fsdafrica

Credit on the Cusp:

Strengthening credit markets for upward mobility in Africa

Executive Summary

Building healthy credit markets in Africa by 2026

African economies are currently undergoing dramatic changes, not the least of which is a changing consumer base. Absolute poverty is reducing as a new class of consumer—the cusp group—emerges. This group, now accounting for 23% of sub-Saharan Africa's population, gets by on $2-$5 per day, are active earners and are straddling the formal and informal worlds. For this group, healthy credit markets could expand opportunity and enable upward mobility, helping to build a true middle class. But, for this to happen, credit needs to expand and to do so in healthy ways. After taking a deep look at the experiences of cusp group borrowers and the lenders who serve them in Ghana, Kenya, and South Africa, we conclude that donors and policymakers ought to take an active role in enabling cusper credit markets to open in a healthy way, seizing a once in a generation opportunity to leverage financial markets for upward mobility.

Across the entire sub-Saharan Africa region:

- Regulators, donors, and lenders in all markets across the region should take note of the shifting demographics across the region and **the key importance of the cusp group** as a market, political force, and as the future middle class in countries that create the right conditions for them and their children to thrive.
- Regulators in all markets should improve their **credit market monitoring** by refining reporting requirements for lenders, helping regulators better track market developments in finer grained detail in terms of product type and market segment.

In markets where cusper credit remains constrained, but could open very quickly on new digital channels:

- Regulators should **encourage the expansion of a diverse range of credit offerings over electronic channels** as a means of expanding access at significantly lower cost and potentially at lower risk than is currently possible, especially in places credit information sharing mechanisms lag behind and only a small share of cuspers have formal salaries.
- Donors should support experimentation with new kinds of P2P lending, for example, an **E-Bay for person-to-person lending**, helping open the cusper credit market in ways that traditional banks have not.
- As new electronic lending takes hold, regulators and banks should introduce **machine learning e-arbitration** of small disputes, enabling efficient and smart management of disagreements in a quickly-growing market.
- Regulators ought to invest in **digital identification and digital asset registries.** Outdated and largely manual systems are inhibiting market development, rendering effective credit information sharing impossible in some markets, making it difficult to turn assets into collateral, and exposing vulnerable consumers to fraud in some of their largest investments. Blockchain technology and ubiquitous mobile phone utilization opens new opportunities for registries that are clear, consistent, and available efficiently to all.

Where credit access is already very open and indebtedness begins to pose a new kind of threat to cusper welfare:

- Regulators—or even private lenders—could introduce the concept of a **learner's license** for credit, helping borrowers restrict their borrowing in early years while they learn the rules of the road and work towards a longer-term financial future of building assets.
- Regulators should consider new approaches to restraining lender behavior, such as by **capping lender losses allowed**. By setting a limit for allowable losses, regulators would restrict lenders' willingness to simply price for high-risk lending operations, which has encouraged reckless lending has kept interest rates high for all cuspers in South Africa.
- Regulators could also introduce **"Last in, first out"** rules, which would rank lenders' claims on borrowers' incomes in the order in which lenders issued loans. In the event of default, the last lender to give a client a loan—tipping the scales of affordability—would have the lowest priority in terms of repayment, thus encouraging lenders to be disciplined in the issuing of loans to already strained borrowers.
- Donors could support fintech tools that **actively remind borrowers of their own debt service** at the moment of temptation by, for example, lighting up a credit card in red when the balance is approaching a dangerous limit or sending borrowers a warning text message when the balance grows at too quick a pace.

Background

Enthusiasm around the once-popular "Africa Rising" narrative is abating in the face of slower-than-expected growth, macro volatility deriving from continued reliance on raw material exports in many countries, and the reality of persistently high inequality. Even through a period of high growth, we did not see large numbers of people move into the middle class, typically characterized by stable jobs, budgets with space for expenditure beyond pure necessities, and the possession of collateralizeable assets like land, homes, and cars. Instead, we observed a shift from absolute poverty into a "cusp" group of those getting by on about $2-$5/day. They straddle the formal and informal economies, and while they strive for a stable middle class future, they remain vulnerable and largely lacking in meaningful assets. This group is large—including nearly a quarter of Africans today—and politically important. Their successful entry into the middle class—a real engine for sustained growth via domestic markets—is by no means guaranteed.

