Enterprise and Cooperative
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Poverty-oriented
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No. 17

The performance of the Lesotho credit union movement: internal financing and external capital inflow

Pete Sparreboom-Burger

International Labour Office Geneva

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List of acronyms

ACCOSCA	African Confederation of Cooperative Savings and Credit Associations, Kenya
BEDCO	Basotho Enterprises Development Corporation
CLL	Christian Council of Lesotho
CMA	Common Monetary Area
CRS	Christian Relief Service
CUNA	Credit Union National Association, U.S.A.
FAO	Food and Agriculture Organisation of the United Nations
GDP	Gross Domestic Product
GNP	Gross National Product
GOL	Government of Lesotho
GTZ	German Development Agency
IMF	International Monetary Fund
LADB	Lesotho Agricultural Development Bank
LAPIS	Lesotho Agricultural Production and Institutional Support project
LCC	Lesotho Council of Churches
LCCUL	Lesotho Cooperative Credit Union League
LCUP	Lesotho Credit Union Project
LNDC	Lesotho National Development Corporation
MOA	Ministry of Agriculture
MOH	Ministry of Health
ROSCA	Rotating Savings and Credit Association
SACU	Southern African Customs Union
UNCDF	United Nations Capital Development Fund
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions, Canada

I. Introduction

In this report we look into the effects of using financial cooperatives in Lesotho as conduits for getting financial resources to the poor. The empirical study which forms the basis of this paper aimed to discover the factors that have determined the extent of success of credit cooperatives in this country. It is part of a larger empirical investigation carried out in several developing countries, which must provide a proper basis for a judgement on the desirability of promoting credit cooperatives by providing them with external funds.

In Lesotho there are approximately 80 primary credit cooperatives, known by the name of credit unions. Each credit union belongs to one of twelve chapters, which may be considered as secondary organisations. These chapters roughly follow Lesotho's subdivision into districts. The chapters do not execute any financial function; their main task is to elect regional representatives to the board of the tertiary organisation, the Lesotho Cooperative Credit Union League (LCCUL). The credit union movement in Lesotho has received enormous amounts of aid over the past twenty years. Despite all this aid, it currently finds itself in a very sorry state, with only a small proportion of all credit unions still being active and LCCUL on the verge of financial collapse.

This report is organised as follows. In chapter II we describe the theory that provides the basis for a number of hypotheses that we have tried to test empirically for the case of Lesotho. Chapter III enters into the methodological problems that we faced with the empirical work. In chapters IV and V we provide background information on the macroeconomic environment and the financial system in which credit unions operate.

The next chapters give an overview of the results of the empirical investigation that we carried out. After looking at the performance of the credit union movement in the second half of the 1980s in chapter VI, in chapter VII we give an overview of the aid that the movement received. The effect of this aid is analysed in chapter VIII, and the internal functioning of the movement is scrutinized in chapter IX. We close off with a number of conclusions.[1]

[1] Exchange rate: The Lesotho Loti is fixed at par to the South African Rand. From 1985 to 1991, the exchange rate was:

Year	1985	1986	1987	1988	1989	1990	1991
Loti/US$	2.193	2.268	2.037	2.262	2.618	2.584	2.751

II. Theory and hypotheses

It is often assumed that the credit cooperative is an efficient, target-group oriented form of organisation which deserves to be promoted in developing countries. Also, it is often assumed that external funding strengthens the functional capacities of credit cooperatives. However, the observable facts in many countries do not seem to support this.

In their paper on the theory of credit cooperatives, Krahnen and Schmidt (1995) raise three fundamental questions:

1. Is the performance of cooperative financial systems really so weak? And if it is:

2. Is external funding more likely to strengthen or to undermine credit cooperatives?

3. To what extent are disappointing results related to aspects of internal financing of credit cooperatives?

The available knowledge providing answers to the above questions is generally unsatisfactory. The above-mentioned authors suggest a number of hypotheses to be tested in order to determine the factors that determine whether or not credit cooperatives are successful.

By providing funds for onlending, donors add to the share capital of a credit cooperative. Krahnen and Schmidt elaborate on the possibility that the injection of equity from the outside has the following effects:

— it diminishes the ability of a cooperative to mobilize funds on its own;

— it decreases the quality of the credit portfolio; and

— it boosts the importance of the secondary and/or tertiary level of the cooperative system as opposed to the primary level.

Internal equity is provided to a credit cooperative by its members, who are expected to buy one or more shares in the organisation. The return on their shares depends on the profit that the credit cooperative makes. However, since shares can be sold back to the cooperative against nominal value, some prefer to talk about the savings that members hold with a credit cooperative in stead of their shares. As a result of this ambiguity, it is common practice to talk about share savings of credit unions members.

Krahnen and Schmidt suggest that problems in raising equity or share savings are inherent in the principles on which credit cooperatives are based. These problems, and the way they are linked to those principles, may be summarized as follows:

— *solidarity principle*: although costs are necessarily high due to lack of economies of scale, loans need to be extended against low interest rates for solidarity reasons; this reduces the possibility to attract share savings by paying high dividends;

— *redeemability principle*: because members can sell back their ‘shares’, the credit union needs to maintain a highly liquid position, and the management is more motivated to distribute profits in favour of (irredeemable) reserves in stead of dividends on shares;

— *equality principle*: the principle of one member - one vote decreases members' motivation to increase their savings.

In this report we will test the hypotheses that have just been described. We will make use of the list of 16 more specific hypotheses that were formulated by Krahnen and Schmidt, and that are reproduced in Appendix A. Where hypotheses are refuted or at least not confirmed, we will attempt to offer explanations for this diversion. These explanations may be seen as alternative hypotheses.

III. Methodology

In their paper on the theory of credit cooperatives, Krahnen and Schmidt elaborate extensively on the methodological problems involved with the measurement of the performance of credit cooperatives. The present study was carried out according to their suggested guidelines, and the questionnaires designed by the same authors were used as a basis.

Lesotho's credit union movement received most aid in the period between 1980 and 1991, but data on the period before 1985 are scarce or non-existent. Therefore, the time frame chosen for the study was the period 1985-1991.

It was not possible to study a representative sample of the credit unions that were active in the period 1985-1991, because a great number of them are no longer active, and it is therefore difficult to access the information required. It has, however, been attempted to select a sample of credit unions that is well distributed on a regional basis. In March 1995 there were 80 credit unions, divided up into twelve chapters (LCCUL 1995). Lesotho is divided up into ten districts, and the chapters of the League roughly follow that regional distribution, be it that there are two more chapters than there are districts.

All credit unions are supposed to fill in a monthly report and send it to the League. Only 28 credit unions were considered up to date with their monthly reports (i.e. they had handed in reports after 31 December 1992). Since the extent to which a credit union is up to date is an indicator of its activity, and thus the accessibility of data, it was decided to select a sample from those that were considered up to date. A 40% sample would have come down to 12 credit unions, exactly one per chapter. However, we found that in two chapters there were no credit unions which were up to date, so that in order to maintain an even regional distribution, a random sample of ten credit unions was selected.

First, data about the primary credit unions were collected from the monthly statements that they had sent to the League. Secondly, this information was complemented by data collected directly from a number of credit unions, through interviews with the management or members of the supervisory committee. Some of this information was collected from the year reports which the management presents at the annual general meeting and the reports of the credit committees.

Most of the staff of the Lesotho Cooperative Credit Union League were new, and they were not able to provide us with detailed data about LCCUL over the period between 1985 and 1991. Most of the information presented in this report was collected and compiled from a great number of documents that were acquired elsewhere, and from interviews with one of the staff members who did work at LCCUL during the period under consideration. We feel that this information was sufficient to give an impression of the performance of LCCUL and of the effect of external aid.

Caveat

It must be said that some questions can be raised about the reliability of the data gathered. Boeckenholt (1988) made an intensive study of the monthly financial statements of a high number of credit unions, and she pointed at the following shortcomings:

— the financial statements are often not completely filled;

— changes in the balance sheet are not stated in the cash report, and can therefore not be checked;

— some credit unions are not able to add the balance sheet correctly;

— donations stay registered on the balance sheet over the years, and thus distort the picture that the balance gives;

— depreciation is not applied, and unrecoverable loans are not written off, which leads to an overvaluation of the assets;

— the profit & loss account seems to create special difficulties. In most credit unions monthly profits or losses are not added to the balance sheet, and not carried over to undivided earnings at the end of the year, but simply added up to “Assets” or “Liabilities”, so that the balance sheet total is at least equal on both sides;

— the statistical report at the end of the financial statement, which is to contain information on delinquent loans, clearly looks very complex to many, so that that part of the form is not filled at all by most credit unions;

— the correct calculation of interest is a major problem.

The only two credit unions that kept their books correctly, and that also closed the books correctly at the end of the year, were Mazenod and Maseru Township, both urban credit unions. We could conform most of these finding, and we found that the quality of the administration hardly improved after 1988. Additional problems that we noticed will be mentioned in the report where this is relevant for the interpretation of data, but there are some that we would like to mention here.

We found that it was especially difficult to acquire information on the number and value of loans extended by credit unions. Only one credit unions had reports of its credit committee, and some of the others could provide us with the ledger books and receipt books which contained this information. Knowledge about the conditions under which these loans were extended was very meagre.

When we checked with LCCUL, we found that the staff of credit unions with whom we had talked had systematically underestimated the number of external grants and loans their credit union had received between 1985 and 1991. Also, the conditions under which aid was given to primary credit unions were hardly ever remembered, so that this information had to be collected from project evaluation reports.

We have tried to compensate for the limited reliability of primary data by complementing them with data from secondary sources. On this basis, we consider that a number of conclusions can be drawn in the next chapters.

IV. The macroeconomic environment

As indicated in chapter III, we will study the performance of the Lesotho credit union movement in the period 1985-1991. In order to understand the circumstances in which the movement found itself, we will here give a general description of Lesotho's economic situation in that period, based mainly on Brown (1995), IMF (1994) and Sechaba (1993).

Lesotho is a small country in Southern Africa, completely surrounded by the Republic of South Africa. Population density is highest in the western lowlands, and lowest in the high and difficult mountains in the east. In 1992, its population was estimated at 1.9 million, of which 85% was residing in rural areas. Its Gross National Product per capita reached a mere $580 in 1992, making it a low income country. Between 1985 and 1992 GNP increased in real terms at an annual rate of only 0.8%.

About 38% of the male labour force were employed as migrant workers in South Africa in 1992 (compared with an estimated 45% in 1987), and the remittances of Basotho[2] migrant workers constituted more than 40% of GNP. This phenomenon reflects a continuing lack of opportunities in the domestic formal sector, despite government attempts to develop manufacturing and services, and severe pressure on agricultural land. Unemployment was estimated at 41% in 1992, 20% higher than in 1986.

Only about 10% of the total land area is suitable for arable cultivation (with a further 66% usable for pasture). The sector's contribution to GDP has declined, from 47% in 1970 to 15% in 1991, owing to a fall in yields by an average of 3% per year. This was mainly caused by severe soil erosion, the prevalence of poor agricultural practices, and by the impact of drought. Misguided agricultural policy has also played a role. Very few people have access to land that provides full time work and enough produce for subsistence. The most recent periods of drought were during 1982-1985 and from 1990 to 1994. In 1991/92 only 20% of basic needs were met from domestic production.

