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Drivers, inhibitors and the future of co-operative financial institutions: A Delphi study on South African perspective

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ABSTRACT

This study investigates the performance drivers and inhibitors in South Africa's Co-operative Financial Institutions (CFIs) by employing a hybrid Delphi-SWOT study. Issues generated by 36 experts over four rounds of questionnaires, suggest that the sector is suffering more from internal than external inhibitors. From the 22 future developments identified by these experts, six growth strategies within the control or influence of management were drawn in the areas of technology, people, marketing, culture shift, environmental and policy interventions. The study presents a CFI performance ecosystem based on identifying key drivers, inhibitors and strategies to achieve high-performance growth.

1. Introduction

Financial markets failure is one of the challenges facing many economies as large banks tend to engage in credit rationing of small to medium enterprises (SMEs) and marginal communities citing information asymmetry and transaction cost challenges. The situation has worsened in the past two decades due to mergers and acquisitions which reduced the number of banks (Berger et al., 2001; Leyshon and Thrift, 1993). Ryan et al. (2014) found that increased bank market power results in increased financing constraints for SMEs across 20 European countries. Similarly, in Spain Carbó-Valverde et al. (2016) found that credit-constrained SMEs depend on trade credit, but not bank loans, and that the intensity of this dependence increased during the financial crisis. In a recent banking market structure study in Poland, Hasan et al. (2017) found that cooperative banks facilitate access to bank financing, lower financial costs, boost investments, and favour growth for SMEs. They found that regions where cooperative banks hold a strong position are characterized by the rapid pace of new firm creation, whilst the opposite effects appear in the majority of cases for local banking markets dominated by foreign-owned banks. Unlike traditional banking institutions, Co-operative Financial Institutions (CFIs) are member-focused deposit taking and loan granting institutions, and

are efficient in generating borrower-specific information, which can address 'informational' distance. The role of CFIs in the provision of ethical and social finance is a loud call for research to understand their qualitative performance drivers and inhibitors by engaging co-operative finance experts to enhance their performance.

Recently, a number of studies have started looking at how CFIs, which are a grassroot innovation, have performed during and after the global financial crisis compared to investor-owned banks (Becchetti et al., 2016; Birchall, 2009; Birchall, 2013; Kuc and Teply, 2015). Globally, Crear (2009) observed that not a single financial co-operative has received government recapitalization following the recent global financial crisis. Statistics from the World Council of Credit Unions, a global trade association for credit unions and financial co-operatives, shows CFIs' total assets reached \$1,8 trillion and serving 236 million members in 2016, up from \$1,2 trillion and 177 million respectively in 2007 (WOCCU, 2016). The one member one vote system ensures CFIs serve common needs rather than the needs of a handful of individuals as in the case with traditional banks (Davis, 2001; Jones and Kalmi, 2015; McKillop and Wilson, 2015). However, effective governance depends more on the willingness of members to exercise their ownership rights to express their views to the board of directors and to hold them accountable for value creation. CFI performance should be targeted

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towards value maximization (Keating and Keating, 1975), cost minimization, service maximization – whether for savers or borrowers (Keating and Keating, 1975; McGregor, 2005), and profit maximization for sustainability (Davis, 2001; Goddard et al., 2014; Keating and Keating, 1975).

The CFI penetration rate in South Africa is the lowest in the world at 0.06% compared to Kenya (13.3%), Rwanda (13.8%), Togo (26.7%), Australia (17.6%), Canada (46.7%), United States (52.6%), Ireland (74.5%) and the worldwide average of 13.5% (WOCCU, 2016). Over recent years, there has been a decrease of South Africa's CFIs and membership from 121 and 59,394 in 2011 to 30 and 29,818 respectively in 2017 (CBDA, 2017). The decrease can be partly explained by the CBDA's prescribed minimum membership and share capital contribution at 200 and R100,000 respectively. In 2007, South Africa passed the Co-operative Banks Act and formed the Co-operative Banks Development Agency (CBDA) in 2009 with a mandate to formally regulate, supervise and develop the sector. The implementation of the regulation could have been harsh to small but growing CFIs, forcing them out of the regulatory environment.

The study employed the ranking-type Delphi technique to gather expert opinions from those working in or with financial co-operatives. The major objectives of the study were, first, to properly understand the qualitative performance drivers and inhibitors of CFIs, and through a SWOT analysis to identify internal and external factors determining performance. Second, to forecast future developments that must happen in the co-operative finance industry to drive high-performance in the next 10 years and help craft growth strategies. We chose a forecasting period of 10 years because multiple organizations align their goals closer to the South Africa's "National Development Plan 2030", a socio-economic policy, and the United Nations' Sustainable Development Goals 2030. These ambitious plans target to end poverty and reduce inequality by 2030 through inclusive growth, hence the need to bring our year 2027 forecast closer to the national and global visions. The need to build robust inclusive financial services is necessary, as access to finance (A2F) appears to be highly correlated with poverty reduction (Beck and Demirgüç-Kunt, 2008). The contribution of CFIs towards members' financial well-being cannot be overlooked, hence the need to understand their performance drivers. A contribution to a better understanding through rigorous research is of value not only to researchers, CFI practitioners and members, but also to policymakers and regulators.

