THE GOVERNMENT OF LESOTHO (GoL)

MINISTY OF FINANCE AND DEVELOPMENT PLANNING (MoFDP)

Inclusive Finance Strategy of Lesotho (2012/13-2016/17)

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1. Introduction

The Government of Lesotho (GoL) is committed to promoting and supporting the development of inclusive finance in order to increase employment, production, productivity, and export to reduce poverty and ensure economic growth. The National Strategic Development Plan (NSDP) states that the GoL in the next 5 years (2013 to 2017) would improve access to financial services for the Micro, Small and Medium Enterprises (MSMEs), ensure financial stability and encourage development of low cost products that could be supplied not only by banks but also by non-bank financial service providers.

Attaining higher savings and investment ratios is critical to achieving the economic growth, increase employment, and enhance food security. However, there has been a surplus of savings over investment, which has resulted in the accumulation of financial assets by the Central Bank of Lesotho (CBL) and the commercial banks, much of which are held overseas. This is unusual in developing countries, which generally face shortfall of capital and therefore find it hard to make productive use of their labour. In Lesotho's case, there appears to be demand and supply constraints which affect the effective intermediation of savings into investment. Designing and implementing the national inclusive finance strategy in Lesotho will significantly contribute to ensuring that savings are increased and invested domestically in productive activities and finally meet the strategic objectives and targets of the NSDP.

Although agriculture's contribution to GDP has been declining, it still remains an important sector in Lesotho, which generates employment for most households. With a 75% rural population, about 40 percent of the Basothos are employed in the agricultural sector, mostly on subsistence basis and the majority of those employed in this sector are women. However, diversifying and increasing agricultural productivity is restricted by (a) credit market failure; (b) limited access to information and technical support; (c) limited market integration; (d) climate change; and (e) high risk and low return within the sector. The development of MSMEs is crucial for the achievement of development objectives such as poverty reduction, generation of decent employment, improving the situation of women and increasing indigenous ownership of investment in the economy. However, despite the potential role of MSMEs to accelerate growth and the creation of decent jobs in Lesotho, they are hindered by inadequacies in technical, management and entrepreneurial skills; competitiveness; infrastructure; regulatory work; quality of products; and limited access to finance, markets, and information. The lack of or limited access to finance is worsened by absence of documented track record (credit history), and lack of collateral for most of small business operators.

The national strategy is a long-term plan of action designed to facilitate the development of financial inclusion in Lesotho. It is designed to: (i) establish a shared vision for the sector; (ii) define guiding principles and the support required for the development of inclusive finance in Lesotho; (iii) stipulate the core elements needed to promote financial inclusion; (iv) indicate the role of stakeholders in implementing the strategy; (v) identify the targets and specific results to be achieved within the next five years; (vi) propose the strategic interventions and actions plan;

and (vii) coordinate the activities of various sectors in implementing the strategy. Although lack of inclusive finance policy has contributed for the current gaps already identified in the Financial Institutions Act of 1912, the inclusive finance strategy can serve as a valuable input in the financial sector development program of Lesotho.

Inclusive finance is part and parcel of the wider financial sector, the Ministry of Finance and Development Planning is best positioned to align the national strategy for inclusive finance with the financial sector strategy and other macro and sectoral policies. Therefore, the Ministry of Finance and Development Planning will be the lead institution to take the responsibility of guiding, coordinating and monitoring its implementation. While the government will lead the process, the commitment and participation of all stakeholders at all levels (micro, meso, macro and client levels) is essential to move the strategy forward. Donors are also important actors in supporting and facilitating the implementation of the national strategy. The national strategy is developed and drafted by key stakeholders themselves through a participatory and consultative process. Moreover, a diagnostic study on the delivery of inclusive finance in Lesotho was conducted to generate detailed information and serve as an input in designing the inclusive finance strategy for Lesotho.

2. The rationale for inclusive finance in Lesotho

A stable, liquid, competitive and efficient inclusive finance in Lesotho is one of the preconditions for expanding agricultural production, increasing the number of micro and small enterprise operators, creating employment and increasing household income in a sustainable way. The provision of financial services, particularly to the excluded, would increase income in the wider economy by mobilizing savings and providing loans, which can be used to support the creation of small business in urban and rural areas. The development of inclusive finance in Lesotho can also play an important role in reducing risk and vulnerability, and in increasing the ability of Basothos to access basic services like health and education, thus having a more direct impact on growth, employment and poverty reduction. Although investment is important for growth, which could be generated through local or foreign saving mobilization, the issue lies on the mechanism of converting savings into investments (collecting and allocating savings). This will depend more on the availability of efficient financial institutions/systems than on anything else. Thus, the most important prerequisite for growth and development in Lesotho is the existence of sustainable and vibrant inclusive finance providers/systems that convert savings into investments and supports private sector development, agricultural development and promotion of exports.

Although there have been a number of initiatives and support to inclusive finance development in Lesotho, there are hardly any sustainable inclusive finance providers involved in the delivery of client-centered financial products. As a result, there is a huge unmet demand for financial services and a large percentage of the population in rural and urban areas, is still without access to loans, savings, insurance and payment systems. This is caused by a number of problems at macro, meso, micro, and client levels. The problem is aggravated by the ongoing "old paradigm" of subsidized and targeted credit co-existing with the "new paradigm" built on commercial and market oriented inclusive finance providers. A national strategy for inclusive finance in Lesotho is needed to overcome the current limitations on expanding outreach, creating sustainable finance providers, delivery of demand-driven and affordable financial services and on filling the gaps between demand and supply.

