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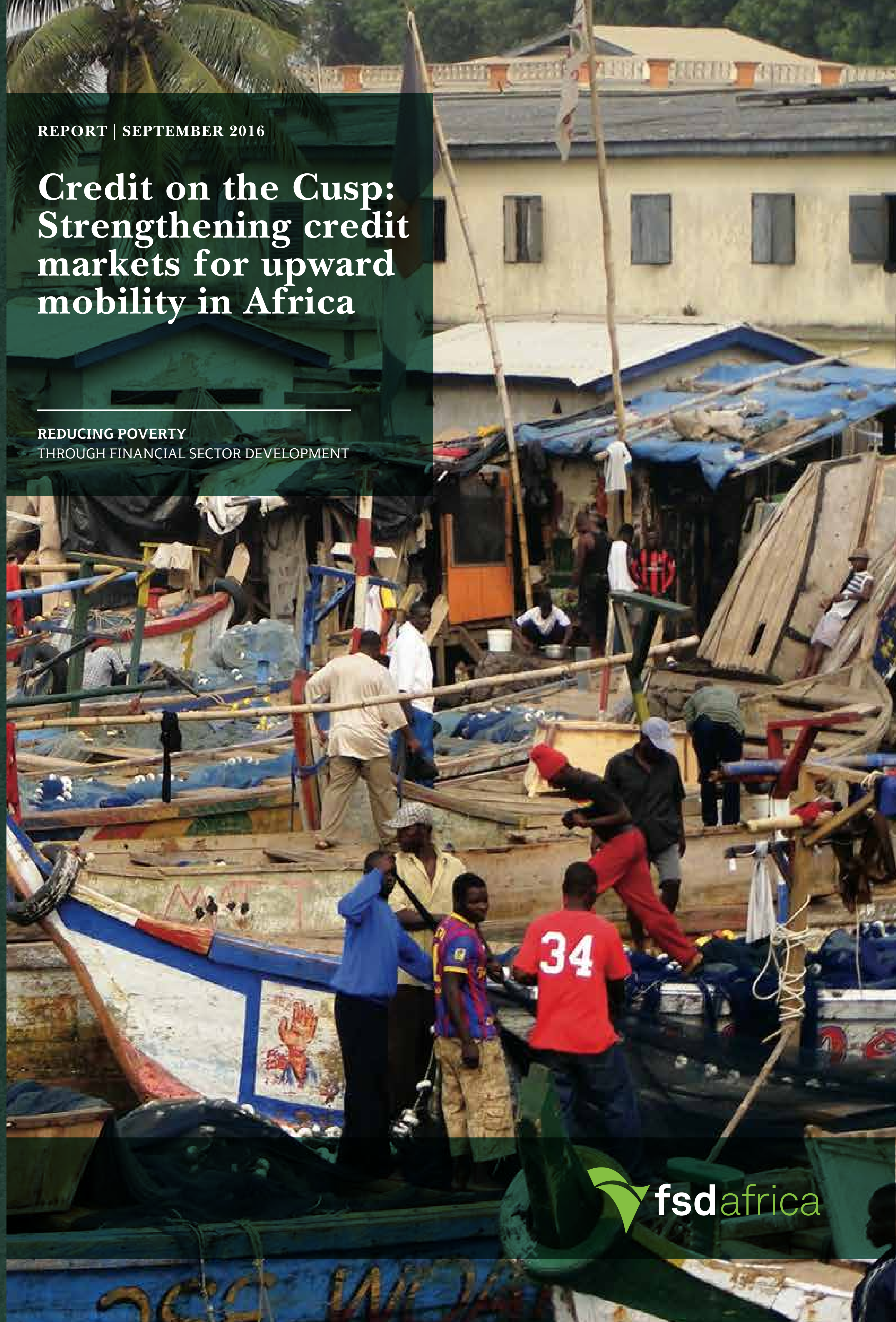
Credit on the Cusp: Strengthening credit markets for upward mobility in Africa

REDUCING POVERTY
THROUGH FINANCIAL SECTOR DEVELOPMENT



Executive Summary

Building healthy credit markets in Africa by 2026

African economies are currently undergoing dramatic changes, including a changing consumer base. Absolute poverty is reducing as a new class of consumer—the cusp group—emerges. This group (which we call "cuspers") now accounts for 23% of sub-Saharan Africa's population, covers a segment of active earners getting by on $2-$5 per day and is straddling the formal and informal worlds. For this group, healthy credit markets could expand opportunity and enable upward mobility, helping to build a true middle class. But, for this to happen, credit needs to expand and to do so in healthy ways. We conclude that donors and policymakers ought to take an active role in enabling cusper credit markets to open up in a positive way, seizing a once-in-a-generation opportunity to leverage financial markets for upward mobility.

Across the entire sub-Saharan Africa region:

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

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

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

investments. Blockchain technology and ubiquitous mobile phone utilization open new opportunities for registries that are clear, reliable and easily available to all.

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

- Regulators—or even private lenders—could introduce the concept of a **learner's licence** for credit, helping borrowers restrict their borrowing in early years while they learn the rules of the road and work towards a longer-term financial future of building assets.
- Regulators should consider new approaches to restraining lender behaviour, such as by introducing **"Last in, last out"** rules, which would rank lenders' claims on borrowers' incomes in the order in which lenders issued loans. In the event of default, the last lender to give a client a loan—tipping the scales of affordability—would have the lowest priority in terms of repayment, thus encouraging lenders to be disciplined in the issuing of loans to already strained borrowers.
- Donors could support fintech tools that **actively remind borrowers of their own debt service** at the moment of temptation by, for example, lighting up a credit card in red when the balance is approaching a dangerous limit, or sending borrowers a warning text message when the balance grows at too quick a pace.

Background

Enthusiasm around the once-popular "Africa Rising" narrative is abating in the face of slower-than-expected growth, macro volatility deriving from continued reliance on raw material exports in many countries, and the reality of persistently high inequality. Even through a period of high growth, we did not see large numbers of people move into the middle class (typically characterised by stable jobs, budgets with space for expenditure beyond pure necessities, and the possession of collateraliseable assets like land, homes and cars). Instead, we observed a shift from absolute poverty into a cusp group of those getting by on about $2-$5 per day. This group straddles the formal and informal economies, and while they strive for a stable middle-class future, they remain vulnerable and largely lacking in meaningful assets.

Credit markets play an important role in shaping cuspers' destiny. On a macro scale, credit facilitates growth, creating new opportunities for cuspers across the region. At a micro level, healthy credit markets can improve the well-being of cusper families by helping them smooth incomes and expenditures, increase and diversify earnings, and accumulate assets even in the face of economic fluctuations that tend to impact upon them, and the classes below them, disproportionately.

But today, Africa is severely under-lent. Most countries in the region have very low credit-to-GDP ratios. Africa needs more credit, and it needs better credit. A healthy credit market simultaneously offers **accessible** credit at a reasonable cost, has **robust** lenders who strategise to endure, offers **diverse** forms of credit suiting borrower needs, and has a preponderance of credit that is **value adding** for consumers and lenders alike.

Given major shifts taking place in African economies, how can donors and policymakers guide credit market development in a way that strengthens the economic well-being of the cusp group over the next 10 years? FSD Africa, which exists to help strengthen financial markets in sub-Saharan Africa, commissioned this research to seek answers to this question through the experiences of cusp group consumers, and the lenders serving them, in three distinctive markets: South Africa, Ghana and Kenya.

Faces of cusper credit markets

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

South Africa we call **"Stuck."**

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

And borrowers—especially when they get their first jobs—often take as much of that credit as they are offered. In a society wedded to the ideas of transformation and post-apartheid upward mobility, desire is a powerful force. With large extended families often depending heavily on every one of those coveted formal salaries, borrowers underestimate the demands on their payslip from living expenses, let alone loans. In South Africa, cuspers borrow to display their wealth; to announce to the world that they have arrived.

So borrowers overextend. Salaries are diverted nearly entirely to loan payments, leaving little to live on. The loss of that formal job or the loss of the income of a spouse places tremendous strain on borrowers who find it difficult to bounce back. It's more difficult in South Africa than it is in the other markets for someone to start over with a low-capital trading business. Self-control seems to set in only after painful and debilitating debt experiences.

One might expect lenders to tighten up to avoid defaults, but they are competing to extend seemingly lucrative loans to cuspers. Eventually, when competition entered and caught up, one of the early players making unsecured loans, African Bank (ABIL), competed by offering the same borrowers more credit over longer periods. These are risks that are often too heavy to bear for cuspers, whose jobs are uncertain (especially over longer periods) and whose budgets are tight. Bad loans mounted, forcing the bank to be bailed out and restructured.

South Africa now struggles with an extensive indebtedness problem. But many of the tools that make a credit market work are already in place: suppliers are incentivised to expand their outreach, cost-effective income verification is available for the large formally employed sector, credit information sharing is highly sophisticated, and there is a specific regulator watching credit market conduct and monitoring consumer debt. Still, the market is failing to self-correct.

Kenya we call **"Uncertain."**

Loans have historically been based on collateral and relationships. Those who wanted to borrow would first save for several months with the lender before a credit offer was extended. Though credit information is now shared to some extent, borrowers tend to stay put with the same bank or microfinance institution in order to keep accessing larger loans.

But that landscape is changing. Mobile phone-only lending, based initially on proxy scores determining eligibility for small starter loans, has expanded access for many first-time formal borrowers in a very short period. So far, these loans—led by Commercial Bank of Africa's (CBA) M-Shwari product—have started very small. But newer entrants, like Kenya Commercial Bank (KCB), are offering larger starter loans, averaging $27 for a first-time borrower, up from $5 on M-Shwari. These short-term loans are often used for convenience purchases and unexpected needs rather than investments. As the loan size grows, but duration stays constant, some borrowers begin to feel pinched. They stop paying, prioritising the parts of their budget—including other kinds of loans—that feel more pressing. Technology is encouraging very rapid growth in formal lending, and the forces of competition seem to be encouraging larger, longer loans. Kenya's digital lending revolution could either pave the way for a rapidly expanding credit market that begins to offer more diverse forms of credit and continues to unlock new value for cuspers, or could give rise to heavy competition in short-term, primarily consumption-based credit that could lead Kenyan cuspers towards a "South Africa" debt situation.

Ghana we call **"Squeezed."**

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

Group-liability microfinance loans have been an important entry point into formal borrowing for many cuspers. At Opportunity International Savings & Loans (OISL), group liability is the only option for individuals unable to put up 150% collateral. With group cohesion reportedly deteriorating amidst urbanisation and competition, OISL is considering changing its focus to SMEs and individual borrowers who can meet collateral requirements—in other words, moving away from most cusp group borrowers.

Today's incentives push lenders to consolidate their focus on fewer credit-worthy persons—payroll clients and, to a limited extent, above-the-cusp entrepreneurs—squeezing the cusp group even more. Mobile lending schemes—like M-Shwari—could be incredibly valuable in opening the credit market to cuspers in Ghana, should a financial institution rise to the occasion.

Conclusion

Credit markets will play an important role in shaping the destiny of the cusp group. Without attention from donors and policymakers, it will be exceptionally difficult for most African countries to find Goldilocks credit markets that are able to extend opportunity to more cuspers over the next 10 years, without risking over-leveraging and massive over-indebtedness. The challenge is daunting, but not impossible, and can begin with simple interventions like improved market monitoring. Failure to act, though, means certain failure. It means that an entire generation of cuspers will fail to rise.

Photo credit: Paul Saad

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Acronyms

ABIL	African Bank Investment Limited
AfDB	African Development Bank
APR	Annual Percentage Rate
ATP	Ability to Pay
BFA	Bankable Frontier Associates
CapEx	Capital expenditures
CBA	Commercial Bank of Africa
CRB	Credit Reference Bureau
FSD Africa	Financial Sector Deepening Africa
IMF	International Monetary Fund
LOP	Logistics of Payment
NPL	Non-Performing Loan
OISL	Opportunity International Savings & Loan
OpEx	Operating expenditures
P2P	Person-to-Person
PPP	Purchasing Power Parity
SME	Small and Medium Enterprise
WTP	Willingness to Pay

About BFA

BFA (Bankable Frontier Associates) is a global consulting firm specialising in the development of financial services for low-income people around the world. Our approach is to seek out, create and implement solutions to the challenges faced by low-income people in managing the financial matters that underpin their lives. We purposefully partner with cutting-edge financial and nonfinancial institutions that touch the lives of low-income customers. In creating solutions, we integrate our deep expertise in customer insights, business strategy, new technology and growth-enabling policy and regulation. Founded in 2006, our clients include donors, investors, financial institutions, policymakers, insurers and payment service providers. BFA has offices in Boston, New York and Nairobi.

For more information, please visit: www.bankablefrontier.com

BFA Bankable Frontier Associates

About FSD Africa

Financial Sector Deepening Africa (FSD Africa) is a non-profit company funded by the UK's Department for International Development, which promotes financial sector development across sub-Saharan Africa. It is located in Nairobi, Kenya. FSD Africa sees itself as a catalyst for change, working with partners to build financial markets that are robust, efficient and, above all, inclusive. It uses funding, research and technical expertise to identify market failures and strengthen the capacity of its partners to improve access to financial services and drive economic growth. FSD Africa is also a regional platform. It fosters collaboration, best practice transfer, economies of scale and coherence between development agencies, donors, financial institutions, practitioners and government entities with a role in financial market development in sub-Saharan Africa. In particular, FSD Africa provides strategic and operational support to the FSD Network. FSD Africa believes strong and responsive financial markets will be central to Africa's emerging growth story and the prosperity of its people.

For more information, please visit: www.fsdafrica.org

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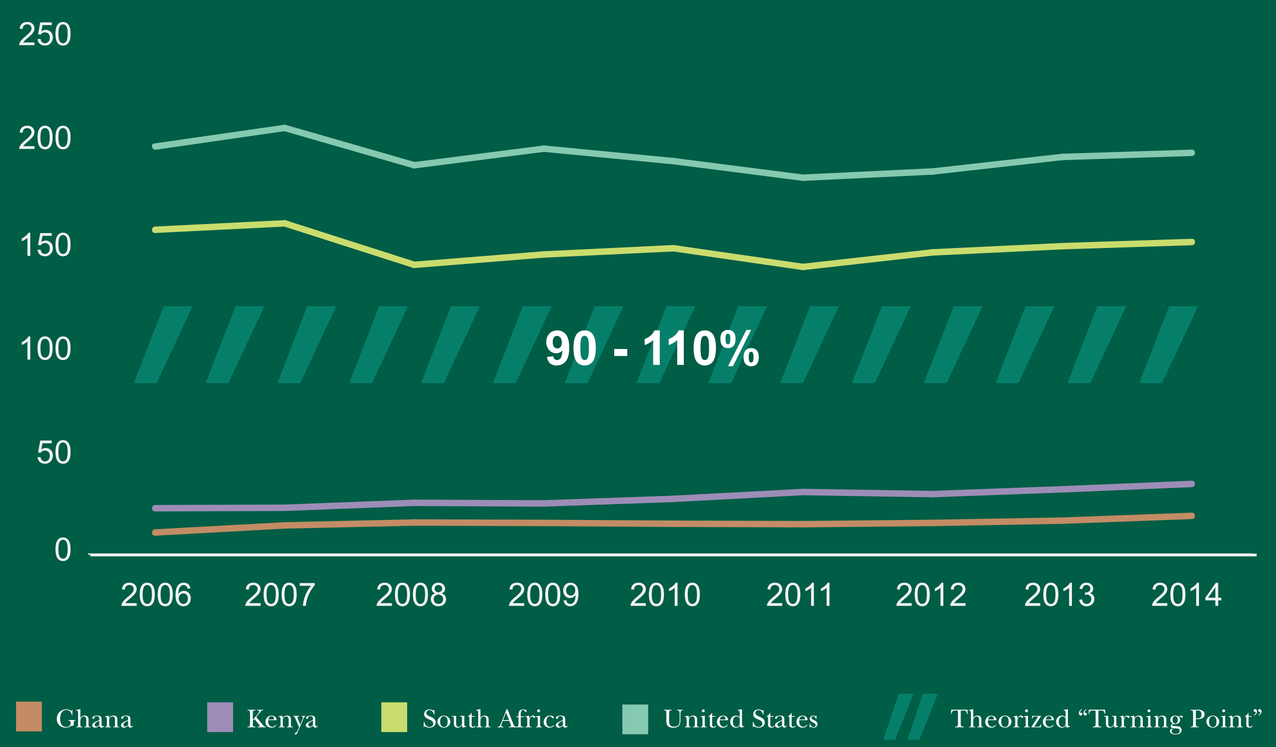
Photo credit: Peter-Wachira Irungu

Figure 1: Domestic credit to private sector as a share of GDP in focus countries[i]

Domestic Credit to Private Sector as % GDP, World Bank Indicators



Credit on the Cusp: The Expansion Imperative

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

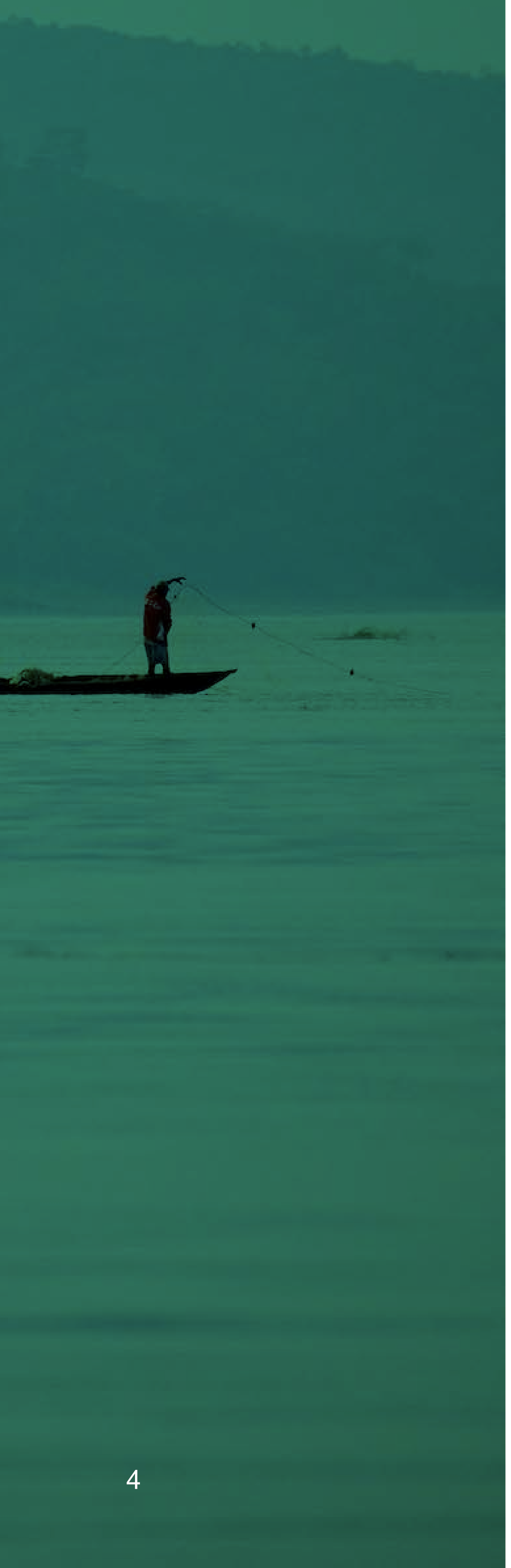
Credit markets play an important role in shaping that destiny. On a macro scale, credit facilitates growth, creating new opportunities for cuspers across the region. At a micro level, healthy credit markets can help improve the well-being of cusper families by helping them smooth incomes and expenditures,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

But today, Africa is severely under-lent. Most countries in the region have very low credit-to-GDP ratios (see Figure 1).