Lesotho has never been a desperately poor country (Sechaba 1991). In 1990, only Botswana, Tunisia, Lybia, South Africa and Mauritius had a higher Human Development Index than Lesotho, while 36 African nations fell below Lesotho. However, poverty has been very unequally distributed. The rural areas, and especially the remote mountains of Lesotho, have indeed been places of real deprivation. But even in these areas there are many households with regular income from the mines.

Lesotho's economy is highly dependent on the Republic of South Africa. Not only does the country export labour services to its neighbour, South Africa is also the main source of Lesotho's imports. The country profits from this situation in the sense that customs duties, acquired through the Southern African Customs Union (SACU), are an important source of revenue for the government. But since the import coefficient was around 70% in the period under consideration, Lesotho's price level was also highly influenced by the South African price level. Partly for this reason Lesotho suffered from double digit inflation over the whole period.

Lesotho is also related to South Africa through its membership of the Common Monetary Area (CMA). Its banking system shows close interdependence with that of South Africa[3]. The free flow of funds between the countries limits the scope for independent financial market policy in Lesotho. The Central Bank of Lesotho follows developments in South Africa closely when it sets the discount rate, the minimum savings rate and the rates it pays on commercial bank deposits. Partly as a consequence of that, financial markets were quite repressed in the beginning of the period, in the sense that interest rates were low.

However, in 1988 an IMF-supported structural adjustment programme was started, and some macro-economic indicators improved as a result. GDP growth increased, but part of this effect was offset by the retrenchment of mine workers. The impact of the programme on the financial sector was considerable, especially on the level of interest rates. Between 1987 and

[2] *Basotho (singular Mosotho) are the inhabitants of Lesotho.*

[3] *The local currency, the Loti (plural Maloti) is fixed at par with the South African Rand.*

1989 both lending and deposit rates almost doubled, lending rates ending up between 20 and 30% and savings rates between 12 and 16%. However, because of continuing inflation real interest rates remained mostly negative (Central Bank of Lesotho, 1991). Figures are given in appendix B.

The economy and the credit union movement

The credit union movement reflected several of the basic characteristics of the economy. In the period under scrutiny, most credit unions were still located in the countryside. Since many men worked abroad in the mines during most of the year, the women worked on the land and carried the responsibility for the children and the elderly. Many women received remittances from their husbands, and earned a small seasonal income from the land. It was this money that they wished to save mainly for investing in agriculture, and for paying school fees for the children and covering the high costs of burials of the elderly.

The retrenchments of mineworkers provided many families with a substantial but final injection of income, which they could use for investment, but left them without a regular source of income. The droughts had a negative effect on the income of many credit union members. As rural people had hardly any alternative source of income, one would expect this situation to have affected their participation in credit unions, or in any form of savings scheme, in a negative way. And since agriculture became a riskier business, one would think that credit unions would move their saving and lending facilities away from this sector and into sectors that were less sensitive to the vagaries of the climate.

As is usual with structural adjustment, the short term effects of the IMF-supported programme did not benefit the rural poor. They and their credit unions lost any protection that they might have benefitted from, and suddenly had to compete. The credit unions had to react to the economic developments over this period, and it is one of the purposes of this study to find out to what extent operating principles and external inflows of funds have helped them to adjust. However, we will first position the credit union movement within the total financial system of Lesotho.

V. Financial institutions

The development of the credit union movement came about in the broader context of the development of financial markets in Lesotho. In this chapter we will describe the history and characteristics of the formal and the informal financial sector. The history of the financial sector is important because it indicates the Basotho's experience with savings and credit, which has influenced their behaviour towards credit unions.

The formal financial sector

Formal banking started in Lesotho with the arrival of Standard Bank, a British commercial bank, in 1902 (Maruping 1992). It merged with Chartered Bank in 1977. Some competition was introduced when the second foreign commercial bank, Barclays Bank, came to Lesotho in 1957. In 1966 the Lesotho Post Office took over the Lesotho-based operations of the South African Post Savings Bank.

In 1957, the Basutoland Cooperative Banking Union was established. It was to serve as a bank for independent marketing cooperatives. After an initially successful period, lack of managerial experience led to the liquidation of the bank in 1963. A similar development was experienced by the Lesotho Cooperative Savings Society, founded in 1959, which focussed on housing finance. It flourished for a short while, but due to lack of qualified management and staff coupled with misuse of funds it eventually collapsed, and was liquidated in 1981. When it became clear that Lesotho Cooperative Savings Society was ailing, in 1976 the Lesotho Building Finance Corporation was founded.

The commercial banks and the Post Office were seen as mobilising savings in Lesotho and transferring those funds to finance developments in South Africa. They were also paying extremely low interest rates on deposits. These were some of the reasons for the government to found Lesotho Bank in 1972. It took over the banking operations from the Post Office. Although it was envisioned as a development bank, Lesotho Bank was soon operated as a commercial bank, oriented primarily to the needs of locally-owned business borrowers and foreign-owned companies. Halfway through the 1980s it had become by far the largest bank in Lesotho. It was solvent and highly profitable, and later took over the Lesotho Building Finance Corporation.

Lesotho Bank operated a compulsory savings scheme for Basotho miners in South Africa. Under the scheme, which was introduced in 1973, South African mining companies transferred 60% (reduced to 30% in 1990) of the basic pay of Basotho miners to the so-called Deferred Pay Fund at Lesotho Bank, which earned an interest rate equal to the savings deposit rate. The account was used to support each miner's family in Lesotho. Under normal circumstances the miners could access the Fund directly only at the termination of their employment contract, but more withdrawals could be made in case of emergency. Miner's savings under the scheme did not serve as down-payment or collateral for small loans.

Lesotho's commercial banks can be described as (a) well managed, (b) adequately capitalized, (c) limited in number, (d) operated in highly segmented markets (each serving a particular segment), (e) guided by fairly conservative standards in their credit risk appraisals, and (f) adhering to short-term maturities in their portfolios. Some business leaders have complained about the limited range of products offered by commercial banks. Banks have pointed out that bankable projects are scarce and that generally default rates are on the high side. Furthermore, contract enforcement by the judicial system is ineffective, as handling of cases is often delayed and court rulings are not executed.

The private commercial banks (Barclays and Standard) only maintain offices in relatively high-density urban areas where there is a higher level of commercial traffic and where their preferred clients have ready access. Lesotho Bank' mobile offices reach more distant towns, but even this bank concentrates its credit activity in urban markets using its branch network to mobilize deposits. All three banks are highly liquid, in the sense that their credit deposit ratio is very low. None of the three commercial banks currently in operation in Lesotho provide significant numbers of loans to low-income people, be it for agriculture, small enterprises or consumption.

In the absence of a development bank, the government initially channelled development finance and external funds through the Lesotho National Development Corporation. LNDC was established in 1967, to initiate, promote and facilitate the development of industries, mining and commerce. It soon focussed on supporting large enterprises and attracting foreign investment. In order to also assist small-scale local entrepreneurs with loans, shelter, training and extension services, the Basotho Enterprises Development Corporation was formed in 1975. Bad loan recovery eventually resulted in the withdrawal of donor funds, and the termination of credit provision to small entrepreneurs.

The only formal bank that has a history of targeting the poor in rural areas is Lesotho Agricultural Development Bank (LADB), which started operations in 1976. During the first ten years of operation the bank made loans from grants and concessional borrowing from international agencies. By 1986 the bank had to realize M 2 million of bad debt. This was a result of poor lending practices and inadequate provision for losses. Most loans were out for 12% and low down-payments had been required. In 1986 losses began to be written off against reserves and government paid-in capital. The LADB began to rely more on deposits as a source of funds, and by 1991 deposits accounted for more than half of its liabilities. However, for some years the cost of deposits (the pass-book savings rate) was higher then the rate on loans. In 1989 statutory regulations governing bank loan interest rates was revised to allow the bank to set market-determined interest rates.

The informal financial sector

Because of the lack of interest of the commercial banks, and the lack of success of development institutions and banks, the Basotho have had to rely largely on sources of informal finance. For rural people, the main vehicle for storing and accumulating savings has been livestock. Gardiner and Carvalho (1990) found that in the period 1985/86 to 1988/89 the sale of livestock products had a positive real rate of return, and that prices of livestock also stayed ahead of inflation. As we saw before, formal real interest rates on savings were mostly negative during that period.

With the monetization of the economy, lending among family and friends continued. Usually, no collateral and no interest were asked, repayment terms were flexible, and the practice was based on reciprocity.

Nowadays, many people participate in rotating savings and credit associations (ROSCAs). The most well known are Setokofeles. The Basotho probably learned about these in the mines in South Africa. The members of Setokofeles meet every month and contribute a certain amount of money. Each month another member receives the total amount collected in that month, and repayment is automatic through the monthly contributions. In this way all members, except the last, receive a lump-sum of money much earlier than if they had saved individually. The Setokofele encourages savings discipline, and peer-pressure prevents defaults. A constraint is that the payment cycle cannot usually match the liquidity demand cycle of all individuals. The absence of interest rates also causes the costs of funds and inflation to be ignored. This means that the person who is last in receiving the money benefits least.

Another kind of ROSCA that is a widespread is the Christmas Savings Club. Members contribute a certain amount of money every month, and every month the money collected is lent out to one or more members against a high interest rate (10 to 20% per month). Since access to formal finance is difficult, the demand for this kind of loans is high. The loans have to be paid back before the end of the year, and in this way the total fund grows. At the end of the year, just before the expensive Christmas-holidays, the total fund is divided among the members.

A third source of informal finance are moneylenders. Individuals or groups of individuals with a regular income or a certain saved capital lend out small amounts to people in need with a profit-making objective. Although no study has been done on the practices of moneylenders in Lesotho, it is widely known that lending is character-based, and interest rates charged are high.

There is a fourth source of informal finance, the importance of which is unknown, are burial societies or Mpate Sheleng. Burial expenses in Lesotho are high, and therefore people from a village or a neighbourhood often try to find a way to insure themselves against those costs. They pay a monthly premium, and the society pays out at the moment a member or his or her family member dies. It is generally assumed that each of the 8000 villages in Lesotho has at least one burial society. Some of these burial societies are involved with lending out the funds that they accumulate form the premiums.

The financial sector and the credit union movement

The credit union movement in Lesotho came about at a time when poor rural people had hardly any access to loans in the formal sector, and when their needs were no longer being met by the informal financial sector. It has its roots in 1960 when a team from Canada, working through the Pius XII University College (now the National University of Lesotho), began discussions with the government and started training courses for potential credit union leaders. By 1968, credit unions had grown to such an extent (there were then some 30 unions) that the leadership decided they needed a national office. The Lesotho Cooperative Credit Union League (LCCUL) was established. In the following chapter we will attempt to find out how well the credit union movement in Lesotho performed between 1985 and 1991.

VI. Performance of the credit union movement 1985-1991

As we saw in chapter II, it is often assumed that the performance of cooperative financial systems is low. In this chapter we will attempt to give an impression of the performance of the credit union movement in Lesotho. Since credit unions are non-profit organisations, profits are not a good criterion for success. Krahnen and Schmidt suggest the use of a different criterion: the extent of target group orientation, be it on the condition that the cooperative is economically viable. We will first study the figures that we were able to collect from reports on the whole movement, including LCCUL. Since some of this information is incomplete and another part is unreliable, we will subsequently present some of the data we collected from a sample of credit unions.

