The role of financial literacy on the growth outreach of South African microfinance institutions

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ABSTRACT

With the increased emphasis on financial inclusion by developing countries, the emergence, impact and sustainability of microfinance institutions (MFIs) is considered topical. This paper assesses the influence that financial literacy has on the growth outreach of MFIs, from a South African context. Using an online questionnaire, we collected data from 44 respondents, representing various MFIs in Limpopo, South Africa. In addition, interviews were conducted with four subjects from the regulatory body, MFSA. We applied panel data fixed effects regression, with binary logit component to measure relationships and effects of the variables under study. According to the results, there was strong consensus that financial literacy of MFI clients, proxied by loan portfolio education, and financial budgeting and investment training offered to MFI clients, improves overall MFI growth outreach, and MFI sustainability in the long run. The contribution of this paper is that, since microfinance institutions by mandate, pursue socio-economic goals, many are not geared towards being financially sustainable. However, with the drying up of grants by mandate, pursue socio-economic goals, many are not geared towards being financially sustainable. Hence, it is important for them to implement alternative measures to ensure that their borrowers meet their repayment obligations timeously, hence improving institutional growth and sustainability.

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INTRODUCTION

The genesis of the microfinance concept arose from the lack of affordable and reliable financial options for the small business investment (Malhotra, 1995). In its basic form, microfinancing is the process of lending short to medium term unsecured loans, to small vulnerable players in society, with the intention to boost productivity and eradicate poverty (Njeru, et al., 2017). Microfinance institutions thus exist to promote financial inclusion through financial coverage for micro, small and other vulnerable groups such as women, with no collateral requirement (Baumann, 2001).

According to the World Bank (2019), the microfinance industry grew significantly between 2000 and 2009. It has been averred that developed nations manage leverage, and ensure that all clients and MFIs are equipped in terms of financial literacy for financial sustainability. The World Bank (2019) also reported that in many developed countries across the globe, the microfinance industry architecture has evolved over the years. Whereas MFIs in many Latin American countries have made progress in the transition to self-sufficiency funding, NGO MFIs still dominate in the Middle East, North Africa, Eastern Europe and Central Asia (Angaine and Waari, 2014). As such, funding for microfinance institutions is no longer borne by donors alone, but regulatory systems have also been changing, thereby transforming MFIs into regulated institutions with return seeking investors (Assefa, 2017).

Measuring the cost of sustaining the microfinance, 67% of the growth contribution was attributed to leverage and financial literacy among the funded MSMEs. In most developing countries such as India, South Africa and Zimbabwe, MFIs target the MSME sector, and vulnerable population who cannot gain access from the mainstream banking system (Akoijam, 2012). Microfinance has thus been seen as a positive tool for spurring sustainable growth in productive economic sectors such as MSMEs, while contributing...
towards other socio-economic activities and government expenditure. One of the most common characteristics of microfinance has been that of outreach growth, which has remained relatively low for South Africa. This is evidenced by that, in South Africa, 30% of small businesses are making efforts to access microfinance products and services, although information paucity is constrained due to low financial literacy rates among the communities (Demirguc, 2018). In addition, South Africa has not realised significant MFI growth, as close to 75% of local MFIs are not reaching the rural vulnerable, farmers, women, youths, and small businesses, who form the bulk of their target market. It is these statistics which cause concern to scholars and policy makers alike, and thus there is a need to undertake an empirical study to unearth why the majority of MFIs are unable to attain the targeted growth outreach despite a thriving market for microfinance products and services.

Although Huntra and Elvis (2019) affirmed the positive developments on addressing MFI growth in South Africa through subsidies, the growth rate of MFIs has been declining exponentially. Little is known about financial inclusion and financial literacy, to boost the growth of MFIs in the South African context, based on current scholarly literature. Based on such arguments, the current research sought to assess the influence of financial literacy on the sustainable growth outreach of South African microfinance institutions, an acknowledgement of the importance of MFIs in achieving some objectives of the SDGs that seek to improve financial inclusion in developing countries.

