



**The Behaviour of Microfinance Institutions in  
Targeting and Lending Strategies  
Case of BRAC and Finance South Sudan Limited in  
South Sudan**

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***Andrew Ohide Loting Valerio***

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Members of the Examining Committee:

Dr. Howard Nicholas

Dr. Robert Sparrow

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***Inquiries:***

**Postal address:**

Institute of Social Studies  
P.O. Box 29776  
2502 LT The Hague  
The Netherlands

**Location:**

Kortenaerkade 12  
2518 AX The Hague  
The Netherlands

Telephone: +31 70 426 0460

Fax: +31 70 426 0799

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## List of Acronyms

AML	Anti-Money Laundering
ARC	American Refugee Committee
BRAC	Bangladesh Rural Advancement Committee
BSS	Bank of South Sudan
CGAP	Consultative Group to Assist the Poorest
CORDAID	Catholic Organization for Relief and development Aid
CPA	Comprehensive Peace Agreement
CTF Act	Counter Terrorism Financial Act
FDS	Finance and Development Service Co. Ltd
FSSL	Finance South Sudan Limited
GDP	Gross Domestic Product
GEMSS	Generating Economic Development through Microfinance in South Sudan
GNI	Gross National Income
GRSS	Government of the Republic of South Sudan
GSS	Government of South Sudan
I-CSP	Interim Country Strategy Paper
IFC	International Finance Corporation
IMF	International Monetary Fund
IRDP	Indian Integrated Rural Development
MDGs	Millennium Development Goals
MF	Microfinance
MFI	Microfinance Institution
MFI	Microfinance Institutions
MFPs	Microfinance Providers
NAMIPO	National Microfinance Policy
NBHS	National Baseline Household Survey
NBS	National Bureau of Statistics
NGOs	Non-Governmental Organizations
OPM	Oxford Policy Management
ROSCAs	Rotating Savings and Credit Associations
RUFI	Rural Finance Institution
SSDI	South Sudan Development Initiative
SSDP	South Sudan Development Plan

SSMDF	South Sudan Microfinance Development Facility
SSP	South Sudanese Pounds
SUMI	Sudan Microfinance Institution
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Program
USAID	United States Agency for International Development



## **Abstract**

Microfinance has been receiving recognition and support from international community, international organizations, NGOs and governments as a policy option for poverty reduction. Governments, donors and NGOs have adopted development strategies to support the growth of MFIs for the implementation of microfinance programs by providing financial services to the poorest segment of the population. The rapid growth of MFIs has raised concerns from both scholars and academic researchers on whether MFIs are really operating using the right strategies to serve the poor.

Therefore, based on this fundamental idea, this paper examines MFIs (FSSL and BRAC) in South Sudan looking at their targeting strategies, lending methodologies and their problems to serve the poorest. The study shows that for-profit making MFIs tend to target the productive clients and exclude the poorest segment from their programs in terms of both targeting and lending than the no-for-profit making MFIs. Only those MFIs that have programs with well designed products within the demands of the poor may likely maintain the poorest clients.

Overall MFIs in South Sudan have a low level of well designed targeting and lending strategies for serving the poor and poverty level increases due to the current conflict in the country. Government and donors should empower the microfinance sector through financing MFIs, build their capacity and strengthen other poverty related development intervention programs to assist microfinance in poverty reduction.

## **Relevance to Development Studies**

In development studies, microfinance has received great attention and support worldwide as one of the development intervention policy options for poverty reduction. This has been proven by government and donor supports for the development of the microfinance industry through MFIs to implement microfinance programs and provide financial access to the vulnerable poor. Therefore, the choice of this paper to carry out a study on the behaviour of MFIs in South Sudan looking at their targeting and lending strategies as well as problems with serving the poor is more relevant to development studies.

## **Keywords**

Microfinance, MFIs, Target groups, Lending methods, Poverty, Poverty reduction.

# Chapter One: Introduction

## 1.1. Background

South Sudan is one of the newest African countries and in the world at large with a population of 11.3 million and comprises 64 ethnic groups with different languages. It is one of the landlocked countries and is categorized among the low-income countries in the world. South Sudan is bordered by Sudan in the north, Ethiopia in the east, Kenya in the south east, Uganda in the south, Democratic Republic of Congo in the southwest and Central Africa Republic in the west. It is administratively divided into ten states with three regions of greater Equatoria, Upper Nile and Bahr el Ghazal. However, South Sudan was once part of Sudan but suffered domination from external powers and experienced oppression and underdevelopment for a period nearly two centuries. South Sudan due to political, economic, cultural and religious differences<sup>1</sup>, seceded from Sudan when it got its independence on 9<sup>th</sup>, July 2011 (SSDP 2011: 4, 13).

## 1.2. Justification

Worldwide, microfinance has been chosen as one of the policy options for alleviating poverty. The Government of South Sudan (GSS) supports the development of microfinance industry as part of its policies for poverty reduction. Therefore, the paper attempts to analyze the behaviour of MFIs in South Sudan looking at how they target groups, lending methodologies and their problems with lending to the poor.

MFIs started operation in South Sudan in 2006 just after the signing of the comprehensive peace agreement (CPA) as part of the Government of South Sudan policies<sup>2</sup> for poverty alleviation, which would contribute to the achievement of Millennium Development Goals (MDGs) by 2015. However, during the 2005 Donor Conference, both the government and donors agreed to establish South Sudan Microfinance Development Facility (SSMDF) as a government organization in charge of monitoring financial and social indicators for the improvement of MFIs and advice on potential markets. It was established in 2009 as company limited by guarantee (Lee and Stone 2013: 6). However, with South Sudan being a new country, little research have been done on microfinance and was basically looking on how much the government, donor agencies and non-governmental organizations have

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<sup>1</sup> This is taken from the contextual background of South Sudan Development Plan (SSDP) 2011-13 giving the quick overview of the history of Sudan where in fact the Arabs came into Sudan as traders and gradually took over the leadership after the colonial rule.

<sup>2</sup> Policies of poverty reduction are incorporated within the government development documents such as South Sudan development Plan (SSDP), South Sudan Development Initiative (SSDI), Interim Country Strategy Paper (I-CSP).

contributed to the startup of the MFIs as well as looking into the number of staff, number of clients and the loan size. However, no significant achievements have been made on poverty reduction. As such a lot of gaps on microfinance lending policies, increased expansion of microfinance to poor regions and how the poorest of the poor have access to microfinance lending were left unaddressed, which this paper seeks to address to assess the targeting and lending models of microfinance institutions and the problems with lending to the poor.

However, in South Sudan, the absence of formal wage labour, most people are active in the informal sector. Therefore, microfinance has been seen as the main instrument that could help the poor to improve their livelihood and achieve its objectives of poverty reduction (Stewart 2010: 8). Nevertheless, microfinance institutions play a greater role toward the development of the economy through provision of financial access to the poor and preventing them from experiencing financial difficulties. However, this assumption is contested and needs to be analyzed especially in the case of South Sudan where MFIs might have not implemented proper targeting and lending policies with limited provision of some financial products such as micro-savings and agricultural loans (Lee and Stone 2013: 6 and Hulme 2000: 79).

### **1.3. Research Objective**

The main objective of this paper is to analyze the behaviour of microfinance institutions in South Sudan focusing mainly on strategies of targeting groups, lending methods, and the problems with lending to the poor.

### **1.4. Specific Research Questions**

- What is the relative extent of microfinance lending in South Sudan?
- Who do they lend to?
- What are the problems with lending to the poor?

### **1.5. The Research Hypothesis**

In the study MFIs, one of the most frequent assumptions is that the presence of MFIs in the country would improve targeting and lending to the poor people, providing access to financial services and raise their standard of living (Otero 1999: 8). However, to carry out a research that examines the behaviour of microfinance institutions, the following hypothesis has been identified: (1) there has been a relative increase in the size of loan to borrowers from microfinance lending (2) there has been a rise in microfinance lending targeting particular group(s), (3) there have been series of problems with lending to the poor.

However, microfinance has been viewed as one of the core strategies within the government policies for providing financial services to the poorest for poverty reduction (Otero 1999: 8). Nevertheless, this could be achieved through provision of inclusive microfinance lending, targeting the poor in order to improve productivity and increase their level of income to attain basic needs and access to social services (Zeller and Meyer 2002: 5). However, this

research examines the above hypothesis in order to establish the concluding evidence on whether microfinance institutions have been directing their lending services towards the intended group of borrowers. Because worldwide anticipation and government policy toward microfinance institutions is that they represent or partner to implement part of government policies in fighting poverty.

## **1.6. Methodology and Data Analysis**

The method of data collection and analysis is the most crucial and significant process for the researcher to identify in order to address the research questions and provides credible analysis. However, the researcher carried out data collection himself using expert interview method to examine MFIs' strategies for targeting groups, lending methodologies and the problems with lending to the poor, in the two cases of Finance South Sudan Limited (FSSL) and Bangladesh Rural Advancement Committee (BRAC) within Juba town, South Sudan, see appendix 7. The researcher conducted face to face interviews with senior managers and officials from SS MDF, FSSL, and BRAC. Nonetheless, these interviews were based on the institutional settings, sources of funding, financial products, loan facility, regional coverage, productive activities, loan and income tracking. The secondary data was collected from documents and reports of microfinance institutions including their websites, government documents and reports, use of library books, academic literatures, journals, and the internet sources to generate the required information.

The main aim of choosing these two institutions was because of their maturity, relative coverage of the country with microfinance services and considerable number of borrowers. However, conducting interview with the senior manager from SS MDF was to find out the role of the government, donor agencies and NGOs support for microfinance sector in terms of coordination and financial support to strengthen the expansion of microfinance industry in South Sudan.

Since most of the data collected was based on expert interview and with some statistical data from secondary data, the researcher used both quantitative and qualitative (triangulation methods) to analyze the data. Qualitative was used to analyze texts and used quantitative for descriptive statistics such as tables and graphs using excel program to illustrate the findings. O'Leary asserted that 'one approach is not necessarily better than the other. What is important is [...] the work toward reflexive awareness and informed choice' (O'Leary 2004: 87)

## **1.7. Limitations of the Study**

Generally, although a number of microfinance institutions are operating in South Sudan, this research had limited its focus on interviewing and analyzing the two microfinance institutions (BRAC and FSSL) the first registered MFIs in South Sudan. Another institution interviewed was SS MDF that acts as an apex institution responsible for the supervision and support of Microfinance institutions in the country. The interviews were based on face to face discussions with senior official so as to minimize bias and strengthen the validity of secondary data. The researcher used expert interview due to limited

time frame and inadequate resources to cover enormous study in the whole country. However, data collection was based in Juba, the capital city of South Sudan due to financial constraint. The data collection exercise covered the period from second week of the month of July to the third week of August 2015. Besides, infrastructure in South Sudan especially roads are still very poor and coupled with the political situation in the country, inter-regional movements became very limited. South Sudan conflict has affected negatively the economy, limited or ruined the infrastructure such as roads and building structures, and distorted the working environment. Data availability is limited or very raw if available.

## **1.8. Organization of the paper**

The paper is organized into five chapters. Chapter one starts with the introduction that include background, justification, research objective, research questions, methodology and limitations, chapter two deals with conceptual framework and literature review on the behaviour of microfinance institutions focusing on targeting and lending strategies and problems with lending, chapter three explains the general background of South Sudan and MFIs, chapter four deals with case presentations and analysis on microfinance targeting and lending strategies and the problems with lending to the poor in South Sudan with emphasis on the two cases of BRAC and FSSL and chapter five gives the Conclusions.

## **Chapter Two: Conceptual Framework and Literature Review**

This chapter reviews the concept of poverty in relation to microfinance industry to achieve its objectives of poverty reduction strategy and examines microfinance literature base on targeting strategies and lending methods including the problems with serving the poorest group.

### **2.1 Poverty in the context of microfinance lending**

The main focus of this study is to explore and examine the microfinance targeting and lending methodologies in the context of South Sudan and therefore the concept of poverty is fundamental to review because microfinance lending objective is to target the poor by offering financial services to improve their living conditions through participation in income generating activities.

However, the word poverty is a multifaceted concept to define. The concept may mean lack of access to basic human needs such as food, shelter, clean water, clothing and other social services. It may include economic, social and political deprivation. On the other hand, Poverty could also be categorized into relative and absolute poverty. Relative poverty refers to a condition where one may afford the required basic needs but might not have the capacity to buy luxurious assets. Meanwhile absolute poverty refers to a situation where a person may not have enough money to meet basic needs and might lead to social exclusion (SSDP 2011: 12 and Chowdhury and Mukhopadhaya 2012: 502).

Poverty measure adopted by the World Bank of \$ 1.25 a day, dividing populations into wealthy and poor levels or above and below the poverty line should not be generalized all over the world. Simply because the standard of living in the developed country compared to one of the poor developing countries may not be the same and purchasing power parity might not be equal as well (Ravallion et al. 2008: 2,7 and Ravallion et al. 2009: 165). However, considering the inclusive policy of microfinance, most of the poor people seem to be abandoned or excluded by microfinance institutions on the pretext that these poor people lack collateral and may not be able to repay the loans in future. Nevertheless, group lending model has come to act as a solution to include these groups of people, since the group itself serves as a guarantee by sharing each other's conditions in group (Karnani 2007: 36).