Credit markets play an important role in shaping that destiny. On a macro-scale, credit facilitates growth, creating new opportunities for cuspers across the region. At a micro level, healthy credit markets can help improve the well-being of cusper families by helping them smooth incomes and expenditures, increase and diversify earnings, and accumulate assets even in the face of economic fluctuations that tend to impact upon them and the classes below them disproportionately. Whether credit is available to cusp borrowers and the nature of its effect on their lives depends on the health of local credit markets, which are changing substantially in the face of rapid urbanization, persistent inequality and informality, technological transformations, and perpetually weak state institutions.

But today, Africa is severely under-lent. Most countries in the region have very low credit to GDP ratios. But the global financial crisis—and the specific experiences of countries with very high consumer debt—remind us that having a healthy credit market isn't just about having enough credit. Big credit markets are not necessarily healthy and can themselves fuel asset bubbles, financial crises, and overindebtedness.

Africa does not just need *more* credit, it needs *better* credit. A healthy credit market simultaneously offers accessible credit at a reasonable cost, robust lenders who strategize to endure, offers diverse forms of credit suiting borrower needs, and has a preponderance of credit that is value adding for consumers and lenders alike.

Given major shifts taking place in African economies, how can donors and policymakers guide credit market development in a way that strengthens the economic well-being of the cusp group over the next 10 years? FSD Africa, which exists to help strengthen financial markets in the region, commissioned this research seeking answers to this question through the experiences of cusp group consumers and the lenders serving them in three distinctive markets: South Africa, Ghana, and Kenya. Dissecting these stories, we begin to question our old "rules" about how to build healthy credit markets and begin to envision new interventions that can help nurture healthy credit markets across the continent.

Faces of cusper credit markets

Our research brought to life clear faces of three very different cusper credit markets:

South Africa is ***"Stuck."*** Consumer lending to cuspers is extensive, aggressive, and highly formalized. There is plenty of money to lend fueled by easy availability of cheap domestic funds, and a competitive, sophisticated finance and retail sector eager to serve them. The ticket into this vibrant borrowing wonderland is the payslip. The formally employed may not earn much, but they earn it regularly and almost certainly through a bank account, where lenders have very high odds of suctioning their payments out before the borrower has a chance to delay a payment or change his mind. Being relatively sure of repayment, lenders are comfortable lending at very high levels of debt service against these formal incomes.

And borrowers—especially when they get their first jobs—take as much of that credit as they are offered. In a society wedded to the ideas of transformation and post-apartheid upward mobility, desire is a powerful force. Immediately after landing a job, South African cuspers hope to transform their lives—and the lives of their families—overnight, quickly over-extending themselves. With large extended families often depending heavily on every one of those coveted formal salaries, borrowers underestimate the demands on their payslip from living expenses, let alone loans. Efficient credit information sharing helps them dig their own holes, as one successful loan inspires many new credit offers by SMS and mail. "Come, borrow here. Buy your dreams: nice clothes, nice furniture, a television, a washing machine." In South Africa, cuspers borrow to display their wealth, to announce to the world that they have arrived.

Borrowers overextend. Salaries are diverted nearly entirely to loan payments, leaving little to live on. The loss of that formal job or the loss of income of a spouse puts tremendous stress on borrowers who find it difficult to bounce back. It's more difficult in South Africa than the other markets for someone to start over with a low-capital trading business. Consumers shop at Shoprite and Game, not the corner kiosk. Self-control seems to set in only after painful and debilitating debt experiences.

One might expect lenders to tighten up to avoid defaults, but they are competing to extend seemingly lucrative loans. African Bank (ABIL) pioneered unsecured lending to the cusp group: they reduced risk by innovating to both (i) efficiently use information to better predict default and (ii) increase the reliability of collectability. They priced for the risk of lending to this emerging, but as yet financially insecure group by charging high interest rates. Eventually, when competition entered and caught up, ABIL competed by offering the same borrowers more credit and over longer periods, risks that are often too heavy to bear for cuspers, whose jobs are uncertain (especially over longer periods) and whose budgets are tight. Bad loans mounted, forcing the bank to be bailed out and restructured.

South Africa now struggles with an extensive indebtedness problem. But, many of the tools that make a credit market work are already in place: suppliers are incentivized to expand their outreach, cost-effective income verification is available for the large formally employed sector, credit information sharing is advanced and mostly effective, and there is a specific regulator watching credit market conduct and monitoring consumer debt. Many ask, what more can be done? Will new affordability regulations make any difference at all? It seems that the market is failing to self-correct. Or, perhaps, the indebtedness problem needs to become even worse before it will begin to get better.