To our knowledge, there are no studies that have examined the drivers and inhibitors to CFI performance or tried to develop alternative futures using hybrid Delphi-SWOT analysis. The Delphi method is suitable for exploratory research, theory building and forecasting involving complex and multi-disciplinary issues. The only previous attempt was by Marwa and Aziakpono (2015) who used a case study mixed approach to understand what drives the performance of savings and credit co-operatives (SACCOs) in Tanzania. Most studies using Delphi focus on energy, automotive, information technology, agriculture, health, manufacturing and big data analytics (see Campos-Climent and Apetrei, 2012; Förster, 2015; Obrecht and Denac, 2016; Tavana et al., 2012; Vidgen et al., 2017; Worrell et al., 2013).

The current study is structured as follows. Section 2 provides an overview of financial inclusion in South Africa, whilst Section 3 critique the literature on CFI performance drivers and inhibitors. Section 4 provides the data analysis on the convergence of consensus, followed by findings based on the final rankings by experts in Section 5. Finally, we conclude with managerial implications of the findings and recommendations for future research.

2. Financial inclusion in South Africa and the role of CFIs

In South Africa nearly 8.5 million adults are excluded from the formal financial system (FinMark Trust, 2016). In total, 77% of all adults have a bank account. However, if the social grant beneficiaries

(nearly 5.1 million) are excluded, only 58% are banked. About 51% of adults are borrowing from various sources to supplement their limited resources, 46% from non-bank financial institutions (NBFIs), whilst only 14% are borrowing from banking institutions. On the 'quality' aspect, the narrative for developmental credit is becoming the norm as only 5% are using credit for developmental reasons. In 2016, 33% of adults were saving, with 15% saving through banks, 14% saving with NBFIs, 8% with informal institutions and 11% saving at home. Previous attempts to increase financial inclusion through the Mzansi account (an entry-level national bank account targeting the mass population in 2004) failed, due to lack of quality of access to finance. Kostov et al. (2015) confirmed that Mzansi accounts are perceived as not meeting the aspirations of those aiming to climb up the financial services ladder, making CFIs a suitable alternative.

CFIs helps to bridge the financial exclusion gap by pooling members' financial resources together for on-lending to the same members (Frame et al., 2002; McKillop and Wilson, 2015; Périlleux and Szafarz, 2015). As member-driven organizations operating within a common bond, they are better placed to reduce informational opacity and high transaction costs which usually result in credit rationing in credit markets (Stiglitz and Weiss, 1981). This enables members to break the poverty trap caused by lack of economic opportunities and low productivity due to lack of access to financial services. Since CFIs are owned and operated by members, they have an objective of maximizing services provided to members. This immediately suggests that profit maximization is not an ultimate objective, since there are no non-member suppliers or customers to exploit (Fried et al., 1993).

3. Literature review: CFI performance drivers and inhibitors

There are seven streams of empirical papers dealing with the performance dynamics of CFIs: industry professionalization (governance), policies, technology diffusion, social capital, outreach, economic trends and sector perception. Several studies reveal that co-operatives established with the social purpose of serving poor communities have the real possibility of becoming sustainable and effective, *if and only if* they adopt a radical commercial approach to organizational development. Professionally managed CFIs are found to be attractive to middle-income earners (Crear, 2009; Goddard et al., 2009; Jones, 2008; Jones and Kalmi, 2015; McKillop and Wilson, 2015). Campos-Climent and Apetrei (2012) find human capital related factors as top priorities in overcoming challenges in Mediterranean co-operatives. McKillop and Wilson (2003) argued that if CFIs were to achieve social goals, they first had to achieve their economic ones. McKillop et al. (2007) found CFIs that concentrate solely on serving the needs of the financially excluded to be inherently weak and not sustainable in the long term. CFIs were advised to formulate policies and outreach strategies to draw members from a cross-section of the population to achieve a balanced mix of funding and membership (Jones and Kalmi, 2015; McKee and Kagan, 2016).

CFIs are driven by the social trust among people sharing a common bond much needed in building social capital and community relations. Putnam (1993) and Knack and Keefer (1997) posit that social capital supports growth and development through a number of channels, such as the reduction in uncertainty, transaction costs and contracts enforcement, thereby enhancing efficiency. A survey by Sabatini et al. (2014) in Italy found that unlike any other type of enterprise, co-operatives have a particular ability to foster the development of social trust. In a similar study using a 2003–2011 dataset to understand the relationship between the market share of Italian credit cooperative banks and some measures of trust, Catturani et al. (2016) found that cooperatives require high levels of social capital to be successful. Trust is one of the pillars of well-functioning markets as the more the trust, the less the transaction costs.

In addition, CFIs need to appeal to a broader spectrum of people to correct the perception that they are just the poor people's banks rather

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