Managing Decentralization at the Small Enterprise Foundation (SEF)[1]

NORTHERN PROVINCE, SOUTH AFRICA

Late one Monday night, Benjamin Pilusa descended into the lowland savannah of northern South Africa from the foothills of the ragged Drakensberg Mountains in his small white bakkie.[2] The two-lane highway was shrouded in darkness and snaked among citrus fruit plantations, cattle ranches, and wildlife reserves. Sprawling green shrubs and meter-high grass crowded around the edge of the highway. Occasionally, a towering baobab tree peeked around a corner.

Benjamin was exhausted. The monthly operational meeting of the branch managers with their zonal manager had lasted seven hours. The number of client dropouts was quietly increasing. They had deliberated for hours on the causes of this trend and possible solutions. Then, Benjamin, like the other branch managers, had to stay after hours to complete his weekly submission of loan applications and repayment reconciliation forms. The long drive back to his branch in Giyani was the last thing he wanted to do that evening, but he had no choice. Early the next morning he would have to attend a meeting to evaluate a loan officer operating in Maphata. The small Tsonga[3] village was too far from the Small Enterprise Foundation's zonal office in Tzaneen, the region's commercial centre. If he could arrive in Giyani within an hour, he hoped to have a couple of hours to relax. He pushed down on the accelerator.

As he yawned, Benjamin began to lament, "Why did I ever open my big mouth about decentralization? More responsibility only brings more work. The head office is asking us to do so many extra things that I no longer have time to do the required administrative work. I can scarcely track how my own branch is performing! Every Monday, I attend an incredible number of exhausting meetings; committee meetings to discuss the incentive scheme design, training on financial and human resource management, workshops to debate proposed changes in policies and procedures...Where does it end? We are growing so fast and changing so many things. Can we really cope?"

Suddenly, a cow emerged from the darkness of the highway only a few hundred meters in front of him. It was standing in the middle of the highway lazily swatting mosquitoes with its tail. Benjamin slammed on the brakes. As the tires screeched, the bakkie began to slide but stopped a meter short of the cow. Looking up for the first time, the cow slowly began to saunter to the side of the road. Smoke was rising from the bakkie's tires. Benjamin was frozen in his seat. He whispered, "Wazza Friday malamulela!"[4]

The Small Enterprise Foundation

The Small Enterprise Foundation (SEF) is a non-governmental organization that offers credit to micro-enterprises in the villages and townships of South Africa's Northern Province. Founded in January 1992 by a white South African with a strong sense of mission, its primary objective is "to provide micro-entrepreneurs with access to credit that will enable them to realize their potential and thereby generate income and employment." The organization envisions achieving this objective and also becoming a sustainable institution. Its staff had set a goal of covering all operational and financial expenses by June 2003. [See the companion case "Building the Board at SEF" portraying SEF's establishment and growth over the years.]

SEF had two lending programs that were both based on the group methodology employed by the Grameen Bank in Bangladesh. In order to receive a loan, clients formed groups of five. Six to eight groups met biweekly at a "centre" to receive loan disbursements, make repayments, submit savings and discuss issues. A client committee (elected by clients) managed the centre. A SEF loan officer assigned to the geographical area where the centre met assisted the committee, facilitated financial transactions, monitored centre performance, and recruited new clients.

Before a group could join a centre, it had to meet certain screening requirements. Each group had to undergo training