Nonetheless, microfinance has been generally acknowledged as one of the policy options by donor community, international organizations, governments and NGOs for alleviating poverty through provision of small loans (Campbell 2010: 1082, Bali Swan 2004: 3 and Bassem 2008: 343). Conversely, Bali Swan (2004) asserted that there has not been any impact on the poverty level of households particularly on female borrowers, health, schooling, fertility and empowerment of women. Instead the study shows that microfinance has a bigger impact for the household nearer to the poverty line, rather than the poorest of the poor. The study suggested that microfinance program might result in redistribution rather than a rise in income and

employment if the economic growth in the country could be slow (Bali Swan 2004: 3)

## 2.2 Targeting groups

Targeting plays a central function in government programs for poverty reduction policies in the underdeveloped countries and allow policy makers to direct programs to the poor with the best use of the limited resources (Wodon 1997: 2083). A target group according to Ledgerwood (1999) is a group of prospective clients who share a common objective and tend to have the same characteristics that could attract a mixture of particular products and services. It represents a section of clients who may possibly have a demand for microfinance services (Ledgerwood 1999: 33). However, for MFIs to select target group, they should first establish their objectives, know a group of clients and ascertain if the target group could be reachable to maintain financial sustainability. The target group should be selected based on effective demand for financial services with capacity of that group to take on debt. In fact these groups could be known by the 'characteristics of the clients (poverty level, gender, ethnicity, caste, religion, and others)' and the type of 'business activities (existing business, growth-oriented business or specific economic sector)' (Ledgerwood 1999: 33). Wodon (1997) pointed that other indicators for targeting could be based on the characteristics of household that include education, occupation, land ownership and geographical location, citing that education could be a better targeting indicator for urban areas while land ownership would be better for rural areas (Wodon 1997: 2083).

Institutions that fail to state clearly their objectives and their target group or could not design their products to meet the demand of this group usually encounter complexities running their programs. An institution for example, that aims to offer financial services to the poorest group but fails to define who the poor are and the level of their poverty may end up providing services to diverse level of poor group with different model of program that could suit particular donors. It has been suggested that donors and practitioners should be clear concerning proper target group for particular MFIs that constantly aim to meet the demands of those clients (Ledgerwood 1999: 33 and Morduch and Haley 2002: 3).

### Types of group targeting strategies use by MFIs

Targeting group involves two types that include direct and indirect targeting.

**Direct targeting** aims at specific allocation of certain funds to offer loans to a particular segment of group. It is founded on the idea that certain group of people or sector lack access to financial services, hence, loans should be made available to them through government and donor permission and sometimes the government or donor may subsidize the cost of borrowing to clients (Ledgerwood 1999: 34). However, direct targeting may lead to loan diversion and low rate of repayment and those selected may not have business skills or may pursue unproductive projects that could not need funding (Ledgerwood 1999: 35). **Indirect targeting** on the other hand shows that products and services could be made to people outside the financial services rather than providing funds to particular group who fail to match a set profile for targeting. It aims at those who could not have opportunities for income

generating activities due to market imperfections or other obstacles to financial services. This occurs since certain groups outside the target group might have some alternatives for financial services that the target group may not possess (Ledgerwood 1999: 35).

## 2.3 Microfinance Lending Methodologies

MFIs have gained international support and operate relatively successful in some countries like Bangladesh, Bolivia and Indonesia that have developed relative income and created employment opportunities for the poor in underdeveloped countries (Bhatt 2001: 319). Nevertheless, MFIs have gained widespread operation in the underdeveloped countries to offer basic financial services to underserved poor people with small loans (Roberts 2013: 120). But this does not mean it has been only confined to developing countries but micro-lending has also been introduced in transitional economies such as Bolivia and Russia as well as western countries like Canada and USA and served millions of households worldwide (Abbink et al. 2006: 614). The low success of microfinance industry in serving the ultra poor could be related to the lending methodologies which until now, one of them have not properly address the problem of the poorest people. The poorest remain underserved within the MF sector although the core objective of MFIs is to serve the very poor people. MFIs generally share the same prime objective of providing financial services such as loans and saving to the poor so as to free them from financial limitations and help reduce poverty (Godquin 2004: 1909).

However, the fact that MFIs could not function in the same manner conventional banks operate should not be concluded that MFIs may not be interested in profit making and efficiency matters. There has been recognition that economies worldwide seems to progress base on people buying and selling as well as lending and borrowing. It has been recognized that, when the market operates smoothly it attracts market players where sellers would be linked to buyers and lenders to worthy borrowers (De Aghion and Morduch 2004: 135).

### Debates on different lending methodologies within the MFIs

MFIs have several lending methodologies including the renowned group lending and individual lending. *Individual lending* is a system where an MFI provides loans to individuals who are not necessarily members of a group provided the borrower has certain level of collateral and security for loan guarantee. According to Ledgerwood (1999) individual lending possess the following characteristics: the loan is guaranteed by collateral or alternatively guarantor; potential borrowers are screened using credit check and character reference; factoring in the loan size and terms to business needs; the loan size and terms of business often increase in due course; and staff relationship with customers to decrease monitoring costs. Individual loan seems to be greater than the group loan and might even be less costly to establish (Ledgerwood 1999: 68 and CGAP 1998: 10).

*Group lending* is a method where people form themselves into groups with a common objective to have access to financial services (Ledgerwood 1999: 68). However, each member accepts a joint liability of the loan provided to individuals. This method reduces the level of defaulters and increases the chances of successful loan repayment rates and acts as substitute for the



collateral and could act as an alternative for providing loans to the poorest people (Gutierrez-Nieto et al. 2007: 131, Morduch 1999: 231 and Ledgerwood 1999: 70).

Though group lending has been relatively acknowledged by a number of scholars and practitioners as an effective lending methodology, it still needs some modifications to include the poorest group since it applies the condition of joint liability as a proxy for collateral. However, MFIs have been operating under one umbrella to fulfill their mandate of providing loans and other financial services to poor people worldwide and in particular the developing countries (Hartarska and Nadolnyak 2007: 1207 and Bassem 2008: 343, 345). The loans have been provided to poor people base on the market approach and on a sustainable manner to benefit the very poor. Nonetheless, MFIs apply innovative lending techniques such as group lending and individual non-collateralized loans focusing on systematic increments on the loan size based on repayment conditions as well as charging interest rates base on the market environment so as to reimburse the high screening, monitoring and enforcement costs (Hartarska and Nadolnyak 2007: 1207). The Indian Integrated Rural Development Program (IRDP) for example, ended up with loan repayment rates of about thirty percent before it has been renamed and rehabilitated.

### **The Grameen experience**

Grameen Bank in its experience has been able to convince donors that it has been 'possible for lending institutions in rural areas' to be protected from political involvement and that lending to the poor may generate higher rates of repayment. As such most Grameen's life loan repayment rates have been reported at ninety-eight percent and this achievement has been centered on the methodology of group lending that has been adopted worldwide (De Aghion and Morduch 2004: 137). Nonetheless, the Grameen policy was to provide collateral free loan to the poorest only but it could give loans to individuals in a special consideration but individual borrowers interested to get loans to run their individual projects would have to consult the bank with four other borrowers having similar loan request to obtain the loan as a group to avoid strategic defaults. However, this has attracted the attention of many researchers to investigate this methodology, with many have argued that to help micro-lenders overcome an adverse selection problems, borrowers should be allowed to form their own groups voluntarily (De Aghion and Morduch 2004: 138).

### **Critical uncertainties on borrower's information and security in lending**

Nonetheless, the modern financial institutions have emerged working in touch with the local communities that may have access to the information of the borrower at relatively less cost and might not be of great interest to profit but focus on job creation for both women and the youth that could lead to development and improve livelihoods. However, MFIs as an intermediary institutions, offer small loans to the poor population who could provide little or no collateral but this could not necessarily mean the loans could be free or grants, instead loans are repayable with interest depending on the terms of the loan (Gutierrez-Nieto et al. 2007: 132). However, conventional financial institutions in certain instances might provide some loans to the deprived poor groups as part of the socially responsible investment policy, but this only serves the government policy of poverty reduction.

However, the argument has shown that MFIs pay less attention for loan provision to individual than group lending with the assumption that individual lending lacks guarantee except guaranteed by collateral. Therefore, under this scenario, the poorest seems to be excluded from the lending program and may remain vulnerable (Gutierrez-Nieto et al. 2007: 132). Nonetheless, the conventional banks have hard time differentiating between risky and safe borrowers and if identified properly, it charges riskier borrowers with high interest rates while safer borrowers would be charged with low interest rates. However, the issue would be if the bank fails to identify the borrowers' characteristics, the bank may resort to charge flat high interest rates to all potential borrowers and this might force safe borrowers to quit the credit market (De Aghion and Morduch 2004: 138).

Conversely, one of the advantages for group lending has been putting local information work for the outside lenders. In certain occasions even if the bank could be left without information on the type of defaulters, villagers usually ought to have good information about the relative risky conditions of their neighbours (De Aghion and Morduch 2004: 138 and Ledgerwood 1999: 70). Considering the situation where MFI could provide loans to a joint group lending at flat interest rate, an MFI would scrutinize the loan applications from borrowers who are considered heterogeneous in their location, group lending ability and preferences for the group quality (Godquin 2004: 1910). However, before applying for the loan, the borrower has to acquire clear information regarding cash requirements, expected returns and the chances of succeeding to do various projects during the operation. Therefore, the critical decision would be for the borrower to consider the cost of the project return in comparison to external return and should be higher than every installment of the loan (Godquin 2004: 1911).

### **Empirical differences of the lending models**

According to the empirical evidence from Zimbabwe in 1986, it has been found that group lending performs better than individual lending during periods of good harvest and worsened during years of draught where high default rates are expected. Whereas, some studies have shown that group lending that applies private information for the selection of their group members and techniques of selection raises the peer repayment performance (Godquin 2004: 1912). However, MFIs have been cited as an innovative means of solving such problems. But within the microfinance lending, although individual lending differ in their implementation, the most shared and prominent lending has been the group lending (Abbink et al. 2006: 615). Indeed group lending model has been the foundation of microfinance lending since loan could be backed by peer group instead of requiring formal collateral. But shifting from group lending to individual lending may lead MFI out of uncollateralized lending that has been necessary to reach the very poor clients (Marsland and Strøm 2009: 29).

However, in the market where villagers know the types of safe and risky characteristics of borrowers, the group lending method would encourage 'assertive matching', where safe borrowers would have to form their groups among themselves and risky borrowers would have no option but also to form groups among themselves since they are liable to default (De Aghion and Morduch 2004: 138). However, under group lending, the group members play a greater role in monitoring each other and may warn to impose social suction

if the peer has chosen risky project and each member bears monetary penalty in case of default (De Aghion and Morduch 2004: 139-140).

### **Formulating various lending strategies to tackle riskier borrowers**

However, in the standard MF program, borrowers involving in the riskier projects could form a joint group that could apply for the group loan. This acts as a joint liability and could provide insurance against personal risk even if an individual program fails and some borrowers failed to repay the loan, the whole group may still be able to pay the loan. In this case joint liability could act as an alternative to collateral. However, microcredit has greatly been successful in developing countries than the conventional credit programs. Showing that repayment rates have been raised to the point formerly not experienced in the developing regions (Abbink et al. 2006: 615).

According to various studies, it has been found that smaller size of group lending (as seen in the Grameen bank example of typical 5-10 people in the group) seems to be more effective or preferable than larger group because of better “in-group” coordination and might reduce the level of free riding issues. Conversely, others argue that group with ten or more members might still operate efficiently (Abbink et al. 2006: 615-616 and Hulme and Mosley 1996: 5). However, group lending method has gained recommendations from researchers but it still has some problems; for instance, when one borrower failed to repay the loan among the group of say five, the other four would be under pressure to contribute for the loan and if they could not, the loan may no longer be lent to any of them even if they were excellent clients (De Aghion and Morduch 2004: 141).

Nonetheless, with modern innovation, microfinance has been increasingly progressing towards bilateral contracts between micro-lenders and clients, specifically progressive lending where borrowers could be given small loan size base on weekly repayment and would increase annually as the borrowers display their reliability and trustworthiness. This has allowed micro-lenders to examine and screen out the riskier borrowers before increasing the next loan size (De Aghion and Morduch 2004: 141). On the other hand, borrowers become fearful of being denied future access to loans if they could not repay the previous loan (De Aghion and Morduch 2004: 141-142).

However, in the formation of self-selection group for example, it might be difficult to form such groups in the transitional economies of urban contexts than in the rural ‘closer-knit’ communities and has been argued that the focus on group lending in such economies could be abandoned and favorable dynamic programs could be planned (Abbink et al. 2006: 616). However, group lending performs better in the repayment rates than those achieved by individual lending. Though the rates of individual contribution of large group reduced slightly but the impact of free riding has been eradicated by larger spreading of risk (Abbink et al. 2006: 616).

### **Borrower preferences in microfinance lending (male vs female)**

A number of MFIs tend to target women as their clients; this could be because women seem to be the most reliable borrowers or because of the goal that advocate for women empowerment in MF programs. However, the study found that women tend to contribute greatly to public goods than men (Abbink et al. 2006: 617). However, repayment of group loan tends to be in form of group contribution but this is usually difficult to determine whether a

member default could be strategic default or due to the project failure, because information about the success or failure of the project is said to be private (Abbink et al. 2006: 618). However, micro-lenders may not wholly depend on progressive lending because where there would be a great number of micro-lenders, failure to refinance the borrowers might cause default and those who default may join other micro-lenders. Conversely, if the loan size increases, the default rate might increasingly become attractive particularly when the relationship between the micro-lender and the borrower has a final date of repayment (De Aghion and Morduch 2004: 142).

