Refocusing A Parastatal Financier: A Case Study Of The Mpumalanga Agricultural Development Corporation

by

Madumelana Innocentia Mhlongo

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Study leader: Prof. Gerhard Coetzee

DECLARATION

I, Madumelana Innocentia Mhlongo, hereby declare that this research study is my own work and that all sources that I have used or quoted have been indicated and acknowledged by means of complete references.

Signature : ……………………………

Date : ………………………………..

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DEDICATION

I dedicate this to my dad, J T Mhlongo. That one dream you shared with me and knowing the kind of joy you would find in this, kept me going.

ABSTRACT

The approach to development finance and sound financial policies are crucial aspects that impact on the success of any development finance institution (DFI). The success of a DFI is measured on the basis of its ability to operate with as little financial dependency on external sources or none at all. Other key factors are the ability to carry out its mandate and objectives, as well as to meet expectations of the community it is supposed to serve. International best practices in rural finance are known to ensure sustainability of organisations. Institutions that have proved to be successful have become reference points in terms of best practice. The legacy of such institutions and the examples they have set can be useful in developing frameworks for restructuring DFIs.

Through reference to literature on the justification for restructuring a DFI, it can be determined and confirmed whether it is indeed necessary for any institution to undergo restructuring. The restructuring framework and the international best practices can be used to perform a gap analysis for the purpose of identifying the shortfalls in the restructuring of an institution. Given the context within which an institution operates, that is, the environment, socio-economic aspects and the historical background, a gap analysis can be performed as a way of benchmarking the targeted institution with best practice institutions. In the event that the synthesis of the gap analysis reveals that the current restructuring processes within an institution need tightening, completely new strategies need to put in place. Recommendations can be based on the strategies of best practice institutions and the policies of the new approach to development finance, as well as Kotter's (1995) guidelines on transformation, as quoted by Coetzee (2002).

This study will contribute to the restructuring and transformation of DFIs by proposing strategies that the Mpumalanga Agricultural Development Corporation (MADC) can use to achieve its objective of becoming a self-sufficient institution. Where restructuring has already begun in the MADC, this study attempts to identify those areas with gaps and recommend strategies that can be put in place.

In its endeavour to asses the gaps in MADC's approach to development finance, it was found that the MADC had weak strategies with regards to products and services offered, capitalization, governance, measurement and reporting as well as human resources. In order to close the gaps identified, recommendations to make up for the specific gaps were made based on what proved to work for best practise institutions. By accepting the findings of this study and implementing the proposals outlined here, it is envisaged that the MADC will be able to review the strategies that were established and implemented after embarking on a restructuring process.

TABLE OF CONTENTS

LIST OF TABLES

ANNEXURES

LIST OF ACRONYMS AND ABBREVIATIONS USED

Agriwane	KaNgwane Agricultural Development Corporation
AC	Aligned Commitment
BAAC	Bank for Agriculture and Agricultural Co-operation
BUD	Bank Rakyat Indonesia Unit Desa
BKK	Badan Kredit Kecamatan
BOD	Board of Directors
CEO	Chief Executive Officer
DACE	Department of Agriculture, Conservation and Environment
DBSA	Development Bank of South Africa
DFI	Development Finance Institution
EXCO	Executive Committee
GB	Grameen Bank
KNDC	KwaNdebele Development Corporation
KEDC	KaNgwane Economic Development Corporation – within KaNgane homeland
KLM	KwaNdebele Landbou Maatskappy – within KwaNdebele homeland
MADC	Mpumalanga Agricultural Development Corporation
MDC	Mpumalanga Development Corporation
MEC	Member of Executive Council
MEEC	Mpumalanga Economic Empowerment Corporation
RFI	Rural Finance Institution (only used when quoting from various texts)

NOTES TO THE READER

The proposal for this study was written in 2000 when the MADC came into being. The information that was gathered regarding the background and operations within the MADC is based on the situation from February 2000 up June 2003. It is possible that some of the factors raised in this study may have changed significantly since June 2003.

1. INTRODUCTION AND BACKGROUND

1.1 Background

"There is no golden recipe how to improve access to financial services in rural areas. No single institutional format that can be applied in all circumstances, and there are more obstacles to agricultural development bank reform than positive and supporting influences. Reform is always easier where the economic circumstances of clients and the milieu in which they operate result in profitable clients. Rural financial intermediation faces several challenges, including shortcomings and systematic weakness of rural financial markets, urban-biased and poorly designed interventions not based on the realities of rural markets. Thus reform of rural financial institutions, in any format, is not an easy task" (Coetzee, 2002).

Agricultural development is facing many challenges in post-apartheid South Africa. One of these challenges is access to financial services for small-scale farmers. As the agricultural sector undergoes a change in this new dispensation, a need to change the financial services arises, since most of the development institutions used an inequitable approach in the provision of financial services, which resulted in poor access to financial services for small-scale farmers (Coetzee, 1991). State-supported financial institutions need to reach a large number of clients at a low cost, whilst decreasing their clients' level of dependency on government grants. "The challenge is to redress the inequities of the past, while at the same time pursuing the goal of an equitable, efficient and sustainable agricultural sector" (Coetzee, 1991).

One indication of poor access to finance is the fact that small-scale farmers often cannot meet the requirements of financial institutions in terms of fulfilling collateral and other requirements. Finance has been a major problem for most of the rural people who have attempted to engage in commercial farming. According to Coetzee (1991), commercial banks extend short or medium term credit to farmers but tend to exclude farmers who do not have title deeds to the land they farm or who fail to provide conventional bank security. A need therefore exists to address such gaps as most rural dwellers cannot meet these requirements.

One of the reactions from governments was intervention in the form of agricultural development banks. "Historically, Agricultural Development Banks were set up by their respective governments to promote rural development and alleviate poverty; however, in a number of countries they have tended to undermine rural finance and development" (Coetzee, 2002). This was because of their supply-led nature and political intrusion in day-to-day activities of these institutions.

Most of the development finance institutions (DFIs) are unsustainable and their outreach and growth are restricted. According to Coetzee (2002), this is partly as a result of their failure to mobilise voluntary savings within the constraints of domestic regulatory frameworks and weak and inefficient politically influenced operational practices. Meanwhile, their repayment rates are low and transaction costs are high. Although it is true that many DFIs are unsustainable, most of them remain as major service providers.

The Strauss Commission investigated access to financial services for rural people and concluded that all the institutions providing retail financial services in rural areas suffer from high operating costs, from limited reach or from both (Coetzee, 2002). For this reason a few state-owned agricultural finance institutions were restructured with the intention to improve their performance in terms of meeting the expectations, both of government and of the communities they serve. The restructuring process was supposed to ensure efficiency in various aspects within the institution, as studies have shown that DFIs are not meeting the demand made on them. "In general, specialised institutions established to implement targeted and often subsidised loans were frequently planned and operated in a non-viable manner, or within economic, political, social and institutional environments, which hampered effectiveness" (Coetzee, 2002). One example of such parastatals is the Mpumalanga Agricultural Development Corporation (MADC). The MADC as a specialised institution is currently undergoing restructuring, with the aim of becoming a self-sufficient institution.

1.1.1 The problem statement

DFIs in South Africa do not benchmark their objectives against sustainability and outreach objectives because they tend to be supply-led in nature. One good example of this is the MADC. This institution is engaged in a restructuring process and the purpose of this study is to measure or assess whether this restructuring will lead to a focus on sustainability and outreach within the context of Mpumalanga's economic, social and political environment.

The MADC is a parastatal created by the restructuring of the Mpumalanga Development Corporation (MDC), which was formed as a result of the amalgamation of Agriwane (the agricultural development corporation of the erstwhile KaNgwane homeland), KaNgwane Economic Empowerment, KwaNdebele National Development Corporation and KwaNdebele Landbou Maatskappy (from the KwaNdebele homeland). In 1994, when South Africa entered a new political dispensation, all the government institutions in the former Eastern Transvaal (now Mpumalanga) were amalgamated. Since the MDC was made up of a number of institutions, it inherited the policies, operational strategies and values of these institutions. This combination of different focus areas, influences and organisational cultures brought about an extremely troubled and unfocused institution.

The MDC became an unstable organisation that needed direction, since there was confusion regarding policy and governance after the amalgamation of the four homeland parastatals. "Because of varied and repeated unsuccessful efforts to integrate the activities of the former KaNgwane and KwaNdebele development institutions, and the resultant attempts to marry differing personnel policies, development strategies, cultures and actions and apply these in a uniform manner across the province, it became obvious towards the end of 1996 that drastic surgery was needed to salvage the deteriorating situation and to introduce elements of stability into new organisational structures, strategies and future development efforts" (MDC Task Team, 1997).

This led to the restructuring of the MDC, which was officially announced by the then Premier of Mpumalanga on 5 December 1996. The MDC Board of Directors established a task team, whose brief was to:

i. Return/transfer various functions to different government departments;
ii. Create a vehicle to undertake functions that cannot be done by departments;
iii. Empower disadvantaged communities in a way that best serve their interests in a focused, market-driven fashion, and
iv. Privatise a number of functions.

The question that arose was: Will the MADC embrace the challenge and achieve what the restructuring process is meant to achieve? Thus;

i. Is the current governance, management and staff component suitable and poised to maintain the vision of the institution and achieve sustainability?
ii. Are the set strategies and policies for capitalisation, monitoring and evaluation the best possible means of improving financial performance?
iii. Is the institution offering products and delivery systems that will enable it to turn around its income while, at the same time, meeting its clients' needs and expectations?

1.1.2 The study objective

This study is intended to analyse and illustrate how the MADC as a DFI is handling a paradigm shift, *id est* moving towards a more demand-driven system. It is envisaged that the study will:

i. Analyse international best practices, particularly the policies and strategies underlying self-sufficiency and outreach;

ii. Develop a best practice framework for South Africa and the South African context that can be used by DFIs in a restructuring process, and

iii. In the case of the MADC, apply the framework to assess its performance by comparing it with best practice institutions.

1.2 Rationale for using MADC as a case study

The MADC was selected as a case study for the following reasons:-

i. It is currently undergoing a restructuring process. One of the main reasons why restructuring was considered was the fact that this institution was performing poorly. The Mpumalanga Provincial Government realised that the agricultural division of the MDC could not successfully meet agricultural demands and needs, particularly those of the previously disadvantaged farming individuals and communities within the province (MADC Annual Report 2000/2001). The demands and needs referred to here are financial needs, mainly credit for accessing land and production inputs.

ii. To date, there has not been a well focused and structured study that has looked at the case of the MADC as it undergoes a restructuring process.

iii. It is the only remaining agricultural development parastatal from the old homeland range of institutions.

The findings of this research will be presented in such a way as to form the basis for a proposed strategy for enhancing the policies and strategies adopted since the refocusing and restructuring process in the MADC was initiated.

1.3 Research methodology

The study will be conducted using qualitative research methodology. According to Jacob as quoted by Seliger and Shohamy (1989), the qualitative research methodology attempts to present the data from the perspective of the subjects or observed groups, so that the cultural and intellectual biases of the researcher do not distort the collection, interpretation or presentation of data. In this study, interviews will be carried out with previous and current management, previous board members and staff members of the MADC.

Data will be analysed both qualitatively and quantitatively as decisions about research questions had already been made at inception. Although the data will be analysed qualitatively, quantitative analysis may be applied when the need arises and the information justifies the technology applied. The ultimate goal here is mainly to discover the phenomena from the perspective of participants. In the qualitative mode of discovery, the researcher will be a participant-observer. "Unlike descriptive and quantitative methods, this method is viewed as an organic development dictated by the research in progress and not by a predetermined focus or hypothesis" (Seliger and Shohamy, 1989). A hypothesis will not be drawn, owing to the nature of the research methodology used. Therefore a variety of methods were used to collect data, as follows:

- Observation (the researcher worked for the institution under study during the period of restructuring);
- Literature review;
- Interviews with management, staff and clients (emerging farmers);
- Field notes, and
- Journals, brochures, fact sheets about MDC.

1.4 Structure

This study is presented in three separate parts. The first part mainly consists of a literature review, which provides insight into the rationale for restructuring, the role of finance in economic growth and indicates how adopted policies, based on either the new or conventional approaches, can affect the efficiency of an institution. An overview of the operational strategies of successful DFIs and the importance of the environment are also covered.

The second part of the study examines international best practices, with special reference to lessons that can be learned from them and which can be used to develop a framework. The framework for restructuring and measuring performance of DFIs is also developed in this section of the study.