3. Brief overview of the inclusive finance sector in Lesotho

The Finscope Lesotho 2011 survey revealed that about 66% of the adult population borrowed money from formal and informal sources. Out of the respondents who took loan in the last 12 months, about 58% of the respondents indicated that they took short-term credit to cover the living expenses of the households, when their income is insufficient. The next most frequent motivations for borrowing are: covering school fees (22.8%), followed by medical expenses/medical emergencies (13.2%), other emergencies (6.8%), funeral expenses (5.1%), and paying off another debt (2.4%). Taking loan for another person to use and to take care of a sick relative/relatives accounted for 2.4% and 1.9% respectively. ***Only 2.3% of the adult Basotho borrowed for the purpose of starting new businesses or expand existing businesses.***

A large part of the population has limited access to the formal financial sector. Considering that a predominant portion of the population of Lesotho is dependent on agriculture and the informal sector in rural and urban areas, the banks and insurance companies, with their branch network mainly concentrated in urban areas, are not able to effectively mobilize rural savings and provide credit, particularly to agriculture and micro, small and medium enterprise operators. The financial services to the rural areas and MSMEs are currently being provided mainly by institutions in semi-formal and informal sectors. The absence of deposit-taking MFIs and lack of strong financial cooperatives has further limited the expansion of inclusive finance in Lesotho. The banking and credit policy of the CBL does not enjoin on the banks and insurance companies to provide financial services to the rural areas or to the MSMEs, which are critical to the growth of the national economy. Consequently, the formal finance providers have the freedom to adopt their own policies, with no responsibility of meeting the development objectives of the government.

Currently, the formal financial system in Lesotho comprises commercial banks, insurance companies, insurance brokers, Saving and Credit Cooperatives (SACCOs), and moneylenders licensed by the CBL under the Moneylenders Act, 1989. There are challenges both in the demand and supply side, which constrain the delivery of quality financial services in the country. The lack of microfinance knowledge, limited capacity of the adult population to be involved in productive activities and inadequate financial education has limited the expansion of inclusive finance in the country. Although the Financial Institutions Act of 1999, Cooperatives Act of 2000 and the credit-only Institutions Act of 2010 were not, as such, prohibitive in expanding sustainable inclusive finance providers such as deposit-taking MFIs, there are no active MFIs and strong financial cooperatives in Lesotho at present. As a result, the majority of the Basotho are served by the informal sector such as the Rotating and Saving and Credit Associations (ROSCAs), unlicensed moneylenders, Stockvels and burial societies.

The delivery of financial services in Lesotho has been directed to sectors and individuals that do not drive economic growth and promote productive activities. Lending to the agricultural sector has been declining because of weak marketing arrangements that do not guarantee control over sales proceeds as well as high production and marketing risks. There is a need to put in place enabling environment/foundation that will facilitate the development of agricultural finance in the country. The absence of an enabling regulatory framework, very limited capacity of the regulators, weak legal/court system to enforce contracts, and absence of a national ID are also limiting factors to mobilize savings and improve access to credit. Lack of loan capital, limited institutional capacity of inclusive finance providers, absence of demand driven and client-centered financial products, limited use of ICT to improve MIS and expand front-office technologies, very weak meso-level support and very limited non-financial support to build the capacity of clients are the key challenges in expanding inclusive finance in Lesotho.

Addressing the key challenges of expanding inclusive finance in Lesotho requires the support of government, private sector and development partners and a deliberate effort of building the capacity of the key players at macro, meso, micro and client levels. The national strategy is an indispensable instrument in helping government, finance providers, technical service providers, donors, and other stakeholders to guide the development and expansion of inclusive finance sector in Lesotho.

4. Definition of inclusive finance in the Lesotho context

Inclusive finance is broadly defined as access to a range of quality financial services such as credit, savings, insurance and payment systems and remittances by diverse financial service providers (banks, microfinance banks , deposit taking MFIs, credit-only MFIs, financial cooperatives, NGOs, etc) to those who are excluded or denied financial access from the mainstream financial system. It should be noted that financial inclusion does not only refer to increasing the count (number) of people who access financial services but refers also to improvements in quality of financial services extended. Quality here refers to affordability (costs such as interest, fees and commissions), appropriateness or product fit (new product development and improving the existing features of the product so that client special needs are met), convenience (proximity, loan processing time etc) and to the provision of financial services with dignity (customer care, consumer protection, etc). In the Lesotho context, inclusive finance is part and parcel of the financial sector and the National Strategic Development Plan.

5. The Vision

Consistent with the Lesotho five-year National Strategic Development Plan which focuses on creating employment through developments in MSMEs, agriculture, mining and tourism, inclusive finance will have the vision of achieving economic empowerment of Basotho who are excluded or have no financial access from the mainstream formal financial system. To this end, inclusive finance will create opportunities to increase wealth and empower Basotho through sustainable growth.

6. The Objective

The objective of the national strategy is to develop an inclusive financial system in Lesotho within the next five years (2012/13-2016/17) aligned with the National Strategic Development Plan and other development programs and policies of government. The national strategy will focus on improving the delivery of quality and diverse financial services to the excluded population by focusing on sustainability, accessibility and affordability.

The national strategy on inclusive finance strategy aims to

(i) Facilitate and expand the outreach of quality financial services by diverse providers and innovative products to meet the needs of MSME operators, smallholder farmers, and low income people involved mainly in productive activities

(ii) Increase the financial and investment capacity of the private sector in urban and rural areas by linking with the formal financial sector

(iii) Create and capacitate sustainable inclusive finance providers such as deposit-taking MFI, financial cooperatives, and credit-only MFIs

(iv) Create an enabling policy and regulatory environment at macro level and support meso level infrastructure

(v) Educate society on financial services (knowledge barriers) and implement client protection interventions

7. Target groups

The inclusive finance strategy targets broadly the low income people in Lesotho excluded from the mainstream formal financial system, namely MSMEs, smallholder farmers engaged in production, processing, and marketing of agricultural products; women; youth; men; self-employed; and, disadvantaged groups in rural and urban areas.

