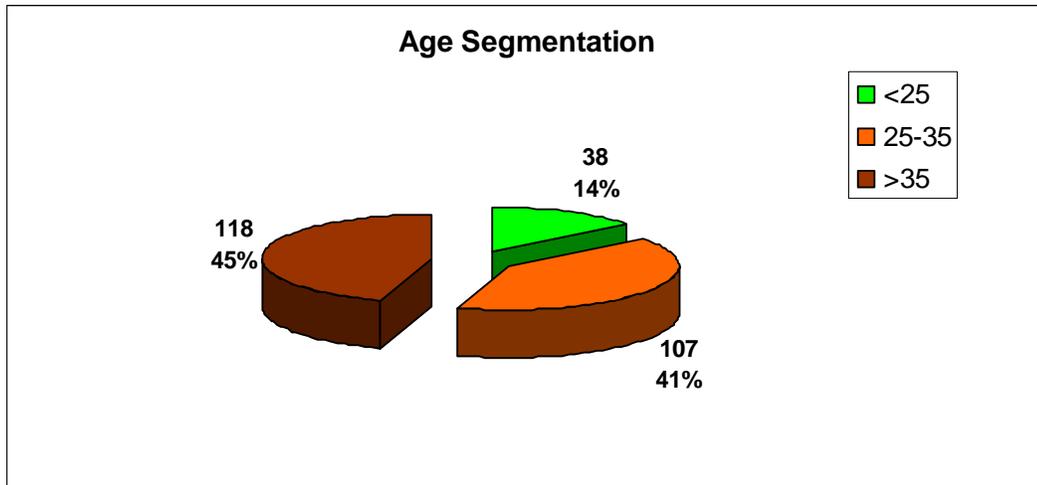


Figure 3: Age segmentation of respondents

In figure 3, the dominant age group of the sample was respondents older than 35 whilst the minority was respondents younger than 25.

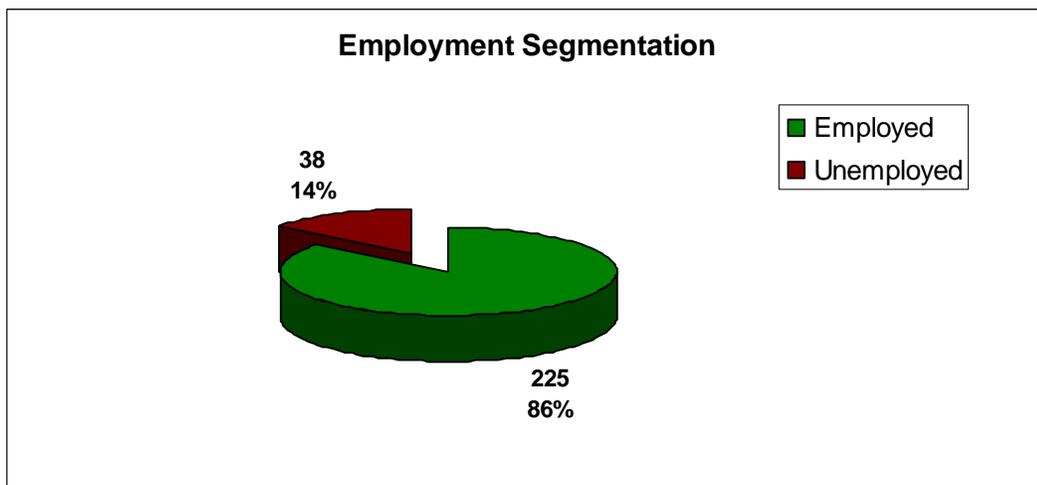


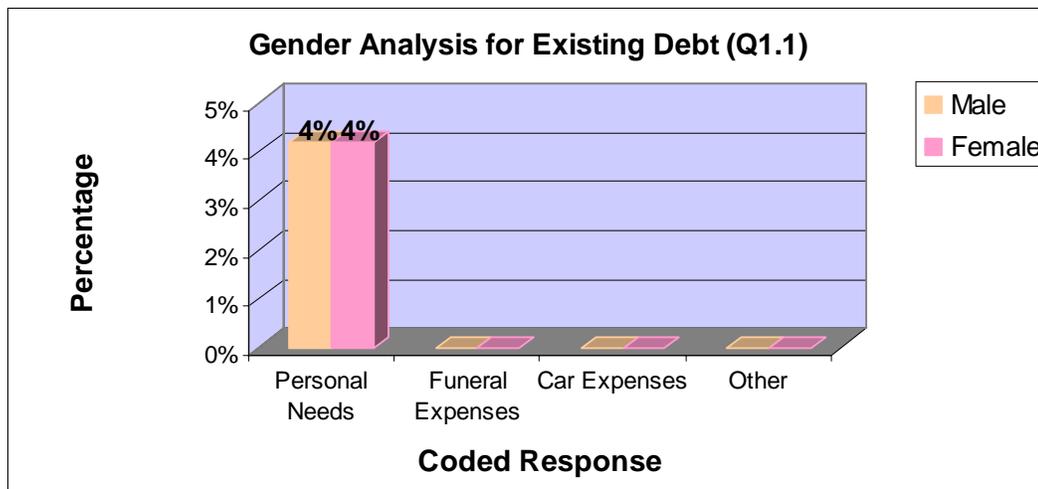
Figure 4: Employment segmentation of respondents

The overwhelming majority of respondents were employed and this is represented by figure 4.

