

Making Access Possible

2021



Lesotho

Financial Inclusion Refresh



**SUSTAINABLE
DEVELOPMENT GOALS**
17 GOALS TO TRANSFORM OUR WORLD



Unlocking
Public and Private
Finance for
the Poor

Making Access Possible

Making Access Possible (MAP) is a multi-country initiative to support financial inclusion through a process of evidence-based analysis feeding into a financial inclusion roadmap jointly implemented by a

range of local stakeholders. Through its design, MAP seeks to strengthen and focus the domestic development dialogue on financial inclusion. In each country, MAP brings together a broad range of stakeholders

from within government, the private sector and the donor community to create a set of practical actions aimed at extending financial inclusion tailored to that country.

This report was prepared by Acacia Economics lead by Ryan Hawthorne, Sha'ista Goga, Zubair Patel, Nicola Wills, and Gareth McHardy, with management and oversight from the FinMark Trust team lead by Brendan Pearce and Nikki Kettles. Thank you also to Damola Owolade for overall management and technical guidance, and Palesa Sematlane for local coordination work in country, as well as key stakeholders who participated, including the Ministry of Finance, Members of the Financial Inclusion Steering Committee, the Central Bank of Lesotho (CBL), industry leaders in the banking and insurance industry, MNOs, parastatals/State Owned Enterprises, NGOs, and Financial Technology Companies. We thank Mr Robert Likhang, Principal Consultant From RL Consulting who also shared very valuable insights specifically on the Lesotho SMME sector and the inclusive growth.

A special thank you as well to the UNDP Lesotho team, especially Mrs Mabulara Tsuene, Head of the Strategy and Policy unit, who played a critical role working with us in evolving financial inclusion within the context of inclusive growth and the domestic financing agenda.

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The cover symbol and artwork

Through the MAP programme, we hope to effect real change at country level and see the impact of financial inclusion on broader national growth and development. The cover graphic features the Aloe polyphylla, the national flower of Lesotho. The flower symbolises growth and development while the circle represents inclusive growth. Each flower is an example of the successful growth in a unique environment.





Working together to support implementation of Agenda 2030

Countries are seeking new ways to address complex and interconnected challenges. Fulfilling the promise of the United Nations Sustainable Development Goals (SDGs) requires multisectoral approaches that bring together expertise from a range of perspectives. By harnessing our comparative advantage and working within the context of our respective mandates, we can collectively make significant progress towards realising the vision of the SDGs.

Financial inclusion is increasingly positioned as an enabler of broader development goals, in support of the SDGs. More and more countries are including an inclusive financial sector as a key objective in their national development plans, and this tendency is further underpinned by the G20 leadership of financial inclusion, which highlights the ongoing relevance of the SDGs and nationally led financial inclusion efforts. Furthermore, financial markets play a vital role in creating a sustainable future. Access to finance for individuals, SMEs and governments is important to a number of the SDGs, helping to facilitate secure payments, including for basic services and trade; smooth cash flows; offer financial protection; and improve allocation of capital while also enabling investments in many areas.

This MAP refresh, in supporting country efforts, increases the focus on inclusive growth (especially through SMEs and agriculture), access to basic services (energy, health and education), and improving household resilience, as well as gender equality. Increased reliance on technological innovation and digital financial services will help to improve the scale and efficiency of financial inclusion interventions.

This refresh was undertaken by the United Nations Capital Development Fund (UNCDF) to jointly address UNDP's Signature Solution 1, which seeks to work with countries to keep people out of poverty, relating directly to SDG 1: eradicate all forms of poverty, wherever it exists.

The core focus of Signature Solution 1 is helping people get out of – and stay out of – poverty; and hence the analysis and interventions identified help eradicate poverty, such as by creating decent jobs and livelihoods, providing social safety nets, and ensuring access to services such as water, energy, healthcare, credit and financing support for investment in productive assets.

Partnering for a common purpose

By combining inspiration, ideas, knowledge and resources with our partners, we become more than the sum of our parts.

We are committed to empowering investors—public and private alike—with the clarity, insights and tools they need to optimise the positive impact of their investments, closing the gap between high-level principles and financial performance to make a positive contribution to society.

MAP was initiated by the UNCDF and developed in partnership with FinMark Trust. In the SADC region, FinMark Trust is a MAP implementing partner.

FinMark Trust is an independent non-profit trust whose purpose is ‘Making financial markets work for the poor, by promoting financial inclusion and regional financial integration’. The Trust works to unlock real economic sector development through financial inclusion, by gathering and systematically analysing financial services consumer data to provide in-depth insights, and following through with systematic financial sector inclusion implementation actions to overcome market-level barriers hampering the effective provision of services.

Note on the use of household data

Within this document (unless otherwise referenced), demographic, income and financial usage data is obtained from the 2021 FinScope Consumer Survey undertaken in Lesotho. A summary report and presentation of FinScope is available as a separate deliverable, and the FinScope dataset is available for future research at <https://uncdfmapdata.org>.

Our technical response

The effective use of a wide range of quality, affordable and accessible financial services, provided in a fair and transparent manner through formal or regulated entities, by all people living in Lesotho.

The National Inclusive Finance Strategy (‘NIFS’, 2017-2021) set out the above vision for Lesotho and financial inclusion, developed in collaboration between the Government of Lesotho and the MAP programme, and informed by the 2014 MAP diagnostic report for Lesotho. In addition, in 2014, the CBL launched the Financial Sector Development Strategy (FSDS), an overarching strategy for the financial sector, that had a chapter in financial inclusion.

The MAP programme first involves assessing the economic and human development plans for a country, often linked to United Nations SDGs, and then secondly the means by which financial inclusion can help achieve these objectives.

In this MAP refresh report, we review the implementation of the 2014 MAP diagnostic and 2017 NIFS and consider key market changes to identify financial inclusion interventions that can grow the economy and benefit society. A review of the financial inclusion landscape will inevitably touch on some activities of the FSDS.

Lesotho at a glance

2020-2021

GDP (2019)

US\$2.4
billion

USD 6.1 billion in PPP terms

GDP per capita (2019)

US\$1,158

PPP: USD 2,882

*Lower-middle-income country.
GDP per capita among the lowest in SADC*

CONTRIBUTION TO GDP
Public administration

23%

CONTRIBUTION TO GDP
Textile and clothing

14%

CONTRIBUTION TO GDP
Wholesale and retail trade

11%

High level of cross-border remittances which are largely inward.

45%
Value of imports in relation to GDP

Negative GDP growth since 2017, resulting in GDP contraction

20%

percentage of GDP made up of remittances to Lesotho



118,130

people work for micro, small and medium sized enterprises (MSME)

Official development assistance

5%

Percentage of GNI 2017 to 2019

Lesotho at a glance

2020-2021



Total population

2.1
million



1.5 million

adults 15 years and older



49% male

51% female

Lesotho ranked 139
out of 162 countries
on the Gender
Inequality Index

0.553

POPULATION

60%
Rural

40%
Urban

60%

of labour force is
employed in the
informal sector



Due to Covid-19
jobs are scarce, risking a
reversal of the progress
that the country has made



24%

Extreme poverty rate

Based on M352 per adult
equivalent per month
(2017/18)



23%

unemployment

12% of labour force
employed by MSMEs



Youth unemployment

71%

(Aged 15-35 years, 2019)

One of the
top 20% most
unequal
countries

32%

Individuals living
below international
poverty line

90%

3G coverage

BUT ONLY

42%

individuals using
the internet

82%

Individuals own
a mobile phone

Financial inclusion and access to finance



Significant achievements include

Increase in access points for consumers through mobile money agents, and considerably larger volumes of financial transactions other than merely cash out.

Overall, the percentage of adults (18+) with access to at least one formal financial product increased from 61% in 2011 to 87% by 2021.

61%
2011

87%
2021

Only 39% of adults (18+) were banked in 2021, which is a mere one percentage point more than in 2011.

38%
2011

39%
2021



The set target of 85% was met and surpassed

The National Inclusive Finance Strategy (NIFS) 2017-2021 aimed to increase the percentage of adults (18+) with access to at least one formal product from 61% (FinScope 2011) to 85% by 2021, among other goals.

82%
2011

91%
2021

Formal and informal inclusion increased to 91%

Adults with access to more than one formal financial product increased by 40%

31%
2011

71%
2021

Use of bank account

Barriers to owning a bank account include:

53%

"I can't maintain a minimum balance"

26%

"I do not need it"

8%

"the charges are too high"



38% of women are banked



40% of men are banked

Financial inclusion and access to finance

Remittances

An increase of adults remitting over the years



57%

2011

72%

2021

The most popular means of sending money is through mobile money as it is the most used method for 84% of individuals that send money.



75% of women remit



69% of men remit



Savings

Formal savings increased from 35% (2011) to 48% (2021)



22% of women save informally



13% of men save informally

Urban adults

35%

Save at banks

23%

Save informally

Rural adults

14%

Save at banks

13%

Save informally

Credit

Usage for both men and women contracted over the period 2011 to 2021



64% of women borrow



54% of men borrow

49%

Youth borrowing

63%

Adults borrowing

Reasons reported for loan not being granted:

62%

Insufficient deposit

10%

Insufficient income

Insurance

Uptake of formal insurance increased from 40% to 49% (2011 to 2021)



62% of women insure



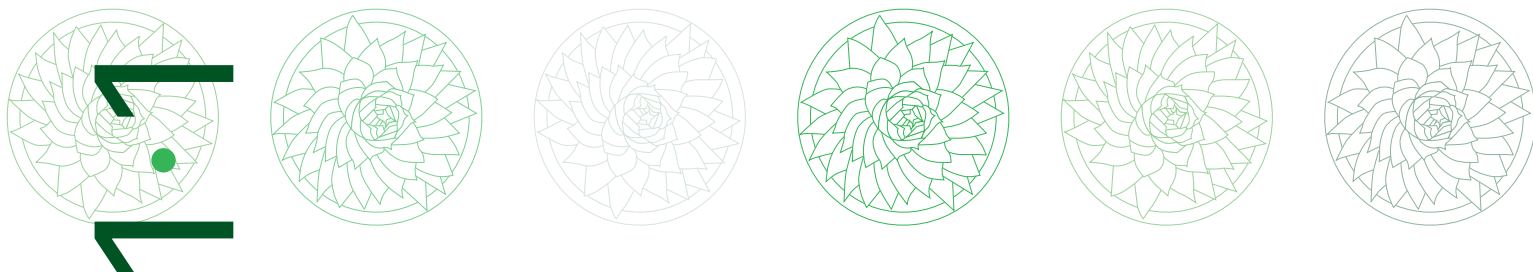
52% of men insure



70% of the elderly population insure | 25% of youth | 59% of individuals aged 25-60 years old.



The changing environment

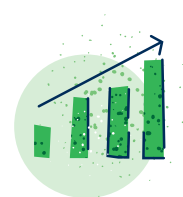


Changes in financial inclusion

To provide a vision and direction for financial inclusion in Lesotho the following policy goal was proposed: “Increase access to quality and diverse formal financial services to support economic growth and improve household welfare by increasing outreach and quality of financial services, increasing financial and investment capacity, creating and capacitating inclusive financial service providers, ensuring an enabling regulatory environment, and customer education.”

These five objectives form part of the national strategy to develop an inclusive financial system in Lesotho within five years (2017 to 2021), aligned with the National Strategic Development Plan (NSDP) and other development programs and policies of government.

The table shows the progress made with regards to the specific targets of the NIFS. Significant progress has been made in reaching these targets, as many targets have already been met while there is still some work to be done on others. Significant achievements include increases in access points for consumers through mobile money agents, and considerably larger volumes of financial transactions other than merely cash out. Overall, the percentage of adults (18+) with access to at least one formal financial product increased from 61% in 2011 to 87% by 2021.



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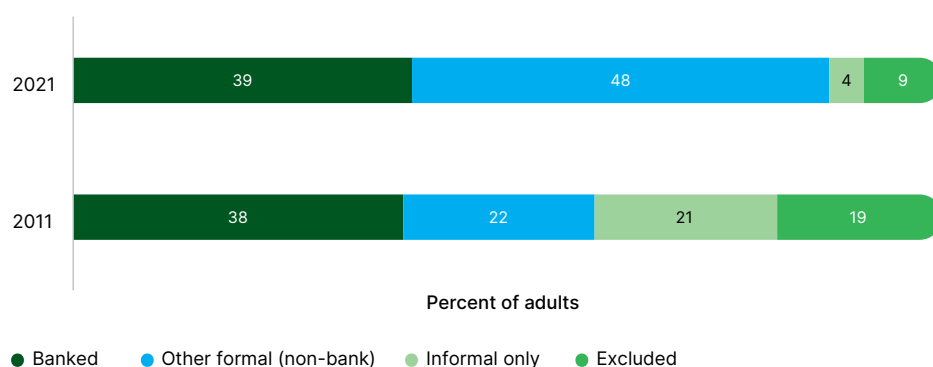


Figure 1: Access to financial services

Source: FinScope 2011 & 2021

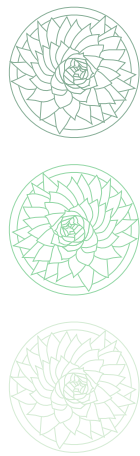


Table 1: Progress made towards the national inclusive finance strategy objectives

TARGETS	PROGRESS HIGHLIGHTS
1. Increase percentage of adults (18+) with access to at least one formal product from 61% (FinScope 2011) to 85% by 2021	87%
2. Increase percentage of women (18+) with access to at least one formal product from 61% (FinScope 2011) to 85% by 2021	90%
3. Increase percentage of adults (18+) with two or more formal products from 53.2% ¹ to 65%, and women from 61% to 67% by 2021.	Adults: 71% Women: 73%
4. Promote use of alternative channels, increasing percentage of adults (18+) with at least one formal product from a non-traditional channel (i.e. excluding banks) from 22% ² (FinScope 2011) to 38% by 2021.	84%
5. Increase percent of adults (18+) saving from 58% (FinScope 2011) to 70% by 2021.	56% ³
6. Increase number of access points (including bank branches, POS, ATM and agent points) per 100,000 adults (18+) from 299 to 900 by 2021	1,044 branches, agents ⁴ , POS and ATMs
7. Broaden usage of bank transactional accounts beyond monthly cash ATM (mailbox) withdrawals; increasing non-ATM withdrawal transactions from 11% to 40% of total transactions by 2021.	Cash out accounts for only 32% of the value of mobile money transactions ⁵
8. Reduce average cost of low value (M 400-500) unregistered mobile money transfers / cash outs from M8.44 / M6.28 to M5.00 / M4.00 by 2021.	Transaction charges are M4 to M9
9. Reduce average cost of a non-bank low value (M850) domestic remittance from 7.96% to 4% of remitted value, and cross border from 5.7% to 4.5% by 2021.	Option available via Shoprite for less than M25 per transaction
10. Effective interoperability between mobile wallets and banks to increase availability of cash in / cash out touch points, by introducing bank to wallet, wallet to bank and wallet to wallet interoperability.	Partially available
11. By 2018, develop and approve a local Strategy to leverage inward remittances for investment.	Not achieved
12. Increase percent of SMMEs with access to productive credit from 2% (FinScope SMME 2016) to 20% by 2021, and those with access to any formal financial service from 45% to 60%.	Not achieved
13. Finalise microinsurance regulation by 2017 to enable a conducive regulatory environment for improved delivery and uptake of micro-insurance products.	Microinsurance framework has been developed
14. Develop a framework / strategy by 2018 to (i) encourage MFIs as an alternative credit and deposits provider, (ii) create a graduation path to formalize large informal financial service providers such as money lenders and funeral parlours, and (iii) to introduce new classes of providers as needed e.g. e-card providers.	Microfinance institutions have been developed as alternative financial service providers
15. Increase percent of adults with access to insurance products (other than funeral insurance which is already well developed) from 4% to 20% by 2021.	This was not achieved. Only 11% of insured adults have non-funeral insurance
16. Put in place a Financial Sector Consumer Protection Framework by end of 2017.	A financial consumer protection division was established at the CBL
17. Establish a dedicated Unit responsible for financial inclusion within the Private Sector Department at the Ministry of Finance by 2018.	Not achieved

Source: NIFS (2017-2021) and FinScope 2021



FinScope 2011 revealed that in regional terms there was comparatively high levels of financial inclusion within Lesotho. Among the 14 African countries in which FinScope surveys had been undertaken, Lesotho had the lowest financial exclusion figure, with only 19% of the adult population being financially excluded. 38% of adults had a bank account and a further 22% made use of only other formal (non-bank) financial products/services. This means that 60% of Lesotho adults were formally included in 2011, with a further 21% only served by informal financial services.

Financial inclusion expanded since 2011.⁶ Formal inclusion (bank and other formal (non-bank)) increased from 60% in 2011 to 87% in 2021. This contributes to the resources available for financing domestic development in Lesotho. Taking into account informal services, the proportion of individuals who are financially included increased from 81% in 2011 to 91% in 2021 (see Figure 1). This was largely driven by an increase in other formal (non-bank) products/services. 66% of the adult population use mobile money which contributed significantly to increasing financial inclusion in Lesotho. The proportion of individuals that rely solely on informal means to manage their financial needs decreased from 21% (2011) to 4% (2021), and those that use or have informal financial products/services decreased from 62% to 46% over the same period. When looking at the depth of access in Lesotho, we find a substantial improvement from the previous FinScope survey as 71% of adults have access to more than one formal financial product in 2021 compared to only 31%⁷ in 2011. Furthermore, it exceeds the national inclusive finance strategy target of 65% for 2021.

Banking penetration barely improved since the last FinScope Survey. 39% of adults (18+) were banked in 2021, which is only one percentage point more than in 2011. Some of the main barriers to owning a bank account are “cannot maintain the minimum balance at 53%, followed by “do not need it” at 26% and “high bank service charges” at 8%. The 2018 Multiple Indicator Cluster Survey of 8,847 households carried out by the Bureau of Statistics showed that 42% of households had at least one member that had a bank account.⁸ Taken together, this evidence suggests that the proportion of households that have access to a formal bank account has not changed significantly since 2011.

