

On the suitability of group lending model in South Sudan's Small and medium enterprises sector

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Abstract

Post-conflict societies, such as South Sudan are characterised by weak regulatory frameworks and lack of political will to implement much needed reforms. This often impacts directly on the economy. The legal, social and financial environment is also weakened in the process, leading to the demise of key economic drivers. The small and medium enterprise (SME) sector is critical for the growth of nascent economies such as South Sudan's. The effectiveness of SMEs as key economic drivers is amongst other things dependent on their access to credit. With only a few SME-specific credit facilities in South Sudan at the moment, it is important that these institutions adopt funding models that will suit the poor, most of whom do not have collateral and credit history. Group lending appears as a suitable model for the poor. The success of this mode of SME funding in selected jurisdictions, namely Angola, Bangladesh, Bolivia, Burundi, and Colombia underscores such a position. The socio-economic, legal and political environment of the three jurisdictions studied in this paper where group lending has been successful closely mirror that of South Sudan. The dynamics of group lending will, therefore, likely suit the needs of South Sudan. Hence it is suggested as one solution to uplifting the small business sector of Africa's newest country, although attention must also be given to other critical development factors such as a sound regulatory regime, an effective taxation system and access to credit.

1. Background

Until June 2011, the State of South Sudan did not exist. The history of the formation of Africa's newest State dates back to the pre-colonisation era, right through its merger with Sudan in the north and its subsequent secession after years of wars of self-determination. Its total landmass covers an area of 644 000 square kilometres with a population estimated at 8.3 million. About 83 per cent of this population is classified as rural. The South Sudanese Pound is the legal tender. Fifty-one per cent of the population live below the poverty line. Less than one per cent of the road infrastructure is paved. Neglect and destruction due to the prolonged conflict has resulted in massive infrastructure loss. Today, South Sudan is considered one of the world's poorest countries, with just 30 miles of paved roads and only 15 per cent literacy rate (World Bank, 2011; Raganathan and Briceno-Garmendia, 2011). Despite going into oil exports as from 1999, South Sudan's economy continues to suffer from macro-economic instability and high levels of poverty, unemployment and debt. The oil boom, which raised the value of total exports from US\$620million in 1996 to

US\$4,522million in 2006, has failed to impact on other sectors of the South Sudanese economy because of high uncertainty, volatility and risk of dependence on fluctuating oil prices in the international market, unsustainable oil revenues and lack of diversification (Nour, 2011). Like most African territories, pre-colonial Sudan was organised under traditional African leadership, where indigenous peoples formed independent self-governing entities (El Obaid and Appia-Gei Atua, 1996). Many tribal kingdoms existed, particularly in the south. With the Ottoman Empire's occupation from 1821 to 1885 the territory saw the rise of the nation State in Northern Sudan. The South was also subject to British colonial rule during the years 1898 to 1956 with Egypt rubber-stamping the arrangement. In 1956 Sudan obtained independence from Britain, which until 1946 had ruled the Sudan as two separate entities, even though ten years earlier, the British had decided to merge the South and the North into one entity. Hence independence was granted to Sudan as a single unified nation (Bradbury, 2013). The merger was however, filled with endless problems. Both South Sudan and the other peripheral regions in the western and eastern parts of the country were characterised by political, economic, and cultural hegemony and marginalization by the apparatus of the Sudanese State in the centre (Jok, 2007). Political discontent characterised the fragile relationship that was sustained over years by the two merged entities. There were allegations that politicians of the North were not so much concerned with the people of the South as they were with South Sudan as a real estate and a resource base (Jok, 2007). This marginalisation of the South was exacerbated by patronising behaviour and ethnic tensions often encouraged by 'divide and rule' policies, thus ensuring that ultimate control of political and economic power primarily lay in the hands of one ethnic group (Bayart *et al.*, 1999; Cheru, 2002). The region suffered from lack of infrastructure development and serious neglect of existing infrastructure as a result of two episodes of civil war (1955- 72 and 1983-2005). This also resulted in major destruction and displacement of much needed infrastructure, thereby negatively impacting upon the largely rural and subsistence economy. The two decades of civil war claimed 2 million lives, and internally displaced some 4 million others. Yet another significant amount of people were forced to flee the country and seek refuge across the African continent and the globe. The conflict was not necessarily restricted to the South Sudan region, there were other territories where armed conflict also took place on a regular and sustained basis (Bradbury, 2013). Conflicts were inordinately reported in the regions of the Nuba Mountains, the Southern Blue Nile, Abyei, eastern Sudan and Dafur. This therefore made the entire region unstable, and crippled its growth. The conflict that had plagued Sudan ended after the signing of the Comprehensive Peace Agreement (CPA) on 9 January 2005, paving way for a new constitutional order. It allowed for a referendum to be held, in terms of which the question of whether or not South Sudan would secede from the North was determined (Bradbury, 2013). In January 2011, the people of Sudan voted in favour of secession from the northern territory. Those voting in favour of the creation of a new State represented over 98 per cent of the registered voters. Consequently, on 9 July 2011 which marked the end of the transition period envisaged by the CPA, the new State of South Sudan was born. Thereafter the Government of South Sudan quickly complied with the application procedure for admission to the United Nations (UN). The UN Security Council

recommended the membership of South Sudan to the UN on 13 July 2011, and the UN General Assembly welcomed South Sudan as the 193rd State on 14 July 2011.¹ One way to address the high levels of poverty in the country is by providing credit to the poor, particularly in peasant and agrarian societies such as South Sudan (Abdalla, 2013). Yet, accessing credit in South Sudan remains a challenge and this is partly due to the fact that there are only a few microfinance institutions that grant credit for starting businesses. A further core problem that hinders microfinance institutions from increasing their footprint in South Sudan is information asymmetry. Oteng-Abayie *et al.*, (2011) also attribute this to either poor portfolio quality to meet the excess demand or a misapplication of capital resources in the microfinance sector. The lack of access to credit limits the realization of growth potential for SMEs; which includes greater participation and maximization of social capital, increased empowerment, poverty reduction, and stimulating entrepreneurship (Neverson, 2013). It therefore becomes imperative to explore a lending model that will address the challenges of information asymmetry, whilst at the same time being effective in addressing the credit scarcity situation. The aims are broadly to review the SME sector in South Sudan and outline its contribution to economic growth; explore the role of microfinance in post-conflict States; analyse the suitability of group lending model as one of the ideal models and its applicability especially in post-conflict states and recommend the most suitable type of group lending in South Sudan.