In the third part of the study the framework generated in the second part is applied within the context of the MADC. It is envisaged that this study will be informative and comment on the current strategy of management in terms of what MADC regards as services and products, the financial technology that it has adopted and its structure and policies. In a nutshell, the study measures the current performance against the standards of international best practice.

To accomplish the objectives, this study covers all aspects around efficiency, economic growth and sustainability of institutions. The content includes but not limited to the following:-

- Rationale for restructuring
- Key factors to be considered when institutions make a paradigm shift.
- The role of finance in economic growth
- Factors that influence the policies adopted by DFIs.
- Implementation of policies in both the new and conventional approaches to development finance.
- Overview of key factors that make DFIs efficient and sustainable
- Development of a framework for measuring the performance of DFIs.
- Testing of framework that was developed
- Evaluation of the MADC using the developed framework.
- Recommendations to MADC based on findings of the evaluation process.

The study is presented in the following format;
Chapter Two: Literature review
Chapter Three: A best practice framework
Chapter Four: A broad overview of the MADC
Chapter Five: Evaluating the MADC: A gap analysis
Chapter Six: Recommendations and conclusion

1.5 Key issues from the chapter

The study aims to contribute to the restructuring of MADC in the form of guidelines assisting it in its change to a self-sufficient institution. In this chapter the questions that form part of the study objectives were discussed and the methods that will be used to undertake the study are presented. The study will contribute to the restructuring and transformation of DFIs by proposing strategies that the MADC can use to achieve its objective of becoming a self-sufficient institution.

2. LITERATURE REVIEW

2.1 Introduction

DFIs operate on the basis of policy and guidelines from their own governments. The underlying polices and objectives of any given institution influence the performance of that institution which, according to Yaron (1992), should ultimately be measured in terms of outreach and sustainability. More recent developments in the provision of rural financial services have demonstrated that proper institutional design and adherence to appropriate policies pay off handsomely and have the potential to generate substantial achievements in terms of both sustainability and greater institutional outreach (Yaron, 1998).

According to Levine (1997) financial institutions and markets play a significant role in economic development. However, considering the functions of financial institutions in economic development, it can be deduced that it is only when a financial institution is efficient that it will be able to make a significant impact. These functions will be discussed later in this chapter.

In this chapter, the focus is on the role of the financial institutions and markets in economic growth. There are two approaches that primarily influence DFIs in designing their operational strategies, being the conventional (supply-led) approach and the new (demand-driven) approach.

The discussion gives clearer understanding of how the two approaches differ in terms of efficiency and what can be attributed to differences in their varying methods of operation. This chapter will further look at factors influencing DFI policies and how these factors are handled in institutions with different policies and approaches, as reflected by the conventional and new approaches.

2.2 The essence of restructuring DFIs

Restructuring is a process of change that has to take place once the need to undertake it has been assessed and is considered rational to do so. Institutions that undergo a restructuring process at any given time do so for different reasons with different objectives. The reasons for restructuring and the process on its own depend on the context of the institution, its environment and operations. "Several issues are at stake in the restructuring process of development banks" (Coetzee, 2002). This statement confirms that over and above the reasons for undergoing the restructuring process, much more has to be considered.

Coetzee (2002) suggests a number of factors that have to be considered in the process of restructuring. These factors are:-

i. Economic justification, *id est* whether or not a specific institution should continue to exist. In a market economy the answer must be sought why the institution exists in the first place, what market failure led to the institution's creation and whether this market failure continues to exist.

i. The guidelines or framework for restructuring should be clear and based on international best practices. Over the past 30 years, considerable experience has been accumulated regarding the refocusing and restructuring (and closure) of parastatal finance institutions in the world. As will be illustrated in this study, a concomitant body of best practices should also be studied, within context, to see what we can learn from this experience when planning and executing restructuring of DFIs.

ii. The management of transformation and restructuring. Economic justification and a good framework will not guarantee the success of the process. Its success is greatly dependent on how the implementation of the devised framework is managed. A considerable body of knowledge and experience exist in the business world on the management and implementation of turn-around strategies. This should be considered in the process.

iii. The politics of the change process. The restructuring process and the outcome envisaged have to be in line with the politics of change. The support and attitude of stakeholders will have an impact on the ultimate outcome of the process. It is important that the hopes, aspirations and fears of all stakeholders are considered in the change process and that these are actively managed.

Kotter (1995) has established eight steps in the transformation of an organisation. His guidelines will be useful later in the study when recommendations are made to the MADC, especially with respect to the management of the change process. These guidelines places the emphasis on the new approach to development finance, in terms of which institutions should strive to be self-sustainable and have a positive development impact and outreach.

Table 1 : Kotter's eight steps to transforming an organisation		
Step 1	Establishing a sense of urgency	Through examination of the market, identifying and discussing crises, potential crises and potential opportunities.
Step 2	Forming a powerful guiding coalition	Assembling a group with enough power to lead the change effort and encouraging the group to work together as a team.
Step 3	Creating a vision	Creating a vision to help direct the change effort and developing strategies for achieving that vision.
Step 4	Communicating that vision	Using every possible vehicle to communicate the new vision and strategies, teaching new behaviours by the example set by the guiding coalition.
Step 5	Empowering others to act on the vision	Getting rid of obstacles to change, changing systems and structures that seriously undermine the vision, encouraging risk-taking and non-traditional ideas, activities and actions.
Step 6	Planning for and creating short-term gains	Planning for visible improvements in performance, implementing these improvements, recognising and rewarding employees involved in the improvements.
Step 7	Consolidating improvements and producing still more change	Using increased credibility to change systems, structures and policies that do not fit the vision, hiring, promoting and developing employees who can implement the vision, reinvigorating the process with new projects, themes and change agents.
Step 8	Institutionalising new approaches	Articulating the connections between the new behaviours and success of the organisation, developing the means towards leadership growth and succession.

Source : Kotter (1995), as quoted by Coetzee, G.K(Ed), Agricultural Development Banks in Africa : The Way Forward. Nairobi : African Rural and Agricultural Credit Association.

2.3 The new and conventional approaches

The two approaches to development finance differ in many respects, as illustrated in Table 2 below. In essence, the core differences relate to assumptions regarding the ability of the poor to pay market-related interest rates and the savings ability or propensity of the poor. The success of DFIs is highly dependent on strategy and operational structure. International experiences have led to a clear distinction made between these two paradigms in development finance.

The conventional approach in development finance is mainly characterised by the supply-driven approach to credit. This approach is rooted in poverty and is aimed at empowering the poor, hence tends to focus on breadth of outreach. The result was a lack of interest in sustainability of institutions, nor banking as such, but only in utilising financial services at any cost in order to reach as large a number of people as possible, even if these services had to be subsidised. What mattered most was reaching a large number of people.

This approach resulted in principles that were too costly to the beneficiaries. As a general rule, the DFIs offered credit at heavily subsidised rates to farmers, targeted credit to specific uses and did not offer savings services (Woller, et al. 2002). The approach failed owing to the fact that cheap credit, which was intended to benefit poor farmers, led to very high transaction costs and, in turn, the targeted groups suffered the consequences. Instead of institutions setting their interest rates for cost recovery purposes, they should come up with a strategy that would minimise the costs. "The irony of the subsidisation of interest rates is that it usually contributes to more expensive loans to the borrowers who are targets of the cheap credit policy" (Coetzee, 1997). For instance, the Grameen Bank focused on the poor but set simple loan procedures that were administered at village level to avoid high transaction costs. Interest rates were set to cover cost at full operation and aiming for financial viability (Todd, 1996).

In contrast, the new approach uses transaction costs in its definition of the problem. As a result, the approach ensures that operations within the institution are carried out with the transaction costs being kept as low as possible. Transaction costs include the fees of processing applications and the cost of the time taken to respond to applications. "The reasons why transaction costs are high in the conventional approach include the opportunity costs of time spent in negotiating cumbersome borrowing procedures, transport costs of visiting the lender several times to transact loans, costs of providing acceptable collateral, and in some cases, paying bribes to influence lending decisions" (Vogel and Adam, 1997). DFIs using the new approach ensure that they engage all strategies to minimise such costs. For example, they ensure that the time taken to process applications is kept as short as possible.

The Grameen Bank is one institution that has a good strategy in place to offset transaction costs. "Its strategy was to shift the task of processing a transaction and made a collective responsibility through the group, then introduced a strict credit discipline and close supervision through weekly meetings and home visits" (Todd, 1996).

Institutions using the new approach have a better chance to achieve success because they have a profit-driven motive and usually see their clients as participants in the business rather than beneficiaries. These institutions ensure that interest rates are market-related; they mobilise savings and are always concerned about efficiency, leverage and performance. These are the kinds of factors that will be used in this study to reflect the different perspectives of the two approaches under discussion. The factors will further be considered in assessing the key to the success of best practice institutions and in benchmarking of the MADC with international best practice institutions.

Table 2: An overview and comparison of the conventional and new approach to financial services		
FACTORS	THE CONVENTIONAL APPROACH	THE NEW APPROACH
Identification of problem	- Poverty	- Transaction costs
Transaction costs	-Transaction costs are not a concern since the problem is seen to be poverty. - Lack of means to reduce transaction costs results in expensive credit.	- Creates mechanisms that off-set transaction costs by encouraging increased investments through resource allocation, reduced risks and savings mobilisation.
Interest rates	- Interest is subsidised and charged at below-market rates. - Loan is more expensive for borrowers who were meant to receive cheap credit. - Taxes other individuals, even depositors, hence in the long-run there are no depositors as they are discouraged by the charges.	-Rates charged are market-related. -Rates charged guard against inflation therefore help to achieve sustainability in the long run.
Perception of users	-Users are perceived as beneficiaries who are entitled to credit.	-Users are seen as clients, hence the number of depositors exceeds that of borrowers.
Sources of funds	- Vertical flow of capital, that is, they depend mainly on donor or government funding.	-Horizontal flow of capital. - Savings mobilisation is a tool used to improve resource allocation etc.
Information systems	- Depend on primary data collected by lenders. - As resource allocation is not a primary concern, a great deal of information is collected and tends to be difficult to process. - Information collected focuses on borrower and loan.	- Flow of information is horizontal. - Information is accessed from reputable organisations and information is not too general and not specific. - Collect information that is useful for growth.
Measurement of success	- Success is based on the number of borrowers who have benefited. - Whether or not the organisation is growing is not a concern, since the number of people reached is the primary concern.	- Success is based on overall performance, that is, on loan recovery, number of clients served, transaction costs, profitability and sustainability of organisation.

2.4 The role of finance in economic development

Financial institutions and markets basically perform five functions. These functions are also key to the understanding of the functioning of DFIs. According to Levine (1997), the significant role that financial markets play is seen in these functions, which are:

i. Mobilising savings;

ii. Allocating capital;

iii. Trading of risk;

iv. Monitoring of managers, and

v. Facilitating exchange of goods, services and financial contracts.

2.4.1 Savings mobilisation

The role of financial markets is to create better technologies that would offset the negative effects of transaction costs and information asymmetries in order to make investors comfortable and more willing to buy products. Once the risk is diversified and liquidity is boosted, improved savings mobilisation occurs (Levine, 1997). This is essential in poor areas, where the majority of clients normally do not have access to savings facilities and where this is the most important financial product. When clients entrust their savings to banks, they also transfer the monitoring of investments function to banks.

2.4.2 Allocating capital

Information can be a scarce resource. Lack of information usually makes it difficult for investors to allocate capital or invest in the best possible way. Without the necessary information it is difficult to find an option with fewer risks but which will yield maximum returns. According to Levine (1997) savers will be reluctant to invest in activities about which there is little reliable information. The same savers may however not have the time, capacity and means to collect and process information on a wide array of enterprises, management and economic conditions. Financial markets therefore collect information on behalf of investors and evaluate the information, thereby determining the best possible place to invest and also how to make the investment.

2.4.3 Trading of risk

In most business-related issues, risk is a factor that affects growth or progress of any kind. The role of financial markets in trading of risks is seen in the ability of financial markets to alleviate the problems that exist due to risk, through hedging, trading or pooling the risk. Good financial institutions strive to diversify risk. This in turn impacts on capital accumulation and technological change. Financial markets also exist to ensure that investments, projects or initiatives are transferable in terms of term structure. The more liquid an investment/project is, the greater the number of investors who are interested. DFIs should therefore fulfil this function in the absence of market-based institutions in an attempt to build sustainable financial markets.

2.4.4 Monitoring of managers

Supervision, monitoring and evaluation are processes that are costly to run. Financial markets and institutions facilitate corporate control, whereas managers who are not owners of the institution in question remain objective and focus on enhancing product specialisation, hence ensuring comparative advantage. In the long run, the monitoring process boosts the relationship between financial institutions and firms, as it results in easing of external funding constraints which also leads to lower costs of information (Levine, 1997).