8. Guiding principles for the strategy

The inclusive finance strategy of Lesotho is built upon existing experiences within the country and the rest of the world. Thus, the national strategy will be guided by internationally accepted inclusive finance principles and paradigms to provide direction to those seeking to enter the market and/or those already operating in the sector. These include:

1. Clear distinction and separation of charity (welfare policy) from inclusive finance and ensuring that financial discipline is in place in the sector.
2. The need for increasing outreach to provide financial services to larger numbers of the financially excluded population.
3. Strike an appropriate balance between the social and economic (financial) objectives of inclusive finance providers.
4. Use market based pricing (avoiding subsidized interest rates) which can also promote saving mobilization, foster competition, and remove barriers to entry and exit. Sustainable inclusive finance providers should cover their full cost from the interest income they collect and to this end, microfinance providers need to separate the responsibilities of delivering financial and non-financial services.
5. Setting in place an appropriate regulatory and supervisory framework to ensure an effective oversight on the activities of inclusive finance providers, adoption of best practices and ensure the stability of the financial system.
6. Building the institutional and managerial capacity of inclusive finance providers.
7. Mobilizing loan capital for inclusive finance providers through savings mobilization, commercial funding (national and international commercial lending), donor funding, equity, etc.
8. Developing innovative financial products that respond to the needs of the excluded, which are convenient, accessible, flexible and affordable.
9. Develop a transparent governance, management, accounting, internal control and information systems.
10. Align inclusive finance with the National Strategic Development Plan and the wider financial sector development strategy.
11. Securing the independence of inclusive finance providers from political interference.
12. Limiting the role of the government mainly to creation of an enabling environment that facilitates inclusive finance in Lesotho and to the pursuit of policies that create incentives for greater private sector participation in the financial market.
13. Adherence to performance standards, by measuring outreach, productivity, efficiency, sustainability and portfolio quality of inclusive finance providers.
14. Agreeing to the internationally accepted principles developed by CGAP (see annex 1).

9. Specific targets of the national strategy

The design of the national inclusive finance strategy in Lesotho sets specific targets to be met after five years. These include the following:

(a) Provide loans to 500,771 Basotho by 2016/17
(b) Provide saving products to 492,425 Basotho by 2016/17
(c) Increase the loan portfolio of inclusive finance providers by 500 million Maloti
(d) Support the establishment of 3 deposit-taking MFIs (establish and transform two from within Lesotho and attract the establishment of one deposit-taking MFI from abroad (such as FINCA, Opportunity International, etc)

(e) Support the establishment of 2 large financial cooperatives in rural and urban areas

(f) Support the establishment of 3 new credit-only MFIs and transformation of 5 moneylenders into credit-only financial institutions

(g) Support the establishment of sustainable financial cooperatives

(h) Increase the number of women clients in the sector to a level of 60%

(i) Eliminate exclusion by improving financial access to the disadvantaged groups

(j) Implement client protection interventions, provide financial education and Business Development Services to all clients

(k) Establishment of credit reference bureau

(l) Develop the meso level infrastructure and build the capacity of technical service providers

(m) Create an enabling legal and regulatory environment, building the capacity of regulators and government institutional support providers such as CBL and the Cooperative Department of the Ministry of Trade and Industry, Cooperatives and Marketing

Given the absence of microfinance institutions, very weak financial cooperatives, proliferation of moneylenders, and lack of finance providers for smallholder farmers, agribusiness operators, micro and small enterprise operators and the role of access to finance in implementing the ambitious growth and development plan of Lesotho, the targets of the inclusive finance strategy are achievable.

10. Strategies to achieve the objective and targets

In order to realize the vision and objectives of the national inclusive finance strategy, specific interventions and actions are needed at four levels: namely, macro, meso/institution, micro and client levels.

10.1 The macro level

This includes development of an enabling policy, legal and regulatory system; capacity building of regulators and government support providers; improvements in the infrastructure; formulation of a client protection law to deliver quality financial services, mobilize savings, expand outreach and promote innovations.

(i) Creating an enabling legal and regulatory system

The success of the national strategy for inclusive finance in Lesotho is largely dependent on improving the legal and court system to enforce contracts. Designing a legal framework and registry to use moveable and non-movable properties as collateral will assist inclusive finance providers to deliver loans using individual lending methodology, without collateral. Moreover, once the issue of title deeds for land is addressed in Lesotho, it will be much easier to use it as collateral.

(ii) Strengthening the capacity of regulators and government support providers

Implementing the new Financial Institutions Act of 2012 requires developing detailed regulations and supervision manuals for each financial institution in the four categories. Moreover, there are issues in the FIA 2012 affecting the growth and development of inclusive finance in Lesotho, such as the paid up capital requirement of the inclusive finance providers, which need to be revisited and addressed. There are also a number of initiatives in the pipeline which need to be finalized. These include: Insurance Bill, Credit Reference Bureau Bill, the Financial Cooperative Bill, the Payments, Clearing and Settlement Bill. In the short-run, the intervention is to enact the pending bills. However, having the draft bills enacted by parliament is not an end by itself. There is a need to build the capacity of the regulators and key actors in government to properly implement the bills. Thus, building the capacity of the regulators in CBL and the Cooperative Department of the Ministry of Trade and Industry, Cooperatives and Marketing is a priority.

(iii) Improving the infrastructure

Finance providers in Lesotho fail to expand their rural network mainly due to poor physical infrastructure. Improving roads, warehouse infrastructure, electricity, telecom, implementing the national ID project, and improving the security infrastructure has a direct effect in reducing the transactions costs of doing business (lower interest rates and fees) for inclusive finance providers and the excluded population. There is a need for the support of other government stakeholders and donors in improving the physical infrastructure. Therefore efforts to reach out and share information and need of the development of the inclusive finance sector should be made. Pending development of appropriate infrastructure, other innovative approaches to ensure reach of financial services like phone banking etc should be implemented through public private partnership arrangements.

(iv) Client protection law

Regulators, government institutions, networks/associations and finance providers have the responsibility of protecting clients from unethical behavior. One of the interventions to address the issue of client protection in Lesotho is through a client protection law. Once the law is gazetted, the regulators and government institutions will monitor and supervise the mandatory implementation of consumer protection.