## 5.2 Unproductive Spending

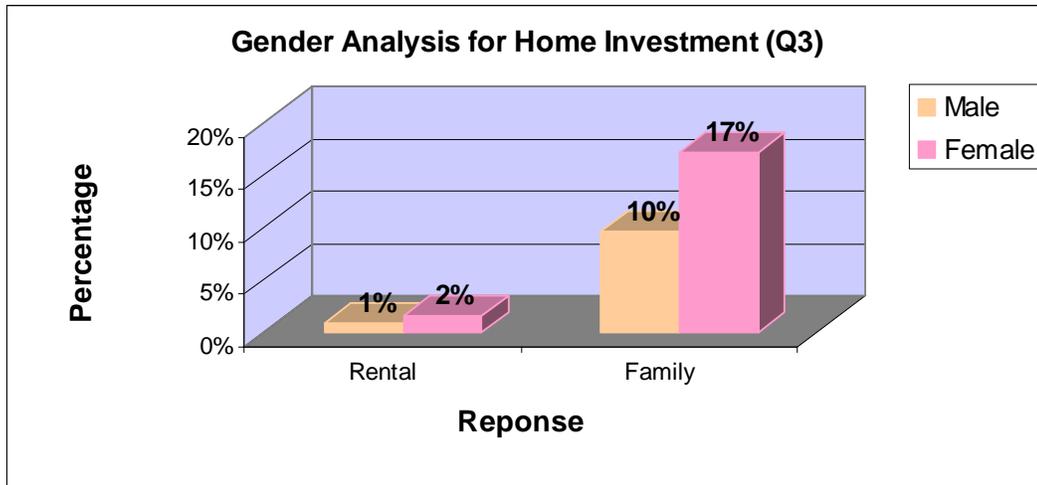
The data input was from responses to questions on loan usage for existing debt, building onto a home for the purpose of housing family and responses extracted from question 6. Question 6 responses encompass personal needs, funeral expenses, car expenses and other expenses.

### 5.2.1 Comparison of results across gender



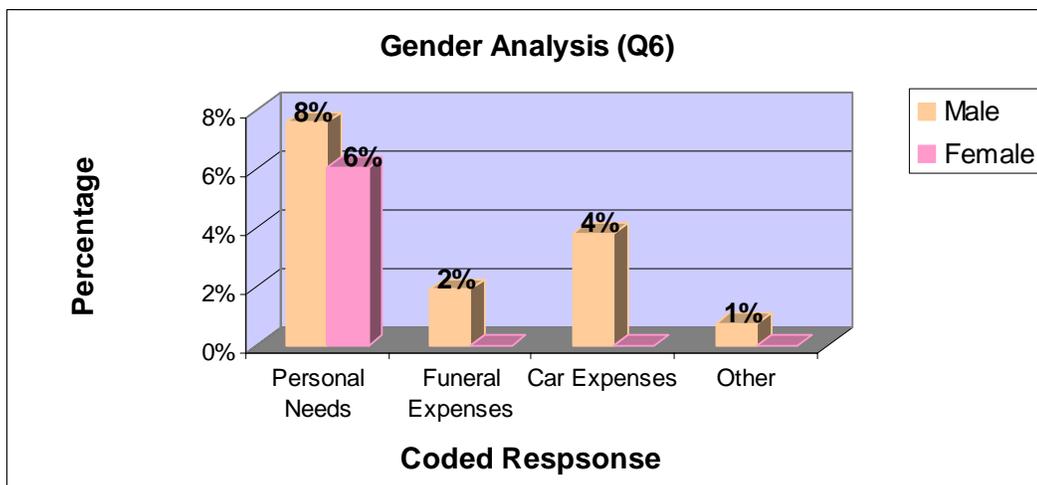
**Figure 5: Gender responses to Spending on Existing Debt**

In figure 5, we see that 4% of both males and females in the sample spend their loans on personal needs.



**Figure 6: Gender responses to Home Investment (Family)**

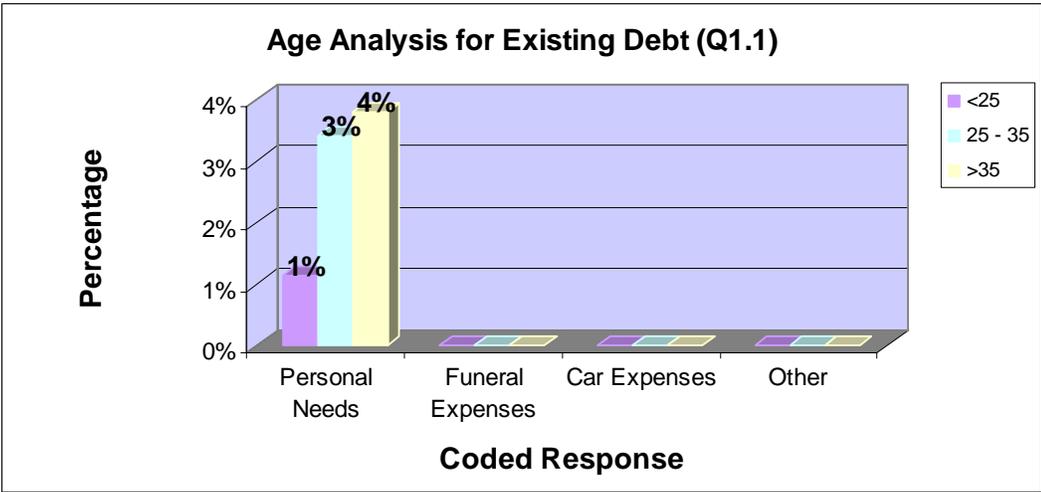
Figure 6 shows that 27% of both males and females combined invest in building onto their homes to house family with females showing 7% greater proportion than males.