Financial access differs among demographic groups. Interestingly, 93% of women are financially included compared to only 89% of men. However, 40% of men are banked compared to 38% of women. Women also use more informal products/services than men (50% relative to 42%). In terms of age, 46% of adults aged 25 to 60 years are banked compared to 33% of youth (18 to 24 years) and 22% of elderly individuals (above 60 years old). Moreover, 50% of elderly individuals make use of informal financial products/services. The data reveals that 88% of youth are financially included compared to only 69% in 2011, with the largest uptake coming from those only using other formal (non-bank) products/services. This is likely driven by uptake of mobile money among the youth. The proportion of youth access to mobile money is 73%, greater than the adult proportion of 66%. When looking at locations, we find that 95% of adults who live in urban



The proportion of individuals who are financially included increased from 81% in 2011 to 91% in 2021.

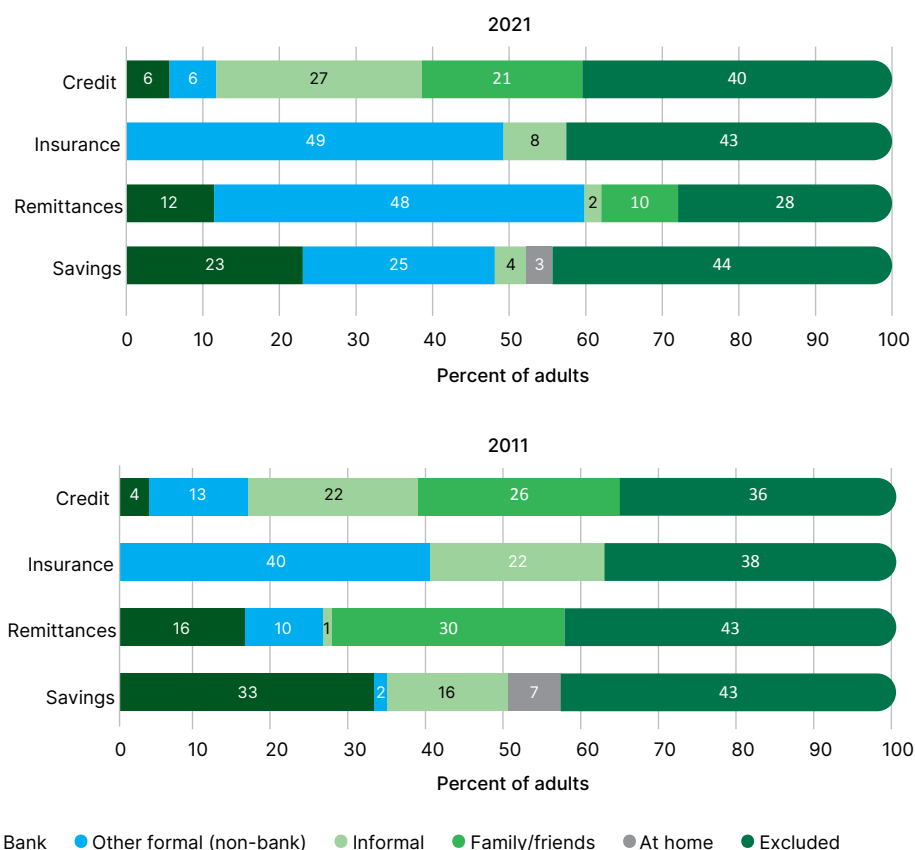


Figure 2: Financial services access across products

Source: FinScope 2011 & 2021. Bars may not equal 100% due to rounding.

areas⁹ are financially included with 57% being banked, compared to 88% in rural areas being financially included with only 26% being banked.

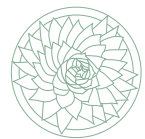
The use of formal credit decreased while formal remittances, insurance and savings increased. Figure 2 shows that remittances have the deepest reach among adults in the formal products category (59%), while credit has the lowest (12%). Formal inclusion for remittances, insurance and savings increased by 129%, 23% and 40% respectively, while credit decreased by 29%. The uptake in other formal (non-bank) savings and remittances is mostly driven by mobile money while for insurance it is funeral cover.

Total credit usage has contracted by 8% since the previous FinScope survey (see Figure 2). Credit usage for both men and women contracted over the period 2011 to 2021, with women borrowing more than men (64% of women borrow compared to 54% of men in 2021). In terms of age groups, the youth borrow the least at 49% with adults aged 25 to 60 years borrowing the most at around 63%. When looking at the reasons given for being denied a loan in Lesotho we find the main reasons being “not having a down payment” (62%) followed by “income was too low” (10%).¹⁰

Total savings usage has decreased by 1% point (see Figure 2). However, there has been a large increase in adults that only save using other formal (non-bank) channels (2% in 2011 to 25% in 2021). This has mainly been driven by mobile



Credit usage for both men and women contracted over the period 2011 to 2021, with women borrowing more than men.



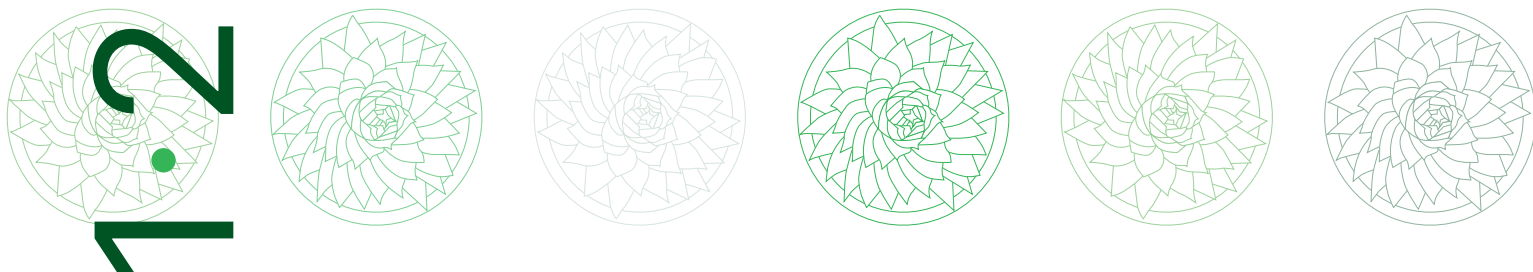
money. Women make use of more informal savings channels relative to men (22% as opposed to 13%). When looking at locations, 44% of Lesotho adults living in rural areas save compared to 72% of urban adults. Furthermore, 35% of urban adults save at banks and 23% make use of informal savings while 14% of rural adults save at banks and 13% save informally.

Total uptake of insurance has fallen by 8% which was driven by a decrease in the number of adults using informal insurance products (see Figure 2). However, funeral cover remains a strong driver of insurance uptake as 93% of insured adults (57%) have funeral cover. The main barriers to the uptake of life cover are “never heard about it” (26%) and “don’t have a regular income” (18%) and for funeral cover, burial society or mpate sheleng they are “don’t have a regular income” (35%) and “don’t have a job (unemployed or retrenched or retired)” (19%).¹¹ There is also an interesting gender disparity with 62% of women having insurance compared to only 52% of men. When looking at age groups, 70% of the elderly population are insured compared to 25% of youth and 59% of individuals aged 25-60 years old. Furthermore, 30% of elderly individuals use informal insurance channels compared to 24% of adults aged 25 to 60 years old.

Total remittances usage have increased from 57% of adults remitting in 2011 to 72% in 2021 (see Figure 2). This came from an increase in other formal (non-bank) remittances which was largely driven by mobile money, which was used by 84% of adults that sent money. Women engage more in remittances than men, as 75% of women remit compared to 69% of men. Furthermore, 83% of individuals living in urban areas engage in remittances while only 64% in rural areas.

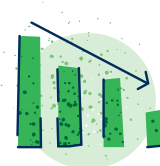


Women engage more in remittances than men, as 75% of women remit compared to 69% of men.



Economy, population and growth

Lesotho is a lower middle-income country (along with Angola, Comoros, Eswatini, Zambia and Zimbabwe in SADC, for example) and is characterised by very low GDP growth. The United Nations defines Lesotho as one of the 47 least developed countries in the world.¹² Lesotho has a population of about 2.1 million people, a gross domestic product ('GDP') of approximately USD 2.4 billion in 2019 (USD 6.1 billion in purchasing power parity, 'PPP' terms), and a GDP per capita of USD 1,158 (PPP: USD 2,882).¹³ Lesotho has one of the lowest GDP per capita among SADC countries (Figure 3) and GDP in USD has declined at approximately 0.3% per annum over the past five years since the initial MAP diagnostic was conducted.



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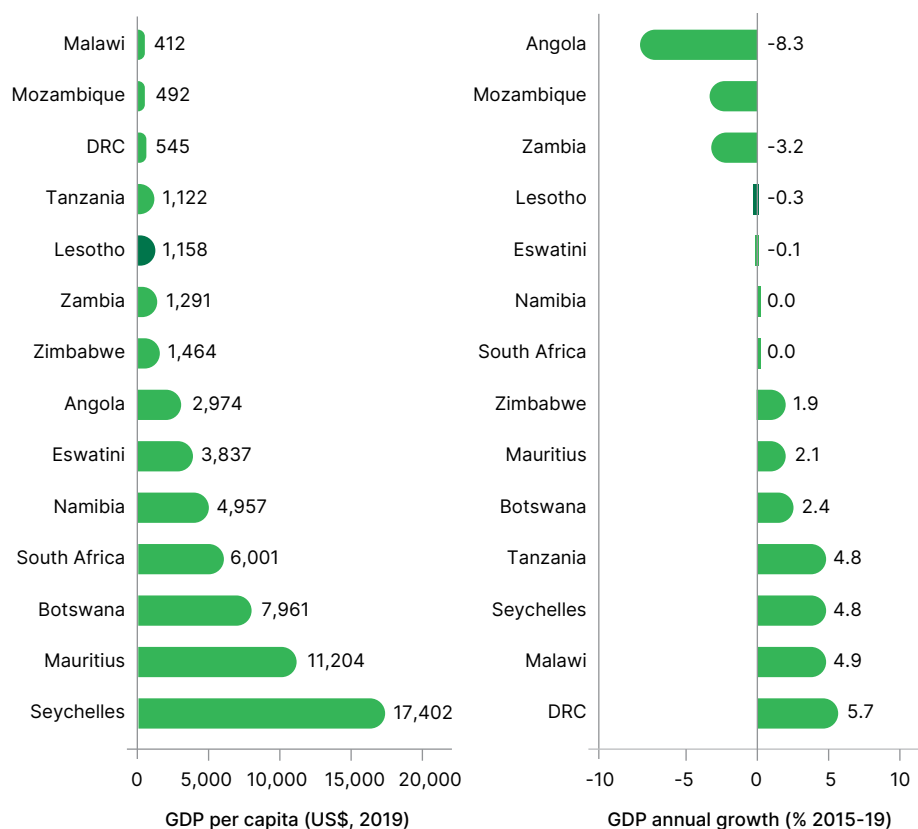
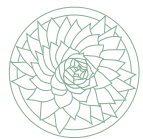


Figure 3: GDP per capita in 2019 and annual growth between 2015-2019 (SADC)



This implies that the economic growth rate in Lesotho is not able to raise average GDP per capita. At the same time, the human development index for Lesotho has increased over time, from 0.503 in 2015 to 0.527 in 2019, with increases particularly in life expectancy at birth (increasing from 51.0 to 54.3 over the same period), expected years of schooling (improving from 11.2 to 11.3) and GNI per capita (measured in 2017 USD PPP terms), from 3,077 to 3,151.¹⁴ Inflation is relatively stable in Lesotho, declining over time from an inflation rate of 6.1% in 2012 to 4.3% in 2020.¹⁵ Lesotho's public debt is expected to expand to 62.8% of GDP in 2021.¹⁶

Lesotho's economic prospects are linked to growth in surrounding areas.

The negative economic performance of Lesotho in recent years has been fostered by the general trend of slow global economic growth - accompanied by a major downturn in both emerging markets and advanced economies.¹⁷ Furthermore, the political instability in the country, as well as the slow economic growth in neighbouring South Africa (Lesotho is a landlocked country surrounded by South Africa), has contributed to reduced economic performance overall. According to the World Bank overview of the Lesotho economy,¹⁸ the real GDP growth rate is projected to average 0.6% between 2019 and 2021, largely attributed to the expected negative impact of Covid-19 (coronavirus).

Economic growth prospects are linked to large infrastructure investments.

The private sector in Lesotho is small and largely informal, and the public sector plays a significant role.¹⁹ In the medium-term, economic growth is expected to be aided by public investment in construction-related projects including those associated with the second phase of the Lesotho Highlands Water Project (LHWP II), the Lesotho Lowlands Water Development Projects (LLWDP -I and-II), and government roads.²⁰ In addition, the water and electricity subsectors will be boosted by green energy projects that are predicted to gain traction over the coming years (for example, the World Bank's 'Renewable Energy & Energy Access Project' in Lesotho).

There is also a relatively large diaspora living outside Lesotho (especially in South Africa). Remittances to Lesotho amounted to approximately 20% of GDP in 2020 (Lesotho ranks second in Sub-Saharan Africa on this score, and tenth worldwide).²¹ The extensive regional integration impacts livelihoods and the overall financial inclusion profile – the close link with South Africa means that Lesotho has a high degree of financial integration with South Africa. This includes sharing an exchange rate and monetary policy, partially integrated capital markets and payments systems, a banking system that is closely integrated with that of South Africa, a high level of cross-border remittances (largely inward) and cross-border trade in financial services.²² Migrant labour has a central impact on household structures and livelihood activities. Those dependent on others for their main income source is the single largest target market segment, whilst many other adults also receive remittances as an additional source of income. Apart from the direct impact of remittances, the large migrant population means that there is considerable room for other financial services targeted at the diaspora.



The private sector in Lesotho is small and largely informal, and the public sector plays a significant role.



This would, for example, include repatriation funeral insurance and cross-border payment of dependents' insurance premiums, retirement or other long-term savings, and cross-border payment of loans.²³

The population of Lesotho is more urbanised than in many African countries, and the population is relatively young. Of the 2.1 million people living in Lesotho in 2020,²⁴ 40% live in urban areas and 60% live in rural areas. At the same time, the population is urbanising: the proportion of people living in urban areas was 34% in the 2011 census, increasing to 40% currently. There are also large numbers of young people: 31% of the population is younger than 15 years old (there are approximately 1.5 million people aged 15+), and half of the population is aged 24 years and younger.

There are approximately 1.35 million working-age people in Lesotho, only around half (0.67 million people) of which are in the labour force. According to the findings of the 2019 Lesotho Labour Force Survey,³⁸ the working population was estimated at 1,346,770, of which 52% were female. About 672,711 persons were in the labour force, either employed (521,445) or unemployed (151,266). The broad-based population pyramid for Lesotho depicts a large young population relative to the older age groups. The average household size is five people, with 49% of Lesotho's population consisting of young children below the age of 15 and the elderly population (65 and over) comprising 5.8% of the total.²⁵

Lesotho is administered in 10 districts, 80 constituencies and 129 local community councils. More than a quarter of the population (27%) live in the Maseru district (Figure 4), and together with the neighbouring Berea (13%) and nearby Leribe districts (17%), 57% of the population lives in three districts (projected to grow to 60% by 2026). There are four ecological zones in Lesotho, which is 30,000km² in area: the lowlands (17%), foothills (15%), mountains (59%), and the Senqu River Valley (9%).²⁶ Economic activity largely takes place in the lowlands, foothills and the river valley.



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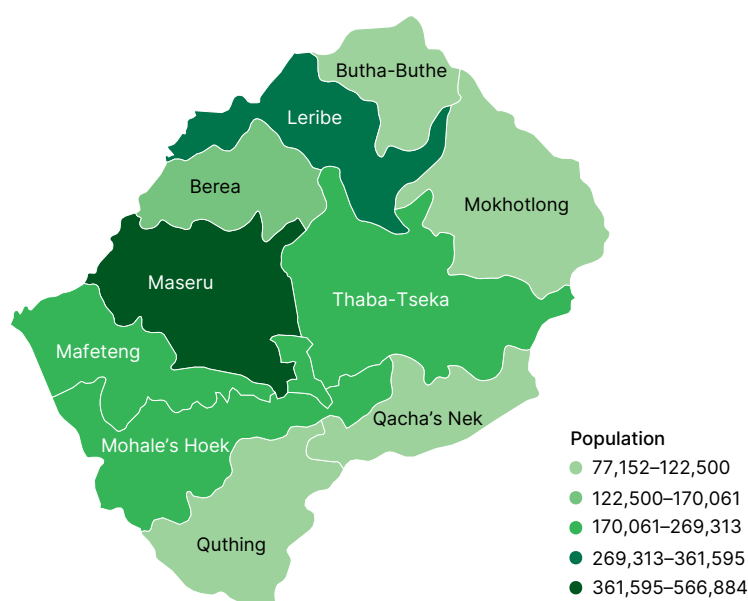


Figure 4: Lesotho population by district (2021)

Source: Acacia analysis of Bureau of Statistics data

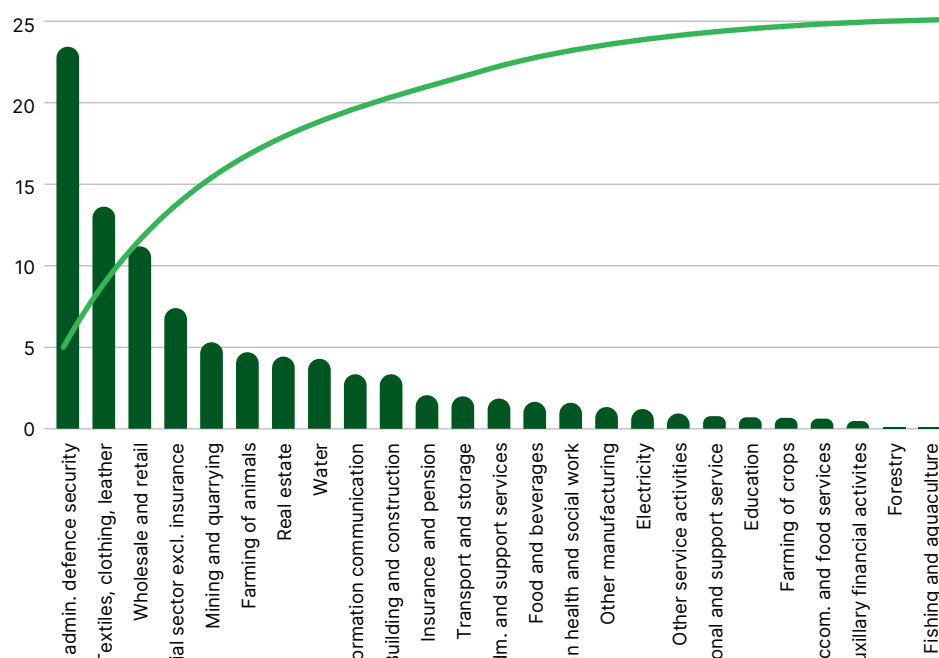


Figure 5: Decomposition of economy by sector (% of GDP) – line depictions cumulative sectoral contribution

Source: Central Bank of Lesotho. Lesotho Economic Outlook 2020-2022.