Target group orientation and viability of the movement

In a report that was produced by LCCUL at the occasion of its 25th anniversary, a table that showed the overall development of the movement was presented. This table is reproduced below, and it shows that the movement has experienced growth ever since its inception. Since we are most interested in the period between 1985 and 1991, we may note that growth was higher before 1978-1988 then after. The figures are an indication of the degree of target group orientation, since most members of credit unions belonged to the poorest strata of the population, mainly rural women.

Table 1: Growth of the credit union movement

	1968	1978	1988	1992
Credit unions	30	50	71	71
Members	10,000	22,000	24,000	29,000
Savings	M 159,000	M 614,000	M 2,377,000	M 3,252,000
Loans	M 89,000	M 420,000	M 2,084,000	M 2,400,000
Assets	M 168,000	M 688,000	M 3,437,000	M 4,722,000

Source: LCCUL (1992)

These figures give a positive impression of the performance of the movement. However, it is questionable whether the information provided by LCCUL is very reliable. Gardiner and Carvalho (1990) found that there were not 71 (as mentioned in the table) but as many as 83 credit unions in the middle of the eighties. The World Council of Cooperative Credit Unions (WOCCU 1992) talks about growth, but subsequent contraction of the movement by the end of the eighties. LCCUL had the names of 80 credit unions in its administration in 1995, of which not one had been established after 1992 (LCCUL 1995).

We are either faced with a problem of definition or a problem of presentation. Our interpretation is that there are indeed 80 credit unions or more, most of which were set up before 1988, but a number were no longer active (dormant) towards the end of the period. It was in the interest of LCCUL not to show a fall in the number of credit unions, while, as we will see in the next chapter, it was in the interest of WOCCU to acknowledge the fact that a number of registered credit unions went dormant towards the end of the period.

Another criterion for the performance of the movement is the growth in the range of products offered. A wider range of products permits an organisation to become more efficient and effective in reaching its target group. Here we can distinguish between LCCUL and its member credit unions.

According to Gardiner and Carvalho (1990), in 1985 LCCUL provided a high number of services. It had established a central finance facility, where credit unions could invest surplus savings or from which they could receive credit to supplement their savings. LCCUL provided training schemes for members and staff of credit unions, organized field visits, and offered insurance for savings and loans as well as audit services, reaching out to very remote areas of the country. However, by the beginning of the nineties it no longer offered basic technical support services to the primary societies, and it merely acted as a central finance debt collector and an intermediary for the insurance scheme. Staff number had gone down from more than 30 to only five. This collapse in the provision of services raises questions about the actual performance of LCCUL.

As to range of products of the primary credit unions, we found that on the liabilities side many only distinguished between share savings and deposits. Like share savings, deposits could be withdrawn at any time. Deposits were distinguished from share savings by the fact that they did not earn interest or dividend. Also, they could not be used as down-payment or collateral for loans. We think that while share savings served to provide access to loans and earn a dividend, which they only did if they were not withdrawn, deposits were used as a current account or as an insurance mechanism for emergencies. New savings products were not introduced.

On the assets side, the range of products was not very broad either. Credit unions distinguished between agricultural, other productive and provident loans. The terms of all those loans were generally very uniform. Interest rates were the same for every kind of loan. No formal collateral was required, but loans could not be more than once, twice or three times a member's savings, depending on the credit union and the year. Repayment was to be monthly, except in the case of agricultural loans, where a grace period of approximately 6 months was granted. The introduction of new lending instruments was not so much related to the performance of the credit union, as it was to the inflow of external capital.

We proceed to studying the economic viability of the movement. LCCUL could not provide us with data on its viability between 1985 and 1991. However, Crush (1982) stated that already in 1978 LCCUL could cover less than half of its operating expenses. This situation had worsened considerably by 1988, when according to WOCCU (1992) the League could cover less than a third. Its costs were mainly being covered by external aid. It had a debt for a mortgage loan to the Lesotho Building Finance Corporation on which it was not possible to make repayments. An audit carried out in 1990 proved that LCCUL was technically insolvent. When aid stopped, ACCOSCA (1992) notes that LCCUL started to cover its deficits from the Central Finance Facility.

LCCUL did have figures available for 1992. Below, the balance sheet and the profit & loss sheet for that year are presented. As can be seen, LCCUL made considerable losses in 1992, reaching almost 10% of expenses. It may be clear by now that losses were not incidental, but a symptom of the situation in which LCCUL had found itself for a number of years.

Table 2: LCCUL Balance Sheet 31 December 1992

Liabilities			*Assets*		
Demand deposits	M	269,934	Vault cash	M	79
Time deposits	M	556,316	Deposits with ACCOSCA	M	5,200
Savings deposits		M229,175	Balances at financial institutions	M	6,230
Liability reserve	M	577,136	Loans	M	525,407
Loans from donors (LCUP)	M	318,421	Securities	M	14,685
			Other assets	M	1,399,381
Total liabilities	M	1,950,982	Total assets	M	1,950,982

Table 3: LCCUL Profit & Loss Sheet 1992

Expenses			*Revenue*		
Personnel expenses	M	68,435	Interest from credit extension	M	93,020
Operating expenses	M	230,600	Other revenue	M	178,900
Travel expenses	M	10,000			
Interest on savings and deposits	M	1,100	Loss	M	38,215
Total expenses	M	310,135	Total	M	310,135

The bad health of LCCUL was partly due to the state of the primary credit unions. Many were no longer able to pay their dues, and the majority could no longer participate in the insurance scheme that constituted another source of income for the League. Delinquency to the Central Finance Facility was over 80%. Already in 1982 Crush found that average repayment rates at primary credit unions was between 100% and 30%. Mindock (1983) estimated the national average for seriously delinquent loans (over 6 months) at 31%. From reports we understand that delinquency rates have risen since then, until in 1992 ACCOSCA estimated that delinquency rates varied between 50 and 90%. As a consequence, losses were very high.

The most significant evidence of low performance is the fact that, as we saw before, currently only 28 of the 80 credit unions that are members of LCCUL are considered active, in the sense that they have been submitting their monthly reports up to 1993. The credit unions that are not considered active are called 'dormant'. During our fieldwork it turned out that some of the credit unions that were considered active by LCCUL, had gone dormant in the mean time. It is likely that although the dormant credit unions have never been declared as such, they are in actual fact bankrupt and thus no longer viable.

Target group orientation and viability of the sample

LCCUL was not able to provide us with an overview of the financial situation of all its member credit unions, nor did it have summaries of the situation of the ones that were still active. We therefore studied the state of ten credit unions that could provide us with data over the period 1985-1991. It must be remembered, however, that the results necessarily give a positively biased impression of the state of the movement, *as it was not possible to study the ones that went under.*

In order to determine target group orientation, we tried to collect data on the number of savers and borrowers, and the volume of savings and loans.

The figures presented on this page show the development of the number of members and the volume of share savings of those ten credit unions. Both increased over time, be it at a decreasing rate. Eventhough the growth in savings in real terms was much less, in nominal terms members kept on adding money to their account. Considering the development of the income of credit union members, as described in chapter IV, we may conclude that credit unions in the sample were successful in mobilising members and savings.

Figure 1.

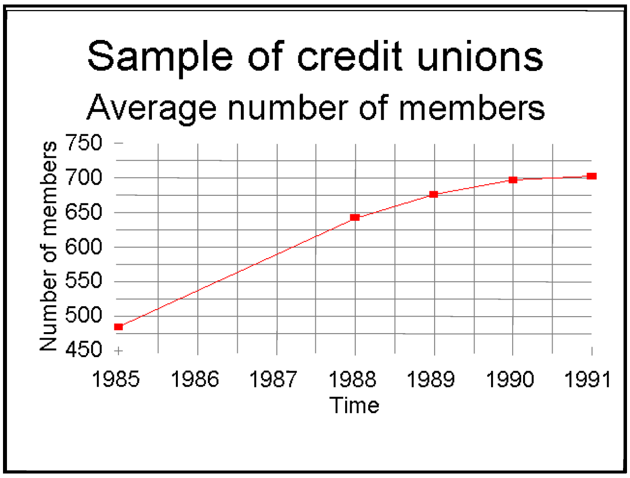
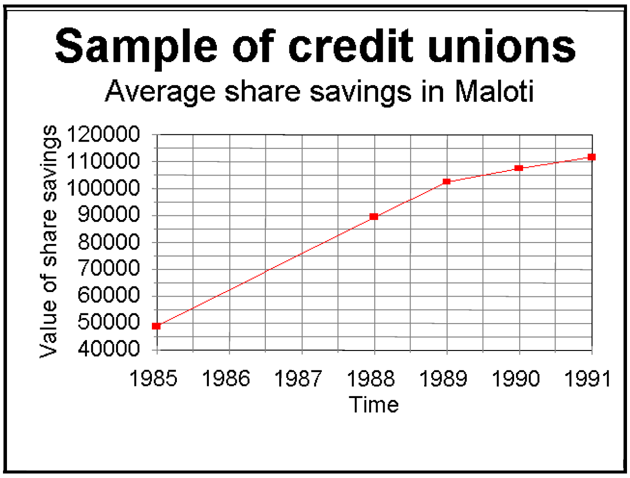


Figure 2.

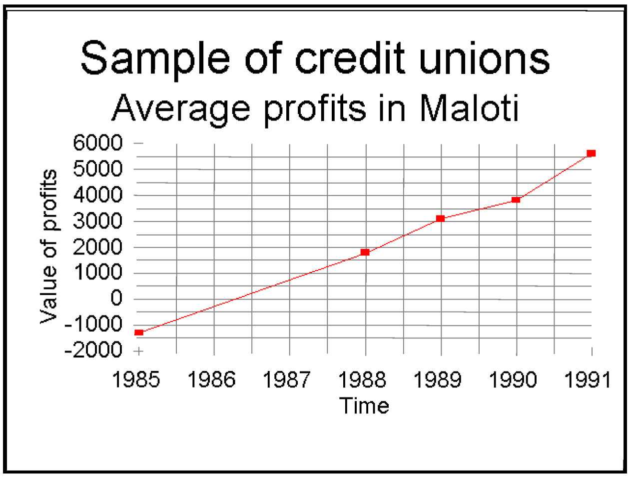


Data on the volume of loans outstanding (or loan portfolio) at the end of the year was readily available at most of the ten credit unions. However, because of generally high delinquency rates (see below), these figures were more of an indication of target group orientation in the past. Therefore, it was decided to collect information on the volume of credit extended in each of the years asked for, and this information could only be calculated directly from the ledgers of six credit unions.

While all of those credit unions experienced a growth in the volume of credit extended in the beginning of the period, a fall was experienced by most in the latter part of the period.