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

Background

Photo credit: Ollivier Girard



Background

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

Africa Rising? The failed emergence of a middle class

In the past five years, a number of highly publicised reports[ii] on the economies of Africa have painted an optimistic view of the continent's future and predicted the emergence of a new middle class. But the reality is that both growth and investment have been more moderate than expected in the past few years. Rather than a new era of stability, many economies are facing continued macroeconomic volatility and persistent inequality. The predicted expansion of the middle class has failed to materialise.

Periods of high growth have been high water marks in economies with persistent macroeconomic instability. Many of these "Africa Rising" reports have highlighted the high growth rates across the continent. For example, The Economist pointed out that six of the 10 fastest growing countries between 2001 and 2011 were African.

Figure 2: Real GDP growth per capita across focus countries (annual percent)[iv]

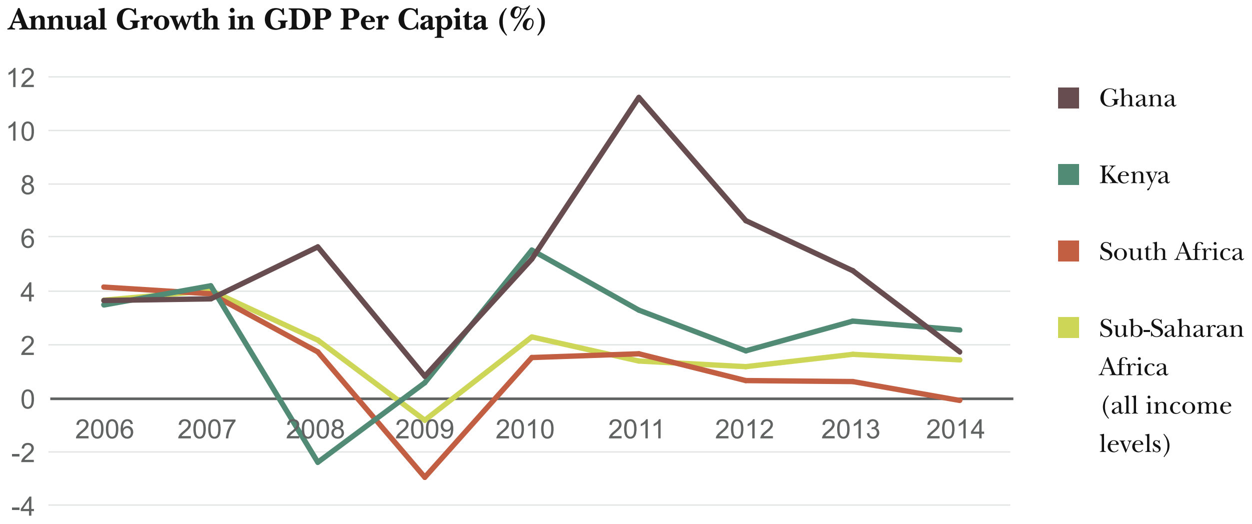
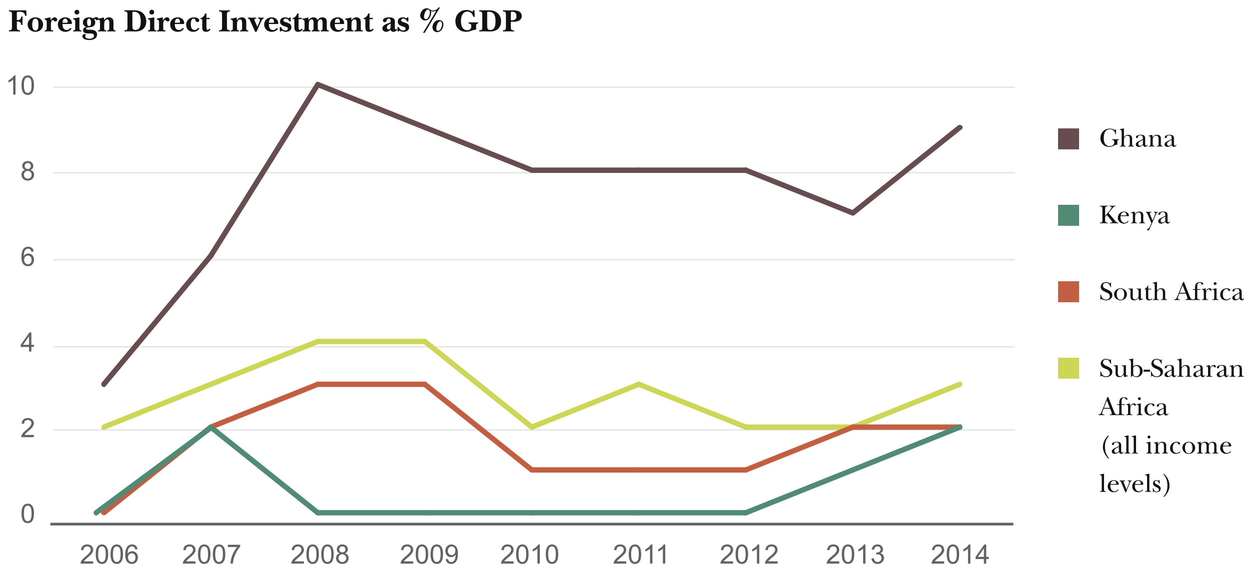


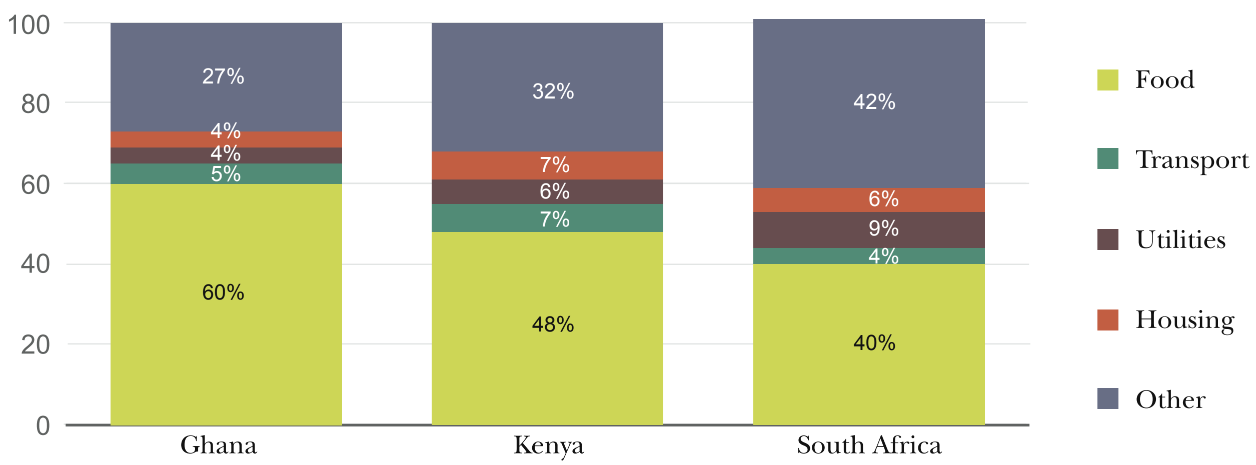
Figure 3: Foreign direct investment as a share of GDP[v]



McKinsey researchers highlighted the fact that continent-wide growth between 2000 and 2008 was about 4.9% (almost 2% higher than the global average of 3%), fuelled by a commodities boom and the end of violent conflicts in some parts of the region. The Economist projected this growth rate to increase to 6% between 2012 and 2022. Foreign investment was also increasing, peaking in 2007 at $87 billion—nearly the magnitude of flows going to China.[iii] This investment was thought to usher in a new decade of consistently high growth rates.
But, if we look at the growth experiences of our focus countries, we see that growth has been moderate. South Africa has been growing very slowly, and Ghana has faced

Figure 4: Composition of cusper expenditure budgets, household surveys [xiv,xvxvi]

Composition of Cusp Consumption Budgets (%)



declining growth and macroeconomic volatility in spite of high levels of investment.

Demographic dividend or demographic curse? Many have argued that Africa will soon capitalise on a "demographic dividend" achieved by a large youth population moving into the workforce with higher levels of education than previous generations.[vi] But whether the demographic dividend is actually realised relies on education investments keeping pace with increases in school enrolment and on the capacity of the economy to create jobs for a larger, more educated workforce.[vii]

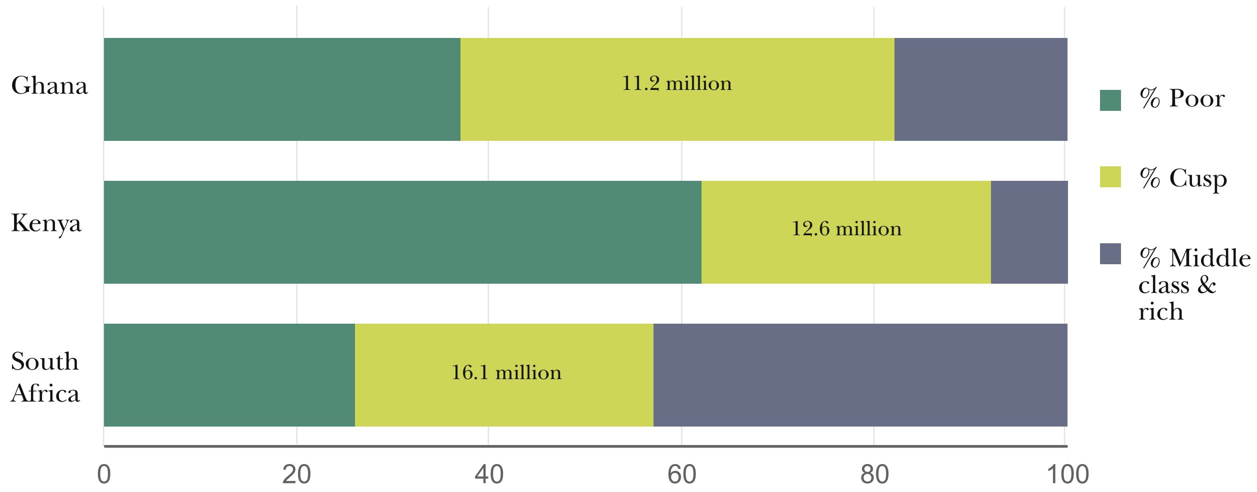
Labour productivity in sub-Saharan Africa has been improving, growing at a rate of 2.7% per year between 2000 and 2008. But these gains have been fuelled largely by rapid urbanisation, which accounts for 20-50% of the increase in labour productivity in some African countries. Also, recent volatility in growth across the region has highlighted how dependent many of the region's economies are on export commodities. Without significant growth in manufacturing and other more employment-intensive sectors, it's unclear whether Africa's economies will be able to absorb the large, educated youth population into their workforces.

Incidence of poverty—in terms of headcounts and "lived poverty"—remain strikingly high. High levels of inequality have meant that the gains of the past 15 years have not been evenly distributed. Rates of "lived poverty", based on incidence of families going without basic necessities, have changed very little since 2002.[viii] A large share of the population continues to go without sufficient food, medical care, water, cooking fuel and cash income. Seven out of 10 of the region's people still live on less than $2 per day. [ix] The number of impoverished people on the continent has doubled since 1981.[x]

Instead of a growing middle class, we have a new, vulnerable cusp group. In Africa, analysts have thought that the combination of growth, urbanisation and a general shift

Figure 5: Distribution of the population in cusp households in focus countries[xx]

Distribution of Cuspers on Income (%) by Country



away from agricultural livelihoods would expand the middle class. A middle class is important for reasons beyond the welfare of those who are able to graduate out of poverty. It is middle-class consumers who drive domestic demand and continued GDP growth, and many political scientists believe that a larger middle class ensures greater political stability.

The African Development Bank (AfDB) reported that Africa's middle class had grown to 34% of the African population by 2010, up from 27% in 2000. However, nearly all of that growth was in the subgroup they call the "floating class", getting by on just $2-$4 per day. Over the same period, the rate of transition from the floating class into the more stable middle class categories of $4-$10 per day has been negligible. [xi]

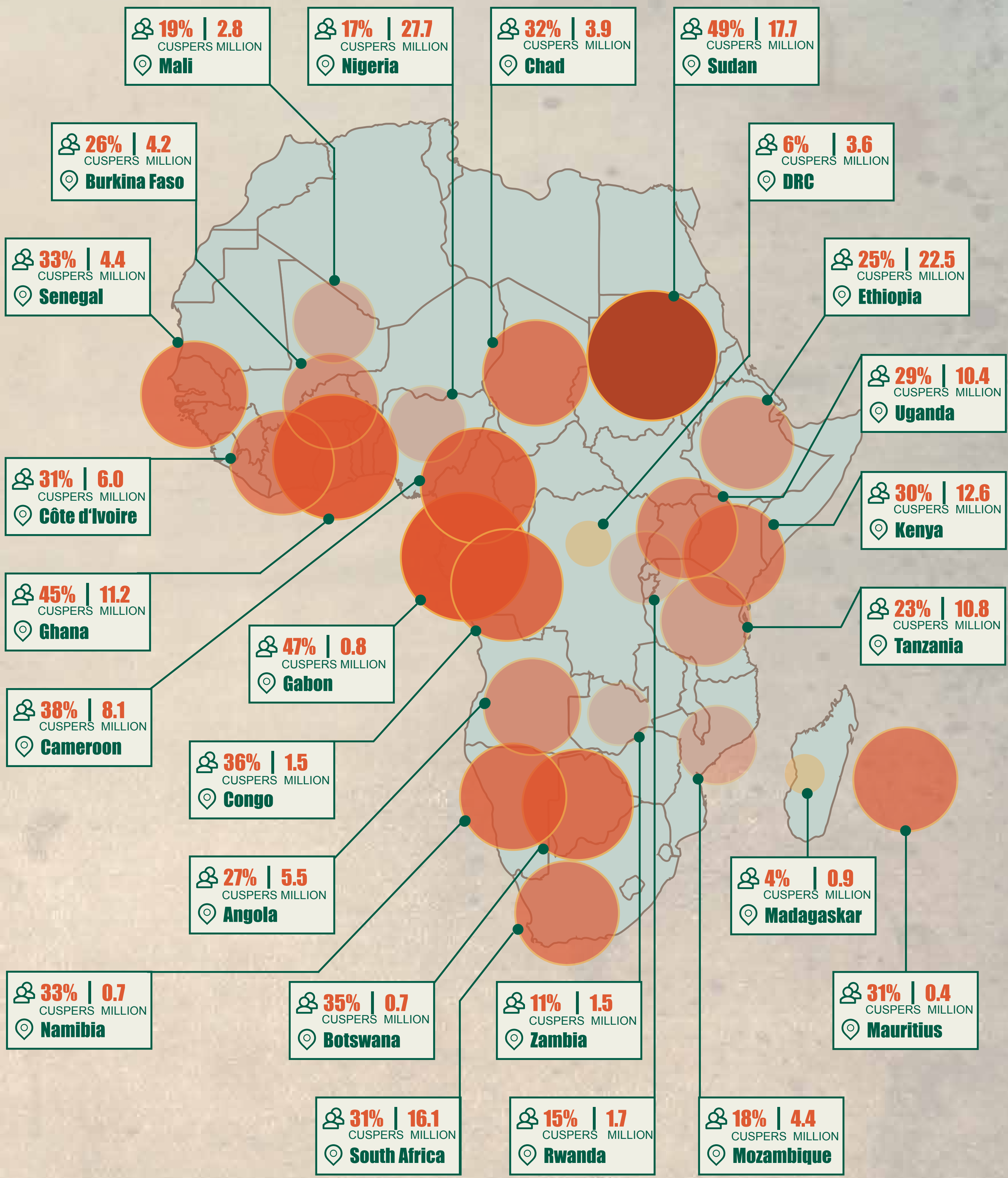
We find $2 to be an incredibly low bar for entry into the "middle class." AfDB authors argue that at this level, a household's food consumption expenditure drops to below 50% of income. But, we see that the share of cusper budgets going to food remains quite high, above 50% in some markets. Where the share of the budget going to food may drop—for example in South Africa with a sophisticated and efficient retail industry—those costs are replaced by spending on necessary transportation, utilities and housing, which are also relatively inelastic necessities.

The structure of cusper budgets makes these households particularly vulnerable to inflation and exchange rate fluctuations, serious problems in all three of our focus markets.[xii] In Kenya and South Africa, where we have disaggregated data on consumer prices, we find that low income groups—the groups less capable of dealing with price increases—typically experience larger increases in inflation than the headline rate and the rate for higher income earners.[xiii]

The nature of the cusper labour market also leaves them vulnerable. Cuspers occupy the low-skilled labour market, often in the informal sector. Even when they have formal jobs, those jobs are often uncertain and unstable.