South Africa has been microfinancing from as early as 2000 in order to eradicate poverty in Southern African countries (Kimathi et al., 2015). However, despite such vision, the microfinance institutions are failing to satisfy the targeted market. The main microfinance institutions in South Africa which are not growing significantly fall in different categories, namely the Non-Governmental Organizations, Investment, Savings and Lending Institutions.

According to Diar et al. (2017), clients lacking financial knowledge on investment end up borrowed funds and divert them from investment to consumption. This will result in failure to pay back the loan. Lusardi and Mitchell (2014) defined financial literacy as the knowledge on saving, investment and planning to asset in making financial decisions. Lack of financial literacy results in poor financial decisions and consistency borrowing of unplanned funds. Most of these individuals end up missing their payments resulting in negative impacts on their credit profile. Financial literacy is one of the major influencing factors to consider towards accessing financial services (Kou et al., 2021). Individuals lacking financial literacy are viewed as high-risk clients, and are thus mostly charged higher interest rates. This factor is worth examining as it affects the growth of MFIs, and poor knowledge of finance, which then affects MFIs’ sustainability. As such, we seek to assess the impact of financial literacy of clients, on the growth outreach of MFIs in the Limpopo Province of South Africa, with a view to add not only to the scholarly literature, but also make recommendations to the microfinance sector as to how they can ensure their sustainability through growth outreach, while also empowering their clients. To achieve our goal, we will use both online questionnaires and interviews to collect data from our target sample. For the purposes of data analysis, we will apply a logit regression model.

The remainder of this paper is organized as follows: the literature review presents a critical analysis of the existing theoretical and empirical studies on the subject matter. Thereafter, we outline the research methodology adopted to address the research question. The results are presented and discussed, followed by the conclusion which recaps the key findings, makes recommendations, and puts forth proposals for future studies.

**Literature Review**

This study is underpinned by the theory of financial literacy. Josh and Antony (1970), cited in Malhotra (1995), averred that financial literacy is a critical factor that hinders MFI growth outreach and financial sustainability of financial and rural financing institutions. The critical assumptions of this theory are that irrational people do not adopt financing options. The more financial organizations educate societies on financial management and financial effectiveness, the higher the demand for the finance, as triggered through financial literacy. In that case, financial institutions relatively grow, *ceteris paribus*, in terms of growth outreach, impact and financial sustainability.

MFI growth outreach and performance can be measured in a number of ways, including in terms of return on revenue, portfolio size of loans issued to small business, financial self-sustainability, leverage and impact (Mohsin et al., 2018). Furthermore, MFI growth performance in developing countries such as Nigeria was rated as low around 30% of the total assets liquidated in issuing loan portfolios. On the other hand, in terms of the growth outreach performance, Morocco and Netherlands covered almost 90% of the total targeted small businesses such as artisanal miners, horticultural intensive farming and entrepreneurial business activities.

Zeller and Meyer (2018) suggested that the growth of microfinance institutions can be measured in the form of outreach. Outreach growth is positively affected by financial literacy in the sense that the more people are educated on the products, services and portfolios available from MFIs, the higher the likelihood of microfinance reach and uptake by the poor and small businesses. As such, financial literacy is key in poverty alleviation, as well as the adoption of financial services provided by MFIs.

Ashta and Fall (2012) implored that outreach has a significant contribution towards overall performance and growth of MFIs. Similarly, Alemayehu and Lemma (2014) argued that by increasing the outreach of MFIs, many underdeveloped countries have reduced poverty. The donor support has a crucial role in customer outreach, as it increases the operating cost which in turn affects the efficiency of MFIs (Githinji, 2008).
Clients usually use the borrowed funds for consumption instead of investing to enable them to repay the borrowed funds, and this is due to a lack of financial knowledge (Diar et al., 2017). For MFIs to achieve growth the clients should be able to repay the loans hence the need of MFIs to give financial advice to its customers. According to Mulunga (2010), MFIs fail to manage the business resulting in liquidity problems. This therefore implies that the growth and outreach of MFIs is determined by the skills and qualifications of the workforce. To achieve growth there is a need to educate both internal and external stakeholders of MFIs.