Kenya we call ***"Uncertain."*** In this country where formal financial access has expanded more recently and formal lending has grown slowly, many equate lending with benevolence and tell of the transformative power of a loan that enabled children to fulfill their educational potential and for an entrepreneur to grow and diversify his businesses. Loans have historically been based on collateral and relationships. Those who wanted to borrow would first save for several months with the lender before a credit offer was extended. Though credit information is now shared to some extent, to keep accessing large loans, borrowers tend to stay put with the same bank or microfinance institution.

But that landscape is changing. Mobile-phone only lending based initially on proxy scores determining eligibility for small starter loans has expanded access to many first-time formal borrowers in a very short period. So far, these loans led by Commercial Bank of Africa's (CBA) M-Shwari product, have started very small. But, newer entrants, like Kenya Commercial Bank (KCB), are offering larger starter loans, averaging US$27 for a first-time borrower, up from US$5 on M-Shwari. These short-term loans are often used for convenience purchases and unexpected needs rather than investments. As the loan size grows, but duration stays constant, some borrowers begin to feel pinched. They stop paying, prioritizing the parts of their budget that feel more pressing. A lender with no physical presence feels very far away. Technology is encouraging very rapid growth in formal lending, and the forces of competition seem to be encouraging larger, longer loans. Kenya's digital lending revolution could either pave the way for a rapidly expanding credit market that begins offering more diverse forms of credit and continues unlocking new value for cuspers or heavy competition in short-term, primarily consumption-based credit could lead Kenyan cuspers towards a South Africa debt situation.

Ghana is ***"Squeezed."*** Amid fiscal instability and high inflationary pressure, those with capital are choosing to invest in risk-free treasury bills currently returning 25% per year rather than much riskier consumer lending, particularly to the cusp group, which is made even more unstable by the country's macro-economic situation. The loans that are trickling out are relatively small, expensive, and short in duration. Any capital used for investment demands dramatic cutbacks in the household budget, since investments cannot produce sufficient returns within the loan durations available. Still, those who can do borrow, but typically from a place of weakness rather than strength. Here, cuspers borrow to cling to their current level of welfare, to rescue ailing businesses, or to avoid catastrophe more than to finance opportunity. Cuspers with a coveted payslip can try their hand at bank credit, while the self-employed are limited to group-based credit and the risks thereof. Once they find a lender who is willing to extend a loan, they tend to stick with them and grow their loan limits slowly. Credit information sharing—though mandated by law—is largely elusive today, as enforcement of full lender participation is weak.

The doors of Ghana's commercial banks are only half open to cuspers whose lower levels of literacy and preference for personal treatment make them feel unwelcome. Instead, they entrust their substantial savings to small, lightly-regulated networks of susu[1] collection companies, rural banks, and cooperatives. Though the risks are high and tangible—nearly everyone we spoke to who used these institutions also experienced a collapse and loss of funds—they treasure the personal touch and try to gauge the strength of these savings spots based on institutional affiliations and word of mouth.

Group-liability microfinance loans have been an important entry point into formal borrowing for many cuspers. At Opportunity Savings & Loans (OISL), group liability is the only option for individuals unable to put up 150% collateral. With group cohesion reportedly deteriorating amidst urbanization and competition, OISL is considering changing its focus to SMEs and individual borrowers who can meet collateral requirements, in other words, moving away from most cusper group borrowers. Incentives so far seem to push lenders to consolidate their focus on fewer credit worthy persons—payroll clients and to a limited extent, above-the-cusp entrepreneurs—squeezing the cusp group even more. Mobile lending—like M-Shwari—could be incredibly valuable in opening the credit market to cuspers in Ghana should a financial institution rise to the occasion.

Conclusion

Credit markets will play an important role in shaping the destiny of the cusp group. Without attention from donors and policymakers, it will be exceptionally difficult for most African countries to find Goldilocks credit markets that extend opportunity to many more cuspers over the next ten years without risking over leveraging and massive overindebtedness. The challenge is daunting, but not impossible and can begin with simple interventions, like improved market monitoring. A failure to act, though, means rather certain failure. It means that an entire generation of cuspers fails to rise.

A project of FSD Africa
Implemented by Bankable Frontier Associates
Public Report Scheduled for Release September 8, 2016

[1] Susu collection is organized saving collection, in which contributors deposit regularly, often daily, and the collector holds their savings, typically for a fee of one day's savings per month. "Susu" can also refer to savings groups in Ghana.