LIVING ON THE CUSP

23% of sub-Saharan Africans are living in “cusper” households that get by on **$2-$5 per person per day.** This map shows their total percentage per country (relative to the overall country population) and size in millions.



They are less likely to have a written or long-term contract and are more likely to lose their jobs during downturns.[xvii] In South Africa, for example, 62% of unemployed cusp earners lost their most recent jobs involuntarily compared with 43% of their wealthier peers.[xviii]

The importance of the cusp group

We believe this cusp group is not just an artefact of African development trajectories, but an important new segment, deserving of our attention for many reasons.

First, who are the cuspers? We define the cusp group as those individuals who:

1. **Live on $2-$5 per day per capita.** They do not live in absolute poverty, but neither are they on the kind of solid footing that avails them significant month-to-month purchasing power.
2. **Actively earn their incomes.** They are not solely dependent on remittances or social safety nets. This group is earning an income actively, striving to achieve middle-class living standards.
3. **Straddling formal and informal worlds.** They are not purely confined to the informal economy in terms of labour markets, consumption markets and financial services. Instead, their economic activities straddle both worlds.

We believe the cusp group is particularly important as we think about evolving credit markets in Africa for three main reasons:

1. This group is **large.** We estimate that about 23% of sub-Saharan Africans, or 227 million individuals (cusp earners and their families) belong to cusp group households.[xix]
2. The experience of credit in this group of consumers has important **policy and political ramifications.** This group is politically important and their experiences can induce the creation of new credit regulation—or modifications of existing regulation—affecting credit markets well into the future. At relatively low income levels, they remain somewhat vulnerable, and negative experiences in credit markets in particular can then be felt deeply and dramatically.
3. This group is likely to be an **engine of growth** through consumer spending as budgets shift away from an overwhelming focus on food. Should they find solid footing in the middle class, they will also provide the benefits to consumption and political stability that a larger middle class affords.

Theory: Credit & cusper well-being

What role do credit markets play in this story of upward mobility?

Credit & growth. A positive relationship between financial deepening and growth has long been a cornerstone of economic theory.[xxi] Credit affects growth through two primary channels: firms and consumers. Credit helps new firms enter the market, achieve economies of scale, invest in productivity gains, innovate, and cushion the impact of fluctuating terms of trade and exchange rate volatility.[xxii] The IMF points out that strong financial sectors make monetary policy more effective and widen the fiscal policy space.[xxiii] For consumers, credit can boost aggregate demand, contributing towards growth.

Of course, credit is not always a force for good in an economy. High levels of credit may have a negative effect on growth. Some studies suggests that when private credit extension exceeds 90%-110% of GDP, credit can slow or even reverse growth.[xxiv] Credit does more to help middle income countries grow than it does for higher income countries.[xxv] With the exception of South Africa, all of our focus countries today are well below this threshold (Figure 1).

Credit & crises. Credit booms can be destabilising for an economy, given the empirical link between credit booms and banking crises.[xxvi] Of 129 banking crises studied by Laeven and Valencia, 45 were preceded by a rapid expansion of credit. Almost no country has avoided a banking crisis,[xxvii] including our focus countries: Kenya (1984 and 1992), Ghana (1982) and, more recently, South Africa.[xxviii] Similarities exist across banking crises:[xxix]

1. Asset price booms are common, many with overvalued housing or mortgage prices. These booms tend to be fuelled by rising credit resulting in increased asset leverage. Once these prices fall, consumers often find themselves struggling with reduced household wealth, putting pressure on debt repayments.
2. The probability of a crisis increases with a boom—and the longer and larger the boom, the greater the probability.
3. Credit booms are often associated with a deterioration in lending standards, leading to systemic risk.

Pre-crisis periods are usually characterised by benign macroeconomic conditions. However, higher debt leverage makes households and financial systems more fragile. Financial crises lead to recessions which are larger, and generally longer, than would be the case during business cycle recessions. Credit crunches lead to larger declines (usually 10 times greater) than other types of recessions. The bigger the build-up of private debt before a crisis, the harder the fall in household spending.[xxx]

Credit & consumer well-being. Apart from encouraging economic growth, consumer credit can cushion individual families from downturns, particularly by smoothing consumption and enabling better job searches after retrenchment.[xxxi] In Africa, credit can help enable livelihood shifts, especially from agriculture into small enterprise. It can also help finance and education spending, important for the upward mobility of the next generation. Both of these choices—a shift away from agriculture and increases in education spending—are hallmarks of movements towards a middle class.[xxxii]

Credit for consumption has also been a powerful force for bringing new welfare-enhancing technologies—like cars and washing machines—within reach of cuspers and the middle class in markets like the US and Brazil. In both cases, rising incomes were met with rising credit extension, which produced both huge welfare gains and unintended consequences.

In the United States, economic historian Louis Hyman describes the way that rising incomes and consumption borrowing led to the rise of discount stores that made it harder for small retailers to compete:

> *"Rising incomes had enabled Americans to borrow more than ever before. But because they locked up all their future income in houses, cars, and furniture, they needed everything else to be cheaper."* [xxxiii]

Table 1: Overview of demand-side sample

		South Africa	Kenya	Ghana
Areas included		Johannesburg & Rustenburg	Nairobi & Nakuru	Accra & Kumasi
Number of participants		30	30	29
Male %		57%	50%	53%
Main % income formal employment		37%	50%	43%
Main % income self-employment		27%	43%	43%
Average monthly income for household (local currency)	median	ZAR 6,000	KES 32,000	GHC 790
	mean	ZAR 7,275	KES 40,387	GHC 933
Average monthly income for household ($—not PPP-adjusted)	median	$472	$318	$214
	mean	$573	$402	$252
Average monthly income for household ($—PPP adjusted)[xxxviii]	median	$1,113	$791	$760
	mean	$1,350	$999	$897

In Brazil, a series of social reforms and a commodities boom enabled a massive expansion of the middle class, bringing those within that class into relatively stable employment and freeing them up for greater consumption spending. Banks, flush with capital from the commodities boom, were eager to lend to this expanding group of consumers, largely through retail instalment credit for the purchase of things like motorbikes, televisions and washing machines. This credit both helped cuspers acquire new consumer goods and tempted many to over-commit, leaving little income left after paying off credit bills each month.[xxxiv] When consumers experienced small disruptions in their regular income and expenses, they had difficulty keeping up with payments, leaving delinquent borrowers branded as "negativizado."[xxxv] They were then blocked from further credit—a lifeline—for five years. In a nationwide survey of Brazilian adults, BFA found that 34% had been on the blacklist at some point in their adult lives and 23% were currently on the list.[xxxvi] The country launched a positive credit reference bureau in 2013.

In search of the Goldilocks credit market

Achieving just the right amount of credit in a market is no easy task, but it's an important one: too little credit and opportunities are missed, too much and borrowers face overwhelming debt burdens and economies are at risk of banking crises. Reaching the appropriate equilibrium is primarily a regulatory problem. The nature of credit as a temptation clouds consumer judgment. Money today is a powerful force, particularly for cuspers who are strapped for cash.

Regulators ought to care about both the volume and the quality of credit in their markets if their aim is to build "healthy" credit markets. We propose that a healthy credit market exhibits four key features:

1. **Accessible.** In a healthy market, there are as many credit-worthy people as possible, and ideally all of them are able to receive "reasonable" loan offers. This requires lenders to be appropriately incentivised to reach a broad market with credit tools that deliver real value at a reasonable cost.[xxxvii]
2. **Robust.** Lenders must be strong and resilient. In healthy markets, not only do they serve as many clients as possible, but they also do so with a long-term perspective which enables them to do it prudently, with manageable and sustainable risks to their balance sheets and shareholders. They strategise to endure.
3. **Diverse.** A healthy credit market offers variety in terms of the credit offerings available to a wide range of equally diverse borrower segments. Borrowers have de facto options of loan types that fit their various borrowing needs.
4. **Value adding.** Credit can be a powerful and helpful tool for borrowers, opening new opportunities and helping meet critical needs otherwise unobtainable at the moment of need. But credit can also be wasteful and costly if consumers develop an over-dependence on it. We believe that healthy credit markets have not just sufficient credit, but a preponderance of "good" credit, which is credit that produces more value for both the consumer and the lender than the costs. From the lender side, that includes operation costs and costs of funds, meaning the loans are profitable. From the consumer side, it means the

quantifiable benefits of having accessed the loan are greater than the interest paid and opportunity costs incurred by making those payments.

A value adding mortgage, for example, enables a borrower to acquire an asset: a home that can be wealth building for the borrower and reduce expenditures on rent. If the borrower experiences a net gain in wealth from reduced rent payments and retained or increased value in the home (above interest paid on the mortgage), she is better off. The loan has been value adding for her. If the lender has earned a profit on this loan, the loan has also been value adding for the lender. Value addition is not the sole preserve of asset-based lending. Loans for consumption and school fees can also be value adding so long as the benefits to consumers and lenders simultaneously outweigh costs. In healthy credit markets, this dual-benefit value in lending relationships is the norm rather than the exception.

Research methodology: faces of cusper credit markets

Our driving question for this project was: **Given major shifts taking place in African economies, how can donors and policymakers guide credit market development in a way that strengthens the economic well-being of the cusp group over the next 10 years?** We sought to answer this by better understanding the experiences of cusp group borrowers, and the lenders who serve them, in our focus countries.

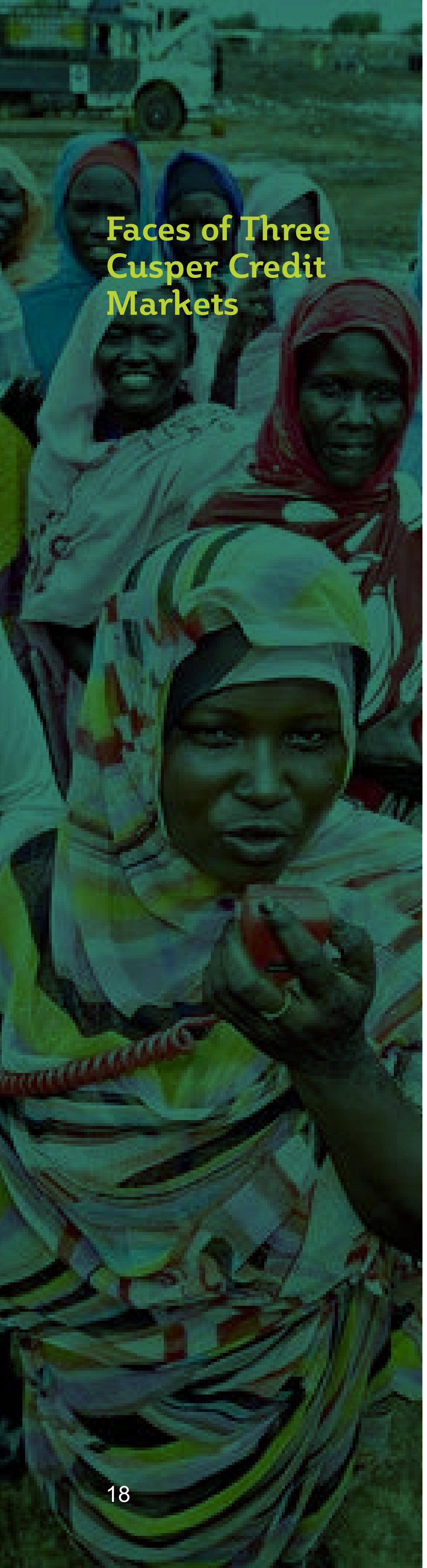
From the supply-side perspective, we conducted interviews with individual banks, lending associations, credit bureaus and regulators. We focused on specific lending models in each country that were particularly prevalent within the cusp group. In South Africa, we looked closely at unsecured lending, particularly the case of African Bank. In Kenya, we examined alternative algorithm credit scoring, in which lenders like Commercial Bank of Africa, through its M-Shwari product, are extending loans to clients by judging initial credit worthiness from things like their phone and M-PESA usage records. In Ghana, we examined traditional microfinance models, like that implemented by Opportunity International.

On the demand side, we targeted two urban areas per country, looking at the country's largest city and a secondary city that has been growing quickly in population size. We recruited 30 individuals per country to participate in in-depth discussions with our team, lasting between 90 minutes and two hours, to understand their borrowing attitudes and experiences in the broader context of their life stories over time. We focused on cusp group individuals, also including a few who had risen from the cusp into the middle class, in order to understand those trajectories. In South Africa and Kenya, where BFA has previously conducted Financial Diaries, we also included some former Diaries respondents who qualified for the study. This gave us an opportunity to build on previous relationships and to see how these individuals' credit experiences during the Diaries were continuing to shape their current lives. Audio from all of the demand-side interviews was recorded and transcribed.

Photo credit: Caroline Gluck (Oxfam)

Faces of Three Cusper Credit Markets

Photo credit: John Ferguson (Oxfam)



Faces of Three Cusper Credit Markets

Demand-side decision making

As we look at the life and borrowing experiences of euspers across our focus markets, it's helpful to keep in mind the key factors that influence euspers' decisions to borrow. We focused on four key variables:

1. **Need for funds now.** This can come in many forms, including an opportunity to invest in things like a new or expanded business; a problem, like the urgent need to repair the roof of one's home or pay a medical bill; or a desire, like the impulse to buy something that is outside of one's budget, but that feels attainable in the presence of credit (this might cover things like a new phone, a vacation or an expensive pair of shoes).

2. **Availability of credit.** The validity of these three needs as justifications for borrowing can increase and decrease with the perceived availability of funds to fulfil them. Where credit is tight, borrowing for a vacation seems absurd. Where it is not, living "like a monk" seems equally unfathomable.

3. **Ability to pay.** Borrowers enter credit agreements with the intention of repaying the loan that was given to them, and their expectation of being able to repay is based on their understanding of the cost of the loan and the future resources available to service it.

- **Cost.** The total cost of the loan—to the extent that the borrower actually knows and understands this cost—factors into borrower assessments of whether a loan is affordable.
- **Expectations of future income.** Like a lender, a borrower takes a risk when borrowing, hoping that he or she will continue earning at his or her current levels or—in some cases—be able to increase earnings by taking a loan. These assessments may not always be accurate and, for borrowers, are mostly made by individual guess rather than any kind of quantitative modelling.
- **Expectations of future expenses.** Borrowers consider their upcoming expenses when they consider the affordability of loans, but often this is only a salient factor in borrowers' minds when they have a large future expense looming, like paying school fees for a child or paying off another debt.

4. **Willingness to pay and expectations of enforcement.** When potential borrowers are considering whether to take a loan and, if so, from where, part of the decision is influenced by how painful—and how fair or unfair—they expect enforcement to be in the event they are unable to keep up with payments. This has to do with the financial costs associated with mounting arrears or potential court fees, consequences related to non-payment such as the termination of a credit relationship or negative credit record, and also with the social stigma and humiliation that can come with collections and repossessions.

As we look across these markets, we see that the nature of these factors—shaped by macro conditions and culture—vary widely, shaping the nature of credit experiences.

Table 2: Summary of credit market comparisons in focus countries

	Ghana	Kenya	South Africa
	"SQUEEZED" High interest rates and macro uncertainty make informal cuspers unattractive risk	**"UNCERTAIN"** Many good credit stories in past, but poised for aggressive growth in digital lending	**"STUCK"** High levels of indebtedness, waiting for market self-correction
REGULATORY ENVIRONMENT			
Functioning of credit bureau			
Traceability and contactability			
Contract enforceability[xxxix]			
MARKET CONDITIONS			
Size of cusp population (% and # of people in cusp households)	45% 11.2 million	30% 12.6 million	31% 16.1 million
Credit-to-GDP ratio	20%	34%	151%
Interest rate spreads	22%	10%	3%
Market concentration—banking sector[xl]			
Share of adults with a mobile money account[xli]	13%	58%	14%
Share of adults with a bank account[xlii]	35%	55%	69%
Share of salaried employees[xliii]	23%	17%	80%
Availability of cusper credit	Mid-sized loans available, w/short terms, high interest	Expanding rapidly for very small loans	Diverse types available for anyone with payslip
CONSUMER DECISION-MAKING MODELS			
Primary need for funds now	Solve a problem	Seize an opportunity	Fulfil a desire
ABILITY TO PAY			
Cost	Think of cost as total interest paid	Think of cost as total interest paid	Think of cost in terms of instalment size
Expectations of future income	High levels of uncertainty	Strong and self-determining	May expect stability, but actual pattern of harsh ups and downs and limited ability to increase earnings
Expectations of future expenses	Biggest expenses are recurrent expenditures, mainly food and school fees	Plan ahead for big investments, such as school fees or housing	Workers cater for many others; expect rapid lifestyle transformations

“Stuck” in South Africa

In South Africa, euspers occupy a relatively low space on the national income distribution, between the third and sixth deciles. They are still waiting for the promise of post-apartheid prosperity to reach them. Many have benefited from state-sponsored housing and government cash grants, but are striving to enter the middle class through formal employment. Formality is the law of the land in South Africa: 75% of adults are banked, including 60% of euspers.[xliv] Formal employment is common, though this also differs by income with 29% of cusp adults having a formal labour contract versus 66% in the middle class or above.[xlv] But those formal jobs in the cusp group are not particularly stable.

Borrowing in South Africa is widespread. FinScope[xlvi], which often under-reports borrowing, shows that 35% of the sample of adults had borrowed in 2013, either through a loan or other formal credit facility. This figure includes 22% of cusp group households. Roughly 11% of cusp group households were using formal credit or credit products, such as retail cards or credit cards. Overdraft facilities and mortgages were rarely used, covering just 1% of cusper households in 2013. According to the National Credit Regulator, the market added six million new credit-active clients in the past seven years. But along with growth has come indebtedness. Over the same period, the share of credit-active consumers with impaired credit records has risen from a low of 36% to a high of 48%, settling back to 45% by December 2014.

When we listen to the stories of South African cuspers, we hear the ways that a boom in readily available credit—particularly that extended to salaried workers—has been financing the lifestyle dreams of cuspers looking forward to the promise of post-apartheid prosperity.

In Johannesburg, we heard stories of cuspers striving for regular employment, but finding that jobs were seldom stable. Those who found jobs were expected to support an entire household. Many expected that a salary should enable them to live a lifestyle that, in reality, their wages could not support. Striving to transform their lives overnight, young people overextended themselves in debt and were quickly buried when faced with shocks to their income—cuts in hours, periods of maternity leave, the loss of a spouse’s job. They look back with regret. Government grants provide some safety net, but getting another job can be tough. Trying to get back on one’s feet in the informal sector is also daunting with retail dominated by large, formal, low-cost chains.