2. Significance of the study

These aims are important because as highlighted above, South Sudan is a new State and has just come out of war. It is currently building its economy through the establishment of institutions and the promotion of sustainable development through sound economic policies. Amongst these economic growth policies, SME development takes centre stage, hence the need to prioritise the improvement of the business environment. With a majority of the population located in rural areas and living under the poverty line, access to finance by the poor is vital for economic growth. Studies on the provision of finance or business development and support programmes in South Sudan are limited. The unavailability of such studies creates a knowledge gap on their effectiveness in improving the lives of the poor. This study will therefore contribute towards bridging that gap to enable policy makers and the private sector in South Sudan to successfully grow the economy. The paper was premised on the assumption that the Sudanese conflict led to a 141 collapse of key institutions and frameworks which are key to SME development. This impedes South Sudan's efforts to rejuvenate its economy nine years after the CPA which ended the conflict was signed, and three years since South Sudan came into existence. The solution might lie in the model of financing known as group lending.

¹ This is a simple procedure where the State desiring admission submits an application to the Secretary-General and a letter formally stating that it accepts the obligations under the Charter of the UN. The UN Security Council (UNSC) then considers the application. Any recommendation for admission must receive the affirmative votes of 9 of the 15 members of the UNSC, provided that none of its five permanent members — China, France, the Russian Federation, the United Kingdom and the United States of America — have voted against the application. If the UNSC recommends admission, the recommendation is presented to the General Assembly for consideration. A two-thirds majority vote is necessary in the General Assembly for admission of a new State. Membership becomes effective the on date the resolution for admission is adopted. The recognition of South Sudan as a State was quick, and this can be attributed to a great extent to the role of the UN in admitting this new entity to its membership through UNSC Resolution S/Res/1999(2011) adopted on 13 July 2011.

3. The South Sudanese economy

As highlighted above, South Sudan's economy is still struggling to recover from the effects of the 20 years of political unrest (Taha, 2012). The economy is predominantly subsistent and highly dependent on imported foods. Since independence, South Sudan's economy has been embroiled with high inflation especially in the first 12 months after independence. Inflation reached 80 per cent during that year and was driven by the increase in food prices (Akongdit, 2013). South Sudan is highly dependent on oil and the oil exports account for almost the totality of exports and about 80 per cent of GDP (World Bank, 2013). The income from the oil exports finances about 70 per cent of public spending and the remainder comes from the donor community. This heavy reliance on donor funding and oil revenues, however, raises two concerns (i) the fluctuation of oil prices could have a huge impact on government revenues and development programs and (ii) vulnerability of the exchange rate. Nour (2011) also highlights that whilst South Sudan's oil exports have many positive effects on the economy, the negatives still remain highly problematic. These include lack of economic diversification and a volatile fiscal policy resulting from oil earnings that enter the economy predominantly through public finance channels. The population in South Sudan is increasing with major implications for the economy. South Sudan has a population size of 8.26million (2008 estimates) which comprises a majority of young people (72 per cent below age of 30). It has, however, been reported that there has been a substantial inflow of returning Sudanese citizens after the signing of the CPA. These statistics may be outdated but there has not been an official census since then. Some authors have estimated the population to be 10.05million in 2011. This rapid population growth will pose a threat the country's economic growth because it will put a strain on the provision of health, education and infrastructure services. However, on a more positive note, the population growth can translate to a rapid growth in the labour force (AfDB, 2013). Notably, the population boom also translated to influx as people were drawn towards South Sudan's capital, Juba, in search of better economic and living conditions. Owing to its slightly improved infrastructure and relative stability, Juba became the staging area for the major role players in South Sudan's economic development, the non-governmental organisations, international governmental organisations and the Government of South Sudan itself. This convinced investors as well as business people from Ethiopia and Eritrea to invest, particularly in the hospitality industry (Grant and Thompson, 2013). However, Grant and Thompson (2013) also argue that this influx led to the ruralisation of the Juba urban space, and hence encouraged a continuation of the informal economy. The South Sudanese economy is mostly agrarian (Oxfam, 2013). Currently 83 per cent of the population is located in rural areas. The population predominantly relies on crop farming or animal husbandry for their livelihood and about half of the total population (51 per cent) live below the poverty line (Southern Sudan Centre for Census, Statistics and Evaluation, 2010). In fact, about 78 per cent of households depend on crop farming or animal husbandry as their primary source of livelihood (Government of South Sudan, 2011). This is further compounded by low literacy rates, which mean that a majority of the labour force is unskilled or lacks professional skills. The implications of this problem are huge because there will be a large inflow of foreign skilled workers therefore exerting pressures on domestic wage rates (Maxwell *et al.*, 2012). All the above are set within the context of a South Sudan whose infrastructure base remains undeveloped, with a road link that is largely