10.2 The meso-level

The specific meso-level supports and interventions include development of a supportive meso-level infrastructure that provides inclusive finance providers with the required human, financial, and information resources to provide quality financial services to the excluded population is a key strategic intervention of the nation strategy.

(i) **Establishing the Lesotho Association of Inclusive Finance Providers (LAIFP)**

The microfinance forum in Lesotho has served as the platform to discuss the issues of inclusive finance in Lesotho. It has been effective in providing value adding services to members and key stakeholders in the microfinance sector. However, there is a need to transform the forum into a sustainable network of inclusive finance providers in Lesotho. This requires the support of existing inclusive finance providers, government, donors and others. The LAIFP will be involved primarily in advocating for an enabling policy and regulatory environment; build the capacity of inclusive finance providers through training and technical assistance; conducting studies to understand the challenges of the sector; discussing and disseminating the results of its research activities; knowledge management and disseminating best practices; and monitoring and appraising the performance (financial and social performance) of inclusive finance providers in Lesotho. It should be reiterated that the support of government, donors, members and other stakeholders, particularly at early stage of the establishment LAIFP, is a prerequisite to ensure its sustainability.

(ii) Strengthening the Lesotho College of Cooperatives

If given the right support and management independence, the Lesotho College of Cooperatives is an ideal institution to provide training and technical support to the staff of the Cooperative Department of the Ministry of Trade and Industry, Cooperatives and Marketing and members of financial cooperatives in the country. The college could also be involved in conducting research and regular conferences/workshops to discuss the issues of financial cooperatives in the country. This intervention will require conducting a detail study which focuses on restructuring the college.

(iii) Establishing a Credit Reference Bureau (CRB)

Although establishing CRB is in the pipeline, there is a need to speed up the process, which will have a significant impact on improving the quality of credit delivery and reduce loan default rates in Lesotho. The bureau will also be a useful tool in increasing outreach and efficiency of inclusive finance providers. Establishing CRB will require conducting a detailed study to assess the institutional and legal challenges, management and governance, and identifying the appropriate institution, where it should be housed. There is a need to support the current initiative of establishing CRB by banks and extend its services to all inclusive finance providers, mainly the deposit-taking MFIs and large financial cooperatives.

(iv) Establishing the Lesotho Inclusive Finance Training and Research Institute

Improving efficiency and expanding outreach of inclusive finance providers depend on building of the human resource capacity of the sector. Given the lack of inclusive finance training providers in Lesotho, establishing the inclusive training and research institute would be the appropriate option. With the support of the government and donors, Lesotho University can take the lead in establishing the institute. On top of providing training, the institute will also be engaged in promotion and research in the area of inclusive finance.

(v) Promoting linkages between commercial banks and inclusive finance providers

The ability of the inclusive providers in Lesotho to expand operations over the coming five years also depends on their access to commercial loans (domestic loans and other sources of capital). However, inclusive providers must demonstrate their credit worthiness to banks. Although the strategy recognizes the importance of the provision of wholesale funds for inclusive finance providers to expand their outreach, linking inclusive finance providers with banks helps the bankers to channel part of their liquidity to the inclusive finance sector. Banks also benefit by outsourcing some of the more difficult micro-lending components of their programs to inclusive finance providers whilst leading to greater coverage of the target groups. To this end, there is a need to build the capacity of the inclusive providers, including the NGOs which organize the potential clients into self-help groups, and link them with banks. There will also be a need to build the capacity of the banks to understand the MF sector. Moreover, given the excess liquidity in the banking sector in Lesotho, the GoL has an option of enforcing a directive which forces banks to lend at least 20-10% of their loan portfolio to the excluded population. Compliance to the directive will encourage banks to look for various options such as opening specialized departments; establishing sister microfinance institutions; outsourcing other microfinance institutions or financial cooperatives; contributing to the autonomous apex for wholesale lending or the national credit guarantee scheme, etc.

(vi) Establishing an autonomous apex institution for wholesale lending, managing the partial credit guarantee scheme and provide capacity building support to inclusive finance providers

Supporting the establishment of an autonomous apex institution could serve as an appropriate channel in enhancing access to loan capital and manage the various credit guarantee schemes initiated by government, donors and the other development partners. The apex can also serve as an independent institution to build the capacity of stakeholders at, macro and micro levels. Eligibility to access loan capital, credit guarantee fund, and capacity building support from the apex institution will require adherence to the minimum agreed performance criteria, reporting, and achievement of an acceptable rating. The criteria set by the apex should be based on international best practices. This will assist in building confidence and increase the amount of government and donor funds channeled through the apex. However, implementing the standardized criteria and verifying the reports will require a data base and regular performance reporting system (industry performance and benchmarks). Establishing the apex institution will require a comprehensive study which reviews best practices, proposing the right type of governance, institutional setup and systems and the entire transformation process. Although this is medium to long-term intervention, there is a need to form one efficient national-level credit guarantee scheme by merging the different schemes and initiatives in the short-run.

(vii) Establishing a new apex of financial cooperatives or Lesotho Credit Cooperative Unions

Although the Lesotho Credit Cooperative Union LTD (LCCUL) has been there for a long-period of time, it has been non-functional in the last decade. All attempts in the past to revitalize the LCCUL have failed repeatedly. The Cooperative Department has a position of entirely dismantling the existing LCCUL and establish a new apex of financial cooperatives, which shall facilitate the operations of primary and secondary societies. The new apex of financial cooperative is expected to play a key role in providing technical assistance, training, central finance facility (provide credit, deposit and investment services to members), enforce self-regulation, and promote financial education.

(viii) Assist other support service providers

The government, donors and other development partners should assist in building the capacity and the market for technical service providers, who will offer specialized services in the field of training, consultancy, accountancy, auditing, management information system and Business Development Services (BDS). Although inclusive finance providers are expected to specialize in the delivery of sustainable financial services, there is a need to coordinate and integrate their activities with BDS providers. The strategy should emphasis on building the capacity of non-financial service providers.