In Rustenburg, we spoke mostly to families linked to mining. Men came when they were young to build a life they hoped would pull their extended families out of poverty. Many were successful, slowly climbing the ranks and regularly sending resources back home to educate and house their extended families. The mining labour recruitment and management service, Teba, enforced saving habits on new mineworkers that helped them avoid some of the early temptations of debt in their young lives, allowing them to make investments—mostly in their rural homes—through accumulated savings. Mineworkers’ lives were gradually transformed, with debt stress only emerging during protracted strikes, when arrears accumulated while income stalled. But most were able to overcome even this setback quickly after they returned to work.

There are two distinctive credit stories: the first is temptation and vulnerability, but the second is the transformation that credit alongside career growth can bring, particularly when the temptations of youth can be overcome.

The first toe dipped into the formal credit market is typically with store cards and furniture hire purchases. Most of our respondents’ first borrowing experiences were either with a store credit card at a retail chain like Jet, Edgars, Woolworths or Mr. Price. Retail businesses, including clothing retailers and furniture dealers, can afford to take more risk than most banks, since they earn a margin on both the merchandise and credit. Their business model also incorporates increases in earnings from sales generated from getting to know the purchasing and payment histories of card users, targeting them with new offers by SMS and mail once they register, and increasing their credit limits over time, which can drive increased purchases in their outlets.

When it comes to these retail cards, lenders look for the borrowers rather than vice versa. Ivan told us, “When you walk around the streets in town, you’ll find them sitting outside the store and asking people to open accounts.”

Sometimes, opening the account is itself a signal of having made it into the middle class, signalling status by opening cards for higher end stores or buying furniture from pricier shops. Lynn recalled:

> *“Hey! I had so many accounts. Let me tell you, let me be honest. I had Edgars, I*

had Truworths, I had Woolworths, I had American Swiss, I had African Bank, hee! …Almost everything I had… Yes, Geen and Richards, it was one of the most expensive! It was in style, and Morkels also."

Automatic increases on credit card and store card limits make the savvier borrowers particularly concerned. Many developed the habit of using their entire credit limits on their cards regularly, paying them off over many months. Automatic increases in credit limits made many fearful that they couldn't keep up with payments. Ivan, who used a credit card for groceries between paydays, explains:

> *"The credit card doesn't have a problem, it's just that you'll keep on swiping and when they see that your balance is going down they'll increase your credit [limit]… You'll find that the limit was $236 (ZAR 3,000) now it's $276 (ZAR 3,500). So in that way I realised that this will be ongoing debt. It won't get finished…I said no, this is not okay. It will get up to $787 (ZAR 10,000) and how will I pay back? Sometimes you end up using it unnecessarily because it is money."*

Respondents told us that African Bank would do something similar with unsecured loans, offering more and more credit once you had taken a loan. Lynn in Diepsloot told us:

> *"They can give you $787 (ZAR 10,000) this month and the following month they'll tell you that you qualify for a $3,947 (ZAR 50,000) loan."*

A payslip opens new credit doors. While even those in the informal sector could often get a store card or hire purchase, credit options, including unsecured loans, really opened up when one had a formal payslip. This meant you received monthly cash flows and you had a bank account from which those cashflows could be tapped directly.

When Lindiwe got her first formal job at a casino and was struggling to keep up with all the needs at home, her colleagues encouraged her to just take her payslip to the banks and request a loan:

> *"[It wasn't difficult at all] with African Bank and Capitec. They just loan you even if they can see that you can't afford to pay them back they just give you…they just want your payslip and your expenditure only and give you money."*

Without a payslip, there is a much higher bar for borrowing eligibility. One must prove that sufficient cash flows will be coming through the bank account to enable automated deductions. So, many of our self-employed respondents felt locked out.

Sizwe, who runs a computer repair shop, explained:

> *"I've never even asked [for a loan]. I know the regulations and can see that I've got a disadvantage…It's not easy to see how much I earn by looking on my bank statement. 'Cause it's not everything that goes into the account."*

Instead, those who can't borrow for themselves often ask the employed to take the loans on their behalf. Lindiwe borrowed for her husband to buy a car on the back of her casino payslip. Zack, working in the mines, borrowed for an uncle who needed to pay lobola (bride price). It's hard to turn down these requests given social norms of sharing and helping.

But the payslip also elevates demands on cuspers' consumption budgets. While formal employment is prized—not least for this access to the wider credit market—it often brings with it many new responsibilities, which the newly employed worker is expected to cover from his or her salary. Often a large number of household members—and sometimes extended family—depend on just a single income earner for their sustenance.

When Nomsa got her job in the supermarket, her mother believed their entire family could now live differently. Without consulting Nomsa, she took a dining set out on credit at Ellerines, expecting Nomsa to make the monthly payments on her behalf. This became a problem for Nomsa, given other debts, once she went on maternity leave and faced a pay cut. The dining set was repossessed.

Those who are working are expected to make outsized contributions to help with things like school fees and funerals. If they do not, they will be ridiculed. As one respondent explained, people will ask "What are you paid with? Stones?"

And an entry into the credit bureau plus a payslip invites more aggressive lending. Once our respondents had a payslip and began borrowing formally, they told us that they were bombarded with new credit offers and offers to increase their credit limits.

Ken, a former loan officer himself at Ellerines, African Bank and a number of microlenders, felt that as soon as the credit bureau showed he was a good payer, it was as if everyone wanted a piece of his pocket:

> *"In less than six months [after getting my first job] they started sending me the pre-approvals. I don't know how they got my details because they always claim that we got your details from the database blah blah blah. And then I don't know what database is that…The more you are a good payer in South Africa, that's where you get a lot of pre-approvals."*

Before long, many find they have committed huge shares of their salary to monthly debt payments. Once income in the household falters, serious debt problems emerge. A number of our households in South Africa were in the midst of serious debt stress. They had stretched themselves thin with borrowing, leaving little room to manoeuvre when things went wrong.

Sipho's family had just got a government house, and he wanted to borrow some money to wire the home for electricity and plaster the walls. He borrowed about $2,362 (ZAR 30,000), but used about $1,654 (ZAR 21,000) to pay other debts first, leaving only about $630 (ZAR 8,000) for the repairs. The debt service left him only with about $197 (ZAR 2,500) a month to live on. That was fine as long as his wife was working. When his wife lost her job, his outstanding loan quickly grew to $4,173 (ZAR 53,000). Blacklisted and buried in debt payments, he sought help with a debt counselling service, which defrauded him of several months of payments without making the agreed payments against his debts. He feels hopeless:

> *"I blame myself, I can't blame the banks because I needed cash. I blame myself why I took so many credits now it is difficult for me to pay back. As I said before it was easy the time my wife was working. Others were phoning me and sell their products if I'm*

interested I should come with my particulars. When they say approved, I'll say yes, good, I want it. That 'approved' killed me. Now it's only 'declined' everywhere."

Some lenders recognise the vulnerability of cusper employment and sell retrenchment insurance alongside their loans. But this also appears to have led to a misconception among many that if you lose your job, your loan is automatically written off. Our respondents told us they would write letters to their lenders expecting that the loan was forgiven, only to find out years or months later that the debt remained, and arrears had accumulated to new heights.

Where formality reigns, job loss entails a very hard fall. When our South African respondents lost a job, it was often years before they were able to find another. The income earning opportunities available in the meantime were often very meagre. If they attempted self-employment, they needed to piece many different activities together in order to get by. Small informal vendors could not compete with large, cheap supermarket chains.

Cuspers shop around for the institutions that give them the money they are looking for, but they pay more attention to monthly instalment sizes than the cost of funds. When borrowing—particularly unsecured bank loans—many are looking to get as much money as they can for a project. They may visit multiple institutions, but this is more to compare how much a lender will give, and over what time horizon, rather than to compare interest rates. When we asked respondents about the costs of loans, they nearly always replied in terms of the monthly instalment.

When they weren't able to get as much credit as they hoped from their current banks, our respondents hopped around to other institutions. Lindiwe had her salary deposited into Standard Bank, but they referred her to African Bank for loans. There she had a personal loan and credit card. When she wanted more, she tried at Nedbank. Then Capitec. Then Absa. Then Capfin. By the time she retired, she had outstanding debt at six institutions.

As they get older, many regret the borrowing mistakes of their youth. When young people get their first jobs, they are tempted to transform their lifestyles overnight, and credit makes it a little too easy to do so. They begin competing with neighbours and friends to have nice clothes, a nice sound system, a new TV. Rather than one loan at a time, they are soon committed to multiple loans, often with more than half their take-home pay being used for debt service.

Lynn told us:

"I wish people when they start working, they must go for counselling, because lack of information is killing us. You end up having so many debts unaware. If I could start working now, I don't think I'll play that game, I know now…I wouldn't have a single instalment, because buying things on hire purchase is very expensive…I didn't know. I didn't know…I have learned by my own mistakes."

Borrowing is embraced as a helpful tool when it helps people acquire things they can see, things that last. Credit has been particularly helpful in building and renovating homes, for example, or buying assets like furniture and appliances that would otherwise seem out of reach, but

whose value is enduring. Catherine in Diepsloot told us she only borrows at furniture shops and only for one item at a time. She wants a visible reminder of her commitment:

> *"You are looking at the goods…You are looking at the fridge and saying, 'That fridge, I'm paying that one.'"*

Respondents told us that this is motivating. You know why you are making sacrifices, and that you have made those sacrifices for something that will be meaningful in your life well into the future.

Formal and informal sources of credit are not substitutes. Tighter credit in the formal sector is likely to reduce consumption, rather than shift borrowing to the informal sector. The types of credit that our South African respondents were able to access from informal sources—like savings clubs and moneylenders—were very different from what was available from banks. Typically, only very small sums were available in the informal sector, and typically the entire sum, plus hefty interest charges, was due in the course of a single month (possibly two). Formal credit providers offered more money, longer terms and more diversity. Typically, moneylenders in South Africa would lend our cusper respondents less than $79 (ZAR 1,000). Interest rates could be 50% per month.

Formal credit—governed by collections rules—is seen in many ways as "softer" than informal credit. As described above, informal moneylenders were viewed as particularly strict and uncompromising, but so were a range of savings and lending clubs. Respondents told us that if you miss a stokvel payment, you lose your entire payout. Just like that.

Formal lenders are forced to be more honest and their behaviour is governed by law. Respondents believed they could negotiate with formal lenders, while other obligations in their lives were less flexible. Milly, who took a loan from African Bank for a washing machine, explained:

> *"I can go and negotiate with them [at the bank] in months I won't be making any payments because of the situation, but the landlord won't understand."*

Indebtedness is not uncommon. The term "blacklisted" is part of household vocabulary. For our respondents, the categorisation was not so much a stain on their pride as a legitimate inconvenience. When they needed to borrow now, their options were much more limited. The only thing worse than borrowing too much was not being able to borrow at all.

Sipho explains:

> *"Now I'm blacklisted because of my poor credit record…Now, if I have a problem, well…even last week I went home for a funeral, and it was during the month, and there was nowhere I can borrow money unless I go to this people when you borrow $7.9 (ZAR 100) they add $3.9 (ZAR 50). We know the African Bank but these ones are African mashonisa (loan sharks). They break us these people, because they know there's nowhere to go."*

Laws of Motion Highlighted in the South African Cusp Experience:

1. **Acquiring a first formal job is a particularly vulnerable moment for first-time borrowers.** Because their cash flows are now deemed regular and reliable, and can now be easily tapped with confidence, these potential borrowers are attractive to lenders in all markets. But, they are also often inexperienced and tempted to borrow more than they can actually afford.

2. **Where informal labour markets are limited and dependency on borrowers is high, economic falls are very hard.** In South Africa, those who lose jobs may stay out of work for long periods. It is not as easy as in Kenya or Ghana to start over with small stock in a low capital trading business and build up into an enterprise that can support a real livelihood. Instead, those who lose work seem to very quickly fall into very deep holes, but the debt remains.

3. **Borrowers care most about loan size, speed, and duration.** Few borrowers, especially those new to formal borrowing, know how much debt service they can manage and often rely on lenders to judge affordability, in effect saying "if I get approved then I must be able to afford it." When money is needed, it is difficult for borrowers to exercise restraint and self-control, or to assess the sustainability of projected returns on investment. For cuspers, dreams are often much bigger than incomes.

4. **Formal and informal borrowing are rarely substitutes.** While formal lenders in South Africa claimed that constrained formal credit would drive borrowers into the arms of ruthless informal lenders, we don't actually see formal and informal credit being used as substitutes very often. Informal credit—from family and friends, moneylenders, and savings and investment clubs—tended to be much smaller in value and intended for very different use cases than the kinds of loans available in the formal sector.

5. **Formal lenders are often viewed as softer, more fair and more private than informal ones.** In South Africa, cuspers are typically aware of the restrictions on lender behaviour that limit aggressive and humiliating collections. In Ghana, this awareness is emerging in urban contexts. In Kenya, using a formal lender can often mean that an individual accesses a loan independently. It gives the borrower pride to take on a loan independently. Across markets, we were told that formal lenders negotiate when things go wrong. In contrast, late payments to family and friends trigger gossip, and late payments to moneylenders lead to various forms of public humiliation.

"Uncertain" in Kenya

Cuspers in Kenya operate in a very different social space to cuspers in South Africa. Occupying the higher percentiles in Kenya's income distribution, many cuspers already feel quite accomplished. Our respondents, in Nairobi and Nakuru alike, have either stayed in the same social class or have transformed their lives from previously very poor backgrounds and now feel quite close to achieving "middle-class" status. It's a quite different feeling from cuspers in South Africa, more of whom feel they've yet to really "make it."

While Kenya's retail and labour markets are much more informal than those of South Africa, access to formal financial services, including bank accounts, mobile money and credit, has been expanding at an explosive pace. Historically, most cusper borrowing has been informal, through friends and family, savings groups and credit with individual shopkeepers. But that may be shifting with a generation of new lending products rolling out on mobile channels. About 86% of cusp adults, according to the 2013 FinAccess survey, were using mobile money. And all mobile money users had the choice, beginning two years ago, to apply for loans via M-Shwari,[xlvii] where early credit limits were set based on airtime and remittance behaviour on the Safaricom network. In two years, Commercial Bank of Africa's M-Shwari product hit nine million accounts and had disbursed more than 20 million loans.[xlviii] This initial mobile lending product was soon followed by KCB M-PESA, offering somewhat larger loans over longer periods. Equity Bank then followed with Equitel loans disbursed over their own SIM card accounts, and a range of smaller fintech companies also entered the space, including Branch and MyBucks. In a very short time, millions of new individuals—many of them cuspers—entered the formal credit market for the very first time.

In general, our Kenyan cuspers' stories were optimistic. Many are proud of real life achievements they have created for themselves, often through entrepreneurial activity. Even where respondents were formally employed, these salaries were leveraged for investments in household businesses undertaken in a quest to keep "developing" and to pay for the education of children.

Respondents here are grateful for an expanded banking sector that has delivered more accessible savings and credit to "ordinary" people like them. They applied for new loans either by building a savings history with the bank or through group lending mechanisms. By planning for the use and repayment of these loans, they could be responsibly managed and channelled into investments that made a big difference in respondents' lives. Sometimes—with and without loans—our respondents faced serious financial challenges, often due to a health emergency or business problem. But they were typically able to bounce back quickly, by taking small amounts of capital and turning them over in business or seeking support from broad and deep social networks.

Entrepreneurial activity is a key path for upward mobility for Kenyan cuspers, whether or not they have a formal job. Unlike South Africa, where formal jobs reign supreme, Kenyans view their own business activities as the route to upward mobility. There are not many formal salaried jobs available and many explain that the jobs available to those with similar education levels are low paying relative to what one can earn in business. Business provides flexibility, independence and no upward limit on earning potential. Many make an active choice to leave or forgo employment in favour of business.[xlix]

Dennis, a young businessman in Nakuru, recounted his shift from working for others—as a matatu taut, a petrol station attendant, and then a security guard—into hawking sweets, shoes and clothes, before becoming an independent motorbike taxi driver:

> *"I found self-employment to be very interesting, because you enjoy life as you wish, you control yourself, and even the earnings were a bit higher. The business picked immediately and I was able to save \$2 (KES 200) per day after expenses."*

Many cusper spouses collaborate around investment and borrowing, and sometimes in ways that challenge traditional gender norms. Husbands and wives in our Kenya sample seemed largely collaborative around income generation with spouses often working in complementary livelihoods and helping one another invest in business activities that helped the family get ahead. In Kenya, this kind of collaboration seemed more close, supportive and bi-directional than in our other two markets.

Susan, for example, got a formal government job, and learned that she could borrow substantial sums based on her payslip. She decided to take a loan of \$5,000 (KES 500,000) for her husband, a taxi driver, to buy his own car.

"When I got employed, I thought of why can't I surprise him and empower him financially? He had taken care of my child while I was in college and we had been married about 7 years. So I decided to buy him a cab so that he can run his own business."

About half of Susan's salary goes to debt service for this loan. But with the cab, Susan's take-home pay, and her side business running a salon, the couple feel stable. Among her many plans for the future, she tells us, "I also want my husband to have a fleet of more than five cars and be operating nationwide."

Kenyan cuspers may be vulnerable, but they are also resilient. Kenya's informality of labour and retail markets seems to have made it easier for our cusper respondents to get back on their feet after inevitable setbacks that beset this segment across the three focus countries: job loss, medical expenses, and the death of important income earners and supporters.

Paul's father died when he was still young. To help his mother make ends meet, he dropped out of a technical training course and became the family breadwinner. He planted tea. He raised chickens and sold some to invest $40 (KES 4,000) with two friends to open a restaurant. When that business eventually petered out, he borrowed $50 (KES 5,000) from a relative to start a butchery, a business that continues today alongside his farming activities. With his earnings—and helped along by a series of loans that have helped him make lumpy payments—he has put his siblings through school, his wife is now studying at a local university, and his children are also all in good schools. Just a little investment went a very long way.

Loans, even small ones, can help with that resilience. Bank loans often seemed a risky way to start a business, but not to expand it. Instead, many fund the start of a business with savings or soft loans from relatives. But, since such low amounts of capital can be used to start—or revive—an enterprise, even very small formal loans at just the right time can be extremely helpful.

