

Chapter 4: KFC's RURAL DEVELOPMENT DIVISION

4.3 The structure of the KFC

4.1 Introduction

The board of directors of KFC report to the KwaZulu parliament via the In this chapter the KwaZulu Finance and Investment Corporation's rural Development Division is described. KFC has been used for illustrative purposes and for creating benchmarks for comparing similar situations. The choice of KFC is because of its generally accepted status as relatively the most successful RFI in South Africa, its success in mobilising savings and the availability of information.

4.4 The KFC's Success Story

4.2 Background of the KFC

KFC is a statutory development corporation established by proclamation R73 of 1978, in terms of the Promotion of Economic Development of National States Act, No 46 of 1968, as amended by the KwaZulu Corporations Act, No 14 of 1984.

KFC's mission (KFC, 1994) is to contribute significantly to the socio-economic empowerment of the people of KwaZulu/Natal. The KFC's stated primary development principle is to foster a holistic approach to development. The Rural Development Division (RDD) is the key component of KFC's overall development mission. The focus of the RDD is to stimulate the rural economy through the provision of financial services in rural areas. As such in the past any economic activity which entrepreneurs wanted to engage in has been given consideration.

4.3 The Rural Development Division's Portfolio

4.3 The structure of the KFC

The board of directors of KFC report to the KwaZulu parliament via the Economic Affairs Office of the provincial government of KwaZulu/Natal. KFC is subdivided into three strategic business units namely development, industry and finance, and administration. Agriculture and rural development, housing and small business, all fall under the development division of KFC.

4.4 The KFC's Success Story

The basis of KFC's success lies in the manner in which its operations emulate the commercial sector. KFC's main activities are primarily lending and savings mobilisation. The Rural Development Division (RDD) remains one of the largest and most diverse formal retail rural development financiers in South Africa. The policy of funding entrepreneurs and entrepreneurial groups on a demand driven basis has had a high level of success.

KFC's other notable success has been the ability to facilitate co-operation with other agencies in the region for the execution of large-scale projects. At operations level the debtors' book has been kept clean with write-offs of the division averaging 4% over a number of years. The book has maintained consistent growth over the years (KFC, 1994).

The Division's business primarily consists of loan finance. Over the years 1991 to 1995 45% of the division's business (excluding the sugar agency loans) in Rand terms has been short-term loans and 51% medium term loans. In terms of number of clients, 84% of the division's annual clients over the same period have been short-term borrowers and 15% medium-term borrowers. Long term

4.5 The Rural Development Division's Portfolio

4.5.1 Introduction

This study focuses on the RDD as a Specialised Business Unit (SBU) of the KFC. The RDD services consist of credit provision as part of a package initially under what was initially called the Farmer Support Program (FSP), and later the Rural Support Program (RSP).

The RDD's mission is to "assist rural households and communities to identify and satisfy their consumptive, productive and agricultural needs by actively facilitating development, mobilising private and public sector finance and assisting rural entrepreneurs in achieving their economic goals" (KFC annual report, 1996)

4.5.2 Clients

The Division finances individuals and groups. Individuals financed range from rural businessmen and women who have large loan requirements, for example farm purchases in the former Natal part of KwaZulu/Natal, to small-scale producers for their seasonal input requirements. A significant portion of individuals financed is woman. Groups are also eligible for finance if they are constituted into a legal entity with a recorded constitution.

4.5.3 Loan Finance

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financing has on average only accounted for 4% of the value of the division's annual business.

The RDD lends money to individuals, groups and through agencies such as sugar mills. The RDD sugar agency business has to date accounted for approximately 50% of the value of the loan capital advanced per annum.

The RDD also lends money through projects where it becomes involved with other financiers such as the Financial Aid Fund, the financial intermediary of the South African Sugar Association, and construction companies who develop large-scale irrigation projects.

Loan applications are submitted directly to advisors based at the branch offices at the project site and are generally investigated and processed locally. The Branch Loans Committee appraises or approves or in cases of large loans recommends the application for approval by the relevant authority. The loans are then processed and disbursed. The head office specialists (project management and subject matter specialists) are available for investigating project loan applications and newer types of business.

4.5.4 Ithala Savings

The formation and operation of Ithala, the saving arm of KFC, has proven to be not only an innovative strategy in terms of following lessons of experience on savings mobilisation in the literature but also successful in mobilising funds. Currently Ithala provides close to 34% of the Corporation's capital requirements. It is envisaged that this will grow to 60% by 1996/97.

4.5.5 Non-financial services

The RDD provides various client services aimed at assessing needs, facilitating development and mobilising support for training and grant funding provided for development projects. The RDD provides post establishment service, which is aimed at monitoring and assisting clients that have been financed. The division also undertakes research and development, and policy and strategy initiatives both internal and external to the organisation.

4.5.6 Nature and volume of business

The RDD is involved in four main areas of business, namely agricultural activities, agri-business, community development, consumptive services like water and sanitation provision and research and development projects. Agricultural and agri-business applications are appraised according to viability considerations, whereas community development and consumptive services are appraised according to willingness-to-pay and affordability considerations. From 1989/90 to 1995 the division on average lent R9.3 million per annum through the provision of 1338 loans per annum.

Cumulative number of clients financed total close to 24 500. As at March 1996 the outstanding balance for the individual loan portfolio was R14 million and for the agency business R9, 6 million, making the total outstanding balance near R25 million.