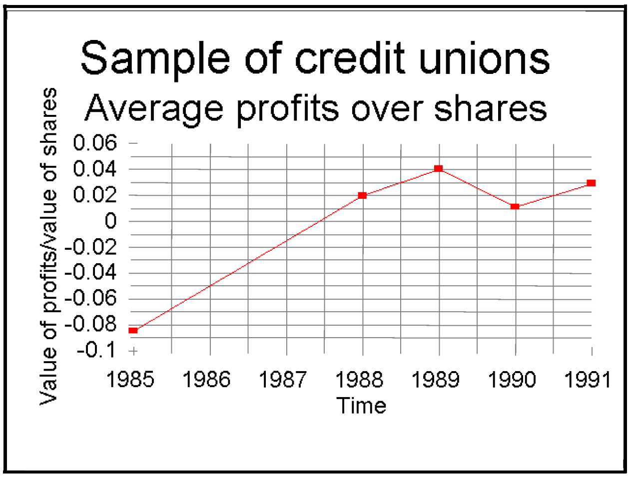
Another criterion for the extent of target group orientation would be the number of borrowers. Figures on numbers of borrowers are supposed to be registered by so-called credit committees within the credit unions. However, as we already mentioned in chapter II, only one of the credit unions visited was able to present reports of its credit committee over several years, casting some doubt on the proper functioning of credit committees and thus of credit unions. At four credit unions it was possible to calculate the number of borrowers for each year from the book of cash receipts. None of these credit unions showed a uniform trend in the number of borrowers. We will look into possible reasons for the absence of a clear trend in this indicator of performance in the following chapters.

Figure 3.



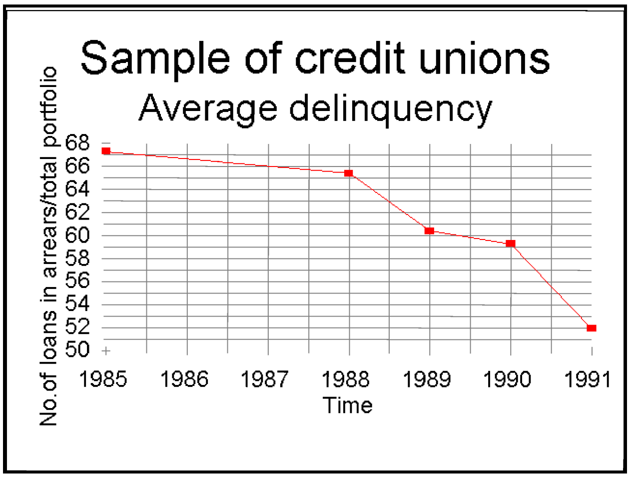
As we saw earlier, target group orientation is a criterion for judging the performance of a credit union, but viability is a necessary condition for good performance. In an effort to determine the viability of the credit unions in the sample, we started off by gathering information on profits. As can be seen in figure 3, the average profit of the sampled credit unions was negative in the beginning of the period, but gradually increased. Figure 4 shows that profits as a percentage of share capital increased in the beginning of the period but then stagnated at a low level.

Figure 4.



There are reasons to believe that this apparently positive development may not be very significant, as will be explained next. Credit unions are expected to calculate their monthly profits and write them in the profit & loss statement. Then they are supposed to accumulate the monthly profits that were made since January, and write these accumulated profits in the balance sheet. Very few of the organisations studied were able to do this correctly. Subsequently, in December of each year, they are supposed to allocate a part of those accumulated profits to dividends for the shareholders, and part to the reserves. LCCUL recommends that 25% of profits are allocated to reserves and the rest distributed as dividends. Not one credit union did this on a regular basis; profits were often allowed to accumulate over several years, thus presenting an overly positive picture of the credit union.

Figure 5.



As was mentioned before, delinquency although declining, was high all over the period. This can be seen in figure 5. Delinquency was calculated as the number of loans in arrears as a proportion of the total loan portfolio. It is unlikely that any of the credit unions could sustain such high delinquency rates. It is reasonable to believe that the quality of the loan portfolio in the other credit unions was much lower, and the ten organisations that we present here have probably only been able to survive as a result of their success in fighting delinquency.

Conclusion

We have seen in this chapter that the performance of the Lesotho credit union movement has indeed been disappointing. Official figures can be very deceiving. We found that LCCUL virtually stopped providing services to its target group, the credit unions, during the period under consideration. Also, the League was never viable in the sense that it could cover its costs, a situation which was partly due to its credit union base.

We found that approximately 65% of this credit union base are considered dormant, and it is likely that most of them are no longer viable, and technically bankrupt. Like LCCUL, they do not provide any services to their target group anymore. Even the ten organisations that survived the period in which most credit unions went dormant did not show a positive overall picture, especially in terms of their still very high delinquency rates. There is no reason to believe that these ten are strong enough to eventually survive.

In 1992 ACCOSCA went so far as to conclude that the Lesotho credit unions displayed all the symptoms of a dying movement. It had such serious operating and financial problems, that its future survival was very much in the balance.

To what extent has this disappointing performance been due to the inflow of external funds, and what has been the role of the very principles on which credit unions are based? Those are the questions that we will try to answer in the following chapters. We will start off by offering an overview of the external funds that the movement has received.

VII. Projects channelled through the credit union movement

From 1971 to 1991, Lesotho's credit union movement received continuous support from different donors through various projects. Tables 4, 5 and 6 below give an overview.

Table 4: Support of USAID to LCCUL 1971- 1989

Year	*Project*	*Executing agency*	*Source of funds*	*Amount of funds (US$)*
1974-1976	Small Farmer Production Credit Project: - institutional support - commodity support - technical assistance - small capital grant for onlending	CUNA Global Projects (later WOCCU)	USAID grant	..
1971-1978	Southern Regional Training Project: - regional courses - technical advisor	ACCOSCA WOCCU	USAID grant	..
1980-1983	LCCUL Development Project: - training - support for a central lending facility (CFF) - onlending for productive purposes	WOCCU	USAID grant UNCDF loan	600,000 100,000
1984-1986	LCCUL Development Extension, incl. credit line with LADB	WOCCU	USAID grant LADB loan?	400,000 50,000?
1986-1988	Lesotho Credit union Project, part of the Lesotho Agricultural Production and Institutional Support Programme (LAPIS), incl. credit line	WOCCU/ USAID	USAID grant	2,100,000
1988-1989	Revision Project: - training - administration	WOCCU/ USAID	USAID grant	200,000

Compiled from: WOCCU (1992)

Table 5: Dated donor support excl. USAID 1972 -1991

Year	*Donor*	*Project*	*Beneficiary*
1972	Catholic Relief Service	Hiring of a clerk	LCCUL
	CARITAS International	Acquisition of office equipment	LCCUL
1973	CARITAS International	Hiring of 4 field officers	LCCUL
1977-1980	Misereor (DM 180,000)	Development of credit unions: - salaries - equipment - transport - education of members - training of committees	Credit Unions
1980-1991	GTZ ($ 2,000,000)	Promotion of Small Farmer Production Credit: - technical assistance - training - commodity support	Credit Unions
1983-1987	Catholic Relief Service	Decreasing contribution to salary of 47 clerks	29 Credit Unions
1982-1989	Misereor	Contribution of 75% to building of offices in villages	22 Credit Unions
1987-1991	EZE (DM 140,000)	Contribution of 75% to building of offices in towns, through LCC	4 Credit Unions

Compiled from: LCCUL (1992)

As can be seen in the three tables, a very high number of projects were channelled through the credit union movement in Lesotho, mostly through LCCUL. The aid can be categorized as follows:

— aid aimed at strengthening credit unions and LCCUL, through institutional support and training

— aid aimed at helping credit unions and LCCUL by covering part of their operational costs, mainly salaries

— aid aimed at assisting credit unions and LCCUL by partially covering investment costs, such as those of office buildings and vehicles

— aid aimed at strengthening the agricultural sector by means of technical support and credit, by channelling this aid through LCCUL and the credit unions

Table 6: Undated donor support between 1981-1988

Donor	*Project*	*Description*	*Target group*
FAO	People’s Participation Project	Setting up of new credit unions	3 Credit Unions
GOL Dept. of Health	Promotion of Ventilated Pit Latrines	Channelling of loans through credit unions	2 Credit Unions

GTZ	Credit Union Manager Training Programme	18 managers for 9 months	18 Credit Unions
GTZ	Provision of Vehicles	2 cars and 5 motor-bikes for 5 years	LCCUL
GTZ	Provision of Agricultural Equipment	- equipment loans - equipment stores - reparation sites	Credit Unions
GTZ	Strengthening of LCCUL	- advise - training	LCCUL

Compiled from: LCCUL (1992)

The total project funds provided to support the Lesotho credit union movement between 1974 and 1990 exceeded US$ 6,000,000. Most of this aid was provided in the form of grants. Despite this extensive support, the movement is now on the verge of financial failure.

Over the period 1985 to 1991 most aid received fell into the fourth category. USAID and GTZ provided funds through programmes that targeted loans in kind as well as technical assistance to poor farmers. The repayments of the loans were supposed to flow into a revolving fund at LCCUL. The projects were complemented with aid in the first three categories: institutional support and training to LCCUL and the credit unions, as well as the supply of vehicles and the full payment of the salaries of a number of staff at LCCUL. Both donors tried to improve the functioning of the movement without interfering in the principles on which credit unions were based.

It was difficult to obtain information on the GTZ-supported projects, especially since no evaluation report seemed to be available in Lesotho. However, we did have the opportunity to study an extensive report by the World Council of Cooperative Credit Unions about the projects supported by USAID (WOCCU 1992). In order to understand the background of the projects that were in place between 1985 and 1991, we will provide a short history of the projects funded by USAID.

Support by USAID

USAID has been the main funder of the Lesotho credit union movement. It first got involved with the Lesotho credit union movement in 1974, when it financed a Small Farmer Production Credit Project. From 1971 Lesotho was also the basis for the USAID-funded Southern Regional Training Programme. In 1973-74 a consultant from the United States Credit Union National Association recommended a substantial strengthening of LCCUL's management, including the replacement of the general manager, to cope with the demands of a growing movement. Attempts to implement changes were obstructed by political pressures in the movement, which led to the termination of the USAID-funded technical advisor in 1976 and the project in 1978. The general manager was to remain in his position until the late 1980s.

However, following a resolution from the League board in 1980 to address management problems, USAID decided to finance a new project for institutional support. UNCDF provided a loan to the League for onlending to credit unions for productive purposes. The end-of-project evaluation in 1983 stated that while the necessary policies and procedures were in place to address loan delinquency problems and to attain self-sufficiency, performance in these areas was inadequate. It attributed this to the fact that most loans were for rain-fed subsistence crops which had a high failure rate in Lesotho's arid climate, and that the credit unions neglected to apply loan appraisal and collection procedures developed by the project. Also, it pointed to a lack of efforts on the part of credit unions and LCCUL to address financial and management control problems.

At the end of their 1980-1983 credit union development project, USAID was in the process of planning the $ 28 million Lesotho Agricultural Production and Institutional Support (LAPIS) project. Credit unions were being considered as one vehicle to deliver production credit to farmers, through the Lesotho Credit Union Project (LCUP). However, in their present state, credit unions were not strong enough to provide production credit. USAID funded a bridge project to strengthen 25 credit unions for the LAPIS programme, by hiring and training staff to deliver in-kind credit to farmers. Member training in agricultural production methods and marketing was to be added and carried out by a LCCUL field officer and the Ministry of Agriculture (MOA).