According to the World Bank’s 2015 Global Findex Report, South Africa recorded the highest rate of borrowing from the period of 2013 to 2014. The constant borrowing is a result of lack of financial literacy, an assertion supported by Wang et al. (2020), with the view that poor knowledge of finance increases the chances of making unsecured and personal loans. A study carried out in 2017 by the Financial Sector Conduct Authority on South Africa found that there is need for South Africa adult population to improve their financial literacy. Financial literacy is one of the major influencing factors to consider towards accessing financial services, according to Kou et al (2021). Individuals lacking financial literacy are viewed as high-risk clients, and they are mostly charged high interest rates. The charging of high interest results in forcing microfinance clients to resort to borrow from unregulated money lenders known as loan sharks, or Mashonisa in South Africa. This will negatively affect the growth of MFIs, hence there is a need to educate microfinance clients about financial knowledge and literacy.

This study hence aims to add to the available scholarly literature on the factors that give rise to microfinance success by examining the role of financial literacy on the growth outreach of microfinance institutions in South Africa.

**Research Methodology**

**Research design**

In order to address the research objective of this study, we adopted a qualitative approach since the data gathered was in qualitative categorical form which was measured using nominal and ordinal scales. The researcher gathered data on qualitative categorical independent variables such as literacy, and technology leverage, financial and operational self-sufficiency which were used to predict a categorical dependent variable on the sustainability of MFIs in South Africa. Therefore, a logit regression model, which is qualitative in nature, was deemed most appropriate. Raul (2015) further points out that if the researcher seeks to generalize findings based on a sample, the most appropriate approach is a qualitative one. Although this study is geographically premised on MFIs in the Limpopo Province of South Africa, its findings can be generalised to other provinces in the country, and possibly extended to similar developing economies.

**Population and sample size**

The target population for this study constituted of managers of microfinance institutions (MFI) registered under the Micro Financiers in South Africa (MFSA), specifically in the Limpopo Province of South Africa. Since the research is delimited to Limpopo Province, the MFSA (2020) report showed that there were approximately 148 MFIs operating in the province, which formed the population for the study. For robustness purposes, we also included four managers from the MFSA regulatory body, bringing the total population of 152 subjects. From this population, we were able to draw our sample for the study. The researchers applied stratified sampling, and adopted a 50% random proportionate sampling technique for this study. Firstly, the researcher grouped participants into two main strata, on the basis of operational level. The first stratum constituted of managers working in the identified MFIs in Limpopo Province, while the second stratum was comprised of managers representing the umbrella body, MFSA. Furthermore, the researchers adopted a 30% sample size per stratum, based on Sinkey’s (2005) recommendation to reduce bias in the sampling process. As a result, the eventual sample size was 48 subjects, being 44 from the MFIs and all 4 managers from the MFSA regulatory body.

**Data collection and analysis**

The study used online questionnaires, as well as online interviews to gather the required primary data. The questionnaire was a semi-structured tool which allowed the collection of responses using both open-ended and close-ended questions. Questionnaires were administered to the MFI managers, as they constituted the larger number of respondents, while online interviews were conducted with the four representatives of MFSA. The choice of administering the data collection instruments online was informed by the then-prevailing COVID-19 pandemic which prohibited the researchers from physically interacting with any of the potential respondents.

With regards to data analysis, quantitative analysis was also undertaken using STATA Version 15 to run the panel data fixed effects regression, with binary logistic component to measure relationships and effects of the variables under study.