The Lesotho NSDP identifies manufacturing, commercial agriculture, innovation and creative industry, and accommodation/tourism as key growth sectors. The manufacturing sector is supported by a significant textiles, clothing and footwear industry, that benefited from market access due to the US – Africa Growth and Opportunity Act (AGOA) (Figure 6).²⁷ The sector has declined in recent years largely due to the end of the Multi-Fibre Arrangement in 2005 (a preferential access agreement for access to US and EU markets), and the 2008 financial crisis. Nonetheless, this sector remains the largest private sector employer in Lesotho, accounting for the bulk of the approximately 50,000 private sector jobs.²⁸ Lesotho is the second largest producer of merino wool in the world and also has emphasised other agricultural products, such as fresh fruit and vegetables, and aquaculture. While growth in the coming years is largely being driven by the construction of the various water projects, growth is also expected in tourism and the agricultural sector (Figure 6). In order to facilitate the growth of these sectors, a considerable amount of work is needed in respect of the overall ease of doing business in Lesotho: in 2019, Lesotho ranked 122nd out of 190 countries in respect of the ease of doing business overall.²⁹

Lesotho is a small, open economy, and cross-border trade is predominantly with South Africa. As a percentage of GDP, the value of imports and exports are 94% and 45% respectively.³⁰ Approximately 80% of imports into Lesotho are from South Africa, comprising mainly food products.³¹ A large constituency of the exports comes from manufacturing sector exports to the SACU market (mainly to South Africa) in the form of small electrical parts and machinery, auto parts, and miscellaneous items.³² Lesotho is part of the SADC free trade arrangement ('FTA'), and imports are duty free from member countries except for sugar, second-hand clothes, original vehicle components and wheat flour.³³

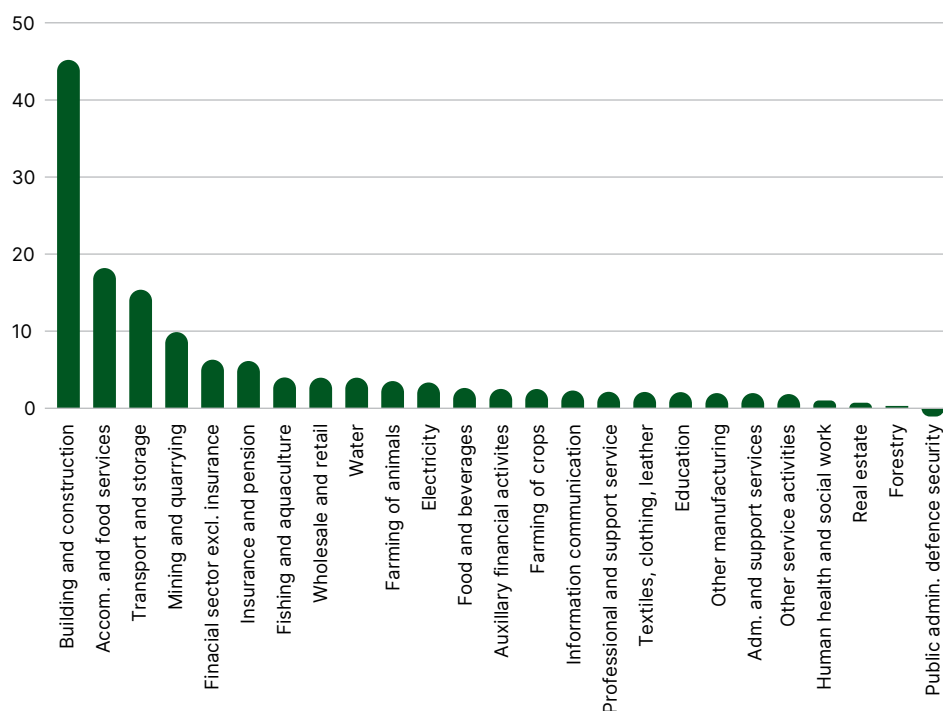
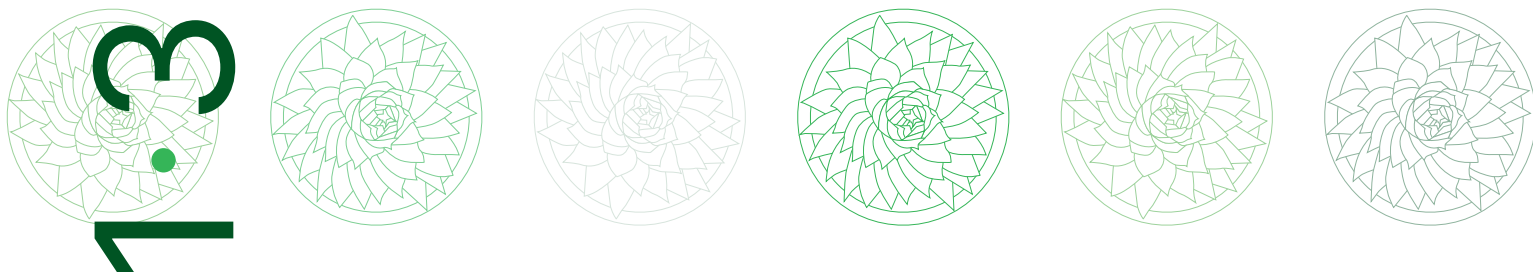


Figure 6: GDP growth by sector (% , 2022)

Source: Central Bank of Lesotho. Lesotho Economic Outlook 2020-2022.

Lesotho may benefit from greater trade integration within the SADC and wider Africa region, as more members sign up for the SADC FTA and the African Continental Free Trade Agreement (AfCFTA). In order to achieve greater integration, logistics are an important area for development in Lesotho, as Lesotho is ranked 154th in terms of the Logistics Performance Index.³⁴

Since independence in 1966, Lesotho has attracted a lot of foreign aid in most of its development programmes, including those channelled to civil society organisations.³⁵ Lesotho's government is to a large extent unable to mobilize local finances and thus depends on Southern African Customs Union revenues (accounting for more than 50% of revenues in some years),³⁶ remittances from abroad, and revenue from exporting water and energy, via the donor-funded Lesotho Highlands Water Project.³⁷ Net official development assistance (net-ODA), which relates to the grant portion of bilateral donor funding, accounted for over 5% of gross national income between 2017 and 2019.³⁸ Bilateral assistance in respect of health and population accounts for 74% of ODA funds, and education a further 13%. The largest multilateral donor is the International Development Association ('IDA'), part of the World Bank group (accounting for almost 40% of gross ODA). Given the donor spending priorities in respect of health and population, it may be helpful to consider linking financial inclusion interventions such as in respect of digital national identification documents, and airtime subsidies for community healthcare workers, discussed in Section 6.1.



Policy and regulation

The policy and regulatory environment in Lesotho has developed over time, where financial inclusion is concerned. This is particularly so in respect of e-money regulations enabling mobile money and similar financial service providers, and with the introduction of pension fund legislation.

The key economic planning document is the NSDP II (2018/19-2021/22). The NSDP II emphasizes economic growth in the manufacturing, agriculture and tourism sectors, various aspects of social development, including in respect of health and education. These form important inputs into the links between the real economy and financial inclusion in this MAP Refresh, as discussed in more detail in Section 5.

IN RESPECT OF THE FINANCIAL SERVICES SECTOR THE NSDP II PRIORITISES:

- Improving access to credit particularly by the business sector (discussed in more detail in Section 3.5),
- Improving financial inclusion (the subject of this report), and
- Improving domestic resource mobilisation (considered here, for example, in respect of reforms needed to expand access to financial services that can help expand deposits, discussed in Section 4.2 for example).

In respect of the governance of financial inclusion in Lesotho, the Ministry of Finance leads a steering committee that is responsible for implementation of the financial inclusion strategy. The various divisions of the CBL are part of the financial inclusion steering committee, together with Finmark Trust and UNDP. This committee met periodically between 2016 and 2020. In addition, the CBL hosts the FSDS secretariat that also linked to financial inclusion but concerned a broader set of interventions. This secretariat has since been dissolved as the FSDS project came to an end. There is also a sector-wide forum, which met quarterly, for the purposes of sharing information, and implementing projects such as Finscope and the Lesotho SIMM project (discussed in more detail in Section 4.1).



The NSDP II emphasizes economic growth in the manufacturing, agriculture and tourism sectors, various aspects of social development, including in respect of health and education.



Given the successes of these projects, as well as support for individual initiatives such as FinMark Trust's involvement in the Shoprite money transfer scheme, the existing structure is working reasonably well. At the same time, the financial inclusion steering committee comprises staff members from the CBL and Ministry of Finance who have other responsibilities and this has limited the capabilities of the implementation team and resulted in a lack of participation in financial inclusion activities. In addition, given the emphasis in this MAP refresh on the links between financial inclusion and economic and human development, it will be important to expand the steering committee and forum to additional stakeholders in the coming years, as discussed in Section 6.3.


Table 2: Key financial policies and regulations in Lesotho

	POLICY / REGULATION	OVERVIEW
FINANCIAL POLICY / REGULATION	Pension Funds Act, 2019	This provides for the regulation of the pension funds sector by the CBL, and provides for the registration and regulation of pension funds.
	Collective Investment Scheme Regulations, 2018	The regulations allow for the licensing of asset managers, and collective investment schemes and agents. Minimum capital requirements for asset managers are set out, among other rules and requirements.
	Payment Systems Regulations, 2017	The intention of these regulations are to provide for licensing and oversight of issuers of electronic payment instruments including e-money.
	Insurance (Capital, Solvency and Reserves Requirements for Insurance Regulations, 2016)	The regulations include capital, solvency and reserve requirements, requiring for example a minimum share capital of M4 million and requiring that 30% of assets be held in Lesotho, and prescribing maximum exposures to various asset classes.
	Financial Institutions (Large Financial Cooperatives Regulations, 2016)	These regulations create the regulatory framework for large financial cooperatives, including for protecting deposits and shares of members, and to strengthen governance. The regulations apply to cooperatives registered in terms of the Cooperative Societies Act of 2000, where deposits or assets exceed M5 million.



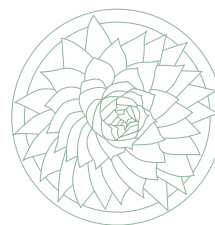
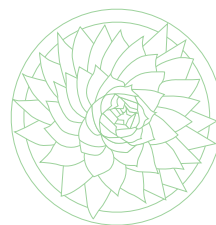
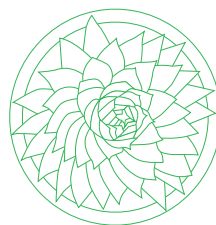
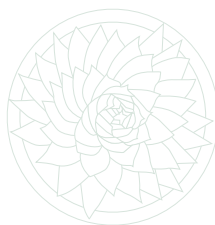
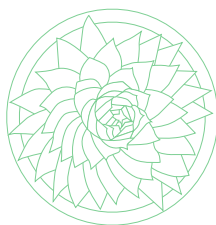
PART 1 NOTES

- 1 The 2011 figure is 31%.
- 2 22% is the proportion of adults in 2011 that only used other formal (non-bank) products/services.
- 3 There has been a large increase in total other formal (non-bank) savings but there has also been a large drop in bank and informal group savings.
- 4 This includes all mobile money agents (more than 13,000 in 2020), and not only 30-day active agents (closer to 6,000 in 2020).
- 5 Excluding cash-in.
- 6 FinScope 2011 Lesotho Brochure. FinScope is a survey of the demand for financial services in Lesotho undertaken in 2011, as well as qualitative demand-side research undertaken in both urban and rural areas.
- 7 Lesotho Financial Inclusion Roadmap 2014-2020 - UNCDF
- 8 Bureau of Statistics. 2019. Lesotho Multiple Indicator Cluster Survey 2018, Survey Findings Report. Maseru, Lesotho: Bureau of Statistics. Referred to as the 'MICS' hereafter.
- 9 In this document references to urban areas in the FinScope 2021 survey include peri-urban areas.
- 10 FinScope 2021.
- 11 FinScope 2021
- 12 UNCTAD. 2020. The least developed countries report. Available: Online
- 13 World Bank. World Development Indicators. Available Online.
- 14 UNDP. 2020. Human Development Report. Available: Online
- 15 IMF: World Economic Outlook (WEO) Database, October 2020
- 16 African Development Bank Group. 2021. Lesotho Economic Outlook. Available: Online
- 17 World Bank in Lesotho. Available: Online
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- 19 World Bank. 2020. Lesotho Policy Notes. Available: online.
- 20 World Bank in Lesotho. Available: Online.
- 21 World Bank. 2020. *Phase II: COVID-19 Crisis through a Migration Lens*. Available: Online
- 22 Lesotho MAP 2014.
- 23 Lesotho MAP 2014.
- 24 The medium variant of the population estimates for Lesotho are 2,063,972 in 2020, and 2,077,310 in 2021. See report on demographic indicators for Lesotho, developed by the Bureau of Statistics.
- 25 MICS 2019.
- 26 UNDP. Climate Change Adaptation, Lesotho. Available: Online
- 27 World Bank. 2020. Lesotho Policy Notes. Available: Online
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- 30 World Integrated Trade Solution. Available: Online
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- 33 Tralac. 2019. Intra-Africa trade and tariff profile. Available: Online
- 34 World Integrated Trade Solution. Available: Online
- 35 Rose, J. 2016. 'Partnerships between Foreign Agencies and Civil Society Organisations in Lesotho: A Marriage of Convenience'. *Sociology and Anthropology*, 4(6): 473-481. DOI: 10.13189/sa.2016.040606
- 36 Tralac Blog. 2018. *Revenue sharing in the Southern African Customs Union (SACU)*. Available: Online
- 37 Devex. Available: Online
- 38 OECD-DAC. Available: Online, and Online



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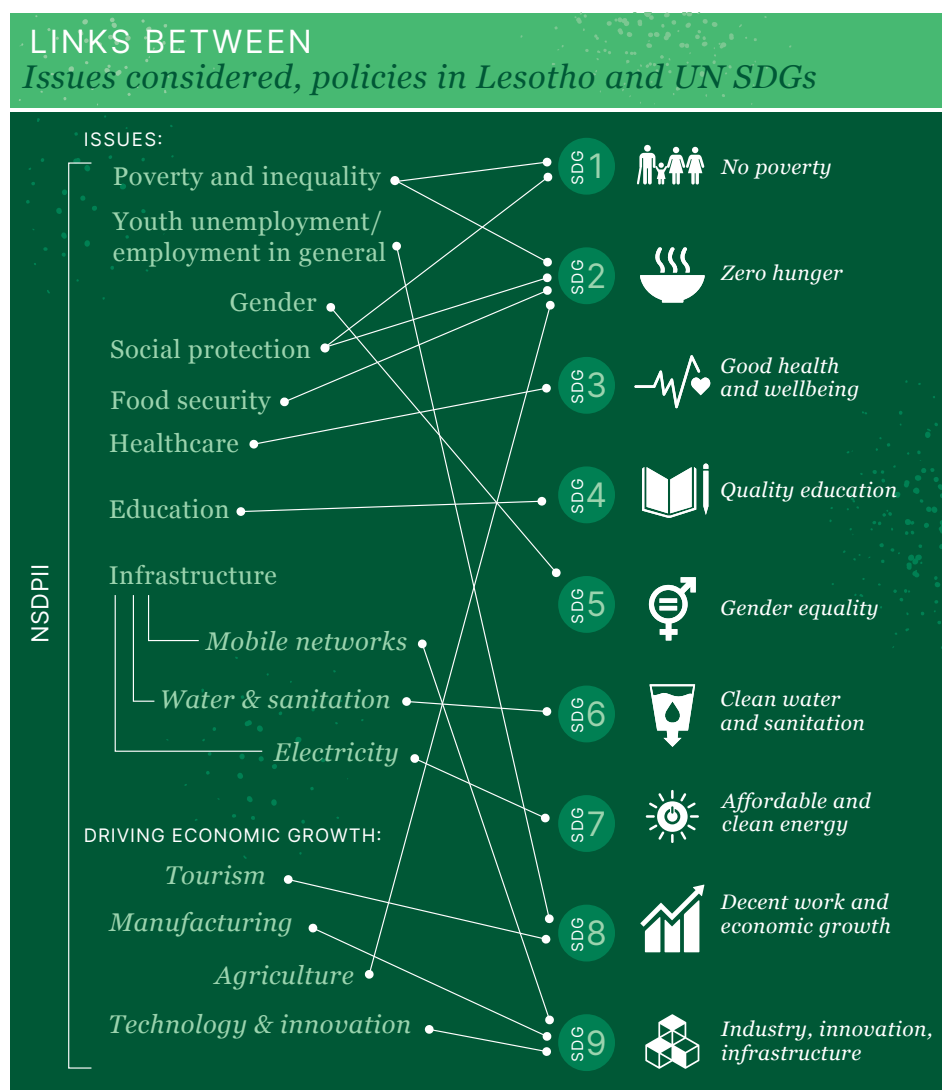
Social and
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questions,
and links
to financial
inclusion

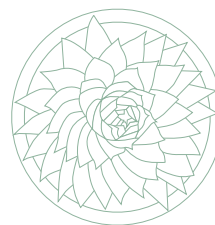
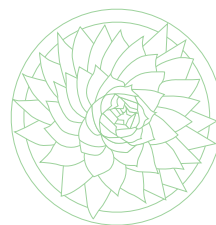
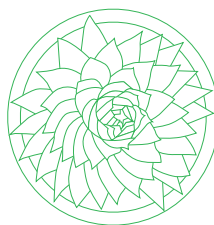
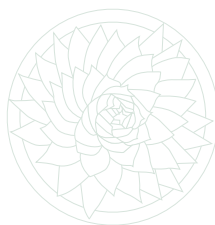
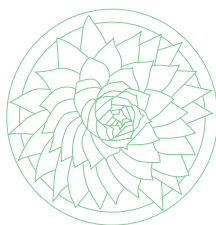
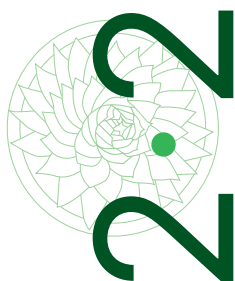


Introduction

This MAP refresh project involved selecting a number of issues for deeper analysis

These issues were selected due to (i) their likely impact on human development, (ii) relationship to government policies in Lesotho, and in particular the NSDP II (2018/19-2021/22), and (iii) links to the SDGs (see Table 3). In what follows we summarise some of the issues in Lesotho and links with financial inclusion.





