

THE SMALL ENTERPRISE FOUNDATION

(An association incorporated under Section 21 of the  
Companies Act)  
(Registration number 1991/034850/08)  
MANAGEMENT REVIEW

30 JUNE 2001

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The Small Enterprise Foundation, SEF, is a non-profit, non-government organisation dedicated to ending poverty. The organisation was registered in July 1991 and disbursed its first loans in January 1992. The following is a summary of performance:

Indicator	30 June 2001	30 June 2000
Number of loans outstanding	12 247	11 214
% Women clients	98%	97%
Value of loans outstanding (principal)	R7.38 million <sup>1</sup>	R8.71 million
Current average loan size disbursed	R1 149	R1 275
Number of loans disbursed since inception	72 188	52 845
Amount disbursed since inception	R70.2 million	R50.0 million
Bad debt rate	2.66 %	0.04 %
Portfolio at risk > 30 days	1.49 %	0.43 %
Re-scheduled loans (due to illness)	R86 198	R58 945
Death write-offs	R41 846	R40 177
Total Savings as held by clients	R2.24 million	R2.24 million
Total staff	94	98
Total operations staff	79	86
Head office, development & training staff	15	12
Clients per loan officer	231	184
Operational self sufficiency <sup>2</sup>	68 %	64 %
Financial self sufficiency <sup>3</sup>	65 %	65 %

<sup>1</sup> At the close of the financial year the Rand/US\$ exchange rate stood at R8.03 = US\$1.00

<sup>2</sup> Operational self sufficiency = Loan interest income / (total operating costs + loan loss provision)

<sup>3</sup> Financial self sufficiency = Total income / (total operating costs + total financial costs + loan loss provision)

**Introduction**

The Small Enterprise Foundation is a growing development organization

**Values**

We believe in:

Respect for all

Having positive impact on the lives of our stakeholders

Striving for operational efficiency and self-sufficiency

**Mission**

To work aggressively towards the elimination of poverty by reaching the poor and very poor with a range of financial services to enable them to realize their potential

**Vision**

A world free of poverty

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### Background

As the above statements indicate the aim of SEF (The Small Enterprise Foundation) is to strive for the elimination of poverty by working with the very poor in a sustainable manner. The principle methodology used is group-based microcredit, modelled very much after the approach of the Grameen Bank. In group-based lending personal guarantees amongst a small, five person, group replaces the conventional lending requirement for collateral.

Loans are for enterprise only, with a series of checks being in place to ensure that loans are not diverted for other purposes. Since inception SEF has disbursed 72,000 loans to the value of R70 million (US\$8,7 million). SEF currently serves 12,247 poor clients.

While SEF may not collect savings it facilitates regular savings through the existing Post Office network. Total client savings as held in group accounts at the Post Office amounts to R2,2 million (US\$278,000).

Within SEF there are two programmes. The original one, MCP, the Micro-credit Programme, serves existing micro-enterprises and currently has 8,575 active clients. The second programme, which was started in 1996, is TCP, the Tšhomisano Credit Programme<sup>4</sup>, which focuses exclusively on those households with an income approximately equivalent to that of the poorest 30% in the province in which SEF works.<sup>5</sup> TCP uses a targeting methodology, Participatory Wealth Ranking, to identify the poorest households and has developed a range of strategies to ensure positive impact when working with the poorest. At year-end TCP had 3,672 active clients.

SEF has been particularly dedicated to not only building an efficient microfinance programme but it has very specifically focussed on the very difficult task of identifying the very poor and ensuring that it has positive impact with this target group. The organisation's poverty targeting approach is regarded as a pioneer effort in the microcredit field. The organisation is frequently consulted on this work and has been asked to train others in this approach on various occasions, including at the regional Microcredit Summit Campaign conferences in Zimbabwe, India and Mexico.