unpaved. The rail network is still being rehabilitated after being damaged during the conflict. Access to electricity is still scarce, only 1 per cent of the population has access to electricity. Access to water supply and sanitation is still heavily constrained. Communication infrastructure is also undeveloped (AfDB, 2013). Donor support in South Sudan has played a major role in improving the population's economic and social welfare. Total donor commitments in 2010 amounted to US\$ 4.2 billion excluding US\$ 4 billion injected into peacekeeping initiatives in the same period. This aid architecture has, however, neglected the primary role of building government capacity and legitimacy but focused mainly on humanitarian activities. It is worth noting that the World Bank has put a strategy in place to help South Sudan overcome the aforementioned challenges. The strategy's core focus areas are (i) improving economic management and governance for effective local service delivery and (ii) expanding productive employment opportunities (World Bank, 2013). 143 In spite of these seemingly positive developments, not all is well with the South Sudanese economy. Three problems are particularly pressing. First, weak national security poses a threat to the economy. The continued internal conflict amongst ethnic and tribal groups has resulted in over 2 million people killed and an equally large number displaced. Hence the capacity of the armed forces to protect citizens and restore order and peace is insufficient. The business environment is therefore left vulnerable to collapse (AfDB, 2013). Second, business activity in South Sudan is still concentrated in a few economic sectors. Doing business in South Sudan is not without delays and huge costs. South Sudan's ranking in the Doing Business Report 2014 shifted to 186 from 184 in 2013. Key indicators such as starting a business, registering property, getting credit, protecting investors, trading across borders and resolving insolvency, dealing with construction and getting electricity are still of great concern. At the same time, indicators such as enforcing contracts and paying taxes seem to be well underway (World Bank, 2014). Third, cross border trade in South Sudan is still a huge concern. South Sudan trades mainly with its neighbours; Uganda, Sudan, Ethiopia and Kenya. It relies heavily on the sea ports of both Sudan and Kenya for any trade involving sea ports. The domestic conflict that erupted in December 2013 negatively affected trade flows within South Sudan and imports into the country through the displacement of people across the country, destruction of markets and the supply chain. As result the exports of sorghum, dry bean and maize grain from Uganda into South Sudan markets reduced drastically due to insecurity of cargo traffic into South Sudan (Food Security and Nutrition Working Group, 2014). The poor have been badly affected by the weak economy. This is compounded by the limited number of microfinance programmes aimed at providing credit to the poor. According to Littlefield *et al.* (2003); Makina and Malobola (2004); Rhyne (1998), creating an enabling environment for the poor to access credit often stimulates a self-propelling cycle of sustainability and massive growth. It further impacts on the lives of the poor in a powerful way (Kotir and Obeng-Odoom 2009). Apart from these benefits, microfinance can also have socioeconomic benefits, by equalising the economic playing field (Kai and Hamori, 2009). Other benefits of microfinance include income growth and stability, reduced income inequality, less vulnerability, employment creation, health and nutrition improvements, school attendance, improved social networks and women's empowerment (Stewart *et al.*, 2010; Barnes, 1996; Beck *et al.*, 2004; Hietalahti and Linden, 2006; Hossain and Knight, 2008; Khandker, 2001).

4. Conceptual and theoretical framework

There are a lot of countries that have experienced conflict in recent years, a majority of which are low income countries. Conflict has of late manifested in complex ways making it difficult to distinguish between peacetime and wartime. Crisp (1998) affirms that there is a thin line dividing war and peace in the modern world, arguing that 'countries oscillate along a continuum between armed conflict and peace.' Effectively this means that peace and war often coexist in any country or region. This oscillation directly affects any attempts to revive the economies of post-conflict countries such as South Sudan, and influences the decision on which lending model is best suited for each territory. Microfinance has played a crucial role in restarting economies in post-conflict countries. Microfinance institutions operating in post-conflict countries help break the vicious cycle of economic stagnation and conflict that continuously affects billions of people around the world. Microfinance also contributes immensely by providing a platform for the rekindling of social interaction and boosting reintegration and trust amongst communities before prompting economic recovery of the State (Spanda Foundation, 2011). Other known social effects of microfinance in post-conflict areas include the ability to empower women and refugees and other vulnerable groups, returning and reintegration of internally displaced people and former combatants into communities and reconciliation between ethnic groups (Spanda Foundation, 2011).

5. The fundamentals for the growth of SMEs

It is trite that the creation of an enabling environment for economic growth, especially in post-conflict societies like South Sudan is a fundamental consideration for development. Hence the need to ensure that the following key economic drivers are in place, *viz.* (i) a sound regulatory framework and tax regime (ii) unhindered access to new technologies (iii) access to finance, and (iv) development of skilled and trained labour as well as supporting infrastructure. In the case of South Sudan, all these pre-requisites are set within the milieu of an economy in transition, with a nascent legal system that is still trying to address variable teething problems (AfDB, 2013). Small and medium enterprises (SMEs) are essential for the growth and sustainability of any newly democratized nation. They are the engines of job creation and economic growth in emerging markets that are central to the larger equation of development. This is true of most small businesses that operate in the developing world. These small businesses represent one of the developing world's most powerful economic forces, contributing significantly to employment and Gross Domestic Product (GDP). Correctly incubated and nurtured, small businesses can be integral parts of thriving, globally competitive industries, and pivotal in large scale job creation, thereby reducing inequality, poverty and other social ills.

6. The SME sector in South Sudan

South Sudan generally lacks a history of the private sector and business culture. Over time, however, the private sector has come to be dominated by foreign business people, mainly Greeks, Syrians, Lebanese, Italians and British (AfDB, 2013). In post-independence South Sudan these businesses shifted hands and today nationals of neighbouring East African Community (EAC) countries dominate the private sector. These include business people from Kenya, Uganda, Ethiopia, Somalia and Eritrea (US Chamber of Commerce, 2011). This