2.4.5 Facilitating trading of goods, service and financial contracts

Financial markets and financial institutions bear the responsibility of assessing the value of goods, which is an expensive process. This lowers the transactions costs for clients and, in turn, would allow specialisation. The critical issue for our purposes is that the financial system can promote specialisation (Levine, 1997).

Levine (1997) argues that the establishment of financial institutions would represent a process created by the market to increase the efficiency of financial transactions, thus also creating an efficient market. It is not clear whether this reaction would happen by itself in the case of rural financial markets. Thus, one strategy could be government intervention in the form of the establishment of a rural and agricultural bank. However, such an institution should still provide the five functions listed above, towards decreasing the cost of information and transaction and should facilitate the private sector provision of these services.

2.5 Factors influencing policies adopted by DFIs

The policy adopted by DFIs forms the basis of their success or failure. The differences in approaches are outlined in Table 2 in terms of different variables. Decisions on the policy adopted by a DFI are influenced by the approach of the government, which, in turn, impacts on its success. Table 2 above revealed what underlies a choice of policies in both the new and conventional approaches. DFIs may be regarded as efficient or inefficient, depending on the application of policies shown above. For this reason these policies will be considered in the development of a framework that will be used to analyse the MADC.

2.6 What underlies the success of DFIs?

The success of a financial market depends not only on the policies adopted by the institution, but also on the environment in which the institution operates and on its approach. This discussion looks at the effects of international best practices in development finance, as well as at the environment and the policies that underlie the success of DFIs. In its definition of an efficient DFI, this study will adopt the definition by Yaron (1998), in which he defines an efficient institution as one that is financially self-sufficient, can remain sustainable and can achieve the desired outreach.

2.6.1 The environment and its influence on DFIs

The environment in which the various mechanisms and strategies are applied, affects the outcomes of their application. There are a number of environmental factors that can influence the performance of a financial institution. These factors make it imperative to examine the issues that may affect this performance. For the purposes of this study, the factors discussed will be limited to historical factors, socio-economic factors and political factors.

2.6.1.1 Historical factors

Historical factors refer to the history of the institution in question and a timeline and understanding of the inception, the growth and maturation of the institution through its life cycles. The evolution of the institution has an impact on the current performance, owing to some strengths and weaknesses that may be inherent in the institution being restructured. "Improper use of rural financial institutions by governments and improper utilization of donor funding have added substantially to the severity and persistence of the problems found in these markets" (Adams, 1992). This implies that in the case of government-owned institutions, there could be a tendency to keep the legacies left by different leaderships over time. The possible success of DFIs with a history of poor polices, can be affected due to failure of staff to adapt effectively and quickly enough or the clientele to accept change.

2.6.1.2 Political factors

Government policies have an influence on the functioning of DFIs. Should the objectives of the DFI be politically orientated, efficiency may not be more of a priority when compared to welfare of the people. Most DFIs have suffered the consequences of misuse by governments in their attempt to intervene in the problem of market failures. According to Adams (1992) policy makers tend to impose tasks that are not suited to the inherent capabilities of the financial markets. "Attempts to use financial markets to transfer subsidies and to target loans are not benign when it comes to the well-being of these markets" (Adams, 1992). In other words, the status of the financial institution is generally ignored whenever an effort to subsidise or issue loans to clients is considered. Any DFI that embarks on setting a financial policy will have to consider broader macro-economic policies that ultimately affect financial policy.

Governments use policies as tools for intervention. Every policy formulated is based on the particular objectives the government wants to achieve. "Agricultural policies, like others, are formulated to achieve certain objectives: welfare maximization, retention of political power and to bargain from the outcomes of pressure groups" (De Gorter and Swinnen, 1994). These policies are also a result of existing problems or distortions, usually referred to as market failures, which are the result of lack of information, high transaction costs and off-setting of over-/under-production. The policies are thus strongly related to the conventional approach inherent in government-owned DFIs.

The conventional approach, which is observed in most of the state-owned organisations, makes such institutions vulnerable to political interference. For this reason decisions in state-owned organisations are highly influenced by politicians who are more interested in winning votes and who do not understand or appreciate the fundamental operations of these institutions. It should be borne in mind that any state-owned organisation is, in many ways, compelled to comply with the objectives of the government's policies.

According to De Gorter and Swinnen (1994), analysis of agricultural policies shows that they are based on the models that influence most of the decisions taken by government, as follows:

i) Government maximising welfare

This model entertains public interest, which implies that in trying to ensure that there is equity in terms of distribution of resources, government advocates protection of farmers through subsidies, if not through cheap credits. One of the practices used in these models is the lowering of prices on basic foods, which government uses in an attempt to alleviate poverty.

ii) Collective action by pressure groups

The second model implies that a policy can be subject to the pressure that beneficiaries place on government. The pressure groups are likely to put government under pressure by means of boycotts, petitions and the like. Pressure groups' influence is felt very acutely; hence government usually relents and meets their demands. Decisions made on the basis of political pressure therefore lead to poor performance. "Political intrusion and other interferences with the bank's decision-making process, on the part of government, international agencies and domestic interest groups reduce institutional viability"(Gonzales-Vega, 1990).

iii) Politician-voter interaction

This model's implications are often seen in governments' strategy of using project-based policies and not price-based policies. This, according to Bates (1990), is due to the fact that high prices mean that there is no benefit to government and always tends to favour its opponents. Therefore, even if it does not make economic sense to embark on a particular project, the government would go ahead and implement the projects.

The above-mentioned models imply that the viability of government-owned institutions is vulnerable as soon as government policies have to be considered. In addition to pricing policies, taxes and subsidies that critically influence farmers' incomes, appropriate macro-economic management and financial policies are crucial for the viability of agricultural development banks (Gonzalez-Vega, 1990).

2.6.1.3 Socio-economic factors

Gonzalez-Vega (1990) argues that appropriate macro-economic management and financial policies are crucial for the viability of agricultural development banks. This argument is supported by Adams (1992) who argues that a healthy economy makes it much easier to develop an efficient and growing financial system to support it. Declining economies usually have very few people who are credit-worthy. Yet it is through credit-worthiness, people's level of income, availability of jobs and education background that people are enabled to participate in economic activities.

In areas where these economic factors are at low levels, communities will not be able to benefit from local DFIs or add value through their savings. "Stagnant and declining economies limit the number of people who are credit-worthy, erode the ability of borrowers to repay loans, reduce income available for deposits" (Adams, 1992). People's positive attitude, literacy and high level of understanding of financial markets will enhance the success of a DFI.

Most agricultural sectors in developing countries have implemented urban-biased policies that have resulted in poor performance of the sector. Such policies have put small-scale farmers in an even more disadvantaged situation and governments have introduced directed credit as compensation. Attempts to compensate the sector for the undesirable results of urban-biased policies that were implemented in developing countries meant the adoption of directed concessional credit programmes (Coetzee, 2002).

2.6.2 Best practices in development finance

Best practices are derived from experiences of DFIs that are different in a number of settings. The successes and failures of institutions over time contribute to a body of knowledge referred to as "best practice", which provides guidance on basic rules and approaches towards successful development finance interventions.

Best practices, according to Woller et al. (2003) are those practices that improve institutional efficiency and effectiveness in areas such as management and management systems, finance and accounting, marketing, service delivery and product design and development. The identification, standardisation and widespread adoption of best practices are believed to be some of the essential ingredients of industry-wide self-sufficiency, capital market access and maximum outreach to poor clients (Woller et al. 2003).

According to Coetzee (2002), lessons that can be learned in the development of viable financial institutions need to be contextualised. Coetzee (2002) further identified two macro-economic policy categories for organising the lessons that may be learned from best practice institutions. These categories are
financial sector policies and agricultural and rural development policy.

According to Yaron (1992), the lessons in the context of financial policies and institutions are:

i. They have policies that allow for accountability, investment in human capital and rewards that relate to sound financial performance and sustainability. The importance of investing in human capital can never be over-emphasised. Grooming staff to have a culture of responsibility is the best tool that any institution can have because, no matter how excellent the technology can be, with governance favourable and good strategies in place, an institution without committed staff is doomed.

ii. They are concentrated on areas that have relatively high population densities. When the population is high, there is always a guaranteed market because there are a wide variety of clients that the institution can service. This practice owes its existence to the fact that a demand-driven approach informs how best to place a financial market.

iii. They have innovative low-cost delivery systems. Good delivery systems are necessary for ensuring efficient and low-cost operational procedures in screening borrowers, processing loans and monitoring. Loan collections will also be affected by the delivery systems that have been put in place. This will help to avoid the pervasive red tape that often characterises supply-led financial institutions and clients who ultimately incur high transaction costs.

iv. Development of domestic savings to reduce dependency on donors. The benefit of obligatory savings, a policy that was implemented by Bank Rakyat Indonesia Unit Desa (BUD) and Badan Kredit Kecamatan (BKK) also in Indonesia, was seen in how it permitted a gradual increase in borrowing eligibility upon timely loan repayment.

v. Advanced management information systems that facilitate effective planning, control and timely monitoring of loan repayments. Yaron (1992) argues that timely loan repayments improve the possibility of continued operations without constant reliance on government or donors or grants. This is enhanced by a tight monitoring and evaluation technique that demands efficiency in management, information systems and technology. Therefore, a DFI that aims for high loan collection will automatically have advanced technology and efficient management, as there will be an added effort to enhance the environment that will ensure that its aim is achieved.

vi. They have innovative and flexible loan terms and always relate to social, economic and cultural circumstances. Yaron (1998) further gives an example of their offering of weekly or monthly repayment schedules tailored to the clients' cash flows. A DFI that responds to the needs of the clientele it serves is obviously demand-driven. Best practices place the emphasis on being demand driven rather than on being supply-led. Assessing the needs of the clients ensures that products and services rendered are those desired by the clients.

According to Coetzee (2002), lessons that can be learned from best practice institutions in the agricultural and rural development category are:

i. Stabilising price levels.

ii. Avoiding overprotection of industrial products that are used as agricultural inputs.

iii. Maintaining a sound exchange rate policy.

In the agricultural and rural development policy context:

iv. Aligning relative domestic input/output prices with international prices.

v. Removing price controls and other distortions from agricultural product prices.

vi. Avoiding over-taxation of agricultural exports.

vii. Improving market access and information services to farmers.

viii. Avoiding the use of subsidised interest rates as a "second best" measure in order to compensate for distorted "urban-biased" policies which depress product prices or which tax agriculture indirectly (overvalued exchange rates).

ix. Investing adequately in rural infrastructure and human resources.

On account of their good track record and the legacy that best practices institutions have left, as well as the impact they have had on communities, the operational strategies and policies used by these institutions will form the basis of the framework to be developed in this study.

2.7 Key issues from the chapter

It is evident from this chapter that the approach to development finance and sound financial policies are crucial aspects influencing the success of any organisation. These concepts form the basis of understanding of the proper and ideal position for sustainability of a DFI. This chapter also revealed that analysis of the environment of a DFI can assist in contextualising the best practice application as the restructuring of a DFI takes place. Together with an exposure of best practices as discussed above, the understanding of all concepts discussed in this chapter will assist in developing a framework for sustainability in development finance. This chapter therefore serves as a prelude to the development of a framework for success in development finance.

3. A BEST PRACTICE FRAMEWORK

3.1 Introduction

A framework is simply a set of guidelines that dictates the direction that the restructuring process should take. In order to ensure that mistakes of the past are not repeated, a study of international practices within the context of the dynamics in South Africa is considered. In this chapter a best practice, contextualised framework is built following Coetzee (2003), in which the emphasis is on the new approach to development finance, whereby institutions strive to be self–sustainable and have a positive development impact and outreach.

3.2 Developing a framework for success

The framework under discussion is supposed to provide a guideline for DFIs that are still struggling to achieve self-sufficiency and sustainability. “These guidelines will ensure that most of the negative elements of the Conventional Approach will not be present in a restructured institution” (Coetzee, 2001). In the current application, this is made possible by the fact that the framework is developed and further tested against international best practice institutions before it can be used to measure the performance of the MADC.

In setting up a framework, focus is aimed at how best practice DFIs handle the crucial aspects that make up the framework. The framework is a set of the following aspects:

i. The market: Clients, products and services
ii. Capitalisation
iii. Governance
iv. Measurement of success
v. Human resources.