Poverty and inequality

SDG 1.1: “By 2030, eradicate extreme poverty for all people everywhere, currently measured as people living on less than USD 1.25 a day.”

Despite Lesotho being a middle-income country, there are high levels of poverty and inequality (including gender and rural-urban inequalities). Approximately half of Lesotho's population falls below the national poverty line of M649 per adult equivalent per month, and the extreme poverty rate in 2017/18 was 24%, based on M352 per adult equivalent per month.¹ Lesotho falls into the top 20 percent of countries ranked by inequality, with a Gini coefficient of 44.6.² In addition, Lesotho faces high inequality of opportunity, with variables such as place of birth, parents' education, health shocks and environmental shocks contributing to half of the current level of inequality in Lesotho. Moreover, relatively low intergenerational mobility exacerbates high inequality in Lesotho.³ Comparatively, poverty and inequality levels in Lesotho are higher than the averages for developing countries and for its peer middle-income countries.⁴

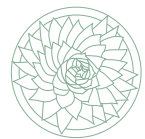
From agricultural to manufacturing and service based. Since the 1970s, the Lesotho economy has been transformed from predominantly agriculturally based, to a greater role for the services and manufacturing sectors. This may have improved livelihood options in the urban sector, but at the same time it has significantly undermined the capacity of the rural and agricultural sector as a source of livelihood, employment, and income. The shifting balance towards manufacturing has also worsened poverty in rural communities, particularly those that depend on food production. Lesotho subscribes to the principles of New Partnership for Africa's Development (NEPAD) which is a pledge by African leaders, based on a common vision and a shared conviction to eradicate poverty and sustain growth and development of their countries. It will therefore be necessary to take measures to restore the sources of livelihoods for the rural population.⁵

There are important links between poverty alleviation and financial inclusion.

Economists have documented the important link that financial inclusion, including through greater access to mobile money, plays in mitigating the effects of economic shocks⁶ and, in the longer term, increasing per-capita income levels.⁷ Financial access in terms of uptake is not the main problem in Lesotho, as on the whole the adult population is already served by financial services. However, the



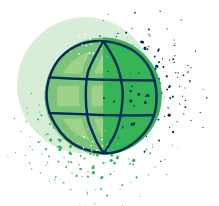
Since the 1970s, the Lesotho economy has been transformed from predominantly agriculturally based, to a greater role for the services and manufacturing sectors.



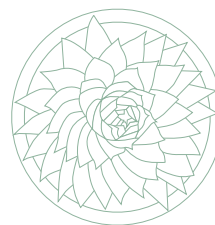
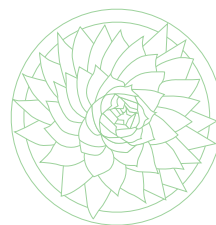
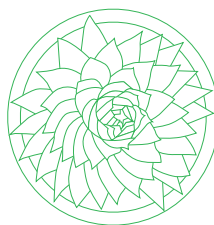
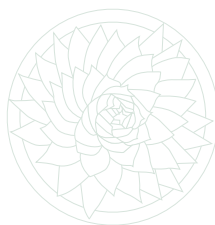
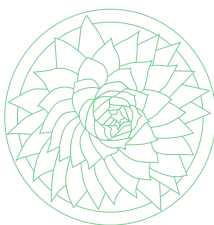
kind of financial services being used include high-cost bank accounts, low-value community or home-based savings, high-cost informal loans, funeral cover, and informal remittances – services that do not serve to lift people out of poverty, but rather help them to “get by”.⁸

The low and irregular income profiles of many of the adult population serves as a challenge for formal eligibility, especially for credit. Alongside this, the geography and infrastructure constrain the scope for further largescale penetration into rural areas. This means that the focus should be on how to extend the reach of financial services – increasing both the depth of access as well as the distributional reach into rural areas (60% of the population lives in rural areas, mostly engaged in livestock herding and subsistence agriculture).⁹ It is important to consider how financial services can be leveraged or re-engineered to alleviate poverty and support economic growth. This will require a targeted roadmap that focuses on the “biggest marginal gain” activities from a consumer needs and welfare perspective.¹⁰

Additional aspects of poverty and inequality in Lesotho, and links with financial inclusion, are discussed in the sections that follow.



The geography and infrastructure constrain the scope for further largescale penetration into rural areas. This means that the focus should be on how to extend the reach of financial services.



Employment

SDG 8.6: “By 2020, substantially reduce the proportion of youth not in employment, education or training.”

Labour force

The unemployment rate in Lesotho is high and is more severe for those living in rural areas, with low levels of education, and for young women. At 23%, the official unemployment rate is high, although this is in the context of a longer-term trend of declining unemployment (decline has slowed in the last seven years).¹¹ The measure becomes 38% when expanded to include discouraged jobseekers, who have stopped looking for work during the survey period because of various reasons. The high expanded unemployment rate implies a significant number of discouraged jobseekers and it is important that policy interventions targeted towards reducing unemployment take this into account. In addition to low job creation, direct constraints to productive employment include inadequate skills among the workforce.¹² Labour productivity in Lesotho is one of the lowest in the world and production remains predominantly labour-intensive. The lack of productive employment results in high vulnerability to poverty. The Covid-19 crisis is likely to worsen some of the challenges faced by the youth in Lesotho, including their aspirations for their future and social skills and confidence.¹³

Unemployment for the youth is significant. Unemployment, inactivity, and poverty particularly affect the youth in Lesotho – the overall unemployment rate is estimated to be 23%, however the unemployment rate among youths aged 15 to 35 is 71%,¹⁴ thus private sector-led job creation is a top priority especially for youth.¹⁵

There is a large informal sector that should be considered. According to the 2019 Labour Force Survey, approximately 60% of those employed work in the informal sector.¹⁶ The Covid-19 pandemic has severely impacted businesses – this large informal sector in particular. Given Lesotho’s cross-border trade dependence on South Africa, the lockdown and border closings have disrupted supply chains and logistics. Many businesses, especially informal operators, had to either cease operations or only operate partially and have lost revenues and customers and are in desperate need for relief assistance as well as support for recovery and growth.¹⁷



The Covid-19 crisis is likely to worsen some of the challenges faced by the youth in Lesotho, including their aspirations for their future and social skills and confidence.

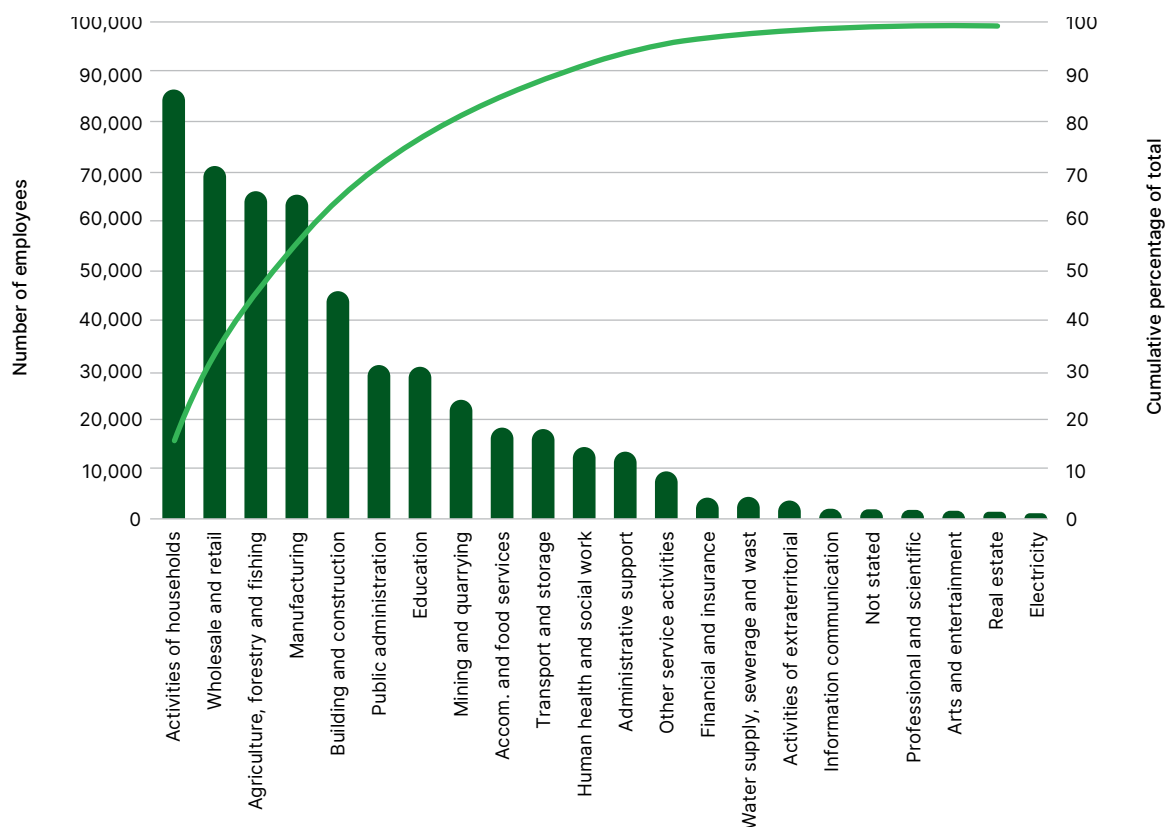
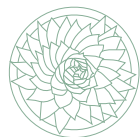


Figure 7: Employment by sector in Lesotho (LFS, 2019)

Source: Authors' analysis of Lesotho Bureau of Statistics data

Limited diversification in terms of sectors with formal employment opportunities

(and scope for future expansion into other markets). In 2019, the largest formal employment sector in Lesotho is 'Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use.' This is followed by 'Wholesale and retail trade; repair of motor vehicles and motorcycles', 'Agriculture, forestry and fishing' and then 'Manufacturing' (Figure 7). Some progress has been made in respect of the manufacturing sector, including exports to the SACU market (discussed in Section 2.2). Many of the workers in the formally employed private 'Manufacturing' sector are in the clothing, textiles and footwear sector, with the textile and apparel sector employing approximately 40,000 people – largely women.¹⁸ Horticulture, aquaculture and agro-processing, manufacturing, and mining sectors have products already being exported to regional and international markets or have potential for export development mainly through value addition. It is important to note that these sectors have scope to be developed to absorb more of the labour force into the formally employed category, as well as to help drive export growth and promote economic growth for the country.¹⁹



Labour migration

Lesotho has close links with South Africa, with extensive regional integration.

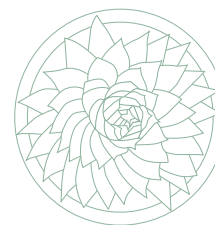
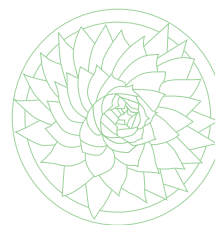
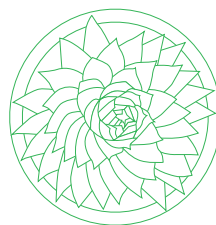
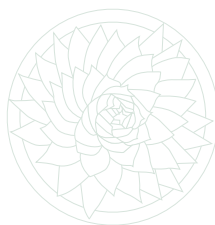
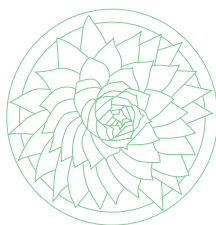
There is thus a high level of cross-border remittances (largely inward) – remittances to Lesotho amounted to approximately 20% of GDP in 2020.²⁰

Migrant labour has a central impact on household structures and livelihood activities. Apart from the direct impact of remittances, the large migrant population means that there is considerable room for other financial services targeted at the diaspora. This would, for example, include repatriation funeral insurance and cross-border payment of dependents' insurance premiums, retirement or other long-term savings, and cross-border payment of loans.²¹

Looking at migration within the country, natural growth and increasing rural-to-urban migration is driving urban growth. Lesotho's urban population is estimated at 40% of the total population, which is comparable to the average urbanization rate for Africa of 42%. However, the rate in Lesotho is projected to reach 45% by 2050, which could pose problems given Lesotho's lack of ability to manage urbanization and weak land regulation. Although urbanization is seen as a positive, it has led to informal development and urban sprawl in the periphery of Lesotho's cities. The steep terrain here poses development challenges for infrastructure (discussed in Section 3.10), service provision, climate change adaptation mechanisms and response during natural disasters.²²



Lesotho's urban population is estimated at 40% of the total population, which is comparable to the average urbanization rate for Africa of 42%.



Gender related disparities

SDG 5.a: “Undertake reforms to give women equal rights to economic resources, as well as access to ownership and control over land and other forms of property, financial services, inheritance and natural resources, in accordance with national laws.”

Women are more likely to be unemployed compared to men.²³ This is in the context of the country ranking 139 out of 162 countries on the Gender Inequality Index (GII) in 2019.²⁴ Using another measure, the Global Gender Gap, Lesotho’s score of 0.695 implies a rank of 88th out of 185 countries in 2020, trailing behind other African countries such as Rwanda (0.791 – 9th) and Namibia (0.784 – 12th).²⁵ We therefore discuss some of details of these disparities, and financial inclusion responses.

A lot has been done to keep girls in primary and secondary school, but this does not necessarily translate into employment. Free education policies (discussed in Section 3.9) are particularly relevant here because many girls that dropped out of high school did so due to a lack of funds. The education system was also amended to accommodate young girls who fall pregnant in school, as the alternative is often being married off. Girls were enrolled into summer school programs where, in addition to the national curricula, they were taught entrepreneurship skills.²⁶ Overall, women in Lesotho tend to have better education outcomes (discussed in Section 3.9), with women more likely than men to attend up to secondary school.²⁷ However, despite higher levels of school education, women are still more likely to be unemployed. This could be because of lower levels of tertiary education for women,²⁸ or remaining biases in the labour market.

Women continue to have higher formal and informal financial inclusion than men. This inclusion is not necessarily indicative of improving gender equality, but can be an opportunity to leverage gender equality. The increase in formal financial inclusion for women between 2011 and 2021 is largely due to more women using other formal (non-bank) products/services (Figure 8). Although there has been a decrease in the proportion of individuals that only use informal financial mechanisms, the proportion of women that use or have access to informal financial mechanisms is 50%, and 42% for men. When looking at financial

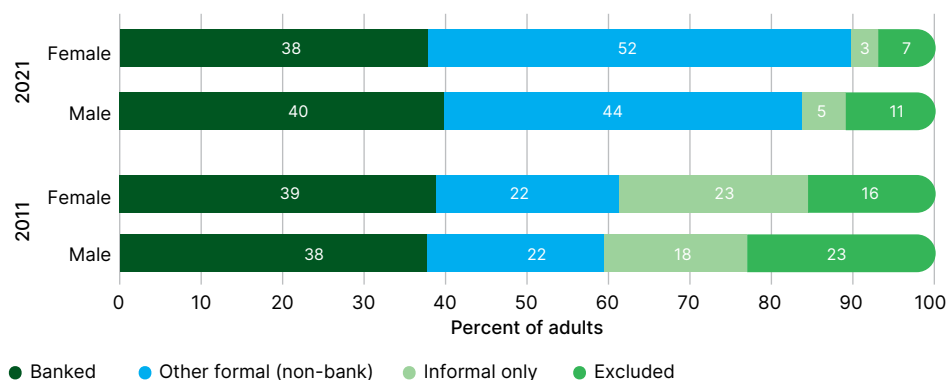


Figure 8: Financial access by gender

Source: FinScope 2011 & 2021. Note: Bars may not equal 100% due to rounding.