prompted the South Sudanese Government in 2013 to initiate efforts to entice human capital currently in the diaspora, to come back and contribute to the economy. South Sudan also has an informal business sector, which is hardly documented. This is largely due to the trade restrictions and high associated costs of doing business. Nevertheless, this informal sector also makes significant contributions to the country's economic growth. Be that as it may, there are clearly identifiable deficiencies of the informal business sector in this territory. The sector is therefore characterised by the following: (i) many informal businesses consider themselves to be entrepreneurial in character; (ii) self-employment in the informal sector is the preferred option; and (iii) businesses often avoid paying licence fees and then offer bribes to officials when caught (AfDB, 2013). The main business activities in the informal sector are laundry services, bread making or selling, selling of soft drinks, market stalls, grass collection, charcoal making or selling, artisanal quarrying and stone crushing, beer making or selling, domestic help and casual labour in hotels and markets. The income generated from these informal business activities plays a crucial role in improving the livelihood of the people of South Sudan. A greater portion of the income is spent on food, schools fees and medicine. The informal sector also provides employment to a majority of the population because formal sector employment is very limited and requires individuals to be skilled and literate (Maxwell *et al.*, 2012). The private sector in South Sudan is still developing, and it comprises a large number of micro and small businesses and only a few medium and large sized businesses. In December 2010, there were 10, 746 businesses that were registered in South Sudan. A majority of these businesses (80 per cent) were involved in wholesale and retail trade, accommodation and food services. There were about 89 firms involved in construction and infrastructure related services. Out of the total registered businesses, three quarters employed less than three people. A majority of the registered businesses are owned and managed by individual entrepreneurs (AfDB, 2013). The informal sector has emerged to also play a crucial role in filling service delivery gaps both in urban and rural areas. The informal sector provides basic services such as water, sanitation and electricity which the national grid has failed to provide. Due to the non-existence of trade regulatory institutions, the informal sector has developed elaborate mechanisms to provide credit, wholesaling and marketing and distribution services throughout the country (World Bank, 2009).

7. The regulatory framework

Controlling business activity through various pieces of legislation presents an interesting insight. It can either improve the operating standards for various business activities or hinder the growth or development of those business activities. Hence the legislative control of small business has been viewed by some as an impeding factor to the growth of SMEs and has been termed small business 'overkill'. Complicated laws, rules and regulations concerning companies can be especially tough on small and growing companies. (Bartlett and Bukvic, 2001). In its present state, South Sudan lacks the legal and institutional framework necessary to support private sector development, but that has not been a fatal flaw in attracting business (Kosar, 2014). This translates to lack of protections and certainty for investors. It also presents the new State with multifarious problems such as the exploitation of workers, unprotected property rights, health and safety issues, as well as lack of shareholder protections. Even though this lack of an established legal framework looks

gloomy, there is a bright side to it. It effectively means there is no stifling bureaucracy attempting to enforce a confusing set of rules and laws that could neutralize the positive effect of any such institutional framework (Kosar, 2014). Despite the challenges highlighted above, there are anchor pieces of legislation in place, that would enable one to conduct business in South Sudan. Of interest is the Companies Act of 2010 which regulates the formation and registration of companies. South Sudan seems to be following prevailing trends in the region in respect of shareholding; for private companies it is fixed at a minimum of two shareholders, whilst 50 is the minimum threshold for public companies (International Bank for Reconstruction and Development, 2013). The Land Act of 2009 is also pertinent to conducting business in South Sudan. Under this Act, non-citizens are not allowed to own land, but can access land for investment purposes only. There are, however, no regulations governing how a business acquires land. Despite South Sudan's attempts to regulate access to and ownership of land, this area remains a murky one. Overlapping claims over ownership of the same piece of land by both communities and the government are quite common. The negative impacts of these problems in relation to small business development are quite high. The problems with land ownership date back to the administration of Sudan by the colonial power as a single entity (ElHadary and Obeng-Odoom, 2012). Informal ownership, derived from traditional or customary title has over the years continued to be overlooked by the central government, which left many customary land owners without title and security of tenure and contributed to recent conflicts in Sudan. This has a negative impact on poverty reduction as customary land owners cannot use their property as collateral for accessing credit (ElHadary and Obeng-Odoom, 2012). A sound regulatory framework should not only create an enabling environment for SMEs to thrive, but must also be able to deal with threats such as corruption, which is a major threat to good governance in Africa in general. The capacity of governments to monitor, assess and respond to the problem is limited, and this is particularly true of post-conflict nascent economies. South Sudan has a fairly good legal framework on corruption, for example the 2012 Petroleum Revenue Management Bill (PRMB) instils transparency in oil transactions. This is buttressed by other laws such as the Public Financial Management and Accountability Act 2011 and the Taxation Amendment Act 2012. Despite the existence of these laws, the effectiveness of the South Sudan Anti-Corruption Commission which was established in 2007, in dealing with corruption has been hampered by a weak judicial system (Wanjala, 2012). Wars have a tendency to re-mould social, economic and legal arrangements. The laxity with which law enforcement is carried out often foments delinquent practices which may over time become legitimised. This is further compounded by the fact that the taxation system is prone to collapse during war time, as it did in the Sudan region. As a result, informal tax collection systems began to spring up. These included roadblocks at county, state, and national borders. Needless to say, this system had and continues to have a very negative effect on prices and decisions by entrepreneurs to operate outside specific areas. This also affects the prices of goods, including inputs into domestically produced goods. The pressure to inflate prices to accommodate over taxation often renders these goods uncompetitive with imported finished goods. The environment also promotes multiple taxation as a product moves to the market throughout South Sudan, thereby leading to price increases. The net effect of this taxation regime is that some enterprises will be discouraged from trying to expand

operations beyond the capital city of Juba. It is estimated that business profit taxes range from 10 per cent for a small business or enterprise, to 15 per cent for a medium sized business to a maximum of 20 per cent for a large business or enterprise (International Bank for Reconstruction and Development, 2013). The effect of this is to encourage the disparate development of South Sudan with a bias towards the Juba area.

7.1 Unhindered access to new technologies

Access to new technologies is vital to the success of SMEs. The use of appropriate technology improves the SMEs' competitive advantage. It is therefore important that SMEs continually upgrade and improve their technology in order to become competitive and efficient (Nieman and Niewenhuizen, 2009). Access to new technologies can also help businesses to successfully manage information throughout their functional areas (Urlacher, 1999). Access to technology would also allow SMEs easy access to information required for them to access credit, as well as simplifying the application procedure online. Without these new technologies in South Sudan, both financiers and SMEs lose out. Financiers cannot offer easily accessible platforms for loan applications, neither can they advertise their services online. Sudan's infrastructure including the information, technology and communication sector was heavily depleted by the protracted armed conflict. For instance the telecommunications and postal services inherited from the British were completely destroyed by war and neglect. In the run up to the secession, a memorandum of understanding between South Sudan and Sudan facilitated the development of a mobile communications market in South Sudan. This soon attracted international mobile communications operators like MTN. Despite these advancements, the South Sudan telecommunications industry is still at its infancy, (Ranganathan and Briceno-Garmendia, 2011); and the cost of accessing the new technologies is still high. Therefore, chances of utilisation of these new technologies by SMEs look grim.