**Figure 7: Gender responses to other uses of the loan**

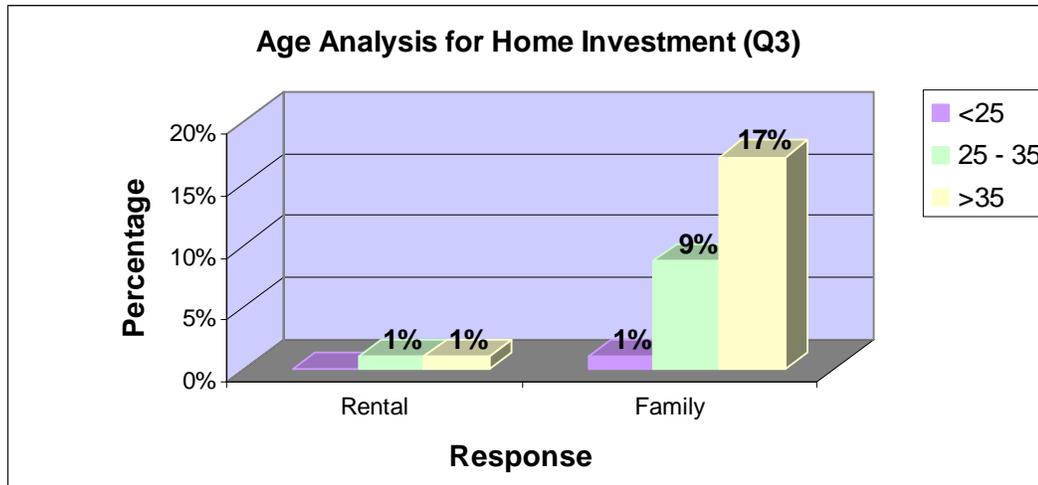
Like figure 5, males and females tend to spend more on personal needs but it is also observed in Figure 7 that 6% of males spend their loans on car and funeral expenses, as compared with females.

**5.2.2 Comparison of results across age**



**Figure 8: Age group analysis of Existing Debt spending**

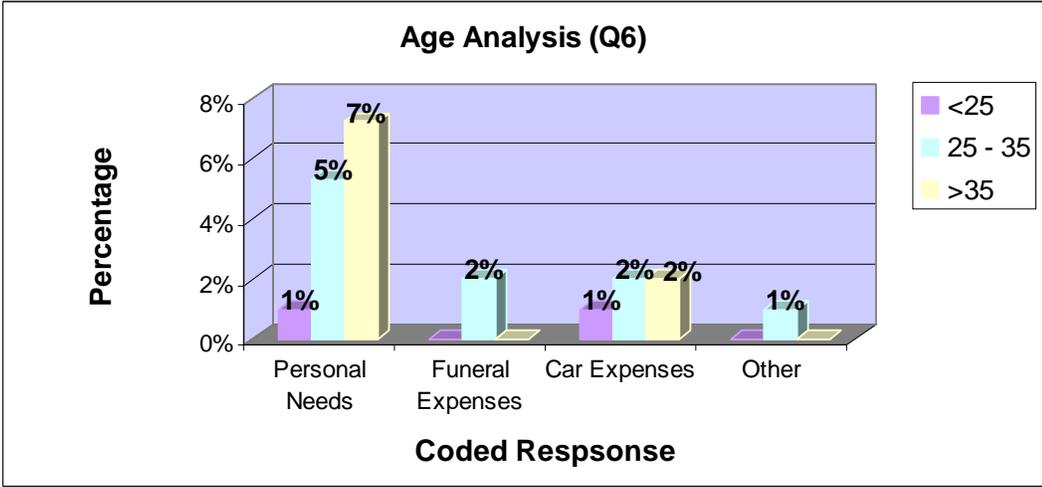
In the age analysis done in Figure 8, once again it is observed that 7% of respondents' older than 25 largely engage in debt spending that facilitates personal needs.



**Figure 9: Age group analysis of Home Investment (Family)**

Figure 9 shows that 17% of respondents over the age of 35 invest in their homes for their family compared to 9% of respondents between the ages of 25 and 35.

In the qualitative responses to the question of other uses for the loan, respondents reiterated findings represented in Figures 5, 7 and 8, that personal needs was the primary driver for the loan. This is presented in Figure 10.