3.2.1 The market: Clients, products and services

DFIs face the challenge of providing services to the relevant people in terms of what is needed. The products offered and services rendered should in essence benefit both the institution and the beneficiaries. The products, according to Gonzalez-Vega (1990), should have a combination of quality, cost, depth, breadth, length and variety of outreach. It is crucial to determine how the product/services are designed, whom they are meant for and how they benefit the community.

According to Seibel (1999), in order to achieve viability, an institution needs to offer attractive credit products such as the following:

i. Provision for accessibility, simplicity and timely delivery
ii. Readiness to accept suitable collateral and substitutes
iii. Proposal of proper loan periods
iv. Provision for the payment of small regular instalments
v. Provision of collection services in conjunction with savings deposits.

The core strength and attractiveness of the product is crafted on the basis of Seibel's (1999) recommendation which suggests that savings should be considered, collaterals and instalments are accommodative yet accessible and simple in order to allow efficient delivery. Seibel (1999) further recommends cooperation with other agencies to provide add-on services in order to strengthen client-support services.

BKK made an effort to accommodate its target group, which mainly consisted of a very low-income, illiterate group. This led to a design of six loan maturities that were meant to suit its target group. The maturities ranged from one day to a season. Its delivery model included a mobile banking system that was meant to provide standardised financial services at village level (Yaron, 1992). This is an example of a design of a product and delivery system that focuses on the needs of clients, while also looking at cost and keeping sustainability of service provision in mind.

3.2.2 Capitalisation

The current failures that exist emanate from the vertical approach to resource allocation, whereby the sources of funding were mainly subsidies from government and, in some cases, also donors. According to Coetzee (2003), among the most important deficiencies of the state-sponsored specialised institutions have been the conspicuous lack of balance between voluntary savings mobilisation and the institutions' sizable loan portfolios.

Capitalisation of a financial institution depends on its financial policies regarding sourcing of funds, rates charged on lending to borrowers and mechanisms used to collect. DFIs have to take into account the fact that their existence is primarily meant to intervene in the case of market failure that the government could not resolve on its own.

A horizontal approach should be adopted, together with other mechanisms based on best practices in financial markets and commercial practices. The best practices approach depends on savings mobilisation as the main source of funds, supported by good loan collection.

Seibel (1999) makes the following suggestions for savings mobilisation:

i. Provide safety and attractive returns
ii. Promote voluntary services with savings available if the client want to withdraw
iii. Provide accessible collection services.

DFIs need to be creative and find means of offsetting transaction costs and making the products lucrative to the beneficiaries. This can only be made possible by putting policies and strategies in place that will enhance savings mobilisation. This implies that there is a need to encourage deposit mobilisation, resource allocation and reduction of risks.

To encourage savings mobilisation, the BKK and Grameen Bank introduced obligatory savings to ensure financial discipline. According to Yaron (1992), this enhanced financial discipline and reduced risk for the institutions. The DFIs that practised it managed to increase borrowing eligibility upon timely repayment.

3.2.3 Governance

According to Coetzee (2002), most DFIs continue to suffer political interference. It is one thing for government to be concerned about and involved in the financial status and overall performance but, when it comes to operational issues, it is crucial that government leaves these to the board and management and allows them to exercise their business skills. "Of paramount importance is the rules and application of those rules in the selection of appropriate governors…" Coetzee (2003). Proper selection of board members and leadership is a key to enhancing good governance.

According to Srinivas (2003), governance is a system of checks and balances whereby a board is established to guide the managers. Their main function is to review, confirm as well as to approve plans and performance of senior management. Proper governance ensures that an institution survives and moves beyond dependency. "Good governance engenders trust that allows a financial institution to attract depositors and investors" (Srinivas, 2003). Private investors are more likely to be interested in doing business with institutions that appear to be properly managed and that are performing well.

Srinivas (2003) argues that the board should consist of members who have a diversity of skills, including financial, legal and managerial expertise, so as to be able to give effective guidance to senior management and to critically analyse management's plans and reports. Members should not simply be appointed on the basis of political affiliations. It is crucial that board members do not have political agendas that could influence the direction of the organisation. King's II Report as cited by Ehlers & Lazenby (2004) also supports the argument. "The board should include strong non-executive directors who are of high calibre and have the necessary skills and experience to make judgements on the strategy, performance, resources, transformation, employment equity and standards of conduct of the organisation." (Ehlers & Lazenby, 2004).

Best practice institutions are able to run the management of the institution without interference from the government. The management of such institutions strategise and makes decisions on what will enhance productivity in their day-to-day operations. Government's role should be limited to the selection and appointment of a board of directors, the allocation of funds and the review of financial and operational performance.

The Bank for Agriculture and Agricultural Co-operatives in Thailand (BAAC) is an example of a successful government-owned institution. Although the Ministry of Finance owned 90 per cent of the capital, there was visible respect for the autonomous operations of the institution. The BAAC was free to draw up and implement its own staffing policies such as recruiting, salary structure, promotions and dismissal (Yaron, 1992).

Earlier restructuring efforts in South Africa led to aligning the rules on the type and appointment of board members in DFIs with the requirements of the Bank's and Company Acts which prescribe the number and expertise required of board members (Coetzee, 1997).

3.2.4 Measurement and reporting

Most DFIs have suffered from inadequate credit evaluation, management and follow-up procedures that resulted in poor loan collection. According to Coetzee (2002), this was caused by the fact that their operations were not driven by commercial financial performance and objectives. Yaron (1992) suggests that assessment of a DFI should be based primarily on the DFI's sustainability and the level of outreach achieved by it.

Self-sustainability is indicated by a Subsidy Dependence Index (SDI), which measures the percentage increase in the average lending interest rates required to compensate for the elimination of subsidies, including the subsidy which a DFI receives through paying interest on its borrowed funds at below-market rates (Yaron, 1994).

Outreach is a hybrid measure that assesses the extent to which a DFI has succeeded in reaching its target clientele, the degree to which the DFI has met its clients' needs and the extent to which the DFI has met its clients' demand for financial services (Yaron, 1994). Schreiner (1999) concurred with Yaron's views when he proposed a framework of outreach in terms of six aspects: worth, cost, depth, breadth, length and scope. According to Yaron (1992), best practice institutions achieved significant outreach through measurement of the following:-

i. The value of their outstanding loan portfolio and the average value of loans extended. This, according to Schreiner (1999), is the cost of outreach, which he describes as the sum of price costs and transaction costs. Schreiner (1999) suggests that better outreach in terms of costs would be achieved through a reduction in the cost of supply.
ii. The amount of saving and the average value of savings accounts. In Schreiner's framework, this aspect is referred to as "worth of outreach".
iii. The variety of financial services offered. According to Schreiner's framework, this is the scope of outreach, which is basically the number of types of financial contracts supplied by an institution.
iv. Schreiner (1999) suggests a number of proxies for depth of outreach. These are gender, location, ethnicity, housing and access to public services. For example, participation of women and the poor. According to Schreiner (1999), the value that society attaches to the net gain of a given client is weighed in terms of welfare theory, which is the weight of the client in the social welfare function, and which is referred to as "depth of outreach".
v. Percentage of total rural population served. This is the breadth of outreach. Breadth of outreach represents the number of clients (Schreiner, 1999).
vi. The annual growth of DFIs assets over recent years in real terms. This refers to the length of outreach, which is basically the time frame of the supply of micro-finance (Schreiner, 1999).

Yaron (1998) argues that government is in a position to promote financial markets by strengthening the supervision and prudential regulation of financial institutions, deregulating interest rates, reducing excessively high reserve requirements and relaxing credit controls. According to Srinivas (2003), the extent to which the services of DFIs are filling a gap in the lives of poor communities is demonstrated by a rapid growth in demand, despite relatively high interest charges, and by low rates of default among borrowers. These are the kinds of aspects that will be used to assess the MADC.

Best practice institutions ensure that good monitoring and evaluation strategies are in place. Supervision and regulation of these institutions are also undertaken in a way that ensures that the interests of both government and clients are addressed. BancoSol, a commercial bank in Bolivia that is the result of an institutional change of an non governmental organisation (NGO) microfinance institutions (MFI) displayed professional and rigorous monitoring of its financial performance by the prudential supervisor, new lenders and shareholders (Gonzales-Vega *et al,* 1997).

3.2.5 Human resources

People are key in creating a vision and in ensuring that the vision is realised. The management and staff of any organisation are essential to the success of that organisation because they are responsible for acting out the vision of the institution. An institution can embark on a paradigm shift with good intentions and excellent new policies in place but, as long as the people who are supposed to implement the new policies and strategies do not change their attitude and are not capacitated to deliver accordingly, the mission will not be realised. Seibel (1999) suggests provision of skills and motivation training, orientation, promotional and refresher training, as well as exposure training for management. Gratton (2003) states that employees' attitudes, behaviour, skills and capabilities underpin the value created in an organisation and she further confirms that human potential is created and developed through a combination of "soft" and "hard" processes, in which the "hard" forms the process backbone of an institution. The "hard" is a performance management process which creates a shared set of strategic objectives and constantly aligns and realigns the behaviour of every individual to the business goals.

It is essential that management and staff as a whole have a shared vision in order to attain the goals of an organisation. They also need to work together as a team and show commitment to the ideals and principles of the organisation. Generally, evaluation of whether or not restructuring has achieved the desired end result is effected through the concept of "aligned commitment". According to Kreitner & Kinicki (1995), aligned commitment (AC) implies that all members of a work team are at the same level in their commitment to the organisation to facilitate a competitive edge in fulfilling its mandate. AC implies that all employees focus on the same goal and take ownership of the goal.

The following are the five elements of AC:

i. **Knowledge** refers to the training and development components in an organisation. It covers employees' knowledge, skills and abilities, methods and techniques applied to train and develop them and stimulate their growth. Therefore, knowledge indicates the extent to which a learning environment exists in an organisation.

ii. **Information communication in an organisation** refers to the importance of information, its dissemination and the effectiveness of information distribution and how well employees understand it.

iii. **Empowerment** refers to the provision of opportunities for employees to assist with the identification of problems, definition of their inputs in decision-making on related issues such as how work methods can be improved and the delegation of more comprehensive powers and responsibilities.

iv. **Rewards/recognition** refers to the acknowledgement of an employee's efforts in the organisation, giving recognition (such as financial reward, praise, promotion and more, or by withholding this), giving rewards (such as salary increases, training and more, or withholding it) and disciplinary steps. It includes considerations such as linking pay to performance and performance ratings as these play a significant role in a rewards/recognition system.

v. **Shared goals and values** have to do with how effectively the formulated goals and values have been conveyed to employees and the extent to which all employees understand and take ownership of these goals and values.

Best practice institutions engage committed and diligent people in the organisation. BancoSol is a very good example of a DFI that owes part of its success to a good management system and staffing. BancoSol improved its performance through adapting and designing a stricter management structure, putting in place improved systems and new chains of command. The human capital, according to Gonzales-Vega *et al* (1997) embodied experienced staff who had benefited from costly training and from learning by doing.

3.3 Testing the framework: Examples of application of policies

For the comparison to be accomplished, three institutions that are known to be successful were used as good examples through the adoption of the parameters listed in the framework. Yaron (1992) compiled a matrix of successful Rural Finance Institutions (RFIs) and used these institutions to show good practices of successful institutions. One of these RFIs is used to test the framework in this study, as these RFIs are some of the few public rural financial institutions that are widely perceived to be successful. This institution is the Bank for Agriculture and Agricultural Cooperatives (BAAC) in Thailand. The second and third institutions used to test the framework are the BancoSol in Bolivia that is considered successful in the work of Gonzalez-Vega *et al* (1997) and Equity Building Society in Kenya whose path of reconstruction is well captured in the report by MicroSave Africa (2002).

Table 3 below shows how these different institutions applied the policies used in the developed framework. The selection of examples was based on the fact that all three mentioned above are known to be successful, although their application of such policies differed at operational level. All three institutions apply these policies in different ways.