7.2 Skilled and trained labour

The need to train labour and impart skills to the SME sector in South Sudan is further heightened by the fact that war situations tend to disempower many individuals. As a result, when hostilities end, a large portion of the society has either lost any economic skills they might have had prior to the war; or were prevented from acquiring any skills by the conflict. It therefore becomes necessary for governments of post-conflict States to invest in re-skilling and training of their populations. In South Sudan, there are currently efforts by the International Finance Corporation (IFC) to help SMEs with business registration and business management training, particularly under the IFC's Business Edge Program. This has benefited more than 12 500 businesses countrywide (International Finance Corporation, 2014). The Government of South Sudan has also embarked on efforts to try and attract skills lost to human capital flight, which is now highly concentrated in the diaspora in the US, the UK and Australia. The Government is offering skilled South Sudanese in the diaspora incentives to return home. For example, an educational loan scheme was established in the US, for South Sudanese living in the diaspora, on condition that upon completion of their studies they will work in South Sudan for a period of time that is equivalent to the period of study. These interventions are still fairly new, and as such it is difficult to determine their

success. They have also been criticised for being weak, despite the Government's attempts to prioritise transfer of skills to locals (Grant and Thompson, 2013).

7.3 Access to credit

In its attempts to reform the informal business sector, South Sudan established the White Nile SME Fund which is a US\$ 50million investment fund investing in SMEs with operations in three countries, namely South-Sudan, Uganda and Rwanda. The Fund aims to achieve sustainable economic development by (i) encouraging entrepreneurship in these fast growing markets and (ii) creating a local manufacturing, services and agricultural base to provide the South-Sudanese economy with locally produced goods and services. However, these noble interventions are hampered by the lack of risk capital and support. About 70 per cent of the fund will be invested in South Sudan and 15 per cent in each of the other countries. It is expected to provide risk capital to about 45 companies with an investment size in the range of US\$ 100 000 to a maximum of US\$ 2million (Africa Assets, 2014). In general, the Fund's investments are made mostly through mezzanine or quasi-equity instruments, including debt with profit sharing or a royalty scheme, preferred shares, convertible debt, or subordinated debt with warrants. Mezzanine financing offers the advantage of creating current income and cash flow through interest whilst securing an upside equity potential (Africa Assets, 2014). It is trite from the foregoing that the South Sudanese system has failed to yield results in relation to the highlighted sectors. There is, therefore, need for reform in order to uplift SMEs and allow them to contribute positively to the country's economy.

8. International examples from which South Sudan can learn

8.1 Group lending in Africa

The application of group lending in some post-conflict areas has yielded different results. For example, in a study conducted by Wilson (2002), it was revealed that in Mozambique, Cambodia and Rwanda, people preferred individual compared to group loans. Richer borrowers wanted to save and borrow individually instead of forming groups with the poor. They believed that solidarity groups led to sharing other people's problems especially if borrowers are put into a group with people who have no experience in running a business. There was, however, a portion of borrowers in Mozambique who still preferred solidarity groups in the period immediately after conflict. Solidarity lending was predominantly preferred in Angola. The mass migration which led to the destruction of civil society and strong individualism did not deter the people from wanting to build relationships and cooperate with each other through solidarity groups. Group lending is often perceived as a new concept that was innovated by the Grameen Bank in Bangladesh. However, it existed long before the Grameen Bank with two types of institutions that practised it in varying forms. These institutions were the Irish Loan Funds and the German credit cooperatives. The Irish Loan Funds were formed in the 1700s, grew in size in the 1800s and declined significantly in the nineteenth century. The funds granted unsecured small loans, took deposits and were based in the rural areas. The borrowers needed to be two in order to access the loans and they were both liable for repayments. The repayments were done on a weekly basis (Hollis and Sweetman, 1997; Presscott, 1997). There have been innovative lending systems adopted by different economies. Germany for instance, had in place what were

called credit cooperatives, a form of group lending scheme. The German credit cooperatives were developed in the late nineteenth century and mainly provided financial resources to the rural people. These funds had a policy of unlimited liability which meant that if the cooperative failed, any member of the group could be held liable for the total debt of the group (Guinnane, 1993; Banerjee, Besley and Guinnane, 1994; Presscott, 1997). The establishment of these institutions has been centred on two concepts: risk sharing and credit.

8.2 The Grameen Bank of Bangladesh

South Sudan's economy is still nascent, having recovered from decades of civil war. However, the South Sudanese Government can learn from other jurisdictions that have successfully implemented sustainable lending models for the poor, within the context of a post-conflict economy. For instance, the group lending model employed by the Grameen Bank in Bangladesh proved a success. A war of independence had left the country devastated in the run up to its independence in 1971, and in dire need of economic recovery. The Bank was established in 1983 by Professor Yussuf Muhammed in Bangladesh. The Grameen Bank is known world over for its innovative lending to the poor who would otherwise not access credit from formal lending institutions primarily because they lack collateral. The Grameen Bank includes the poor by practising collateral-free lending which will rely on peer monitoring and pressure in enforcing loan repayments. The Grameen Bank's group lending methodology allows the formation of groups of five members with separate groups for women and for men. The loans are granted to the individual members of the group, however, the group remains liable for repayment. Therefore if one member defaults, the other group members cannot receive additional credit until the outstanding loans are repaid. The Grameen Bank organises the groups into a community called a centre which usually comprises six to eight groups. The centre serves the purpose of monitoring repayments and ensuring transparency in transactions in order to eliminate any possible challenges of group collusion among selected groups. The amount of loans granted by the Grameen Bank is less than US\$100 to an individual per year and repayable in 50 equal weekly instalments. The loans are granted for various business activities identified by each member of the group or the group members help each other in selecting the business activities. The selection of business activities and the loans received are discussed at the centre meetings (Khandkher, 1996).