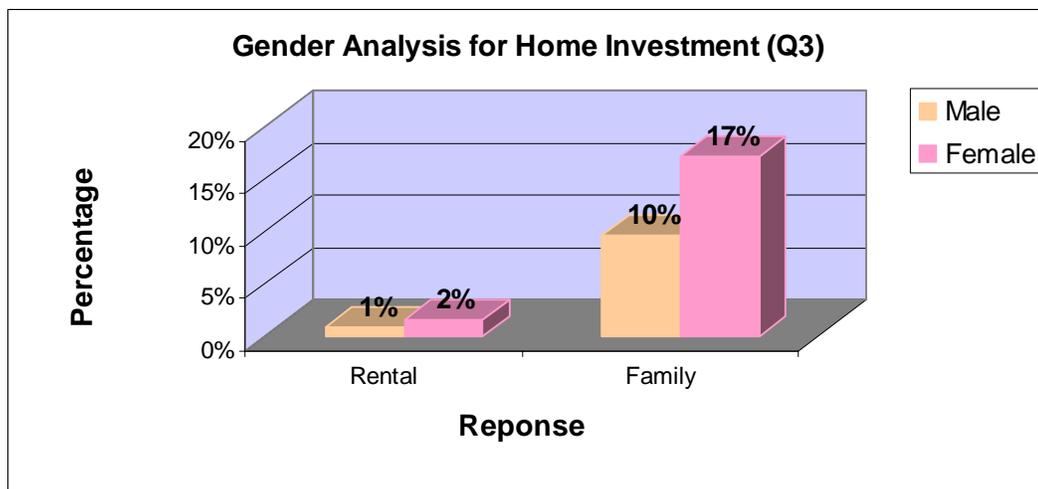


**Figure 10: Age group analysis of other uses of the loan**

### 5.3 Productive Spending

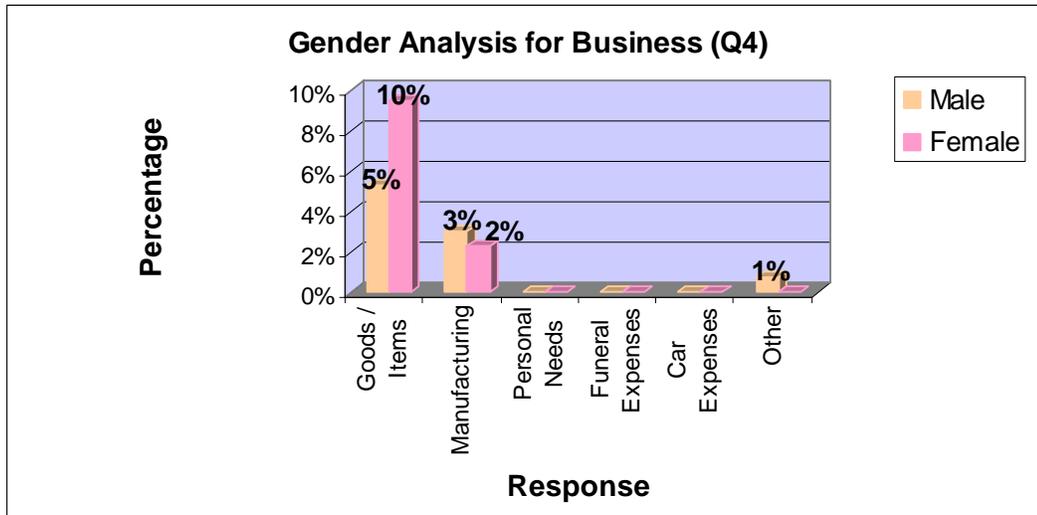
The data input was from responses to questions on loan usage for business purposes, education and building for rental income.

#### 5.3.1 Comparison of results across gender



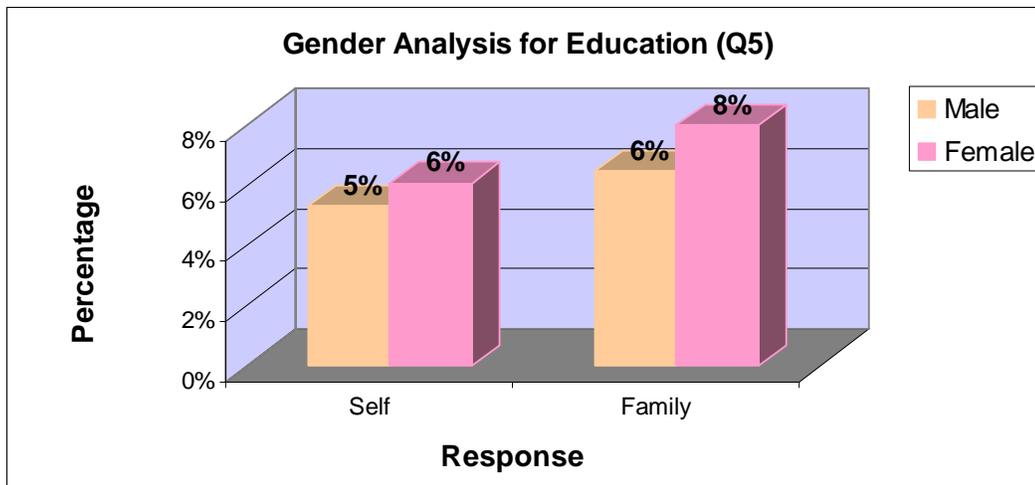
**Figure 11: Gender responses to Home Investment (Rental)**

Both males and females do not spend a considerable amount of their loans on home investment for the purpose of generating rental income. Figure 11 shows responses of 1% and 2% for males and females respectively.



**Figure 12: Gender responses to Business Investment**

Figure 12 shows twice as many females, as males, investing in businesses that buy and sell goods.



**Figure 13: Gender responses to Investment in Education**

Figure 13 indicates an aggregated 25% of males and females investing their loans on education. Females marginally spend more than males in educating themselves and their families.