Esther and her husband were on an upward trajectory with her running a second-hand clothes business and he a motorbike taxi until they were beset with a series of setbacks. Her husband suddenly died from meningitis and Esther herself was hospitalised with pneumonia. By the time she recovered, her savings were exhausted, and she needed stock to get her business back up and running in order to pay school fees for her son. A microlender loan of just $85 (KES 8,500), payable over one month, helped her buy two bales of second-hand clothing, generate profit, pay off the loan, and get back on her feet.[1]

Many Kenyan cuspers already feel quite close to the middle class. In Kenya we began asking our respondents about the income levels they believed constituted middle-class status. Many felt that they were in fact quite close to middle-class status themselves, often having come from more impoverished backgrounds in their childhoods. Rather than feeling victimised or downtrodden, they seemed to feel—for the most part—proud of their accomplishments and confident that they would continue to be able to meet their needs in the future.

Cindy and her husband were both 19 years old when they had their first child, and they barely got by. They were forced by their parents to try and find a way on their own. Today Cindy runs a small restaurant and salon, and believes her monthly household income—about $150 (KES 15,000) —is comfortable. When we asked her what "middle-class" would be, she told us:

"I would say around $200 (KES 20,000)… The upper class is around $1,000 (KES 100,000)…I would say the middle class is someone who is able to pay a house rent of $60 (KES 6,000) a month. Someone who can afford to spend $2 (KES 200) daily on food but they are not able to buy bread on a daily basis."

Kenyan respondents appear to be patient about big investments. Perhaps it is the combination of relatively scarce consumption credit and this feeling of satisfaction that make Kenyan cuspers willing to wait, save, and plan for big purchases, unlike our South African respondents who rushed to acquire furniture, appliances and clothing. Our Kenyan respondents planned their big purchases, often over many years. One respondent, a spice vendor, built his home over six years, making incremental investments every year. Another talked about the importance of saving for assets:

"You should just wait for your chama (savings group) turn to go buy a toaster! …With God's timing, we will have money to buy everything."

There seemed to be a division between those who now want to play it safe and those who still feel risks need to be taken to get ahead. Those who either felt they were already middle class or were very close to being so seemed fairly content with their current lives, and were not necessarily full of big ideas for new and grander transformation. They continued to work in their jobs and their businesses, but weren't particularly interested in taking on big new investment projects.

But another segment of people, more typically those who felt they still had a way to go (in terms of earnings) to reach middle class, seemed hungrier to climb the income ladder. And, to do that in Kenya, most seemed to assume, there was only one path: business. More business, bigger business, lots and lots of plans! And business means risk. These individuals were willing to take on big risks—and big loans—to try to fulfil their many plans.

Some even view borrowing as helpful because of the pressure it creates to increase earnings. Paul is always taking loans for new projects—one at a time—for school fees, housing, rental houses and various businesses:

"Personally I think if I live without debts, I don't know what kind of a man I would be. Because if you don't have a debt, why are you even waking up? You just sleep because there is nothing that you are going to pay. I believe in having debts."

Loans are often viewed as "help", and we heard few stories of remorse in borrowing. Most of our credit stories involved credit truly opening a new opportunity for the borrower or the borrower's family, helping them pursue something that would have otherwise been impossible.

One outspoken advocate for loans was Henry, who runs a spice business. He was introduced to Equity Bank in 2008. They told him that if he saved for six months, they would give him a loan. He was shocked when they lived up to their promise and gave him his first loan of $500 (KES 50,000). From that starting point, he's taken many more loans with the same bank, and others, and claims that these loans have changed his life:

> *"When I started taking these loans, I started seeing an improvement in my life…That is when I started having hope for the future. So I have been working hard till I bought another piece of land."*

He tells us that when he first came to the city, he had only one pair of sandals and one pair of shorts. Now, he leads a comfortable life and all of his children are in school. He considers credit a "blessing", and:

> *"If God has blessed me with something, I should also be ready to give someone who is in need."*

Where we observed debt stress, it was more often tied to business operational challenges than temptation and overspending. Just like in South Africa, our Kenyan respondents found borrowers—rather than lenders—more responsible for debt problems, but their reasoning was different. In Kenya, cuspers believed self-control was only part of the problem, and one that manifested itself not in unnecessary luxury or temptation spending, but in failing to "have a plan" for the use of new money, to be sure you used it quickly and in a lump sum. If you don't it slowly trickles away and you can no longer even remember what you did with the money.

Sally was once in a chama where she was forced to borrow from time to time. The group gave her a loan of $80 (KES 8,000) and she had little interest in the money.

> *"I can't even tell what I did with the money, because I didn't even want the loan in the first place. You know, when money comes that you hadn't planned for, you just misuse it."*

The other reason things go wrong is that repayment is so closely tied to business earnings, which go up and down. This is not just the loans that are taken for business investments. Even when the money is used for things like land or school fees, businesses at the household level must do well to maintain the family's ability to pay. As one respondent explained:

> *"When it comes to individuals who are employed, they don't have a big issue when it comes to loans, because you know at the end of the day some amount will be taken to the bank. But if you are getting money from your own business and it keeps fluctuating, then that's when you can have a problem."*

But, advance planning was not a feature of the kind of impulse, short-term borrowing that many did with new alternative algorithm-based lenders. We observed respondents using the quickly accessible, small kinds of loans available on M-Shwari, KCB M-PESA, and even to a certain extent on the new—and now discontinued—AFB credit cards[li] for impulse needs or convenience without giving much thought to repayment.

The need for these kinds of loans is quite strong. Few keep much cash around, keeping as much as possible flowing through the business to increase earnings. So when they need money quickly, it's these types of loans they seek.[lii] Edward, a shoe seller in Nakuru, explained:

> *"Us business people we don't have that money that we can say we have kept aside and use later. So what we do is to borrow from friends or that M-Shwari and when money comes you pay back."*

For very small loans, the lack of planning is not necessarily a problem. The borrower will still be able to repay. However, as loan sizes grow, some worry. Cindy runs a hotel and salon in Nairobi. She has been borrowing a lot to finance bits of work on the home she is building upcountry. Now, her limit has grown to the highest among her friends and she's getting nervous:

> *"I was feeling in case my limit goes as high as $100 (KES 10,000) I cannot pay it back within one month. Even my current limit of $60 (KES 6,000) is intimidating on its own. I get stressed knowing that I have to pay that money within a month's time."*

More than in South Africa, loans from family and friends can serve as substitutes for formal loans. Some in Kenya, for example, have been able to get loans and grants from family and friends in sizeable, lumpy amounts that can be used for "big" things like buying land, building a house, paying school fees or starting or growing a business. These are particularly helpful for those who feel they are "unstable" and might struggle to repay a loan with a strict payment schedule. They are also typically more accessible—and more affordable—for borrowers who are relatively worse off than the people who are lending. In those cases, the loans are viewed more as "help" and may not need to be repaid at all.

But even those who can borrow fairly large sums from friends and family prefer—when they have the option—to go to a bank most of the time to show independence and respect. One respondent explained:

> *"You cannot rely on someone all the time. You have to hustle on your own, and I wouldn't want to be a burden to anyone. It's just that it gets overwhelming sometimes and I am forced to borrow, otherwise I want to struggle as a man and know how to hustle with life and make life move. That's how I found out about the loans at Equity and the terms and conditions were fair to me. Then again the people who help me [with loans], my sisters-in-law, they just got employed recently, so they don't have many commitments for now, but I cannot rely on them, because they will start getting their own commitments soon."*

Even more commonly, family and friends are called on for small, quick loans for day-to-day bridging. These tend to be only around $10 (KES 1,000) or so. Here, M-Shwari can serve as a substitute. Sometimes it's preferable to use M-Shwari if you don't already have a loan outstanding. Francinah explains:

> *"Sometimes you feel embarrassed. You think [your friends] are counting the numbers you borrow from them."*

But it's the friends, the ones who were generous enough to lend without interest, who she rushes to pay back. She tends to leave the M-Shwari loan sitting in spite of "all the messages" that annoy her.

> *"Sometime you just want to do other things with the money rather than repaying the loan."*

Table 3: Kenyan cusper borrower perceptions of short and medium term loans

	Short-term consumption loans	Medium-term, investment-oriented loans
Value needed	$100–300 (KES 10,000-30,0000)	$500-3,000 (KES 50,0000-300,000)
Typical term	1-3 months	6 months-3 years
Formal lender options	M-Shwari, KCB M-PESA, microlenders, commercial banks (via advances to payroll clients)	Microfinance institutions (group liability), commercial banks (often with collateral and guarantors)
Availability of alternatives	Yes, many: friends and family, shylocks	Yes, but fewer: friends and family if they are relatively better off
Advance planning	No—these tend to be for urgent needs or for purposes of convenience	Yes—the plan is both for the use of the money and the source of funds that will be used to repay
Prioritisation of payments/ value of relationship	Sometimes—more competition/options for these: • If comes from a peer, yes • If comes from better off in network, not so much • If comes from technology only, no	Yes—such loans are valued very highly and want to ensure future access

While "blacklisted" has become a household word thanks to M-Shwari, respondents seemed much more motivated by shame and the threat of lost collateral than being reported to the credit bureau, particularly on the new lending platforms. For many, M-Shwari was something that they liked, but also could live without. Paying back the loans was rarely a priority.

Lewis, a *matatu* driver, has defaulted on both his AFB credit card and a number of M-Shwari loans. It's a matter of prioritisation, he explains—willingness to pay, rather than ability to do so:

> *"I have not just been serious…I am not good in paying loans…I can pay, even today I can pay [for them] all. But whenever I plan to pay, other things come in my way, like my father calls me and I send him money instead of repaying the loan…I have been blacklisted twice."*

One respondent stood out as being particularly motivated to pay his M-Shwari loan as soon as he received an SMS threat. He has used many loans, and his limit has grown from $4 (KES 400) to $50 (KES 5,000). Once, he took a loan at a time he had many obligations: spending around Christmas and his daughter entering school. He had $28 (KES 2,800) outstanding and received a text from CBA saying he would be reported to the CRB.

> *"I got worried, and I called Safaricom and asked what it all meant. They told me that it meant I would not be able to take a bank loan. I would be forced to pay back the money and an additional penalty of around $25 (KES 2,500) for my name to be removed. I was told I would not get a chama loan and other loans."*

He paid immediately. "It wasn't that I didn't have money. There were just so many uses for the money."

In contrast, fidelity to relationship-based lenders and those that require frequent face-to-face social contact remains high—even among the same borrowers comfortable defaulting on M-Shwari. Shame and the risk of having your collateral confiscated seemed to be much stronger motivators among our respondents. Maggie runs a small restaurant on the outskirts of Nairobi. She's been in a number of microfinance groups and has never missed a loan payment on her group loans, but M-Shwari is another story:

> *"With Bimas (her current microfinance institution) you have to pay weekly. One has to attend meetings and if one does not pay, the group members have to contribute for you and I did not want to bother the group. We have very good group members: no one has ever defaulted…You know when you have a lot of debts, the one who harasses you more is the one you pay first. But the one who is far, one can always ignore or postpone the repayment. Someone can come and say 'I am not leaving here until you give me my money'. You will have no choice but to find a way of paying that person. But I believe debts should be repaid."*

Maggie took four loans with M-Shwari until her loan limit increased to $30 (KES 3,000). That's when she stopped paying. She has been told she is blacklisted, but is not very worried. Even after they told her she was blacklisted, she borrowed again from Bimas, and she believes her record will be automatically cleared in time:

> *"It is unfortunate that I was blacklisted, but I was told I will be cleared after some time…I have a good record at Bimas, maybe they don't check [the CRB] or [CBA] just threatens and doesn't actually blacklist. I have never borrowed from a bank but recently I took a loan of $800 (KES 80,000) from Bimas."*

Incomplete information sharing supports this differential prioritisation of lender relationships. Unlike in South Africa, there is not yet full positive and negative information sharing in practice.

Respondents in Kenya tended to be relatively price-aware of their loans, if not necessarily price-sensitive. When we asked about interest rates, many borrowers in Kenya could tell us the total interest charged vis-a-vis the principal they were receiving. For example, when we asked Henry about his latest Equity loan, he said, "I had taken $3,000 (KES 300,000). I will repay $3,920 (KES 392,000) in total." Perhaps because many are paying these loans with income from self-employment, rather than with salary income, they rarely quote price in terms of instalment value and think instead of total cost in this way.

But, just because they are price aware (at least for these substantial loans) does not mean that they are price sensitive. The more confident and experienced businesspeople, in particular, feel constrained by loan size rather than loan price. Until recently, it was not easy to move one's credit history from one lender to another. Their incentive has been to stay at the same place in the hope of accessing larger and larger loans. A few respondents told us they would take as much money as lenders were willing to give them. As credit information sharing expands, perhaps we will see more shopping behaviour, but our respondents seem primarily interested in shopping on loan size for now, rather than loan cost.

Laws of Motion Highlighted in the Kenyan Cusp Experience:

1. **High levels of borrowing can be sustained if the duration is sufficient and household income is diversified.** Some borrowers take on extremely high levels of debt service and have no problems at all repaying. For others, it becomes a disaster. Where high debt service levels appear to be sustainable is where there are complementary income streams within a household and where both incomes are maintained throughout the duration of the loan.

2. **Credit corrupts a culture of patience.** Kenyan respondents, with little ability to borrow for large sums, save for investments, particularly housing and land. They build up slowly and are proud of slow, persevering investments. Ghanaian respondents, similarly, save with discipline through daily collections. While they sometimes struggle to accumulate large sums, the habit of saving is respected, admired and upheld. Our South African respondents seem much more anxious to have the life they feel they deserve the minute they begin working. Perhaps in part because credit makes it possible, they pursue quick transformation using various credit products at their disposal.

3. **Many feel you have to take some risks—and some loans—to get ahead.** Saving is not going to be enough. Cuspers with a single income stream can feel stuck. Getting into the middle class means taking a risk to do something more to get ahead, such as running a side business, taking a loan on a piece of property, making some risky investments, and stretching to pay for tertiary education for children.

4. **Poor credit market infrastructure may inhibit acceleration of credit expansion.** Some lender discipline is forced on Kenyan lenders by the inability to tap cash flow streams and by the lack of good credit sharing data. Lenders cannot easily infer borrowers' existing debt service obligations and may therefore exercise somewhat greater caution in the values of credit extended to borrowers.

5. **"Out of sight, out of mind."** Perceived distance between borrower and lender can erode prioritisation. When retrenched workers in South Africa write to lenders to inform them of their job loss and don't hear back, they often assume the loan has been suspended or written off, only to find mounting arrears months or years later. Similarly, when M-Shwari does not call, many late payers simply ignore the SMS threats, which do not feel salient. Kenyan borrowers prioritise making payments where there is a human interface, particularly where there is some social pressure to save face and not cause others harm by your actions. When the original purpose of the loan has lost its lustre (e.g. an asset has lost its value, such as clothing that is no longer used or equipment that is broken), motivation to keep paying off the debt tends to wane.

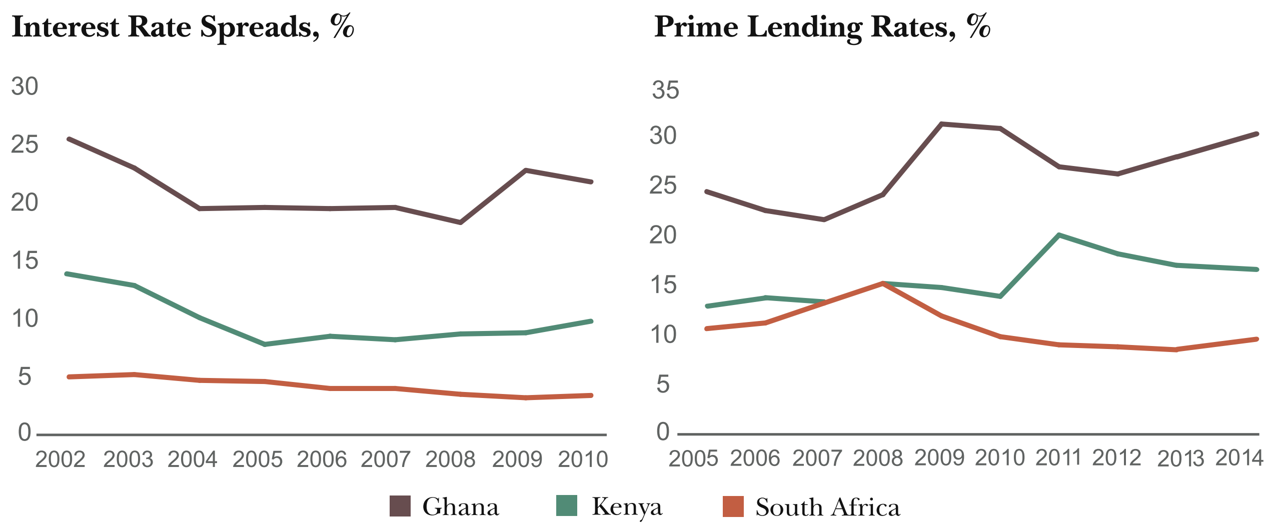
“Squeezed” in Ghana

In recent years, Ghana’s once promising economy has faced a barrage of challenges that impact cuspers directly and indirectly through the credit market. For a time, the country experienced high rates of growth, helped by commodity exports such as cocoa, gold and oil. But the growth rate has plummeted, and falling foreign currency inflows coupled with persistent high demand for imports have put pressure on the cedi, causing a nominal depreciation of more than 30% in 2014. Inflation averaged 17% in 2014. Growth in GDP has declined sharply (from 7.3% in 2013 to 4.2% in 2014) while fiscal and current account deficits have widened.

The retail financial sector is diverse, with a wide range of small savings and credit institutions. According to the most recent FinScope study in Ghana, only about 30% of Ghanaian cuspers have bank accounts. Much of the other saving activity happens informally, or in a grey zone of registered but non-bank institutions like cooperatives and susu collectors.[liii] Formal credit access is limited across the population, including higher income groups, inhibited by both high prime lending rates (a reflection of the economy) and high interest rate spreads (a reflection—at least in part—of high operational costs, as the OISL case illuminates).