As the bridge project unfolded, a number of roadblocks to effective implementation appeared. MOA extension workers were not adequately trained to effectively assist farmers with the intended high-value agricultural production, so that it was decided to establish a credit line with LADB. At the same time, farmers were reluctant to obligate themselves for fertilizer and other inputs that require rain to be effective, the more so because the necessary irrigation equipment was not readily available and would be difficult to maintain. Additionally, marketing services were undeveloped.

However, in 1986 it was concluded that LCCUL was prepared for LCUP, as staff and members had been trained, an in-kind delivery system had been set up, and an effective system for monitoring and reporting loans performance was installed and operational in 45 credit unions. Extensive training had been provided to credit committees in the application of credit policies and procedures, and over 50 loan collectors were trained and asked to collect loans on a commission basis.

The project goal of LCUP was "to provide production loans to selected credit union member farmers in order to increase their disposable income from the production of medium to high-value agricultural produce and to support the development of the credit union movement through institutional and financial development of the LCCUL". The primary goal was the LAPIS credit objective. The secondary goal was institutional support. LCCUL had no interest in or support for the former objective, except in as much as it facilitated the second objective. USAID had exactly the opposite priorities.

We investigated the terms under which loans were to be given to participating farmers, and found the following. A farmer would receive a total of three loans, the largest of which was over M 12,500. This amount was much higher than the usual loans that credit union members received, which were on average no more than M 250. This amount was based on a calculation of expected yields under the condition that the farmer adopted advanced agricultural technologies. The amount was not related to the amount of savings in the account of the farmer, as was usual in credit unions. No collateral was asked, but since the largest part of the loan was provided in kind, in reality the material served as a partial collateral. The loans carried an interest rate of only 1% per month, just like many of the regular loans that credit unions gave out, and had to be paid back monthly after a certain grace period. But the payback period, 5 years, was again much longer than that of regular loans, which, we found, averaged about one year.

The intent was that credit unions would identify, amongst their existing membership, farmers who would qualify for technical assistance from MOA to grow irrigated vegetables. These farmers would apply for a loan from LCCUL. LCCUL would in turn request an advance of project funds to a revolving fund, from the project technical advisor. The advisor would provide project funds to LCCUL and these funds would be on-loaned through the credit union to the individual.

What actually happened was that the LAPIS technical advisors would identify farmers who, by virtue of the proximity of their land to a river, would qualify for credit and technical assistance. The farmer was taken to the credit union to sign forms he did not fully understand, the LAPIS project staff would define the input requirements, plan the crop, buy the inputs, deliver and install a complete irrigation system and supervise the farm work as best as they could. By the time the credit union could organise a meeting to discuss the farmer's application for membership, he already had a loan and the credit union had a loan from the League. As a result, neither the farmer, the credit union nor LCCUL felt any ownership or responsibility for the loan.

Only 8 credit unions and 28 farmers received loans under the project. It clearly supported individuals rather than credit unions. While the majority of the League's credit unions were not directly impacted by the production credit programme, human resources had to be diverted to support the few.

By 1988 LAPIS management realized that project returns had been overstated and farmers would lose money. Also, equipment started to break down and high-level skills proved difficult for farmers to learn. Grading, packing and marketing of produce were a problem. As a result, it was decided not to expand the programme to more farmers.

In 1988 the departing WOCCU resident advisor concluded that with the provision of 3,250 person days of training to League and credit union committee members and staff, as well as to credit union members, 400 technical assistance visits to credit unions by league staff and 67 credit union audits completed, the quantitative project outputs had been met. However, the credit union system was deteriorating. There was conflict at all levels of the credit union system. The LCCUL staff could not keep up with the transactions and no one, LCCUL staff, credit unions, LAPIS advisors or farmers had even remotely accurate information about loan balances or repayment records.

When a new resident advisor arrived, the LAPIS production component technical staff and MOA staff were preparing to assist the 28 irrigation schemes with their inputs. Seed and fertilizer were ordered, irrigation pipes and pumps installed between 1986 and 1988 were being upgraded and other basic implements were being purchased. LAPIS project staff were busy delivering equipment, crop planning and so on. Suddenly, the new advisor, in conjunction with LCCUL, ended the established practice of pushing through the project. It took another technical advisor and two LCCUL staff a full year to get a picture of the situation and to negotiate new loan agreements. By this time the whole production credit system had collapsed.

Following are the main findings of the USAID evaluation mission with regard to the credit component of the project:

1. The credit facility was not sustainable. LAPIS, LCCUL and the credit unions fell short of being able to provide the expected level of support to farmers. Not one of the 25 credit unions was in a position to support such a complex credit programme.

2. All loans were in serious arrears. No credit union had effectively collected the loans nor had the ability to appraise the quality of loan applications for complicated irrigation loans.

3. LAPIS loans were to new members and much larger than traditional loans. This caused conflict and adversity at the credit union level.

4. The advisor's priorities were out of line with the project expectations. Advisor priorities were toward credit union institution building while the project required that priority be given to LAPIS project objectives for getting loans to farmers to produce high-value crops.

With the apparent problems in the programme, USAID came to the conclusion that continued support for LCUP would not contribute to overall LAPIS project objectives. In 1990 all financial support for LCUP was terminated, and USAID withdrew completely in 1992. Loan delinquency had spread through the entire system to the point where drastic measures were required to try to save the movement (Gardiner 1993). In 1993 the LAPIS loans were all still unpaid, production had almost ceased and what little equipment there was that had not been lost or stolen was broken down.

Conclusion

In this chapter we saw that between 1971 and 1991 an enormous amount of money was pumped into the Lesotho credit union movement by a high number of donors through a great variety of projects.

Early in the process WOCCU identified a number of problems. Agriculture was a risky business in Lesotho, and markets were underdeveloped. The adoption of new agricultural techniques was slower than the project staff had hoped. The interests of management seemed to differ from the interests of members, and there was no enthusiasm for new credit technologies.

Aid between 1985 and 1991 was not aimed at strengthening credit unions but at strengthening agriculture. The programmes financed by GTZ and USAID required the rapid adoption of new agricultural methods by farmers, a change in the attitude of the management of LCCUL and credit unions, and the effective introduction of more sophisticated credit technologies.

The donors based the design of their projects on a number of assumptions. The major constraint for the development of the agricultural sector was perceived to be a lack of access to credit. Poor people's capacity to save was heavily underestimated. It was assumed that because the productivity of agriculture was low, credit needed to be cheap, and credit unions agreed with this point of view. The possible consequences of cheap credit for the functioning of credit unions were not taken into account. Credit unions were seen as units, where management and owners alike sought to maximise the benefit of the members.

Donors also were of the opinion that another important constraint faced by credit unions and farmers was a lack of education. Until people were educated credit unions faced high operational costs, which could be covered temporarily and then phased out. It was assumed that education would automatically lead to a fast adoption of better technologies.

The experience in earlier years should have made the donors wonder whether their assumptions were realistic. In the following chapter we will look into the role external funds played in the performance of the Lesotho credit union movement.

VIII. External capital inflow and performance

In this chapter we will attempt to find out in what way the injection of external equity has strengthened or undermined the functional capacities of credit cooperatives in Lesotho. Most of the credit unions in our sample did receive some support at some point in time. Since different credit unions received aid in different years, something can be said about the effect of aid on their performance.However, since aid to the apex organisation was continuous between 1971 and 1991, it is more difficult to analyse the effect of aid on LCCUL's performance. We can however study the performance after the withdrawal of aid.

As we saw in the last chapter, in the period between 1985 and 1991 funds were provided to different primary credit unions through five projects:

- Ministry of Health — loans for the building of Ventilated Improved Pit Latrines
- Misereor/EZE — donations for the building of offices
- CRS — donations for the payment of clerks
- GTZ — loans for agricultural equipment and inputs and for small-scale enterprises
- USAID — loans for high-value vegetable and fruit production under irrigation

In chapter II a number of hypotheses were formulated about the effect of the inflow of external capital on the performance of credit unions:

— the inflow of external funds decreases the ability of a credit union to mobilize its own funds

— the inflow of external funds decreases the quality of the loan portfolio

— the inflow of external funds increases the importance of secondary/tertiary credit unions

We will look into these hypotheses one by one.

Ability to mobilize funds

According to Krahnen and Schmidt, the main reason for people to join a credit union is the access it provides to credit. Thus, as an inflow of external capital increases the funds available for lending, at first the membership grows, and people increase their savings so they can borrow more. However, the availability of external funds makes it possible to lower the savings requirements on which receipt of a loan is conditional. Thus, in the long run, a credit union's ability to mobilize its own funds declines, and it becomes dependent on the donors.

We saw in chapter VI that on average, membership, share capital and shares per member in the sample grew fast until 1989, when growth started to diminish. 1989 was also the year when many miners started to be retrenched and when aid started to be cut. Growth after that year was very much slower than before, but on average there was no fall.

Part of this effect can be attributed to the described policy change that is often a consequence of inflows of aid. According to WOCCU (1992), up until 1983 it was common credit union practice, supported by LCCUL, to provide loans to members up to the amount in the member's savings account. Members complained about this conservative practice, saying that they were only borrowing their own money and for that reason did not feel an obligation to repay. Therefore, WOCCU encouraged credit unions to borrow or withdraw funds from the central finance facility at LCCUL and their bank accounts and lend them to their members.

We found that in the years after that, many credit unions, including the ones who did not borrow from LCCUL, introduced the possibility for a member to borrow two or three times his or her savings, and some credit unions abandoned any restriction. They did not, however, effectively introduce more sophisticated credit technology to select and monitor borrowers and to recover these loans, as we will explain later.

Because the inflow of external funds diminished later in the decade, and because delinquency stayed on a high level at the credit unions that did not receive aid, many credit unions had to return to a restriction on the loan/share ratio. This reduced the access that members had to funds, and probably contributed to the slow-down in the growth of share savings.

The two smallest credit unions of the three which received an irrigation loan under the LAPIS project experienced no more growth but complete stagnation in their membership after the injection of funds, and a fall in share capital five years later. There was no growth in savings because only two or three members had access to the LAPIS loans. The inflow of funds was however accompanied by a general lowering of the savings requirement. Many members took loans above their repayment capacity. The LAPIS farmers could or would not pay back their loans, and neither could or would the other members who had taken out loans. Once LAPIS farmers got away with this, so did other farmers. As delinquency rose to extremely high levels, the access of other members to loans decreased very seriously. And since the main reason for people to join a credit union is the access to loans, some of them eventually withdrew their shares.

We saw before that deposit savings did not serve as collateral for loans, and were really used as current accounts. Many credit unions actually introduced deposits at some moment in the period under consideration, and others abandoned them. It is not surprising to note that the quantitative importance of deposits was only slight, and no relationship could be observed between the injection of funds and growth or fall in deposits.

Overall, we found that the presence of projects led to a temporary lowering of the savings requirement, without a simultaneous improvement in credit technology. This led to the extension of loans above repayment capacity and higher delinquency rates. A renewed restriction on access to loans caused a reduced growth in savings, and in the case of very high delinquency, a fall in savings. Thus, in the long run the inflow of external funds did indeed affect the credit unions' ability to mobilize funds in a negative way.

