Public Disclosure Authorized

FINANCIAL INCLUSION IN NAMIBIA: SUMMARY NOTE

OCTOBER 2016

Acronyms

ATM	Automated Teller Machine
CPSS	Committee on Payment and Settlement Systems
DBN	Development Bank of Namibia
ES	Enterprise Survey
FAS	Financial Access Survey
FLI	Financial Literacy Initiative
ICR ROSC	Insolvency and Creditor/Debtor Regimes Report on Observance of Standards & Codes
MFI	Microfinance Institution
MSME	Micro, Small, and Medium Enterprise
NBFI	Non-Bank Financial Institution
NEEC	Namibia First National Enterprise/Establishment Census
NPL	Non Performing Loans
RSP	Remittance Service Providers
SOEs	State-Owned Enterprises
TA	Technical Assistance
WBES	World Bank Enterprise Survey

Executive Summary

This note summarizes recent World Bank work on financial inclusion in Namibia. This includes: (i) a stocktaking exercise on financial inclusion in Southern Africa carried out in 2015; (ii) the 2014 Namibia Insolvency and Creditor/Debtor Regimes Report on Observance of Standards & Codes (ICR ROSC); (iii) the 2014-2015 Namibia World Bank Enterprise Survey (WBES); and (iv) the 2014 Review of the Market for Remittances in Namibia on the Basis of the CPSS-World Bank General Principles for International Remittances Services. The goal is to provide a snapshot of financial inclusion (for individuals and enterprises) in Namibia as well as to identify main issues and related policy recommendations.

Namibia has the second largest financial system in Southern Africa (SA). The financial system is relatively well-developed compared to regional peers and is dominated by non-bank financial institutions (NBFIs). Pension funds and insurance companies are the largest component among NBFI. Reportedly, the banking sector is sound, profitable and adequately capitalized. The main four commercial banks hold more than 95 percent of assets and deposits with three of them being mainly South African owned.

Financial inclusion for individuals has increased remarkably in recent years and Namibia stands out for the high percentage of banked individuals. Importantly, the increase in the banked population has largely emerged from low-income earners who tend to live in rural areas. The Financial Literacy Initiative (FLI, et al 2013) found that 60 percent of Namibians had bank accounts, which is slightly higher than the level observed in South Africa and the East Asia and the Pacific (EAP) Region. Similarly, Global Findex 2014 finds a relatively high percentage of individuals with accounts at financial institutions (58 percent vs. 69 percent in South Africa and 51 percent in LAC).

Notwithstanding these notable improvements on financial inclusion at the household/individual level, some issues remain. Given the large size of the country and the small population size, there is low coverage of bank branches/ATMs in rural areas. Enhancing the use of more innovative delivery channels like mobile banking could enhance financial inclusion in rural areas. In addition, increased financial inclusion has been driven by transactional and savings products with relatively low usage of credit and insurance. Other reported issues are high prices of some financial products (e.g. insurance and micro-lending), limited availability of some financial data that restricts the ability of consumers to compare prices/costs, lack of consumer awareness of lower cost products (e.g. Basic Bank Account) and MFIs mainly targeting salaried individuals. The latter would be limiting MFIs potential contributions to enhance financial inclusion for microenterprises and lower income individuals.

At the enterprise level, access to finance is perceived as a key obstacle by businesses with no visible improvement in recent years. Firms (irrespective of size/age) rate cost and access to finance as the top 1 constraint for their growth. Informal firms and MSMEs have lower access to credit. In particular, access to working capital financing in Namibia is low compared with other countries. Lack of collateral is identified as a key obstacle to improve access to financing for MSMEs and informal enterprises. Other reported obstacles are the lack of credit history and financial statements, enterprises low level of skills/training/expertise (e.g. to prepare business plans), informality (lack of business registration), MFIs targeting salaried individuals mostly, and lack of financial products tailored for micro-enterprises.

Recommendations to Enhance Financial Inclusion

Financial sector interventions/efforts in Namibia should seek to enhance employment and reduce inequality. The country suffers from chronic high unemployment, HIV/AIDS, and a distribution of income that is among the World's most unequal—only a minority of the population lives in conditions expected in a middle income country. The unemployment rate (broad) is 27 percent and the labor force participation rate (60 percent) falls below the averages for Sub-Saharan Africa, middle-income countries and low-income countries. Economic growth has not generated jobs as the structure of economic production and trade is tied closely to metals, minerals, and other natural resources. Efforts to enhance financial inclusion should focus on increasing financial inclusion at the enterprise level (particularly MSMEs and informal enterprises) given links to growth/employment and relevant improvements at individual level.

Reform priorities to enhance financial inclusion at the enterprise level:
- Strengthen the collateral framework (e.g. registration of movable collateral) and credit information framework (e.g. to include positive and negative information). (See recommendations to strengthen ICR below).
- Promote expansion of MFIs into underserved segments (micro-enterprises and low income individuals), including through the regulation of deposit taking MFIs.
- Evaluate/prioritize government initiatives to support the SMEs considering international experience (including the additionality/sustainability of SME credit guarantee schemes and the need for national risk facility fund given private equity funds already present in a small market).
- Evaluate the need to: promote alternative financing products to bank financing (factoring/leasing) and enhance current support to business training.

Reform priorities to enhance financial inclusion at the individual level:
- Promote innovative delivery channels (focus on mobile banking given high access to mobile phones).
- Promote micro-insurance.
- Enhance financial consumer protection and literacy (including better disclosure).
- Enhance transparency and efficiency of remittance market (please see below).

Key recommendations to strengthen the ICR are (World Bank 2014a):
- *Creditor rights:* modernize the secured transactions regime.
- *Risk management and restructuring:* regulate the credit information system; incentivize restructuring, modify tax treatment; reform the scheme of arrangement.
- *Insolvency:* modernize the regime for insolvency, including reorganization and cross-border insolvency.
- *Institutions:* increase judicial capacity; enhance communication between authorities; introduce a regime for insolvency professionals.

Actions to enhance the efficiency and safety of remittances transactions to and from Namibia include (World Bank 2014b):
- Developing common standards of transparency applicable to all Remittance Service Providers (RSP) and ensuring that senders and receivers of remittances are informed of all the relevant elements of transactions.
- Clarifying the framework for the protection of consumers of remittance services and explicitly assigning institutional responsibility for protecting the rights of consumers of remittance services.
- Fostering the use of electronic channels for the collection and disbursement of remittances and ensuring the interoperability of payment instruments.
- Leveraging NamPost for the delivery of remittances.
- Consider relaxing currency exchange control requirements for low-value transactions.
- Review licensing procedures for RSPs and procedures for the authorization of new products, services, partnerships, agents and similar.
- Eliminate few remaining elements that seem to be preventing some players in the market from competing on a level playing field for the delivery of payment and remittance services
- Closely monitor (and consider banning) exclusivity agreement clauses by which international money transfer operators can prevent local RSP with whom they are partnering from offering other services along with those of the international MTO.

I. Introduction

This note summarizes recent World Bank work on financial inclusion in Namibia. This includes: (i) a stocktaking exercise on financial inclusion in Southern Africa carried out in 2015; (ii) the 2014 Namibia Insolvency and Creditor/Debtor Regimes Report on Observance of Standards & Codes (ICR ROSC); (iii) the 2014-2015 World Bank Enterprise Survey (WBES) in the country; and (iv) the 2014 Review of the Market for Remittances in Namibia on the Basis of the CPSS-World Bank General Principles for International Remittances Services. The goal is to provide a snapshot of financial inclusion (for individuals and enterprises) in Namibia as well as to identify main issues and related policy recommendations.