10.3 The micro/institution level

The support to inclusive finance providers, delivering quality financial services to Basothos in rural and urban areas, is the core strategic intervention of the national strategy. The specific support and interventions in the next five years include:

(i) Building the financial, managerial and institutional capacity to increase the outreach of inclusive finance providers

Building the financial, managerial and institutional capacity of inclusive finance providers is an important intervention of the national strategy. These include: the provision of training and education to staff (including the board of directors) of inclusive finance providers; developing systems and procedures and effective governance; enhancing mobility; improving the management information system (MIS); supporting acquisition of appropriate equipment, etc. However, the capacity building support at micro level should be institution specific. The institutional and managerial capacity building support to government owned finance providers should focus on the transformation processes which make them autonomous and financially sustainable. Since there are no deposit-taking MFIs, large financial cooperatives and credit-only MFIs in the country, the only option is to create them from within Lesotho or attract commercial investors from outside. There is also a need to build the capacity of the existing NGO-MFIs, Saving and Credit Cooperatives and moneylenders to be transformed into deposit-taking MFIs, large financial cooperatives and credit-only MFIs respectively. Moreover, tailored support should be given to inclusive finance providers reaching more excluded and inaccessible areas. In the short-run, NGO MFIs such as Moliko Finance Trust (MFT) have limited loan capital to meet the huge demand for loans. There is a need to provide capacity building support by government, donors and other development partners to MFT until it is transformed into deposit-taking MFI.

(ii) Developing new products and improving the existing financial services

Developing quality financial products that respond to needs of the excluded population by giving due focus to loan, savings, insurance and payment systems and remittance products are key in the capacity building interventions packages. Inclusive finance providers should use innovative approaches such as the value chain financing and warehouse receipt systems to provide financial services to MSME operators and smallholder farmers, particularly for those engaged in productive activities. The interventions on product development should focus on four categories of financial products:

(a) **Loan products**: these products include financial services for diverse activities in both rural and urban areas. The loan products will address the working and investment capital needs of the excluded population, mainly MSME operators, smallholder farmers, youth, women and disadvantaged groups such as those living with HIV/AIDs. The market for loans includes agricultural and microenterprise activities focusing on productive activities, housing loans, consumption loans, etc.

(b) **Saving products**: these products help in developing the saving culture of the excluded population and allow inclusive finance providers to generate internal resources for on-lending and be involved in real financial intermediation. The saving products of inclusive finance providers should be accessible to the excluded population in terms of proximity, be attractive in terms of prices, safe and secure, simple in features and convenient (good customer service).

(c) **Micro-insurance**: the poor or excluded are able to utilize the financial services, such as loans, when basic household risks are mitigated. In Lesotho, where more than 75% live on agriculture, production and market risks are very high. There is a need to develop appropriate micro-insurance products such as crop insurance, livestock insurance, deposit insurance, credit life insurance, asset insurance, etc, to protect both the clients and the inclusive finance providers. A lot of civic education will be necessary to motivate the excluded population to purchase insurance products. Moreover, there is a need to provide support to develop and pilot the micro-insurance products in collaboration with the insurance companies.

(d) **Payment systems and remittances**: The aim of this product is to reduce the physical handling and labor costs associated with an ever expanding volume of paper money, cheques, deposit slips, and the like, as well as to provide increased convenience and service to the public. Some of the more advanced payments mechanisms have been due to technological advances including ATM machines, cash cards, debit cards, point-of sale terminals, mobile phones and home banking over the internet. The other technology-related innovations include direct deposit and direct bill payment schemes. There is a need to support the improvement of the payment systems which directly benefits the excluded population.

(iii) Optimal use of back-office and front-office technology platforms

The use of ICT reduces the cost of delivering financial services to clients and brings banking and microfinance services to new clients and remote districts which were previously beyond the practical reach of traditional microfinance channels. Lesotho's two telecom service providers have shown some interest to experiment the technology-based delivery of financial products or approaches. The national strategy should support the following interventions which encourage the inclusive finance providers to promote back-office and front-office technology in expanding their activities:

(a) Developing the infrastructure to take advantage of technological advances

(b) Implementing efficient organization of the payment systems through inter-technology interoperability

(c) Promoting branchless banking (delivering financial services by mobile phones and point-of-sales terminals) to substantially reduce transportation and transaction costs

(d) Promoting affordable card-based payment instruments (smart, debt and credit cards)

(e) Developing the right regulatory framework to promote technology-based financial products

(iv) Promote competition in the sector

There are no microfinance institutions in Lesotho which will make it difficult to talk about competition among inclusive finance providers in the market. As a national strategy, there is a need to attract and increase the number of inclusive finance providers by providing incentives and building their financial and managerial capacity.

(v) Incentivizing the Sector

There is a need to provide incentives to those inclusive finance providers involved in piloting new innovations. One of the interventions is the creation of an innovation fund for inclusive finance providers committed to promote new products, systems and approaches which are aimed at including the excluded. Institutions and individuals at various levels should access this fund on a competitive basis.

10.4 Client level

Besides financial access, there are a number of non-financial support services required by the excluded population, which strengthen financial knowledge, technical skills, business and financial skills, client protection, etc. The key interventions at client level include:

(i) Financial education/literacy

The intervention would involve a series of capacity building activities focused at increasing the poor's knowledge of financial concepts, skills and attitudes and to translate this knowledge into behaviors that results in good financial outcomes both for the finance providers and users of inclusive financial services. Financial literacy has a primary objective of providing knowledge and skills to manage financial resources effectively. There is a dire need to educate Basothos on how to develop a saving culture, manage finances (savings and loans), manage cash flow, manage relations with lenders etc by involving regulators (CBL), the Cooperative Department of the Ministry of Trade and Industry, Cooperatives and Marketing, the microfinance forum, the finance providers themselves, Ministry of Education, the media, etc. The financial education intervention would also involve in developing communication and advocacy strategies to disseminate information about the financial policies of government and availability financial products by diverse inclusive finance providers.