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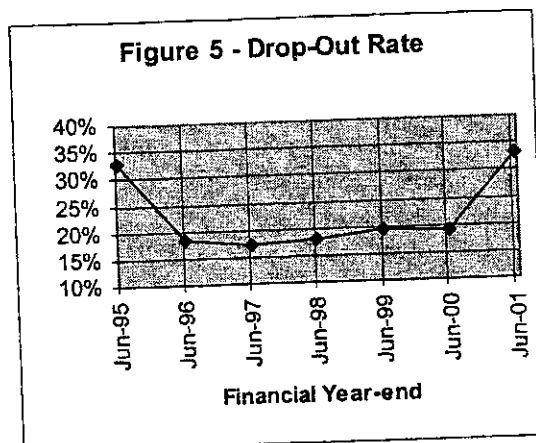
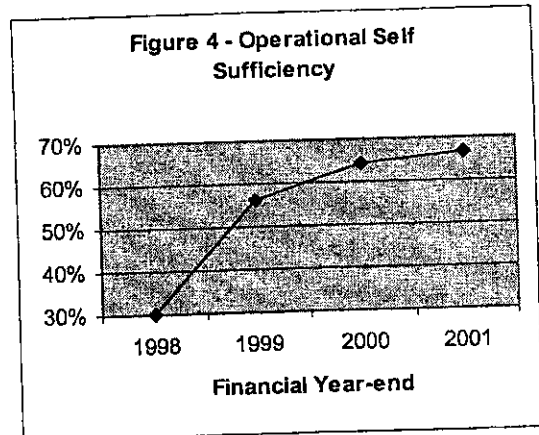
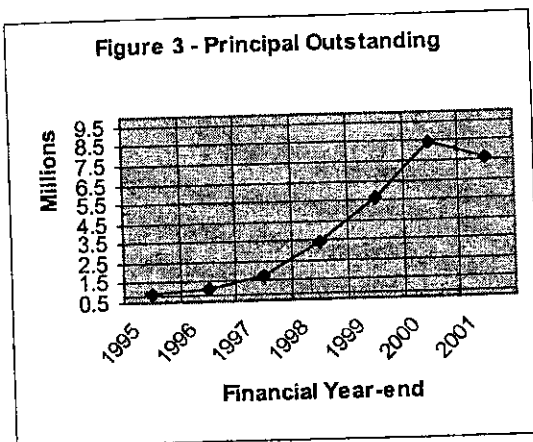
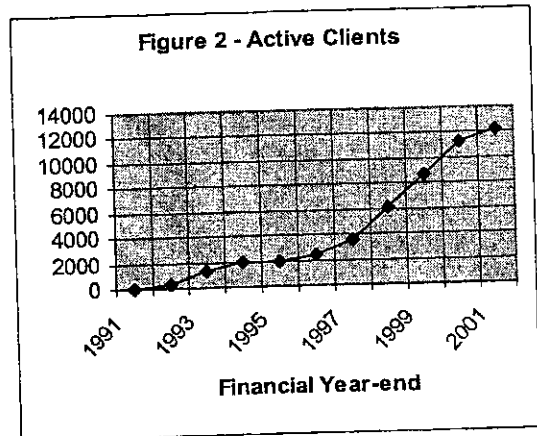
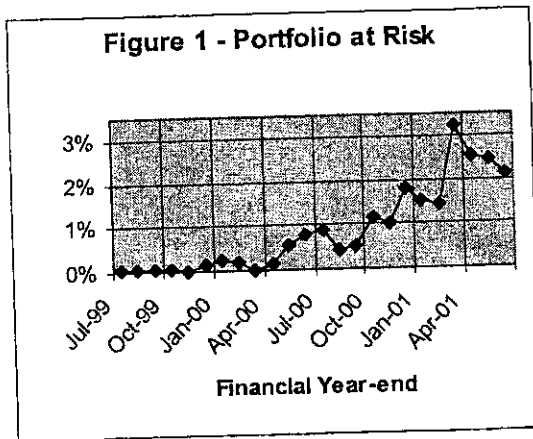
<sup>4</sup> Tšhomisano is the Northern Sotho word meaning "Working together".

<sup>5</sup> The "household subsistence" level is used as the poverty line. Currently this stands at R920 (US\$115) per family of five per month. 40% of households in the Northern Province live below half this line.

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**A Challenging Year**

The past financial year has probably been the most challenging that SEF has experienced in its ten year history. The following graphs illustrate this:



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**A Challenging Year (continued)**

From the above it can be seen that:

- whereas the organisation had virtually no arrears – in fact cumulative write-off from inception in 1992 to June 2000 amounted to only R4 162 – the percentage of the portfolio with arrears in excess of 30 days increased from 0.43% in June 2000 to a high of 3.2% in March 2001;
- whereas the number of active clients had been growing steadily at a rate of between 30% and 70% per annum since the 1997 financial year, the number of active clients only increased by 9% over the past 12 months, considerably below a budgeted growth of 28%;
- whereas the past four financial years saw the principal outstanding growing by a minimum of 48% per year the past year saw this factor falling by 11% versus a targeted increase of 31%;
- whereas operational self-sufficiency improved to 68% for the year this was only a marginal improvement of 4% over the June 2000 figure of 64%, the organisation had budgeted to attain 75% self-sufficiency by June 2001;
- the drop-out rate, defined as the percentage of clients who complete their loans and do not return for a further loan, has deteriorated significantly from reasonably stable levels below 20% to the current 33%.