Another microfinance lending consist of flexibility with regard to collateral, where the bank may reach a number of borrowers through reducing the salvage value of collateral, nevertheless this innovation could still need some form of collateral and could undermine the efforts of micro-lenders to reach the poorest borrowers. It has been argued however that this type of innovation has been proven effective when lending to households just below and above the poverty line focusing on female borrowers or clients (De Aghion and Morduch 2004: 142). This has been proven by other studies that women seem to increasingly take the lead in processing and active in small enterprise business. Another reason could be that women tend to repay loans more effectively and might have effective financial strategy than men as well as use their part of the income to finance health and education for their children (De Aghion and Morduch 2004: 142-143).

### **The demand for savings in microfinance lending**

However, saving has been one of the microfinance concerns, although this type of innovation has not been taken seriously by economist since they have been focusing on credit markets without recognition on savings problems with the assumption that poor households have limited demand for savings since their income seems small (De Aghion and Morduch 2004: 143). Quite the reverse, some scholars argued that even each poor household would wants to save (Hardy et al. 2002: 5) and they have been saving through imperfect and informal ways such as hiding money in the house, handing to depositors and many other ways, while joining rotating savings groups (De Aghion and Morduch 2004: 143-144). Accordingly, most microfinance institutions have started introducing both voluntary and compulsory savings facilities. The voluntary savings has been introduced to meet the individual demand for small savings, while compulsory savings seems to act as collateral and could not be withdrawn without the knowledge of the group and the bank may access it during times of repayment problems (De Aghion and Morduch 2004: 144).

#### ***2.4.1 Repayment Problems for the loans***

Repayment problems remain an over-all concern of MFIs, which would mostly impede the operations of the institutions and may affect their progress in reaching the markets. Nevertheless, every MFI works towards maximizing its repayment performance irrespective of being a profit or non-profit affiliated institution. While maximizing repayment rates, the practice would be a win-win situation that consequently benefits both MFIs and the borrowers, allowing MFI to reduce interest rates charged to the borrowers and as such reduced the financial cost that attracts more borrowers to join the program. In addition, it

reflects the satisfaction of clients demand by MFIs' services and allows MFIs to access funding from donors (Godquin 2004: 1909).

Conversely, Abbink et al. (2006) pointed out that heated debates from practitioners and academic scholars cautioned that lending to group involves a fundamental dilemma: 'It may insure the credit against involuntary default, but individual borrower's reliance on fellow borrowers to repay the loan gives the former an incentive to free ride' (Abbink et al. 2006: 615).

### **Market imperfection could influence repayment problems**

The fundamental causes influencing repayment would either be associated to 'information asymmetries, adverse shocks affecting the borrower or the low performance of institution such as justice or education' (Godquin 2004: 1909). Nevertheless, the main strategy for every individual, has been to dodge and hold others liable for own default if the success of an individual program have not been sufficiently verified by other members of the group (Godquin 2004: 1909). However, Godquin (2004) asserted that for an MFI to attain high repayment rates, it has to implement the policy of 'perfect 100% first-best level' of on time repayment rate, and if this could not be achieved, then the second-level strategy could be applied to increase the repayment performance; this strategy include provision of huge loans to borrowers taking into account the low level of defaulter probability and seeks to lower the repayment delay (Godquin 2004: 1909). As MFIs became aware of their situation, they have come to incorporate a number of safeguards of which the most prominent have been the borrower should be self-selected in the group (Abbink et al. 2006: 615).

On one hand, information asymmetries may occur when an MFI failed to acquire information on the behaviour of the borrower due to high cost. On the other hand, information asymmetries may engender issues of adverse selection such as allocating loans to undesirable borrowers with high risk of default and inadequate effort to use the loan and misdirect it to unproductive projects and might lead to moral hazards (Godquin 2004: 1909-1910). Godquin (2004) argued that adverse selection and moral hazards increase the proportion of borrowers who could not repay their loan on time (Godquin 2004: 1913). However, if the legal system grants little power to an MFI to enforce contracts and the lending institution has low collateral requirements, the cost of strategic default might lower down. However, MFIs tend to use dynamic incentives as well as non-financial services for group lending and could be applied when the borrower renewed his credit. Nevertheless, MFIs would apply dynamic incentives when they measure the loan size to the borrower and the previous repayment behaviour applies to the new loan allocation (Godquin 2004: 1913).

Notwithstanding, clients with timely repayment may improve the condition of the loan and as the repayment schedules became flexible, the loan size increases too. However, there would be need for clients to have high income in order to fulfill loan repayment on time, because if the income may be lower than expected and the repayment might be too high, loan repayment on time could not be met and this would need an alternative source of income to increase the ability of the borrower to repay the loan on time (Vogelgesang 2003: 2086).

### **Pre-scrutinizing borrower's characteristics**

Nonetheless, Researchers have argued that banks should make best distinction between old and new clients so as to 'generate the inside reputation mechanisms' (Vogelgesang 2003: 2086). However, to test this repayment behaviour, the new clients would be provided with small loans and once this initial loan has been successfully repaid, clients could then be provided with better lending conditions favorable for each loan repayment in order to maintain the status of the client desired. For example, 'It has been noted that reputation effect plays a considerable role beyond the borrower – client relationship due to the relatively widespread availability of credit records in the Bolivian microfinance market' (Vogelgesang 2003: 2086). The study however revealed that reputation effect may lead to the continuous system of incentive compatible lending contracts despite the absence of collateral and hence building reputation by microfinance lenders plays a crucial role in the microfinance markets (Vogelgesang 2003: 2086).

In the case of late repayment, this might lead to a borrower paying a penalty in the form of high interest rate than the previous repayment rate. On the other hand, the bank may collect the client's collateral or take the loan to the court if the repayment has been overdue for more than thirty days (Vogelgesang 2003: 2088). However, loan repayment could be influenced by individual characteristics such that borrowers with higher output, high returns and material goods could be more likely to repay the loan than others. On the contrary, improved possibilities for alternative borrowing could decrease repayment incentives, while low interest rates as well as higher penalties may increase repayment rates (Vogelgesang 2003: 2089).

However, in relation to the study from Grameen Bank, it has been found that branches operating in areas of long distance tend to experience higher rates of defaults and this could be influenced by the reducing profits of the new project, decreasing power of dynamic incentives especially when credit could not be denied to defaulter or late borrowers. In contrast, the empirical test from Grameen bank has revealed that 'rural electrification, road width, primary educational infrastructure and commercial bank density are positively correlated with a low default rate as well as the predicted manager pay' (Godquin 2004: 1913). The study by Godquin (2004) found that positive repayment performance was also associated with previous non-financial services but wondered whether these could be best provided by MFI or MFI could operate in partnership with other NGOs providing the same services. However, the study also found that an MFI provides borrowers with the increased size of the loan as they mature in the borrowing group and has as well associated with homogeneous group. The maturity of the group<sup>3</sup> according to the study has a negative effect on repayment performance (Godquin 2004: 1923). Nevertheless, the researcher has provided evidence from Madagascar and Bangladesh that group homogeneity could also have negative impact on the repayment performance of the loan (Godquin 2004: 1923).

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<sup>3</sup> Means as the age of the borrowing group increases, the loan size increases as well depending on their credit worthiness

### **Empirical analysis on repayment problems**

According to the empirical study from Caja Los Andes in Bolivia, Vogelgesang (2003) found that the rate of late repayment has considerably increased overtime in regards to portfolio at risk (PAR 30)<sup>4</sup> has risen from 0.5% in 1995 to 7.3% in mid-2000. Caja Los Andes responded to the increased rate of repayment and enforced timely more strictly in 1999-2000 (Vogelgesang 2003: 2092). As a result, the percentage of prompt repayment of the loan increased from 64% in 1998 to 75% in mid-2000 and the ratio of one to nine days late repayment has decreased from 28% to 13% and ten or more days delay continue to rise from 8% in 1998 to 12% in mid-2000 (Vogelgesang 2003: 2092). Vogelgesang (2004) then asserted that enforcement plays a crucial and desired effect on repayment and so clients could be able to pay punctually in those branches where payment was enforced (Vogelgesang 2003: 2108).

However, an established and a well functional credit management information system may allow banks to make early detection on whether multiple loans may reduce the repayment capacity of the client and to take necessary action accordingly to avoid future negative impact on loan repayment (Vogelgesang 2003: 2108). The riskier group would have to repay more frequently for their peers, while the safer groups would repay less frequent for their peers. However, in the assorted matching, the safer borrowers would have incentives by paying lower interest rates and this makes them enter the credit market, take loan and improve efficiency of their projects (De Aghion and Morduch 2004: 139). On the other hand, the micro-lender shifts the cost of managing riskier borrowers back to the risky borrowers to cover the cost incurred. However, getting back safe borrowers into the market may lower the default rates as well as lower costs. As such, the micro-lender may further lower the interest rates. Consequently, group lending might get rid of adverse selection inefficiencies and may potentially lessen the problems of moral hazard (De Aghion and Morduch 2004: 139). But where borrowers may be protected by limited liability because they lack collateral to provide, they may be tempted to carry out riskier projects than the bank would expect. In this case, the bank would resort to charge high interest rates to compensate the extra risk (De Aghion and Morduch 2004: 139).

## **2.5 Problems with Lending**

In the development of MF industry, maintaining high performance rate have become increasingly difficult as the numbers of micro-lenders continuously growing. However, while a number of micro-providers in the previous years were the main source of loans, currently clients tend to choose among the competing lenders and the need to remain with outstanding lender has risen. The study has shown that the Bolivian economic condition has been characterized by severe difficulties besides high supply of loans in the microfinance market in 1998 (Vogelgesang 2003: 2085). Vogelgesang (2003) asserted that borrowers have increasingly failed to fulfill the repayment of high debts and this had reduced the economic performance resulting to a negative growth in 1999 with deteriorating economic activities since at that time.

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<sup>4</sup> PAR 30- is the percentage of capital at least 30 days overdue

Nonetheless, for an MFI to maintain high repayment incentives yet in the presence of rising saturation and competition, it has to operate in non-monopolistic environment so as to offer long-term services (Vogelgesang 2003: 2085).

When the technique of group lending fails to assist an MFI to achieve high repayment rates and as well the borrowers might be heterogeneous in their default chances, then an MFI may possibly provide various loan size so as to raise the 'value of outstanding debts repaid on time' (Gutierrez-Nieto et al. 2007: 132). Nonetheless, previous researchers argued that provision of credit or loans demands to the poor have been denied by commercial banks with the assumption that this very poor group might not be in a position to provide loans guarantee although some might have feasible and promising investment knowledge that may lead to profitable outcome (Gutierrez-Nieto et al. 2007: 132 and CGAP 1998: 9). In fact for the commercial banks to meet the demands of the poor, would be of great interest to the government, charitable organizations, as well as the 'socially responsible investor' (Gutierrez-Nieto et al. 2007: 132). Nonetheless, the only access to credit for these poor villagers has been through non-commercial development programs providing small credits (Abbink et al. 2006: 614-615).

On the other hand, the failure for most of MFIs could be connected to the same factors faced by the conventional banks such as poor repayment rates, and high monitoring and enforcement costs (Abbink et al. 2006: 615). On the contrary, some researchers argued that although a number of MFIs have been successful in their projects, many programs have failed to "live up" their promise and the overall objective that focus on establishment of sustainable credit program for the poor have not been achieved and most of these programs continue to rely on subsidies and donations from other organizations (Abbink et al. 2006: 615). However, it would be important to improve the design of these schemes in order to enhance the performance of micro-lending.

The challenge could be mainly large in poorer centers where individuals might have good ideas with similar skills but might lack collateral. Nevertheless, this poor person could make a difference even with small loans operating as small scale retailer or crafts-person in developing countries, but traditional banks have denied these groups and focus instead on bigger loans offering to well established, richer clients; despite the fact that the main aim of microfinance has been to change this idea by using innovative modern contracts where micro-lenders could both make gains and serve those who could not be served by traditional formal banks (De Aghion and Morduch 2004: 135).

Nevertheless, the prime policies by conventional banks on credit rationing and collateral requirement are ways to manage information asymmetries in the credit market but these techniques 'leads to exclusion of poor borrowers' (Godquin 2004: 1910). The fundamental nature of microfinance has been to obtain ideas from the present credit methods of informal sector such as intra-family loans, Rotating Savings and Credit Associations (ROSCAs) and the locally money lenders, while building possible means for capital inflows from financial institutions, donors and governments (De Aghion and Morduch 2004: 135).

However, the absence of formal institutions in the villages has been since accepted as a great gap and barrier to rural development though millions



of dollars has been directed through state run development banks since 1950s aiming at reaching the poorest but were poorly planned and credits have been distributed base on political objectives instead of needy due to poor management and the rates of repayment tend to drop (De Aghion and Morduch 2004: 135). However, opportunities for poor people to have access to loans had been affected by numerous limitations such as inability to provide collateral, because poor households possess few or no valuable assets, many poor people live in very remote rural villages making it difficult for banks to reach and the size of the loan required by poor people could be so small causing difficulties for banks to monitor and enforce (Abbink et al. 2006: 614).