(ii) Client protection

Client protection should be a mandatory activity for all stakeholders. It is a very useful instrument to promote greater transparency, information and appropriate use of financial services. The inclusive finance providers should adhere to avoidance of over-indebtedness of clients by taking multiple loans from multiple sources, transparent pricing, appropriate collection practices, ethical staff behavior, mechanisms to redress client grievances, and privacy of client information. The intervention to protect clients should be implemented in a coordinated manner, by involving all key stakeholders.

(iii) Integration the national strategy with other programs, strategies and policies

The provision of technical training and Business Development Services through complementary programs is a critical intervention in building the capacity of the excluded population. Although inclusive finance providers are expected to specialize in delivering financial services to the financially excluded population, there is a need to align and integrate their activities with other development strategies/programs focusing on building the capacity of Basothos.

11. Role of government

The Government of Lesotho is an enabler and facilitator that put in place the right environment and incentives for inclusive finance. It should primarily focus on creating conducive macroeconomic environment; favorable legal and regulatory framework; and improve the infrastructure to support the operations of inclusive finance providers. The government has to support the development of sustainable inclusive finance providers, meso-level players and clients. The Ministry of Finance and Development Planning should be the leading institution to monitor the implementation of the national strategy. The existing microfinance unit, under the Ministry, needs to be capacitated in order to oversee and support the development of inclusive finance in the country. There is need to transform the government owned finance providers (companies and parastatals) into financially sustainable institutions. The government is expected to provide capacity building support instead of "subsidizing" interest rates which distort financial markets. It can also provide incentives to those inclusive finance providers serving the excluded population, particularly in remote areas. This could stimulate the emergence of new finance providers in excluded or remote districts.

12. The role of donors

Donors have an essential role to play in the development of inclusive finance in Lesotho. However, this role needs to adapt itself to the evolution of the sector and to the implementation of the National Strategy for Inclusive Finance in Lesotho. Donors are expected to have common principles, coordinated activities (preferably cooperate on joint funding), and to have clear exit and backup strategies. They need to focus on building the capacity of the stakeholders at macro, meso, micro, and client levels; promoting best practices, and facilitating networking with the rest of the world. Building the internal capacity of donors to support inclusive finance is also a critical intervention. Donors should shift from the support of microfinance through credit components and targeted lending (piece by piece funding) towards a coordinated approach of building the inclusive financial system in the entire country, with a focus on improving financial access to the excluded population.

13. Implementation arrangements, monitoring and mitigation of apparent risks

13.1 Implementing and monitoring the national strategy

The implementation and monitoring of the national strategy for inclusive finance in Lesotho depends on the commitment and capacity of all stakeholders, particularly the government. Regular interactions and exchange of information among stakeholders is essential for proper implementation of the action plan. The entire stakeholders, particularly the core team/steering committee/task force, should take the lead in monitoring, and evaluating progress and measuring the impact of the national strategy. However, it will be the responsibility of the Ministry of Finance and Development Planning to oversee and monitor the implementation of the strategy.

13.2 Apparent risks in implementing the national strategy

The stakeholders in the inclusive financial system should manage potential risks and make sure that risks are identified and measures are taken to minimize their negative impact. The major risk areas that affect the development of inclusive finance in Lesotho in the next five years include:

Macroeconomic instability: An unstable macroeconomic environment such as very high inflation and low input prices can adversely affect the development of inclusive finance in Lesotho.

Inappropriate microfinance methodologies: Failure to adopt sound best practice and methodologies can affect institutional sustainability and outreach of inclusive finance providers.

Unnecessary government and donor interventions: A huge injection of subsidized microcredit in the inclusive finance sector may contaminate the financial markets. Moreover, if government uses microfinance to buy votes, this will affect performance and outreach. Although government and donor support is required, inclusive finance providers should be independent in governance and in managing their operations.

Production and price risk: Since a significant part of the loan portfolio of Lesotho's inclusive finance providers is lent for rural enterprises, there is a high risk for a covariant risk caused by recurrent drought. Moreover, the fluctuation of agricultural output and input prices may affects repayment rates and the sustainability of inclusive finance providers

HIV/AIDs: If the magnitude of the disease is not decreasing from time to time, it could quickly reverse most of the gains made by finance providers and affect the performance of the entire inclusive finance sector.

14. Action plan to implement the national strategy

The national strategy, which is the basis for sound growth of inclusive finance in Lesotho, is accompanied by an action plan that specifies the responsibilities assigned to relevant stakeholders (CBL, Ministry of Finance and Development Planning, donors, finance providers, technical service providers, etc) with timeframe for each activity identified in the strategy.

Table 1: Proposed macro level action plan

Objective	Action/activity	Responsible entities		Priority*	Timeframe**
		Primary	Secondary		
Coordination of implementation of the national strategy	(i)Official endorsement of the national strategy and action plan	MoFDP	CBL	H	S
	(ii)Strengthening a unit under the Ministry of Finance to oversee implementation of the national strategy	MoFDP	CBL	H	S
	(iii)Discuss the strategy in various forums, including public awareness campaigns	SUFIL, MFF	RUFIP	H	S
	(iv)Monitor the implementation of the national strategy	MoFDP, CBL, MFF,	SUFIL, RUFIP	H	S,M and L
Create the necessary policies and legal framework	(i)Enact the bills in the pipeline	Parliament	CBL, MoFDP	H	S
	(ii)Review the draft bills	MoFDP, CBL, finance providers		L	L
	(iii) Align the national strategy with other policies/strategies	MoFDP, CBL	MoTICM, Others	H	S,M and L
Establishing a functional regulatory body	(i)Develop the regulatory and supervision framework for various inclusive finance providers	CBL		H	S
	(ii)Build the capacity of the supervision unit or department	CBL		H	S, M
Building infrastructure	(i)Build infrastructure, including the introduction of national I.D and improving the security	Millennium Challenge Account	Other government institutions	M	S,M and L