### 5.3.2 Comparison of results across age

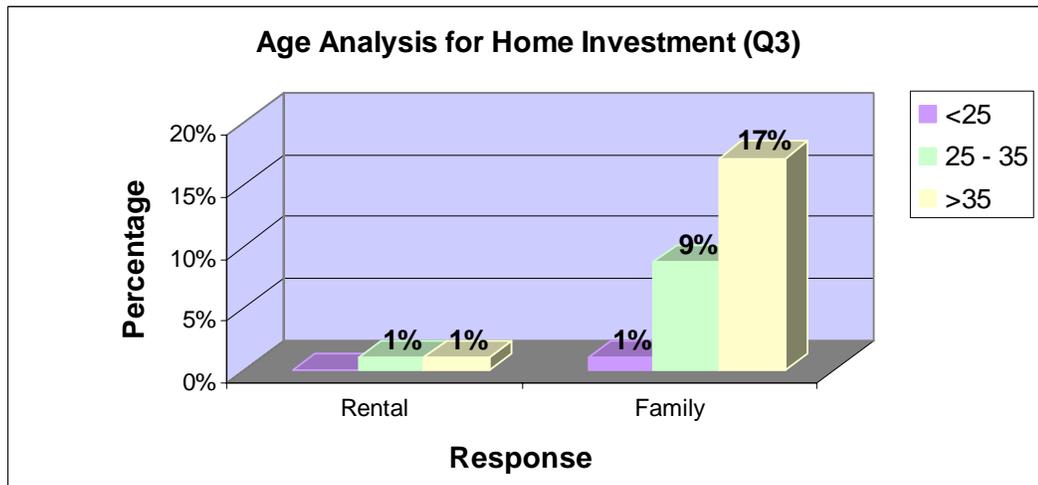
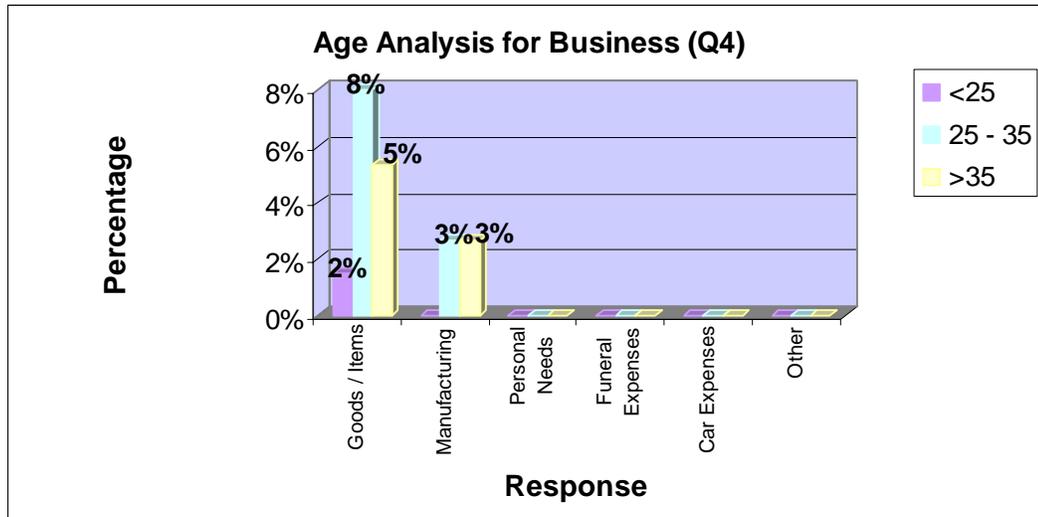


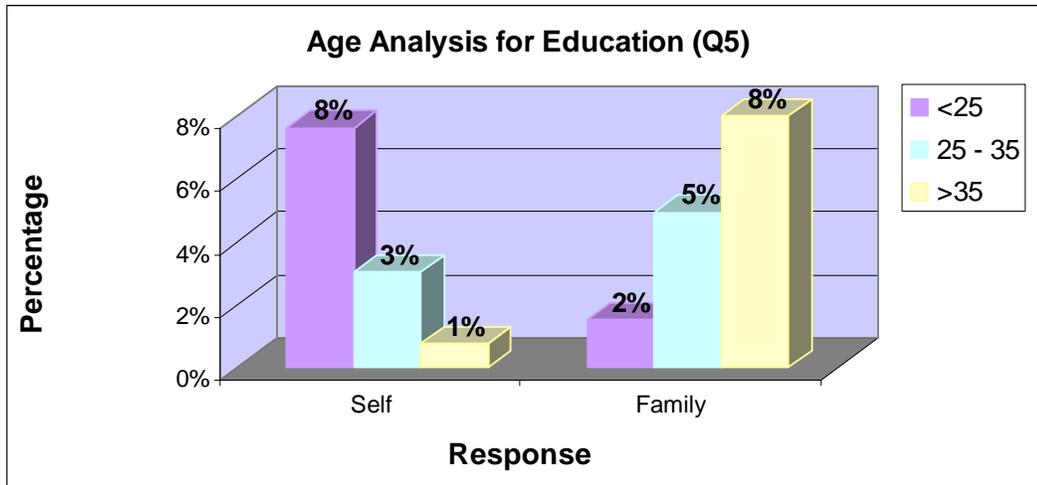
Figure 14: Age group analysis of Home Investment (Rental)

All age groups invest minimally in homes for rental purposes, as shown by Figure 14.



**Figure 15: Age group analysis of Business Investment**

Between 3% and 6% of respondents aged between 25 and 35 invest more than other age groups in businesses that involve buying and selling goods. See Figure 15.



**Figure 16: Age group analysis of Education Investment**

From Figure 16, 5% of respondents under the age of 25 invest more than respondents between the ages of 25 and 35 in educating themselves. Respondents under the age of 25 were a 7% greater proportion of the sample than respondents older than 35 in the category of self education. However, Figure 16 shows 6% of respondents older than 35 spend more than respondents younger than 25 on educating their families.

## 6 DISCUSSION OF RESULTS

### 6.1 Description of Sample

The 263 survey respondents from the Johannesburg region comprised of Black, White, Indian and Coloured individuals of both genders. The 263 questionnaires generated 283 data points as some respondents had multiple uses for their loans. There was a 91% majority of Black respondents which led to the exclusion of any analysis across ethnic groups.

The gender segmentation was split by 53% female and 47% male. Males were generally found to have taken out loans of lower value than females. The minimum loan taken by males was R100 whereas for females it was R400. The average female loan was R26 143 as compared with R17 202 taken out by males. The total loan value for the sample was R 4 448 000.