More than anything else the causes of the above setbacks can be traced back to the organisation's push for growth and self-sufficiency. The pursuance of these goals revealed weaknesses in supervision. A number of corrective measures have been put in place. These include:

**1. Corrective measure with regard to poor performance**

In the past the organisation had not acted with sufficient purpose where staff performed poorly. This year, after a suitable warning period, where stress was put on all staff having to perform well and achieve their targets, firm corrective measures were taken against staff members, including managers, where necessary. During the financial year 15 staff were either dismissed for poor performance or resigned pending disciplinary action for poor performance.

As regrettable as it has been to have had to take this action it has also clearly been vital for SEF to ensure that it is an efficient organisation that is able to attain its goals. This firm action has now ushered in a new culture of performance and accountability within the organisation.

**2. Restructuring of Zones and Branches**

In the MCP zone we were experimenting with branches with a staffing of eight Field Workers, a Branch Manager and a Senior Field Worker, who was to act as an assistant to the Branch Manager.

**A Challenging Year (continued)**

**2. Restructuring of Zones and Branches (continued)**

During the year it became clear that this structure was not working, essentially as Branch Managers were not able to effectively utilise their Senior Field Workers and so their span of control became too great. The result was to move to branches of six Field Workers and a Branch Manager. The position of Senior Field Worker was done away with.

Both zones, MCP and TCP, consisted of five branches managed by a Zonal Manager. It became clear that these zones were geographically too large for one manager to control. Hence it was decided to reduce the standard zone size to three branches.

These changes were implemented in May and June 2001. The two zones were divided into three zones of three branches and one zone with just one branch. Where branches had more than six Field Workers or included a Senior Field Worker these staff were redeployed to fill vacancies in other branches.

We are confident that that this move to smaller more focussed units will see considerable improvement in management control and support for BMs and Field Workers.

**3. Implementation of a more comprehensive Performance Management System**

While SEF has for years been managed through measuring performance against budgets the implementation of this new Performance Management System brings together existing performance components in a more comprehensive way. An important feature is a focus on detailed performance contracts and formal reviews against contract on a monthly basis. The systems also bring together performance standards in a far more thorough manner than was previously the case.

**4. An overhaul of the field staff Incentive Scheme**

In January 1999 the existing incentive scheme in MCP was changed to one which rewarded field staff in line with their number of groups in arrears and in proportion to the principal outstanding of the loan book which they managed. This was motivated by a need to increase income, in pursuit of sustainability, and was meant to encourage staff to look to increasing their portfolios by providing their strongest clients with larger loans. The intention was to provide larger loans to the top-end clients i.e. those who were more than capable of handling more money, and who were in fact constantly demanding access to larger loans. The result, however, was that a significant percentage of field staff, not all, pushed loan sizes with all of their clients.

**A Challenging Year (continued)**

**4. An overhaul of the field staff Incentive Scheme (continued)**

Naturally this was disastrous with many clients taking more than they could handle and soon finding it difficult to keep up their loan repayments. This had a serious knock-on effect as field staff insisted that groups make up the payments for fellow members who were struggling to pay their full instalments. In time this led to many clients preferring to leave the program than face the risk of again having to pay for someone else. This negative effect, members leaving as they had to pay for defaulters accounts for the increase in drop-out rate and is still impacting negatively on the programme.

The contribution of the incentive scheme in "encouraging" poor loan decisions was recognised and so this system has been thoroughly redesigned. A new system, based on the number of groups in arrears and the number of active groups, was introduced with effect from 1 July 2001.

**5. Significant changes to the loan size policy**

Internal studies clearly identified imprudent loan decisions, driven by the need to grow loan sizes for the attainment of sustainability, as a major cause for underperformance. To tighten up on this new loan policies were introduced which link increases in loan size to the growth of clients' businesses. This will lead to slower growth in loan sizes but is designed to assist both staff and clients to make sound loan decisions.