Note: *H=High; M=Medium; and S= Small

**S= Short-term; M=Medium-term; and L=Long-term

Table 2: Proposed meso level action plan

Objective	Action/activity	Responsible entities		Priority*	Timeframe**
		Primary	Secondary		
Establishing the Lesotho Association of Inclusive Finance Providers (LAIFP)	(i) Develop the business plan of the LAIFP	SUFIL/MFF	RUFIP	H	S
	(ii) Allocate an initial fund to hire a coordinator, overhead cost, and other program costs	SUFIL	RUFIP	H	S
	(iii)Hire a competent and committed coordinator on a competitive basis	SUFIL		H	S
	(iv)Organize regular technical national and regional workshops	LAIFP		H	S,M,L
	(ii)Promote data sharing among inclusive finance providers	LAIFP		H	S,M,L
	(iii)Advocate inclusive finance countrywide	LAIFP	SUFIL/RUFIP	H	S,M,L
	(iv)Organize experience sharing visits for all relevant staff of inclusive finance providers	LAIFP. Donors. Government		H	S,M
	(v)Establish agreed performance indicators and monitor the financial performance of the inclusive finance providers	LAIFP, Members		H	S,M,L
	(vi)Promote the services of the inclusive finance sector by using media and others	LAIFP		M	S,M
	(vii)Provide technical assistance and other support	LAIFP, Donors		H	S,M,L
	(viii)Networking with regional and global networks	LAIFP		H	S
	(ix)Cover the initial establishment and overhead costs	Members, LAIFP		M	S
	(x)Enhance the mobility of the network staff	LAIFP, Donors		M	M,L
	(xi)Logistical support	Donors		M	S
				M	S,M

Support the Lesotho college of cooperatives	(i)Conduct a study to assess the capacity building needs of the college in providing training to financial cooperatives (ii)Submit the proposed interventions to government and donors (iii)Provide the support	MTICM, RUFIP MTICM MTICM/donors	SUFIL	H H H	S,M S,M S,M
Establish a Credit Reference Bureau (CRB)	(i)Conduct the feasibility study to establish the Bureau (ii)Establishing the data base and update regularly (iii)Cover the initial establishment and overhead costs	CBL/Banks CRB CBL/Banks		H H H	S S,M S
Promote linkages between commercial banks and MFIs	(i)Build bankers' awareness on commercial viability of inclusive finance providers (ii)Introduce rating of inclusive finance providers to build the confidence of banks (iii)Initiate credit guarantee schemes	Banker's association, LAIFP Members MoFDP, Banks		M M M	S,M S,M S,M
Establish Lesotho Inclusive Finance Training and Research Institute (LIFTRI)	(i)Conduct a training needs assessment study (ii)Provide appropriate technical and skill training (iii)Conduct coordinate research activities (iv)Publish and disseminate the results of the researches (v)Cover the initial establishment and overhead costs	SUFIL LIFRI LIFRI LIFRI LIFRI	RUFIP/ Donors	H M M M H	S S,M and L S,M and L S,M and L S
Establish an autonomous apex to provide loans and capacity building	(i)Conduct a feasibility study to establish the apex (ii)Establish functional an autonomous apex (iii)Assess the performance of	RUFIP/SUFIL CBL/MoFDP The apex	CBL/MoFDP	H H H	S S S

	inclusive finance providers (iv)Establish clear criteria in accessing funds (iv)Deliver the loans and capacity building to the stakeholders	The apex		H H	S S,M and L
Establishing a new apex or Lesotho Credit Cooperative union	(i)Conduct a background study and develop the business plan (ii)Conduct a workshop to discuss the study and the business plan (iii)Call a general assembly to ratify the MOU and by-laws, elect the board members (iv)Recruit the CEO and the core staff (v)Provide fee based value adding services to members	MTICM, RUFIP MTICM, RUFIP MTICM The apex	SUFIL SUFIL	H H H H	S S S S S,M, and L
Assist other technical service providers	(i)Provide capacity building to auditors, accounting firms, etc (ii)Support Business Service providers (BDS)	SUFIL/MoFDP SUFIL/MoFDP	 RUFIP	H H	S S,M and L

Note: *H=High; M=Medium; and S= Small

**S= Short-term; M=Medium-term; and L=Long-term

Table 3: Proposed micro or institutional action plan

Objective	Action/activity	Responsible entities		Priority*	Timeframe**
		Primary	Secondary		
Institutional and managerial capacity building	(i)Conduct the training needs assessment (ii)Training and re-training all staff of finance providers (iii)Conduct exposure visits to learn from best practices (iv)Develop systems and procedures based on best practices (v)Develop Management Information System (MIS) (vI)Enhance the mobility of microfinance providers (vii)Transform successful credit only MFIs into deposit taking MFIs (viii)Mobilizing and sensitizing communities	SUFIL/RUFIP Finance providers SUFIL/RUFIP Finance providers Technical service provider MoFDP/donors Finance providers	MoFDP/CBL MoFDP/CBL CBL	H H H H H H H H	S S,M and L S S,M S,M S,M S,M and L S,M and L
Building the financial capacity of inclusive finance providers	(i)Develop saving products and mobilize savings for on-lending (ii)Develop credit guarantee scheme and link with banks (iii)Attract social investors and others as equity investors	Finance providers MoFDP Finance providers	SUFIL CBL/RUFIP	H H H	S,M S,M S,M and L
Product development	(i)Conduct a study to identify the strength, weaknesses of the existing financial products (ii)Provide training in market research and product development by involving MicroSave in Kenya	Finance providers Technical service providers		H H	S S

	(iii)Establish an innovative fund to encourage new products that meet the needs the excluded	MoFDP	Donors	M	S,M
	(iv)Pilot new and innovative financial products	Finance providers		H	S,M
	(v)Refine existing products and scale up the successful pilots	Finance providers		H	S,M
Promote I.T based products	(i)Develop a roster of best practices in front office and back office technology platform	Finance providers	Donors	H	S
	(ii)Allocate funding to inclusive finance provider for identifying and securing cost effective IT	Finance providers	Donors	M	S,M
Promote competition in the sector	(i)Build the capacity of inclusive finance providers	RUFIP/SUFIL/	Donors	H	S,M and L
	(ii)Provide incentives to encourage new entry	MoFDP		H	S,M and L
	(iii)Use the market approach to increase competition	Finance providers		H	S,M and L