**Reliability, validity and ethical considerations**

The study conducted content validity and reliability testing, prior to final data collection. The researchers used the Cronbach alpha test for reliability, and varimax factor analysis to assess validity of the research instruments. Ethics clearance was applied for, and approval was received from the relevant committee.
Findings and Discussion

Response rate

The researchers administered 44 online questionnaires, of which 40 were successfully returned, thereby registering a 91.91% response rate. In addition, the researchers administered four online interviews, and all four identified subjects participated, giving a 100% response rate. The combined overall instrument response rate was therefore 91.67%.

Reliability testing

Our Cronbach’s Alpha Test for Reliability of the research instrument yielded the following results:

<table>
<thead>
<tr>
<th>Table 1: Reliability Test Results</th>
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<tbody>
<tr>
<td><strong>Average inter-item covariance:</strong></td>
</tr>
<tr>
<td><strong>Number of items in the scale:</strong></td>
</tr>
<tr>
<td><strong>Scale reliability coefficient:</strong></td>
</tr>
</tbody>
</table>

**Source:** Authors’ own computations

The reliability test returned a Cronbach’s alpha coefficient value of 0.7408 (74%), which is within the desired threshold, in order for the questionnaire to achieve consistency and objectivity. According to Ralws (2016), a Cronbach alpha coefficient value of at least 0.7 is required to pass the reliability test. As such, the questionnaire administered for the purposes of this study was a reliable instrument.

Empirical Findings

The influence of financial literacy on the growth outreach of MFIs

Our objective sought to assess the influence of financial literacy towards the growth outreach of South African microfinance institutions. Financial literacy in this instance was measured using various proxies including loan portfolio education, and financial budgeting and investment training that MFIs offered to their clients, on-the-job training for MFI staff, and business skills training for borrowing clients.

The results showed that the majority (80%) of the respondents strongly agreed that financial literacy, proxied by loan portfolio education, and financial budgeting and investment training that MFIs offered to their clients, significantly improves the growth outreach and impact of MFIs. Financial budgeting and investment training is worth considering as a tool since it is critical in ensuring the effective use of borrowed funds. With effective use of borrowed funds, MFIs are able to achieve growth and sustainability, as their clients will be able to repay borrowed funds, due to higher financial literacy levels. This will also improve the overall loan portfolio quality of MFIs. In addition, there was general consensus (75%) amongst the respondents on the importance of on-the-job training for MFI staff, whose benefit would also extend to the growth outreach targets by MFIs. Regular on-the-job training is less costly from a human capital perspective, and can serve to increase the workers’ experience and empower them to better assist clients.

Interestingly, respondents indicated that attempts to offer business skills training, as a form of financial literacy, had a negligible and almost minimal impact on outreach growth of MFIs. In order to statistically confirm the influence of financial literacy on the growth outreach of MFIs, we ran regression analysis, and the statistical values are presented below:

<table>
<thead>
<tr>
<th>Table 2: Influence of financial literacy on MFI growth outreach</th>
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</thead>
<tbody>
<tr>
<td><strong>Dependent Variable (MFI growth outreach)</strong></td>
</tr>
<tr>
<td>Loan portfolio education</td>
</tr>
<tr>
<td>Financial, budgeting and investment training</td>
</tr>
<tr>
<td>On-the-job-training</td>
</tr>
<tr>
<td>Business skills</td>
</tr>
<tr>
<td>Number of Obs</td>
</tr>
<tr>
<td>Number of Groups</td>
</tr>
<tr>
<td>Chi-2 (Prob&gt;ch2)</td>
</tr>
</tbody>
</table>

**NB:** Robust standard errors in parenthesis; (***), (**), (*) indicates the level of significance at 1%, 5% and 10%, respectively

**Source:** Authors’ own computations
The findings in the table above show a beta coefficient value of 0.05. This is indicative that the growth outreach of MFIs in South Africa is positively and significantly influenced by financial literacy in the form of loan portfolio education offered to clients by MFIs. In addition, the results show that the outreach growth of MFIs in South Africa is to a large extent, positively influenced by financial literacy in the form of financial, budgeting and investment trainings offered to clients by MFIs, as reflected by the beta coefficient of 0.50. Moreover, we found that on-the-job training of MFI staff yields a positive impact on the growth outreach of MFIs in South Africa, as reflected by the beta coefficient of 0.63, and a 1% level of statistical significance. On the other hand, our results confirmed that the growth outreach of MFIs in South Africa is negatively affected by financial business skills offered to clients by MFIs. The overall model has confirmed that financial literacy has a highly positive impact on the growth outreach of MFIs in Limpopo Province, South Africa.