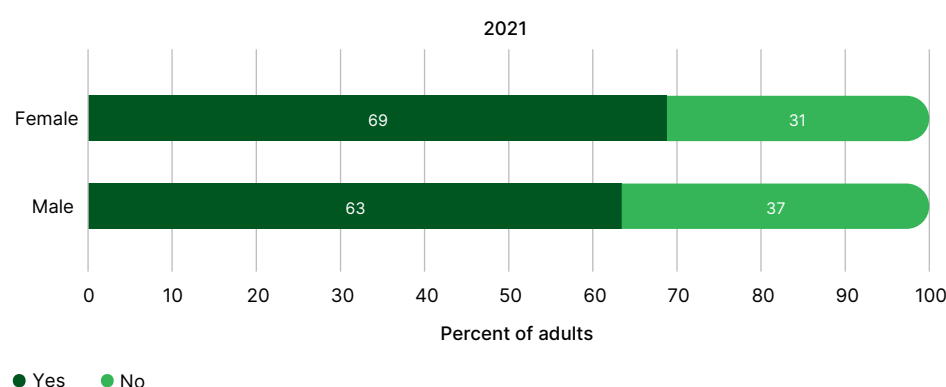
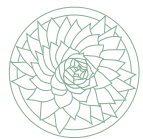


Figure 9: Mobile money usage by gender in 2021

Source: FinScope 2021

products/services we find that women save as much as men but borrow more at around 64% compared to only 54% of adult men.²⁹ There is also an interesting gender disparity with insurance as 62% of women have insurance compared to only 52% of men. Furthermore, 69% of women use mobile money services compared to only 63% of men (Figure 9). However, migrant workers (majority male) are oftentimes absent from home, leaving the care of the children solely to their wives. Thus, although Lesotho is a patriarchal society with deeply entrenched gender roles, women are taking a leading role within the family and financial decision making. This positions financial inclusion as a tool for engineering greater gender equality.

Women still continue to experience discrimination and disadvantage in access to land and housing,³⁰ fuelled by increased competition over land.³¹ The housing rights of women in Lesotho are embedded in customary law, and particularly vulnerable in rural areas. Recent legislative and institutional changes have meant a new environment in which women are negotiating secure land tenure.³² This means that the number of women that are benefiting from land allocation, land registration and land inheritance has increased. However, policy implementation failure, limited awareness of the new laws by both policymakers and women results in inconsistency in the application of the law, capacity limitations and



the continued dominance male biased norms undermine women's land rights.³³

This has been especially apparent in the context of Covid-19 with lockdown restrictions worsening violations of women's customary land rights in the region. In particular, the scaling down of court operations had denied women access to whenever they were dispossessed of their land and unjustly evicted by their male counterparts in Lesotho.³⁴

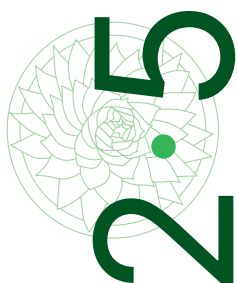
Despite the progress that has been made in solidification of women's economic empowerment and financial inclusion, there are gaps that need to be addressed.

Traditional cultural practices, such as gender inequality in land access and inheritance, place women at a comparative disadvantage and urgently need to be addressed. Asset ownership is a constraint to women's access to credit and other financial services, as women usually do not have complete ownership of assets such as land that could serve as collateral when seeking financial products. Thus, in order to ensure that women are empowered through financial inclusion, regulations on asset ownership need to be reformed and enforced.³⁵ In terms of women-specific financial products and services, impact assessment and quality evaluation should be expanded to include women empowerment strategies and funds. This will ensure that the most effective strategy is implemented as well as ensuring that funds are utilised efficiently.

Gender disparity issues must be simultaneously addressed while implementing financial inclusion strategies. According to report by the Alliance for Financial Inclusion (AFI),³⁶ targeted interventions such as affordable and flexible credit facilities, education and literacy support mechanisms, training, quota systems for women and other regulatory incentives, could help break down the social, cultural and stereotype barriers that remain an obstacle for women's economic empowerment and financial inclusion. Thus, additional research needs to be conducted to determine how women's financial inclusion can be improved and to increase women's contribution to poverty reduction and economic growth.



Asset ownership is a constraint to women's access to credit and other financial services, as women usually do not have complete ownership of assets.



MSMEs

SDG 8.3: “Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services.”

Many people depend on MSME's for an income, with 118,130 people working in the sector in 2016 according to the FinScope MSME survey.³⁷ This number includes individuals who are both self-employed or employed by an MSME, and in 2016 this made up approximately 12% of the labour force³⁸ The MSME sector is recognized as being a significant contributor to job creation, development and economic growth. However, 82% of MSMEs are informal and so there are many constraints to significant development in this sector.

The formalization of businesses in Lesotho is a cumbersome and time-inefficient process. As discussed below, Lesotho ranks 84th out of 190 countries in respect of starting a business (Figure 10). With only 29.8% of Basotho having access to the internet, there are significant inefficiencies and cumbersome processes with respect to the formalization of businesses.³⁹ The One-stop Business Facilitation Centre is a promising undertaking, Lesotho still has a way to go with reducing the time it takes to register a business and with streamlining the delivery of licences and permits.⁴⁰ It can be noted that political turmoil in Lesotho is inhibiting the adoption of business legislation and Licencing Bill, which is aimed at alleviating constraints for business in registration.⁴¹

One means of improving this score may be to allow banks to play a role in tax and business registration, collecting and processing these documents with the relevant authorities. Research on this has shown a positive impact in Malawi, for example, where an intervention to support formalisation was carried out in around 2012. In order to study the impact of the formal registration of predominantly retail businesses in Blantyre (70% of the sample were involved in retail), four follow-up surveys were conducted of firms who benefited from the formalisation interventions in 2012.⁴² The last follow-up survey was conducted in 2015. The businesses were treated in three ways in 2012: (i) assistance with registering the business, (ii) assistance with business and tax registration, (iii) costless business registration together with a banking information session and offer to



The MSME sector is recognized as being a significant contributor to job creation, development and economic growth.

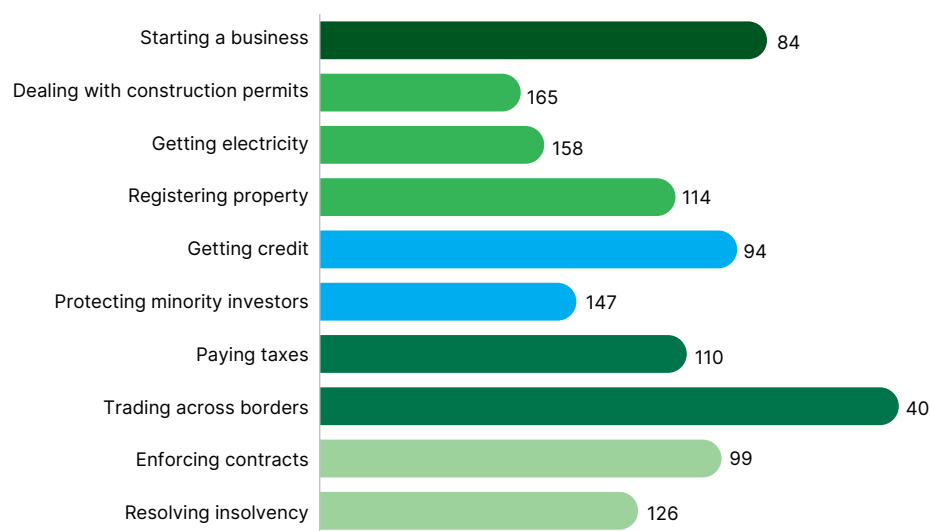


Figure 10: Lesotho's rank on ease of doing business (out of 190 countries in 2020)

Source: World Bank, 2020. Doing Business. Available: Online

open a business bank account. The researchers found that 75% of businesses received registration certificates. However, the treatment did not result in an expanded tax base nor improved trust in state institutions. While registration of the business had no impact on business outcomes, the banking information session was associated with a 20% increase in sales and a 15% increase in profits. The reason for the increases were more access to formal financial services. Thus, there may be an opportunity for banks and other financial institutions to offer free registration services for businesses applying for a formal bank account. Increased links between formal financial services providers and businesses operating in the wholesale and retail trade may help, therefore, to further the development of this sector. This may also have other benefits, including wholesale and retail traders becoming bank agents, since bank agents must be registered businesses.

MSMEs face significant credit constraints in a largely uncompetitive business environment. In terms of starting a business, Lesotho ranks 84 out of 190 countries and ranks 99th with regards to enforcing contracts (Figure 10). A largely uncompetitive business environment is one of the most binding constraints on the growth of the private enterprises, adversely affecting both foreign direct investment (FDI) and local MSMEs.⁴³ Notwithstanding the uncompetitive environment, only 10.4% of MSMEs had access for formal credit according to a 2014 FinMark Trust study, illuminating a serious constraint with enterprise development.⁴⁴ The credit issue is due in large part to the lack of a unified framework for secured transactions, low credit bureau coverage and slow progress in the development of a collateral registry.⁴⁵

Lesotho Revenue Authority (LRA) and Ministry of Finance may consider means by which the tax system may be used to help with MSME funding. A difficult problem facing MSMEs is funding value added taxes (VAT), which are usually payable on invoice rather than on receipt of cash.⁴⁶ The LRA might consider, in this regard, allowing all MSMEs (firms with a limited turnover) to delay paying VAT until they have received payment, and perhaps having a simplified approach to income and payroll taxes while the firm is in its start-up phase, for perhaps the first 12 or 24 months.



Access to finance and financial inclusion levels is a constraint to MSME sector growth.

The 2016 FinScope MSME survey⁴⁷ found that the main constraint to starting up a business was access to finance (49%). Moreover, while two-thirds of business owners are financially included, the other 35% (28,000) are financially excluded (do not use any formal or informal financial products or services) to manage their business finances. In addition, only 41% of business owners (31,000) are banked and 12% (9,000) have other formal non-bank products and services. The main barrier related to banking was affordability, as 65% of business owners indicating that they are not banked due to monetary reasons.

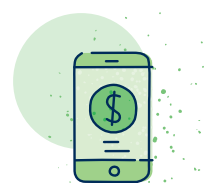
Cashless payments still problematic for merchants. Focus Group Discussions (FGDs) reveal that cash is still key for merchants, and there may be regulatory constraints to uptake of digital financial services linked to know-your-customer (KYC) requirements.⁴⁸ From the merchant's perspective, there was a lack of variety of products, an underlying preference from staff for cash payments, and transaction limitations due to KYC laws. To note here, one aspect of formalizing MSMEs is encouraging them to use cashless payment mechanisms, which can offer a range of ancillary benefits, as discussed below.

Promotion of digital products aided by value-added services as a solution.

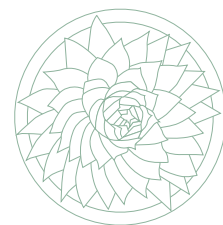
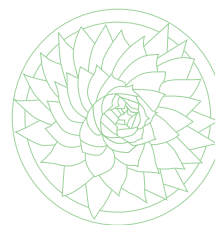
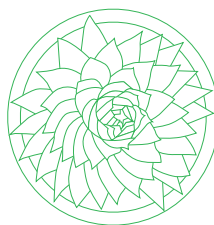
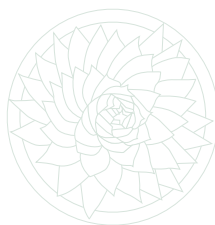
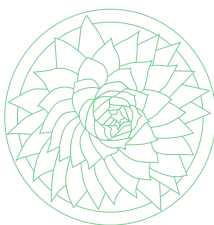
Merchant payments via mobile money show potential if promoted. During the course of a joint promotion between Vodacom and a supermarket and a bakery, and between Econet and a bakery, in 2018, digital transactions increased.⁴⁹ By comparison, a butchery that has accepted Vodacom mobile money payments for some time did not experience significant growth over time. Interoperable merchant payments may need to be considered in Lesotho together with the implementation of the national switch. With the national payments switch project, there is an opportunity to move away from legacy card-based payment systems to instant payments including by means of QR codes.⁵⁰

Moreover, value added services may help promote merchant payments. Providing value added services, such as digital credit, which solves an important problem for merchants would be an incentive. In a 2020 GSMA report, for example, 19% of operator respondents reported lending to digital payments clients.⁵¹ This approach is not only being adopted by mobile money providers but also by providers such as Square and PayPal. This may be the best means of growing digital financial services and paying for the costs of digital payments platforms. CGAP has identified additional value-added services, such as customer or employee loyalty reward programmes,⁵² customer relationship management, business intelligence, staff management, etc.⁵³

Training can also be provided, such as the SMME support network. The intervention reached 1,157 individuals and business owners, while 187 businesses received training.⁵⁴ Of the 187 businesses, 107 were informal entrepreneurs. The network has also promoted the use of mobile money through the creation of a video, which was used in MSME campaigns. The results of this initiative are tangible with 34.2% of respondents registering with MNOs, while there is also evidence of better record keeping among businesses.



One aspect of formalizing MSMEs is encouraging them to use cashless payment mechanisms, which can offer a range of ancillary benefits.



Social protection

UN sustainable development goal SDG 1.3 is as follows:

“Implement nationally appropriate social protection systems and measures for all, including floors, and by 2030 achieve substantial coverage of the poor and the vulnerable.”

Social protection has reduced poverty and inequality, but cost-effectiveness and targeting of the poor can improve. According to the World Bank's 'Lesotho Policy Notes', social protection spending in Lesotho is very high (6.4% of GDP and 14.3% of government spending) and has reduced poverty and inequality in Lesotho. However, cost-effectiveness is low, and most resources end up going to the non-poor. Due to various social assistance programs overlapping, coverage of social assistance programs is approximately 20% of the target population⁵⁵ - low by international standards. For such high spending on social protection (amongst the highest in developing countries), results on poverty and inequality reduction and human development outcomes would be expected to be a lot higher than they currently are. Lesotho does however still have a relatively well-developed social protection system compared to other SADC countries, and gives regular support to households and individuals throughout the various stages of their lives. Current social protection program spending reduces the poverty rate by 3.4 percentage points at the upper poverty line and by 6.5 percentage points at the food poverty line and reduces inequality by 4.1 percentage points (a pre-transfer effect).⁵⁶ Five programs— child grants, public assistance, school feeding, cash-for-work assistance, and old age pensions—were found to be effective, whether measured by impact or spending effectiveness.⁵⁷

There is a need to use new data sources and existing databases to identify the households that are affected and require assistance – connecting them to payment systems. Given Lesotho's high vulnerability to climate change shocks, it is important that social protection programmes and their delivery systems are able to respond flexibly and quickly to shocks. There is progress in this area, with the Ministry of Social Development currently completing the assessment and registration of vulnerable households. The rising poverty and vulnerability due to the Covid-19 crisis puts additional pressure on social safety nets and other social services – it is imperative that they scale up and adapt as the impact of Covid-19 is being felt by a group broader than those in the existing social protection system. These payments need to be made



Given Lesotho's high vulnerability to climate change shocks, it is important that social protection programmes and their delivery systems are able to respond flexibly and quickly to shocks.



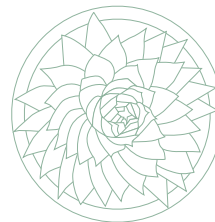
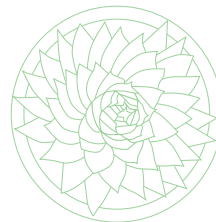
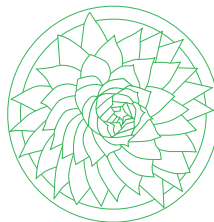
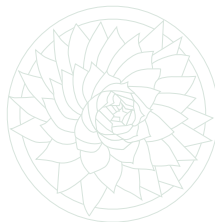
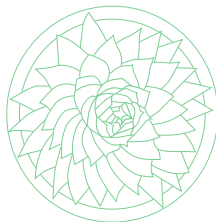
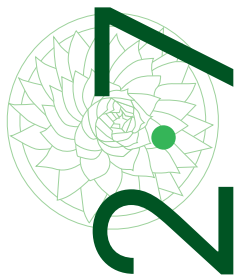
quickly and efficiently, as well as obeying social distancing protocols. The vast majority of payments are made in cash (non-digital) without proper control. For example, the old-age pension (OAP) recipients walk a long way to collect their cash transfer from the established pay points. The Government of Lesotho is trying to address this through mobile payments⁵⁸ – which once established could be further leveraged in order to ensure all social protection payments meet their intended recipients in a timely and efficient manner. This can result in administrative cost savings of approximately 20%.⁵⁹ In addition, the digital identity project proposed by FinMark Trust recommended linking the national ID system in Lesotho, which includes a biometric component, to social cash transfer programs, which are currently cash-based.

The problems that the social protection system faces are worsened by cash payments that make the transfers opaque and harder to monitor. Expanding usage of electronic payments (including mobile money) could improve speed, costs, targeting, and verification of transfers. There is potential for digital processes to assist with improving the efficacy of social transfers. In this regard, the NDSPII highlights the importance of implementing the National Information System for Social Assistance ('NISSA'). As part of this implementation process, digital means of targeting can be used to supplement existing methods for example, using satellite imagery such as vegetation maps and indices for Lesotho, which can be a proxy for income particularly for subsistence farmers or small scale livestock producers. Data on household expenditure, needed to more effectively design social cash transfer programmes, could potentially be gathered from digital service providers together with high frequency telephonic surveys to assess impact etc.

Furthermore, there may be means of communicating with beneficiaries by digital means, which make benefits easier to understand. The government might use this as an opportunity to put pressure on the mobile money operators and banks to reduce their prices based on significantly larger economies of scale arising from shifting social cash transfers to digital means or mobile money. In addition, digital identities can also reduce fraud. For example, the Ministry of Finance uses the national ID system in Lesotho to identify duplicate old age pension recipients and civil servants.⁶⁰



The digital identity project proposed by FinMark Trust recommended linking the national ID system in Lesotho, which includes a biometric component, to social cash transfer programs, which are currently cash-based.



Climate change

SDG 13: “Take urgent action to combat climate change and its impacts.”

Climate change poses major risk for agriculture, forestry and water security.