8.3 Bancosol of Bolivia

Apart from the Grameen Bank, there are other examples of effective lending models for poor economies. Whilst Bolivia has not witnessed a full scale war since the Spanish war in the 1800s, there is on-going low intensity civil conflict in Bolivia emanating from control over natural resources. The discontent which forms the bedrock of the Bolivian strife began with the privatization of Bolivia's natural gas in the mid-1990s, which led to large scale public demonstrations against the government. The military response of the State over the years, coupled with the fact that the conflict has mainly been between rural indigenous citizens and urban dwellers, created an economic climate akin to post-conflict South Sudan. Bolivia's BancoSol is an early example of an MFI that focused on lending to the poor without the requirement of collateral. It started operating on 10 February 1992 as a private commercial

bank. The core objective of the establishment of BancoSol was to efficiently provide affordable lending and to maintain sustainable deposit relations with the self-employed entrepreneurs in Bolivia. Four years after inception in 1996 BancoSol had a borrower base of 71 000 with a total loan portfolio of US\$47.4 million (Van Tassel, 2000). BancoSol provides unsecured loans with repayment periods ranging between 12 to 24 weeks. The loans are made to solidarity groups with a membership size of four to ten and the group receives the loan from the bank and divides it amongst themselves. The group members remain jointly liable for each other's loan and therefore, BancoSol requires that the group members work within a short distance from each other (Prescott, 1997). BancoSol has been able to achieve self-sufficiency in its operation through striking a balance between costs and risks and developing a lending technology suitable for its target market. The lending technology has derived low cost repayment incentives that have focused on contract design and enforcement rather than intensive screening and monitoring (Gonzalez-Vega, Schreiner, Meyer, Rodriguez and Navajas, 1996). The success of group lending was also noted in the following three territories and indicates a high likelihood of the success of this model for South Sudan. This is because all three territories are post-conflict societies whose socioeconomic and political arrangements mirror those of South Sudan, and the last two are also located in Africa.

8.4 Colombia

Colombia's experience is relevant for South Sudan since it is a developing country located in the global south. Colombia is also recovering from what has been termed one of the world's longest civil wars and still has a high number of displaced people (Centre for Justice and Accountability, 2014). These people have an acute need to improve their livelihood and self-employment has been the only available option. Opportunity International, a global microfinance network, has partnered with two local organizations, the Asociacion General de Apoyo a la Pequena Empresa and Oportunidad Latino America Colombia that offer microfinance to improve the livelihood of the internally displaced persons (McNulty, 2005). These organizations employ three lending methodologies: trust bank recently renamed trust groups, solidarity groups and individual lending. The trust group methodology combines financial services and social interventions such as health awareness and self-governance (McNulty, 2005). The groups, mostly women meet once a week to share personal and business advice, receive financial training and vote on loan-related topics. Trust groups elect leaders and build a safety net of each other by guaranteeing each other's loans (Opportunity International, 2014). When a loan is repaid the money is then available for the next person. The method has led to a loan repayment rate of 98 per cent (Opportunity International, 2014; Handicap International, 2006).

8.5 Angola

Angola had been in conflict for over 40 years during which millions were killed and displaced. The Bicesse Accords (May 1991) and The Lusaka Protocol (November 1994) brought hope for peace but that did not last long. It was not until 4 April 2002 when a memorandum of understanding was signed between the Angolan army and the rebels establishing a ceasefire that Angola enjoyed relative peace. The war destroyed Angola's

economy and led to the accumulation of a massive war debt (Porto and Parsons, 2003). Group lending in Angola was piloted in 1995 by the Development Workshop through the Women's Enterprise Development (WED) project. The project aimed to improve the economic condition of women in the informal sector in Luanda. The project started off with 48 women in fisheries and it was a huge success. This success led to an implementation of the project on a limited scale and used a more rigorous and sustainable group loan methodology. Hence the Sustainable Livelihoods Project (SLP) was launched and it employed a lending methodology which was tested for the first time in Angola. The SLP targets economically active women and men in the urban informal sector. It utilises a means test to select eligible clients from those suggested by other members of the group (Cain, 2004). Loan repayment is stretched over four months with weekly instalments. The group is not required to have collateral, but the group members co-guarantee all loans and weekly payments. Thus solidarity group lending in Angola has been identified as a key model in rebuilding social capital and livelihoods in post conflict areas.

8.6 Burundi

Burundi also has a history of violence between the Tutsi and Hutu tribes and was heavily intensified during the 1993 to 2005 civil war. Over 200 000 were killed during that conflict (Human Rights Watch, 2009). Turame Community Finance, an MFI in Burundi has been active in post-conflict Burundi and has utilized group lending to resolve conflict between the two tribes and improve their economic well-being. This group lending model is called community bank lending methodology. Apart from granting loans to the groups, Turame offers conflict resolution training for its staff and bank training for the groups once they have been formed. The groups benefit from such training because they learn ways of empathizing and internalizing the concepts of reconciliation. Turame was established by World Relief in 2004 and by 2006, it was recognised as the top MFI in Burundi. Turame projected their growth in 2011 to be about 28 000 clients (Ganthier, 2012). It should be noted though, that group lending is not necessarily a runaway success. There are territories, such as Malawi, Zimbabwe where it has failed to achieve the desired results (Dube, 2012; Simtowe and Zeller, 2006).