## **2.6 Chapter Summary**

Unlike the traditional banking system, MFIs play a fundamental role in serving the formally excluded poor people by the modern banking institutions to access financial services through provision of small loans using group or individual lending. However, despite the efforts made by MFIs to serve the very poor, it has been observed that this poorest group has not been served to the expectation of microfinance objectives. The fact that MFIs could not function in the same way traditional banks operate should not be concluded that such institutions may not be interested in profit making (Bassem 2008: 344). Increasing efficiency of MFIs would improve the economy leading to economic growth of the country. Although a number of MFIs have been successful in their programs, many have failed to live up their promise and core objectives that focus for the establishment of sustainable credit programs for the poor. Repayment problems have been influenced by information asymmetries leading to adverse selection and moral hazards. Increasing availability of funds from donors may cause an MFI to choose risky borrowers. On the other hand, increasing access to microfinance loans increases the rate of default and borrowers tend to run riskier and unproductive projects. The opportunity of poor people to have access to loans have been affected by lack of collateral, having less or no assets, living in distance poor rural villages and often looks for small loans that are costly for banks to enforce. There should be need for MFIs to make distinction between new and old borrowers so as to generate inside reputation mechanisms and identify safe borrowers from risky borrowers before providing new loans.

## Chapter Three: General overview of South Sudan and presentation and debate on MFIs

The study explores and examines the behaviour Microfinance institutions in South Sudan, looking particularly at the lending methodologies of microfinance institutions and who do they lend to and what are the problems with lending to the poor. This chapter gives an overview of South Sudan economy; explains the poverty situation and its dispersion in the country, the context of financial sector and the participation of MFIs within the financial sector to implement the poverty reduction policy, presentation and debate of MFIs as well as looking at the government and donor support towards MFIs in South Sudan.

### 3.1 The South Sudan Economy

Over the last few years till now, there has been a common assumption that everything in South Sudan is at early stage. That sounds right because South Sudan has just emerged from series of wars with Sudan and with continuous militia activities and internal conflicts in the country; the efforts of bilateral and multilateral aid have been wasted because of endless instability. South Sudan economy ranks among the low-income counties in the world. The economy is still at the initial stage and entirely depends on oil revenue 98% of total income and contributes to 60% of GDP with 2% from non-oil revenue (SSDP 2011: 13). According to 2013 country economic outlook – World Bank report, South Sudan has a GDP of US\$ 15.7 billion with GDP per capita of US\$ 1,582.1 (I-CSP 2012: 4 and SSDP 2011: 25).

However, the majority of the people depend on livelihood activities with 78% of the population depending on subsistence agriculture and animal husbandry. Although most of the population involve in subsistence farming, only 4% of arable land is cultivated and only 1% of households have bank account despite the presence of microfinance industry in South Sudan (SSDP 2011: 13).

Table 1: South Sudan Macroeconomic Performance

Period	2008	2009	2010	2011	2012	2013
<b>GDP (billion USD)</b>	15.55	12.23	15.73	18.83	10.37	11.8
<b>GDP per capita (USD)</b>	1,705.36	1,284.73	1,582.15	1,814.03	956.75	1,044.99
<b>GNI per capita (USD)</b>	2,560	2,670	2,640	2,250	1,760	1,860

*Source: Microfinance country study (M-CRIL 2015: 16)*

#### 3.1.1 Poverty Situation in South Sudan

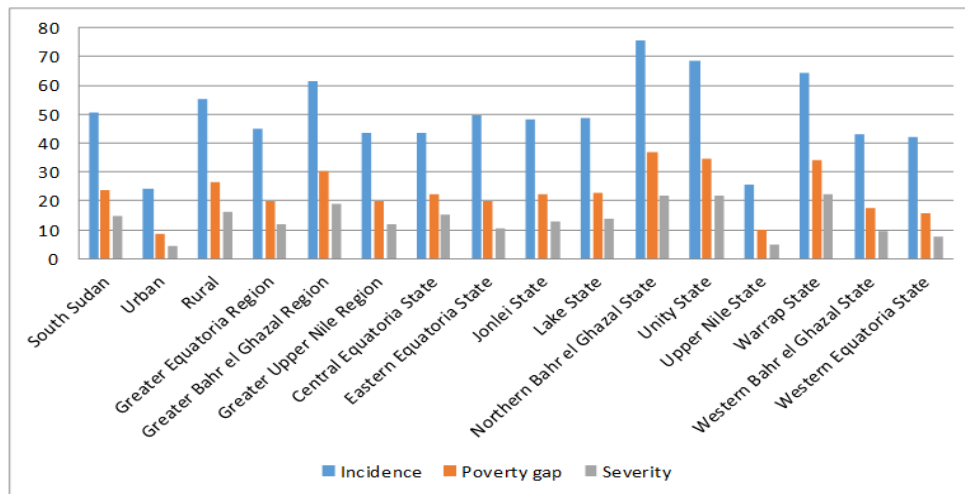
Poverty remains a worldwide concern and continues to be the top among the international debates to find an appropriate strategy in reducing its levels. South Sudan has been categorized as one of the most underdeveloped regions in the world due to years of prolonged conflicts and neglects despite being endowed with abundant natural resources (I-CSP 2012: 12). Poverty is

widespread and is much more severe in the rural areas including the peripheries of the country (SSDP 2011: 12). Poverty in South Sudan is being characterized by a number of dimensions that include low level of consumption, poor access to health and education services.

The effect of long wars and continuous conflicts in South Sudan has made it more difficult and challenging to advance the fight against poverty. However, among the central objectives of the South Sudan Development Plan (SSDP), is the poverty reduction and improvements of human development to build the national economy (SSDP 2011: 12). Poverty in South Sudan remains a challenge with half of the population living below the poverty line that needs huge interventions from both the government and international community by promoting microfinance activities to address the demands of the poor for financial services.

The rate of illiteracy contributes greatly to the level of poverty in the country. Especially in rural areas where people lack business skills and women tend to have little or no role in household decisions and coupled with “cultural barriers” may not be allowed to operate business (Ledgerwood 1999: 37). Poverty measure has been long recognized in the literature that people at various levels of living standards tend to take different perspective on what poverty really means. Ravallion et al. (2008) noted that ‘the critical level of spending that a poor person would deem to be adequate in order to escape poverty is likely to be lower than the level a rich person would deem adequate to avoid being poor’ (Ravallion et al. 2008: 2). According to the South Sudan National Bureau of Statistics (NBS 2010), the poverty incidence in the country is estimated to 50.6% of South Sudan population live below poverty line and the level of literacy is 27% of the country’s population. ‘The average consumption in South Sudan has been 100 South Sudanese pounds (SSP) per person per month. Average consumption for the poor has been 36 SSP per person per month compared to 163 SSP per person per month for the non poor. Average consumption in urban areas has been 168 SSP per person per month compared to 88 SSP per person per month for the rural areas’ (NBS 2010: 1, 10 and I-CSP 2012: 7). That means with the exchange rate of \$1=2.24 SSP in 2010, the average consumption for the poor has been \$0.53 per person per a day. In the I-CSP, it has been noted that 90% of the population live under \$1 a day (I-CSP 2012: 8).

Figure 1: Poverty Levels in South Sudan



**Source:** *Poverty in South Sudan, estimates from NBHS 2009 (NBS 2010: 44)*

According to figure 1, Northern Bahr el Ghazal State has the highest poverty level at 76%, while Upper Nile State has the lowest at 26%.<sup>5</sup>

### 3.1.2 Financial Sector in South Sudan

Sudan and South Sudan in 2005 after the CPA have been operating with two banking systems with Khartoum using Islamic system and South Sudan applying conventional system. The dual system gained support for the South Sudan financial sector. Bank of South Sudan (BSS) was established as a branch of Central Bank with responsibility to manage the financial institutions using the conventional laws and policies (Atil 2009: 4-5).

However, in the global economic system, financial sector plays a significant role in regulating the state economy and lay strategic institutional framework to create employment for the majority of the population. In addition, where there is efficient and effective financial sector with a well-developed institutional framework with strong intermediary policies, this could strengthen the institutional capacity of the sector (SSDP 2011: 32). South Sudan financial sector is still at the rudimentary stage and lacks credible data that requires big intervention from the international institutions including the International Monetary Fund (IMF), World Bank, International Finance Corporation (IFC) and many other bodies.

#### The development of the financial sector

In 2013 the South Sudan financial sector comprises of a number of institutions operating in the country, which include 28 commercial banks, 10 MFIs, 86 Forex Bureaus and a few number of insurance companies. However, despite rising numbers of financial institutions, competition and services are still minimal and mainly concentrating in a few urban centers (SSDP 2011: 32). Nonetheless, financial products mainly offered by these institutions include basic deposit accounts, foreign exchange transfers plus remittance services and a number of commercial banks are providing loans, trade finance and saving

<sup>5</sup> The more detailed levels of poverty could be found in the appendix 1.

products. The lending system in South Sudan tend to be a short term lending and centered within commerce, trade, construction service loans and hotels in the urban areas (BSS).

However, MFIs have been pushing hard to reach the rural areas with designed products for agriculture but their operation had been minor due to poor infrastructure, insecurity, inadequate skills and lack of modern farming equipment. Hence, less than 3% of the population has access to financial services compared to Kenya and Uganda that had reached 40 and 21 percent respectively (SSDP 2011: 32). Nevertheless, the majority of South Sudanese are generally involving in the informal sector which acts as the main credit provider for the population.

### ***Institutional capacity building within the Financial Sector***

The Bank of South Sudan since its commencement in July 2011 has been operating in collaboration with support from donor partners and international financial institutions including IMF, World Bank, IFC and other NGOs in building the financial sector (Hardy et al. 2002: 3). However, with this cooperation and coordination, the BSS have gained much from technical assistance that has built the capacity of its staff as well as unilateral agreements from these partners and other governments. In addition the commercial banks staffs have received a number of similar trainings sponsored by the IFC and other international financial institutions. Nonetheless, commercial banks have been able to develop modern financial transaction system as well as complying with the Anti-Money Laundering and Counter Terrorism Financial Act 2006 (AML/CTF Act) rules and regulations as per the BSS instructions, section 82 regulation No 19, 2012 (BSS 2012: 10). Whereas, Bank of South Sudan Act 2011 section 58 states clearly that ‘no restriction shall be imposed by the BSS or other authorities in the making of payment and transfer for international transactions’<sup>6</sup> (BSS). In fact this is in line with the South Sudan Investment Act that allows capital repatriation, profit and dividends; non-discrimination of investors, both local and foreign investors could own and operate business in any sector of the economy and would have special incentives on application to the Board of Investment in South Sudan.

However, the policy of BSS promotes international trade that strengthens exports diversification while encouraging import substitution. Furthermore, the BSS maintains price stabilization policy and to maintain confidence in the national currency while promoting safety, stability, efficiency and transparency of the banking and financial system in the nation. The BSS has also introduced policies for easy access to financial services such as credit and monetary policies to improve the lending environment, establish credit bureau that address issues of credit markets and strengthen financial systems (BSS).

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<sup>6</sup> Taken from (section of BSS) the compiled report on the South Sudan Investment Conference (SSIC)

### ***3.1.3 The role of MFIs for poverty reduction in South Sudan***

Governments all over the world are responsible for formulating policies and strategies for fighting to reduce poverty that could contribute to economic growth and development. However, without macroeconomic policies for development interventions, poverty may remain an issue of concern and might rather be unsolved. The United Nations (UN) launched poverty reduction strategy in 2005 urging world nations to reduce poverty by half by 2015 (Stewart et al. 2010: 12). Among the strategies of alleviating poverty include food security, access to free education and clean drinking water. Nevertheless, microfinance was cited as one of the strategies that could be used for alleviating poverty by providing small loans to the poor, to involve in small scale businesses and improve their standards of living (Morduch and Haley 2002: 1, Caudill et al. 2009: 651-652, Maxwell 2012: 2 and I-CSP 2012: 3). However, how much effort a country puts in fighting poverty, it remains un-eradicated even in the developed countries there might be still some poor people. Indeed, poverty alleviation has been made more difficult in the developing countries especially in poor countries where limited skills in the field of development coupled with the culture of corruption have become a serious setback in fighting poverty (Stewart et al. 2010: 12 and 14).

The microfinance origin started since eighteenth century but could be dated back to 1976 when a Bangladeshi, Nobel Prize winner Mohamad Yunus, established the Grameen bank and start lending to the poor, marginalized women in the villages to help improve their conditions. However, microfinance has been chosen as one of the policy tools for poverty reduction in the developing countries (Abbink et al. 2006: 614, Chowdhury and Mukhopadhaya 2012: 500 and Khan and Rahaman 2007: 2). It has been also acknowledged as an alternative to the banking institutions that could provides financial services to poor individuals and groups to improve their livelihoods (Guérin, and Palier 2005: 15). Conversely, some scholars argue that such ideology of achieving such initiative remained partial and contested. Microfinance services to the poor have generated many arguments; while some recognized its beneficial services to the poor others argue that it has not benefited the poorest of the poor. Conversely, some researchers and practitioners argue that microfinance may or might not help the poor to some extent since most MFIs fail to provide loans to the rural villages to serve the very poor or some poor households might not have business skills to make proper use of microfinance loans and use them for unproductive projects or for consumption smoothing (Daley-Harris 2002: 168).