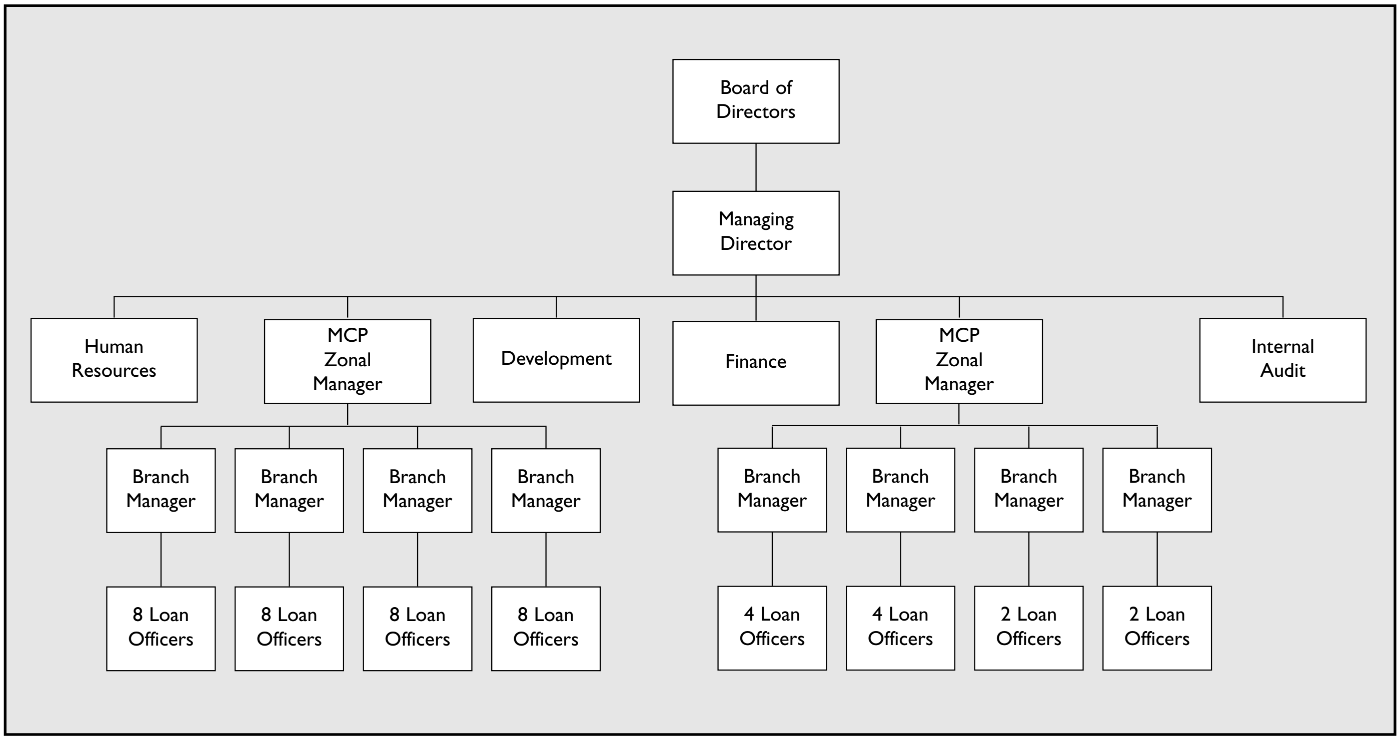

Exhibit 1. SEF Organization Chart

in SEF policies and procedures, and open a savings account at the Post Office. If the group's loan application was eventually approved, the group received loan disbursements and deposited savings into this account. After passing oral examinations by the branch manager, the centre and the zonal manager, the group was recognized and could formally submit its loan application to the loan administration department.

SEF's initial lending program, the Micro-Credit Program (MCP), aimed to provide credit to experienced business owners of either gender. Clients had to have at least 6 months experience operating their businesses. Although men were eligible for MCP loans, the vast majority (97%) of clients were women.

In contrast, the Tshomisano Program (TCP) aimed to provide credit and business training only to women from the poorest 30% of households in the region. Many of these women did not have any previous experience managing a business. Since TCP only began in 1995 and its policies and procedures were stricter than those of MCP, its clients represented a much smaller proportion of SEF's current active client base.

Over seven years, SEF had taken a deliberate approach to managing its growth. By December 1998, its client base had grown to more than 7,500 active members and principal outstanding had reached R4,644,872 (R6=U.S.$1). SEF's slow growth had contributed significantly to its impressively low delinquency rate. Through June 1997, defaults totalled only R810 and delinquent loans amounted to only R510. Although SEF had written off R18,109 due to deaths and rescheduled R8,855 in loans since its inception, these figures were very low when compared to other micro-finance institutions. While SEF had grown slowly, it had developed an organizational culture that had achieved virtually 100% repayment while reaching some of the poorest people in South Africa.