9. Factors to consider in learning from others

In learning from these international examples, the South Sudanese economic managers must consider two crucial factors, namely (a) group lending dynamics, and (b) group loan repayment performance. The recent increased interest in the adoption of this concept originates from the growing knowledge of informal financial intermediation using groups (Paxton, 1996). In a country such as South Sudan which was previously afflicted by armed conflict, it is vital that the delivery of any financial intermediation should take into account the dire effects of the war on the behaviour of the people. One such effect is the high level of mistrust amongst the people which stems from their relationships during the war. It is common that in war afflicted areas, people form groups or alliances according to their political, ethnic or other inclination. The group therefore acts as a protecting wall and a source of information to the group members. It is therefore crucial that any form of financial intermediation that the State or any party provides in such societies, should be channelled

through these groups rather than individuals. Financial intermediation through groups has been widely embraced and has in some jurisdictions proved to be the ideal model. Groups in general have Characteristics that could enhance the success of a group lending model and these include targeting, transparency, screening of potential borrowers, incentives to repay and ability to enforce repayment. Groups tend to meet more frequently and such high frequency of meetings helps discourage the participation of untargeted individuals, hence credit will be advanced to deserving individuals. Groups are also transparent and open because of their frequent meetings. Transparency helps in minimising possible collusion between bank staff and group members in activities that could be detrimental to the group. Groups also have the ability to screen potential members prior to joining the group in order to ensure that the group comprises of trustworthy members. Through meeting frequently groups provide an incentive for members to repay their loans, which can also be done during the meetings. Hence it will be easier to identify defaulters and the necessary social pressure can be exerted on the defaulters (Johnson and Rogaly, 1997). Conlin (1999) also suggests that the implementation of microfinance programmes through groups can minimise overhead costs. Groups allow the programme's fixed costs such as meetings and training to be imposed on the groups. This approach discourages risky borrowers from participating in the programme, hence safe borrowers feel motivated to repay their loans in order to obtain additional loans. There are two variations of group lending: *Sequential* group lending and *Static* group lending. In *Sequential* group lending, the group members take loans one after another whilst in *Static* group lending all the group members take loans at the same time and start their different projects simultaneously. Research has shown that *sequential* group lending is the most effective variation because it allows the lender to finance more viable projects if the monitoring technology meets the required efficiency standards (Aniket, 2003). *Sequential* group lending also resolves the problem of under-monitoring in group lending schemes. This lending model can succeed even without joint liability; however, the repayment rate may even be more higher if it involves joint liability (Chowdhury, 2005). Group lending has been presented as a lending methodology whose success is not deterred by whether the borrowers have full information about each other prior to the formation of the group or not. Armendariz de Aghion and Golier (2008) also affirm that in cases where borrowers are uninformed about their potential partners, group lending plays a major role in reducing the negative externalities from risky borrowers to safe borrowers. Whilst in cases where borrowers have full information about each other, group lending simply insulates safe borrowers from risky borrowers. This brings about the concept of positive assortative matching which means groups are allowed to form themselves into homogenous groups. Positive assortative matching has been claimed to solve adverse selection problems in group lending. However, Guttman (2006) and Aniket (2006) argue that positive assortative matching may not be the solution if members of a group are under a threat of refinancing. Risky borrowers may be willing to pay more to have safe borrowers in their groups compared to what a safe borrower will be willing to pay; hence there will be negative assortative matching. Regarding factors affecting group loan repayment performance, there are numerous factors that have been identified to affect loan repayment performance within groups. These have been drawn from various studies. Kono (2006) conducted a study in Vietnam to capture the role of joint liability, monitoring, cross-reporting, social sanctions,

communication and group formation in borrowers' repayment behaviour. The study revealed that joint liability creates enormous free riding problems and reduces repayment rates. The study also discovered that under joint liability, people failed in risk sharing, that is, those who defaulted in previous repayments continued to default strategically and those who paid large amounts were always the same individuals. Furthermore, the study revealed that group formation is effective in the sense that it allows self-selection amongst borrowers and excludes those who default strategically. Karlan (2007) and Fedele (2005) studied the role of peer selection under joint liability contracts and concluded that if joint liability contracts are offered in group lending, safe borrowers will choose contracts with higher joint liability and lower interest rates whilst risky borrowers will choose contracts with lower joint liability and higher interest rates. This results in improved loan repayment performance and welfare of the groups especially because the risky borrowers have no collateral. Al-Azzam *et al.* (2008) also conducted a study that sought to examine the impact of joint liability, screening and monitoring activities and social ties of the group leader and other group members on repayment performance. The findings of the study revealed that the group leaders' joint liability and screening and monitoring activities are strongly related to repayment performance than any other variables for the entire group. Further, social ties of all members have a significant role on repayment while monitoring activities had no effect. Hermes *et al.* (2005) also concluded that the monitoring activities do not have any stronger positive impact to the repayment performance of the group. Bassem (2008) as well as Al-Azzam *et al.* (2008) studied the factors that affect repayment in group lending in Tunisia and concluded that internal rule of conduct, same business, knowledge of the other members of the group before its formation, peer pressure, self-selection, sex, education, and non-financial services positively influence loan repayment. However, homogeneity and marital status negatively influence loan repayment. Cassar *et al.* (2007) and Abbink *et al.* (2006) came up with evidence to the effect that societal similarities, group size and trust amongst group peers is more vital to group loan repayment compared to general friendships or societal trust between members. Proponents of this view such as Ahlin and Townsend (2007) conclude that repayment performance is affected negatively by joint liability and social ties and positively affected by strength of local sanctions and correlated returns. Coleman (1999) reveals evidence to the contrary with the revelation that the number of relatives in the village has a positive and significant influence on borrowing. He believes that relationships amongst group members would increase trustworthiness which is necessary for one to be selected into a group by their peers. The relationships would further assure support and insurance for a member who would have difficulty in repaying a loan. Sharma and Zeller (1997) oppose this view and conclude that repayment problems escalate if there are more relatives in a group because relatives tend to trust each other. As a result they do not conduct screening, monitoring and enforcement in the formation of their groups. Goransson and Östergren (2010) also added that individuals usually have a greater chance of receiving more loans if they have low trust levels. Hermes *et al.* (2005), conducted a study which sought to investigate the relationship between monitoring and social ties of a group leader with group members against repayment performance. The study which was conducted amongst 102 groups in Eritrea concluded that social ties of a group leader have a positive relationship with the repayment performance of groups. However, there is no evidence supporting the