It is envisaged that in the future 70% of the loans advanced will be for financial, agricultural and Agri-business activities and 30% for community development and service provision. Short-term loans will account for 48%, medium term for 40% and long term 12% of the RDD business.

Table 4.1: Loans disbursed by the KFC's RDD (1984/85 to 1992/93)

YEAR	LOANS ADVANCED		AVG	SUGAR AGENCY		TOTAL	
	R'MIL	NUMBER	SIZE(R)	R'MIL	NUMBER	R'MIL	NUMBER
1984/85	1.4	504	2778	3.25		4.65	
1985/86	1.1	455	2418	1.7		2.8	
1986/87	1.8	2616	688	1.45		3.25	
1987/88	3.3	2579	1280	1.28		4.58	
1988/89	6.3	2924	2155	1.12		7.42	
1989/90	4	1604	2494	2		6	
1990/91	3.9	840	4643	3.29		7.19	
1991/92	5.5	958	5741	4.1		9.6	
1992/93	5.7	1895	3008	2.17		7.87	
TOTAL	33	14375	33205	20.36	10125	53.36	24500

(Source: DBSA, 1995)

The cumulative investment from 1984/85 to 1994/95 through the agency business amounts to R20.36 million and for the individual loan business R33.0 million. In total the cumulative investment in agriculture in the region for the period 1979 to 1993 amounts to R76.7 million. For the same period the cumulative number of clients financed total close to 24 500. As at March 1995 the outstanding balance for the individual loan portfolio was R14 million and for the agency business R9, 6 million, making the total outstanding balance nearly R25 million.

It is envisaged that in the future 70% of the loans advanced will be for funding agricultural and Agro-business activities and 30% for community development and service provision. Short-term loans will account for 48%, medium term for 40% and long term 12% of the RDD business.

4.5.7 Infrastructure and Administrative Capacity

The Division comprises of two sections, namely field operations (Loans) which form the bulk of the Division, and the specialist and support services. There were 75 staff employed in the Division in 1996 of whom 7 were specialist staff who support field staff.

The Corporation and Division follow a decentralised operational structure where the bulk of the business takes place at the ten branch and satellite offices located throughout the region.

4.5.8 Systems and procedures

The bulk of the Division's business is received, investigated, appraised, approved and processed at the branch offices. Currently there is an on-line system where transactions and the processing thereof are done on a real time basis. Software has been specifically developed and systems implemented for the credit and savings transactions resulting from the needs of the clients of the development department and Ithala savings bank.

The productive ventures financed are appraised according to viability considerations. Consumptive activities are appraised according to affordability and willingness to pay criteria. One of the main decision making criteria for loan applications is an assessment of the client themselves; specifically their record in the community, with other credit providers, and with the KFC itself.

4.5.9 Bad Debts and Arrears

Once a loan has been deemed irrecoverable, that is all avenues of collection have been exhausted, it is written off. Between 1989 and 1995 the bad debt write-offs have averaged R50 000 per annum. They have been decreasing by

25% per annum and account for 6% of the total transaction costs and 4.5% of the total capital lent. Generally a client in arrears is not eligible for further finance. Clients are encouraged to pay back all their accounts before being considered for new ones, alternatively they must be in good standing to qualify for additional finance. In exceptional circumstances, for example natural disaster situations or where special deals have been negotiated, generally with third party guarantors, refinancing of arrears debtors is considered. The arrears have on average been in the region of 25% of the outstanding balance.

4.5.10 Erosion of the seasonal Loans client pool

The volume of KFC's business and the number of clients it reaches could be broadened and expanded with more direct funding from the public sector to include the poorer communities. The cost of servicing seasonal and small loans with current systems is costly and as a result alternative systems and procedures are currently being investigated to reduce the RDD's transaction costs. Numerous problems associated with seasonal loan recoverability and high transaction costs have resulted in the client base being eroded in most target areas. The most prevalent reason for the loss of clients has been bad credit records with the KFC.

4.6 Areas of growth in the loan business

Increasing demands are being made for smaller/micro loans to cover rural household production activities such as dressmaking and other cottage industries. A trial project servicing this type of business has been implemented and it is expected to attract more clients in the near future. In addition, micro-loans provide a mechanism to reach a broader base of clients, especially those at the lower end of the economic ladder. If implemented correctly this improves access and reduces transaction costs.

4.7 Conclusion and summary

Despite the success the KFC has had in providing loan and development assistance to the rural people of KwaZulu/Natal it still faces a number of challenges in turning the business around to a self-sustaining business. Disbursements are still the yardstick by which success is measured at branch level, and not the profitability of the business. Transaction costs issues are still the concern of the organisation, as clients tend to be located far apart. The KFC however is still regarded highly because of its attempt to run the business professionally.

4.7.1 SDI calculation guidelines

The first guideline considered in this study, the first one is that the SDI should be calculated for the measurement of development performance of financial institutions. The KFC is a holding company with various subsidiaries, banks, building and construction companies. As such these subsidiaries are not included in the calculation of the SDI. The required financial statements to be included are the income statement and the balance sheet.

The second guideline that should be consistently followed is to avoid comparing during the calculation process from one year to another. This allows for calculation comparisons across a number of years within an RFI and among different RFIs to be meaningful. Consistency approaches to the estimation of the components of the SDI formula, e.g. the market rate (m); the weighted average concessionary rate (c) and depreciation, should be followed.