Table 3: Evaluation of the framework against best practice institutions			
FACTORS	**BAAC (Bank for Agriculture & Agricultural Cooperatives) in Thailand**	**Equity Building Society in Kenya**	**BancoSol (Banco Solidario in Bolivia)**
Market: Products and services	-Savings deposit -Credit -Marketing services -Decentralisation and expansion of branches -Reduced transaction costs for both saver and borrower. -Permitted micro-credits and micro-savings. -Formed joint liability groups. -Combined traditional loan approval with decentralised of technical assistance.	-Moved from a product-driven approach to a market-driven approach. -Focused on small and micro-enterprise sector. -Refined products and services to suit clients' needs, which allowed a wider menu with six savings products and five loan products. -Competitors were mainly NGO MFIs and savings and credit cooperative societies, as well as commercial banks. -Conducted a market research and product development exercise in order to challenge the competition head on.	-Had wide range of loan products and three deposit products -Pre-ownership of a micro-enterprise was prerequisite to qualify for loan. -Increased revenue-generating capacity of loans -Weekly but flexible loan collections. -Retained technology of personalising contact with clients (low risk and cost of lending).
Capitalisation	-Supported "mobile banking" through offering investment project assistance at village level. - Introduced short-term loans accounting for 75% of annual disbursements whereby principal is paid and interest collected after loan disbursement.	-Mobilised deposits and clients as shareholders which motivated them to deposit even more. -Differentiation of minimum opening balance on deposits accounts accommodated lower-end and corporate clients on deposit account. -Encouraged development partner support and publicised it.	- Inherited productive assets from PRODEM hence non-loan asset were source of revenue. - Moved away from donor funding and depended on market-based liabilities hence in the long run, deposits were higher than loans from public and private entities. - Reduced operating expenses as a proportion of productive assets, which resulted in sustained rate of returns on assets.

FACTORS	**BAAC (Bank for Agriculture & Agricultural Cooperatives)**	**Equity Building Society**	**BancoSol (Banco Solidario in Bolivia)**
Governance	-Government-owned bank - Policies and activities controlled by Minister of Finance through 11-member Board of Directors, where Agriculture Ministry and Corporative act as vice chair-person. - Had leadership that defined the priorities and growth strategies of the institution.	-Core investors determined leadership. -Board of Directors consists of seven members who jointly own 37% of shares. -54% is owned by public, while staff owns 9,4% of shares.	- It was a private, fully chartered regulated commercial bank. - Had a regulatory framework of central bank and norms of superintendency of banks and financial institutions. -Board of Directors consisted of NGOs, donors and investors who were also shareholders.
Measurement and reporting	-Had moderate dependency on subsidy outreach – served the poor, number of clients served increased at a low rate. Subsidy extended is measured against business. -Depended on self-help group to ensure efficient delivery. -Groups were self-monitoring and therefore successful.	-Subsidy-independent. -Invested in computer technology and market research as the industry was growing to ensure efficiency. -Weighed all activities in terms of impression created with all clients..	- Subsidy-independent. -Had good breadth of outreach showing accelerated growth of loans disbursed, rapid increased in number of clients. - Did not serve poorest of poor, had pre-requisite of having been in business for at least a year.. In terms of depth of outreach, 78% of clients were women. - Put more emphasis on contract design and enforcement that would ensure low costs rather than intensive screening and monitoring.
Human resources	Had freedom to establish staffing policies. Staff members were promoted according to branch level profitability, deposit mobilisation, loan disbursements and loan repayments.	-Equity appointed young people who easily became part of its culture. -Staff was highly motivated as performance was highly rewarded. -Strategic considerations and responsibilities were left to the young and educated employees who got good exposure.	-Had good human capital as result of high cost training and learning by doing. -Incorporated experienced staff inherited from PRODEM. -Put experts in assets and liability management. -Gave 10% of branch's profit to staff.

3.4 Measurement of aligned commitment (AC)

The framework developed was found to be inadequate in assessing stakeholder commitment, and specifically with regard to management and employees, for this could only be determined if a representative number of stakeholders provided their views. In view of this, a questionnaire had to be developed to specifically focus on the issue. The concept by Kreitner & Kinicki (1995) on AC, together with the scales developed for measuring AC were considered appropriate for this case study.

According to Kreitner & Kinicki (1995), AC is a concept that can be quantified as follows: AC = f (knowledge; information; empowerment; recognition; shared goals/values).

A questionnaire was designed containing three questions for each element of AC. The questionnaire was administered to determine the current level of AC of the institution in question, in this case the MADC. Each statement is evaluated on a five-point scoring system.

The multiplication of the elements in the AC equation indicates that if one element (e.g. knowledge) is not present, AC = 0. Thus, all five elements have to be present for an organisation to receive a positive rating. A high rating means a vibrant effective and efficient workforce, as well as a good environment (Coetzee, 1996).

3.5 Key issues from the chapter

In this chapter, a best practice framework was developed and evaluated and the procedure for assessing AC was explained. The framework will be used in the next chapter for measuring the performance of the MADC, using the primary and secondary information that was gathered. A questionnaire for measuring AC was developed. In the next chapter, the MADC is first explained and described, where after the performance of the MADC is evaluated, based on both the framework and the questionnaire.

4. AN OVERVIEW OF THE MADC

4.1 INTRODUCTION

In the previous chapters the role of finance in economic growth, the effects of policies and environment on the efficiency of a financial institution and the concept of best practices in development finance were discussed. These discussions facilitated the development of a framework that can be used to measure the performance of a DFI. This framework has been illustrated through its application to three institutions with best practices.

This chapter focuses on the MADC, specifically on its historical, political and socio-economic environments. The mandate and internal functioning of the MADC will also be discussed. After an overview of the MADC has been provided, the framework will be applied in the next chapter.

4.2 The context and the environment

The restructuring process of the development corporations in Mpumalanga dates back to 1995 when the Mpumalanga Provincial Legislature passed the Eastern Transvaal Development Corporation Act (Act No. 3 of 1995) which, *inter alia*, provided for the transformation, restructuring and amalgamation of existing development corporations and their subsidiaries, …"the ideal being to have a lean, mean and an efficient Development Corporation" (Matlala, 2000).

Since then, many studies have been conducted and strategies proposed for refocusing and restructuring this entity. The MADC has gone through processes that need to be described. Adequate information and the context of restructuring are crucial to this study. Before assessing MADC using the framework, a descriptive narrative is presented on some of the factors that may affect its performance level.

4.2.1 Historical background of the MADC

The focus of this section is on the evolution of the MADC, since the phases it has gone through have a significant impact on the decisions taken and strategies adopted. There are three main phases that show how the MADC came to be in its current state. These phases can be briefly described as follows: -

Phase 1-The homelands era (prior to 1994)

This is the period when the corporations operated within the context of the homelands. That is, Agriwane Agricultural Development Corporation under KaNgwane and the KLM under KwaNdebele. The corporation did all the planning and decision-making on behalf of the farmers. The farmers remained unskilled yet there was a system in place which was supposedly designed to empower them.

Phase 2- The Mpumalanga Development Corporation- MDC (1994-1998)

This phase was characterised by administrative challenges, largely due to the confusion[1] that resulted from the amalgamation process. The corporation was so big that administration and management became very difficult.

Phase 3-The restructuring of MDC (1998-2000)

During this period the MDC was restructured. Restructuring mainly took the form of downsizing the MDC and of refocusing it on the core business as recommended by the De Loor Task Team. This led to the retrenchment of staff members and payment of severance packages. The splitting/dismantling of the MDC into four separate corporations followed. This marked the birth of the MADC.

This phase began with many challenges. The first was the fact that no Chief Executive Officer (CEO) was appointed to lead the overall process in the MADC. During this time the CEO of the Mpumalanga Economic Empowerment Corporation (MEEC) acted as CEO of the MADC. This resulted in a lack of focus on the change process within the MADC.

The key elements of each of these phases will be presented in a table as follows:-

[1] According to interviews with category A staff members as discussed later in study (4.5.2), the confusion referred to was sudden lack of direction that staff seemed to have when they changed offices and line of reporting.

TABLE 4 : The three phases of MADC			
FACTOR	PHASE 1 : The homeland era (pre-1994)	PHASE 2 : MDC (1994 –1998)	PHASE 3 : The restructuring of MDC (1998 – 2000)
Market: Clients, products & services	- Supply-driven initiatives. - No research done to determine needs and market trends. -Corporation managed all process on behalf of farmer.	- Amalgamation had a geographic purpose rather than operational purpose, hence remained the same as in phase 1. - No review was done. - All changes had negative impact on accessibility and farmers suffered the consequences.	-Focus was more on downsizing the institution than performing market research. - Marketing related functions ceased to exist due to whites taking severance packages. - Clients started to feel abandoned.
Capitalisation	- DBSA was funding projects while government subsidised interest. - Vertical flow of capital – no savings/investment as funding was readily available.	- DBSA ceased its funding. -Government was the only source of funds, vertical flow continued. - Loan collection and repayments started to decline due to neglect of operational activities.	- Vertical flow of capital remained. - Provincial Department of Agriculture source of capital. - Debt book having an increase of defaults.
Governance	- No transparency.	-New structures were introduced to encourage democracy e.g unions. - Black leadership was introduced and a new Board of Directors was appointed.	-MDC split into four separate institutions towards the end of the phase, one of them being MADC. - New board of directors appointed in October 2000.
Measurement and reporting	- Reporting systems designed to fulfil the needs of funders rather for assessing performance. - Sustainability was not a concern, hence no monitoring and evaluation were done. - Bean-counting – only kept record of how much was spent in the budget and how many got funding.	- No focus on performance. - Huge administration task of amalgamation led to neglect of records. - Poor performance was detected from complaints of beneficiaries to government.	- Concerns are rising and need to put good strategies in place is realised. - Emphasis was more on financial reporting rather than development impact due to lack of strategies and putting more focus on overall restructuring

	- impact assessment was not a concern		
Human resources	- Management was almost entirely white and majority of blacks were underqualified and lacked skills, therefore high dependence on whites. - Skills development not government-driven, hence no HR development policy.	- White staff members started to feel insecure and frustrated under black leadership. - Rise of labour unions resulted in blacks being able to communicate their frustrations.	- Retrenchments and severance packages created tension and instability. -By end of 2000, staff component was 3% white and 97% blacks, total of 149 staff members. - Challenge of skills development as majority of staff members were at a junior level. - More conflicts rising between labour unions and management.
Sources : - Interviews with category A[2] staff member - Matlala (2000) - Annual report 2000/2001 - Researcher's observation[3]			

[2] Interview groups have been categorised according to type of information they could provide. Refer to 4.5.2
[3] Researcher worked for the MADC at the time of restructuring and the views are based on observations and information shared with colleagues who joined the institution prior to 2000.

4.2.2 Political factors

The MADC's Executive Committee (EXCO) has limited autonomy in decisions relating to financial policies and human resources. Strategic planning is a joint effort of the Department of Agriculture, Conservation and Environment (DACE), the Labour Union, MADC EXCO and Board of Directors (BOD). This means that, irrespective of what strategies are proposed by the unit mentioned above, they cannot be implemented before they are presented to Mpumalanga Provincial Government Legislature. Since 80 per cent of the MADC budget comes from DACE, that department has a vested interest in how the funds are applied and would like to ensure that the funds are used to carry out the mandate as outlined in the MADC Act (Act No.6 of 1999).

DACE is not only concerned with the disbursement of funds, but also with the welfare of employees of the MADC. This was evident in the past when the Member of Executive Council (MEC) was willing to talk and listen to labour unions. The incorporation of labour union representatives in strategic planning for the MADC is also evidence of the role of politics. For instance, private investors cannot be attracted without consultation with DACE. The procedure would be to consult the MEC, who would then present the proposal to the Legislature.

4.2.3 Socio-economic factors

The majority of farmers funded by the MADC have been clients since the homeland days. The approach used by Agriwane and KLM was that of doing the work for the farmers and were never really committed to their development, the farmers are still lacking in skills. Although the mandate is to finance emerging farmers, the level of understanding, risk exposure and income levels are significant factors. There is a high level of unemployment in almost all the communities served by the MADC, to such an extent that the farmers rely solely on their farming activities for their income. As these farmers may be the sole breadwinners of very poor households, making repayments may be difficult. On account of current financial policies, these farmers may also be left without savings.

4.3 The mandate of the MADC

In 1998 when the process of restructuring started, it was aimed at making the MDC lean and mean. This eventually implied that there was a need to split the institution into four separate institutions, of which the MADC is one. The process of dismantling started without a clear mandate on the role of the MADC. This resulted in misunderstanding and poor focus on what the corporation was meant to do. It was only later in 2000 shortly after the first Board of Directors was appointed that the mandate of the

MADC was clarified as being that of providing financial assistance to emerging commercial farmers. This is stated more comprehensively in the institution's mission statement and objectives contained in the company profile as follows:-

"The purpose of the MADC is to contribute to the economic growth of the agricultural sector of the Mpumalanga Province." That is meant to be achieved through the following objectives:

i. Providing business and technical counselling;
ii. Facilitating training; and
iii. Creating access to markets and providing loan financing to emerging commercial farmers from previously disadvantaged backgrounds and communities.