Note: *H=High; M=Medium; and S= Small

**S= Short-term; M=Medium-term; and L=Long-term

Table 4: Client level action plan

Objective	Action/activity	Responsible entities		Priority*	Timeframe*
		Primary	Secondary		
Financial literacy	(i)Baseline study on financial literacy	SUFIL	RUFIP	H	S
	(ii)Develop the strategy for financial literacy	SUFIL/MFF		H	S
	(iii)Establish a national financial literacy network	SUFIL/CBL		H	S
	(iv) Develop the tools and the training manual	SUFIL		H	S
	(v)Provide training	Service Providers		H	S,M
	(vi) Deliver the financial education	Service providers		H	S,M and L
Client protection	(i)Baseline study on consumer protection	SUFIL		H	S
	(ii)Develop and enact consumer bill of rights	SUFIL/CBL	MoFDP	M	M
	(iii)Establish a national consumer protection network	SUFIL/CBL		H	S
	(iv)Develop the tools and training manuals	Service providers		H	S
	(v)Provide the training	Service providers		H	S,M
	(vi)Conduct public sensitization campaign				

				H	S,M and L
Integration and alignment with other programs	(i)Develop systems of alignment and integration (ii)Regular meetings among finance providers and relevant development partners	MoFDP MoFDP/SUFIL	CBL/other Ministries RUFI	H H	S S,M and L

Note: *H=High; M=Medium; and S= Small

**S= Short-term; M=Medium-term; and L=Long-term

Annex 1: CGAP KEY PRINCIPLES OF MICROFINANCE

The Consultative Group to Assist the Poor

Key Principles of Microfinance

CGAP is a consortium of 28 public and private development agencies working together to expand access to financial services for the poor, referred to as microfinance. These principles were developed and endorsed by CGAP and its 28 member donors, and further endorsed by the Group of Eight leaders at the G8 Summit on 10 June 2004.

1. **Poor people need a variety of financial services, not just loans**. Like everyone else, the poor need arrange of financial services that are convenient, flexible and affordable. Depending on circumstances, they want not only loans, but also savings, insurance, and cash transfer services.
2. **Microfinance is a powerful tool to fight poverty**. When poor people have access to financial services, they can earn more, build their assets, and cushion themselves against external shocks. Poor households use microfinance to move from every day survival to planning for the future: they invest in better nutrition, housing, health, and education.
3. **Microfinance means building financial systems that serve the poor.** In most developing countries poor people are the majority of the population, yet they are the least likely to be served by banks. Microfinance is often seen as a marginal sector a "development" activity that donors, governments, or social investors might care about, but not as part of the country's mainstream financial system. However, microfinance will reach the maximum number of poor clients only when it is integrated in to the financial sector.
4. **Microfinance can play for itself, and must do so if it is to reach very large number of poor people**. Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs. Cost recovery is not an end in itself. Rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. A financially sustainable institution can continue and expand its services over the long term. Achieving, sustainability means lowering transaction costs, offering services that are more useful to the clients, and finding new ways to reach more of the unbanked poor.
5. **Microfinance is about building permanent local financial institutions**. Finance for the poor requires sound domestic financial institutions that provide services on a permanent basis. These institutions need to attract domestic savings, recycle those savings into loans and provide other services. As local institutions and capital markets mature, there will be less dependence on funding from donors and governments, including government development banks.
6. **Microcredit is not always the answer. Microcredit is not the best tool for everyone or every situation**. Destitute and hungry people with no income or means of repayment need other kinds of support before they can make good use of loans. In many cases, other tools will alleviate poverty better, for instance, small grants, employment and training programs, or infrastructure improvements. Where possible, such services should be coupled with building savings.
7. **Interest rate ceilings hurt poor people by making it harder for them to get credit.** It costs much more to make many small loans than a few large loans. Unless micro lenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs. Their growth will be limited by the scarce and uncertain supply of soft money from donors or

governments. When governments regulate interest rates, they usually set them at levels so low that microcredit cannot cover its costs, so such regulation should be avoided. At the same time, a micro lender should not use high interest rates to make borrowers cover the cost of its own inefficiency.

8. **The role of government is to enable financial services, not to provide them directly**. National governments should set policies that stimulate financial services for poor people at the same time as protecting deposits. Government need to maintain macroeconomic stability, avoid interest rate caps and refrain from distorting markets with subsidized high-default loan programs that cannot be sustained. They should also clamp down on corruption and improve the environment for micro-businesses, including access to markets and infrastructure. In special cases where other funds are unavailable, government funding may be warranted for sound and independent microfinance institutions.
9. **Donor funds should complement private capital, not compete with it.** Donors provide grants, loans and equity for microfinance. Such support should be temporary. It should be used to build the capacity of microfinance providers to develop supporting infrastructure like rating agencies, credit bureaus, and audit capacity and to support experimentation. In some cases, serving sparse or difficult- to-reach populations can require longer term donor support. Donors should try to integrate microfinance with the rest of the financial system. They should use experts with a track record of success when designing and implementing projects. They should set clear performance targets that must be met before funding is continued. Every project should have a realistic plan for reaching a point where the donor’s support is no longer needed.
10. **The key bottleneck is the shortage of strong institutions and mangers.** Microfinance is a specialized field that combines banking with social goals. Skills and systems need to be built at all levels: managers and information systems of microfinance institutions, central banks that regulate microfinance, other government agencies, and donors. Public and private investments in microfinance should focus on building this capacity, not just moving money.
11. **Microfinance works best when it measures and discloses its performance.** Accurate, standardize performance information is imperative, both financial information (e.g. interest rates, loan payment, and cost recovery) and social information (e.g. number of clients reached and their poverty level). Donors, investors, banking supervisors, and customers need this information to judge their cost, risk, and return.