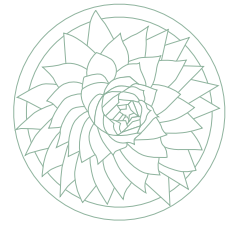
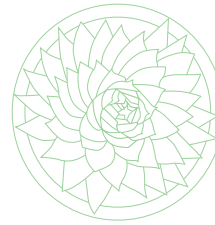
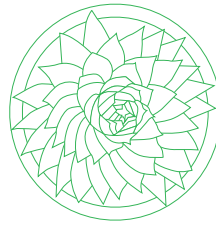
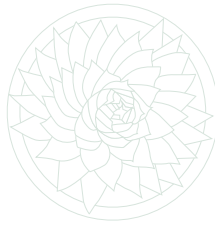
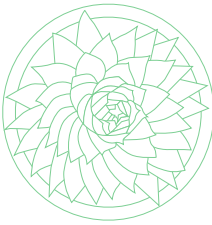
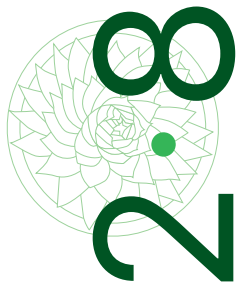
Climate change and its impact is an important goal for Lesotho, where the effects of climate change include rising temperatures and increased frequency of droughts and extreme rain events⁶¹ Water resources are likely to be negatively affected by reduced precipitation and higher temperatures. The UNDP also reports that forests may be transformed into semi-arid areas.⁶²

There are programmes that are being implemented to mitigate these effects, such as the UNDP’s Reducing Vulnerability from Climate Change project, implemented since 2015.⁶³ This involved integrating climate change adaption strategies in the development of land use planning and decision making. In addition, Lesotho has recently signed a memorandum of understanding with the Africa Risk Capacity (ARC) programme, a sovereign drought insurance scheme (discussed in Section 2.6).⁶⁴

Climate-related insurance products, including for the agricultural sector, are likely to be needed in the coming years. This is discussed in more detail in Sections 3.2 and 4.4.



Water resources are likely to be negatively affected by reduced precipitation and higher temperatures. The UNDP also reports that forests may be transformed into semi-arid areas.



Healthcare

SDG 3.8: “Achieve universal health coverage, including financial risk protection, access to quality essential health-care services and access to safe, effective, quality and affordable essential medicines and vaccines for all.”

The healthcare system in Lesotho has the challenge of a high disease burden alongside limited healthcare facilities. Lesotho has the second highest HIV/AIDS prevalence, with 25% of the adult population (15-49 years) being infected by the virus.⁶⁵ In addition, tuberculosis (TB) remain Lesotho's greatest health challenges, with 611 cases per 100,000 people.⁶⁶ HIV/AIDS is responsible for more than 40% of all deaths in the country and poses a significant threat to women and children in particular.⁶⁷ HIV prevalence is higher among women (30.4%), especially young women (ages 15-24), for whom the rate of infection is four times that for men of the same age.⁶⁸ This places pressure on healthcare facilities, with only approximately nine health facilities per 100,000 people and fewer than one hospital per 100,000. In addition, in Lesotho there is limited access to healthcare professionals, low availability of medicine supplies, and a low cost of health services, but also low quality.⁶⁹ While high health costs exert more pressure to the fiscal burden, high HIV/AIDS and TB rates contribute to Lesotho's high inequality and poverty.

Lesotho has made some progress in curtailing the spread of HIV, with the change in new infections down 45% since 2010 according to UNAIDS 2020 data. Additionally, the country has seen a general decline in some of the major communicable diseases. For example, TB infections have fallen with the number of people developing TB falling from 22,000 in 2010 to 14,000 in 2019.⁷⁰ However, at 654 per 10,000 people, infection rates may be falling but are still high in comparison with other countries. Life expectancy in Lesotho for 2019 was 50.75 years, which is low by international standards, but it is improving as life expectancy in 2000 was 47.82 years. Life expectancy is considerably lower for men than it is for women, at 47.66 and 54.34 years respectively.⁷¹



HIV/AIDS is responsible for more than 40% of all deaths in the country and poses a significant threat to women and children in particular.



Government funding and foreign aid in Lesotho is important but not enough to make these kinds of social and economic needs disappear. Donors play an important role in respect of bigger developmental objectives within Lesotho. Food and funding for the 'vulnerable household' feeding programme has been received at times from the WFP and other donors, and assistance and support are provided during drought induced emergencies. The government accords high priority to the control of the spread of HIV/AIDS. The national AIDS programme is an integrated approach towards prevention and control, involving all government ministries and non- governmental organizations. This multisectoral project is executed by WHO and coordinated by the Ministry of Health, and it involves the oversight of the UN Theme Group on HIV/AIDS.⁷² More recently, additional financing has been granted by the World Bank for the 'Southern Africa Tuberculosis and Health Systems Support Project'.⁷³

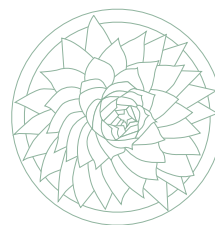
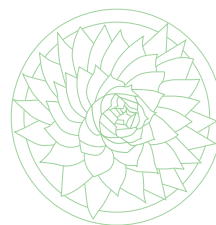
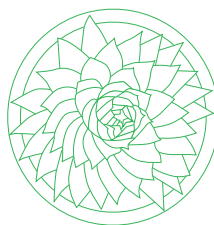
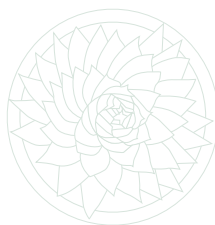
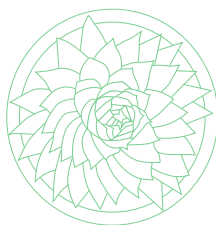
Medical expenses impact on financial behaviour. The average amount spent on health by Lesotho adults is around M204 per month which makes up around 8% of their total monthly expenditure.⁷⁴ Furthermore, the FinScope 2021 survey shows that 13% of adults indicated that they had incurred expenses due to an illness within the household or family over the past twelve months which made it very difficult to pay for other things. Moreover, less than 2% of the adult population have life assurance/insurance and less than 1% have medical insurance or personal injury/accident insurance.

The overall healthcare situation in Lesotho creates an imperative for targeted financial services (be it savings, credit or insurance) as a coping mechanism, as well as for low-cost payment mechanisms in order to send money to those affected.⁷⁵ There is an important link between health insurance and related services. This works in two ways. Firstly, certain financial services and better savings can have a strong positive impact on healthcare as households are able to invest in health-promoting investments and preventative health interventions and have a reduced vulnerability to healthcare shocks.⁷⁶ Secondly, better healthcare incentives are able to encourage an individual to save.

It will be useful in the coming years, as the regulation of the sector evolves, to improve transparency in the sector and study the possibilities for expanded access to healthcare via competing medical societies.



Less than 2% of the adult population have life assurance/ insurance and less than 1% have medical insurance or personal injury/ accident insurance.



Education

SDG 4.3: “By 2030, ensure equal access for all women and men to affordable and quality technical, vocational and tertiary education, including university.”

Despite progress in primary education enrolment, Lesotho still faces challenges in terms of access, completion, and the overall quality of basic education – especially in rural areas. Females receive approximately seven years of schooling on average and males receive closer to five and a half years⁷⁷ – relatively low compared to other SADC countries. On the one side, data from the World Bank suggests that Lesotho’s primary school access exceeds comparative global statistics. The gross intake ratio in the first grade of primary education is 120% for Lesotho, compared to 114% for Sub-Saharan Africa and 105% globally. This is no doubt linked to the implementation of universal free primary education in Lesotho. However, secondary education enrolment rates sit at less than 50%.⁷⁸ Lesotho may fare well in getting children into primary school, but not in transitioning learners successfully through to secondary levels. One of the challenges is that basic infrastructure is lacking which discourages continuous school participation. More than half of the schools in Lesotho operate in informal areas such as huts, church halls, tents, or outside, and only 50% of schools have access to electricity. The lack of appropriate and enclosed classroom spaces also contributes to absenteeism and the high dropout rates of learners, especially during winter months when the high altitude means that temperatures in Lesotho reach uncomfortably cold levels. Schooling participation rates are not the only concerning issue, the quality of education in Lesotho is also poor. Lesotho lags behind average regional learning outcomes in critical learning areas such as reading and mathematics, and the country lacks qualified teachers – most prominently in rural areas.⁷⁹

Policy and government investment has been important for the progress made but the outlay is not balanced. The national primary enrolment rate reached more than 80% due to measures such as universal free education, alongside the government’s investment in building schools in rural areas. In 2000, Lesotho instituted a free primary education policy, with the program being phased-in on a grade-by-grade basis, beginning with grade one in 2000.⁸⁰ Thereafter, the Ministry of Education capped or set fees for high schools. These policies have been further complemented by interventions such as school-feeding



Lesotho may fare well in getting children into primary school, but not in transitioning learners successfully through to secondary levels.



programmes, child grants, and the provision of learning materials.⁸¹ However, investments in early childhood education are unbalanced as about 66% of preschool-age children do not have access to pre-primary education.⁸² This subsector is allocated only 0.4% of the education budget, despite the fact that education investment in early childhood education has the highest rate of return,⁸³ as children need a good start in life to reach their potential as adults.

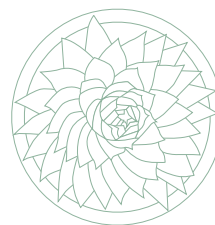
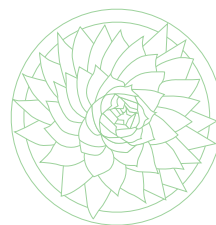
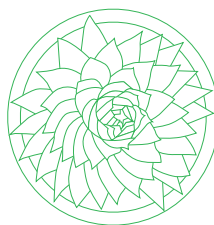
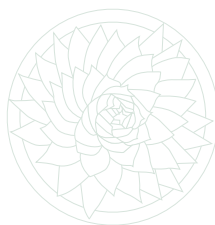
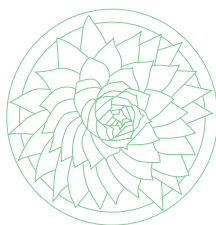
Education may improve labour outcomes but they are not necessarily linked.

On the whole, 42% of school-age youth completes junior secondary school and approximately 30% completes senior secondary school. Labour outcomes among youth are positively correlated with educational attainment – youth with incomplete primary education earn only 26% of the income earned by those with at least secondary education. In addition, at the tertiary level, there are signs of a potential mismatch between the skills pursued by youth and those demanded by the private sector. Two-thirds of university students graduate from the fields of education and social sciences, while most private and public investments are in favour of creating jobs in the fields of agriculture, manufacturing, tourism, and technology.⁸⁴ Nevertheless, qualitative demand-side research indicated that education is seen by people as a key enabler to the future success of children.⁸⁵ Moreover, in the 2021 FinScope survey, when participants were asked what their main reason for borrowing money were, 6% stated that it was for education or school fees. The survey also reveals that adults spend around M344 on average per month on education, which is approximately 12% of their total monthly expenditure. This suggests that financial instruments that assist with savings or the provision of loans for educational purposes may be useful.

There is scope to increase mobile money usage in education. Given the large role that remittances play in Lesotho (see Sections 2.3 and 3.2), it is surprising that the use of remittances for education is low, as only 4% of remittances received was for school fees. Despite the low remittance rate for educational purposes, it is important to note that remittances are mostly done through mobile money and with cash being the dominant payment method used for paying for education⁸⁶ it provides a great opportunity for mobile money operators to digitise school fees.⁸⁷ This would benefit consumers as it would reduce the time and effort spent paying fees and reduce the risk of money being lost or stolen (particularly in instances where fees are given to children to pay). This would also help improve the low repayment rates to the tertiary education bursary scheme in Lesotho operated by the National Manpower Development Council.⁸⁸



Adults spend around M344 on average per month on education, which is approximately 12% of their total monthly expenditure.



Infrastructure

The links between infrastructure and real-world outcomes, including the social impact on people, is considered in this section. Three items of infrastructure were selected, based on (i) the Transitional Stabilisation Programme & Vision 2030, and (ii) the SDGs (discussed in Section 3.1).

Mobile network infrastructure

Strong mobile penetration and thus telecommunications infrastructure is critical to enabling digital services in the country (along with other digital infrastructure building blocks such as suitable payment rails and a national ID). This has implications for the development of businesses, in terms of market access, access to information and systems (including payment), as well as individual financial services. It can be noted that strong information and communication technology (ICT) infrastructure is a base for financial inclusion both in terms of its role in payment systems (both bank and mobile) and digitisation. This is both as a conduit to digital and mobile services including remittances and payment systems. Strong and consistent ICT infrastructure is therefore a prerequisite to the development of a mobile or digital financial ecosystem.

Mobile networks are widely used in Lesotho, and there is extensive network coverage. Around 82% of adults owned a mobile phone by 2021.⁸⁹ In principle, therefore, much of the population is able to access mobile financial services. This has important implications for the delivery of infrastructure in Lesotho more broadly. For instance, the Ministry of Forestry pays beneficiaries that were working on soil erosion and the restructuring of dongas via mobile money.⁹⁰

Despite widespread 3G coverage, internet uptake and usage is limited. According to Research ICT Africa, 3G coverage in Lesotho in 2017 was 90%.⁹¹ However, by around 2020, only 42% of individuals were using the internet.⁹² This is unlikely to be due to usage costs, given that 1GB of data in Lesotho costs around USD 2, which means that Lesotho's prices are among the lowest in Africa (Figure 11). It is more likely that device costs are a significant barrier.⁹³ The Lesotho Communications Authority accordingly is targeting reducing entry-level device costs M1,200 to M850 by March 2023.



Strong mobile penetration and thus telecommunications infrastructure is critical to enabling digital services in the country.

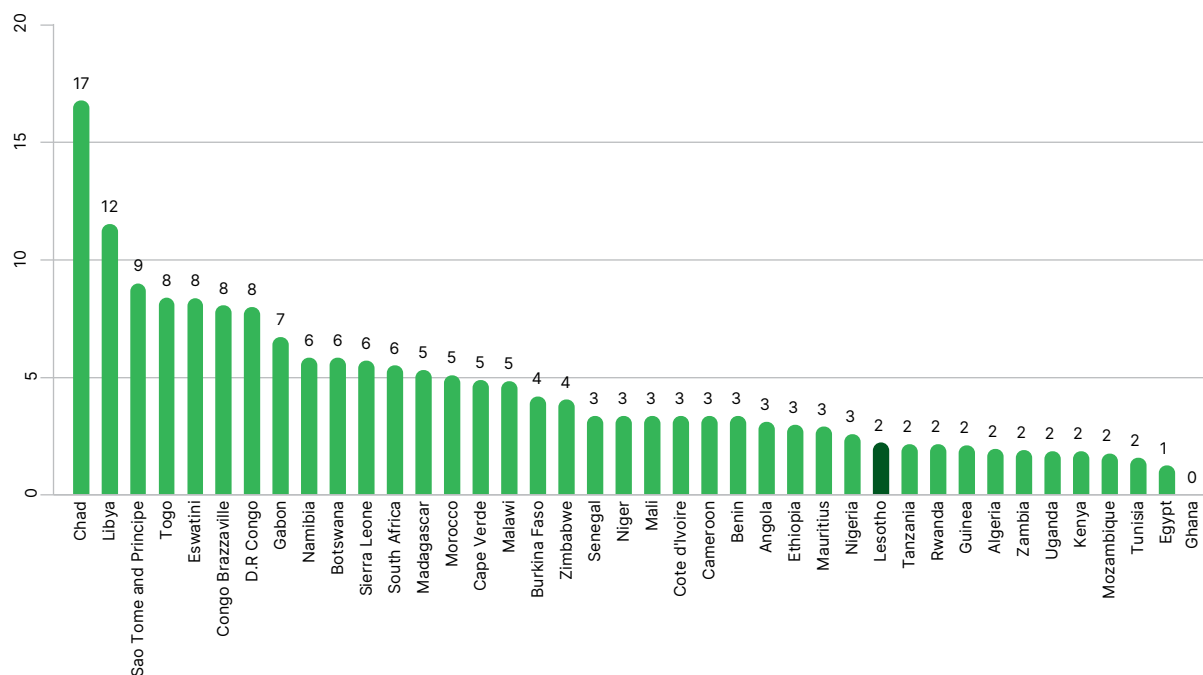


Figure 11: Price of mobile data (1 GB, USD, Q2 2020)

Source: Authors' analysis of Research ICT Africa data, available online.

There are high levels of market concentration. Vodacom Lesotho has a market share of 72%, which suggests that it has market power.⁹⁴ While prices for internet access may be relatively low, there may be other factors arising from Vodacom's high market share that may impeded the development of digital payments, such as a lack of interoperability with other payments service providers or a lack of wholesale access to its network impeding the emergence of rivals. Mobile networks play a key role in the development of digital financial services and are widely used in Lesotho, though not as widely as in other lower-middle income SADC countries, such as Zimbabwe. There is a question as to how competitive markets are, given Vodacom's very high market shares in telecommunications services. In this regard, the Lesotho Communications Authority's initiatives to facilitate greater competition need to be supported.

Water and sanitation

SDG 6: "Ensure availability and sustainable management of water and sanitation for all."