The stocktaking exercise on financial inclusion in southern African countries is part of programmatic technical assistance (TA). The TA follows a two-stage approach: a stocktaking exercise and follow up policy advice. The exercise leveraged on existing knowledge and data to provide a comprehensive cross-country view of the main financial inclusion issues in selected Southern African countries (Botswana, Lesotho, Namibia, South Africa and Swaziland). This added a crucial horizontal dimension that was missing in the individual country activities. The exercise included the analysis of existing financial inclusion data, such as Global Findex Database, WBES, FinScope Surveys and IMF's Financial Access Survey (FAS), to identify the main weaknesses on financial inclusion for individuals and enterprises in Southern African countries. This was complemented by the analysis of relevant analytical work as well as related country and sector strategies. Based on this analysis, the exercise provided an overview of financial inclusion in selected Southern African countries, identified the main financial inclusion weaknesses and knowledge gaps, and offered initial policy recommendations to be deepened in the second stage of the study. This Note presents a summary of the findings of the stocktaking exercise in Namibia.

The World Bank reviewed the legal and regulatory frameworks for creditor/debtor rights and corporate insolvency systems in Namibia pursuant to a joint IMF – World Bank initiative to develop Reports on Observance of Standards and Codes ("ROSC"). The review was based on the international standard, based on the World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems ("Principles"). The review covered four broad categories: legal framework for granting and enforcing security; credit risk management and the environment for corporate workouts and restructurings; legal framework for insolvency; and institutional and regulatory implementation framework. This note provides a summary of the main issues covered in the report related with access to finance.

The 2014 Namibia Enterprise Survey (ES) was conducted from April 2014 until February 2015, under the global ES methodology, with a sample of 580 firms. The survey covered the formally registered, non-agricultural private sector (with a minimum of 5 employees) and was designed to be nationally representative. This included firms in all manufacturing sectors, retail, wholesale, restaurants, hotels, construction, transport, and information technology.

The World Bank reviewed the remittances market in Namibia in February 2014. The review was conducted on the basis of the General Principles for International Remittance Services issued by the World Bank and the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements (BIS) on 2007. The related Report identifies actions to improve the safety and efficiency of remittances transactions to and from Namibia and deliver other benefits associated with the implementation of the General Principles. This note presents a summary of the issues and actions identified in the report.

II. Brief Overview of the Financial Sector in Namibia

Namibia has the second largest financial system in Southern Africa (SA). The financial system is relatively well-developed compared to regional peers (e.g. it is the only other country in SA, besides South Africa, to issue external sovereign bonds). Unlike most African countries, the financial sector in Namibia is dominated by NBFIs, with pension funds and insurance companies being the largest component.

The financial sector is comprised of 5 commercial banks, 1 microfinance bank, and 1 branchless Ebank. Reportedly, the banking sector is sound, profitable and adequately capitalized, with a low Non-Performing-Loan (NPL) ratio (of less than 1.5 percent). Out of the 5 commercial banks, 3 are primarily South African owned, 1 is private and domestically owned, and 1 SME bank is owned by the government. The 4 main commercial banks (3 South African and 1 Namibian) hold more than 95% of assets and deposits.

The financial system also includes 4 autonomous government owned entities designed to broaden access to specific financial products. Except PostBank, these institutions have had limited success, with economies-of-scale problems and relatively large NPLs. Despite taking deposits, these specialized financial institutions are exempt from BON supervision.

Non-bank financial institutions (NBFI) have grown substantially, representing about 140 percent of GDP (of which pensions and insurance comprise about 120 percent). There is a wide range and number of registered NBFI: NAMFISA regulates over 3800 registered entities, including the Namibia Stock Exchange, investment managers and investment companies, micro-lenders, insurers and pension funds. Informal financial institutions are rare. Namibia's Financial Sector Strategy (Government of Namibia 2011) highlights some of the limitations of NBFI in the country, including MFIs with high rates and targeting salaried individuals only, low levels of liquidity of the Namibia Stock Exchange and low access to short-term insurance services.

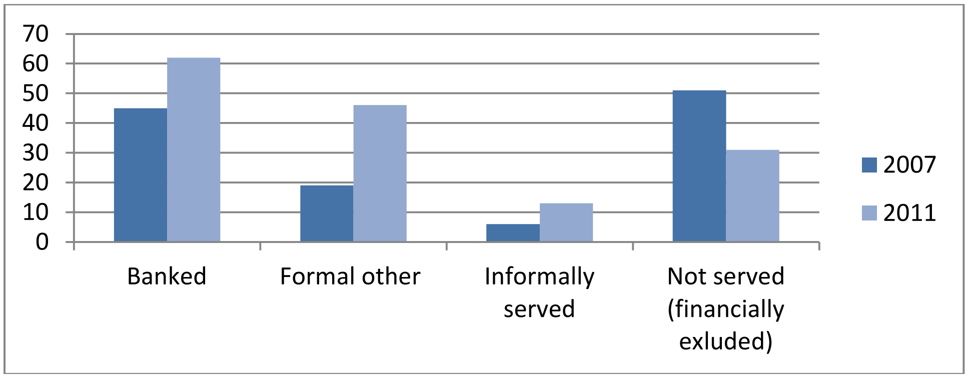
"Namibia Financial Sector Strategy 2011-2021: Towards Achieving Vision 2030" was developed by the Government to address the weaknesses of the financial sector. The overall goal of the Strategy is to promote a well-developed and diversified financial sector, characterized by efficiency, effectiveness and stability. The strategy seeks to reduce financial exclusion by focusing in two areas: (i) consumer financial literacy and protection and, (ii) access to financial services and products (with focus on SMEs).

The development of the SME sector is increasingly seen as an important catalyst and delivery vehicle to reach key development objectives in the country (such as economic growth, employment and inequality). This is reflected in Vision 2030 and a number of government initiatives to support SME development. The latter include allowing greater access to public tenders/contracts to Namibian-owned SMEs, the establishment of an SME bank (which experienced challenges and has not been subject to detailed analysis under this engagement) the promotion of private equity finance, and other initiatives by the Ministry of Trade and Industry (e.g. financing of business plans, business mentorship services and financial assistance). Recent government proposals under evaluation are the establishment of a national venture capital fund for SMEs and a partial guarantee facility to be managed by the Development Bank of Namibia (DBN). Additionally, there are efforts aimed at SME development that are spearheaded by private sector, Non-governmental organizations (NGOs) and private business representative entities.

III. Financial Inclusion for Individuals

Financial inclusion at the individual/household level has increased remarkably in Namibia (Figure 1). According to FinScope surveys, financial exclusion dropped from 51 percent in 2007 to 31 percent in 2011, with large increases on the percentages of individuals formally served by banks and NBFI. In 2011, 62 percent of individuals were banked, 3 percent were using formal non-bank financial products only and 4 percent were using informal products only.

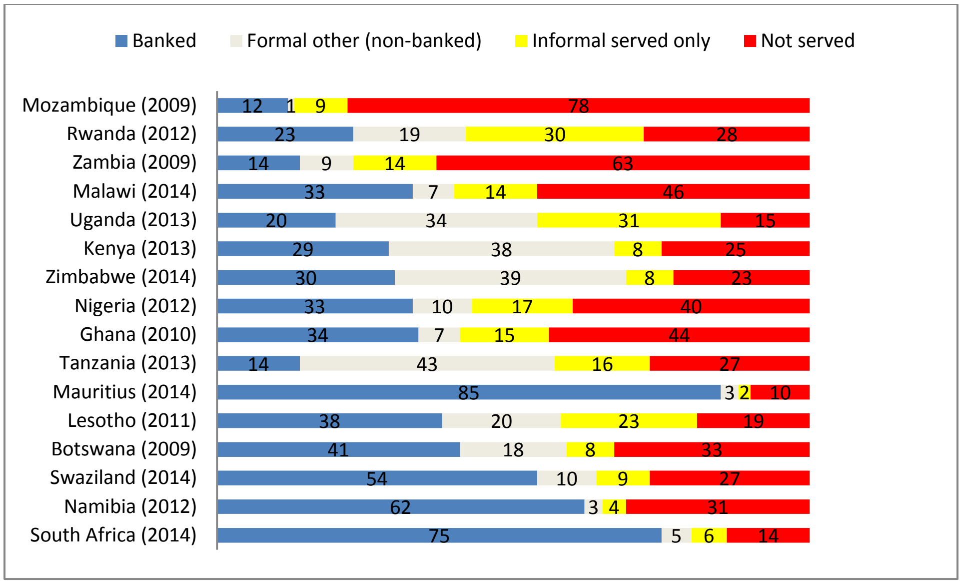
Figure 1: Financial inclusion/exclusion in 2007 and 2011 (percentage of adults)