As shown in Exhibit 1, the organizational structure was relatively flat. The Board of Directors was ultimately responsible for all major policy decisions. It was composed of six members, including the Managing Director (MD). The chairperson was the director of a literacy program in the Northern Province. Two members were national commercial bank managers. One member was the head of another micro-finance institution and the other was the principal of a Tzaneen primary school. At the senior management level, all departmental managers, including the MCP and TCP Zonal Managers, reported to the MD. Each zonal manager was responsible for four branches. Each branch had 2-8 loan officers.

All SEF staff are paid market-based salaries. The Human Resources Department had graded each position and determined salary levels through a survey of similar financial institutions and development organizations operating in the region.

In 1994, senior management designed a very simple incentive system to motivate all staff to grow the organization. Every month, loan officers received R7.20 for every group of five clients in his/her portfolio. For every group that was in arrears during the month, this commission amount was reduced according to the following chart:

No groups in arrears	R 7.20 per group
1 group in arrears	R 6.00 per group
2 groups in arrears	R 5.00 per group
3 groups in arrears	R 3.60 per group
4 or more groups in arrears	no commission

Exhibit 2. Loan Officer Commission Table

The maximum commission that a loan officer could earn was R504 per month. This maximum amount effectively capped the number of groups that a loan officer managed at 70 groups. Senior management felt 70 groups was the largest portfolio a loan officer could manage in a sustainable manner. In turn, branch managers earned 25% of their loan officers' monthly commission. All other levels of management and administrative staff earned 4% of all loan officers' monthly commission. This incentive system effectively increased the compensation of those loan officers with large portfolios to above-market levels.

Micro-Credit Program's Management Team and Field Staff

In July 1998, MCP restructured the organization in preparation for further revenue growth. It consolidated two of its four existing branches and opened a new branch at Giyani. SEF's senior managers expected MCP to open a fifth branch at Mankweng in January 1999.

MCP's four branches reported to a Zonal Office. The Zonal Office was staffed by the zonal manager, his assistant, and three loan administration department employees. The zonal manager was the geographic head of MCP operations. A zonal manager could manage as many as seven branches before a new zone was formed. As shown in Exhibit 1, the zonal manager reported directly to SEF's managing director.

The four branch managers came from diverse backgrounds and possessed different skills. Three of the four branch managers were from the Tzaneen region. The remaining branch manager, Benjamin, grew up in Soweto and attended university in the Western Cape Province. Two of the branch managers had limited formal education. They were older and completed secondary school during the apartheid era. However, they had more work experience than their two younger colleagues who joined SEF after completing their first university degree. Before joining SEF, none of the branch managers had managed a workforce.

Though each branch had 2-8 loan officers, depending on its age, the maximum number of loan officers per branch was eight. In January 1999, three of the branches were at maximum capacity.

Although all loan officers were originally from the Northern Province, the staff was diverse. One third of the field staff belonged to the "old guard"-a group of women recruited from SEF's client base during its initial period of operation. More recently, SEF began recruiting young university graduates who had an interest in rural development. Although the women continued to out-perform the young graduates in terms of principal outstanding and client retention, the younger generation now composed a majority of field staff members.

In the post-apartheid era, many black South Africans, particularly in the Northern Province, continued to suffer from the legacy of separate, under-funded schools. Most SEF staff members came from this disadvantaged background and struggled with time management, basic mathematics, and financial management concepts.

