The Effects of Interest Rate Ceilings on the Microfinance Market:

A Case Study of a Micro lender

by

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Abstract

Access to loans and credit facilities has been, and still is, a major problem for a large portion of the South African society. The problem is particularly significant in the disadvantaged and rural areas where the majority of people do not have access to formal banking services. Against this background the government further exacerbated the problem by prescribing legislation, which is thought to protect borrowers from perceived usurious rates. This particular law in contention is the Usury Act (No. 73 of 1968). The Act imposes interest rate ceilings on loan finance provided by money lending institutions.

The objective of this study was to examine the impact that interest rate ceilings will have on the micro lending market. This was done through looking at a case study based on information obtained from a micro lender. Firstly the study undertook the financial impact analysis on a micro lending business to determine the effect of a change in the maximum interest rate that could be charged by the micro lenders. This process was conducted to help understand the costs, revenues and profits of a micro lending business.

The data, which were based on the micro lender's financial statements, were analysed and evaluated on the basis that the statements reflect the financial position of the micro lender charging an interest rate not exceeding 30 per cent. Calculations were then made to reflect their financial position in the event of them being allowed to charge a maximum rate of 20 per cent, 12.08 per cent and 10 per cent per month.

The results showed that micro lenders could make a profit when charging rates of between 30 and 20 per cent. However when the interest rate is reduced to 10 per cent the micro lender start to lose. The bottom line for micro lenders is greatly influenced by their turnover, as large portions of their costs are fixed. Therefore one micro lender might earn economic profits at 12.08 per cent per month, while another might just break-even.

Simple and multiple regression techniques were used to analyse the data pertinent to the study. The analyses were performed to show the impact, which ceilings on the interest rate have on the market structure, company size and on the characteristics of loan services. The results were evaluated according to their significance. The findings showed that interest rate ceilings can have positive significant effect on risk and the market structure.

Based on the findings of both methods applied to this study, it is evident that the interest rate ceilings could act as a constraint to the provision of credit to low-income earners and operators of small and micro enterprises. The micro lenders offer small amounts of credit to a large number of people, therefore interest rate ceilings may not only ration consumers out of the legal market, but also drive smaller lenders from the market and thus diminish competition.

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List of Acronyms

ABSA	Amalgamated Banks of South Africa
AMDEP	Alliance of Micro-Enterprise Development Practitioner
CGAP	Consultative Group to Assist the Poorest
CISA	Consumer Institute South Africa
DTI	Department of Trade and Industry
EU	European Union
GDP	Gross Domestic Product
MFIs	Microfinance Institutions
MFRC	Micro Finance Regulatory Council
MLA	Micro Lenders Association
MLI	Micro Lending Industry
NGOs	Non Government Organisations
PIN	Personal Identification Number

RDP	Reconstruction and Development Programme
ROSCAs	Rotating Savings and Credit Associations
SA	South Africa
SMMEs	Small, Medium and Micro Enterprises
USA	United States of America