The age group analysis revealed that 86% of the sample was 25 years old or older with 86% of the sample being employed and 14% unemployed. Upon closer scrutiny of respondents who claimed to be unemployed, it was found that approximately 4% of the unemployed were in fact self-employed as business owners involved in manufacturing or buying and selling goods.

## 6.2 Unproductive Spending

### 6.2.1 Comparison of results across gender

The comparison of the results across gender revealed that 4% of both males and females spend their loans on personal needs. Personal needs were categorised as existing debt in the form of accounts. This is in agreement with what Meyer (2002) found. Meyer (2002) found that monies from loans were directed towards household consumption or cross funding debt.

Four percent of Males were found to spend their money on car expenses whereas women had no expenditure related to cars. It is possible that males place more value in cars than females and as a result car related expenses for males is higher than females. Edward and Olsen (2006) stated that woman were responsible for the wellbeing of their families and it was found in the sample that as much as 17% of females used money for the purpose of housing their families. In this category, males comprised 10%. The combined 27% of males and females housing expenses translated into a rand value of R 1 247 500. This represented 28% of the total sample loan rand value.

It was also evident that the difference between male and female expenditure in relation to funeral expenses was 4%. Males are generally seen as the heads of families and it may be that due to responsibility obligations, we find

males dominant in expenses related to funerals. A possible reason for individuals engaging microlenders to cover these costs is the lack of information related to funeral insurance policies or that they are just not affordable. However these reasons were never confirmed or explored within this research.

### **6.2.2 Comparison of results across age**

The foremost reason for age groups 25 to 35 and over 35 spending on existing debt was personal needs. For the entire sample, the dominant reason for taking out a loan was to service personal needs, thus reiterating the point made by Meyer (2002). It is worth mentioning that this is from a response percentage point of view.

Banister and Hogg (2004) stated that branded clothing was purchased to satisfy or enhance self-esteem. It was found that age groups between 25 and 35 and older than 35 comprised an aggregated 19% of expenditure on personal needs. Dholakia (1999) purports shopping centres to be opportunities for socialisation. It is possible that individuals older than 25 spend a considerable amount of time socialising and that is attracting further costs.

Although there was not an overwhelming amount of respondents who claimed that they borrowed money to pay alcohol related debts, it was stated as a reason. French *et al.* (1994) did state that imbibing alcohol can cause a degraded level of performance. Loup (1994) claimed that substandard performance can adversely impact the reputation of a company.

It was found that age groups older than 25 will invest in their homes but this was primarily to house family. The difference between expenditure across age groups was 8% with 17% of respondents older than 35 spending on their homes. Although respondents between the ages of 25 and 35 formed a lower proportion within this category, it was still significant at 9%. The younger than 25 age group showed little to no investment in their homes for family purposes. It is possible that the under 25 age group do not have family obligations that require such an investment or have not purchased a home as yet.

## 6.3 Productive Spending

### 6.3.1 Comparison of results across gender

Jorgensen (2007) showed that rental of rooms within a house is a viable source of income for families. The analysis of the data across gender profiles indicated that less than 3% of both males and females spend their loans on their homes for rental purposes. This may be because the cost of building is greater than the potential rental revenue that will be received. It is also possible that this is not an option as a form of investment due to space constraints around their existing dwellings or the fact that they do not own the homes that they reside in. Although the above reasons are speculative, it does point to opportunities for further investigation.

Ten percent of females were found to have disbursed their loan amounts as compared to 5% of males, in businesses that involved reselling of goods or items. A combined 5% of both males and females posted expenditure in businesses of manufacturing types.

One of the benefits that Morris and Pitt (1995) found was job creation. The 4% of unemployed respondents who owned businesses combined with the 19% of employed respondents who invested in their businesses, clearly are involved in job creation.

The 67 responses to investment in education for themselves and their families translated into a sample percentage of 25%. This comprised both males and females. Although for both genders, family education dominated self education. Interestingly, in rand terms, this represented only 15% of the total sample loan value. This would suggest that the loans taken out are of low amounts.

It was not tested if the components of family education were largely schooling or tertiary costs. Despite this, Borghans and Heike (2005) and Vila (2005) do highlight the importance and benefits of education which these families will receive.

One of the paradigms explored by Edward and Olsen (2006) was the Female Empowerment paradigm. With the view that education is a form of empowering the mind, the findings do not overwhelming support female empowerment within the female group. This may be due to pressures of family commitment and the role that the female plays within the household environment.

### 6.3.2 Comparison of results across age

As with the gender analysis, the age group analysis showed little to no investment in housing for rental purposes. This is supported by 1% or less of individuals across all age groups investing in houses for rental purposes.

The largest loan usage for businesses that pertained to manufacturing and buying and selling goods or items came from the middle age group. The Sample data indicated that 11% of age group 25 to 35 invested as compared with the age group older than 35 who only made up 8% in these types of business. It was also found that respondents younger than 25 showed an insignificant representation of 2% in investment in business.

The total percentage of respondents that indicated obtaining loans for business was approximately 19%. When the rand values were aggregated, it was revealed that this 19% of the sample consumed 44% of the total loan value. The equivalent rand value was R 1 965 500 which may be interpreted as respondents taking out loans of large amounts.

The survey results showed that respondents younger than 25 spent the most on educating themselves as compared with other age groups. It was found that 8% of individuals younger than 25 invested in educating

themselves which was 5% higher than individuals between the ages of 25 and 35. This may indicate ambition and a willingness to improve their skills amongst the younger group.