With high returns on treasury bills, lenders have been conservative, focusing their lending only on the salaried segment (where direct payroll deductions are still possible). The only lending to the informal sector—where most cuspers work—is for small loans, typically administered through joint liability groups. Mobile money in Ghana is on the rise,

Figure 6: Interest rate spreads and prime lending rates in focus countries [liv]



though not yet ubiquitous. An estimated 13% of Ghanaians had mobile money accounts in 2014,[lv] though the operators Tigo and MTN are reporting high rates of growth. MTN reported in August 2015 that they were now hitting 18.5 million transactions per month on their systems.[lvi]

The transition from rural to urban environments can be harsh for Ghanaians. Our respondents viewed the transition to urban environments—in our case Kumasi and Accra—to be a major leap for many respondents who grew up in rural areas. They may have never seen a big city and didn’t know what to expect. For many, the transition was made possible by a family member hosting them and helping them find work, or by “being called” by a relative or someone from the village who needed labour in their urban enterprise. These first jobs would typically last a year or two, when the new migrants became aware that they weren’t being treated very well or that their new hosts had no intention of living up to their promises.

By the time Jacob was 16, his parents could no longer afford school fees. His uncle ran a shop and had offered to employ Jacob and pay for him to learn a trade for four years. After two years, he left. His uncle was not paying him and was not helping him learn a trade. After clearing his head in the village for a week, he came back to Accra to hustle, starting a number of small-scale trading businesses.

Like many, he couldn’t stay in the village for long. In Kenya, some go back to the rural areas to find their feet after a setback, but in Ghana, trips back for those we spoke with tended to be short. The rural areas had very few opportunities. Benedict told us:

> *“Immediately, one settles in the village, he finds himself drinking. You get me? Okay, normally if the individual loses all of his possessions after being successful, for instances his car or house even fails to meet up with his rent…People tend to look at conditions in the village, rendering them to drinking. Some can never have a sound sleep without taking some alcohol.”*

The costs of settling in the city are high, which makes the first transition tough.
One of the major barriers to a smooth transition is the requirement by most landlords to pay rent two to three years in advance in a lump sum payment. As an average monthly cost, rent may not be very high, but coming up with the sum required for a number of years can be a major problem. This is something that people often have to borrow to be able to afford. Of course, not many have access to loans, particularly recent migrants.

So, if things do not go well with the person who "brought" you to the city, alternative options can be limited.

Kofi recalls: "When I came to live with the man who brought me here, he maltreated me." Kofi left, but couldn't afford to pay three years' rent at once. "I used to sleep in front of shops when night fell. Sometimes I slept in the bus after work." Like a few young men we spoke to, Kofi ended up finding an affordable housing alternative by finding a home that was not yet fully constructed and offering the owner his services as a "caretaker"—sleeping in the unfinished building at night to protect it from thieves and vandals in exchange for rent.

This was a less viable option for female respondents. Juliet came to Accra to take a job her sister told her about. She first lived with her sister, but was soon kicked out when the sister's boyfriend disapproved. With nowhere else to go, Juliet ended up living in a shelter that charged just $0.81 (₵3)[lvii] per month and required only three months', rather than several years', pre-payment:

> *"I drew [my sister's] attention to the fact that she was the reason I came all the way here and now that she's handing me this info, is she implying I return to the village or what?... Where I decided to stay was an eyesore. In a room we numbered up to 90 and a lot were unemployed. Some acted as prostitutes which attracted low dignity from the public."*

While staying there, she saved in a bank and eventually came up with $92 (₵350) to pay two years' rent upfront to get a flat in another part of the city.

Support from the social network—and obligations to contribute—were less strong in Ghana than our other two markets.
We heard that many migrants quickly exhausted the hospitality of friends and relatives. In many situations, friends and family just would not agree to help euspers financially. While in Kenya we heard of many instances of relatives helping with loans and gifts to start a business or deal with a challenge, our Ghanaian cuspers felt more on their own.

Even Helen, one of 45 siblings and the daughter of a once prominent chief, lamented "When you ask for financial help, the person won't assist you even if they have it, so there is no need to ask." When we asked Monica, a small business owner in Accra, about the role of her family through her many financial ups and downs, she scoffed "Do we even have family nowadays?"

Even nuclear families seemed not to cooperate very closely on financial matters. Whether we were speaking with men or women, there was very little discussion of spouses in any of their financial life stories. When we asked why, we were often told that this part of their life was irrelevant. Monica explicitly told us, "[My husband] doesn't help me, so I don't mention him when I'm talking about my life."

Church networks seem to partly fill the gap, sometimes offering in-kind help, like temporary housing, and other times money, so long as the recipient's tithe and membership were up to date. Bafo, a teacher, recognises that the church can be helpful, but when his wife needed $263 (₵1,000) for an emergency C-section, he knew that was the wrong way to go. If you want help from the church, he explained, you must be willing to submit to lengthy processes to get support:

> *"If I'm in a financial crisis, it's only my bank and [moneylender] that will help me….I was in hot soup [last year] and spoke to my aunt. She said 'go to your friends, go to your church…I didn't go to the church because my church is not a one man church…It means that to go for a loan, you have to go through a process. The elders must sit, the finance committee must sit, the pastor must be involved, whatever, whatever must be involved – a whole lot of questions going on. The lady is dying in the hospital and I don't want to go through this process."*

As Bafo discusses above, the lack of support from family and friends for a wide range of financial needs can create even more demand for loans—and also personal saving. It also means, though, that if a person has trouble paying a loan or falls behind, they are unlikely to find a family member or friend willing to help.

Formal jobs are scarce. Cuspers substitute jobs with entrepreneurial activity, but those activities are often shifting. Like in Kenya, Ghanaians could often start a small business with very little capital, either taking money from a small pool of savings or by taking goods on credit from a supplier to start a small-scale trading business. The smallest businesses could fuel larger ones. But businesses have to be nimble, responding to life situations and a volatile exchange rate. Few lasted longer than a few years at a stretch.

Monica is a perfect example. After having her first child, she lost her job at an alcoholic beverage manufacturer. She took some plastic cups on credit from a wholesaler and began hawking them. She used some savings from this to graduate into selling scarves, which grew into capital to start a kiosk. That gave birth to a cosmetic business, which she ran alongside the kiosk. But all that hustling with three kids at home gave her a lot of stress, which she blames for inducing an illness that landed her in the hospital. All of her capital was used to settle the hospital bill. A loan from ProCredit helped her venture into a provisions business, but it collapsed under the weight of the loan. Eventually, she sold a shipping container that could be used for a shop and got a little help from a friend to start selling drinking water, her current business.

Our respondents tried to put as much money as possible into their businesses. This meant there was a lot to lose if their stock was suddenly destroyed or confiscated. Unlike Kenya, where there seems to be a fairly high tolerance for informality, our Ghanaian respondents regularly struggled through a major financial setback when the government enforced formality regulations, particularly around import duties and rules governing where hawkers are allowed to operate.

After leaving his first, practically unpaid job, Jacob was given a small lump sum by his former employer, which he used to start a business importing second hand shoes from Togo. In 2001, he had just bought a new batch of stock—with everything he had. He was stopped at the border and his goods were confiscated since he had not paid the import duty.

> *"You were supposed to pay a duty fee and we didn't pay that's why. We were paying some small moneys at customs to give us some leeway, but this group that seized our goods were part of a customs raid. When they caught us, they wanted us to pay a penalty which was four times the actual amount. I couldn't get the money to pay."*

He lost everything. He would have to start over very small, so he ventured into the smallest of small businesses: hawking rubber bands. It was modest, but he found that if he hustled, he could earn about $11-14 (₵40-50) per week in profit. He did this until he could get enough capital to start buying second hand shoes and jeans. This time he let someone else do the importing. Things were great until he and his colleagues were chased from the city, driven out by government officials opposed to hawking. It took a few years for the business to stabilise outside the city centre.

Macroeconomic conditions also put pressure on cusper income streams. Our respondents often talked about how difficult it is to make a living today in Ghana. Of course, that's not just because of formality regulation and enforcement. There are also some serious macroeconomic challenges to contend with. New trade competitors have entered the local market. The exchange rate has become quite volatile and inflation is hitting cuspers hard. Moreover, the economy faces a slowdown which means demand has slumped for the goods and services many cuspers sell.

For Mary, who walks around a residential area selling second-hand clothes from a basin on her head, the challenge is keeping sales up when her customers' incomes slump and their budgets can't make space for clothing. She ends up selling more on credit than for cash:

> *"[Business is] good but not like before. I could carry the things on my head and only get $14 (₵50) for a whole day. Unlike before, if there was a purchase, it was big. But for now, more prefer to buy on credit because of the lack of funds. If I don't give credit, purchases are very low. That's the order of the day now."*

Inflation has a big effect on cusper budgets and businesses. Taxi driver Edwin talked about how it's difficult to increase his fares, even as his costs increase:

> *"If they increase fuel, they increase everything: oil, tires, spare parts, everything, even if you want to pump your tyre. If you want to pump your tyre it was 50 peswas (₵0.50), it's now 70 (₵0.70) …they are using fuel to generate the thing."*

Pursuing opportunity outside Ghana was an important feature of cusper life stories. Much more than our other markets, migration was an important part of the Ghanaian cusper life plans. The fact that parents and other relatives were abroad meant that many children were raised by grandparents or step-parents. Relatives abroad—in some situations—meant a helping hand could be there for those facing hard times—though it appeared to be just as common for migrants to leave and never look back.

Several of our respondents had stories of migration. Many had ventured at some stage to Nigeria, Togo or Cote d'Ivoire, looking for new opportunities and sometimes hoping—but not managing—to venture further afield.

Benjamin hadn't done well in his O Levels and was looking for something to do for himself:

> *"My family was down financially. I couldn't pass four subjects…money was not available, so I went to find greener pastures in Togo…I went to pursue the job of a cobbler…As compared to Ghana, in Togo if you are a shoe maker or shoe shine, in a day, you can buy jeans, one pair of jeans, yes."*

For the first time, he had jeans and some of his own money, but eventually he came home:

> *"Togo is somehow good and somehow bad. If you come from the village, you can stay in Togo. If you are a rich person, you can't be there. Because in Togo there are plenty of mosquitoes and the place we slept was not good."*

Semi-formality in money management was the rule. Very few of our respondents were using big banks. Instead, they saved with rural banks, credit unions, susu collection agencies, susu groups (informal savings clubs), savings and loan companies, and in the house. Unless you were getting a salary, there was little reason to use a big bank. Respondents told us that the big banks didn't welcome them and their procedures were difficult to navigate. One woman visited the branch of one large bank six times trying to get an ATM card. It took three years. Another hoped to open an account at the bank at which she was already paying her child's school fees. The teller refused to assist the semi-literate client with a school fees transaction. The respondent left disappointed and humiliated and decided to stick with her rural bank.

Respondents told us that they typically decided where to open an account and where to borrow money from based on proximity and in-person outreach from agent visits. This preference persists in spite of the many stories we heard of respondents losing money in credit unions and failed susu schemes—even very recently.

Loretta had saved in three failed institutions. Once she would get wind that the place was about to go under, she would rush to withdraw her savings. When it came to her shares of $270 (₵1,000) in Noble Dream, she made it in time and pleaded successfully to be able to withdraw her funds to pay for her children's school fees. Her niece lost $405 (₵1,500) when the institution collapsed just afterwards. In a credit union, she saved $243 (₵900) and was able to negotiate with the management to claim half of those savings as the institution crumbled. But, there was one major loss. She saved $2,612 (₵8,000) with a susu scheme that has since disappeared:

> *"It was a susu scheme. I contributed $0.54 (₵2) each day. I even saved for my son. A friend of mine who used to save with them informed me that the company was on the verge of collapse, so I should go and withdraw my savings. When I got to their office, they were no longer there. I still have the records book thinking one day they might contact me, but nothing of the sort has happened."*


2
925
34

One respondent was just getting started with a food kiosk and was looking to expand his business when a "bank", whose employees wore green uniforms, appeared in the market. They told people that if they saved regularly, they could get a loan. The respondent agreed to save $1.35 (₵5) per day, hoping to get a loan with which to expand his business. Sadly, though:

> *"They bolted with my $95 (₵350). I got very sick. So I had to gather courage to forget about my misfortune. They had a branch here in the market and they locked it up. As we speak, the place is still locked up. The market owner, he told me to forget about it and even said people die and leave the money they make. So I should be strong. He was a friend of mine. So I listened to him and forgot about the whole issue. But it was painful. To pay $1.35 (₵5) every day for someone to run away with your money is very hard to understand."*

Without extensive access to credit, this daily savings ritual—often with two to four separate schemes—is particularly important. But, while there are a large number of willing savings institutions, effective supervision by regulators for such a fragmented market is impossible.

Mobile money usage is on the rise. The majority of our respondents were mobile money users, using the service primarily for remittances but also for other things. Edwin uses the service to collect fares from his taxi customers. Sara sells airtime credit from her account and even makes loans to people who need money quickly. She also uses it to collect the credit she's given to her clients to buy material for clothes.

> *"With the mobile money if somebody wants credit I just send it to you. I use it to buy my own credit too. I also send money to my mum and also if somebody needs money and I have it I send it to the person using mobile money and later I take the money back."*

While it was not common to save explicitly—the way that people do with susu—on mobile money, a number were comfortable keeping some funds in their mobile wallets to deal with unexpected needs. The extensive penetration of agents and growing usage of the service suggests that mobile could become a new, low-cost channel for more diverse, formal financial services, the way that it has in Kenya.

Borrowing is often from a place of weakness rather than strength. With a strong culture of savings and limited, very high cost borrowing, many of the small-scale investment and emergency sums that cuspers need come from savings. When we asked about reasons for borrowing, it was more common to hear that a loan was needed to help solve a problem—often a slumping business—rather than to pursue a new growth opportunity. Unlike Kenya, loans in Ghana were more typically a last resort.

For example, Mary felt forced to take loans from Opportunity International Savings & Loan (also "OISL" or "Opportunity") to help pay for her children's school fees when her husband's business of tiling floors went down. The worst was when her eldest child failed his exams in the last year of secondary school and had to repeat an expensive year of studies:

> *"There the hardship had magnified…I was very tense and busy…[My husband] would give me something small, but later this would become difficult, and we would go for a loan to suppress the hardship."*

Borrowing starts small and in groups, often where people do not know each other—unless borrowers are employed. Most of our cuspers' first experience of borrowing was through group-based lending. Members would need to guarantee one another, reducing risk to lenders, particularly in a context where borrowers cannot be tracked and their cash flows tapped through bank accounts. Though borrowers often did not know each other at first, they tried to acquaint themselves and devise some of their own enforcement mechanisms.

Loretta's first loan was through OISL. Her restaurant business was struggling and she was hoping a capital infusion would help her pick up. She rounded up a group:

> *"We didn't know each other prior to forming the group. I was actually the one who brought together the members of the group. I did that by talking to some of the people who came to eat at the chop bar (restaurant)… We took pains to find the residence of each member so when you don't pay, we come to your residence."*

She didn't have time herself for all of the group meetings that OISL required, so she sent her sister to deal with those: "Although we were working together, I was the busier of the two, so I couldn't leave the work behind and go to the office."

Her first loan at OISL was just $135 (₵500), which she would repay as $7 (₵26) per week for six months. Over a few cycles the loan limit grew. But, Loretta's experience highlights that loans offered to cuspers—particularly when the borrowing relationship is new—start quite small. It's rarely enough to cover the full need.

Insufficient loans make it tempting to misuse the money. Helen stopped taking these small group loans, explaining:

> *"I stopped [taking smaller group loans] when I met Advance Bank. They gave me a bigger loan. When you take smaller loans, you end up misusing it because it's not enough for any venture."*

Employed cuspers are able to access larger, individual loans both through microlenders and commercial banks. In Ghana, it remains legal to deduct loan payments from salaries—at least in the public sector—at source, before funds are released to the earner's bank account. For private sector workers, salaries still pass through accounts, where banks can claim their payments with some security. Around town, signs advertise for loans which specifically target government workers and respondents told us that some lenders require that guarantors be government workers; their predictable, claimable pay makes them attractive. These loans do not tend to go into business activities, but rather towards school fees and land and building projects. For these clients, borrowing becomes a habit—one loan follows the other.

Bafo, a teacher, explains:

> *"Anytime I go for a loan, within that period I feel financially okay and everything moves smoothly…You know education service salaries are not the best so we try to go with loan, loan, loan till we retire."*

Faced with many uncertainties, some cuspers are borrowing to save. A number of our respondents took loans—at high interest rates—only to put the money aside. Sometimes, that was to wait for the right moment to make a big investment, but at other times it was because respondents feared they would be unable to keep up the loan payments. They would keep the funds around to make payments if they fell short.

Walter ran a taxi business and was hoping to be able to buy a piece of land. He joined a microfinance group and took a few loans, but rather than using them to directly buy land or expand his business, he would save them in the bank until the loans were completely paid off, then make an investment. He said this did two things. First, it forced him to put money aside to generate more than savings alone: "I did all of that so I got the urge to pay. It's more of a challenge to work more efficiently." Second, it allowed him to have the money on hand in case his car needed a repair:

> *"If the car developed a fault, it was the same money you had to use…At some point later it even resulted in an engine problem. There I had to go withdraw some money…to sort out and keep the car running."*

If he had waited to borrow once the problem arose, that would have meant more days out of business while applying for the loan. And if a loan was already outstanding with his MFI, he would have no other option to get money for the repair.

With high interest rates and short durations, repayment necessitates sacrifice. Even when the money is channelled to productive investments, entrepreneurs often cannot generate sufficient profits to make loan payments from new profits alone. Helen, for example, borrowed $1,622 (₵6,000) to enable her to buy stock for her shoe business. She spent $176 (₵650) of her $230 (₵850)—77% of her monthly profits—on loan payments. Still, however, she says "The loan has really helped me, because I couldn't have been in the shoe business without it."

Even if debt service is extremely high, many told us that paying is not stressful. Instead, it's paying for everything else in the household during that period that becomes a challenge. Dennis is a security guard and earns $81 per month (₵300). The bank deducts $68 (₵250) per month for payments against a loan he took for school fees. With so little money to take home, he can't afford daily transport to his own home and instead stays with his daughter on weekdays. He depends on his wife's farming for food. He tells us that making the payments isn't stressful, it's trying to pay for basic needs that's a challenge: "Had it not been for my wife who goes to the farm and brings back some foodstuff it would be unbearable", he says.