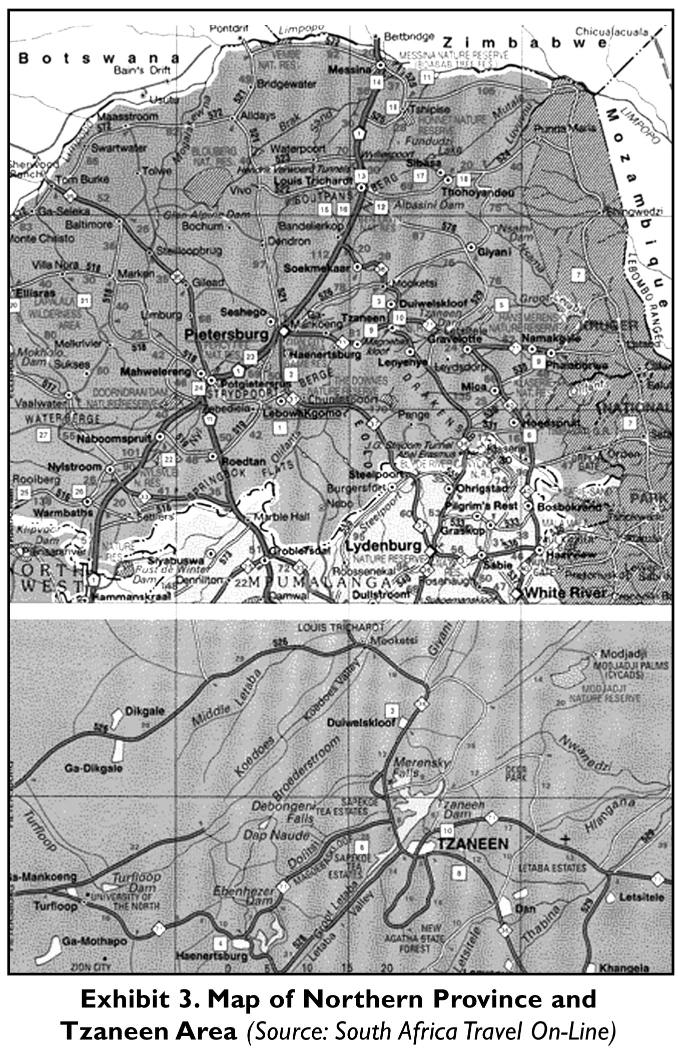

Exhibit 3. Map of Northern Province and Tzaneen Area *(Source: South Africa Travel On-Line)*

The People and Economy of South Africa's Northern Province

Approximately 11% of South Africa's population lived in the Northern Province. The vast majority (95%) was of African ethnicity. The province was largely (88%) rural and suburban.[5]

Residents of the Northern Province, especially the rural African population, were among the poorest in South Africa. In 1995, average annual income for an African household in the province was R26,000 (US$4,333). In comparison, the average for all households in South Africa was R41,000.[6]

Within the province (as well as the nation), income distribution was highly unequal, especially among different gender, racial, and geographic groups. In 1995, 37% of non-urban female-headed households in the province were in the bottom income quintile, 24% in the second lowest, but only 6% in the top income quintile. In contrast, 8% of urban male-headed households were in the bottom income quintile, 9% in the second lowest, and 40% in the top income quintile. This high level of inequality within the province contributed toward making income distribution in South Africa among the most unequal in the world.[7]

The province's economy was heavily dependent upon mining and industrial agriculture. In recent years, several factors caused these two industries to rapidly reduce their workforces with a debilitating effect on the province's socio-economic development: global commodity prices fell drastically, the new South African government lowered trade barriers, and high interest rates choked domestic investment. The National Union of Mineworkers estimated that more than 100,000 jobs were lost due to retrenchments during 1997-98.[8] In addition, according to the Agricultural Employment Organization, the number of permanent farm workers in South Africa was halved from 1.2 million in 1994 to 650,000 in January 1999.[9] The 1996 Population Census by Stats SA indicated that the total unemployment rate for the Northern Province had reached as high as 46%. Since then, further retrenchments in the mining and agricultural sectors have exacerbated this problem and heightened the need to create employment opportunities in the region.

SEF operated in the rural and suburban areas around Tzaneen, a commercial centre in the eastern half of the Northern Province. During the apartheid era, these areas formed part of the Gazan-Kulu and Lebowa Homelands where black ethnic groups were resettled after their traditional land was claimed by the government. These densely populated settlements served as labour pools for local white farms.

Today, the majority of the African population continues to live in these settlements surrounding the main commercial centers such as Tzaneen, the mine at Phalaborwa, and various large plantations like The Downs. In 1996, approximately 650,000 people lived within 50-60 km of Tzaneen. Most were of Northern Sotho and Tsonga ethnicity.

The vast majority of SEF clients were hawkers and retailers. Some also practiced agriculture and light manufacturing, especially in clothing. More than 80% of them had three or more years experience running their businesses. All clients operate their businesses on a full-time basis. Many employed at least one person other than the owner. Exhibit 4 shows the distribution of loans to SEF clients at a village meeting.

The Quest for Sustainability

Among international donor agencies and micro-finance institutions, the term "sustainability" refers to becoming profitable or covering all operational and financial expenses over the long term so that the institution can expand its client outreach and access funds from commercial markets.