Source: Namibia FinScope Consumer Survey

Namibia stands out for the high level of banked individuals in Africa (Figure 2). Namibia ranks third (after Mauritius and South Africa) among African countries with FinScope surveys in terms of the level of financial inclusion and banked individuals. In fact, the levels of financial inclusion and banked individuals are very similar in Namibia and South Africa. Importantly, the increase in the banked population during 2007-2011 has largely emerged from low income earners who tend to live in rural areas. The Financial Literacy Initiative (FLI, et al 2013) found that 60 percent of Namibians had bank accounts, which is slightly higher than the level observed in South Africa and EAP Region. Similarly, Global Findex 2014 finds a relatively high percentage of individuals with accounts at financial institutions (58 percent vs. 69 percent in South Africa and 51 percent in LAC). The percentage of lower income individuals with accounts at financial institutions was also relatively high (41 percent vs. 56 percent in South Africa and 41 percent in LAC). Survey respondents keep their bank accounts to receive and send money, curb spending, keep money safe and save.

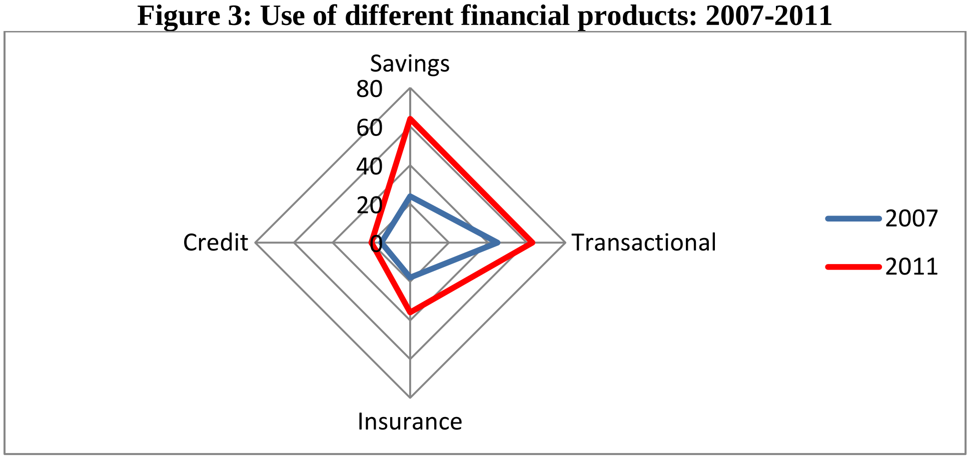
Figure 2: Access strand (% of individuals)



Source: FinScope most recent consumer survey

Increased financial inclusion has been driven by greater usage of transactional and savings products. The introduction of the Nampost Smartcard contributed to increased access by providing low cost alternatives to the unbanked. Government transfers also enhance financial inclusion (10 percent of adults receive government transfers and 60 percent of recipients receive transfers at financial institutions accounts). Usage of transactional and savings products is considerably higher than that of insurance and credit. According to Global Findex 2014, about 57 percent of Namibians save and 27 percent save at financial institutions. In contrast, only 7 percent borrow from financial institutions but this percentage is similar in SSA and other developing regions. Between 2007 and 2010 there was little change in the percentage of individuals using credit (Figure 3). The 2011 FinMark Consumer Survey report for Namibia concludes that notwithstanding relevant improvements, financial inclusion at the household level remains superficial given that its increase has been driven by transactional and savings products and the usage of credit and insurance remains low.

Figure 3: Use of different financial products: 2007-2011



Source: Namibia FinScope Consumer Survey

About 35 percent of Namibians receive domestic remittances, mostly through financial institutions (60 percent) or in cash/person (62 percent) (2014 Global Findex). Remittances also constitute a relevant source of income for Namibians. In 2011, 10 percent of households reported cash remittances (domestic and international) as their primary income source, compared to 19 percent for wages and salaries from government, and 12 percent for old-age pension. Namibia is a net receiver of international remittances (2013 Bank of Namibia figures). Outflows were approximately USD 1.4 billion, with the bigger percentage of this going to South Africa, and other neighboring countries, such as Zambia and Botswana. Remittance inflows were approximately USD 2 billion, primarily from Germany, UK, USA, and from some African countries, such as South Africa and Tanzania. It is likely that these figures, which are estimated based on balance of payments statistics, underestimate the size of both inbound and outbound remittance flows though.

The World Bank Review of the Market for Remittances in Namibia identifies several actions to enhance the efficiency and safety of remittances transactions to and from Namibia (for a complete list please see the Report): (i) developing common standards of transparency applicable to all Remittance Service Providers (RSP) and ensuring that senders and receivers of remittances are informed in advance on all the relevant elements of the transaction; (ii) clarifying the framework for the protection of consumers of remittance services and assigning institutional responsibility for protecting the rights of consumers of remittance services; (iii) fostering the use of electronic channels for the collection and disbursement of remittances and ensuring the interoperability of payment instruments; (iv) leveraging NamPost for the delivery of remittances; (v) consider relaxing currency exchange control requirements for low-value transactions to encourage the use of regulated channels; (vi) review the licensing procedures for RSPs as well as the procedures for the authorization of new products, services, partnerships, agents and similar, (vii) eliminate few remaining elements that seem to be preventing some players in the market from competing on a level playing field for the delivery of payment and remittance services; and (viii) closely monitor (and consider banning) exclusivity agreement clauses by which international money transfer operators can prevent local RSP with whom they are partnering from offering other services along with those of the international MTO.

The main reported barriers to banking are not having enough money to save (56 percent) and not being able to maintain the minimum balance (26 percent) (FinScope Consumer Survey 2011). A study on the cost of financial services (Feasibility 2010) found that the most basic bank accounts appear to require a minimum balance but this balance is low enough so that low income individuals should be able to open accounts. While there is a Basic Bank Account in Namibia, many individuals are not aware of it (only 23 percent of respondents to the Financial Literacy survey indicated that they had heard about it).

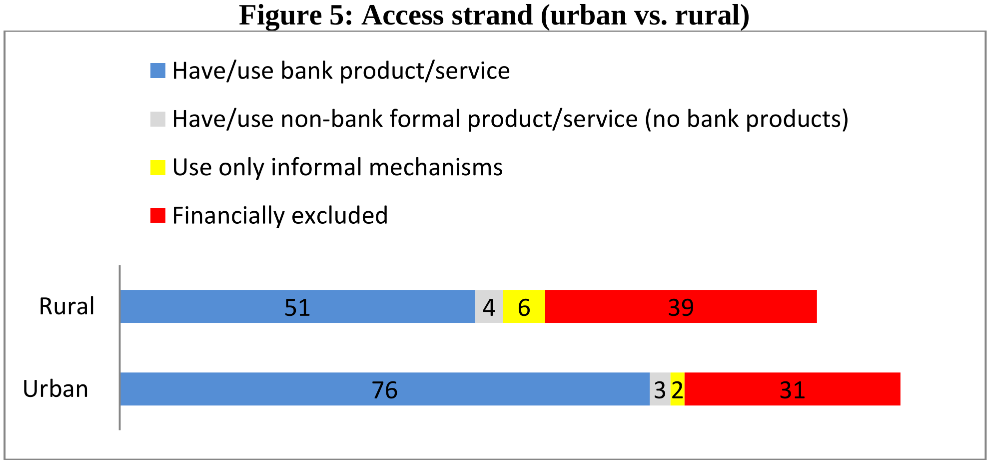
The three most frequently mentioned barriers to credit according to the FinScope Survey are fear of debt (51 percent), being worried not to be able to repay the loan (30 percent) and having no need for a loan (26 percent). Respondents of the Financial Literacy Survey (2013) seemed well aware of the dangers of borrowing money and seemed to avoid borrowing whenever possible. The great majority of individuals who run out of money borrowed from family and friends (57 percent) or someone in the community (10 percent) rather than asking for credit from financial institutions (only 4 percent borrowed from a bank).