Quality of the credit portfolio

Krahnen and Schmidt assert that the inflow of external funds decreases the quality of the loan portfolio. It increases the average size of loans and the volume of the loan portfolio, but delinquency rises. This is worse in the case of injections by government. The larger credit portfolio requires the use of a new credit technology, which consumes part of the onlending funds, thus reducing the volume of the creditline. Until the new credit technology is adopted, managers try to avoid excessive risks by keeping some of the funds from being channelled to borrowers. When the new credit technology is adopted operational costs rise.

We found that indeed, since average share savings per member increased over the period, and the savings requirements for borrowers decreased, the absolute loan size did go up. This effect was made even stronger by the fact that loans provided in the context of projects funded by LAPIS and GTZ were generally much larger than traditional loans. Loan size was no longer related to repayment capacity of borrowers.

ACCOSCA (1992) comments on an important side-effect. When long serving officials of credit unions saw that a new member who had just joined was given a very large loan, they promptly advanced themselves similar sized loans form the credit union's meagre resources. Their rationale was that if anyone was entitled to such a generous loan they were, because they had devoted so much of their personal time and effort to the running of the credit union over the years. However, as opposed to participating farmers, these officials did not take part in a programme to improve production methods. As a consequence, they did not increase their income and repayment capacity.

As was indicated in chapter II and repeated in chapter VI, it was very difficult to obtain reliable and complete data on the total volume of loans extended by the credit unions in the sample, as many did not keep overviews. We can, however, do a little theoretical exercise with the information that we have. We know that in the absence of an injection of external equity, credit unions cannot lend out more than their share capital. They will usually lend out between 50 and 90% of that share capital. We know the value of the loans extended in the context of the LAPIS project, as well as the value of the share capital of the three credit unions which received such a loan. We calculated that the LAPIS loans as a proportion of a credit union's share savings varied between 40 and 400%.

From these figures it can be derived that the volume of loans must have increased enormously as a consequence of the inflow of capital. Krahnen and Schmidt suggest that the injection of external funds causes credit cooperatives to grow beyond the size at which peer monitoring is effective. But we think that the credit unions in the sample were already too big before they received any aid. The smallest had 133 members in 1985, and some credit unions served more than 15 villages. The staff members that we interviewed complained of low attendance to meetings, which made peer pressure even less effective.

Any peer monitoring that was still taking place, was made more difficult by the characteristics of the LAPIS project. The investments that participating farmers had to make were far too complex and too expensive for the ordinary members to understand, and they could not judge whether participating farmers were unable or unwilling to repay.

Krahnen and Schmidt suggest that the injection of external funds requires the adoption of a new credit technology, and the costs of this technology will consume part of the funds for onlending. We found that donors as well as credit unions gave priority to getting credit to the farmers, and paid very little attention to the required improvements in credit technology to make sure that the loans would be paid back. Loans were mostly made in kind, and it was therefore impossible to use the funds for the coverage of operational costs. The lack of funds killed any incentive for managers to improve credit technology.

The main indicator of the quality of the portfolio is delinquency. We saw in chapter VI that the sampled credit unions showed that although delinquency in the sample was very high over the whole period, it fell from an average of 70% to around 50%. The delinquency of two of the credit unions that received a LAPIS loan varied between 60 and 95%. The third simply did not report delinquency levels in most years, we only have a figure of 50% for 1988, and that is probably the lowest of all years.

Many members were unable to pay back because it took them a long time to understand and apply the new production methods. The size of their loans was not related to their repayment capacity. Other members were unwilling to pay back, because LCCUL had received the money or inputs as a grant, to be put into a revolving fund, and did not have to pay back anything to the donors. Contrary to what Krahnen and Schmidt say, members were actually more inclined to pay back to government institutions like LADB than to pay back loans that LCCUL made to the credit unions from a donor-funded grant.

Delinquency in the sample did not grow but fall. This is probably related to the fact that the inflow of funds made people expect repeated access to loans if they paid back in time. The fact that delinquency in the sample kept falling after aid was cut off, can be traced back to an eventual change to more prudent policies. New loans were related to savings or repayment capacity, and a higher interest rate on loans was an automatic selection mechanism. Many credit unions were not able to contain delinquency and went under, and as we said before, the fact that most credit unions in the sample were able to contain delinquency probably partly explains their survival.

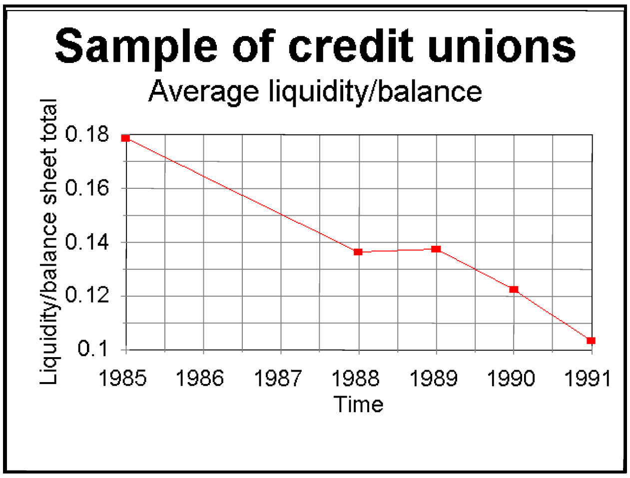


Figure 6.

Krahnen and Schmidt hypothesize that, in the short run, before improved credittechnologies are adopted, the inflow of funds increases the risk of delinquency. The managements reacts by adopting a risk-averse policy, which prevents it from actually channelling the funds at its disposal to borrowers, and leads to high relative liquidity levels. As can be seen in figure 6., this effect was absent in the case of Lesotho. The total volume of loans increased, and since most projects between 1985 and 1991 only provided credit in kind, the existing high liquidity levels could not be maintained.

They also suggest that personnel and administrative costs increase as a consequence of external inflows. However, we found that the projects gave managers no incentive to improve their methods. Interest income from the loans was low, and no alternative funds were available for covering additional operating costs. As members had joined for the access that the credit union gave them to credit, and available funds were large, they were not interested in improved selection, monitoring and recovery methods either. We might add that the picture is blurred because many credit unions received donations from CRS to pay for the employment of clerks for four years or more, starting in 1984. And as we saw in the foregoing chapter, most of the administration of the LAPIS project was carried out by LAPIS staff or not at all.

Importance of higher-level organisation

Krahnen and Schmidt's third hypothesis is that the inflow of external funds increases the expenses made and the control exerted by the higher level organisation.

According to Crush (1982), LCCUL's expenses reached M 52,000 in 1978, while in 1992 we found that its expenses were M 320,000. Since LCCUL hardly provided any services anymore in 1992, it is likely that its expenses were much higher during the period that aid was received. But already with the available figure we can calculate that its expenses amounted to 8.5% of the aggregate share capital of its member credit unions in 1978, while it had reached 9.8% in 1992. We may derive that LCCUL's relative importance with respect to the primary level had indeed increased.

The growing control of the apex organisation would express itself in part through the installation of internal auditing departments at the higher level, and consequently through the imposition of conditions on the application of funds. However, the WOCCU report states that only 67 credit unions were audited between 1986 and 1988, and the Commissioner of Cooperatives became responsible for auditing after that time, this change of policy not being very effective in increasing the amount of auditing.

We do not feel that aid has helped LCCUL to exercise its power over the primary credit unions through the control of their books or the setting of conditions on the application of funds. But we do consider that, the other way around, aid has made it difficult for the primary credit unions to control LCCUL, as it allowed management problems at the higher level to persist. Changes in management only took place after aid had been terminated.

Conclusion

We found that the credit unions in the sample that received substantial amounts of aid did indeed experience difficulties in raising their own funds in the long term. Krahnen and Schmidt attribute this development to the fact that an inflow of funds lowers the savings requirement for borrowers. We found, on the contrary, that in the long run, after aid had ended, high delinquency levels forced credit unions to return to rationing credit through an increase in savings requirements and interest rates. This decreased the incentive for people to become a member and to save.

The portfolio quality in the sample was low, but did actually increase during and after the inflow of aid. Krahnen and Schmidt would expect a decrease in the quality of the credit portfolio, because loans from external funds would not be related to repayment capacity, and cheap, therefore perceived as a grant. Also, the credit union would get into problems because the inflow of funds required a change in credit technology, which must be financed from the funds for onlending. We found that in the case of the credit unions in our sample, repayment was better because people expected repeated access to loans. When aid stopped, the credit unions switched to a more conservative policy, and this probably partly explains their survival. The credit unions in the sample hardly improved their credit technology, because the in-kind loans did not leave them any funds, and they did not feel ownership of the projects.

At the same time, the importance of the apex organisation was heavily boosted during funding, but collapsed after funding ended. We found, as Krahnen and Schmidt expected, that LCCUL's expenses increased disproportionately as a consequence of the inflow of funds. But rather than finding that LCCUL's control over the primary credit unions increased, we found that aid made the primary unions lose control over LCCUL.

The data collected from the sample confirm the statements made in several evaluation reports, that 20 years of aid have not strengthened the Lesotho credit union movement. WOCCU, in its final evaluation report (WOCCU 1992), states that:

> "Too much help created a dependency relationship with funding agencies which actually had a negative effect on achievement of objectives. It is evident that the Lesotho credit union movement received more financial support from numerous donors than it could effectively absorb."

A number of possible reasons are identified in the report:

— for development efforts to succeed the recipients of financial and technical assistance must be completely committed to implementing changes. The Lesotho movement's reluctance to change was evident as far back as 1976, but renewal of aid was not made conditional on the strengthening of the League's management or the implementation of recommendations;

— in the latter stages of the assistance, the primary objective of the funding agency was inconsistent with the needs and development of the credit union movement. WOCCU and LCCUL should have said "no" to the offer of financial assistance.

ACCOSCA draws the same conclusion, by saying (ACCOSCA 1992):

> "Without doubt the single most important factor which has impacted on the Lesotho movement has been the proliferation of badly targeted donor support."

ACCOSCA offers the following tentative explanations for this situation:

— financial self-sufficiency at the national level was never seen as an important priority by either the LCCUL leadership or the donors;

— most of the more recent donor projects supporting LCCUL were not designed to help the savings and credit cooperative movement develop and grow;

— many of the LCCUL projects provided funds for onlending to individual credit union members and this contributed to a massive increase in the level of loan delinquency;

— the vast sums spent on education and training in Lesotho have had little effect.

— donor funding allowed poor leadership to survive and prosper at LCCUL, because proper accountability was not being demanded of them by the members.

WOCCU and ACCOSCA emphasize the inconsistency between the objectives of the the donors and the credit unions movement. We found that the main problem with the aid that was given to the credit union movement between 1985 and 1991 was indeed the fact that its main objective was not to strengthen the credit union movement, but to strengthen agriculture using the credit unions as a means to an end. In the race to meet project targets, project staff pushed credit onto farmers. The farmers took what they could, and, soon realizing that they could get away without repaying, they did so.

The effort to strengthen agriculture through the credit union movement has failed, but we believe that the basic reason for this failure is that there were a number of inherent problems in the functioning of the credit union movement, and aid programmes have allowed these problems to persist. Aid has stimulated imprudent and even risky policies, and not given enough incentives for the improvement of credit technology. We will enter into these inherent problems in the next chapter.