hypothesis that monitoring activities of a group leader has a positive effect on group repayment performance. It is also important to consider the performance of group versus individual loans. Other authors like Andersen and Nina (2000) analysed the effect of effect collateral on group lending in a model with high risk and low risk entrepreneurs in a competitive banking system. The authors concluded that banks have lower risk if they lend to joint limited liability groups than with individual lending. This is because they receive repayment from all over the region. The lower risk then allows the bank to reduce the interest rate which then makes the bank attract less risky borrowers. As a result the bank is able to serve more customers and break-even as is the case with individual lending (Dube, 2012). Empirical evidence suggesting whether group loans outperform individual loans is limited. Hermes and Lensik (2007) posit that even though individual based microfinance institutions seem to perform better in terms of achieving profits, a close analysis reveals that the fraction of poor borrowers and female borrowers in the loan portfolio is lower than for group-based institutions. They further assert that individual-based lending is often negatively affected by increasing interest rates above a certain threshold, whilst the same cannot be said of group-lending. Finally, they argue that the growth of microfinance institutions also has an impact on individual-based lending, for example, as they grow larger, they tend to focus on wealthier clients. This is less pronounced in group-based microfinance institutions. A study conducted by Gomez and Santor (2003) also brought evidence that group lending reduces the borrower default rate compared to individual lending, and it is attributed to peer selection during group formation and peer monitoring once the group is established. Zhang (2008) investigated whether group lending compared to individual lending has the information advantage to overcome *ex-ante* moral hazard and efficiency advantage of improving repayment performance. The findings of the model showed that group lending can overcome *ex-ante* moral hazard problems compared to individual liability if there is peer-cooperation and group members make decisions cooperatively. Gine and Karlan (2010) and Atanasio *et al.* (2011) revealed that individual liability compared to group liability did not lead to any change in repayment but led to larger lending groups.

10. Conclusion and recommendations

The financial system in South Sudan is still developing and much still has to be done to facilitate SME access to credit. There are a number of domestic and international banks operating in South Sudan, a majority of which primarily perform foreign exchange operations. Interest rates, like in many other African countries, remain high (up to 18 per cent) for what is essentially an unsecured loan. Further, credit-seekers lack the capacity to present a proper business plan or feasibility study to justify a loan. It should be noted that there is no credit reporting mechanism as of yet. The IFC is currently empowering local banks through training in credit risk management. The Corporation is also helping in designing agriculture and trade finance products, aimed at rejuvenating South Sudan's SME industry. Norfund has also established an investment company, Kinyeti Venture Capital Ltd in cooperation with the Swedish Fund (Swedfund). Kinyeti offers SMEs in South Sudan loans and equity, with a goal of making investments of between 275 000 and 5million NOK (approximately US\$ 46 103 to US\$ 838 237). There are a few microfinance institutions in South Sudan that practise group lending. The Equity Bank offers group loans only to women

who are new in the business environment. The women only access the loans once they have formed groups of 15 to 30 members. Finance South Sudan Limited also offers group loans to groups of 5 to 20 members. The borrowers' business should have existed for at least six months and the groups undergo a four-week training before accessing the loans. Rural Finance Initiative also offers group loans to low income rural dwellers. The MFI has successfully alleviated poverty in the rural areas of South Sudan. These findings show that the practice of group lending in South Sudan is very limited and there is poor or no documentation of the effectiveness of the model. It is trite that group lending is a topical issue in microfinance. It is still a phenomenon that other countries are adopting because of its success in countries such as Angola, Bangladesh, Bolivia, Burundi and Columbia. However, there have also been some cases of failure of the methodology and these give a holistic view of the effectiveness of this methodology in reaching the poor (Dube, 2012). All these notwithstanding, group lending offers hope for the South Sudanese economy, which is still at its infancy and the scars of the protracted civil conflict are still very fresh. There are numerous social, economic, legal and political challenges which negatively affect the establishment and growth of the SME sector. South Sudan's efforts to revive the SME sector are quite visible, but have produced very little over the past 3 years. Group lending offers an opportunity for South Sudan to create funding opportunities for small businesses, who would otherwise not have access to finance that is provided by mainstream financial institutions. Group lending would also help emerging business people without land to access credit to grow their business concerns. We therefore recommend sequential group lending as a viable model for South Sudan as opposed to simultaneous group lending. In sequential group lending, the borrower disburses loans sequentially within the group and the second borrower obtains the loan only if the first borrower successfully repays their loan. Whilst in simultaneous lending, the borrowers in the group receive their loans simultaneously from the lender. The pros of sequential lending that suit the business environment in South Sudan is that it allows the lender to temporarily separate the borrowers' decisions on their respective tasks. Hence the lender only incentivises the borrowers' tasks individually and not collectively. Sequential lending is also effective in case where the group has heterogeneous members, that is, members with different business management experience. The members that have vast experience will be able to school those that have little or no experience. Since the business environment is still at its infancy, it is important that the lenders increase their profits in order to finance more projects. Sequential lending will help the lender achieve this by allowing them to sort out the borrower's type in the first period of lending and as the transmission of information amongst the borrowers increases. As a result, the lender is able to screen the groups more effectively using the outcome from the first borrowers. Although sequential lending leads to the punishment of the whole group if the first borrower's project fails, it does, however, allow the lender to finance a wider range of projects as compared to projects that can be financed through simultaneous lending. Sequential lending will also allow the lender to lower the loans allocated to the borrowers because the loans are not granted collectively but individually. Grameen Bank also follows sequential lending with much recorded success (Aniket, 2007). For South Sudan, we do not recommend the use of the means test utilised by MFIs in Angola in selecting groups. This is because the involvement of the MFI in this fashion interferes with the group's autonomy, and detracts

from organic group formation, which is key in post-conflict societies. Groups should therefore have the autonomy to compose themselves, as this is largely influenced by ethnic, political, and economic considerations as well as personal considerations such as trust. It should be noted, in conclusion that further insight into the topic of this paper could still be explored in future when more relevant data is available from South Sudan.

Biographical Notes

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