4.4 Functioning of the MADC

4.4.1 The market: Products and services

The MADC offers a wide variety of products and services. It is not clear whether this product range is the result of thorough research, or just assumptions about the demand for projects. However, clients still have a problem with the time taken for the approval of the applications and, as a chain reaction, funding does not reach applicants in time. In an attempt to improve on efficiency with regard to loan applications, MADC developed a 15-day loan-processing procedure. Within this 15-day period, pre-assessment is conducted; an application is used for checking budgets, market for products and other related factors. A response is then given within five days. If assistance is needed, the business advisor will then assist the applicant to complete a comprehensive business plan and resubmit his/her application. This process normally takes 10 working days before it is approved or rejected. These changes took place in 2002.

According to the MADC's mandate, the target group is the emerging commercial farmer. The products offered are:

i. Seasonal loans - this is a cash crop production loan. The loan period is up to 12 months with a ceiling of R300 000. The interest rate is two per cent below prime rate.
ii. Business loans – this is a loan aimed at helping farmers to acquire new farm ventures or improve existing farms. The loan period ranges from five to eight years with a ceiling of R500 000 that can be allocated. This is a high-risk loan allocated for enterprises that give returns over a long term.
iii. A revolving credit facility – this is a loan aimed at existing business persons who seek financing to trade in the agriculture sector. A revolving credit facility of up to R100 000 can be allocated. This loan does not have to be paid back in full before the farmer can ask for further financial

assistance. The farmer qualifies for the loan as long as the new loan amount does not exceed R100 000 when added to what is currently owed.

Additional services are also rendered, such as:

i. **Business advice** – Business advisors are employed by the MADC on a full-time basis to advise farmers on what crops to consider for the climate and soil in a particular area, the type of loan to apply for and how best to approach farming.

ii. **Counselling services –** Business advisors also assist those who experience serious financial difficulties owing to the business collapsing while they are still in debt. They assist with ideas on how to go about surviving the crisis.

iii. **Specialised technical advice** – This is advice given mainly on operations in the field. Business advisors have some agricultural background and are knowledgeable with regard to basic farming principles and techniques; hence they are in a position to advise farmers when the need arises.

iv. **Facilitating training of clients** – As business advisors co-ordinate big projects, they make sure that all the companies supplying other types of services or products provide the relevant training related to that service or product. For instance, companies selling fertilizers would be expected to train farmers on how best to use the fertilizer. When a training need arises, business advisors are expected to write a proposal on the training of farmers so that funds can be made available for such a project.

v. **Facilitating mentorship programmes** - This service is provided to farmers who have surmounted all the barriers in the route of an emerging commercial farmer and have come close to being a fully fledged commercial farmer. This is a motivational service and creates relevant business links for the farmer.

vi. **Project management** – Most of the projects funded by the MADC operate on a system of grouping clients. That is, clients form a homogenous group in terms of the type of crop they farm, the size of the land and the community that they come from. The various communities are categorised as projects under the management of the MADC and this institution works on the planning, budgeting and control of these.

Best practice organisations normally do not mix technical advice on farming with the provision of financial services (Coetzee, 1997). This often leads to disastrous results, especially when risk need to be apportioned in terms of production and investment decisions. The range of services provided by MADC also leaves it vulnerable and client default can lead to major write-offs and necessary provisions.

4.4.2 Capitalisation

Despite improved technology and strategies, the lean structure and increased focus on core functions, the corporation still seems to survive on government funding, which is increasing annually. This is evident in the figures of budgets allocated between the years 2000 and 2004. In 2000/2001, the budget was R15 million, in 2001/2002 it rose to R21 million. In 2002/2003 it was R36 million and in 2003/2004 it was R42 million. About 80 per cent of the annual budget comes from government, with the government contribution increasing as a proportion of total revenue.

In an attempt to express how they view the MADC, some small-scale sugar cane farmers refer to it as "ku kwa badala u zo phinda u buya" (meaning "pay and come back").[2] This clearly indicates that, as far as these farmers are concerned, their experience with the corporation is that they remain indebted to it for life, as they keep going back to it year after year for loans without ever attaining self-sufficiency.

Most of the time the MADC has maintained a lending rate that is not market related. The current rate is two per cent below prime rate. The institution is heavily subsidised by the government and there are still periods when a serious lack of funds has hampered the efficient running of the corporation. This was the result of unprofitable projects and poor loan repayment and collection. According to the annual report (2001), the MADC had a liability of R17 million, of which R11 million was money due to DBSA and the rest being inherited expenses. The MADC was continuing to pay for projects/services that it no longer used. An example of this is the Sybrandtskraal Energy Centre where the MADC continued paying for the weighbridge account, whilst Zijamele farmers used the centre. Annual report (2001).

In 2003, the MADC was faced with a debt book with a high percentage of defaults. This called for a strategy to counteract the situation which would enhance good servicing of loans and assist payment of loans that have long been outstanding.

At present there are no special loan collection methods The only effective method for collecting loan repayments is by signing cessions, which only applies to small-scale sugar cane farmers. This method ensures that the money owed to the MADC is deducted before it even lands in the farmers' hands.

4.4.3 Governance

The MADC's Board of Directors is appointed by the MEC for DACE, in consultation with the Provincial Legislature. The members of the first Board who served from 2001 to 2003 had legal and agricultural backgrounds as some were farmers and representatives of farmer associations (as obtained from interview information – see 4.5). It may appear that the rationale for appointments was political[4] since there remained gaps in terms of financial background, rural finance expertise and socio-economic development. The MADC EXCO has the power to appoint, set salaries and staff incentives and implement policies. However, this is all subject to the budget that is allocated by DACE. The strategic planning is done by the EXCO, together with the BOD, DACE and labour union representatives.

4.4.4 Measurement and reporting

The main method used for measuring success during the Agriwane and KLM era was to keep a record of loans disbursed without assessing their impact on the communities. Reporting was never up to standard due to the accounting staff's lack of understanding of the system and the fact that there was no link between activities in the accounting and the social development sections. Some of the problems that led to poor monitoring and evaluation, according to Wakeford (2000) were as follows:-

i. The knowledge of the accounting members on the system was limited.
ii. The lack of connectivity between systems impacted on the completeness of reports.
iii. With more than one isolated system, problems with a holistic picture concerning outstanding loans and repayments presented the accounting and financial staff with a number of headaches when reconciling accounts.

Technology was also a challenge. In summarising the technology status in the corporation, Wakeford (2000) mentioned that there was lack of dedicated support of Information Technology (IT). Some of the findings of Wakeford's research were that the financial application ACCPAC used at the time had not been upgraded for a number of years and that staff members could not even relate to the system that was used. "Staff members over a period of time have disassociated themselves from the full functionality of the package due to lack of training and the difficulty of using the DOS version" Wakeford (2000). This kind of problem had a negative impact on the efficiency of the institutions in terms of record keeping, general functioning of the management information system and general service delivery.

There has recently been an initiative to set up a strategy for measuring the performance of the institution, which focuses not only on financial performance, but on the institution as a whole, that is, on policies, management and staff. At the time of this study, the strategy had still not been put into practice, hence its outcome and effects cannot be discussed at this point.

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[4] It was common knowledge that one member was the leader of the provincial farmers union while two others were local councillors in their communities.

4.4.5 Human resources

The MADC has a total staff component of 149, the ratio of qualified to unqualified staff being 1:9. The reason for this is because it has staff working on projects owned by the corporation (Thekwane Citrus, Moloto Roses and Letolo poultry). The current effort to develop human resources requires the expenditure of 30 per cent of the MADC's annual budget on staff training due to the fact that majority of staff retained are at junior level.

On its own the budget appears to be sound and to reflect the commitment of the institution to human resource development. However, it raises the question of whether the development is properly planned and in line with the objective of the MADC becoming a sustainable institution.

4.5 Data gathering

4.5.1 Introduction

The restructuring of the MADC is a process which, according to the researcher's knowledge, has not been documented. The current scenario at the MADC has been greatly influenced by the phases that evolved from the homelands era to date. The greatest challenge was accessing written information on the pre-1994 phase, especially regarding political and financial matters. For this reason interviews were very useful in data gathering.

4.5.2 Methods

As mentioned earlier in the study, different methods were considered to acquire relevant information.

Observation : the researcher joined the institution at the time when the MDC was dismantled into four separate institutions. This created an opportunity to undertake the study and use observation as a tool. It is for this reason that some information and views are based on observation.

Literature review: local and international literature on development finance was considered.

Interviews: there were four categories of interviewees. A questionnaire was designed to assist in accessing information from category A & B, as listed below. These categories were as follows:

Category A: Long-serving staff members who worked for either Agriwane or KLM. Informal interviews were conducted with a few individuals followed by a questionnaire they completed to assist in determining aligned commitment of the organisation.
Category B: Staff members who started working for MDC after 1998. Interviews were conducted and questionnaires introduced in a similar way as category A interviewees. This group also assisted in terms of responding to questions on operational issues.
Category C: Management from 1998 to 2003. Questions asked were more on policy issues.
Categories D: Clients or farmers. This took form of field investigations that were performed while running day-to-day activities. The interviews were in a way disguised as information was provided while researcher was fulfilling other daily tasks. The **field notes** that the researcher collected served the purpose.

Journals, brochures, fact sheets and more: Some information could be accessed through this method but this was very limited. Only information on post-2000 could be accessed.

4.6 Key issues from the chapter

The details of the MADC discussed above are meant to highlight the context within which the MADC operates, for the purpose of assisting in the comparative analysis of the MADC and the findings thereof. The history and background illustrated the confusion that existed and ill-conceived restructuring which confirms that it was indeed rational to undergo restructuring, in accordance with the justification for restructuring, as discussed earlier in the study.

5. EVALUATING THE MADC

5.1 Introduction

In this chapter, the relevant information on the MADC will be collated for analysing the MADC, using the framework that was developed. In view of the fact that the intention of the study is to add value to the restructuring process of the MADC so that the MADC can forge ahead in terms of adopting new policies and strategies, part of the focus will be geared towards human resources. Assessment of the human element will take the form of assessment of the aligned commitment within the MADC.

5.2 A comparison of international best practices with those of the MADC

The analysis is presented in Table 5 below.

TABLE 5: Comparison of international best practices with those of the MADC	
Factors	MADC scenario
The market : Clients, products and services.	Products: Revolving loan - set at a certain limit - always available, depending on balance owed. Seasonal loan –short-term loan meant for production Business loan Non-financial services: Business and technical advice Counselling Training and mentoring. Organising markets for clients
Capitalisation	Interest accumulating in bank accounts Sale of products from state-owned projects 80% government funding No savings facilities for farmers No shareholding agreements with non-farmers
	Lending interest rates The lending interest is currently at 2% lower than the prime rate. Methods for loan security No collateral required, security in form of signing cessions so that buyers can directly pay the MADC all money due for loan repayment. Market access is regarded to be a collateral substitute. Collection of repayments Farmers pay directly into the MADC's bank account or directly to debtor's clerk at the MADC offices. When cessions have been signed, buyers deduct money due to the MADC and pay this directly into the MADC's account.
Governance	Branches exist for administration purposes (receiving applications) but do not play any funding role, no loans approval. DACE and labour union form part of strategic planning 2001-2003 Members of the board play a regulatory role while being farmers themselves.
Human resources	Since 2003, 50% of annual bonus is performance-related. Although this is a positive step in terms of organisational development, the institution has to identify and adopt a sound strategy to motivate staff and enhance performance of employees.

5.3 Synthesis and comparative results

5.3.1 The market: Clients, products and services

Both the best practice institutions and the MADC focus not only on lending money. While the MADC renders advisory services and does facilitation of training, the other institutions add benefits that are not necessarily linked to their clients' farming activities or businesses, such as counselling, organising markets for clients and mentoring, The most important difference is that the best practice institutions focus on financial savings products and services, while the MADC only focuses on credit products and then add financial and technical advice.

The MADC has services which place it at a higher risk in terms of a great liability, for instance, the case of Sybrandtskraal Energy Centre mentioned earlier. Whilst DFIs should rather seek to have a stronger asset base and settle for products and services that will enhance such a condition. MADC practices are typical of conventional DFIs that do not engage in serious market research that could lead to product development and refinement, refocusing and structuring of delivery systems, ensuring promotion of products through efficient research.