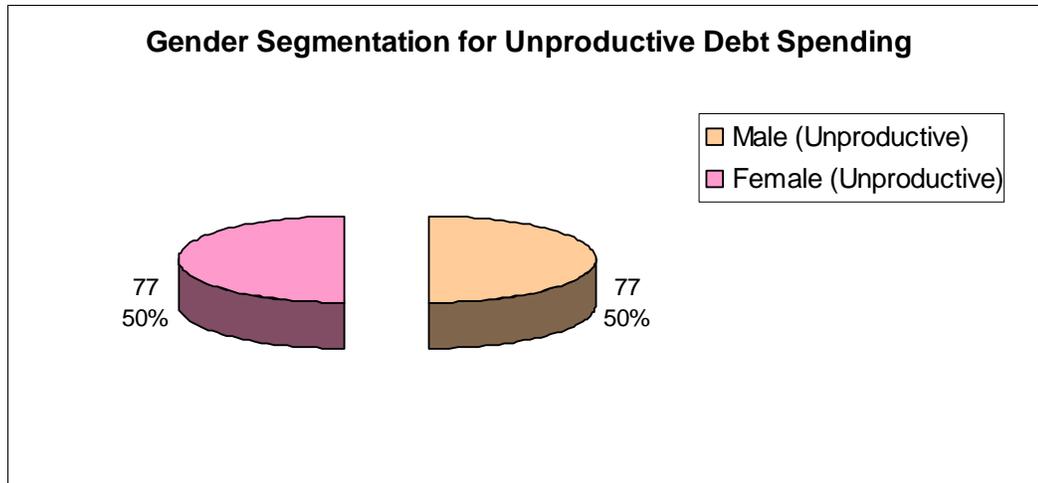
The middle age group, 25 to 35, leaned more towards family education than self education. The split was 5% for family and 3% for self. It is possible that the middle age group understand the need to improve their own level of education as well as that of their families.

The responses to education spend related to family was dominated by the age group older than 35. Eight percent of respondents in this age group invested in educating their families. This was 3% higher than the age group 25 to 35 and 6% higher than the age group younger than 25. As noted in the age analysis for home investment, older respondents seem to be family focussed.

## 7 CONCLUSION AND RECOMMENDATIONS

The purpose of this research was to investigate what borrowers from microlenders, in the Johannesburg region of Gauteng, spent their loans on. The spending was categorised as productive or unproductive which depended on whether there was a return on the money deployed or not. If it was found that there were groups of borrowers who engaged in productive debt spending, this would be useful information to financiers to re-evaluate their risk models and introduce new products into the market at varying interest rates. This may be achieved through preferred partners with suppliers. An example would be if individuals require loans for building, the financier pays the building suppliers directly and the individual collects the relevant building materials.

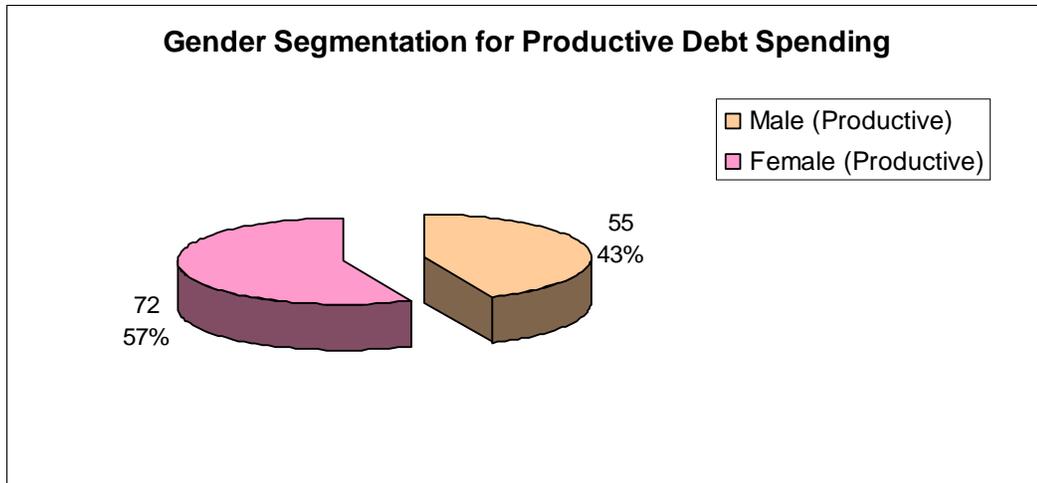
It is worth mentioning that although the sample frame comprised of microfinance institutions, 86% of the respondents were employed. This suggests that the risk that South African microfinance institutions carry is mitigated by the employed status of the borrower. It would also seem that this is a regular commercial bank approach which markedly differs from banks like the Grameen bank, which mitigates risk through strong social networks and trust (Meyer, 2002).



**Figure 17: Gender responses to Unproductive Debt Spending**

The survey sample showed that the primary reason for individuals borrowing money was for home investments. Although the total number of Yes responses was 76, this was not for rental purposes instead it was primarily to house their families. Figure 17 indicates males and females spent an equal amount of money on unproductive debt. This was driven mainly by personal needs, which might indicate the state of our economic environment.

According to Weller (2007) and Chen (2006), poor labour conditions, rising consumer prices and disproportionate increases in household income will cause debt to rise. This may be a viable reason as to why so many respondents divert their loans towards personal needs. The incomes of respondents are not sufficient to support their needs and as a result they turn to microloans. This is a short term solution and can result in further debt which may have other social and psychological ramifications.