A policy like this also has another positive side effect as it encourages and rewards clients for growing their businesses, for keeping profits in the business.

**6. Revision of SEF's Mission Statement**

In the previous financial year the decision was taken to merge SEF's two methodologies i.e. the poverty focus of TCP and the general microcredit focus of MCP. In pursuance of this objective and in response to the many changes that the organisation was undergoing it was decided to rework the mission and vision statements. This was done through a series of participative workshops with all staff and SEF's directors. The statements at the beginning of this report are the result of this process.

**7. Increase in Interest rate**

The poor performance of the last year meant that SEF fell significantly behind its growth targets. On top of this the average loan sizes fell to a far lower level than had been anticipated. Subsequent to the end of the financial year a full analysis was done of expected financial performance over the coming years. This analysis demonstrated that SEF could not break even with its current interest rate.

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A Challenging Year (continued)

7. Increase in Interest rate (continued)

Earlier in the year SEF's Development Department had conducted a loan product survey with clients. This study looked at what product attributes the clients identified as the most important and was used as a basis for improving the product design. A by-product of the study was an understanding of clients' perceptions of SEF's existing interest rate. Clients consistently did not raise the interest rate as an issue, thus indicating that it was not having a major impact on them.

It should be noted that despite the above findings indicating clients' perceptions of the interest rate many members of SEF's senior management team and board of directors were most reluctant to increase the interest rate. A primary reason for this reluctance was the concern that we were pushing our inefficiencies on to our clients, the very poor.

Faced with the analysis that showed that SEF could not break-even the board had no choice but to approve an increase in the rate. For example, whereas the rate for the most typical loan in TCP, a six month loan, was 20% on the initial loan amount this will be increased to 23%. These rate changes will only take effect later in the year.

Financial analysis shows that on condition that the organisation is able to bring its drop-out rate down to acceptable levels of 18% to 20%, this higher interest rate will enable SEF to breakeven before December 2004.

**Environmental Factors**

The previous paragraphs have outlined the steps taken to correct underperformance. At the same time it is recognised that there may be a number of external factors that have also contributed to increasing arrears and drop-outs. While we hesitate to attribute blame for disappointing performance to such factors and while we have not conducted sufficient research to know their significance, we have nevertheless noted the following:

- In recent years SEF has experienced an increase in competition, especially with the arrival of Provident Financial, a door-to-door micro-loan company. Provident has grown from zero to roughly 34,000 clients, all in the Northern Province, within the last three years.
- Increased competition for our clients themselves from two sources:
  - Formal retailers opening up operations in remote rural villages; and
  - Local commercial farmers not only selling directly to our clients, as they always have, but now also marketing their produce directly to the same rural communities.