As expected, particularly given the large size of the country, financial inclusion is lower in rural areas. Back in 2011, the FinScope consumer survey showed higher financial exclusion and lower access to banks in rural areas (see Figure 5 with 51 of individuals in rural areas with bank accounts vs. 76 in urban areas). The latest Global Findex (2014) finds a similar percentage of individuals with accounts at financial institutions in rural areas (54 percent) but a small difference with urban areas.[1] Enhancing

[1] Please note that part of the difference in percentages is explained by the use of different variables by FinScope and Global Findex. FinScope measures possession/use of any bank product or service and Global Findex measures accounts at financial institutions (banks and other types of financial institutions such as credit unions and

financial inclusion in rural areas is important given that Namibia's population is largely rural (3 in 5 adults live in rural areas). While bank branches have increased in the last couple of years, they are concentrated in urban areas. Physical access to banks is good in urban areas with 90 percent of adults needing an hour or less to get to a bank. But, as expected given the large size of the country and the small population size, distance to banks is larger in rural areas (with more than 40 percent needing an hour or more to reach banks). This highlights the need to promote more innovative delivery channels. Mobile banking seems particularly promising given high access to mobile phones is high (95 of the population has access according to FinScope 2011).

Figure 5: Access strand (urban vs. rural)



Source: FinScope Consumer Survey Namibia 2011

A study on the cost of financial services in Namibia and its impact on low income individuals and MSMEs (Feasibility 2010) found considerable variability in prices and some unaffordable services for low income individuals. There was considerable variability between the maximum and lowest price for a comparable service and consumers faced difficulties in making comparisons due to weak financial data disclosure as well as the need to improve consumer protection and literacy. For some financial services, the lowest pricing appeared to be out of reach for low-income consumers (e.g. vehicle asset insurance, at 11 percent and 17 percent of gross monthly income). The study found that financial provision in Namibia was, for the most part, designed for wealthier and middle class consumers and that regular employment was a condition to access many financial services.

In particular, the cost of insurance was reported as a relevant barrier (FLI et al 2013). The 2013

microfinance institutions).

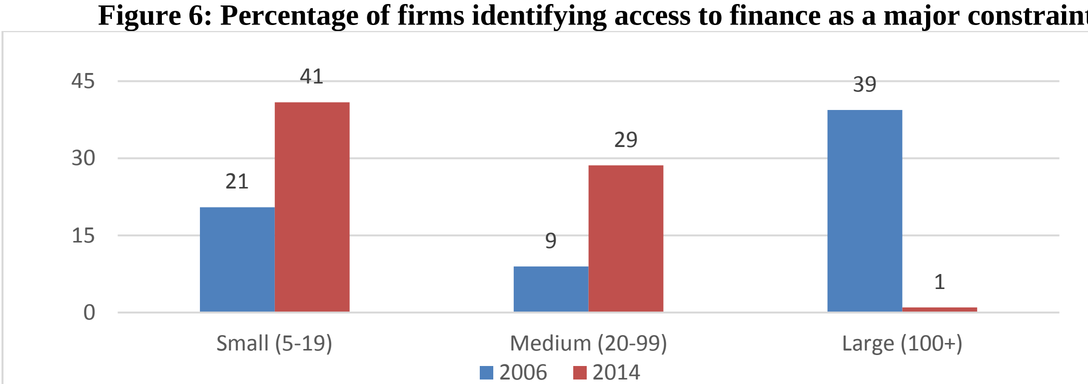
Financial Literacy Survey found that about 26 percent of respondents had insurance products (lower than the 36 percent reported by FinScope 2011). By far, the most relevant reason for not having insurance was that respondents thought it was too expensive (46 percent), followed by lack if income (21 percent). Funeral cover was the most popular type of insurance product (31 percent) followed by life insurance (24 percent), vehicle insurance (11 percent), health insurance (11 percent) and property insurance (10 percent).

IV. Financial Inclusion for Enterprises

The majority of enterprises in Namibia are informal (unregistered) and micro-small according to the 2009 Namibia First National Enterprise/Establishment Census (NEEC) (Sherbourne 2012). Most of the country's largest businesses are either State-Owned Enterprises (SOEs) or foreign multinationals. The majority of the country's smallest businesses are informal, unregistered micro businesses, with many being subsistence businesses. Between these extremes there is a layer of medium-sized formal businesses. Medium sized enterprises constitute a wide range of enterprises of different ages across a wide range of sectors, with most having the appropriate legal status. Nevertheless, many depend on the public sector (Government and SOEs) and only a few are export oriented.

Access to financing is consistently perceived as a key obstacle for doing business in Namibia. Different business surveys find that access to and cost of capital are perceived as key obstacles to business performance and investment. The World Bank Enterprise Surveys (WBES), which cover formal enterprises only, find that during 2006-2014 there was a considerable increase in the percentage of firms identifying access to finance as a major constraint (from 18 percent to 37 percent of firms overall). The increase emerged from smaller enterprises (see Figure 6). The 2013 Namibian Business and Investment Climate Survey (which covers formal and informal enterprises) found that access and cost of finance was the biggest obstacle for all businesses (irrespective to size or age) and enterprises perceived it had deteriorated (Schade 2013).[2] Similarly, the 2009 Namibian Business Climate Survey showed that the dominant reason for not making significant investments was lack of financial resources and access to finance was also seen as the main reason for bleak employment expectations (Stork 2010).

Figure 6: Percentage of firms identifying access to finance as a major constraint



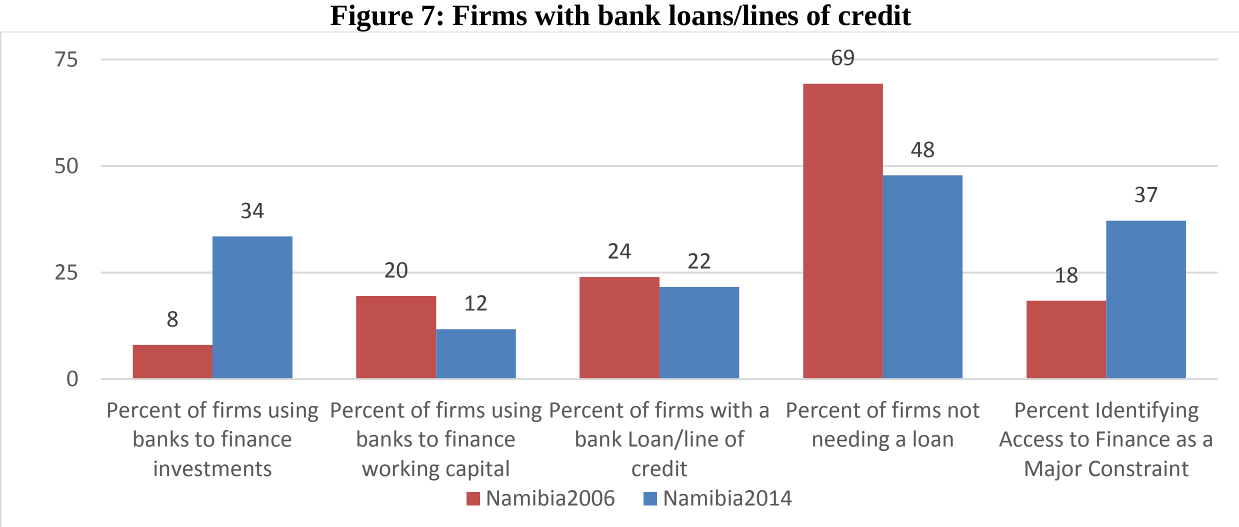
Source: World Bank Enterprise Survey

These negative perceptions are consistent with: (i) the relatively low percentage of Namibian firms having lines of credit/loans (with little change overtime), (ii) the relatively low percentage of firms

[2] The Namibian Business and Investment Climate Survey is conducted by the Namibia Chamber of Commerce and Industry (NCCI), Institute for Public Policy Research and the Namibian Manufacturers Association (NMA). It targets enterprises from formal and informal enterprises across the country (13 regions). The sample included 601 enterprises reflecting the contribution of economic sectors to the economy.