As SEF sought to become sustainable by June 2003, it encountered several obstacles, most notably increased expenses due to an expanding operation and the unionization of some field staff. In 1996, senior management decided to begin expanding its operations, and over the course of the next two years it opened two new branches and recruited new staff. In 1997, half of SEF's staff joined the Paper, Printing, Wood, and Allied Workers Union (PPWAWU). The increase in basic salaries detrimentally affected the organization's cost structure. The recent drive to expand rapidly combined with union pressure to increase salaries much faster than inflation threatened SEF's goal of becoming profitable.

At the organization's first sustainability workshop in October 1997, senior management presented SEF's troubled financial position to the zonal and branch managers. The branch managers were stunned. They had not realized SEF was performing so poorly in terms of profit. In fact, some had always thought the organization was sitting on top of a bottomless pile of money.

Following the workshop, SEF's management decided to examine how MCP could increase revenue and the organization as a whole could minimize expenses. Due to TCP's poverty focus, management felt that MCP should be the organization's engine of growth. After conducting some research on the revenue aspects, MCP's effective interest rate was increased, restrictions on loan size growth loosened, and new loan products with shorter terms were introduced. In addition, MCP's field staff began to retain a higher proportion of their clients through improved service and the introduction of new products.

SEF's strategy was not as well defined when it came to expenditures. The organization needed to expand to meet its revenue projections but at the same time it needed to cut costs without delay. Staff salaries were the organization's main cost driver. Negotiations with the PPWAWU were tense and resulted in annual increases in salaries beyond what was projected by senior management in its growth model. Consequently, senior, zonal and branch managers began to explore several ideas to make SEF more efficient and responsive to client needs, including decentralization at the October 1997 workshop.

One Year Later: Decentralization Revisited

One year after the October 1997 workshop, MCP (and SEF as a whole) was performing better than its growth model projected. Its losses were considerably less than expected. (See SEF financial statements in Exhibits 5 and 6.) The organization was on track to reach its goal of sustainability by June 2003. Yet senior management was concerned that the organization relied too much on changes in the interest rate and loan size policy to improve profit margins. MCP still needed to improve loan officer productivity and cost efficiency.

Decentralization was viewed by some SEF managers as the key to making MCP more flexible and responsive to client needs. If more responsibility and authority were decentralized, they reasoned, the field staff and branch managers (who had the most contact with clients) would drive the organization to be more responsive to clients. Yet, little progress had been made in advancing this cause. The branch managers had formed the Profit Center Committee at the request of senior management to consider the decentralization issue. However, they were involved in researching and piloting changes in interest rate and loan size policies at the same time. As branch staffing gradually increased during the year, branch manager workloads increased considerably and they struggled to make meaningful contributions to the committee's monthly meetings.

At the second sustainability workshop in October 1998, Benjamin pondered the branch managers' struggles. Workshop participants were brainstorming ideas for moving towards sustainability, when Benjamin thought, "This process has got to be jump-started." He raised his hand to attract the attention of the workshop facilitator, "We need to discuss the issue of decentralization."

"What kind of decentralization?" asked Joshua Nkuna, SEF's Managing Director. He eyed Benjamin skeptically. Joshua had heard some of the branch managers talk about decentralization but had seen little action by the Profit Center Committee. When the committee had submitted its initial recommendations regarding what decisions to decentralize, Joshua perceived many of them as unrealistic because some branch managers had too limited skills. The logistics of decentralizing these decisions was not clearly spelled out. In his view, the branch managers had largely used the committee as a platform to advocate controversial changes in policies and procedures in hopes of reducing the level of supervision from the zonal manager. While the branch managers argued that they, rather than the zonal manager, should implement some group formation procedures, Joshua strongly disagreed. He believed that the zonal manager played an important role in preventing fraud by getting involved in the group formation process.

Knowing that the committee had much work to do to convince senior management of the wisdom of its proposals, Benjamin smiled and declared simply, "We must become more efficient. We must empower the branch managers!"