IX. Internal financing and performance

It is easy to say that the disappointing results of the Lesotho credit union movement are due to misguided development efforts, but we may ask to what extent aid has allowed already existing problems to persist. We saw in chapter II that the very principles on which credit cooperatives are based may contain the root of the problems that these organisations now face. The central question we will try to answer in this chapter is whether the design of credit unions in Lesotho created difficulties in the raising of equity. Most of the information in this chapter is based on data collected from our sample of credit unions.

Solidarity

Krahnen and Schmidt suggest that the possibilities for attracting share savings by paying high interest rates or dividends are necessarily limited by low income and high costs of credit unions. We tested this hypothesis for the six credit unions that we visited in Lesotho.

First we tried to find out whether income was low. We found that interest rates charged on loans were quite rigid over the period under discussion, and they did not move with the market. Most credit unions in the sample changed the interest rate they charged on loans from 1 to 2% per month during this period. The first rate, which they considered equivalent to a rate of 12% per year, can indeed be considered a low rate compared to rates charged at formal banks. This can be seen in the adjacent table 7.

Table 7. Nominal interest rates on loans

	1985	1988	1989	1990	1991
Prime commercial rate	15	17	20	20	20
Maximum commercial rate	26	27	30	30	30
Lioli credit union	24	24	24	24	24
Khomo Khoana credit union	12	12	24	24	24
Makaota credit union	24	24	24	24	24
Masiasiane credit union	12	12	12	24	24
Mazenod credit union	12	12	12	12	12
Mekaling credit union	12	24	24	24	24

Sources: Central Bank of Lesotho (1991) and individual credit unions

Interest income of a credit union must, among others, compensate for the costs of default. Since delinquency rates were between 70% and 50% for the sample, it is unlikely that the interest rate charged could actually cover the costs of the credit union. This was probably the reason why the interest rate was increased to 24% per year. This new rate was between the prime rate (the rate for the best borrower) and the highest rate (the rate for the most risky borrower) charged by formal banks. But considering that borrowers must compensate for the fact that they do not need to offer collateral in the credit union (as opposed to the banks), and that they are allowed to invest in the risky business of agriculture, the rate may be considered relatively low. It was still much lower than the rate charged by moneylenders (10% to 20% per month). Overall, we may conclude that credit union income was low.

Aid programmes generally did not interfere with the pricing of loans, and donors quite agreed with the need for low interest rates. The loans that were channelled through LCCUL to the credit unions were given to members at the same rates as the loans that were financed with share capital. The fact that foreign donors favoured low interest rates made it very difficult for credit unions to raise the rate for members that did not participate in the projects.

After income we looked at the costs of the credit unions in the sample. These can be subdivided in costs of loan appraisal, monitoring and collection. As to appraisal costs, we found just like Poyo (1995), who studied credit unions in the Dominican Republic, that these were originally virtually absent. Anybody who had been allowed to become a member had a right to a loan. Since the interest rates on loans were relatively low, many members wanted to borrow, and a conflict ensued. We found that credit unions had felt obliged to ration credit by some method, and many had limited the loan/share ratio to 1. In order to select the best borrowers, credit unions were also forced to change to more sophisticated and more expensive methods of loan appraisal.

As to costs of monitoring and collection, Krahnen and Schmidt argue that originally, these were also low thanks to the possibilities for peer monitoring. But, as was mentioned in the last chapter, we found that none of the credit unions visited was small enough to allow for peer monitoring to be effective. This meant they also had to switch to different methods for monitoring and collection. So overall, costs had become very high.

Aid programmes increased the need for better appraisal and recovery methods, and required a fast adoption of new technologies.

Table 8. Real return on savings

	1985	1988	1989	1990	1991
Commercial savings rate	-6.7	-1.5	1.2	6.4	-6.5
LADB savings rate	..	-4.8	-5.0	6.4	-6.5
Lioli credit union	-14.7	-14.0	-13.5	-7.7	-15.5
Khomo Khoana credit union	-11.2	-10.4	-8.6	-2.7	-15.0
Makaota credit union	-14.7	-14.0	-14.3	-9.1	-19.5
Masiasiane credit union	-14.7	-12.0	-11.8	-7.1	17.5
Mazenod credit union	-11.9	-14.0	-7.0	-3.6	-16.0
Mekaling credit union	-6.7	-14.0	-14.3	-9.1	-19.5

Sources: Central Banks of Lesotho (1991) and individual credit unions

We will now look at the level of dividends paid on share savings, especially compared to other forms of saving. We saw in chapter V that the main alternative for share savings in rural areas is investment in livestock, and that the real return on livestock was positive over the greater part of the period. We can see in table 8. that not only were real dividends on share savings of the six credit unions in the sample always negative over the period, they were also much lower than the interest rate paid on commercial savings, never reaching more than half of that rate.

Dividends may be considered as the costs of funds that credit unions face. When foreign aid came in, credit unions were expected to borrow money from LCCUL against a rate that was generally higher than the dividend they paid on their own share capital. This meant that the spread between interest income and the costs of appraisal, monitoring and funds became very small. The small spread made it impossible for credit unions to change to more advanced credit technologies. Krahnen and Schmidt suggest that credit unions would use part of the funds for onlending to cover these costs. However, in the case of Lesotho this was very difficult, as many loans were given in kind. Project staff also demotivated credit union staff to engage in better methods, as their focus was on loan-delivery rather than loan-recovery.

While real dividends were very low, we have seen that membership, savings and savings per person did grow over the period under consideration, even when GNP growth was low and the economic situation was difficult in the countryside. This means that savings of credit union members were quite interest inelastic. We might suggest some possible reasons:

— many credit union members were women, and investment in livestock was generally done by men

— bank branches did not reach into remote areas of Lesotho and therefore did not compete for savings there

— at formal banks, savings did not automatically provide the right to borrow

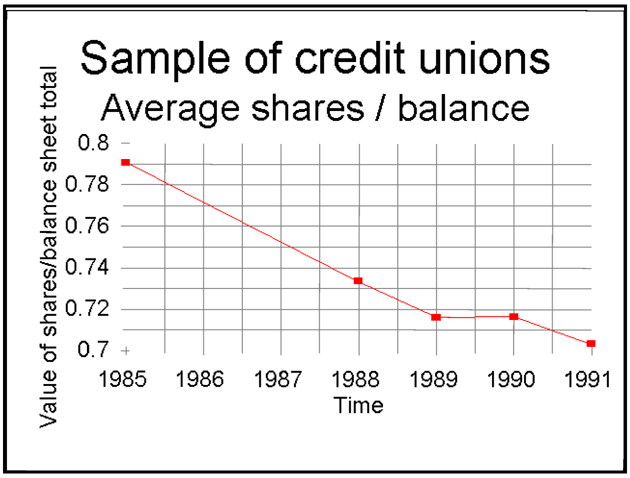
The fact that members save at the credit union even when real dividends are negative confirms the finding in other countries that poor people save and make eager use of savings facilities when these are provided. Apparently there was a lack of alternatives, even in the form of informal rotating savings and credit associations. But we saw in chapter V that at the same time LADB started to open savings accounts at other places in the countryside. It paid a higher interest rate, and savings at LADB showed a much faster rate of growth. It is likely that higher dividends would have attracted more savings, especially in the places where credit unions had to compete with other banks.

It may, on the other hand, be argued that some members had actually already withdrawn their shares. We saw before that especially when people could not borrow more than the balance in their savings account, they did not see the sense of being a member. They therefore took a loan exactly the size of their savings and disappeared. In effect, they redeemed their shares. However, in the period under consideration delinquency in the sample decreased, meaning that this type of redemption was not of importance.

Aid programmes did not have a positive effect on dividends. Since credit unions could attract funds from outside the credit union, they were not motivated to increase dividends.

Redeemability

Figure 7.



Krahnen and Schmidt suggest that because shares are redeemable, the management prefers to allocate the larger part of any profits that are made to reserves, and distribute only a little in the form of dividends. We saw before that average accumulated profits were low but did grow over the period under consideration. We also saw that despite those profits dividends paid were indeed very low, especially in the beginning of the period.

Contrary to what Krahnen and Schmidt say, the downward trend in share capital as a proportion of the balance total (which is actually observed in Lesotho, see figure 7) is not an indication of an increase in reserves. Rather, it shows the increase in donations received by, and irrecoverable debts incurred by the credit unions.

We calculated reserves directly by adding "Reserve Fund" and "Undivided Earnings" on the balance sheet. These reserves as a proportion of the balance sheet (figure 8.) and as a proportion of shares were actually very low (around 5 and 4% respectively). Considering the high delinquency rate, prudent policy would have suggested a higher reserve ratio. The regular upward trend in profits was not reflected in the development of reserves, and they remained very low.

Figure 8.

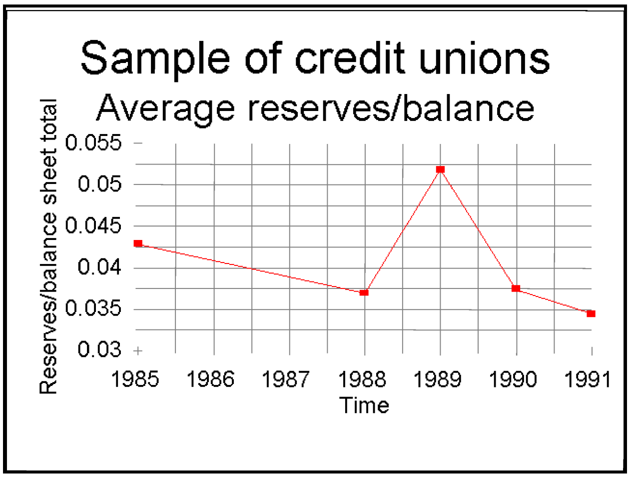
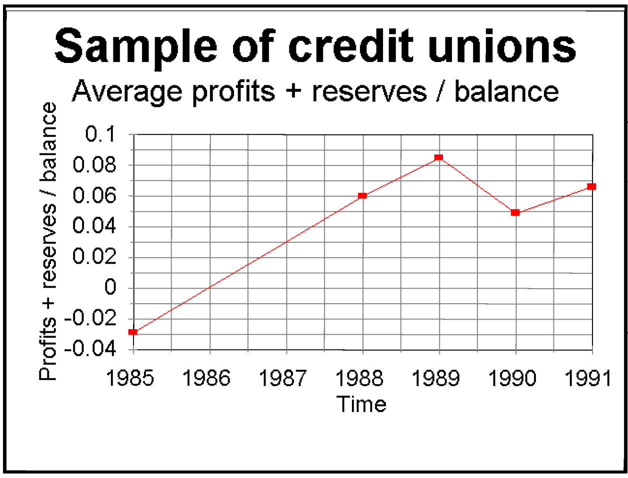


Figure 9.



It is however questionable whether the sum of "Reserve Fund" and "Undivided Earnings" is an accurate indicator of the reserves of a credit union. We noted before that profits are often allowed to accumulate on the balance sheet for several years. They are neither allocated to reserves nor to dividends. But since they are not paid out to members, they are effectively a kind of reserves. In order to see whether a disproportionate part of profits is withheld from members, we might therefore study the development of the sum of accumu-lated profits and reserves. As can be seen in figure 9, reserves plus profits increased until 1989 and then decreased again.