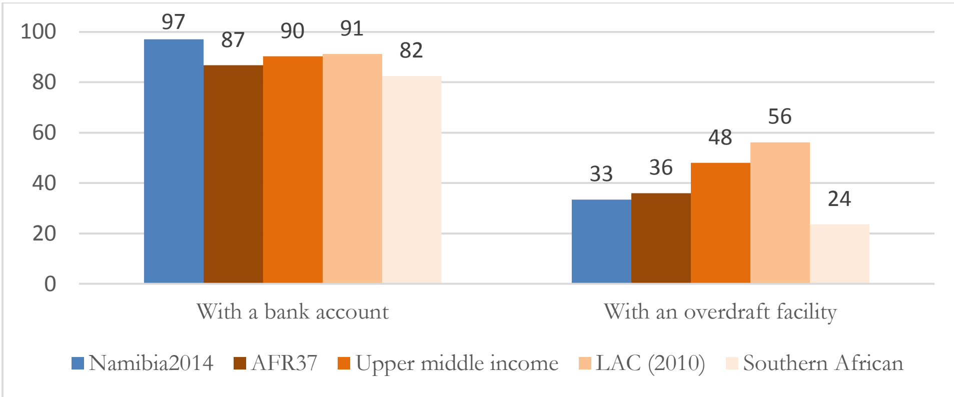
using external financing for working capital, (iii) greater demand for credit, and (iv) low use of overdraft facilities (Figure 7 and 8). Approximately 22 percent of firms in Namibia report having an active line of credit or loan, which trails averages in 37 comparable African countries and upper-middle-income peers (Figure 8). This percentage has remained largely constant since 2006 even when a greater percentage of firms reports needing loans. Additionally, the percentage of firms using banks to finance working capital has declined in the last couple of years (Figure 7). Virtually all formal firms in Namibia maintain a bank account (checking or savings) regardless of enterprise size. In contrast, only a low proportion of firms (one in three) use overdraft facilities (versus other African countries and other upper middle income economies with higher percentages– Figure 8). Interestingly, it is large firms who generally do not use overdraft facilities (compared with smaller enterprises in Namibia and large enterprises in comparator countries –Figure 9). Compared with other Southern African countries, unattainable collateral is considered by firms a bigger obstacle to apply for loans/lines of credit.

Figure 7: Firms with bank loans/lines of credit



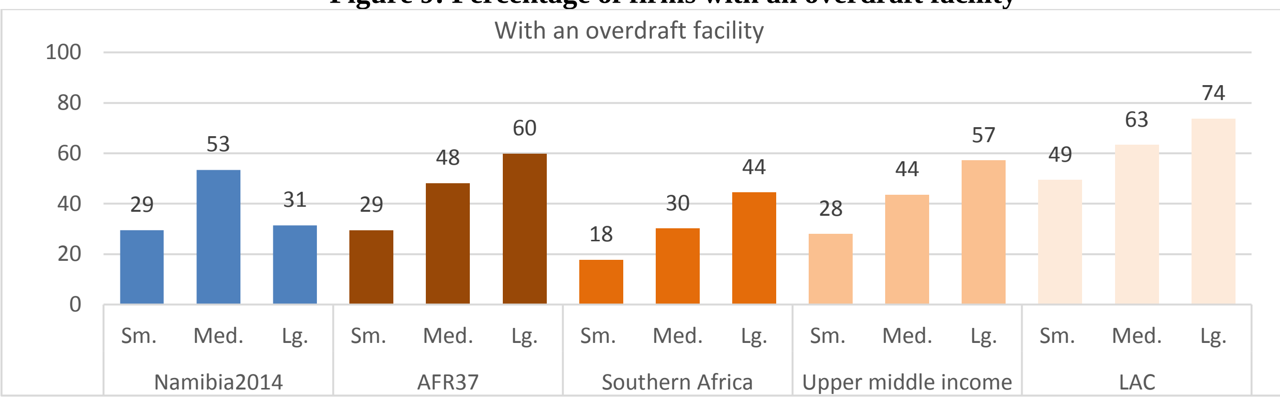
Source: World Bank Enterprise Survey

Figure 8: Proportion of firms using bank accounts and overdraft facilities



Source: World Bank Enterprise Survey

Figure 9: Percentage of firms with an overdraft facility

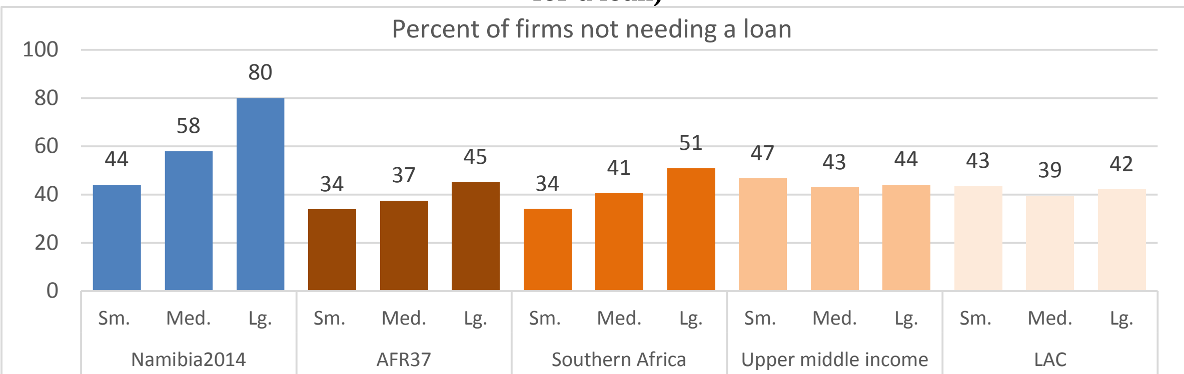


Source: World Bank Enterprise Survey

As it happens in other countries, informal enterprises are more credit constrained. Informal enterprises perceive that access to finance is a bigger obstacle and they have less access to credit from the financial sector (Stork 2010). The 2009 and 2013 Namibian Business and Investment Climate Surveys find that access and cost of finance remains a big obstacle for informal enterprises. While formal businesses have commercial banks as the main source of credit, informal businesses generally take credit from friends and relatives. In the informal sector, reported barriers to access credit are the lack of: (i) skills and systems to generate the necessary data and business plans required to obtain bank loans, (ii) collateral and, (iii) credit history.

Similarly (and in line with international experience), smaller enterprises (MSMEs) find that access to finance is a big obstacle for their business. The 2013 Namibian Business and Investment Climate Survey showed that access and cost of credit is a bigger concern for microenterprises. In particular, lack of access to credit to MSMEs was a main concern, with many smaller enterprises failing to meet bank requirements to obtain a loan such as a business plan, down payment, financial statements, business registration, bank records and adequate collateral (FinMark 2011). Another survey to medium enterprises in Namibia found that access and cost of finance were reported as a significant issue (Sherbourne 2012). In fact, within external obstacles to growth, medium firms perceived access to finance as the top one-constraint. In the same way, the WBES shows that formal SMEs are substantially more likely to report that access to finance is a major constraint to their operations (Figure 6). Additionally, a substantially higher percentage of large enterprises report not needing loans (80 percent of large firms versus 44 percent of small and 58 percent of medium firms – Figure 10).