We do not see a lot of shopping around for alternatives. We heard very little about shopping around for credit offers. After all, they are not so easy to come by unless one is employed. The only comparisons respondents mentioned were between individual-based lenders and group-based lenders. If a lender was willing to work with them individually—and personally reached out to advertise their business—several were willing to switch.

A respondent who had taken a number of group loans explained:

> *"The individual loan is better than the group loan. It was in the group loan that I had to use my money to pay for the other members. With the individual loan I don't have to pay for anyone. And with the individual loan even if I don't have money I borrow from friends to pay because I don't want to be disgraced. When the time is due for me to pay I call the officer and listen for instructions as to where he wants me to do the payment. The individual loan is okay for me."*

There are likely several reasons that shopping is so limited. First of all, cuspers are mostly accessing credit from small-to-medium-sized institutions who approach them. They are not aware of all of their options and researching them would be a costly exercise. The market is diverse and yet only a certain small subset of lenders is willing to serve this segment. Secondly, limited credit information sharing makes it difficult to switch institutions without starting with a very small loan limit and working up again. Thirdly, because so much credit operates on a group basis, the availability of groups in the area is restricting. If you want to join OISL, you must be able to find or create an OISL group that will accept you as a member. Finally, because many are borrowing to solve a problem, they may be less price sensitive—more concerned, that is, with getting the funds quickly as opposed to cheaply.

Bafo, a teacher, who because of his salary has options, still doesn't shop around. He told us:

> *"When I am going for a loan, I don't look at interest. Because I need the money. I don't care because I need the $541 (₵2,000) to pay my landlord to do something which is urgent…I'm not going to use physical cash, it's deducted from my source, so I won't even see it."*

"Good loans" are for big and important things. Like the other markets, the credit that is valued most highly is that which is substantial and helps the borrower do something visible and tangible.

One respondent, who works in a hospital, explained:

> *"If you take a loan and don't squander it that's fine. For example, school fees, you know you can get something from it. But if you take a loan and go and buy fish or chicken for the house that's not advisable. Somebody would even take a loan for a marriage ceremony. If you don't have a good job and you do that it would be stressful for you."*

Saving, most agree, is a much better option for small needs. Like respondents in other markets, those in Ghana believe that if you have to borrow to pay for small things that don't last, it's very hard to find the motivation to repay.

Respondents generally expressed fear over lender collections processes, though some feel like things are changing. A number of our respondents were initially afraid of speaking with us when they learned the project was about credit. They worried, they said, that perhaps we would have them arrested for some long-ago outstanding fee or interest payment. One of these respondents who works as a maid and street sweeper told us that borrowing makes her nervous. She's never seen someone arrested for debt, but she hears about it on the radio. She has to borrow fairly often for school fees, but it makes her very nervous:

> *"Yes, when it is time to pay the loan, then my heart starts to beat but when I go to the bank and they deduct it from my salary, and then I'm free."*

Our respondents complained that defaulters are harassed by phone and in person, that lenders repossess assets worth much more than the value of the outstanding loan, and that they also publish debtors' names in local papers and on the radio, making people ashamed. Perhaps these tactics stimulate willingness to pay in the absence of more solid payment logistics, but they also feel unfair. Many defaulters—particularly in group lending—pay up eventually. Several respondents talked about needing to cover for a fellow member who fell behind on payments, but very few "disappeared" or failed to ever clear their balance. Mary told us about twice covering for members in her OISL group who couldn't pay on time. Eventually, though, they find the money and repay. They just need time, and payments are weekly. "A week comes within a twinkle of an eye", she says.

Some say they see signs of change. After multiple rounds of borrowing, some learn how to better navigate the system, how to negotiate when they have problems. People are learning the rules. Helen thinks the banks have also changed:

> *"Formerly when you default in paying, you were arraigned before a court, but now I guess the bankers have realised that times are hard, so they have stopped doing that."*

Laws of Motion Highlighted in the Ghanaian Cusp Experience:

1. **Where loan access is difficult, paying loans remains a top priority.** In Ghana and for larger loans-funding businesses in Kenya, paying a loan is the first priority of the household. There are not many options for borrowing, and no one wants to close down an option that might be needed in the future. In Ghana, paying the loan was not even a question. No matter what sacrifice would need to be made, loan payments would be made. In South Africa, however, where it is easier to access credit and to move from lender to lender, borrowers appear to feel more comfortable letting payments lapse and catching up later, accepting the knock to their credit score.

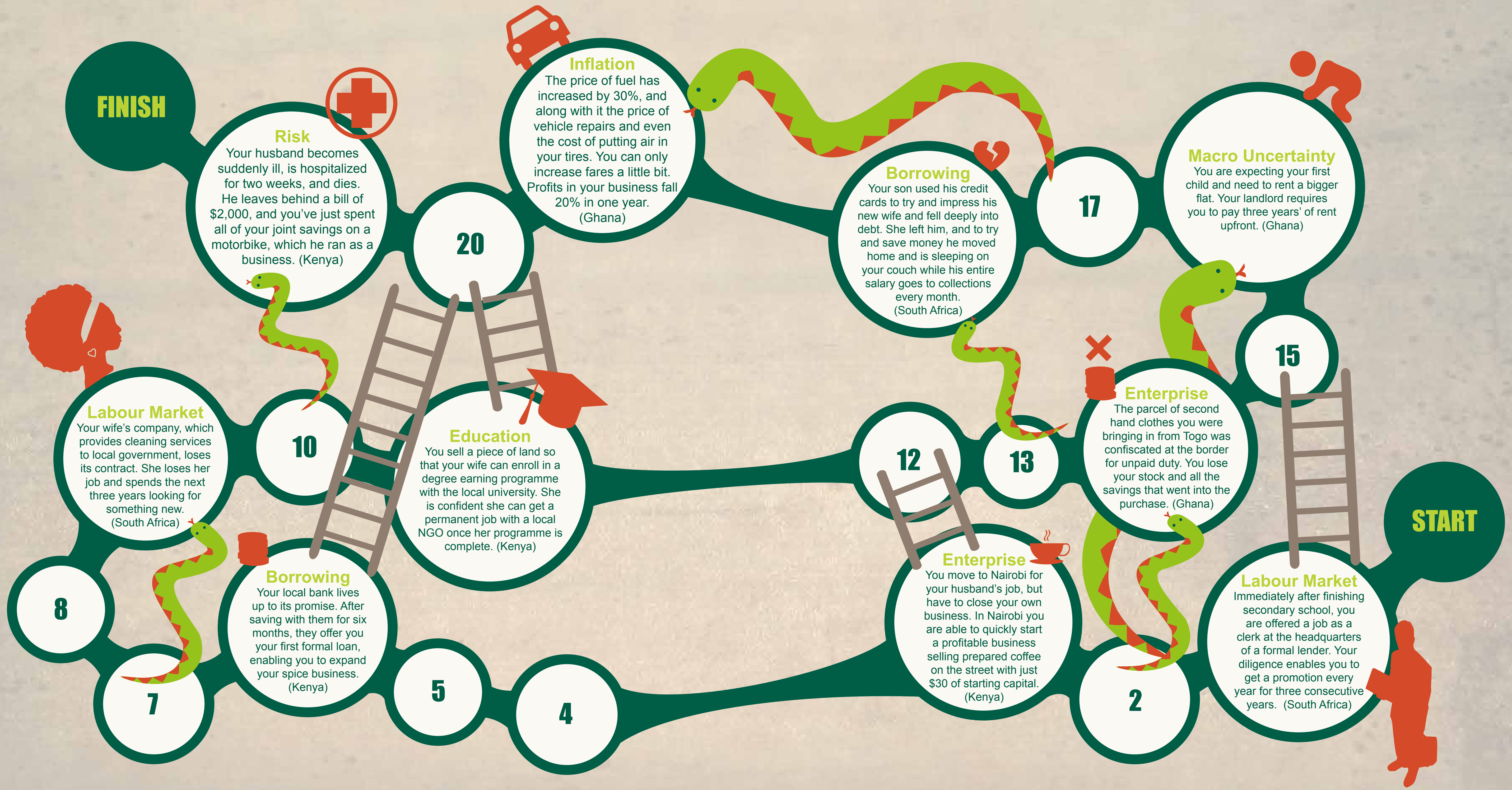
2. **Borrowing in an emergency can be a helpful tool, but in Kenya and Ghana, it must be done at very high cost at payday lending-like facilities.** We observed quickly-processed, high-cost loans saving the day for a number of respondents: keeping children in school, helping a woman recover her business after a tragedy, enabling a young man to seize an opportunity to buy a market stall at just the right time. But this was in Kenya and Ghana, where bank-based procedures for borrowing moderate sums—particularly without a payslip—can be arduous.

3. **Blame the borrower.** When credit problems hit, the overwhelming majority of cusper respondents say BOTH that borrowers are to blame for debt problems AND that it's very difficult to exercise credit self-control or to know one's own loan affordability. Borrowers' main mistakes, they say, are: 1) failure to make a plan for how to put lent money to work and how to make repayments, 2) putting money into bad business decisions and 3) using loans to pay for short-term consumption needs, where what you bought with the loan cannot be seen and admired as an achievement for the duration of repayment and potentially beyond.

4. **Lenders care most about getting their money back.** Where they can directly tap regular cash flows through payroll or bank account deductions, they tend to invest less in long-term relationships with borrowers and relax lending standards since their ability to recoup their debts remains relatively strong regardless of borrower ability, or willingness, to pay. Where they cannot directly seize income, relationships between lenders and borrowers matter more, as do collateral/security and guarantors.

LIVING ON THE CUSP IN AFRICA

23% of sub-Saharan Africans are living in “cusper” households that get by on **$2-$5 per person per day.** They live in shifting economies that bring new opportunities, but also some serious risks. Each of the following boxes is a real life experience from respondents in our research.



Lending on the Cusp

Lender decision making

Lenders operating in these markets are making their lending decisions based on a different set of criteria. The face of cusper lending in these different markets is also heavily shaped by the ways in which the context impacts on the key factors of a lending business model. Managing the risk of non-payment, on a cost-effective basis, is at the core of all lending business models. Loan decision-making (“origination”) is based on three borrower characteristics in the context of a specific loan product:

1. The **ability to pay** the loan **(ATP)** on the agreed terms. This ability typically comes from the borrower’s regular cash flows (e.g. earnings from a job or business) and/or the liquidation of the borrower’s assets (e.g. selling real estate, equipment or inventory). As it pertains to cuspers, this assessment can be costly for lenders when the individual earns in the informal sector, where earnings are volatile and undocumented and where assets are hard to formally appraise.

2. The **willingness to pay** the loan **(WTP)** on the agreed terms. WTP is influenced by both the “carrots” and especially the “sticks” resulting from general environmental factors (e.g. the legal system related to contract enforcement, including the prospect of losing assets or having earnings garnished, or mechanisms to share credit repayment information among lenders) and specific individual borrower factors (e.g. assessing certain dimensions of “character” or simply the history of making payments regardless of ATP circumstances). Here, contract enforcement is critical. Many countries in Africa lack the capacity to *efficiently* manage this kind of enforcement on a large scale (Table 4).
3. The **logistics of paying** the loan **(LOP)** on a timely basis. Where ATP is stretched or WTP shaky, strong LOP can improve the lender’s odds of getting repaid. And even with strong ATP and WTP, for those outside the formal economy and dealing primarily in cash, or those located remotely, away from payment infrastructure or bank deposit points, LOP can be an obstacle to payment.

Table 4: Enforcing contract statistics, World Bank’s 2016 Doing Business Report[lviii]

Enforcing Contracts, Doing Business 2015	**Ghana**	**Kenya**	**South Africa**
Country rank (out of 189)	116	102	119
Time to resolve (days)	710	465	600
Cost (as % of claim)	23%	47%	33%

Prudent borrower assessment (of ATP, WTP and LOP) requires reliable information. A lender must obtain and analyse the information necessary to make informed decisions around the key criteria benchmarks, while acknowledging that current or past circumstances may change in the future.

In practice, many lenders (including our three focus lenders) tend to try to set the criteria range (i.e. their definition of ATP, WTP and LOP) wide enough to enable many paths to “accept”, by having mechanisms to adjust loan terms (rate, duration, amount, security, etc.) to mitigate risk. But their models require constant updating. Borrower risks are always shifting as data availability and quality change—and as the macro economy, competitive dynamics, and the costs involved for the lender (in assessing borrowers, enforcing contracts and making collections) change as well.

Through this project, we looked at three different kinds of lending models that have been targeting cusp group borrowers in the three focus countries. Through their approaches and experiences, we see the opportunities—and challenges—of serving this group profitably, at scale, and while managing risk.

Unsecured lending in South Africa: African Bank

ABIL was a pioneer in bringing formal unsecured credit to the lower end of the formally employed market in South Africa, demonstrating the viability of a model that combined a few key elements. First, ABIL had an appetite for taking more credit risk than others, knowing there was ample reward available via relatively high interest rates, at least for many years when the

Table 5: Summary of the basic features of three lenders

	ABIL	OISL	CBA (M-Shwari)[lix]
Year established	1998	2004	2012 (product)
Security requirements	None	If group guarantee, none; if no group, collateral > 150%	None
Cash flow ATP assessment linchpin	Payslip for income, personal interview (and benchmarks) for costs	Manual assessment by loan officer, also group self-selection	Alternative automated algorithm: activity w/ savings, M-PESA, airtime
WTP considerations	Loyalty in early days; also CRB; legal threat	Group dynamic (social pressure), loyalty (esp. in rural areas)	Loyalty; theoretically CRB but not yet
Rule of law reliance	Threaten garnish or asset seizure	Collateral enforcement	Nothing so far
Credit reference bureau (CRB) usage	Yes use, yes share	No use/share for group Yes use/share for indiv.	Don't use; supposed to share but appear not to
LOP considerations	Critical, via spectrum of automatic mechanisms	Voluntary b/c most lack automated mechanism, but OISL a/c required	Voluntary b/c lack automated mechanism, but M-PESA req'd
Origination process	Mix of manual & auto	Entirely manual	Entirely automated
Cost of operations (as % of portfolio)	Low/Medium (5%, decreased w/ scale)	Very high (44%)	Low (unknown, theory), significant CapEx though
Loan size (range)	Up to \$18k max. at peak, avg. ~ \$1,500 (up ~ 50% in 3 years)	\$200-\$7,500, avg. = \$380 at Dec 2014	\$1-\$1,000, avg. = \$14 at Dec 2014
Loan duration (range)	At peak, up to 84 mos. (avg.<45, spiked to 55)	4-36 months: Group is 4-12; indiv./SME 12-36	1 month, able to roll over for a 2nd month
Interest rate (annual percentage rate, APR)	~ 32% (avg, per 2010-2014 financials, cut in half vs. mid-2000s)	~ 56% (avg, per 2013-2014 financial statements)	~ 138% APR (extrapolated from 7.5%/mo. advertised)
# of borrowers (as of Dec 2014)	~ 2-3 million	74,000 active	2.8m unique since launch, 1.8m active
Loan portfolio (USD, as of Dec 2014)	~ \$4 billion	~ \$22 million	~ \$18 million
Source of funds	Wholesale borrowing and other capital markets	Wholesale borrowing and other capital markets	Savings (> loan book)
Cost of funds (annual)	~ 9%	~ 5%	<5% (2-5% paid on deps)
Non-performing loans (NPLs)	28%[lx] in 2012-2013 (range from 25-33% since 2005, and even higher before that).	2.0% over 90 days (Dec 2014)	2.2% over 90 days (Dec 2014)

unsecured market was relatively untapped. A fair amount of bad loans were expected and priced into the loans. Second, ABIL had a relatively sophisticated approach to modelling risk and making collections.

As an unsecured lender, the linchpin of its ATP assessment was the payslip, which provided proof of reliable cash flow. Over time, ABIL used its database of borrower information to sharpen its risk assessment, differentiating among the formally employed, such as by industry, employer, region, etc. However, it seems—at least in the later years—that not enough care was taken in assessing realistic borrower expenses. Both loan officers and borrowers had incentives to underreport expenses and overestimate non-salary income to secure a larger loan offer. In a quest to compete with other lenders aiming at this market, ABIL began offering bigger loans over longer durations. Whereas this was uncharted territory, this meant they had many loans out there (and an ever-larger aggregate portfolio) for which they had no reliable data on repayment patterns; a deviation in practice from prior data-driven risk-taking. Actual risk turned out to be higher than their models predicted, forcing the bank into receivership in 2014.

As an unsecured lender, the ATP of ABIL's borrowers was a function of maintaining their current cash flows (mostly by keeping their jobs) and WTP was a function of future access to credit. Loyalty to ABIL was strong when competition was light, but this weakened over time with competition. Full credit information sharing still provided some incentive to pay, but overall incentives were lower. Threats of legal enforcement, such as wage garnishment, also weakened over time as the political climate discouraged rigid enforcement.

ABIL intensively focused on LOP, seeking to ensure it had "first bite" at the borrower's salary payment. Its intention was to eliminate the risk of such salary payments being diverted to other uses before the loan obligation was paid. This was a strength for many years, but with policy changes, this too eroded over time. Eventually, the government prohibited tactics that previously were allowed, such as "deduct at source" and "first priority debit order" arrangements. Competition in transactional banking also meant borrowers could easily move their salaries from one bank to another, disrupting debit order arrangements.

This model pushed the frontier of credit, but ultimately perhaps too far, as the strengths of the model cracked when ABIL confronted rising competition by choosing aggressive, ultimately unsustainable, risk-taking in an effort to preserve market share. Competition and growth brought larger loan sizes, longer payback durations and reduced interest rates, in parallel with the above-mentioned weakening of WTP and LOP dynamics and declining growth of real GDP per capita (Figure 2). This weakened the model's ability to absorb bad loans. Table 6 presents a summary financial model for ABIL, which illustrates the dramatic deterioration of margins.