#### **The emergence of microfinance industry in South Sudan**

Microfinance is a new industry in South Sudan having started its activities after the signing of the Comprehensive Peace Agreement (CPA) in 2005. Microfinance industry is being supported by government policy that advocates for inclusive access to social services and sustainable development for all South Sudanese (SSDP: 88). However, the government support and its policies to microfinance sector have been channeled through the Central Bank with financial support from the international organizations and donor agencies providing startup grants for MFIs to carry out their projects (Lee and Stone 2013: 6).

However, South Sudan Microfinance Development Facility (SSMDF) is a government organization that coordinates financial supports between the Central Bank and Microfinance Providers (MFPs). Moreover, SSMDF is tasked to collect measurable social impact indicators from the microfinance institutions so as to understand which microfinance provider has adequate products and intervention generating the greatest impact and why. As such SSMDF makes evidence-based decision to direct its assistance based on financial and social returns to assist MFIs identify opportunities to improve their social impact. Furthermore, SSMDF provides loans to MFPs for on-lending to their clients and technical support grants to build the capacity of MFIs. However, 'the vision for the policy is for all South Sudanese to have access to microfinance' services (Lee and Stone 2013: 6).

Nevertheless, the involvement of microfinance institutions in providing financial services such as micro-credit and loans is to transform the conditions of poor people from the culture of depending on food aid to business oriented community in order to improve their standard of living and contribute to the development of the economy of the country. The main aim is to create a good environment for the ultra-poor to have access to financial services through micro-credits and loans since these very poor could not have access to banks due to their lack of collaterals or the loans they require might be so small for the bank to lend (Duvendack et al. 2011: 8).

However, microfinance activities in South Sudan according to 2008 findings had covered seven out of ten states in South Sudan. Nevertheless, MFIs have three categories of lending in South Sudan, which include individual lending, salary lending and group lending but vary from one institution to another. The size of the loan in 2008 ranges from USD 75 to USD 3,000 depending on the size and product of the client (Atil 2009: 6).

### **3.2. The empirical presentation and debates on MFIs**

MFIs are part of the banking institutions whose main objective is to offer financial services to poor marginalized clients. They provide services such as credits, savings and insurance services as well as social intermediation services that include training and education, organizational support and skills that are connected to the development objectives of MFIs (Khan 2007: 5). Over the last decades there has been rapid expansion both in number and size of MFIs globally. In other countries like Latin America, east and central Asia, MFIs have relatively grown in number and serve a great number of clients (Hardy et al. 2003: 147, Hardy et al. 2002: 3 and Duvendack et al. 2011: 5).

#### **Empirical presentation on microfinance programs**

The most cited successful MFI has been the Grameen Bank in Bangladesh that has adopted rural microfinance operation system although has not been fully sustainable but its impact on development have been remarkably reported. On the other hand, some reports have shown that the 'bank has significantly helped to increase the household income, productivity, participation of labour force and rural wages in the Bangladesh villages' (Bhatt 2001: 319). However, the Grameen experience including other microfinance programs have caused reproduction efforts of such programs in one way or another in developing countries worldwide, but the performance of those programs has not been

encouraging (Bhatt 2001: 319). Nonetheless, the failure of such programs in developing countries has triggered some economist to point out that microfinance has not been an appropriate policy intervention, suggesting that macroeconomic reforms could be necessary for setting entrepreneurship and developing the private sector in low-income countries but not microcredit delivery (Bhatt 2001: 320). As such Marsland (2009) asserted that the result of a survey based on the data set of 704 MFIs conducted by Micro-banking bulletin, revealed that 41% of MFIs have not been financially self-sustainable and that they depend on support from donors. However, critics have wondered that MFIs have increasingly become focusing on profit making at the expense of reaching to the poorer clients. On the contrary, some scholars argued that profit oriented MFIs tend to serve the poorest people since their profit objective make them more efficient and may be willing to look for new markets for the loan products (Marsland 2009: 28). However, it has been argued that microcredit schemes that focus on the poorest clients seem to perform better than other programs in terms of cost of serving the borrowers (Marsland 2009: 29).

### **Debates on the behaviour of MFIs**

Microfinance industry has seen a dynamic growth over the last years and is expected to increase in the coming future (Mawa 2008: 876). Otero (1999) suggested that 'for microfinance to continue its path toward becoming a successful development strategy, it must display these three dimensions: a relationship to the poor, a reliance on permanent institutions, and a connection with the financial system of a country' (Otero 1999: 18). This has been encouraged by the increasing donor and NGOs funding to MFIs. As a result, the formally excluded poor individuals from the financial services have been seen gaining access to complex microcredit products and services and make them progress out of poverty (Wiesner and Quien 2010: 9).

On contrary, it has been argued that funding from donors has not supported the growth of MF industry and might have instead contributed to negative growth progress of the sector. Because some donors tend to focus or direct their financial supports mostly to larger and mature MFIs with only a few could fund smaller and less mature MFIs (Wiesner and Quien 2010: 9). However, this type of poor selection of MFIs by donors might as well lead to poor selection of clients and projects by MFIs. On one hand, the larger and mature MFIs may develop very fast and become much more competitive but might become loose in making analysis and follow up of clients and projects, providing riskier loans, consumer loans and could even offer loans to unproductive programs as such creating repayment problems and over indebtedness (Wiesner and Quien 2010: 9). On the other hand, smaller and less mature MFIs as a result of high competition might have lesser chances to develop and to become more competitive, they may not have the opportunity to exist in the environment where they operate but opt to poor or down markets moving to insecure areas, accepting riskier clients and providing riskier products and services and again contributing to repayment problems and over indebtedness (Wiesner and Quien 2010: 9). However, what is required would be fair competition between MFIs in terms of funding. This leads to consolidation of MF sector and get rid of those institutions with poor performance and with low potentials. Nevertheless, for MF sector to grow, there would be need to have more donors with strong structures in managing



risks and should be attracted to invest in smaller MFIs, help potential new ones to grow, become profitable and competitive in the markets (Wiesner and Quien 2010: 18).

Microfinance institutions and other financial service providers have managed to work together over the past years to provide inclusive financial services through well-designed financial products and delivery methods to meet the diverse needs of the low income poor people. Unlike informal lending such as money lenders and group rotating savings, microcredit applies methodologies such as group or liability lending, pre-loan savings requirements and the slow increase in loan size to evaluate credit worthiness of the borrowers (Chirwa 2002: 2). Moreover, microfinance providers presently maintain to better their strategies of financial requirements of their borrowers and modify the products and methodologies accordingly.

### **3.3 Government policy and Donor support to MFIs**

#### **Government support policy**

The Government of the Republic of South Sudan (GRSS) supports the operation of MFIs in the country as part of its policy of poverty reduction. This has been proven from its development policy documents addressing poverty issue such as (SDDP 2011: 12, SSDI 2013: 15 and I-CSP 2012: 11) and many others from relevant institutions (see appendix 6 and 7). This has also received great support from stakeholders especially during donor conference held in 2005 that lead to the establishment of SSMDf as an apex institution to monitor and support the activities of MFIs both financially and technical assistance through funding from government and donors. However, the expansion of financial sector has been affected by the delay in passing the important laws including central bank law, financial institutions law and publicly-owned enterprises law (SSDP 2011: 33).

#### **Donors and NGOs support**

South Sudan as a post-conflict or conflict affected state like other war affected countries has received great support from donor agencies, international community and NGOs to rehabilitate and rebuild human conditions from the effect of wars through anti-poverty development intervention programs. Series of wars have cause wide spread growing level of poverty all over the country. Since MF is one of the main policy strategies to fight poverty, MFIs have received most of the funds and technical assistance from the donor communities and NGOs. For example FSSL receives funds from CORDAID and UNCDF, while ARC provides networks, and Crystal Clear Software, Ltd., Fern Software and Kiva provide services and for BRAC receives from DFID, DFAT, UNICEF, The Global Fund, and BRAC USA.

### 3.4 Chapter Summary

This chapter presents brief overview of South Sudan economy, poverty situation, MFIs as policy enforcement for poverty reduction, the empirical presentation and debates on MFIs and government and donor support for MFIs.

South Sudan economy depends entirely on oil revenue 98% of total income contributing to 60% of GDP and only 2% from non-oil revenue with agriculture and livestock industry not fully utilized. Poverty is widespread with 50.6% of the population living below poverty line with literacy level of 27% of the population.

The financial sector is functional lead by the BSS comprises of Commercial Banks, MFIs, Forex Bureaus and Insurance companies but the capacity seems to be low with absence of some laws to guide the sector. MFIs are pushing hard to extend their operations to rural areas but constrained by the insecurity and poor infrastructure. However, despite their effort to reach the rural areas, the poorest segment has not been fully served by MFIs even within the urban areas.

South Sudan is supporting MFIs programs through poverty reduction policies with support from international community, international organizations and NGOs.

## **Chapter Four: Case Presentations and Analysis**

This chapter highlights the presence of MFIs in South Sudan and gives a brief background of SSMDf, an umbrella institution in charge of MFIs including challenges facing the sector. Then the two cases of FSSL and BRAC are analyzed separately looking at the background information, target groups, lending methods and problems with lending to the poor groups.

### **4.1 Brief Overview of Microfinance Activities in South Sudan**

#### **Introduction**

MFIs started operation in South Sudan in 2006 as part of government initiative for reducing the level of poverty. However, since 2009 several microfinance institutions operating in South Sudan have increased including small cooperatives and credit groups both local and international with others yet to register (Atil 2009: 5). Furthermore, MFIs estimate had shown that 5% clients were covered within Juba vicinity and benefited only below 1% potential market in South Sudan (Atil 2009: 6). Nonetheless, great number of clients seems to be from urban areas with low level of rural involvement. The lending program tends to mainly target women with few male clients. However, MF industry has covered eight out of ten states of South Sudan who have already benefited from microfinance loans with moderate default rates (Lee and Stone 2013: 7 and Atil 2009: 6). However, this coverage has relatively fallen in 2014 due the recent conflict, with MFIs currently concentrating their operation in the southern parts of the country with some have already quitted MF programs.

#### **Characteristics of MFIs in South Sudan**

The size of the loan ranges from US\$ 75 to US\$ 3,000 given for the period of four to eight month depending on the policy of an MFI and the type of product, with the interest rates ranging from 15 – 36% p.a. There seems to be low level of diversified products and weak services on increasing demand for ‘savings product and housing loans’ (Atil 2009: 6). However, the majority of the clients of MFIs appear to be informal vendors that operate without licenses. Nevertheless, the main area of activities includes trade and services 68%, agriculture and livestock 15% and light manufacturing 11%. As a result there could be need to expand both the breadth and depth of coverage with clear set to support the productive sectors but this may only be possible during peace times (Atil 2009: 6 and Zeller and Meyer 2002: 7).

However, MFIs in South Sudan faced some constraints because of growing demand on products offered currently and in future. These includes scarcity of skilled and low staff costs, continuous demolitions of markets, access to funds, absence of regulatory framework, poor technical support, inadequate credit reference bureau, inadequate capacity of government institutions, limited diversification across sector and product activities, poor security and transport facilities in rural areas, high costs of operation and SSP/USD exchange rate among others (Atil 2009: 6-8).

## **Institutional building and financial support to MFIs**

The main financial and technical supporters to MFIs in South Sudan include South Sudan Microfinance Development Facility (SSMDF) through funding from United State Agency for International Development (USAID), Generating Economic Development through Microfinance in South Sudan (GEMSS), United Nations Capital Development Fund (UNCDF) and United Nations Development Program (UNDP) with microfinance monthly meetings for information sharing and coordination among the members. With all these focusing on key industry in South Sudan, there are still gaps left unaddressed especially the agricultural sector to meet rural development and reduce poverty (Atil 2009: 9-10). However, since the onset of the conflict in December 2013 and the deteriorating security situation in the country, many of these donors and international organizations who have been supporting microfinance industry have left the country.

### ***4.1.1 Overview of SSMDF Activities as an Overseer of MFIs***

This section gives a brief background of South Sudan Microfinance Development Facility (SSMDF), an apex institution and its role in supporting microfinance sector and challenges facing the sector. According to SSMDF staff, microfinance industry is operating in South Sudan since 2006 through MFIs, NGOs and some commercial banks providing financial products such as savings, group loans, individual loans, salary loans, capital loans and agricultural loans. These types of loan products differ from one institution to another depending on their policies and areas of operations.