It seems that low profits made it difficult to benefit either reserves or dividends, neither policy can therefore be confirmed. We feel that the access to aid has not stimulated any distribution of profits, as it reduced the need for paying high dividends, as well as for building up reserves.

We agree with Poyo (1995) that the redeemability of shares tends to affect management behaviour differently. Managers do not need to strengthen their position out of fear for redemption, because redemption is not a very effective instruments in the hands of members in a situation where there is no competitive market for capital or for managers. Members will not redeem their shares easily, because as we saw their main reason for joining is access to credit, which they do not have elsewhere. Also, they will not quickly redeem their shares to enforce a change in leadership, in the presence of a shortage of qualified managers. The limited risk of redemption facilitates excessive shirking and opportunistic behaviour by management.

Aid has been based on the assumption that the interests of management coincide with those of the members. By providing alternative funds, it made the instrument of redemption even less effective. Thus, it has allowed bad management to continue.

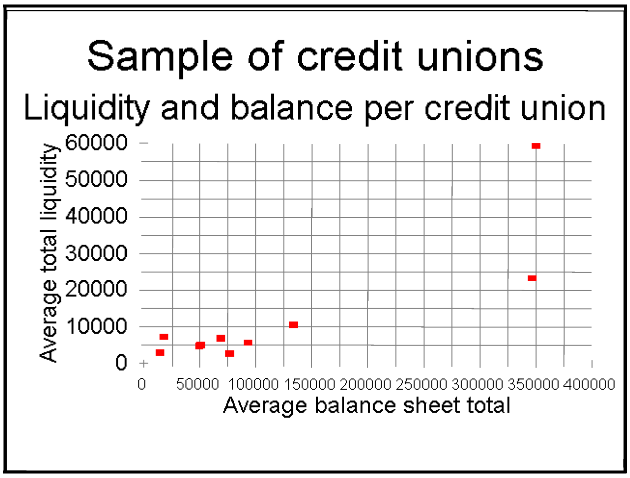
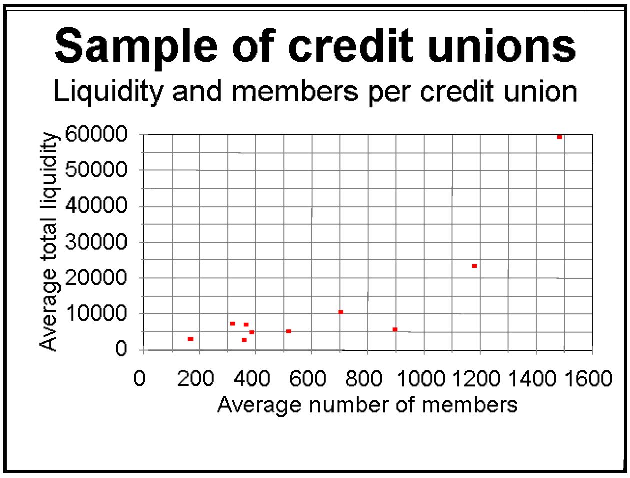


Figure 10.

Subsequently, Krahnen and Schmidt suppose the existence of a relationship between the liquidity reserves and the size of a credit union. They say that small credit cooperatives are sustained by the idea of solidarity, which minimizes the risk to their liquidity, while large credit cooperatives are sustained by large, non-redeemable reserves, and therefore also do not require large-scale liquid reserves. Medium-sized credit cooperatives, by contrast, would need to maintain considerable amounts of liquidity.

Figure 11.



In our sample, the suggested relationship between liquidity reserves and balance sheet total does not show up. This is shown in figure 10.

However, the balance sheet total is only one measure of size. Considering the fact that we are talking about the effect of solidarity on risk, the number of members would be a better indicator of size. But if we plot liquidity reserves against the number of members, we still do no observe the suggested relationship. We would like to suggest three possible explanations:

— our sample was very small and did not include credit unions that were small enough for solidarity to be effective;

— the growth of the average share capital over the years means that credit unions had the experience that inflows of capital were larger than outflows, which lessened their motivation to hold liquidity reserves.

Donor stimulation of a smaller savings requirement for borrowers along with the provision of large loans in kind has made it difficult for credit unions to maintain high and prudent liquidity ratios.

Equality

Krahnen and Schmidt suggest that the democratic one-member one-vote principle demotivates members to increase their savings. If this effect existed, it was more than offset by the fact that many people did not have any alternative place to leave their savings, and they needed the access to loans. However, we found that the limited influence of every one member together with the considerable size of many organisations did affect peer control in a negative way, thus maintaining high delinquency levels.

Gardiner (1990, 1993) considers that the root of the problem of the credit union movement in Lesotho lies in the fact that its development has been top-down and that the democratic process has not been effective. Many members have not felt ownership of their organisations and as a result, in many cases, a small local elite have managed to secure control over the local organisations. He alleges that during the mid-1970s through to the early 1990s credit unions became associated with partisan politics. This politisation and the subsequent corruption of the democratic structure contributed dramatically to the general malaise of the movement.

We feel that this undemocratic development can be attributed in part to the separation of ownership and control, and the limited possibilities for share redemption. This together with the absence of a competitive market for managers encouraged opportunistic behaviour and eventually resulted in high levels of delinquency.

Because the credit unions were not considered to belong to the formal financial sector, control by the Government or by the Central Bank was virtually absent. Support and interventions were largely left to the donors. And as we have already seen, the availability of outside funds increased the power of management.

Conclusion

In this chapter we have looked at the way credit union principles were interpreted, and the consequences this had for the functioning of credit unions.

We found that it was derived from the solidarity principle that poor people should get cheap loans. Cheap credit did not allow for a high return on savings, and as a result, people joined credit unions basically for the access they provided to loans. The low interest on loans resulted in an excess demand for credit, and credit unions reacted by rationing loans by other methods than raising interest rates. The slow growth in equity to meet this demand was related more strongly to the high savings requirements for borrowers than to the fact that low interest on loans did not allow for a competitive return on equity.

The redeemability principle served to handle the problems that are related to the separation of ownership and control. However, due to the absence of competitive markets for capital and for managers, the instrument was not effective. This meant that managers did not have an incentive to increase their power relative to members, by influencing the distribution of profit, and thereby demotivating the formation of savings. Rather, it facilitated excessive shirking and opportunistic behaviour by managers.

The equality principle was used to assure that individual members could not abuse their financial power. It did not demotivate people to save, as their basic motivation to save was the access savings provided to credit. However, the growing size of credit unions led to the loss of possibilities for peer control, and the need for more sophisticated credit technologies. The pricing strategies did not allow for more expensive methods.

When donors (especially USAID) used the credit unions as a means to pursue their own ends, they were over zealous in encouraging members to take loans. The members might not have had the interest the donors had in the projects, and when it became apparent that they could get away without making repayments they did so, thus encouraging others (notably management) to do the same.

X. Conclusions

In this paper we have looked into the effects of using financial cooperatives in Lesotho as conduits for getting financial resources to the poor. We have tried to establish the link between the performance of the Lesotho credit union movement over the period 1985-1991, the influx of external funds and the principles on which credit unions are based.

We found that the performance of the movement was generally disappointing. While it was difficult to establish the growth in target group orientation, it was very clear that the viability of the apex organisation as well as the credit union base was very much in the balance. Decreasing performance went parallel with the injection of an enormous amount of aid. Between 1971 and 1991 more than $ 6 million were pumped in by some 10 donors through even more projects.

We found that the disappointing performance of the Lesotho credit union movement could be attributed mostly to the interpretation that was given to the principles on which credit unions are was based. These principles led to a pricing policy that distorted incentives for members and management alike.

The problems that were inherent in the design of the credit unions were exacerbated by the injection of external funds. Projects were not aimed at strengthening the credit union movement but were targeted at individuals. Necessary improvements in credit technologies were postponed, and distorted incentives were continued. When external support was withdrawn, it was too late to correct policies and save the majority of the credit unions.

In our opinion, the poor in Lesotho would benefit most from a programme that targeted the credit unions themselves. Credit unions should be helped by making them self-sufficient and increasing their outreach by introducing a market-oriented pricing strategy and a results-based system of remuneration.

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Appendix A: Hypotheses formulated in Krahnen and Schmidt (1995)

a. Equity: internal financing and performance

1. The return on cooperative shares is lower than their opportunity costs (i.e. it may not exceed interest income on deposits, which in turn are less remunerative than alternative forms of savings outside the cooperative).

2. By comparison with that of other financial institutions, the application of profits of credit cooperatives is characterized by the allocation of a larger sum to reserves, i.e. too little is distributed.

3. The share capital is a monotonous function of the number of borrowers.

4. The growth of credit cooperatives is primarily the result of business policy decisions to accumulate reserves, with the formation of share capital playing a subordinate role, i.e. the balance sheet item "share capital" grows disproportionately slowly compared with the balance sheet total.

5. Increasing the volume of reserves makes the credit cooperatives more immune to the danger of unexpected withdrawals of share capital: the share of liquid assets as a function of the balance sheet total shows a single-peak distribution (small CCs are sustained bu the idea of solidarity, which minimizes the risk to their liquidity; large CCs are sustained by large, non-redeemable reserves, and therefore also do not require large-scale liquid reserves; medium-sized CCs, by contrast, need to maintain considerable amounts of liquidity.

6. The sum of share capital plus reserves as a share of the balance sheet total exhibits a double-peak distribution, as there are a relatively large number of borrowers (accounting for a high volume) both where the equity ratio is low and where it is high.

b. Onlending: external capital inflow and performance

7. After an injection of external funds the membership of a credit cooperative grows at a faster rate than before receipt of the additional funds.

8. After and injection of external funds there is a temporary increase in the (absolute and relative) volume of share saving.

9. In the long term, the proportion of share savings (at least in relative terms) sinks below its initial level prior to the inflow of capital, provided the interest rates are not adjusted and that members have access to alternative financial institutions in practice.

10. The deposit savings of a credit cooperative start to decline after and injection of capital provided that they pay below-market rates of interest.

11. Following an injection of external funds (i) the average loan amount rises, (ii) the volume of the credit portfolio increases, (iii) the amount by which the credit portfolio increases is smaller than the amount of new external funds, (iv) the quality of the credit portfolio deteriorates, i.e. there is an increase in the arrears and default rates.

12. The deterioration of the credit portfolio after an injection of external funds takes place in the following order of severity: it is worst in the case of funds provided by government sources, including the central bank, somewhat less serious in the case of international "soft loans", and is least severe in the case of "hard commercial loans".

13. Following an injection of external funds, the cooperative's liquidity reserves increase and remain on a higher level in the long term, i.e. there is a permanent increase in the utilization of funds for non-target-group-oriented purposes.

14. Following an injection of external funds there is a disproportionate and permanent increase in personnel and administrative costs at all levels of the credit cooperative system.

15. Where external funds are channelled via the apex organisation, this leads to the installation of internal control institutions (internal auditing departments) and consequently to the imposition of conditions on the application of the funds by the primary and secondary cooperatives.

16. The availability of external funds leads to a disproportionate rise in the "Operating Expenses" reported by the regional associations and the apex organisation.

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