In addition to administering the online questionnaire, interviews were conducted with MFSA representatives, primarily as a robustness check. The findings from the interviewed MFSA personnel with regards to the influence of financial literacy on growth outreach have shown that:

“The education we offer to clients has a positive effect on the growth of our MFIs, although clients do not seem to appreciate the business skills we are trying to impart to them in order to reduce bad debts”.

In a follow-up question which sought to confirm if there are other training opportunities offered to MFIs directly by the MFI regulatory body, Respondent T from the MFSA highlighted that:

“We offer-on-the job training, especially to our members. It is through such diversified training that members are able to recruit clients. To mention a few...we have offered them training on negotiation skills, and marketing”.

On the downside, these findings highlighted that although efforts are being made from both a supply and demand side, to clients and to MFI staff, to increase growth outreach through various training, it appears that MFI clients do not really appreciate the training on business skills which is deemed key for managing bad debts and loan performance.

Our findings are in line with Zeller and Meyer (2018) who postulated that the growth of microfinance can be measured in terms of outreach. Such outreach growth is positively affected by financial literacy in that, the more people are educated on the various products, services and portfolios available under MFIs, the more microfinance reaches the poor and small businesses. Arsysad (2015) also posits that customer outreach was considered as a key strategy in the MFI industry, especially in the southern eastern part of Africa. Kenya and Ghana experienced an increase in outreach growth by 15%, which was attributed from financial literacy. This suggests that the more the customers are educated in terms of the microfinancing, the more they adopt and acquire the loan portfolios which is key for the outreach growth. Volschenk (2002) also found that skilled and rational clients borrow, while irrational customers do not participate in microfinancing. Contrary to this argument, Ashta and Fall (2012) asserted that financial political instability also affects financial literacy progress which in turn lowers microfinance institutions’ growth. In addition, fraudulent activities have also been noted in microfinance institutions, which is something observed through bad debts under South African microfinance.

Conclusions

We conclude this paper by acknowledging the emergence of the significant role played by financial literacy in enhancing the growth outreach of microfinance institutions. By adopting more financially responsible lending techniques, coupled with post-loan approval support, MFIs can strengthen their growth outreach, and by extension their sustainability in both the short and long term. Based on the findings of this study, we advance some recommendations. In order to improve growth through financial literacy, the MFIs must conduct a participatory needs’ assessment to gather information on the training requirements of their clients from the clients themselves, as a motivational tool to acquire financial literacy. Further, the MFIs must continue to invest in financial literacy training for both clients and staff, guided by the environmental scanning, which can identify prevailing and potential risks in the business environment which need to be managed to ensure effective lending and growth of MFIs.

Although there are several definitions and measures of financial literacy, our paper focused only on four variables to proxy financial literacy. Future studies could consider developing a composite index which comprehensively captures all the financial literacy variables in a single index. Also, our study only considered one province in South Africa, and being a fairly rural and less developed one in the country, we suggest that other scholars extend the study and conduct a comparative analysis to determine whether the attitude of clients as measured by the different financial literacy proxies, are similar or differ across provinces. This would greatly assist, not only the respective MFIs, but their regulatory body as well to formulate policies which will protect the borrowing client, without hindering the survival and sustainability of the MFIs.

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Data Availability Statement: The data presented in this study are available on request from the corresponding author. The data are not publicly available due to institutional privacy restrictions and the POPI Act of South Africa.

Conflicts of Interest: The authors declare no conflict of interest.

References


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