Water and sanitation as well as hygiene are considered to be at the epicenter of the poverty cycle in Lesotho. Access to at least basic drinking water in Lesotho remained relatively unchanged from the year 2000 to 2017 with large disparities between urban and rural areas. The gaps in access are strongly affecting the livelihoods and well-being of the Basotho people and preventing further socio-economic improvement. In 2000, it was reported that 68% of the Basotho population had at least a basic drinking water source.⁹⁵ It has since increased

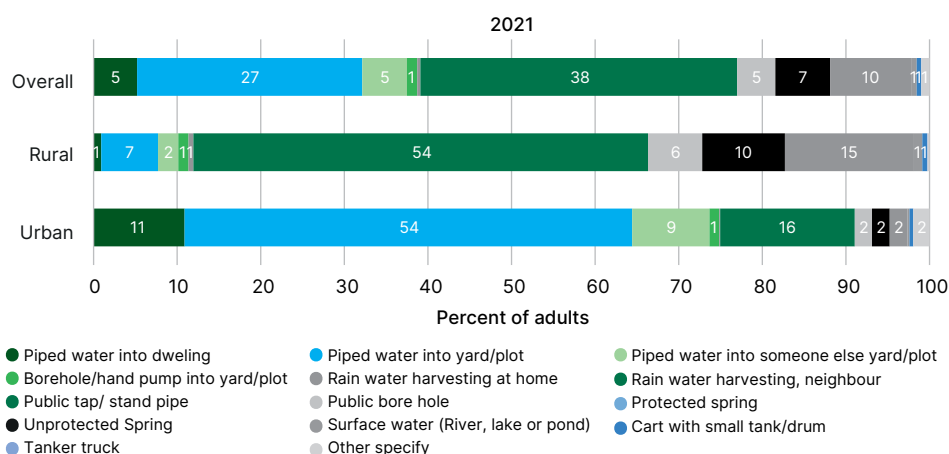


Figure 12: Main source of drinking water for the household

Source: Finscope 2021

only marginally to 69% of the population. However, there is a major difference between rural and urban areas. In rural areas, 59% had basic drinking water compared to 93% in urban areas.⁹⁶ Furthermore, FinScope data shows that 38% of households in Lesotho use some sort of piped water⁹⁷ source as their main source of drinking water in 2021. When split by location we see that 74% of urban households use piped water sources compared to only 10% of rural households (see Figure 12). The main source of drinking water for 54% of rural households come from public taps/stand pipes.

Access to basic sanitation has improved in Lesotho but still remains considerably low by international standards. On a national level, only 43% of Basotho population were using at least basic sanitation services in 2017.⁹⁸ Unlike many other sub-Saharan African countries, there does not seem to be very large disparities between rural and urban areas. In fact, it is estimated that there is 43% coverage in urban areas compared to 43% coverage in rural areas in 2017.⁹⁹ Although low by international standards, sanitation has improved fairly significantly first from 30% in 2010 to 39% in 2015 and then to 43% in 2017. According to the FinScope data, flushable facilities increased marginally from around 3%¹⁰⁰ in 2011 to 4%¹⁰¹ in 2021 with latrine facilities increasing from 68%¹⁰² to 77%¹⁰³ over the same period.¹⁰⁴ Furthermore, when looking at location we find that 8% of urban households use some sort of flushable toilet facility as their main toilet facility, compared to less than 1% of rural households (see Figure 13).

Access to proper handwashing facilities remains critically low in Lesotho with evident disparities across the rural-urban divide. Only 5% of the Basotho population reported having a handwashing facility in 2017. In rural areas, only 2% had a handwashing facility compared to 11% in urban areas. Critically, the situation is more dire considering that only 2% of the population have access to a handwashing facility that includes water and/or soap.¹⁰⁵ This is particularly important given the current Covid-19 pandemic.

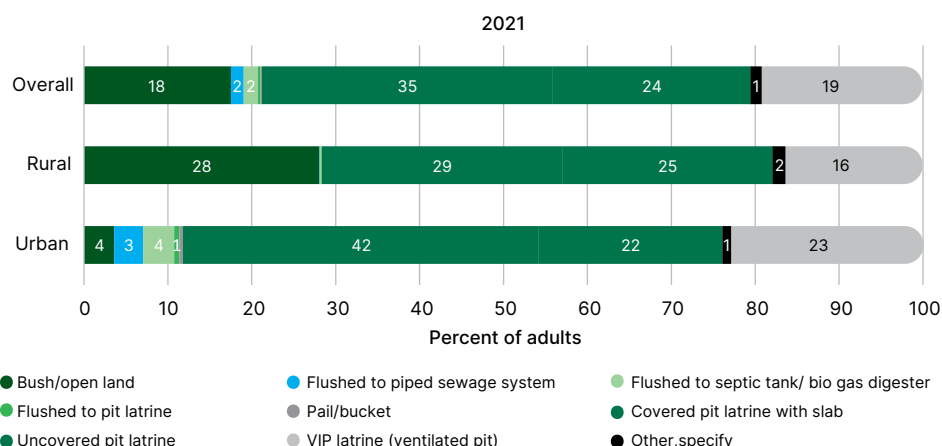
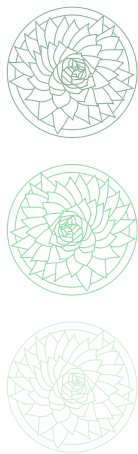


Figure 13: Main type of toilet facility for the household

Source: Finscope 2021

Given the prevailing situation in Lesotho, it is imperative that the country looks to enhance access to basic water and sanitation. A promising avenue through which this might be achieved is using *Fintech* (financial technology). Recent research shows that *Fintech* can accelerate financial inclusion and help households access water resources.¹⁰⁶ This is particularly the case in rural areas where inflated prices for water, high up-front costs along with irregular incomes perpetuate an inequity in access. For urban households, *Fintech* can be used in the payment of up-front costs (connection fees) and can help reduce the costs associated with Pay-As-You-Go (PAYG) models.¹⁰⁷ This may be done by connecting traditional financial products (savings accounts and consumer loans) to connection fee payment. There is also a push towards leveraging MFIs to tailor products towards poor households such that they may be able to firstly connect to the supply and two, be able to finance the purchase of certain ablution facilities (e.g., latrine construction and water filters).¹⁰⁸ Payments for water services could also be digitalized by means of bank or mobile money services.¹⁰⁹ Several innovations may also catalyze the drive towards safer water supplies to households including water ATMs and the installation of “smart” meters.¹¹⁰ Additionally, there are proposals to apply village-level rotating savings and credit cooperative (ROSCA) principles to a water supply and sanitation (WSS) fund, supported by government or donor grants and loans, essentially creating a new line of business (WSS) for the ROSCA.¹¹¹



Several innovations may also catalyze the drive towards safer water supplies to households including water ATMs and the installation of “smart” meters.

Electricity

SDG 7.1: “By 2030, ensure universal access to affordable, reliable and modern energy services.”

Access to electricity more broadly unlocks access to other basic services. Access to electricity unlocks access to basic services like ICT services, education, and healthcare services. Without electricity, it is difficult to expand these services into rural areas. Electricity, together with these additional services, in turn unlocks access to opportunities. For instance, MSMEs are more likely to succeed with a reliable electricity supply and can also develop to supply services to not only the electricity sector but the range of other sectors that need a reliable electricity supply. Overall, the energy poverty nexus has a major impact on social



development, particularly to vulnerable groups such as women and youth who depend upon biomass energy sources which are particularly vulnerable to climate change. Energy is a critical input for agriculture, food processing, water piping and irrigation, and for individual businesses / micro-enterprises. Moreover, because energy is a factor for other sectors, it also implicitly affects access to mobile phone services and financial inclusion, education, and health.¹¹² Developing electricity supply therefore assists a whole range of new productive activities to grow.

Access to electricity in Lesotho has improved over the last decade but is still limited in rural areas. The percentage of the population with access to electricity increased from 17% in 2010 to 45% in 2019, with 76% of the urban population having access in 2019 compared to only 32% of the rural population.¹¹³ The recent FinScope data in Figure 14 shows a similar disparity between urban and rural households when it comes to electricity usage for lighting (proxy for electricity access). 47% of Lesotho households use the electricity grid as their main fuel for lighting and most of this comes from urban households.

Wood remains the main fuel source for cooking. The reliance on wood as the main fuel source for cooking has decreased from 55% in 2011 to 47% in 2021 but it remains the most popular energy source for cooking among Lesotho households.¹¹⁴ Furthermore, only 12% of households reported using electricity for cooking, which is significantly less than those with access to electricity. This makes sense as cooking is more energy intensive which makes it costly to use electricity, so people will instead substitute to cheaper energy sources such as wood.¹¹⁵ For context, Lesotho adults spend on average around M279 on energy per month (approximately 13% of their total monthly expenditure).¹¹⁶

There is a significant billing shortfall at public electricity utilities. The quasi-fiscal deficit, or the implicit electricity subsidy in Lesotho arising from public utilities that do not recover their costs from electricity users, was 0.5% of GDP in 2014.¹¹⁷ The Finscope 2021 survey shows that 88% of individuals in Lesotho use cash to pay for expenses such as water/electricity, paraffin, gas and other fuels, while only 12% use mobile money. Improving financial inclusion, and in particular expanding digital payments, may help to reduce the quasi-fiscal deficit.



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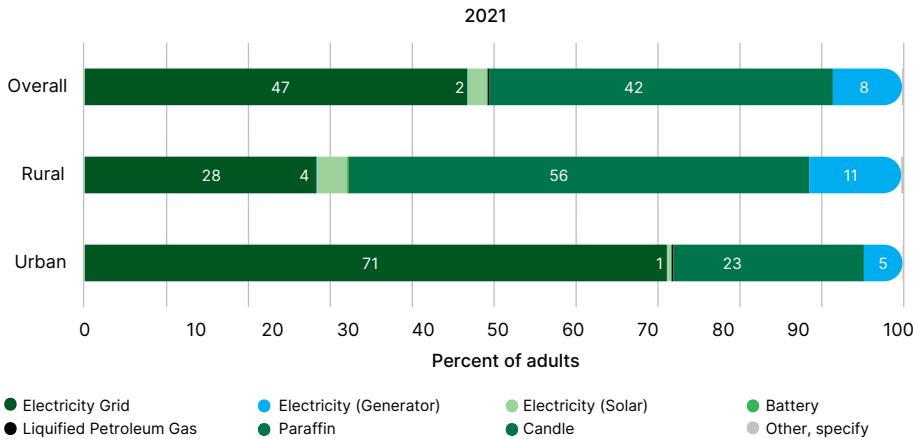


Figure 14: Main fuel used for lighting in the household

Source: Finscope 2021



Lesotho largely relies on hydroelectric power and imports. Lesotho has an installed generation capacity of 72 MW, all of which is generated from renewable sources.¹¹⁸ A single power plant – the Lesotho Highlands Water Project’s Meula Hydropower station – accounts for all domestic grid electricity generation capacity. The Lesotho Electricity Company (LEC) procures more than half of the country’s electricity requirement from the Meula Hydropower station. This hydro power was established as a component of the Lesotho Highlands Water Project (LHWP), a multi-phased project to provide water to the Gauteng region of South Africa and to generate hydro-electricity for Lesotho.¹¹⁹ However, supply is very susceptible to both hydrological variability and plant reliability and availability – especially in colder winter months. Thus, in 2019 Lesotho shifted to being a net importer of electricity from Eskom (mainly) in South Africa and Electricidade de Moçambique (EDM) in Mozambique.¹²⁰

There is an untapped potential for solar energy, which currently accounts for only 0.01% of the generation capacity in Lesotho. In general, the falling prices of renewable energy, particularly from wind and solar sources, together with battery storage, increasingly replace traditional sources of electrical power.¹²¹ However, despite Lesotho’s being among the countries with the highest solar energy potential, only a limited number of solar home system providers are active in the country, and on the mini-grid side only one provider – One Power – has been granted the necessary regulatory approvals to pilot alternative solar-grid connections.¹²² A very important aspect of financing pay as you go solar or even larger residential systems is understanding credit risks and being able to manage these adequately.¹²³ This emphasizes the important role that credit registers and collateral asset registers can play in the development of the energy sector. In addition, SACCOs / ROSCAs may plan an important role here, similar to that for sanitation.

Development finance institutions need to adapt to the worldwide trend towards low-cost renewable energy,¹²⁴ which can be supplied sustainably on much smaller scales than utilities typically consider, including to low-income consumers. The mandates of development finance institutions may need to be amended to enable them to expand access to finance to pay as you go solar and to micro-grid providers. This will help reduce their costs of capital, enabling them to pass on lower cost financing arrangements to low-income consumers. This is already happening in Lesotho, where the Lesotho National Development Corporation (‘LNDC’), has identified approximately 6,000MW of wind power that could be generated in Lesotho in the future. In addition, Lesotho also has small scale hydroelectric power generation possibilities. According to the LNDC, there are 20 to 40 sites where hydro power is possible, generating approximately 20 MW.¹²⁵

Several development partners are active in the grid and off-grid electrification space in Lesotho. The European Union (EU) is currently the biggest player in the energy sector and is supporting its institutional reform – including a review of the energy policy and development of an Energy Act to overcome hurdles for private sector participation in the sector. The EU’s European Development Fund in collaboration with the UNDP is currently implementing a new energy project,



under the broader sustainable energy for all (SEforALL) programme with support from the Global Environment Facility (GEF). The objective of this project is to unlock private investment in small-scale renewable energy projects in Lesotho through the provision of technical assistance and financial support via the Financial Support Scheme (FSS). By supporting local companies to set up private sector-led mini grid-sites and energy centres, the aim is to promote the adoption of rural electrification products. This would mean their ability to retail rural electrification technologies to rural communities and MSMEs.

In addition to its collaboration with the EU, the UNDP is supporting the Government of Lesotho to develop a regulatory framework for mini-grids,¹²⁶ which will solve legal and technical issues and will guide private developers on the setup and operation of mini-grids.

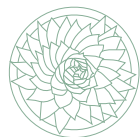
The World Bank has a significant programme on renewable power in Lesotho.

The Renewable Energy and Energy Access Project (2020-2027), that is funded by the World Bank, has the development objective to increase access to electricity in rural and peri-urban areas of Lesotho. This project has two components that have links to financial inclusion. The first component consists of 'Grid Extension to Peri-Urban Areas of Lesotho', aiming to finance the design, procurement of materials, and construction works required to electrify selected industrial and commercial loads in peri-urban areas of Lesotho, as well as provide connections to residential customers nearby.

There may be opportunities for instance for MSMEs to participate in these projects as suppliers, for which finance will be needed. This highlights the importance of relaxing the constraints facing MSMEs, including business registration processes and record keeping, discussed in Section 3.5. The second component of the project is 'Rural Electrification by Mini-grids', which aims to support the electrification of areas where electricity supply through mini-grids represents the least-cost option from a country perspective, as underpinned by the Electrification Master Plan (EMP) and geospatial analysis. It includes following two sub-components: (i) Rehabilitation and Upgrading of Lesotho Electricity Company (LEC) Mini-grid at Semonkong; and (ii) Mini-grid Development under public-private partnership (PPP) Models.¹²⁷ There may be two links to financial inclusion and mini-grids: first, MSMEs may be able to participate in these projects, in the same way they can participate in the first component of this project. Second, mobile payments might be leveraged to facilitate payments for mini-grid services, and regular payments for mini-grid services might be reflected in the credit bureau system in Lesotho. This can enable to consumers and businesses with a good repayment track record to further raise finance.



The Renewable Energy and Energy Access Project (2020-2027), that is funded by the World Bank, has the development objective to increase access to electricity in rural and peri-urban areas of Lesotho.



Transport

Unlocking the transport sector can improve basic services and drive growth.

The transport and storage sector is expected to grow at an annual rate of 15%, the third highest growth sector in Lesotho (Figure 6 in Section 2.2).

Transportation also employs approximately 3.5% of the population in Lesotho that have a job. This is therefore not only a basic service that people in Lesotho need but is also an important potential growth driver. Data from the recent FinScope survey shows that Lesotho adults spend on average around M279 per month on transportation, which is approximately 11% of their total monthly expenditure. The NSDP II has identified a sustainable quality transport network as a supporting infrastructure for the national development plan. This focuses on roads and air transport, rather than passenger transport services, for example.

Over the course of the last five years, the growth of the transport subsector has been negative. In 2015, transportation and storage constituted 2.7% decreasing to 2.4% in 2019.¹²⁸ There may be ways to formalise particularly SMMEs in this sector by partnering with financial services providers and improve access to credit, and it may be possible to improve particularly payments and perhaps even targeted subsidies for public transport. There have been recent successes in linking mobile payments to informal transport providers in Lesotho, a growth area for at least one mobile payments provider participating in this MAP refresh study.¹²⁹ For instance, transport providers are able to sell prepaid electricity to customers while they travel, facilitated by a fintech provider. There may increasingly be opportunities to link digital financial services providers with transport providers in Lesotho.



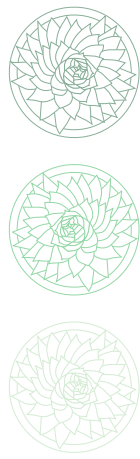
Over the course of the last five years, the growth of the transport subsector has been negative. In 2015, transportation and storage constituted 2.7% decreasing to 2.4% in 2019.

2.11

Summary

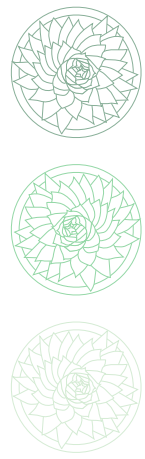
Levels of poverty and inequality are high in Lesotho, and there are relatively few private sector, formal jobs.

As a result, there are a significant number of migrant workers, and remittances play an important role in livelihoods. Social protection is significant, but costs are high and coverage could be expanded. Land tenure is largely traditional in nature, which has an impact on women, and their access to finance. MSMEs face considerable barriers to formalisation in Lesotho, driven in part by onerous KYC and customer due diligence (CDD) requirements for MSMEs. While mobile network infrastructure is extensive (there are high levels of coverage), access to electricity and water are more limited. There are several interventions that can be supported to alleviate these human development and infrastructure issues, including reducing barriers to accessing financial products, supporting better land tenure for women, and supporting local water and electricity infrastructure financing initiatives, including by improving access to credit and the availability of information for credit scoring.