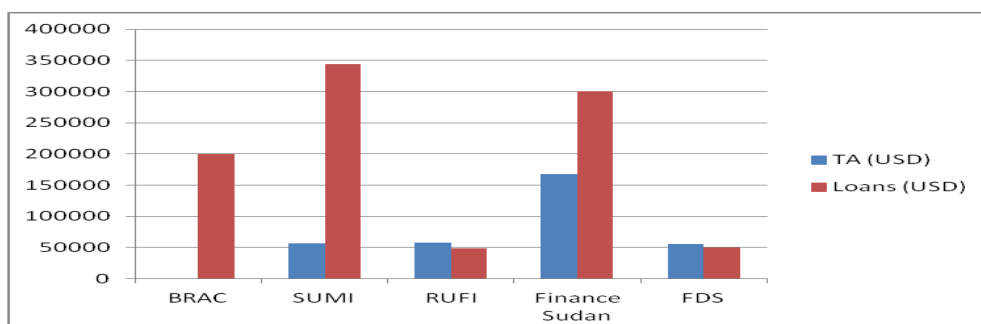
However, SSMDF is an apex institution formed in 2009 as an initiative from the government of South Sudan and donor agencies, governed by five member board of directors, comprise of members from both public and private sector. The aim is to oversee the MFIs and facilitate the creation of a sustainable microfinance sector that could provide inclusive financial services to the underserved and active low-income households to enable them improve their livelihoods and contribute to the development of South Sudan. The institution acts as a link between the government, donor agencies and MFIs as well as channeling loans and providing technical assistance to develop the capacity of MFIs. This institution has been critical to expansion and improvement of professionalism of the microfinance sector in South Sudan. According to the discussion and reference to SSMDF document, it has been stated *that*:

*the SSMDF has been tasked with the following core functions: first, lending money to MFIs which meet certain eligibility criteria required, so as to expand their microfinance operations; second, build the capacity and provide grants to strengthen MFIs and move them towards financial sustainability; and third, advocate issues pertaining to microfinance and help to develop appropriate regulatory framework for the microfinance sector in conjunction with BSS (SSMDF staff) see appendix 7.*

However, according Zaman (2004), he mentioned that the experience has shown that there has been a growing agenda in setting up apex institutions in the world; for example, 'PPAF in Pakistan, RMDC in Nepal, FONCAP in Argentina, LID in Bosnia-Herzegovina and MISFA in Afghanistan' (Zaman 2004: 11). The SSMDF in its capacity with coordinated efforts from the

government and donor agencies was able to provide a number of MFIs with loans and technical assistance in form of grants in 2010 and those MFIs benefited from these loans include BRAC, SUMI, RUFU, FSL and FDS. Furthermore, SSMDf concerns to build a strong and viable microfinance sector; training and capacity building have been the top challenge to build a sustainable MFI industry, because a great number of MFIs in South Sudan tend to be weak and lack adequate or specific budget for training in building the capacity of their institutions (SSMDf 2010: 13).

Figure 2: Status Support for Technical Assistance and Loans to MFIS



**Source:** Own calculation from SSMDf 2010 Annual Report.

The allocation of the loans and technical assistance has been done after assessing the capacity and needs of each institution for funds eligibility (see appendix 4 for details). BRAC however is the biggest MFI operating in South Sudan since 2007 that appears to have well established management team of experts assisted by the local field staff as such may not require technical assistance grants; since it has internal training and capacity building of its local staffs. SUMI and Finance Sudan are also large MFIs but require training and capacity building of the local staff and as well require loans to gain continuous lending to their clients since they lack enough donors; unlike BRAC that has a number of donor supports because of its reputation. However, RUFU and FDS have received small size of the loan since they are still nascent MFIs (Greenfields) and expected to receive more in future to increase their capacity.

Therefore, the major issue behind the success and failure of an apex could be the underlying retail capacity in a certain country. The strength of the MFIs depends generally on the fundamental success of an apex institution. Nonetheless, it has been argued that overestimating the capacity to absorb funds by the MFIs on the ground might lead to the failure of an apex body. The SSMDf has noted that there has been growing policy strategy from government, donors, international organizations, NGOs focusing on poverty reduction through MFIs in South Sudan. However, this raises concern on the absence of aggregate data on supply and demand levels, the size of microfinance industry, and the performance of microfinance industry in South Sudan (SSMDf 2010: 22).

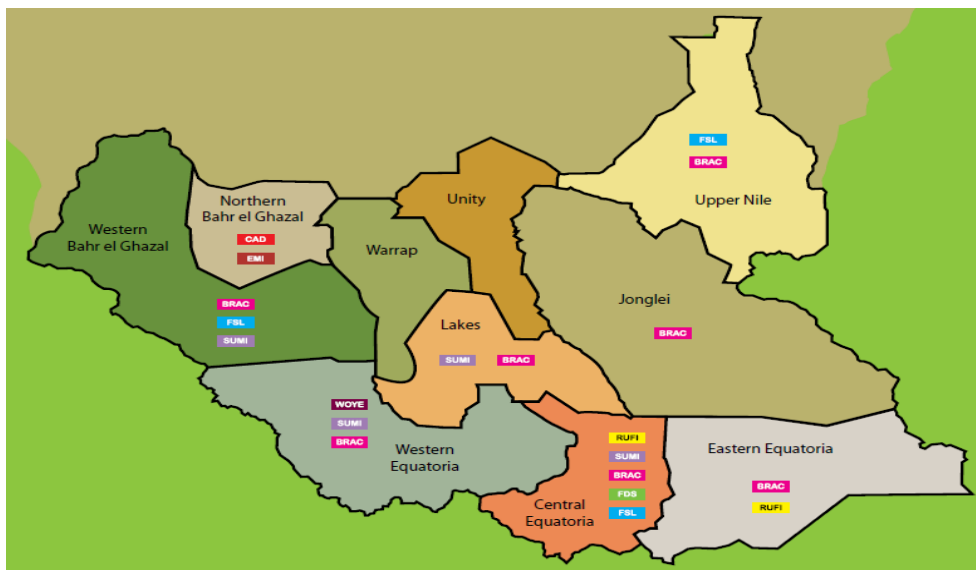
Microfinance industry is one of the strategies of the government of South Sudan to fight reduce poverty since the majority of the population live below poverty level. In 2011 MFIs activities had covered 8 out of 10 states of South Sudan with most of them concentrating in the capital city and operating through the banks leaving poor rural communities and low income people uncovered by microfinance services.

*In that time the number of microfinance clients was about 50,000 and nearly 30,000 borrowers but these number has currently reduced to 15,000 clients and 10,000 borrowers due to the ongoing political situation in the country. Furthermore, microfinance funding has reduced and many donors have left the country due to the current political situation. Sincerely, some big MFIs like BRAC and SUMI have left the programs of microfinance lending due to the ongoing conflict, inadequate skills and poor infrastructure (SSMDF staff).*

However, BRAC has shifted to programs such as education, health, agriculture and targeting the ultra-poor. Inadequate management skills from the locals especially at the leadership or decision making, board levels across MFIs to manage and implement policy frameworks and microfinance policies as such the country depends on foreign experts. As a result of the current conflict, many people have been displaced and had fled the country and many markets have been destroyed making it difficult for business communities to run their daily market activities. In reality, some of the branch offices of microfinance have been attacked, burnt and looted including one of the women MFI in Bor town that has been looted and destroyed making it difficult for them to start business or operation (SSMDF staff).

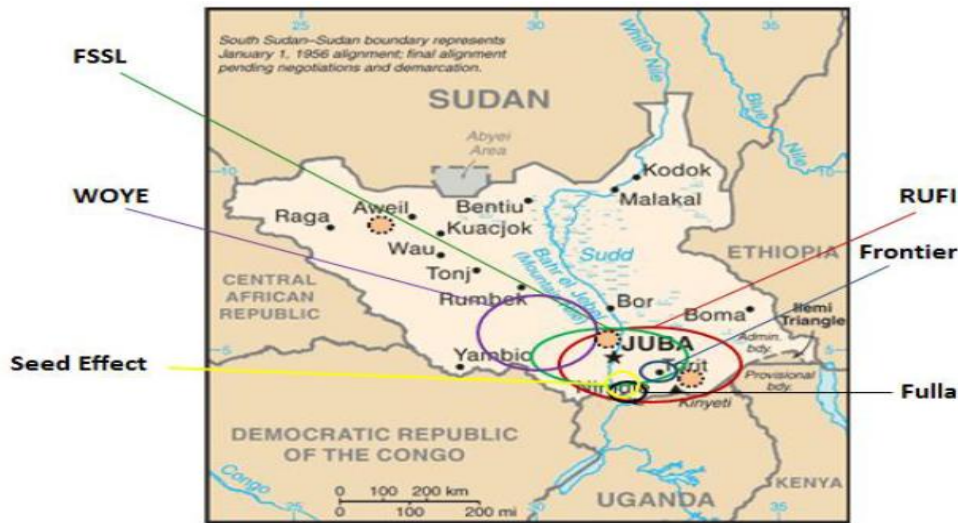
However, base on the difficulties and challenges mentioned above MF industry may face growing future challenges if the current conflict could not be resolved and peace prevails in the country. In deed the absence of donor community could be a serious threat and might lead to the stagnating activities of the MF industry in South Sudan. Furthermore, a number of microfinance clients or borrowers may use the current situation and demolition of the market as a chance to default and hence would negatively affect the microfinance lenders. However, this has already reflected the shrinking coverage of microfinance activities from 8 out 10 states to 3 states only in the southern part, as depicted in the below maps of 2010 as compared to 2015, see also appendix 2 and 3 for MFIs performance.

Map 1: 2010 MFIs Coverage in South Sudan



**Source:** SSMDF Report 2010.

Map 2: 2015 MFIs Coverage in South Sudan



Source: MF Study of South Sudan (2015: 8)

## 4.2 FSSL Case Presentation and Analysis

### 4.2.1 FSSL Institutional Setting

FSSL is among the largest MFIs in South Sudan; currently having five branch offices and a total of seventy-five staff comprising of 49 personnel and 26 loan officers. Its ‘mission is to contribute to the economic rebuilding and stabilization of South Sudan by providing quality financial services to low-income borrowers through sustainable microfinance with a national scope’ (FSSL). The FSSL started its activities in 2003 run by American Refugee Committee (ARC) helping South Sudan by initially providing relief to returnees but subsequently changed to microfinance activities in 2006 after the signing of the CPA in 2005. In 2007 UNCDF had provided capital loan to the institution to improve the microfinance operations in South Sudan. In 2010 the Catholic Organization for Relief and development Aid (CORDAID) a Dutch organization, became the main funder of FSSL including USAID – James’ Program who had also provided funds. After that ARC dissolved their shares to Micro-Africa one of the East African microfinance institution operating in Kenya. In the same year SSMDF also provided loan and technical assistance funds to FSSL. In 2012 Kiva an online fund raising program provided funds to FSSL that cover both the loan for on-lending to the clients and operational cost. However, in 2013 LetShego, a South African microfinance institution and Micro-Africa became the shareholders of FSSL supporting the operational costs. However, during 2015 the funding shifted from LetShego that sold its shares to CORDAID who then become the main funder and shareholder of FSSL. The institution has provided up to 50% for the individual loans. In fact loan refund starts from the first month to the 24<sup>th</sup> month with the interest rates ranging from 2-3% per month and 95% clients retention rate. However, it has been stressed by a staff member that ‘since the beginning of the conflict in South Sudan MF industry has been facing increasing challenges and there is high risk of business collapse if the war continuous in the country’ (FSSL staff).

Table 2: FSSL Institution Characteristics

Fiscal year	2007	2008	2009	2010	2011	2012	2013
Assets	140,474		788,095	1,334,724	2,888,499	1,938,488	2,567,844
Offices			2	5	7	4	5
Personnel	16		25	52	71	65	49
Personnel - Female				17			18
Loan officers			16	26	51	33	26
Loan officers-Female				11			5

*Source: Mixmarket*

Table 3: FSSL Performance Analysis

Fiscal year	2007	2008	2009	2010	2011	2012	2013
Number of active borrowers	283.0		1,332.0	2,764.0	5,623.0	4,017.0	2,416.0
Percent of female borrowers	51%		46%	42%	36%	50%	56%
Return on assets				-67%	-41%	-16%	-6%
Operational self sufficiency	4%		24%	40%	56%	78%	90%
Portfolio at risk > 30 days	0%		42%	10%	5%	11%	16%

*Source: Mixmarket, Crossmarket-Analysis Report*

Looking at both tables 2011 performs somewhat better than other years in terms of staff, offices, number of borrowers and maintains standard PAR 30 at 5%.

#### 4.2.2 FSSL Target Groups

FSSL targets the productive poor or the well-off poor clients who operate basic businesses or small medium enterprises. The institution targets both women and men aged 18 years and above with relatively specific tough conditions for loans qualification like possessing identification card, land and business eligibility documents. The programs seem to be confined within the urban centers with few sub-urban areas served in the counties. Some researchers argued that microfinance program might favour urban population that provide low cost of delivering services and less riskier clients which are nearer to active commercial economic centers and industrial areas while abandoning rural ones that live in distance and hazardous climate because of profit motives (Bhatt 2001: 322). This shows that most MFIs tend to exclude the poorest segment from their programs for the fear of losing profits.

#### 4.2.3 FSSL Lending Methodologies

FSSL applies two models of group and individual lending. The institution offers the following products to its clients such as group loans, women loans, SME loans and development loans. However, for borrowers to apply for the loans, specific qualifying conditions have been applied for obtaining the loans. However, each type of loan product has slightly different conditions from others, for example:

- *Group Loans:* the group loan requires that the borrower should be a South Sudanese national and above 18 years, provide a passport size photograph,



be member of a group with an average of 5-20 members, obtain a letter from Boma chief, sultan (head chief) or market leader, loan size ranges from 100 to 3,000 SSP (equivalent of 32 to 949 USD at an official rate of \$1=3.16 SSP), must have a business, group guarantee and pledge of household/business assets and be willing to meet, save and repay loan on weekly, 2 weeks or monthly basis. The loan is said to benefit, both men and women, no hidden charges; Weekly, Bi-weekly or monthly/loan payment, competitive interest charges, fast processing of loans, monthly loan repayment, business training and friendly customer service.