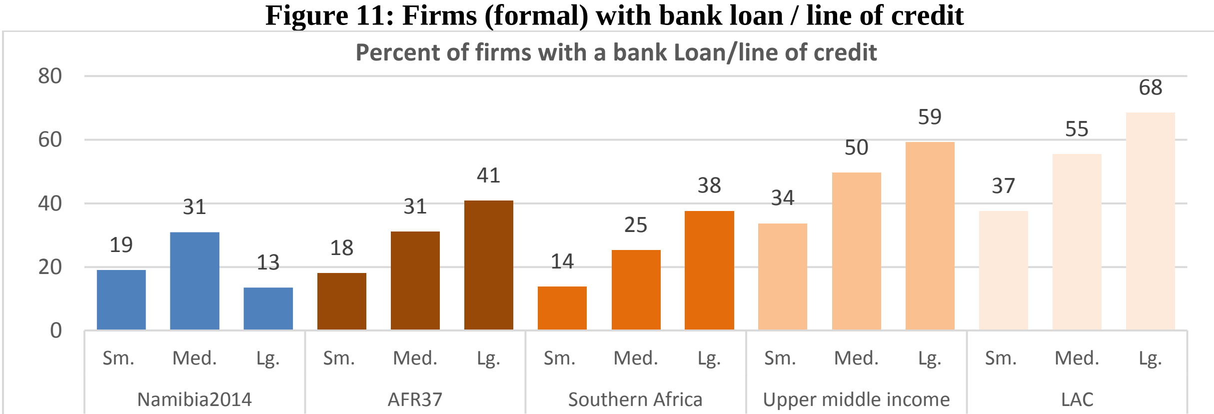
Figure 10: Lack of credit demand related with lack of need (percentage of firms reporting no need for a loan)



Negative perceptions regarding access to financing among micro-enterprises emerge from greater constraints. For instance, a 2011 World Bank report on microenterprise development found that there were no financial products or business development services in Namibia appropriate or affordable for microenterprises (World Bank 2011). The report was based on a pilot sample survey of 800 microenterprises carried out in 2009. The survey found that most micro-enterprises were informal (66 percent) and the sector was characterized by low productivity and underemployment. Lack of access to finance and land were the top one and two growth constraints for microenterprises. External finance was generally obtained from informal sources and suppliers. The report concluded that improved access to finance could raise the average productivity of microenterprises and found that Government-financed business support programs had not been successful in reaching microenterprises.

Formal SMEs are more credit constrained, considering financing as a key obstacle for their operations/growth and being less likely to have credit from financial institutions (WBES). While only 1 percent of large enterprises consider access to financing as a problem, 41 percent of small businesses and 29 percent of medium business think it is a major obstacle for their business. Consistent with these perceptions, a lower percentage of SMEs in Namibia have loans/lines of credit compared with SMEs in upper MICs or LAC (Figure 11). Interestingly (and in contrast with international experience), the percentage of SMEs with loans/lines of credit is bigger than that of large enterprises in Namibia. The relatively low percentage of large enterprises with credit emerges from reported lack of need as four out of each five large firms in Namibia report not needing a loan (Figure 9).

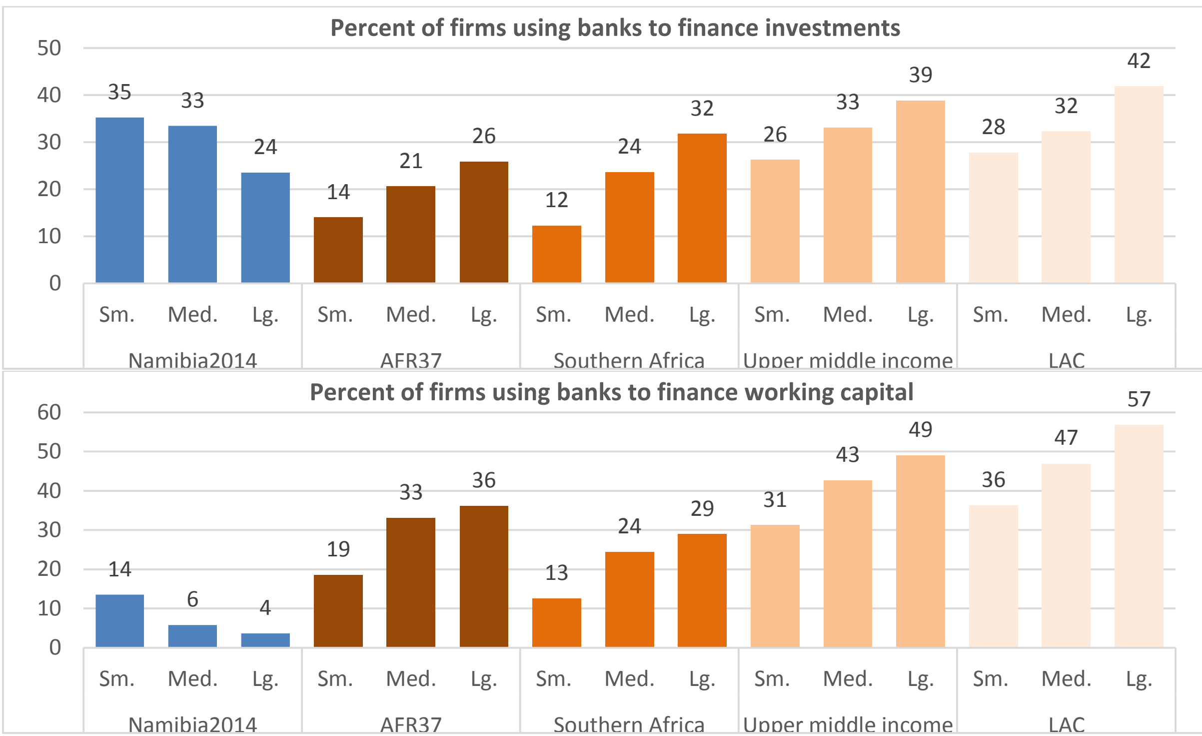
Figure 11: Firms (formal) with bank loan / line of credit



Source: World Bank Enterprise Survey

A remarkably low percentage of Namibian firms use banks to finance working capital (Figure 12). While Namibian enterprises compare relatively well with other countries in terms of the percentage using banks to finance investments, the use of bank financing for working capital is very low. Interestingly, large firms in Namibia are less likely to use banks to finance their investments or working capital compared with SMEs. This is in contrast with trends in other African countries and income-group comparators. In other countries, as enterprises grow in size, a greater percentage of them have loans/lines of credit from financial institutions to finance working capital and/or investments but the opposite trend is observed in Namibia. Larger firms in Namibia tend to be more self-funded for investment and working capital. To a large extent, large firms in Namibia are not using credit due to reported lack of need (four out of five large firms in Namibia reports not needing a loan at all).

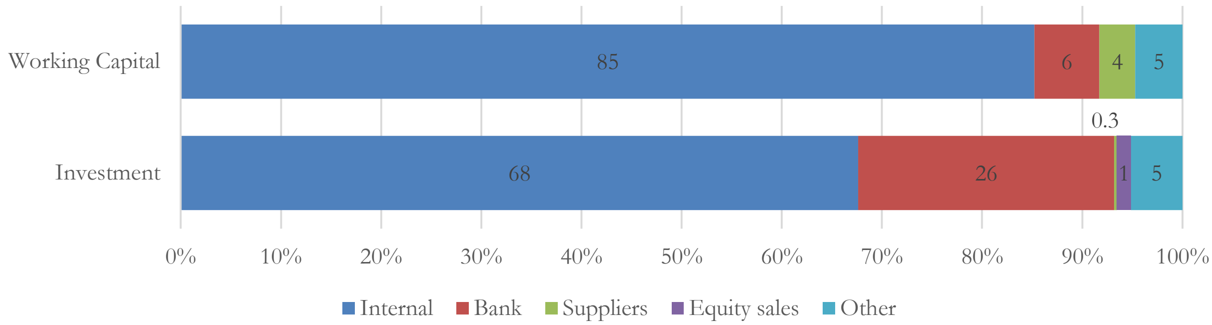
Figure 12: Firms using banks to finance investments and working capital



Source: World Bank Enterprise Survey

Banks are the most relevant source of external financing for formal Namibian enterprises, particularly for long term financing (Figure 13). As it occurs in other countries, Namibian enterprises fund most of their working capital and investment with retained earnings, with banks being the most relevant source of external financing for investments. In fact, more than one quarter of the financing of firms' investments comes from banks; notably higher than the six percent that is used to fund working capital. Firms are much more reliant on internal funds for their working capital, 85 percent of which comes from internal sources. As expected, firms in Namibia are much more likely to utilize supplier credit as a source for funding of their day-to-day operations, rather than fixed asset investment.