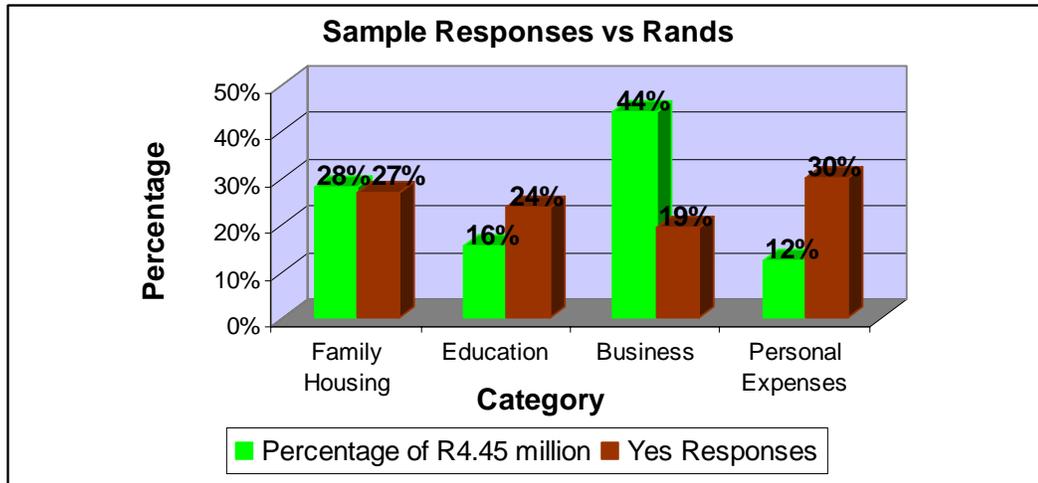
**Figure 18: Gender responses to Productive Debt Spending**

The second and third reason for respondents engaging microlenders was found to be for education and business investment respectively. As defined by the theory, this is a productive means of spending money. Figure 30 depicts the gender ratios of the sample in terms of productive debt spending. Females represented 57% of productive debt spending whilst males were 43%.

Closer interrogation of the data set revealed that males and females younger than 25 years of age spent their loans on educating themselves. This presents an opportunity to provide student funding that is cheap and accessible to this group of the population. In contrast, males and females older than 35 years of age primarily invested in their families' education. It would be of value to understand why this group of mainly employed individuals opted for microloans to fund their families' education as opposed to main stream banking finance.

The analysis of business investment showed that females invested more than males in businesses that involved buying and selling goods or items. It is possible that this is the case because more females than males are running Spaza shops and hawking types of businesses. Money lenders may want to engage in pricing education and product streamlining with these women so as to improve their efficiency and consequently their profits. Helping these businesses to grow has potential gains to financiers in the form of larger amounts being loaned in the future.

Males however were found to be ahead of females in manufacturing type businesses. This is also an opportunity for bankers to fund education and process optimisation as an additional service to granting a loan. This will result in better products and a cheaper cost of production. Besides serving the domestic market, competitively manufactured products may be sold into international markets. This benefits the economy of the country and the individual.



**Figure 19: Sample responses vs Rands**

Figure 19 shows that the respondent percentages tell a different story compared to the rand value representation of each category. Although the highest responses were within the realm of personal expenses (which comprises personal needs, funeral expenses and car expenses), this was the lowest percentage rand value of the sample.

The highest aggregated loan disbursements were by individuals who invested in businesses. This was 44% of the total sample loan amount with a rand value of approximately R2 million. The second highest was building onto homes for family housing. This was an effective 28% and about R1.25 million.

Finally, the sample data show that from a rand value point of view, 60% of respondents engage in productive spending. This is in the categories of

business and education. If we include housing, this value escalates to 88%. This certainly presents opportunities in education; business and housing for financiers to introduce innovative lending models that will achieve mutual financial gain for the borrower and the lender.

## 7.1 Future Research

The following areas could form the basis for future research:

Research could be done on housing finance models that will suite borrowers from micro-lenders to make finance affordable and improve the quality of buildings.

Research into why individuals engage microloans to service unproductive debt. It would be valuable to determine the factors that influence people to take on more debt to support their personal needs.

Explorative research could be undertaken to establish what type of financial products will suite business owners who are using microloans as a source of money.

Research could be done to determine what the components of the education spend are. What is the percentage that is used for primary, secondary or tertiary education?

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## APPENDICES

Appendix A: Questionnaire used for Data Collection



## Appendix A: Questionnaire used for Data Collection

Please indicate a cross (X) where applicable.

<b>Respondents</b>	This questionnaire is aimed at those who have taken loans or in the
	process of taking loans for the purpose of home improvement, debt funding,
	education or other general purposes.

<b>Instructions</b>	If respondent responds <b>NO</b> to Q1 then go to Q2. If <b>NO</b> to Q2 then go to Q3
	If <b>NO</b> to Q3 then go to Q4, if <b>NO</b> to Q4 then go to Q5. Otherwise ask all
	questions in each category.

Category	Questions			
1	Q1	Will you use this loan for existing debt?	YES	NO
	1.1	Why was this debt incurred?		
2	Q2	Will you lend this money to someone else?	YES	NO
	2.1.	Why does that person need the money?		
3	Q3	Will you use the money to build onto your home?	YES	NO
	3.1.	Is this for rental?	YES	NO
	3.2.	Is this for your family?	YES	NO
4	Q4	Will you use this money in your business?	YES	NO
	4.1.	Is your business to buy and sell goods/items?	YES	NO
	4.2.	Is your business manufacturing?	YES	NO
	4.3.	Other, please specify?		
5	Q5	Will you use this money for education?	YES	NO
	5.1.	Will the funds be for your own education?	YES	NO
	5.2.	Will the funds be for your family's education?	YES	NO
6	Q6	If NO to all of the above, what will the money be used for?		