- *Women loans*: This is the same as group loans; the difference could be on the benefit side that it only benefits the women or women associations.
- *SME loans*: in addition requires formal identification i.e. National ID, passport or driving permit, loans range from 20,000 SSP (USD 6,329) and above, must own a business with proof of documents i.e. trading license or Chamber of Commerce certificate, formal securities i.e. land lease, log book and business assets i.e. machinery and the benefit is meant for an individual client.
- *Development loans*: this type of loans seems to be similar to SME loans but only that the loans range from 2,000 to 20,000 SSP, equivalent to \$633 to \$6,329 (FSSL staff).

Indeed, for the client to qualify for the loan, the institution looks at the purpose of the loan the client would intend to acquire and the type of business the client(s) is running or involved and assess its validity. In the case of group lending, the leader of the group provides grantee in the group. On the other hand, the institution provides non-financial services such as trainings on Small Medium Enterprise, capacity building of the staff as well as providing training on clients on the modules of microfinance products, financial literacy and on collateral policy. In general the institution does not provide startup capital for the clients. However, the institution only provides capital lending to those clients who have the existing business and only provide loans to support them in expanding their business. However, FSSL provides a maximum of SSP 100,000 (USD 31,646) for small medium enterprise to acquire assets. However, loans refund depends on the type of loan product. Group and women loan refund could either be weekly or monthly depending on the size of the loan, while SME refunds is made monthly. Robinson (2001) asserted that the financial system approach that puts its emphasis on institutional self-sufficiency tends to focus more on commercial intermediation among the poor borrowers and savers (Robinson 2001: 8).

#### ***4.2.4 Problems with Lending in FSSL***

The FSSL applies both group and individual lending methodologies. However, having examined these lending methodologies, the study has shown that the institution seems to have focus more on productive poor who own some basic business activities and in possession of formal documents. However, FSSL might have miss the policy of serving the poorest people because in the post-conflict or conflict affected states like South Sudan, the objective of MFIs is to serve the very poor people to lift them up from extreme poverty backed by government policy of poverty reduction strategy. But in such situation where loan requirements tend to be tight, many people especially the poor may not have access to the required documents and might not have any business

activity on the ground and hence miss the opportunity of joining the program. Consequently, the poor appears to be excluded from accessing loans within this institution and it could be rather the moderate poor or well-off individuals who may access the loans. Equally, Marsland and Strøm (2009) noted that as MF industry became mature, it tends to abandon its mission of serving the very poor people. Furthermore, financially better off clients tend to crowd out the poorest clients in any microfinance lending program (Marsland and Strøm 2009: 28). Nonetheless, a failure on the clients indicates that the institution would run the risk of being collapsing in the future. However, establishing ideal strategies and policies that could match the diverse demands of the clients could be significant as well as having good relations with the client.

## 4.3 BRAC Case Presentation and Analysis

### 4.3.1 BRAC Institutional Setting

BRAC is an international organization from the Bangladesh. Its mission is ‘to empower people and communities in situations of poverty, illiteracy, disease and social justice’. The objective is ‘to achieve large scale, positive change through economic and social programs that enable men and women to realize their potentials’ (BRAC 2012). BRAC started its operations in South Sudan in 2007, the moment when South Sudan was on the process of rebuilding its economy after years of war with Sudan. Since 2007 BRAC has increasingly grown to become the biggest NGO, providing MF services in South Sudan using integrated approach for poverty reduction. Other programs include agriculture, health, education and targeting ultra-poor.

Considering its microfinance expansion program, BRAC manage to establish operations in seven out of ten states of South Sudan, covering 1,803 communities with more than 23,980 microfinance members. However, the initial MF program began its operations with several small grants with commercial capital from BRAC Africa Loan Fund. In 2008 a sum of USD 3 million has been approved by UNCDF/Microloan for BRAC South Sudan microfinance project that include 1.5 million USD as grants and 1.5 million USD as loans.

Table 4: BRAC Institution Characteristics

Fiscal year	2007	2008	2009	2010	2011
Assets	1,181,334	4,097,717	3,919,736	4,644,357	9,275,872
Offices	8	17		9	14
Personnel	45	40	44	43	54
Personnel -Female				28	40
Loan officers		24	116	20	39
Loan officers -Female				17	30

*Source: Mixmarket*

There seems to be full operation during 2010-2011 with expansion of offices in 2011, increase in number of employees and value of assets.

### ***4.3.2 BRAC Target groups***

BRAC uses integrated approach for poverty reduction targeting the poorest (ultra-poor) to improve their livelihoods. Indeed the loan targets the active age groups of borrowers ranging from 20 to 50 years old, have little or no education and have no access to other microfinance institutions. 'BRAC's microfinance program serves the South Sudanese with reliable access to coast effective financial services. Microloans are specifically designed for poor women as a means to encourage and assist them in undertaking income generating activities' (BRAC 2012: 17). As such in 2011 USD 7.59 million has been disbursed as loans to poor women. It has been noted that not only do BRAC credit program deals with the poorest but also BRAC's borrowing model has been similar to the well-off clients in terms of the loan size (Zaman 2004: 12). However, BRAC's policy of serving clients with little or no education has affected the sustainability of microfinance program seeing that most of the clients may lack business skills and might end up using loans for consumption smoothing and other services.

### ***4.3.3 BRAC Landing Methodologies***

BRAC institution uses entirely group lending method by organizing women into groups of 10 to 20 members after having surveyed the area by branch officers through consultation with community leaders and local elders. The groups could then be split into smaller groups of 5 members each with their elected leader who takes responsibility to solve peer repayment problems. However, new group of borrowers would have to meet four times before loan disbursement takes place and thereafter they would meet weekly to discuss credit decision with assigned loan officers to make their loan repayment. However, the size of the loan ranges from USD 150 to USD 2,000 which might sound reasonable for the poor to get involved in the program and may possibly manage to repay the loan.

Nevertheless, the institution provides training and technical assistance to its clients to improve their business skills so as to maximize their income. On the other hand, women involved in seasonal activities like farming may receive short-term loans. The benefits of microloans include weekly loan repayment, no physical collateral required or life insurance, competitive interest rates, available services both in rural and urban areas. The loans are easily accessible through community organizers by reaching the poor women and meet with them in their villages or at member's residence, as such no travel cost incurred on the side of poor women. This has been emphasized by Robinson (2001) that a number of MFIs applying poverty lending approach that tend to offer microcredit to the poor borrowers at less cost, but such institutions would not be sustainable because the interest rates are too low for the loan to recover the full cost and could not meet the demand for voluntary saving among the poor (Robinson 2001: 8).

### ***4.3.4 Problems with Lending in BRAC***

In 2009 BRAC faced many issues and had run into financial crisis when Nile Commercial Bank (NCB) in Juba, where BRAC transferred most of its funds collapsed resulting to a loss of 6 million US dollars. Furthermore, government demolition of informal markets as an implementation of urban planning policy

affected most of the clients in their business activities. Nonetheless, all these factors affected the performance of BRAC's microfinance program, making it difficult to recover the clients. Consequently, portfolio at risk (PAR>30) rose from 5% to 30% just in 2009 and continue to rise in the preceding years and as well, the number of active borrowers has been decreasing significantly as shown in the below table (Duval 2011: 4). Although the presence of better-off households could not affect the supply of loans to poor households, it has been noticed that poor households use part of their credit share for consumption smoothing than do the well-off households (Zaman 2004: 12). The implication is that the poor may have repayment problems after using part of the loans for consumption and might even include health bills, while the better off would manage to repay the loans.

Table 5: BRAC performance-targets vs actual

BRAC South Sudan performance-based agreement targets versus actual performance								
Indicator	31 Dec. 2009		31 Dec. 2010		31 Dec. 2011		31 Dec. 2012	
	Target	Actual	Target	Actual	Target	Actual	Target	Actual
Number of active clients	15,000	14,247	64,800	18,498	135,000	5,602	180,000	4,278
Percentage of female clients	100%	100%	100%	100%	100%	100%	100%	100%
Adjusted return on assets	25%	-15%	31%	-22%	36%	-15%	40%	-3%
Operational sustainability	32%	41%	67%	24%	106%	19%	143%	30%
Portfolio at risk > 30 days	5%	31%	5%	40%	5%	31%	5%	61%

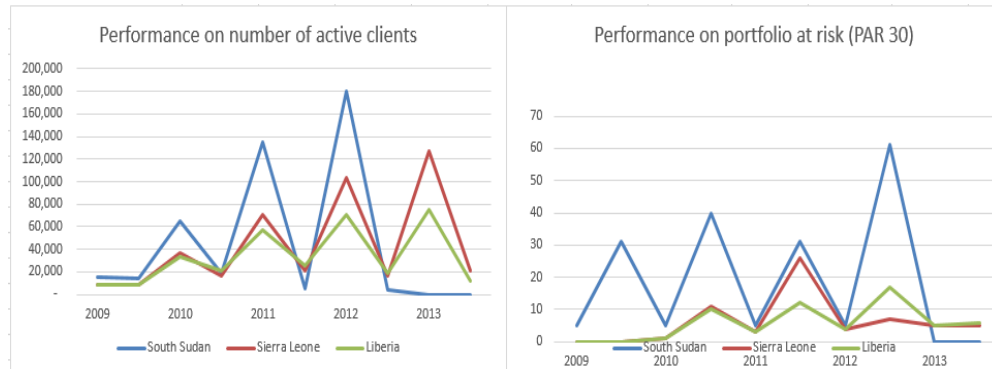
**Source:** Source: Reports to UNCDF/MIX Market (Duval 2015: 4): Table 1.

### Alternative measures to improve the PAR value

However, responding to the situation, BRAC implemented a PAR action plan to establish the cause of decreasing performance on the PAR by introducing tighter supervision on branches with additional staff to trace the displaced borrowers and improve the loan monitoring and collection, but this has not made any positive change and BRAC finally closed the microfinance program in South Sudan after the analysis has shown that microfinance program would not be sustainable in the present environment (Duval 2011: 4). However, microfinance is not the only way to fight poverty but several strategies could play a major role in fighting poverty like what BRAC has decided; shifting from microfinance to programs such as education, health, agriculture and targeting the ultra-poor that benefits the children of its clients directly with free education and health services.

## Comparative analysis for the failure of microfinance program

Figure 3: BRAC's experience in the three post-conflict counties in Africa (Targets vs Actual)



**Source:** Own calculations from BRAC Report tables 2, 3 & 4 (Duval 2015: 4, 6)

However, the study shows that although BRAC South Sudan has been performing fairly better in poverty reduction policy but the actual number of clients has been relatively falling below targets i.e. from 180,000 to only 4,278 in 2012 and the portfolio at risk increasingly rising above the targets from 5% to 61% in 2012. In comparison, Liberia performed relatively better although the actual number of clients has been decreasing but somehow manage to meet the portfolio target from 5% to 6% in 2013. Sierra Leone managed to stabilize the portfolio at risk from 5% to 5% in 2013 even if the number of active clients has been increasingly rising. However, this comparison has somewhat proven the decision of BRAC to close microfinance program and continue with programs of education, health, agriculture and targeting the ultra-poor. However, although this seems like diverging from the main concept of the study, but continuous demolition of informal markets, deteriorating security situation displacing clients and scarcity of hard currency causing serious inflation, has led to decreasing participation of clients in the program and as such has increased the percentage of portfolio at risk, leading to the closure of the program.

## 4.4 Chapter Summary

This chapter shows a brief background of MFIs and SSMDf background giving overall situation of microfinance industry in South Sudan and the challenges faced, and thereafter presents the two cases of FSSL and BRAC separately looking at the background information, target groups, lending methods and their problems in serving the poor.

FSSL targets the productive poor both women and men using group and individual lending methods, providing financial and non-financial<sup>7</sup> services. FSSL program seems to exclude the poorest segment of the clients. While BRAC targets entirely the poorest women with little or no education using exclusively group lending model, providing financial and non-financial services.

<sup>7</sup> Providing basic trainings to clients on business skills and institution's policies

BRAC succeeds in improving the lives of the poor but lack of formal markets and conflict in the country negatively affected the clients' activities and the progress of the two programs.

## Chapter Five: Conclusion

South Sudan is recognizing and supporting MFIs programs through poverty reduction policies with support from international community, international organizations and NGOs in terms of grants and technical assistance. The development policies and regulations of the government such as SSDP, SSDI, and I-CSP and others have been put forward to promote the operation of MFIs in the country to implement microfinance programs for poverty reduction strategy.

The financial sector is functional lead by the BSS, comprises of Commercial Banks, MFIs, Forex Bureaus and Insurance companies. However, the capacity seems to be low coupled with absence of some laws including central bank law, financial institutions law and publicly-owned enterprises law to guide the sector. MFIs are pushing hard to extend their operations to rural areas but constrained by the insecurity and poor infrastructure. However, despite their effort to reach the rural areas, the poorest segment has not been fully served by MFIs even within the urban areas. The SSMDF has been established as an apex institution through coordinated efforts between the government and the donor community with support from Multi Donor Trust Funds (MDTF). It has been tasked to channel funds and provide technical assistance to MFIs. But due to the recent conflict, most of the donors have left the country and lack of funds, resulted to the closure of some MFIs like SUMI.

The study shows that the programs of BRAC and FSSL have somewhat benefited the poor clients, but however, a number of the poorest have been rather excluded from accessing microfinance services.