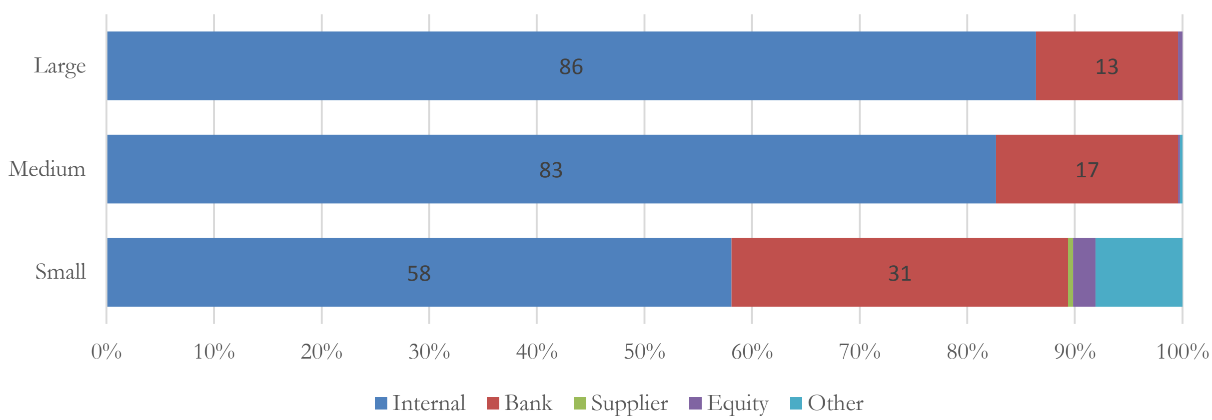
Figure 13: Source of Financing by Type



Source: World Bank Enterprise Survey

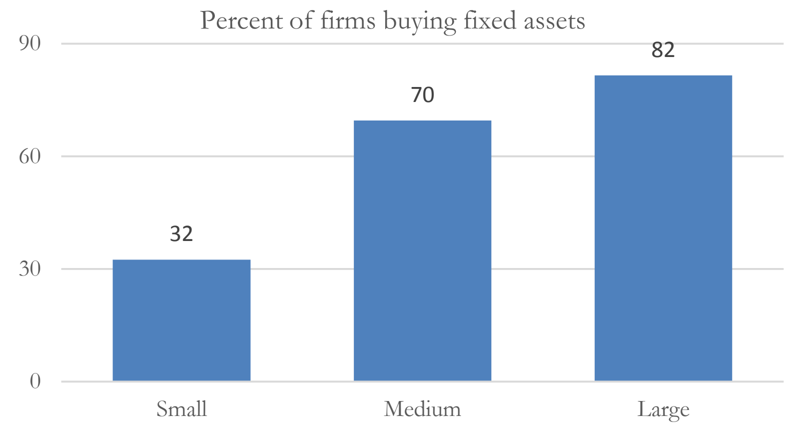
Interestingly, smaller enterprises recur to external financing to a greater extent to fund investments and working capital compared with large firms (Figures 14 and 16). Small firms fund their fixed asset purchases much less through internal funds (58% funding) when compared to medium (83%) and large (86%) firms. In fact, small firms turn to banks and other (often informal) sources to finance their investments. Small firms are investing in fixed assets at lower rates than their larger peers (Figure 15). Reliance on external sources runs parallel to lagging investment by SMEs (especially among the smallest firms –i.e. those with 20 or fewer employees). Roughly a third of small firms reports having purchased fixed assets in the last fiscal year, decidedly trailing rates among medium-sized firms (70 percent) and large firms (82 percent).

Figure 14: Source of investments by enterprise size



Source: World Bank Enterprise Survey

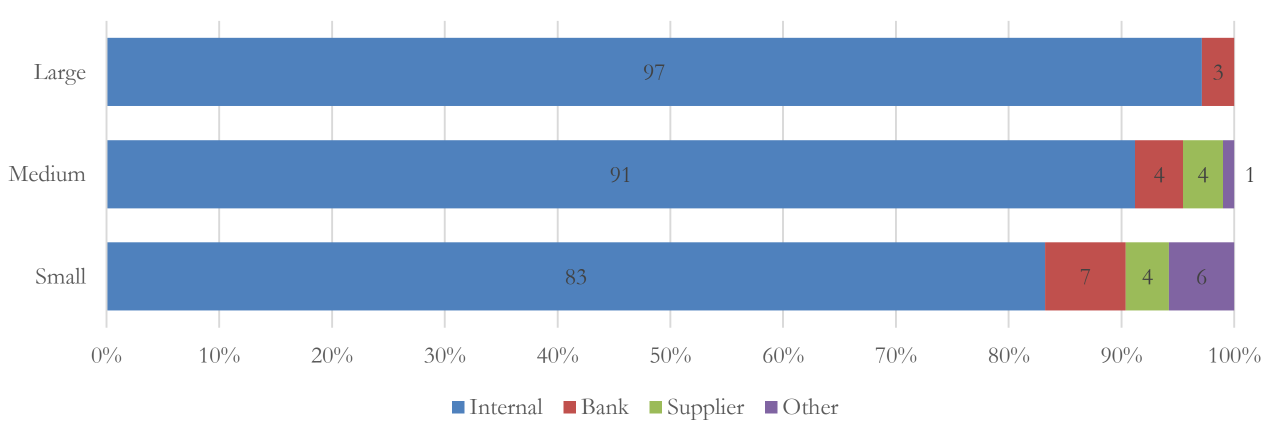
Figure 15: Percentage of firms buying fixed assets (by enterprise size)



Source: World Bank Enterprise Survey

SMEs are substantially more likely to use external financing for working capital (Figure 16). Large firms in Namibia largely self fund their day-to-day operations, financing over 97 percent of their operations with internal funds. By contrast, medium and small-sized firms are substantially more reliant on bank financing, supplier credit (which is not used by large firms), and other sources of financing, which include informal sources such as family and friends.

Figure 16: Source of working capital by size



Source: World Bank Enterprise Survey

The overwhelming majority of loans (or lines of credit) for enterprises come from private

commercial banks. The WBES 2014 found that over ninety percent of loans or active lines of credit to formal enterprises in Namibia are provided by private commercial banks. By contrast, only 7 percent of these loans come from state-owned banks, while a mere 2 percent are provided by some other form of financial institution. Similarly, a recent survey of medium enterprises found that they generally seek financing to grow (working capital or investment) from local commercial banks (followed by the Development Bank of Namibia and other local institutions).

Banks have increased their engagement with SMEs, including through the establishment of specialized SME units and tailoring of products. Since 2000 banks have become more interested in serving the SME segment. Consequently, they have adapted their business model to serve the segment, which has included putting in place SME units. In fact, in a survey (Indongo et al 2013) to financial institutions, all interviewed banks indicated they provide financing products tailored to SMEs and some have specialized units. Some of the products offered include term loans, overdrafts, property and asset financing, and bridging finance among others. All interviewed financial institutions provide additional support services to SMEs (such as training). These support services (e.g. capacity building and skills enhancement) are also provided by other private organizations (e.g. SME Compete). The main reported impediments to lending to SMEs from the supply side are low turnover/ unfavorable credit history; lack of skills, training and experience of businesses; lack of appropriate collateral; lack of own financial contribution; lack of formal incorporation.

While Namibia's private business sector is dependent on bank finance for investment and working capital, there are private equity options available (Sherbourne 2012). Private equity finance remains in its infancy but there have been several related initiatives since mid-1990s. In fact, Namibia has made greater efforts to promote private equity finance than any other country in SADC outside South Africa. These efforts include the Unlisted Investment Programme of the Government Institutions Pension Fund (GIPF). There is now a limited but flexible range of private equity and venture capital finance providers in what remains a relatively small market.[3]

Private equity firms and micro lenders have also enhanced financing options for smaller enterprises (Indongo 2013). Equity firms have been established to enhance access to working capital and other financing needs of SMEs in Namibia. One such firm is The Namibia Procurement Fund which has had an impact in providing bridge finance to SMEs. In the same vein, some micro lenders (such as Fides Bank) have also emerged to provide working capital to SMEs even when their loans are reported to be small and have a high cost. While there are a number of leasing and factoring companies, a BoN paper finds that factoring operations are limited due to capital constraints and leasing services are largely linked to cars or hire purchase for durable goods with no separate/specific legislation covering leasing and factoring (Nakusera et al 2008).