Based on the committee's recent informal discussions (which had not been presented to senior management), Benjamin pro-

	1998	1997
	R	R
CAPITAL EMPLOYED		
Non-Distributable Reserve	366,788	272,240
General Capital Reserve	582,523	582,523
Development Reserve	6,654,460	6,654,460
Educational Reserve	2,300	2,300
Operational Grant Reserve	512,726	-
Retained Income	289,658	1,892,183
Equity Funds	8,408,455	9,403,706
Long-Term Loan	-	531,905
TOTAL CAPITAL EMPLOYED	8,408,455	9,935,611
EMPLOYMENT OF CAPITAL		
Fixed Assests	604,654	134,105
Investments	1,413,732	1,298,957
CURRENT ASSETS		
Loans	3,375,454	1,654,790
Accounts receivable	96,349	82,878
Cash and short-term funds	3,811,396	7,470,422
Total current assets	7,283,199	9,208,090
CURRENT LIABILITIES		
Accounts payable	188,602	179,238
Bank overdraft	157,373	91,158
Current portion of long-term loan	547,155	435,145
Total current liabilities	893,130	705,541
NET CURRENT ASSETS	6,390,069	8,502,549
TOTAL EMPLOYMENT OF CAPITAL	8,408,455	9,935,611

Exhibit 4. SEF Balance Sheet

	1998	1997	1998/97 Growth
	R	R	
OPERATING INCOME			
Loan interest earned	1,026,690	563,712	82%
Interest on investment	974,812	1,370,776	
Interest paid	-114,886	-121,138	
Bad debts	-454	-191	
MARGIN ON LENDING ACTIVITIES	1,886,162	1,813,159	
Operating expenses	-2,276,718	-1,443,648	58%
			-1,365,368
OPERATING (LOSS)/INCOME	-390,556	369,511	
Sundry income	1,349	1,526	
Profit on disposal of fixed assets	500	-	
(LOSS)/INCOME before head office expenses	-388,707	371,037	
HEAD OFFICE EXPENSES	-1,119,272	-763,280	47%
LOSS before grants	-1,507,979	-392,243	
Operational grants received	-	199,680	
LOSS for the year	-1,507,979	-192,563	
Transfer to non-distributable reserves	-94,546	-94,546	
RETAINED INCOME at the beginning of year	1,892,183	2,179,292	
RETAINED INCOME at end of year	289,658	1,892,183	

Exhibit 5. SEF Income Statement *(An association incorporated under Section 21 of the Companies Act)*

ceeded to outline a strategy. "First, SEF must build capacity at the branches and gradually decentralize some decision-making power to them. Due to the legacy of apartheid, the branch staff have missed out on quality formal education. We must fill this gap. In addition, few staff members have had the opportunity to work in a situation where they actually managed people, especially in a participatory manner. The organization must address these weaknesses in staff skill levels in order to build morale and enable staff to work more efficiently and effectively. If the branch staff could become more involved in decision-making, SEF would become a more flexible organization that could meet clients' needs more efficiently.

Second, the organization must revise its performance indicators and targets to reflect its sustainability goals. In particular, it must measure and reward branch profitability that exceeds targets. However, many staff members do not understand what we mean when we discuss sustainability. Before profitability can be used as a performance indicator linked to staff compensation, the staff-especially the branch managers-must understand the concept and its importance to the organization. We must build capacity at the branches to reshape SEF and make it more efficient. Thus, you can see the link between decentralization and the move toward sustainability!"

"Yes, the link is obvious," Joshua responded. "The challenge is how to actually do what you are describing. Some of these ideas have been presented before. We have been discussing them for the past year. But now we need someone from the branches to take charge and lead this process. Are you interested, Benjamin?"

ASSIGNMENT QUESTIONS:

1. Evaluate SEF's recent progress toward sustainability. Is there a need to decentralize decision-making?
2. Design a decentralization action plan for SEF.
3. How will you convince staff of the advantages of your plan and implement it?

1. This case was written by Brian Kuwik of University of Washington under the supervision of Professor Richard Linowes of the Kogod School of Business at American University in Washington, D.C. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.
2. "Pick-up truck" in Afrikaans.
3. An African ethnic group based in northern South Africa and southern Mozambique.
4. "Friday, come rescue me!" in South African street language.
5. Central Statistics, "Earning and Spending in South Africa," 1997.
6. Central Statistics, ibid.
7. Central Statistics, ibid.
8. Business Day, 3/11/99.
9. Business Day, 3/12/99.