Table 6: Summary of ABIL financial model

	2004	2006	2008	2010	2012	2013	2014
Gross interest rate	64%	61%	42%	34%	32%	32%	32%
Loss from bad loans	13%	11%	12%	11%	12%	19%	33%
Net interest rate	52%	50%	29%	23%	20%	12%	-1%
Cost of funds	10%	8%	10%	10%	9%	9%	9%
Net interest margin	42%	42%	20%	13%	11%	3%	-9%
OpEx	20%	19%	11%	8%	7%	7%	5%
Net profit margin	21%	23%	9%	5%	4%	4%	-12%

Alternative data mobile lending in Kenya: Commercial Bank of Africa's M-Shwari

CBA, in its recent "M-Shwari" partnership with Safaricom in Kenya, is at the forefront of an emerging group of so-called "virtual lenders" who are creatively combining the following innovations:

1. *Payment systems.* Virtual lending requires a widely used electronic payment infrastructure, enabling easy and location-agnostic loan disbursement and repayment. In Kenya, this is embodied by the mobile money dynamic led by Safaricom's M-PESA, now used by around two-thirds of Kenya's adult population and more than 80% of cuspers. As long as the lender can easily send and receive e-money to and from each borrower in an expeditious and cost-effective way, then there is no need for cash and no need for physical branch presence—at least not for LOP purposes. In theory, this opens up the market to potentially unprecedented levels of competition, because the barriers to entry for new lenders are quite low—at least with respect to access to payment infrastructure. In Kenya, the dynamic is further helped by a so-called "mobile money mindset", where—thanks to M-PESA—most of the population is familiar and comfortable with conducting financial transactions on their phones.

2. *Big data.*[lxi] This model relies on big data mining and analysis to make risk assessments (of ATP and to some extent WTP) of a large number of borrowers who lack credit records as well as—in some cases—a transactional history with the lender. What is notable about the models studied here is that they at least begin by relying on "automated algorithms" using "alternative" types of data ("AAA"), i.e. not traditional financial records (not necessarily savings and not traditional credit product performance). The alternative types of data include airtime usage, mobile money usage, other electronic billpay activity, or even social media activity that is not overtly financial in nature. These sorts of innovations have been implemented by at least four lenders in Kenya: CBA/Safaricom, KCB, AFB and Inventure. In the case of CBA/Safaricom's M-Shwari, the initial credit score is based on six months of M-PESA mobile money usage data (prior to registration on M-Shwari) as well as data on airtime, small airtime credit, data bundles, and other mobile phone activity. Subsequently, the credit score is based on M-Shwari data on deposits, withdrawals, average balance and ultimately loan repayment behaviour. According to these lenders, the alternative data has indeed proven *sufficiently predictive* and informative to play a meaningful role in prospective borrower assessment, at least for entry-level loans.

3. *Data communications.* Virtual lending requires a widely used means of electronic/remote communication, such as SMS/USSD or email (or the like). This enables easy and location-agnostic communications between a lender and borrowers (or prospective borrowers), covering the following facets of a loan relationship:

- Marketing loans (e.g. SMS promotional blast or online banner ad)
- Soliciting loan application submission (e.g. ensuing SMS or online ad trigger)
- Making loan offers (e.g. via SMS or email)
- Disclosing loan terms and conditions (e.g. via SMS or email or website link)
- Receiving basic information from prospective borrowers, including consents
- Notifications and reminders of payment due dates
- Collections communications after a missed payment, including conveying information on the consequences of ongoing non-payment (namely, reporting to the credit bureau)

In Kenya, the main communication channel is SMS and menus on the SIM toolkit, both of which are regularly used by most Kenyans, including cuspers, even on basic-feature phones. As long as the lender can easily send and receive such communications to and from each borrower in an expeditious and cost-effective way, then—at least in theory—there is no need for face-to-face interaction and no need for physical branch presence, at least not for these communication purposes.

The innovative lenders in Kenya have leveraged these three distinct innovations to package an end-to-end loan proposition that enables the lenders to lend in this purely virtual way.

M-Shwari is doing this on a very large scale, having reached 2.8 million unique borrowers in two years. The model is exciting in its potential to achieve rapid scale with low operating costs and with reportedly low default levels. However, the young model has risks that have not yet been fully tested in what are still relatively early days. For one, the model seems vulnerable to weak WTP dynamics, given that lenders are remote, that there are a number of alternatives emerging in the market, and that most customers are not very aware of the implications of Credit Reference Bureau reporting. Also, ATP dynamics seem vulnerable if indebtedness (debt service obligations) increases with the increasing competition, especially if such lending activity is not all fully and timeously reported to the CRBs.

While LOP is aided by electronic payment systems, it is vulnerable because it still relies on the borrower voluntarily and proactively initiating payments—which in turn comes back to WTP. Unlike CBA's M-Shwari, KCB's KCB M-PESA loan has different WTP dynamics: if loans are unpaid for some period, the bank will warn the borrower, but then claim funds from the KCB M-PESA deposit accounts and any other KCB account. However if a balance remains, KCB's partnership with Safaricom—which came after CBA's—allows them also to sweep borrower *M-PESA* accounts to reclaim funds—which is a potentially powerful "stick" in Kenya where M-PESA is so valued.[lxii] CBA is reportedly seeking this same power, but it is not yet available to them at the time of writing. While this gives lenders some leverage, few receive regular cash flows or salaries via M-PESA, so defaulting borrowers can also choose not to fund these accounts if they are aware that late payments can be deducted automatically.

Microfinance in Ghana: Opportunity International Savings & Loan

OISL of Ghana is somewhat representative of the pioneering "microfinance" model, which has brought formal (primarily unsecured) credit to self-employed micro-entrepreneurs, who are otherwise typically excluded from formal credit markets because of their irregular income or lack of assets to serve as collateral. The core innovation of the model, now well-established, relies on group guarantees as replacements for tangible collateral. Group guarantees allow the lender to more cost-effectively market, screen, monitor and collect small loans within the non-salaried segment. Still, OISL's version of the model has high operating costs relative to portfolio size because it still relies on a very manual (labour intensive) origination process. For them, it is challenging to turn a profit even with relatively high interest rates and a relatively low cost of funds.

Because virtually all individuals in the group segment have informal incomes, those incomes are difficult to verify and almost impossible to confirm with standard documents (like payslips). Most deal in cash and, apart from their OISL relationship, many are unbanked, adding to the challenge of income verification. Loan officers therefore carefully assess income and expenses (ATP) by visiting the place of business and home, and interrogating borrowers to obtain reasonably reliable evidence. For OISL, the group model does not remove the need for a loan officer, who still brings experience and quantitative analytical rigor to the cash flow assessment process (an important task for which OISL is not comfortable relying on the group). OISL's loan approval process is 100% manual,

Table 7: Stylised financial models of focus lenders, circa 2013-2014[lxv]

	ABIL	OISL	M-Shwari
Gross interest rate	32%	56%	123%
Loss from bad loans	19%	5%	3%
Net interest rate	13%	50%	120%
Cost of funds	9%	6%	4%
Net interest margin	4%	44%	116%
OpEx **(including CapEx depreciation)**	5%	44%	9%
Net profit margin	-1%	0%	108%

although simple Excel templates, with pre-set formulas, are used to inform the approval decision at the initial level.

Typically, OISL's group loan applicants do not have credit bureau records, as they often have no experience with formal credit before OISL, and therefore OISL never checks the bureau for group loans. OISL does check the CRB for all non-group loans (larger individual and SME loans), where it can typically find a borrower record.[lxiii]

The biggest WTP incentives for borrowers are the promise of growing loan sizes and the social pressure of the group dynamic. Since few group borrowers have bank accounts with regular cash flows, LOP poses an additional risk. The model relies on the borrower to be proactive and self-motivated to make payments, and, in doing so, to bear the transaction costs associated with group meetings and branch visits. OISL has started to improve payment logistics by beginning to roll out "alternative delivery channels" (e.g. branchless banking), making it more convenient for borrowers to deposit money into OISL.

With a substantial depositor base, OISL's cost of funds is relatively low for Ghana, where treasury bill rates were around 25% at the time of the study. But, their labour intensive approach keeps interest rates high and limits scalability, since personnel must grow with portfolio size. Besides a push for branchless banking, OISL is arming its loan officers with tablets to improve operational efficiency. This reduces paperwork and loan processing time, which is also attractive to customers. Though Ghana is rapidly urbanising, OISL feels that WTP in urban areas is declining, putting more stress on their ability to serve cuspers. Social cohesion in groups is lower in urban areas, where people don't know each other as well. According to OISL, urban borrowers are also more aware that they can force the lender to go through a legal court process for collections, making them slower and more costly (see Table 4 above for Ghana's low ranking in contract enforcement). They also report that the stigma of collectors knocking on the door is less embarrassing in urban areas. Also, loyalty to OISL simply because it is the only MFI option is not as relevant in urban areas where borrowers have more choice. The ability for borrowers to move to other lenders after non-payment is exacerbated by weak credit information sharing, as compliance with required reporting is not very strong, and the lack of standard national identification undermines comprehensive reporting, sometimes resulting in a borrower having multiple unconnected records.

Over the past decade, OISL has looked beyond the group model to more individual lending and, increasingly, to SME lending (together now representing around 40% of the overall portfolio, up from almost zero 10 years ago). The decrease in group loans relative to individual loans is due to multiple factors, including: the weaker effectiveness of group lending in urban areas noted above; pressure to compete with other lenders offering individual loans combined with customer preference for individual loans (because there is no group liability and no need to attend group meetings); experienced group clients "graduating" to individual lending; and, to some extent, the increased availability of collateral (necessary for individual lending), which results from customers that have often built themselves up with loans, as well as from Ghana's relatively new movable assets registry (which improves the practicality of providing such collateral security).[lxiv]

A comparative view of business models

Each of these lenders and these models are largely an outcome of their context. But a comparative look at their business models (Table 7) highlights some important implications for the extension of "healthy" credit to cuspers. ABIL's tolerance for high losses is a key driver of interest rates. Reducing that would mean lending to fewer borderline borrowers, but potentially reducing costs for good borrowers. What's the better tradeoff in a market like South Africa? OISL's high operating costs keep their loans relatively small and expensive for cuspers, in a market that is severely credit constrained but packed with eager savers. In contrast, we see a very compelling business case for CBA, driven by very high interest rates (effective annual percentage rate, driven high by the short-term nature of loans), seemingly sustainable losses from bad loans and presumably low estimated operating costs (including depreciation/amortisation of initial development costs). It is worth noting here that the profit margin shown does not all belong exclusively to CBA due to its revenue share agreement with Safaricom (the MNO).

Healthy Cusper Credit Markets by 2026

Photo credit: Peter-Wachira Irungu

Healthy Cusper Credit Markets by 2026

When credit is good for euspers

Looking across experiences in these three markets, we recognized 10 common conditions under which credit was truly useful and healthy for cusper borrowers:

1. *Not overwhelmed by* **options** *too early.* When new to formal borrowing, cuspers had just a few options, which they could understand and manage as they learned the rules of the road.

2. *Borrowers have* **practice** *(but must lead to graduation).* Related to this, we found that borrowers grew wiser and savvier about borrowing decisions over time. Once they had some experience, they had a better idea of what to expect and what they could manage.

3. *Borrowers have a* **plan.** Rather than finding that all credit for consumption was bad, and all credit for business was "good," we found that borrowers typically fared pretty well when they had a plan for the use of the funds and how they would repay. Many sung the praises of "slow credit": when there was a lag between loan application and approval, they were forced to spend some time thinking about and refining their plans, being sure they would make good use of the money. Instant approvals of larger loans could jeopardise thoughtfulness about the use of funds.

4. *Credit is* **"bought"** *rather than "sold."* Borrowers sometimes got into trouble when they were pressured to take loans they didn't really need.

5. **Diversity** *of credit types.* Borrowers are better off when they have access to diverse credit products that they can match with the nature of their need.

6. *Reasonable* **expectation of economic advancement** *for household.* Respondents were best able to manage credit when their incomes were stable and increasing, providing some flexibility in making loan repayments that included interest. Tightening budgets during periods of slow business or lost employment was very stressful. Demands on existing income can become overwhelming very quickly.

7. *Have only* **one payment.** When borrowers have only one debt obligation, they are better able to budget for the payment and keep enough wiggle room in their budgets to keep up with their credit obligations while they also tend to other needs.

8. **Aware** *of debt service obligation.* When borrowers are aware of their debt service obligations—the share of their incomes going to debt payments every month—at the time of taking new loans, they can make better decisions about their own affordability.

9. *Credit helps smooth* **income variation.** Credit that helps cuspers navigate the ups and downs of their own incomes can be really helpful, even helping them to build assets by keeping them on course.

10. *Unlocks a* **pathway** *towards accumulation of "real" assets.* Where we see real value from the credit market is in helping cuspers accumulate assets, such as land, housing and even vehicles, as well as secondary and tertiary education for their children. That pathway can be direct, but it can also be indirect; helping provide some stability to erratic incomes, helping cuspers overcome moments of crisis, and keeping investment capital—like stock needed for a business—in place.

A call for intervention

Cuspers throughout Africa are going through an important transition. As economies shift and grow, cuspers are leaving agriculture, entering into small business and, to some extent, formal employment. Demand to borrow and to strive for a middle-class life—through enterprise, education and consumption—is rising. In some markets, supply is rising as well, though not always in forms that appeal to and serve the needs of the cusper market. Their livelihoods remain vulnerable, which makes them somewhat risky clients. But their size as a segment and their promise can make them an attractive market for lenders who learn to assess and manage risk. Growth in healthy credit serving the growing, vulnerable cusper segment, however, is not inevitable.

As we see in South Africa, lender incentives have been to take on more risky borrowers, keeping the risk premium on borrowing quite high. Many borrowers have failed to assess their own affordability and, tempted by easily available—often actively sold—credit, they have overextended and found themselves severely in debt. And though some credit—like retail credit at clothing stores—is available to many, very few cuspers are getting access to diverse credit offerings, including asset-building credit like mortgages. The market already has sophisticated credit information sharing and a dedicated credit regulator, but things are clearly not working out for the best interests of cuspers today.

In Kenya, a tradition of slow credit and a vibrant informal sector have opened up transformative opportunities for those who have managed to get traditional loans from banks and microfinance institutions. Historically, though, growth in that kind of lending has been slow. Now, the country is being bombarded by highly profitable, but typically short-term credit offered through virtual channels. This is bringing millions of new borrowers into the formal credit market. But how will this evolve? Will small, short-term virtual loans introduce borrowers to a world of more diverse forms of credit, credit that creates a pathway for building real assets rather than simply smoothing cash flows? Will lenders find the incentive to offer diverse forms of credit when short-term virtual lending offers such an attractive business model? If the credit market continues expanding at this pace, will Kenyan cuspers soon find their savings culture eroded, with more and more facing the indebtedness problems of South African cuspers?

And in Ghana, the market seems squeezed in a low-level equilibrium, where lenders face high costs of lending to cuspers in the informal sector alongside high returns for investing without risk in treasury bills. Even institutions like OISL, dedicated to serving the cusp group, are finding it hard to make the business model work, given the high costs involved in assessing borrowers and making collections. While most banks show little interest in the cusper segment, Ghanaians are actively saving in unstable institutions. Mobile money usage is growing, but we don't yet see any fully virtual models of savings and lending emerging. Making a big upfront investment in the technology to deliver such an offering must seem risky in a volatile macroeconomic environment. Is the answer really just to wait until the economy finds its feet, to just allow an entire generation of missed opportunities?

So what should policymakers and donors do to nudge cusper credit markets in a healthy direction? We propose a few ideas for the contexts we studied:

Across the entire sub-Saharan Africa region:

- Regulators, donors and lenders in all markets across the region should take note of the shifting demographics across the region and **the key importance of the cusp group** as a market, a political force and as the future middle class in countries that create the right conditions for them and their children to thrive.

- Regulators in all markets should improve their **credit market monitoring** by refining reporting requirements for lenders, helping regulators better track market developments in finer grained detail in terms of product type and market segment.

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

- Regulators could **encourage the expansion of a diverse range of credit offerings over electronic channels** as a means of expanding access at significantly lower cost and potentially at lower risk than is currently possible, especially in places where credit information sharing mechanisms lag behind and only a small share of cuspers have formal salaries.

- Donors could support experimentation with new kinds of P2P lending**—an eBay for P2P lending**, for example—helping to open the cusper credit market in ways that traditional banks have not.

- As new electronic lending takes hold, regulators and banks could introduce **machine learning e-arbitration** of small disputes, enabling efficient and smart management of disagreements in a quickly-growing market.

- Regulators ought to invest in **digital identification and digital asset registries**. Outdated and largely manual systems are inhibiting market development. They are rendering effective credit information sharing impossible in some markets, are making it difficult to turn assets into collateral, and are exposing vulnerable consumers to fraud in some of their largest investments. Blockchain technology and ubiquitous mobile phone utilisation open new opportunities for registries that are clear, consistent and easily available to all.

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

- Regulators—or even private lenders—could introduce the concept of a **learner's license** for credit, helping borrowers restrict their borrowing in the early years while they learn the rules of the road and work towards a longer-term financial future of building assets.

- Regulators could consider new approaches to restraining lender behaviour, such as by introducing **"Last in, last out"** rules, which would rank lenders' claims on borrowers' incomes in the order in which lenders issued loans. In the event of default, the last lender to give a client a loan—tipping the scales of affordability—would have the lowest priority in terms of repayment, thus encouraging lenders to be disciplined in the issuing of loans to already strained borrowers.

- Donors could support fintech tools that **actively remind borrowers of their own debt service** at the moment of temptation by, for example, lighting up a credit card in red when the balance is approaching a dangerous limit, or sending borrowers a warning text message when the balance grows at too quick a pace.

Conclusion

Credit markets will play an important role in shaping the destiny of the cusp group. Without attention from donors and policymakers, it will be very difficult for most African countries to find Goldilocks credit markets that are able to extend opportunity to more cuspers, over the next 10 years, without risking over-leveraging and massive over-indebtedness. The challenge is daunting, but not impossible, and can begin with simple interventions like improved market monitoring. Failure to act, though, means certain failure. It means that an entire generation of cuspers will fail to rise.

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About the FSD Network

The FSD Network is a group of nine financial sector development programmes or ‘FSDs.’ Located across sub- Saharan Africa, it includes seven national FSDs (Access to Finance Rwanda, Enhancing Financial Innovation & Access in Nigeria, FSD Kenya, FSD Moçambique, FSD Tanzania, FSD Uganda and FSD Zambia) and two regional FSDs (FinMark Trust in Southern Africa and FSD Africa).

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