5.3.2 Capitalisation

Best practice institutions were used to evaluate the framework for promoting savings mobilisation as a useful strategy for generating funds. The MADC depends heavily on government funding, with about 80 per cent of its annual budget coming from DACE. Although the other 20 per cent of the budget supposedly comes from accumulated interest and sales of products from the projects owned, according to most interviewees and from personal observation, these projects have not been doing well for the past five or more years. In addition, the growing annual contributions from government indicate an increasing reliance on government funds, rather than own generated income. The restructuring process seems to also have affected the projects to a great extent. This was due to change of focus, employees taking severance packages and lack of funds. On the basis of the definition of self-sufficiency, it is obvious that at the time of this study, the MADC was not self-sufficient since from the budget figures indicated, it obviously could not survive without government funding.

As pointed out in the discussion on socio-economic effects on micro-finance institutions, it is imperative that the MADC play a role in enhancing the credit-worthiness of its clients through encouraging them to save. The successful best practice institutions that are discussed and used as references in this study, introduced compulsory savings and therefore did not have problems with farmers paying back their loans. They also became self-sufficient, as they did not need funding to takr their business forward. In other words, savings mobilisation has mutual benefits for both the institution and the clients. An array of incentives has been used to ensure financial discipline and build up a positive relationship between lender and borrower (Yaron, 1992). As the clients are compelled to save money, they are able to pay back the institution and hence the institution is able to grow and finance more clients, thereby achieving a better outreach programme. The target institution would also be known for its ability to add value to the livelihoods of clients rather than demanding the small amount of money that they make from farming.

Loan processing and approval: The MADC's loan approval procedure is relatively drawn out by comparison with those of the best practice institutions. Systems are also not decentralised and little authority is delegated.

Interest rebates and penalty: Successful institutions pay rebates on interest and some penalise clients for late payments as a strategy to encourage clients to repay timeously. This has resulted in benefits for the institution. Yaron (1992) argues that this leads to a gradual increase in borrowing eligibility upon timely repayment and cites the example of BKK, where prompt payments led to doubling of loan eligibility. This is not applied by the MADC where there is little or no penalty for late or non-payment. In many instances farmers have more than one loan, with new loans being issued without existing loans being repaid.[5]

Lending rates: With the MADC charging a rate that is two per cent below prime rate, the income of the institution is adversely affected. All the institutions referred to in the comparative analysis charge real interest rates and also interest rates that largely cover costs. The challenge facing the MADC is that it serves a rural market that has been subsidised by government under KLM/Agriwane for a long time. Since the subsidy is no longer forthcoming and some of the organisations or bodies that used to fund these institutions, such as the DBSA, are currently not willing to continue doing so because of the debt book, the policy should be revised. If not, the farming sector in Mpumalanga will increase its dependency and will stay a financial burden for the government.

Loan security: Successful institutions apply different methods of securing loans, such as asking for collateral and applying collateral substitutes. Asking for collateral from its clients gave rise to an objection that the MADC is unnecessarily denying its clients opportunities.[6] With the rural market,

[5] Based on an interview with an accounting officer, this is a typical situation resulting from poor record keep and poor technology.

[6] This is the conclusion reached by the researcher from interviews with the farmers where they had repeatedly expressed that the corporation does not in any way support them, but work against them.

failure to produce collateral has been common among clients, as the majority cannot afford this. However, the MADC found one mechanism that they apply: the signing of cessions. This method assumes that all the clients will have secured a market for their produce before they produce anything and that the buyers commit themselves to this in writing and the farmer signs a cession agreement, in terms of which the buyer may deduct the amount payable to the MADC from the gross margin. However, this method can be very limiting where buyers do not want to commit themselves to buying from the farmer prior to production of a crop or if the client fails to secure a market beforehand. This mechanism is referred to as linked contracts or interlinking and by itself provides a good mechanism for loan security. However, certain aspects must be in place and it is clear that this is not the case in the relationship between the MADC and its clients.

Loan collection: The MADC's clients have to visit a bank or the MADC offices to make their repayments. Accessibility and travel costs may affect making timely repayments. The weekly collections and mobile systems have contributed to good collection rates in successful international best practice institutions. When it comes to due dates for loan repayments, the MADC system is very flexible, as it accommodates the type of farming enterprise and the time of harvest for every enterprise. This implies that the due dates can be weekly, bi-weekly, monthly, annually or such. An example is that of vegetable producers who may pay on a weekly basis, whereas sugar cane growers pay annually.

5.3.3 Governance

The MADC has limited autonomy in planning and decision-making, compared to the other institutions. This is deduced from the fact that consultations with DACE have to be conducted before a final decision can be made. For instance, DACE and labour unions have to be involved in strategic planning. Furthermore, decisions to involve private investors depend on government's acceptance of the concept. The case for limited autonomy could be linked to high financial dependency on DACE. If DACE provides the MADC with up to 80 per cent of its annual budget, it surely would need to conduct some sort of follow-up with regard to disbursement of the funds. This then entitles DACE to sit in on the strategy sessions and gives it the right to evaluate any concept related to investments.

The 2001-2003 Board of Directors may have been skilled in agriculture-related matters but were not properly positioned when considering their backgrounds. As stated earlier in the study, some of the board members were farmers and representatives of farmer associations. This can be regarded a gap when Seibel's (1999) argument is taken into account. Srinivas (2003) also argues that the board members of a transformed micro-finance institution should understand the motive for combining a social mission with profitability and should not be member of other constituencies, as this would force such members not to act in the best interests of the institution, but rather as apologists for other interests. King II Report recommends the board must ensure that the organization complies with all relevant laws, regulations and codes of business practise." (Ehlers & Lazenby, 2004).

5.3.4 Measurement of success

The criteria for measuring success is traditional, which, according to Yaron (1998), is a way of quantifying profit by presenting a standard financial statement without commenting on sustainability. To date the MADC has changed little from the practices of Agriwane/KLM, where only financial statements were used to determine success.

Although the institution has just introduced a performance measurement system for staff assessment, there is still a need to consider other tools that could be used to measure overall success of the institution. Assessment of all the variables used to determine the SDI of an institution, would ensure that the institution improves on all aspects affecting sustainability. MADC makes no effort to measure outreach and the dimensions of outreach as listed. Thus, not only is there no indication of sustainability, but furthermore, there is no indication of development outreach and impact.

5.3.5 Human resources

Most of the current staff members were inherited from the homeland era, during which there was a lack of interest in the development of personnel and all managerial positions were only meant for the minority within an institution. Although the corporation made attempts to employ knowledgeable and skilled people, the interviews (as outlined in 4.5.2) revealed a high staff turnover at management level. Many staff members in management positions and those who were highly skilled at the start of the transformation process opted for severance packages. This was followed by subcontracting the same employees who took severance packages to train employees. "Some skilled personnel who took voluntary severance packages were subcontracted as consultants and/or as acting managers with a mandate to train staff. Because of racial polarisation and resistance to government policy like affirmative action, little or no training took place resulting in poor service delivery to farmers." (Matlala, 2000).

This factor threatens the success of all the efforts made to restructure the MADC, since management is crucial to successful restructuring. According to Coetzee (2002) most transformation efforts fail due to the inability to manage the process of transformation. The fact that the institution plans to change its image through enhanced efficiency means that it is facing the challenge of empowering its current staff component and attracting new entrants who will add value.

5.4 Aligned commitment within the MADC

A questionnaire containing questions related to each of the elements of aligned commitment was compiled and given to randomly selected employees who were asked to complete it anonymously (Annexure A : questionnaire). The aligned commitment score of each participant was computed as indicated in Appendix B : Scale and scoring of elements of aligned commitment.

The table below illustrates the scores and averages of each of the elements of aligned commitment.

TABLE 6: The score of AC per employee and the average AC for MADC

Employee	SV	Kno	Inf	Emp	RR	AC
1	3.667	4.333	4.000	2.333	3.000	**444.832**
2	3.667	4.000	2.667	2.667	4.667	**486.917**
3	3.333	4.667	3.667	3.333	2.667	**507.040**
4	3.667	3.333	2.667	2.000	1.667	**108.676**
5	4.000	3.333	4.000	2.667	4.333	**616.264**
6	3.000	4.000	4.667	4.333	3.667	**889.854**
7	3.667	3.667	3.667	4.333	3.667	**783.488**
8	4.333	5.000	4.000	4.333	3.667	**1376.950**
9	4.000	4.667	4.333	3.667	3.667	**1087.698**
10	2.000	3.333	2.000	2.000	1.000	**26.664**
11	4.000	4.000	4.000	4.000	4.333	**1109.248**
12	4.333	4.667	4.333	2.667	3.667	**856.937**
13	3.667	4.333	3.333	4.000	4.000	**847.335**
14	4.000	4.333	3.333	2.667	4.000	**616.264**
15	4.000	4.333	4.000	4.000	4.000	**1109.248**
16	4.333	4.333	4.000	4.000	4.333	**1301.626**
17	5.000	4.333	4.000	4.000	4.333	**1501.991**
18	4.333	3.667	3.667	4.000	4.000	**932.246**
19	4.000	4.333	3.667	3.667	4.333	**1009.855**
20	4.000	5.000	4.000	3.667	3.667	**1075.751**
21	3.667	4.333	4.333	3.667	3.333	**841.462**
22	3.000	3.667	4.000	3.333	3.333	**488.836**
23	4.000	4.000	4.000	3.667	3.667	**860.601**
24	3.667	4.333	4.333	4.000	3.667	**1009.855**
25	3.667	4.333	3.667	3.333	4.000	**776.794**
26	3.667	4.333	4.000	4.000	4.667	**1186.472**
27	3.667	4.330	4.000	4.333	3.333	**917.240**
28	3.667	5.000	4.000	4.667	3.667	**1255.133**
29	2.667	5.000	3.333	2.000	3.333	**296.274**
30	3.000	3.667	2.667	3.667	3.333	**358.593**
31	3.667	4.333	3.667	3.000	3.000	**524.388**
32	2.333	3.667	2.333	1.667	2.000	**66.544**
33	3.333	4.000	3.333	3.333	2.333	**345.526**
34	4.333	5.000	3.000	3.667	2.333	**556.039**
TOTAL	**125.335**	**143.661**	**124.667**	**116.668**	**118.667**	**26172.640**
Total Average	3.686	4.225	3.667	3.431	3.490	**683,990**

Shared value (SV), Knowledge (kno), Information (Inf), Empowerment (Emp), Reward/recognition (RR) and Aligned commitment (AC)

The average aligned commitment of MADC is 683, 990 which represents merely 22 per cent of the possible maximum aligned commitment of an organisation which is 3125(Annexure B). The mean of 683, 990 indicates a very weak aligned commitment when it is weighed on the basis of a pre-determined ranges of aligned commitment whereby only an aligned commitment of above 1500 would be regarded as strong (Annexure B).

The weakest link in the aligned commitment within the MADC occurred in the element of empowerment, with knowledge being the strongest link (Table 7). Shared values and information differed slightly.

Table 7 : Effect of five elements on aligned commitment in the MADC

Treatments	Mean Score
Knowledge	4.2253 a
Shared value	3.6863 b
Information	3.6667 bc
Recognition/reward	3.4902 bc
Empowerment	3.4314 c
Aligned commitment	683.990

Generally, shared value, information, recognition and empowerment are the elements that effectively reduced the aligned commitment in the MADC. Thus, in order to strengthen aligned commitment, management needs to place more emphasis on these elements, as they contribute to the success of restructuring.

In general, using the aligned commitment calculation and results, it is clear that the management of the stakeholder process in the MADC is not optimum and is in effect severely lacking.

5.5 Key issues from the chapter

A synthesis of the findings revealed in this chapter indicates that, in some cases, the current restructuring processes within the MADC need tightening and that, in others, altogether new strategies will have to be put in place. This chapter confirms that in terms of best practices, the MADC has serious gaps and deficiencies regarding its market and products approach, capitalisation, governance, measurement and reporting, as well as human resources programmes.

Since the restructuring of the MADC has already begun, this chapter represents an attempt to identify those areas with gaps, for the purpose of recommending strategies that can be put in place. This chapter therefore serves as a bridge to making recommendations on a way forward.

6. RECOMMENDATIONS AND CONCLUSION

6.1 Introduction

"Even where a good argument has been put forth on the reason for the institution and all governance and other rules have been adhered to, the process of transformation and the way this process is managed and supported will ensure the difference between success and failure." Coetzee (2002).

This chapter addresses possible solutions for overcoming weaknesses revealed by the analysis made on the performance of the MADC with regard to its market, capitalisation, governance, measurement of success and human resources.

The comparative analysis indicated that there were some areas in which the MADC has to improve in order to become sustainable. The focus here will be on those areas that were analysed, as well as on introducing mechanisms that will boost aligned commitment within the MADC.