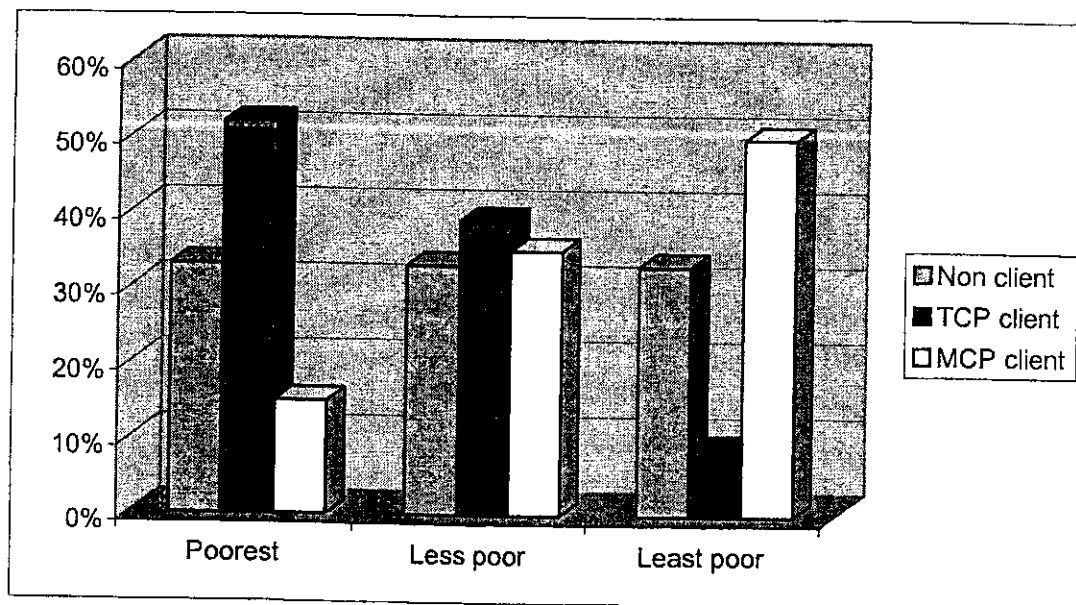
### CGAP Poverty Assessment

From its inception the mission of SEF has been to reach the poor and to provide them with resources to enable them to increase their income through self-employment and thereby move out of poverty. In the early years we did not understand well that South Africa's poor were not at all a homogeneous group in terms of their daily experience of poverty. (In hindsight, considering that 60% of the population of the region in which SEF works live below the poverty line, this seems to have been a ridiculous assumption.) By 1994 we began to realise that we were not reaching a sufficient number of the very poor in the villages in which we worked. This led to the launching of TCP that was entirely separate from MCP with different staff working in entirely different villages and with a very specific mission of targeting very poor households.

When we say that we were not reaching a sufficient number of very poor households in 1994 this was determined through on-the-ground observation. Our own observations were backed up by similar observations by an international evaluation team that worked with SEF in late 1994. Nevertheless neither ourselves nor the evaluation team had at its disposal a rigorous tool to determine the poverty profile of SEF's clients versus the general population.

In 1999-2000 CGAP<sup>6</sup> designed and tested a poverty assessment tool. This tool is meant for use by donors and governments where they wish to better understand the poverty outreach of a particular programme. It is an assessment tool not a targeting tool.

SEF was fortunate in being able to invite CGAP to do a further field test of the tool at SEF. The results of that study are illustrated in the following graph.



<sup>6</sup> The Consultative Group to Assist the Poorest, CGAP, is a joint multilateral and bilateral forum housed at the World Bank. It was created to bring coherence to the activities of international donors in microfinance and to serve as a centre of excellence for the growth of a viable microfinance industry, with a specific focus on reaching the very poor (defined as those living below half their national poverty line).

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**CGAP Poverty Assessment (continued)**

Quoting from the assessment report:

“There is a striking contrast between the poverty profiles of these two programmes. The clients in the poverty targeted programme [TCP] are overwhelmingly situated in the poorest category, while the majority of clients in the non-poverty targeted scheme [MCP] are found in the least poor category. The majority of TCP clients (52 %) are located in the poorest category, as opposed to 9% in the least poor category. The remaining 39% are in the less poor category. In comparison, 15% of MCP clients fell in the poorest category, and 35% are in the less poor group with 50% in the least poor group. The TCP poverty profiles indicate that SEF is reaching the poorest people and point to the success of the targeting mechanism (PWR) in encouraging poorer people to join the programme. MCP in contrast appears to be reaching people who are better off.”

We are most grateful to CGAP, and in particular to Syed Hashemi, for carrying out this test at SEF. The results show through a rigorous, statistical methodology that SEF's decision to launch its poverty focussed programme was indeed very necessary given the organisation's mission.

**Imp-Act – Improving the Impact of Microfinance on Poverty**

The Ford Foundation together with three British universities, Sussex, Bath and Sheffield, have led the formation of an action research programme, Imp-Act, which has the primary objective of improving the quality of microfinance services and the impact of these on poverty. This is being done through strengthening the development of impact assessment systems. SEF is proud to have been selected as one of the organisations that will work with Imp-Act on this agenda. This participation will enable SEF to strengthen its impact monitoring systems that provide vital information that is needed for the organisation to constantly improve its methodologies and thereby achieve its mission.

**HIV/AIDS and Microfinance pilot project**

In recent years some evidence has emerged from countries with a high AIDS prevalence that households in poor communities which are engaged in micro-enterprise and which work with a microfinance programme, are better able to cope with the effects of AIDS. Furthermore it has been noted that such households also have a lower AIDS prevalence than others.

In attempting to explain the above it is seen that, amongst other things, AIDS puts great financial stress on poor households. This includes expenditure on medical services, burial expenses and the loss of income due to illness or death. Households with an enterprise and access to microcredit and microsavings services are better able to cope with these effects through access to savings and loans to meet sudden cash demands as well as a reliance on continued income from an enterprise – family members are frequently able to continue running an enterprise even if the main entrepreneur is ill.