Lack of collateral is seen as a single most limiting factor for SMEs to secure financial support from financial institutions (Indongo 2013). As Table 1 shows, aside from lack of need, high collateral requirements is the number one reason for failing to apply to a loan among SMEs. In particular, small firms are using movable collateral less frequently than larger enterprises. The 2014 WBES finds that while guarantees are required from SMEs at similar rates, a relatively small percentage of small firms are using movable collateral (41 percent) compared with medium firms (93 percent). Nevertheless, the latest Namibian Business and Investment Climate Survey (Schade 2013) finds that enterprises regard the provision of collateral as less challenging compared with previous surveys. To address this obstacle, several government efforts were initiated, such as the establishment of the SME Bank. This bank had not

[3] Given the existence of three fully active private equity funds and a further two or three less active funds which plan to start operating at some stage in the not-too-distant future, any new fund would have to assess its chances of success in an increasingly competitive but probably rather small market.

been established when the stocktaking exercise was conducted, and is beyond the purview of this note. However, it is understood that this bank has experienced challenges and further assessment of its design and performance would be warranted in the future.

Other relevant obstacles are lack of skills, credit history and complex application procedures among others. Aside from the lack of collateral, financial institutions cite lack of skills, training and experience at SMEs, lack of credit history and informality as relevant barriers. SMEs also consider complex application procedures and high interest rates as important reasons not to apply to a loan.

Table 1: Reported reasons for not applying to loans

Reason for not applying for a loan	Namibia	Small	Medium	Large
No need	59%	53%	77%	99%
Procedures too complex	7%	7%	7%	1%
Interest rates too high	9%	11%	0%	0%
Collateral requirements too high	18%	20%	15%	0%
Did not think it would be approved	2%	2%	0%	0%
Other	6%	7%	1%	1%

Weaknesses in the ICR are also constraining access to credit for enterprises and individuals (ICR ROSC). The Namibian legal system is based on the Roman-Dutch law inherited from South Africa. There have been important changes to the legal system since independence, but these changes have been marginal in the area of insolvency and creditor/debtor regimes. The 2014 Namibia ICR ROSC identifies the following issues related with financial inclusion:[4]

- ***Access to credit and the protection of creditor rights.*** The regime for securities over movables (especially the regime for notarial bonds) is not sufficiently effective. The regime is not trusted and there are difficulties to use securities over a general category of assets (raw materials, receivables, etc.). Additionally, there are deficiencies in the registration regime and in the enforcement process of such securities. The regulation of security interests over movable assets could be significantly improved by means of substantive changes in the law and the introduction of a new system for registration. The enforcement system is regarded as being efficient, although there are symptoms of overload in the High Court.

- ***Risk management and restructuring.*** Credit information systems in Namibia follow the South African model and their coverage of the Namibian population is good, but the industry is unregulated and there are no rules providing for consumer protection. Additionally, the credit information system covers negative information only and some information is not reliable. While risk management practices are healthy, there are constraints on access to credit by SMEs. In terms of restructuring activities, there is limited use of informal restructurings (especially in SME cases), marginal use of multi-creditor workouts, marginal use of compromises and schemes of arrangement as well as limitations and disincentives (including unfavorable tax treatment). Restructuring of debts is considered as the best approach to the problems of distressed enterprises, but there are no guidelines for the negotiation of workouts, and the main instrument for restructuring debt, the scheme of arrangement, has important shortcomings that could be addressed.

- ***The insolvency framework.*** The insolvency regime in Namibia suffers the complexities that characterize the original South African model. The provisions applicable to insolvency proceedings

[4] For a complete list of weaknesses please see 2014 ICR ROSC.

are dispersed across different statutes belonging to very different periods. The system is geared towards liquidation, and the only alternative to liquidation, the judicial management process, is considered very costly, not very effective and almost entirely untested in practice. There are several issues that would deserve attention in a reevaluation of the insolvency process, such as the criteria for access to insolvency, the treatment of executory contracts, and the classification of creditors. Additionally, there are issues with the administration of the process (such as delays and difficulties in selling assets as a going concern) and the priority regime (such as a complex ranking of claims and unequal treatment of creditors). The insolvency system is particularly deficient in some of the most advanced areas, such as the treatment of cross-border insolvencies and of the insolvency of enterprise groups.

- ***The institutional framework.*** The institutional framework of the insolvency and creditor/debtor regime needs to be reinforced. Although the insolvency practice has remained at low levels for a long time, it is foreseeable that a larger economy, when faced with economic difficulties, will require higher institutional capacity to deal with insolvency and debt enforcement issues. While the judiciary has a strong reputation, the courts struggle due to heavy workload and lack of specialization in commercial matters. Lack of resources impacts the ability of the Master of the High Court to supervise insolvency proceedings and liquidator's conduct. In this regard, the courts would need to be reinforced, but it is even more important that the Master of the High Court, which performs critical functions in the insolvency system, receives adequate resources. Finally, the regulatory framework for insolvency representatives is an important part of the architecture of the system and deserves special consideration. There is a great need for the development of a regime for insolvency practitioners, with adequate qualifications, and proper supervision and enforcement. In terms of the regulator, there are difficulties in communications with other branches of the system.

Key recommendations to strengthen the ICR are:

- ***Access to credit and the protection of creditor rights.*** Namibia could benefit from the creation of a modern secured transactions regime, which could improve access to credit for small and medium enterprises. A substantive law on secured transactions over movable assets should allow the creation of security interests over all types of movable assets used in entrepreneurial activities, in the most flexible way, and without high costs or complex formalities. The security interests would be perfected by registration in a notice-based registry, organized nationally, according to the criterion of the name of the grantor, and easily accessible through the Internet. Some enforcement procedures should be streamlined.

- ***Risk management and restructuring.*** Credit information systems should be adequately regulated. The draft regulations prepared by the bank of Namibia address current issues and should be adopted. Also, informal restructuring can increase its importance in the system if certain reforms are adopted. In this regard, modifications in the tax treatment of debt forgiveness and debt restructuring would promote the uptake of corporate workouts. The restructuring regime can be reinforced through the reform of the scheme of arrangement (especially with the addition of a stay of creditors' actions).

- ***The insolvency framework.*** The insolvency regulation can be modernized and better coordinated to meet the needs of a modern and developing economy. A new regime could provide for the regulation of insolvency of different types of persons and debt-scenarios/procedures, i.e. liquidation and reorganization or debt restructuring. This will likely provide considerable coherence and internal unity to an otherwise fairly fragmented framework and will allow for proper and timely treatment of indebtedness in the corporate context as well as for natural persons.[5] On the other hand, the introduction of an effective

[5] Various sections of the Insolvency Act 24 of 1936 as well as sections from the Close Corporations Act 26 of 1988 and Companies Act 28 of 2004 relating to insolvency should be revised in order to ensure that they reflect and are in

reorganization process would require substantive reforms. The system should consider the incorporation of regimes for cross-border insolvency and the insolvency of enterprise groups.

- ***Institutions.*** The qualities of the institutional framework can be reinforced with several targeted reforms such as increasing judicial capacity, enhancing communication between authorities and introducing a regime for insolvency professionals. More resources need to be assigned to the courts, especially the Magistrates Courts. The Master's office needs to be sufficiently staffed and resourced to fulfill the important functions assigned to it in the insolvency system. It is also crucial to introduce a new regime for the qualification of insolvency representatives.

line with modern practices. These include the introduction of effective communications among authorities, the modification of the rules for the sale of assets to increase the possibilities of selling the business as a going concern and the modification of the priority regime.

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