In terms of targeting, BRAC's program has been targeting the ultra-poor to graduate them out of extreme poverty. BRAC policies seem to be compliance with government policies of targeting the poorest and providing them access to loans in order to reduce poverty. While, FSSL program targets the moderate and better-off poor who own businesses or SME and seems to exclude the poorest segment from its program. This shows that FSSL focuses more on its institutional financial sustainability than serving the poor to achieve poverty reduction goal. The study suggests that this requires strict monitoring of the activities of MFIs by government agents (SSMDF staff) to ensure compliance with the poverty reduction policy.

The literature shows that BRAC almost entirely targets 100% women clients with little or no education who have not joined any MFI. Targeting women is essential to development agenda and poverty reduction policy, because women are the most vulnerable group depending relatively on unpaid labour with less access to formal financial services. The failure of BRAC from microfinance program could be attributed to rapid expansion of its programs without proper studying of human and geographical characteristics of a particular region(s) coupled with demolition of informal markets and security situation. The study shows that FSSL targets on average 47% female clients as seen on table 3 and mainly within the urban and semi-urban.

Considering lending methods, the study finds that the two institutions vary in that BRAC uses entirely group lending model offering various products and focusing women in rural areas; whereas FSSL uses both group and individual lending models providing diverse products to both male and female

clients but with strict conditions for obtaining the loan. Requesting borrowers to present photographs, own business, ID card and others. FSSL program confines its lending within the urban and semi-urban centers. BRAC has closed microfinance program in 2012 and is currently operating programs such as education, health, agriculture and targeting the ultra-poor where children of its clients benefit directly through free education and health services.

Finally, the literature notices that there is inadequate capacity, weak policies and poor coordination between the government and MFIs for the implementation of poverty reduction programs. There is therefore need for the government and MFIs to embark more on capacity building to breach the gap in order to implement poverty alleviation programs in a successfully manner and achieve the set objective of poverty reduction. Clients training and skills building are also very important for the success of the program because client's failure will also affect negatively the sustainability of the institution. Government should introduce other development intervention programs to help MFIs in fighting to reduce poverty. However, there is need to carry out similar research at the national level to establish and ensure compliance of MFIs with government policy for poverty reduction.



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## Appendices

### Appendix 1: South Sudan Poverty Profile

	Poverty			Poverty gap among the poor	Population (%)	Poor (%)
	Incidence	Poverty gap	Severity			
Southern Sudan	50.6	23.7	14.3	46.9	100.0	100.0
Urban	24.4	8.8	4.6	36.0	15.6	7.5
Rural	55.4	26.5	16.1	47.7	84.4	92.5
Greater Upper Nile	43.7	19.9	11.7	45.6	33.3	28.8
Greater Bahr Al Ghazal	61.6	30.5	18.8	49.5	35.8	43.6
Greater Equatoria	45.2	19.9	11.9	44.0	30.9	27.7
Upper Nile	25.7	9.8	5.0	38.1	12.6	6.4
Jonglei	48.3	22.2	13.1	45.9	14.3	13.7
Unity	68.4	34.6	21.7	50.6	6.4	8.7
Warap	64.2	34.1	22.2	53.1	14.2	18.0
Northern Bahr Al Ghazal	75.6	36.8	21.9	48.7	9.7	14.5
Western Bahr Al Ghazal	43.2	17.6	9.5	40.8	3.7	3.2
Lakes	48.9	22.6	13.6	46.3	8.1	7.9
Western Equatoria	42.1	15.5	7.9	36.9	7.6	6.3
Central Equatoria	43.5	22.5	15.4	51.7	13.1	11.3
Eastern Equatoria	49.8	19.8	10.5	39.8	10.2	10.1

*Source: Poverty in South Sudan, estimates from NBHS 2009 (2010: 44)*

### Appendix 2: MFIs Performance in 2010

	BRAC	SUMI	RUFI	FSL	FDS	WOYE	TOTAL
No. of clients	26,752	10,435	759	4,907	208	1,588	44,649
Active borrowers	18,498	10,389	680	2,764	62	867	33,260
Women clients (%)	100%	38%	60%	46%	34%	68%	58%
Loan Portfolio (SDG)	5,093,287	4,532,054	217,408	2,364,653	17,656	497,148	12,722,206
Portfolio Growth (%)	2%	-9%	31%	37%	-95%	14%	-4%
Operational Self Sufficiency (%)	31%	34%	60%	52%	58%	54%	48%
Branches	29	6	2	4	1	1	43
State Coverage	7	4	2	3	1	1	7

*Source: SSMDF Report (2010: 18)*

### Appendix 3: South Sudan MFIs Performance Analysis 2015

MFI ID	MFI name	Currency	Fiscal Year	Period	As of Date	Gross Loan Portfolio	Number of active	Deposits	Number of depositors
102213	BRAC - SS	USD	2007	ANN	12/31/2007	477,128	3,455	119,744	4,772
102213	BRAC - SS	USD	2008	ANN	12/31/2008	346,119	2,542	206,393	
102213	BRAC - SS	USD	2009	ANN	12/31/2009	3,194,963	3,059	0	
102213	BRAC - SS	USD	2010	ANN	12/31/2010	3,761,117	3,389	0	0
102213	BRAC - SS	USD	2011	ANN	12/31/2011	649,924	5,602	382,400	12,000
115684	Equity Bank Southern Sudan Limited	USD	2009	ANN	12/31/2009	2,432,752	264	18,552,137	
115684	Equity Bank Southern Sudan Limited	USD	2010	ANN	12/31/2010	8,843,145	2,850	54,030,776	28,038
115684	Equity Bank Southern Sudan Limited	USD	2011	ANN	12/31/2011	23,359,948	3,509	165,721,492	42,776
115684	Equity Bank Southern Sudan Limited	USD	2012	ANN	12/31/2012	31,119,222	6,454	124,360,176	96,787
115684	Equity Bank Southern Sudan Limited	USD	2013	ANN	12/31/2013	41,427,955	8,096	137,542,955	105,065
115684	Equity Bank Southern Sudan Limited	USD	2015	QTR	6/30/2015	23,775,341	4,475	167,325,212	132,740
102198	FSL	USD	2007	ANN	12/31/2007	73,879	283		0
102198	FSL	USD	2008	ANN	12/31/2008				
102198	FSL	USD	2009	ANN	12/31/2009	548,663	1,332	164,440	
102198	FSL	USD	2010	ANN	12/31/2010	942,595	2,764	312,999	4,907
102198	FSL	USD	2011	ANN	12/31/2011	2,449,936	5,623	636,897	6,517
102198	FSL	USD	2012	ANN	12/31/2012	1,676,361	4,017	351,638	4,656
102198	FSL	USD	2013	ANN	12/31/2013	2,253,576	2,416	343,441	
102198	FSL	USD	2015	QTR	6/30/2015	955,236	1,082	134,961	
134673	RUFI	USD	2011	ANN	12/31/2011	383,546	0	53,768	
134673	RUFI	USD	2012	ANN	12/31/2012	617,978	1,903	77,052	
134673	RUFI	USD	2013	ANN	12/31/2013	851,290	1,816	121,145	2,205
134673	RUFI	USD	2014	ANN	12/31/2014	1,054,622	1,762	145,691	2,193
102541	SUMI	USD	2007	ANN	10/31/2007	1,030,731	6,146		0
102541	SUMI	USD	2008	ANN	10/31/2008	1,125,613	8,489	0	0
134674	WOYE MFI	USD	2012	ANN	12/31/2012	380,904	1,765		
<b>Totals</b>						<b>153,732,544</b>	<b>83,093</b>	<b>670,583,317</b>	<b>442,656</b>

*Source: Mixmarket-Cross Market Analysis Report (2015)*

### Appendix 4: Status Support for Technical Assistance and Loans to MFIS

MFI	TA Committed (US\$)	Loans Committed (US\$)	Total Commitment Loan & TA (US\$)
BRAC	-	200,000	200,000
SUMI	56,000	344,000	400,000
RUFI	58,185	48,540	106,725
Finance Sudan	168,000	300,000	468,000
FDS	55,000	50,000	105,000
<b>Total</b>	<b>337,185</b>	<b>942,540</b>	<b>1,279,725</b>

*Source: SSMDf Report 2010*

Appendix 5: Structure of South Sudan Development Plan 2011-2013

<b>Pillar</b>	<b>Areas of Focus</b>	<b>Objectives</b>
<b>Governance</b>	i) Accountability ii) Public Administration	Build a democratic, transparent, and accountable govt. managed by a professional & committed public service, with an effective balance of power among the executive, legislative and judicial branches of govt.
<b>Economic Development</b>	i) Economic Functions ii) Infrastructure iii) Natural Resources	Achieve a diversified private sector-led economic growth and sustainable development that improves livelihoods and reduces poverty
<b>Social and Human Development</b>	i) Education ii) Health iii) Social Protection iv) Youth v) Sports	Promote the well-being and dignity of all citizens & accelerate universal access to basic social services
<b>Conflict Prevention and Security</b>	i) Rule of Law ii) Security	Defend the sovereignty and territorial integrity, uphold the constitution, provide equitable access to justice and maintain law and order
Source: SSDP: South Sudan Authorities		

*Source: I-CSP 2012*

## Appendix 6: SSMDF Tasks-Extract from Financial Sector Policy

### OPERATING OBJECTIVES

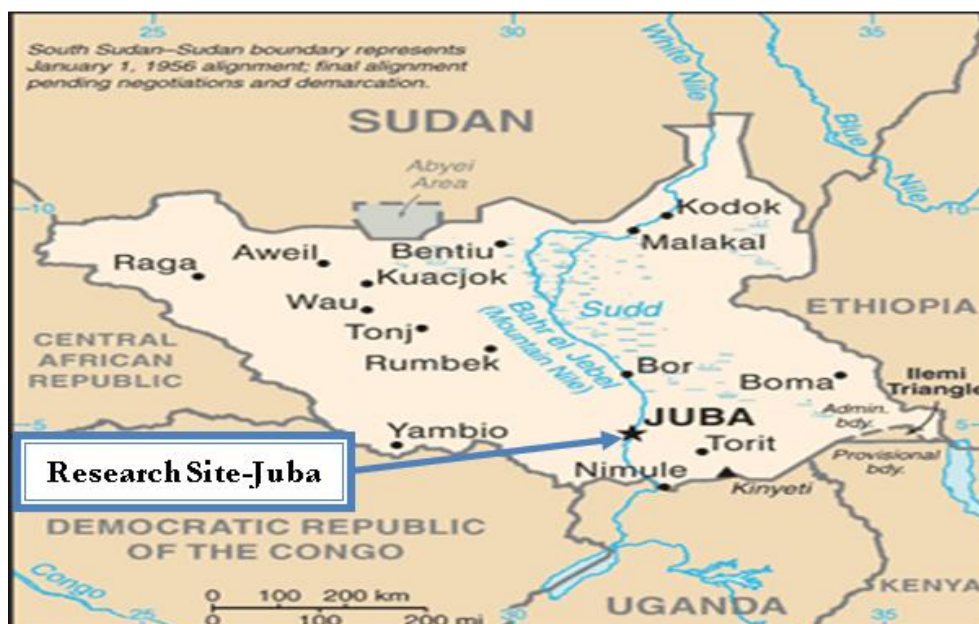
The overall objective of a microfinance development facility is to actively support the development of a strong, sustainable microfinance sector in South Sudan that provides widespread access to high quality financial services to economically active low-income people. The facility is designed as 'transitional' intermediary from the outset and its role is to help jumpstart and develop the microfinance sector. As such, it would be useful from the outset to set benchmark performance indicators (pertaining, for example, to client and geographic coverage; number, diversity and performance of retail providers; availability of support services; etc.) to track progress in development of the sector. It would also be advisable to agree up-front on a timetable and the broad principles and modalities for exit, i.e., the conditions by which this transitional facility will be dissolved and/or its activities delimited and redesigned to reflect the growing maturity of the sector.

Broadly, the SSMDF is designed to undertake the following tasks:

- Coordinate investment for microfinance by establishing a mechanism to channel donor funds to microfinance providers and support organizations for the microfinance sector within a sector-wide development framework;
- Provide well-structured funding for the start-up and development of sustainable microfinance providers, including funding for institution-building, loan fund capital, and client outreach and preparation as required;
- Provide or fund training and advisory services to microfinance providers to build their institutional capacity to deliver high-quality services;
- Promote good microfinance provider performance and transparent operations, by working with practitioners, donors and government to establish sector-wide performance standards, reporting and monitoring criteria;
- Provide an interim umbrella 'monitoring' role for the non-deposit taking microfinance sector (with appropriate exclusions for small institutions), and promote the development of a supportive environment for non-deposit taking microfinance providers (encompassing any relevant legal areas such as taxation and NGO registration);
- Invest in service providers (e.g., trainers, consultants, specialized accounting and auditing expertise, etc.) and other supportive infrastructure (e.g., a national microfinance network) to lay the foundation for a healthy and growing sector;
- Coordinate with policy, legal and regulatory activities of the Central Bank, to ensure creation of an environment that will promote broad-based access to finance, including provision for diverse types of microfinance providers and products;
- Encourage other donors with an interest in supporting microfinance in South Sudan, to utilize the facility for their programs, and provide a mechanism for coordination of existing and new donors and investors and harmonization of strategies and investments sector-wide; and
- Ensure ongoing exposure to best-practices experience, models and tools from elsewhere, e.g. by creating linkages with international specialized agencies such as CGAP.

*Source: Draft South Sudan Financial Sector Law*

## Appendix 7: Map of South Sudan



*Source: Google maps 2015*