6.2 Proposing a way forward

The recommendations made in this chapter are within the context in which the MADC operates and based on international best practice. The aim of the recommendations is to assist the MADC leadership in strategies to improve the performance of the institution and ensuring a more sustainable outcome. It must be noted that these proposals are put forward without any interaction with the board and management of the MADC, thus fine-tuning, focusing and tempering of proposals were not possible, hence the qualification that these proposals are merely indicative.

This proposal will be based on Kotter's eight steps for transforming an institution, the best practice framework that was developed earlier and Seibel's (1999) recommendations as outlined earlier in this study.

6.2.1 The market: Clients, products and services

The fact that the MADC has a non-performing debt book in terms of a high number of defaults makes it obvious that the institution is in arrears due to poor servicing of loans. The audit committee referred to the source of the problem as operational cash flow problems and consequently a lack of funds to repay the DBSA loans. (Annual report, 2001) This calls for a serious review on how the products and services offered have been packaged, their effect on clients' ability to repay their loans and the general quality and commitment of loan collection efforts. In 2003, the matter still had not been resolved, hence again calling for the reviews stated above.

Recommendation:
The MADC needs to review its market by means of market research that would also cover feasibility studies and lead to new and revised products and delivery systems. They further need to ensure that they have a thorough and focused collection strategy and that there cannot be government interference in waving loan payments for favoured farmers or groups of farmers. They also need to reconsider their combined services of technical advice and finance, as the technical advice component increases the risk of default on the financial component.

6.2.2 Capitalisation

The MADC's financial policies were found to contribute to the poor efficiency of the institution. Therefore, better policies that will ensure the sustainability of the MADC will have to be implemented.

As the mechanism currently used to capitalise the MADC is not sufficient to bring about efficiency, this institution is likely to remain heavily dependent on government for funding, unless changes in this regard are effected.

Recommendations:
All successful institutions have been shown to strongly apply savings mobilisation as the main tool for capitalisation. It is high time that the MADC considers generating its own funds from sources other than the income from the sales of products from farms owned. It is obvious that if, for some reason, DACE is unable to allocate about 50 per cent of the MADC's annual budget, the MADC will simply immediately cease to function.

The MADC should consider the following: -

i. Ensure that all loans offered exceeding a certain pre-determined figure are strictly accompanied by a savings option. That is, as a client makes his repayments, a certain portion will go towards that client's savings. This will also serve as an incentive, since clients will realise that the MADC is also interested in empowering them financially.

ii. Get rid of the existing debt book. The debt book is a "turn-off" for most institutions that might otherwise be willing to engage in business deals with the MADC. As long as this issue is not properly resolved, clients will default, taking it for granted that their cases will simply be shelved, with no follow-up, hence perpetuating a culture of non-payment. The MADC should start by implementing a strong collections policy, that includes a rule that no one with outstanding loan amounts is eligible for the same type of loan and that no-one with arrears is eligible for any service from the MADC. It will also help to ring fence the 'troubled' portion of the loan book and ensure that a solid policy of grading arrears loans and handling each grade is in place and well communicated.

iii. Offer pure savings and investments options to interested clients, even if they are not farmers through partnerships with credible banks.[7] This option could even be extended to attract private investors. Although the benefits lie in the institution having a good cash flow to function well without having to depend on government and other sources of funding, it will also boost the monitoring system, since investors will always ensure that proper monitoring is in place as they look after their own investments. These are currently products offered by commercial banks and may result in competition which will boost the quality of products, as all institutions will gear themselves to beat competition.

iv. Review current financial policies and ensure that the following are implemented:

   a. **Interest rebates and penalties**: The only mechanism currently used as a penalty is the accrual of interest on a monthly basis. There are cases of the MADC having issued additional loans to clients with outstanding arrears. One of the most effective penalties would be to discontinue rendering service to those who default. Since the MADC is the only institution focusing on emerging farmers, its clients would repay their loans with the knowledge that they have nowhere else to turn to for assistance. At the same time, it would be very encouraging for good payers if they were treated more favourably than those who default. Interest rebates, as seen in the gap analysis, are successfully used by some of the international best practice institutions and have been proved to work. This is simply because rebates serve as an incentive to pay back timeously.

   b. **Lending rates:** The MADC will have to refrain from setting its rates at two per cent below prime rate. As discussed earlier in the study, this practice is prejudicial to the client. It is crucial that the MADC empowers clients appropriately in order to ensure that they participate meaningfully in the economic circle, rather than remain clients who do not grow to be sustainable, but remain dependent. In the long run sustainable clients will boost the efficiency of the MADC. A too low rate also impacts on the sustainability of the MADC and higher rates based on cost recovery are better than causing a failed institution with no services at all.

[7] This should be done in cognisance of the fact that there are limitations and challenges of providing savings services due to the Banks Act that restrict development finance institutions to offer such.

c. **Loan security:** All the international best practice institutions used in the gap analysis require collateral or collateral substitutes as security for loans. The MADC has to become more innovative regarding collateral and collateral substitutes. The idea is that the use of collateral must serve as a further incentive to repay. In most cases, clients are motivated to pay as they wish to protect their collateral.

d. **Loan collection:** The present mechanism for collection is definitely not efficient, since farmers can only pay the cashiers at the MADC offices or make bank deposits. Accessibility and the cost of travelling may be limiting and hence the MADC should consider mobile pay points that would be available in particular areas on a regular basis (weekly, monthly or other) or link with buyers and effect electronic transfers.

6.2.3 Governance

The MADC needs to improve on governance and autonomy. Although it is true that this is a government-owned institution, the MADC fails to take cognisance of the fact that it owes its existence to the fact that it should address market failures that private institutions cannot address. Broadly speaking, there is a lack of understanding of the role of the development finance institutions in South Africa and more specifically, at the level of provincial DFIs.

Recommendation:
The appointment of board members who come from strong finance, investment and economic backgrounds will definitely add value to the change process at the MADC. There is a need to refrain totally from appointing members who may have benefited or are currently benefiting from the products and service of the MADC (as is the case with the board members who were appointed in 2000), as such members may be biased and torn between what is best for the MADC versus what is best for its clients (best for themselves).

Political interference should be limited. There should be a line drawn in terms of the kinds of meetings and sessions at which labour unions can be represented. In essence, once the government and the labour unions have worked together to ensure that the objectives and the rules of engagement are in place for the MADC, unions should not be involved any more than reacting to the reports of the MADC board and management.

The MADC needs to reduce its level of dependence on government funds. The fact that government annually channels a lot of funds to MADC leads to more intervention by DACE than necessary. This makes sense since DACE has to ensure that the money it allocates to the MADC is put to good use: that of looking after its people. One good way to reduce dependency would be the implementation of improved and efficient methods of capitalisation. The MADC should rather generate 80 per cent of its budget and depend on government for the balance of 20 per cent, rather than continue with the current scenario. Improved financial policies and capitalisation may be an answer, as well as joint ventures with the private sector.

6.2.4 Measurement of success

The most effective way of measuring success starts with a clear understanding of what needs to be achieved. Clear objectives have to be set that are measurable and easy to benchmark. Seibel (1998) recommends setting clear goals and objectives, setting medium-term plans and monitoring as well as developing an industry standard of performance.

It would therefore mean that, in order to successfully move away from traditional ways of measuring success, the MADC would have to start by reviewing its vision, mission and objectives. All the best practice institutions that were used in this study had objectives that they could use as reference to monitor performance.

Recommendation:

The MADC has to consider outreach and sustainability in key performance indicators. The calculation of SDI in the case of the MADC will make an impact, as it will ensure that monitoring and valuation are done vigorously as the institution strive to use valid information for expressing the variables that need to be considered. Outreach should give a clear indication of whether or not the MADC is meeting the needs of its targeted group, namely emerging farmers and poor rural people.

6.2.5 Human resources

The gap analysis revealed that the best practice institutions have highly skilled, motivated and committed staff. Based on interviews and observation, it appears that the MADC has a very high staff turnover, especially at middle and higher management levels. The majority of the staff members have indicated a wish to see an improvement in systems and general operations. The bottom line of the assessment therefore is that there is a strong feeling of uncertainty among staff.

Recommendations:

In order to improve on the current situation, the MADC needs to focus on both training and alignment of commitment (alignment of values). Correction of the social cohesion necessary to effect alignment is essential since, no matter how good the policies and strategies are, if the people who are supposed to implement them do not share the vision, lack the necessary knowledge and skills and do not have the same goals in mind, the institutions will always fail to attain sustainability, no matter how many times it is restructured.

6.3 Conclusion

The need to restructure the MADC became apparent when it was assessed in terms of the framework developed and also in terms of economic justification, requirements and guidelines for restructuring. The recommendations outlined above were compiled on the basis of the strategies of best practice institutions and the policies of the new approach to development finance. It is envisaged that, by accepting the findings of this study and implementing the proposals outlined here, the MADC will be able to review the strategies that were established and implemented after embarking on a restructuring process.

It must be stated clearly that this study is largely indicative of a framework that can be applied to assess a DFI and assist in focusing strategies to restructure DFIs. It is not comprehensive and more research is needed covering best practices on more continents and in more cases than the three used. It also requires consent from the target institution and its owners. In the case of the MADC information is largely from secondary sources and the primary information gathering was limited and intermittent. However, the proposals put forward and the bases of the proposals in the application of the framework are sound, albeit incomplete.

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ANNEXURE A

.QUESTIONNAIRE

The research is for academic research dissertation and it must be filled anonymously. Respond to the statements by making a cross in the relevant block. Read each statement very carefully and pay specific attention to the description of the scale points.

Scale points

Rating	Description
1	To an exceptional extent
2	To a greater extent
3	To some extent.
4	To a lesser extent
5	Not at all

1.	Our organization has specific value system behavioural guidelines such as honesty, quality, profit, etc.)	1	2	3	4	5
2.	Senior management in our organization continuously emphasizes the importance of values (such as mentioned above).	1	2	3	4	5
3.	In our organization, employees receive recognition and/or rewards (praise, pay increases, etc.) for performance based on living up to the values.	1	2	3	4	5
4.	I (as an employee of this organization) possess the knowledge and experience to perform my work effectively.	1	2	3	4	5
5.	I possess the necessary skills to do my work.	1	2	3	4	5
6.	I have sufficient training to do my work.	1	2	3	4	5
7.	My work objectives are clearly defined most of the time.	1	2	3	4	5
8.	My supervisor/manager ensures that everyone knows what has to be done.	1	2	3	4	5
9.	Employees have a clear perception of this organization's objectives.	1	2	3	4	5

10.	I have the freedom to decide how I wish to do my work.	1	2	3	4	5
11.	I have to endure a lot of red tape to get things done.	1	2	3	4	5
12.	I am satisfied with the opportunities granted me to take part in decision making.	1	2	3	4	5
13.	My salary is fair considering what other people in this organisation are receiving.	1	2	3	4	5
14.	I do earn the kind of money I should be earning for the work I do.	1	2	3	4	5
15.	My organization's reward system (salaries, promotions, and benefits) is based on employee value, ability and performance rather than on luck, whom you know and how well people could be manipulated.	1	2	3	4	5

ANNEXURE B : SCALE AND SCORING OF ALIGNED COMMITMENT

The scale used to do the analysis was adopted from Coetzee (1996)

Fifty employees were randomly selected to complete the questionnaire and only 34 responded. The following formula was used:-

AC = shared values x knowledge x information x empowerment x rewards/recognition

$$= \frac{[(1)+(2)+(3)]}{3} \text{ X } \frac{[(4)+(5)+(6)]}{3} \text{ X } \frac{[(7)+(8)+(9)]}{3} \text{ X } \frac{[(10)+(11)+(12)]}{3} \text{ X } \frac{[(13)+(14)+(15)]}{3}$$

Maximum score per institution = 5 x5 x5 x5 x5 = 3125

Each statement was weighted at a 5-score point system as indicated on the questionnaire.

The formula above gives each element of aligned commitment a maximum of five points, which therefore gives an institution a maximum of 3125. The rating is interpreted as follows;

≥ 3000 : Extremely strong AC
2500 – 3000 : Very Strong AC
2000 – 2500 : Strong AC
1500 – 2000 : Moderately strong AC
1000 – 1500 : Moderately Weak AC
500 – 1000 : Weak
≤ 500 : Extremely weak

≥ 3000 : (above 96%)AC
2500 – 3000 : (80 – 96% AC)
2000 – 2500 : (64 – 80% AC)
1500 – 2000 : (48 – 64% of AC)
1000 – 1500 : (32 – 48% of AC)
500 – 1000 : (15 – 32 % of AC)
≤ 500 : (below 15%)