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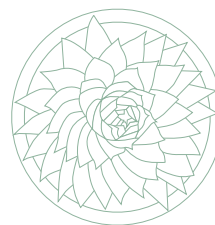
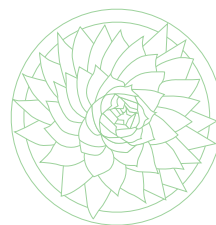
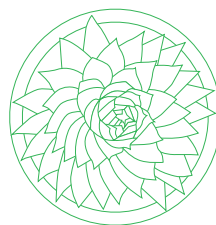
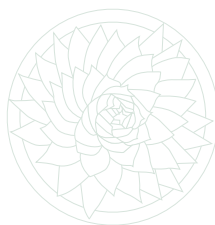
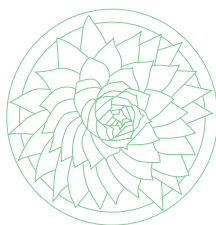
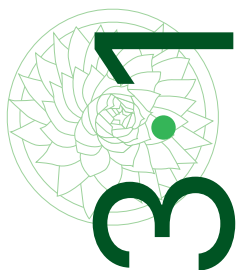


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National Strategy for Financial Inclusion achievements

It is important to reflect on progress against the 2017-2021 National Strategy for Financial Inclusion and MAP roadmap, in order to consider what gaps might still exist, and how best to prioritise future interventions. There are several ways in which the financial services sector is much better positioned to expand financial inclusion, particularly by means of low-cost branchless banking and mobile money services, discussed next in Section 3.1. At the same time, there are several areas where progress has been more limited, especially where regulatory approvals are concerned, discussed in Section 3.2.



Progress on NIFS 2017-2021 and MAP 2014 roadmap

The NIFS 2017-2021 aimed to increase the percentage of adults (18+) with access to at least one formal product from 61% (FinScope 2011) to 85% by 2021, among other goals (discussed in Section 2.1).

According to the Finscope 2021 survey, 87% of adults had access to at least one formal product, which exceeds the 85% target. In this section, we consider progress against the 2016 to 2021 NFIS targets, as well as an analysis of the supply of financial services in Lesotho.

Progress against activities set out in the 2014 MAP and NIFS 2017-2021

Out of approximately 75 activities set out in the NIFS and MAP reports¹, 53 have been completed (Table 4). Key highlights of progress, and important remaining gaps, in the financial inclusion landscape in Lesotho are described in Table 5.

Table 4: Summary of objectives and activities

OBJECTIVE	NUMBER OF ACTIVITIES	NUMBER ACHIEVED	NOT ACHIEVED
OBJECTIVE 1: Increase outreach and quality of financial services	42	30	12
OBJECTIVE 2: Increase financial and investment capacity	7	1	8
OBJECTIVE 3: Create and capacitate inclusive financial service providers	10	7	3
OBJECTIVE 4: Ensure an enabling environment	11	10	1
OBJECTIVE 5: Consumer education	5	5	0
Total	75	53	24



Table 5: Key NIFS 2017-2021 progress highlights and challenges

CATEGORY	PROGRESS HIGHLIGHT	KEY AREA NOT ACHIEVED
OBJECTIVE 1: INCREASE OUTREACH AND QUALITY OF FINANCIAL SERVICES		
Lowering cost of transactions and enhancing range of low-cost savings options (15/20 done)	<ul style="list-style-type: none"> An agent, ATM and related infrastructure location analysis for 5,597 financial access points was prepared as part of the Lesotho SIMM project. 	<ul style="list-style-type: none"> Banking fees remain high. The Post Office might be developed more as a distribution channel. The payment of interest on mobile money balances may need to be considered.
Facilitating low-cost domestic and cross-border remittances and payments (3/5 done)	<ul style="list-style-type: none"> Shoprite channel has been a significant success, as a result of interventions through the MAP/NIFS project. 	<ul style="list-style-type: none"> Mobile money liquidity challenges need to be further dealt with, including through SIMM. Shoprite, and other digital remittances providers, may need to integrate to a greater degree with other financial services providers.
Enhancing risk mitigation beyond funeral cover (5/10 done)	<ul style="list-style-type: none"> A microinsurance framework has been developed. Premiums can now be paid through mobile money. Pension fund legislation is now in place. 	<ul style="list-style-type: none"> Health insurance needs to be developed. Explore the viability of property and agriculture insurance products.
Targeted SMME and farm credit (7/7 done)	<ul style="list-style-type: none"> Research carried out on SMMEs and farmers, and SIMM project has helped leverage mobile money. 	<ul style="list-style-type: none"> Improved credit information sharing among financial service providers (FSPs) needs to be considered.
OBJECTIVE 2: INCREASE FINANCIAL AND INVESTMENT CAPACITY		
Leveraging inward investments by migrant workers (1/7 done)	<ul style="list-style-type: none"> There have been some efforts to better estimate the number of Basotho migrants in South Africa. 	<ul style="list-style-type: none"> Bank transfers are still very expensive. The cross-border regulatory framework needs to be reviewed.
OBJECTIVE 3: CREATE AND CAPACITATE INCLUSIVE FINANCIAL SERVICE PROVIDERS		
Selective Institutional reforms (7/10 done)	<ul style="list-style-type: none"> Microfinance institutions have been developed as alternative financial services providers: the CBL register database has up to almost 90 active MFIs, from just under 30 in the past two years. This is an indication that there is upsurge in formalisation of non-banks FSPs. A pilot for merchant payments was arranged with mobile money providers as part of the SIMM project. 	<ul style="list-style-type: none"> Building on existing progress, more work needs to be done on formalising informal financial services providers.
OBJECTIVE 4: ENSURE AN ENABLING ENVIRONMENT		
National coordination of financial inclusion initiatives (5/6 done)	<ul style="list-style-type: none"> Coordination of financial inclusion is well-run between the CBL and Ministry of Finance, though there are resource constraints. 	<ul style="list-style-type: none"> Better information tracking progress on aspects of the FI plan, such as prices, may need to be considered. The FI steering committee also needs to be expanded, as discussed in Section 6.3.
Development and implementation of new and existing policy and regulations related to financial inclusion (5/5 done)	<ul style="list-style-type: none"> Various pieces of legislation have been passed, including Payments Systems Act, Insurance regulations, Pension Funds Act. Improvements in credit reference bureau system have been made, including incorporating MFIs. 	<ul style="list-style-type: none"> The impact of regulations needs to be considered. Digital financial identities may need to be considered. A pilot phase has just been completed and progress under analysis.
OBJECTIVE 5: CONSUMER EDUCATION		
Consumer education, and more generally consumer empowerment (5/5 done)	<ul style="list-style-type: none"> Better fee disclosure has been implemented, and consumer protection regulations have been enforced. 	<ul style="list-style-type: none"> The impact of these interventions needs to be closely monitored to ensure desired results.



Scaling inclusion through mobile money (SIMM)

The Ministry of Finance and CBL, in partnership with the UNDP and FinMark Trust, carried out the SIMM project. This involved:

- Developing a geographic information system (GIS) database on 5,597 financial access points including mobile money agents, commercial bank branches, ATMs, POS terminals, MFI branches, insurance providers, post offices and agencies, and moneylenders.
- Running a pilot project for merchant payments via mobile money, including focus group discussions with merchants and customers, on-boarding merchants to accept payment via mobile money. This aspect of the SIMM project also included marketing activities, monitoring and evaluation.
- Coordination of various activities, including:
 - A cost-benefit study to inform a roadmap for digitising government payments,
 - A demand study on rural and low income consumers,
 - A mobile money literacy programme,
 - An innovation data hackathon and training of the winning hackathon teams as well as guidance on developing a minimum viable product,
 - Feasibility assessment for digital financial identities,
 - Capacity building on the introduction of interest on mobile money savings.

This project provided successful support to a range of financial inclusion activities, and some of the results of the project are highlighted in each of the sections of this MAP refresh report where they are relevant.

Links between financial inclusion progress and the real economy and human development

There are several links between financial inclusion and the real economy and human development identified both in MAP's research and verified by stakeholders. Financial services, like most services, are not used for their own sake but because people have an underlying need (an economic need) that gives rise to a financial need – and financial services help them meet this need. In their daily lives, for instance, people need to purchase goods and services, or they might need to take care of family by sending relatives money; and people also need to make sure there is enough money over the course of their income cycles to do this. People plan for unexpected expenses but they also plan for the future: for particular events, to acquire durable goods or big assets, and for their old age.

These are all real economic needs. They have nothing to do with financial services, yet they give rise to financial needs: a need to transfer value (geographically), manage liquidity, manage risks, and plan for the achievement of goals (transfer value over time). It is these financial needs that financial services aim to satisfy. Financial needs arise from underlying economic needs – needs that, because they are non-financial, can be termed real economic needs. Without a functional economic need, people would have no need for financial services.



There are several links between financial inclusion and the real economy and human development identified both in MAP's research and verified by stakeholders.



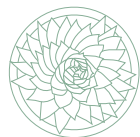
Therefore, how exactly, and to what extent (formal) financial services can contribute to the achievement of economic and financial goals will depend on whether the services match the underlying demand and the individual's/household's/small business's activities in their community, in the real economy and in the wider society. The MAP data clearly demonstrates that vulnerable and excluded consumers 'make a plan' to access required resources, even though this is not easy and they access resources less than their less-vulnerable peers. Often, they pay more and get less; sometimes they pay less and get less. They use what they can – different financial services, formal and informal – to access what they need. Ultimately, consumers are in control of their finances (even if they sometimes need to resort to less-than-optimal financial mechanisms to meet their needs). Either way, consumers already spend money on the crucial resources of education, healthcare and basic services (e.g. energy) in the pursuit of opportunities relating to employment and income earning. While people's money thus greases the wheels of the national and global financing systems, in developing markets consumers are far removed from the financing system because they are more likely to be operating on the margins and in the informal sector. Thus, their contribution or ability to contribute is often not recognised.

At a household or individual level, this expenditure is also not enough to expand infrastructure. Households, in general, are not able to build a new school or clinic – and poor households even less so. However, as MAP data shows, on aggregate this expenditure adds up to substantial amounts. For instance, the 2021 Finscope survey shows that Lesotho adults spend on average around M279 on energy (approximately 13% of total expenditure) and M279 (approximately 11% of total expenditure) on transportation per month.² In addition, the survey also reveals that adults spend around M344 and M204 on average per month on education and health, which is approximately 12% and 8% of their total monthly expenditure, respectively.

Citizen-centric financing. Increasing populations' access to resources obviously requires governments, providers, investors and donors to make additional investment in service infrastructure such as education, healthcare and basic services (including energy). But evaluating viable and sustainable business cases for leveraging existing household spend can help governments fund investment using local financial systems. Citizens increasingly want control over their financing, though; their decisions will therefore influence and impact both the local and national financing agendas.

To drive economic growth, the financial sector needs to contribute to building the physical and human capital available in the economy and/or support innovation in the methods of production (technology), which in turn could contribute to future growth in productive opportunities.

A well-functioning system that can enable inclusive growth partly requires financial service providers to understand how to meet consumers' real economic needs. And where the financially excluded do not immediately present viable business cases, identifying them enables government to determine and define better public-sector provision of services, based on need. Yet, the fact that there are large sections of a society without access to retirement savings, healthcare or education, for instance, is detrimental to that society – because the resulting ill effects are communal. In countries where a significant proportion of the population lack the means to access what MAP has come to term 'the four crucial needs' (basic services and infrastructure, education, healthcare, and entrepreneurship opportunities), economic growth is hampered partly because the inability to meet those needs has undermining consequences that are also communal and societal.



The preceding section provided the insights into the role of financial inclusion, into broader human development and highlighted the linkages between financial inclusion and inclusive growth in Lesotho.

Requirements for robust digital financial services markets

There have been several interventions recommended in the NIFS and MAP diagnostic reports, and in this MAP refresh, that consider progress in markets for digital financial services. In this regard, it is worth pausing at this stage to consider the range of building blocks necessary to develop a robust digital financial services market.

OVERALL THESE FALL INTO THREE CATEGORIES:

1. Digital infrastructure: Competition in digital financial services requires suitable infrastructure to encourage provision. This includes ICT connectivity and coverage, a robust payments backbone with a combination of suitable agent networks, and a strong payments architecture and systems that allow for efficient KYC and onboarding.³ The latter implies, at the minimum a national ID system, but can also include simplified means of ascertaining a proof of address.
2. A dynamic and competitive market: A competitive market enhances innovation, and price competition can be a driver of efficiencies enhancing affordability. There are two key forms of competition:
 - Intra platform competition: Competition between mobile operators for mobile money services and between banks for e-money services plays an important role in enhancing competition within that channel. In instances in which there is existing market power or concentration, features such as interoperability and controls on exclusivity arrangements (for agents or merchants) need to be monitored and in some instances regulated. Where there is vertical integration which changes the incentives for access to an input (for example, where a dominant mobile operator charges competitors for access to USSD and competes downstream on mobile money) this also may need to be regulated in the interests of stimulating competition.
 - Inter-platform competition: Competition between types of services such as between digital banking services (such as e-wallets), mobile money services, and fintech services is also important to minimise market power and stimulate innovation and price reductions. To maximise this, interoperability across platforms (such as through switches), and careful regulation to ensure a level playing field across products (for example, having similar risk rated regulation for banks and telcos), are important.
3. Products and services that drive uptake: To have a high take-up, the products provided need to be suitable for the market in terms of affordability and providing for specific needs and gaps in the market. The UNCDF proposes considering needs in four areas:⁴
 - Basic services and infrastructure (such as electricity, lighting, energy for cooking, and water, accounting for approximately 13% of monthly spend);
 - Healthcare (19% of monthly spend);
 - Education (27% of monthly spend); and
 - Entrepreneurship.

In addition, partnerships that assist in rolling out the offering such as the subsidised payment of grants through digital services is also supportive to increasing access and introducing people to the digital ecosystem.



Digital financial identities and a risk-based approach to KYC, including for companies

The development of digital financial identities in Lesotho has been an important area of success. The Ministry of Home Affairs of Lesotho ('MHA'), together with the Ministry of Finance and CBL and supported by FinMark Trust, have developed a digital financial identities pilot project, after commissioning research on digital identities for Lesotho.⁵ Through this project, digital financial services providers such as Vodacom and Econet are able to verify the customer's ID number and full name with the MHA digitally. This system leverages Lesotho's extensive national ID coverage, which has reached an estimated 1.2 million people out of 1.4 million eligible persons.⁶

Total volumes are increasing significantly over time, with almost 200,000 digital verifications being carried out per month as at the end of 2020. A report from the MHA indicates that several public and private sector entities have recently begun using the system, and usage is growing significantly. The system is being used by the Ministry of Finance to verify old age pensions proof of life information, and by the Ministry of Public Service payroll. One insurer is using the system, as well as two mobile money operators and a bank. There are also two banks who have signed the MOU with the Ministry of Home Affairs but are not using the system because their system integration with the Home Affairs have not been signed off. While use of the system is growing, the bulk of these volumes are accounted for by only one mobile network operator. This is a critical initiative and belongs to the 'digital infrastructure' needed for greater financial inclusion, mentioned above.

There are a number of aspects of the risk-based approach to identity verification that need to be implemented, and the rules proposed by FinMark Trust need to be considered. The remaining aspects of the FinMark Trust report recommendations need to be implemented, including in respect of allowing all financial service providers to follow a risk-based approach, and allowing for biometric verification (Table 6). This is important given the submissions to this MAP refresh, that suggest that requirements such as payslips and proof of address, which banks need to comply with, are a significant impediment to signing up customers. Proof of address often requires a letter from a traditional leader, which can be difficult to obtain. Given that the National ID system requires proof of address to obtain an ID document already, the ID should be sufficient for proof of address. It is also important to consider the KYC transaction risk thresholds for mobile money users, which were reviewed due to implementation of the improved e-KYC regime (the lowest tier was M2,500 daily and M7,500 monthly, which increased during the pandemic to M10,000 daily and M15,000 monthly). Currently, the highest risk tier calls for proof of address, which is unworkable for digital financial services, and is not used by at least one stakeholder participating in this MAP refresh.⁷ There is also a link to social protection that needs to be considered, discussed in more detail in Section 3.6 above. Finally, a concern has been raised about the cost of being connected to the home affairs system, which is M100,000 per year.⁸ It is unlikely that smaller digital financial services providers would be able to sign up at this cost.



The system is being used by the Ministry of Finance to verify old age pensions proof of life information, and by the Ministry of Public Service payroll.

Table 6: Proposed industry-wide, tiered KYC model based on current approach prescribed in the Payment System Regulations (2017)

KYC LEVEL	CURRENT REQUIREMENTS AND LIMITS	VERIFICATION AND TIERED APPROACH RECOMMENDATIONS
Least KYC	<ul style="list-style-type: none"> Full names and surname, phone number, proof of physical address. Current limits for mobile money are: Daily limit M2,500, monthly limit M7,500. 	<ul style="list-style-type: none"> Self-declared/Self registration. There should be a prescribed product/ account/ transaction value limits regardless of provider. Online e-KYC verification using the NID database
Partial KYC	<ul style="list-style-type: none"> Full names and surname, phone number, proof of identity, proof of physical address as contained in the NID database Current limits for mobile money are: Daily limit – M5,000 monthly limit – M15,000. 	<ul style="list-style-type: none"> Online e-KYC verification using NID database and extraction of address details from the NID database. There should be prescribed product/ account/ transaction value limits that accommodate wider use cases such as school fees payment, insurance pay-outs and cross-border remittances. Current limits should be examined to determine if these are sufficient for the mentioned use cases.
Full KYC	<ul style="list-style-type: none"> As per KYC requirements as laid out in the Money Laundering, Proceeds of Serious Crime and Terrorist Financing Act (2008) and its amendments, similar to banks. The current mobile money guidelines propose a limit for this tier (daily limit – M7,500 and monthly limit – M20,000) despite requiring similar KYC requirements as banks. 	<ul style="list-style-type: none"> Online or offline biometric based e-KYC compared to the current verification which is based on comparison against official documentation. The use of biometrics provides a high level of certainty in the identification process (high level of assurance) as the risks faced by both the provider and customer are greater due to the high level of account/ transaction values. It also signals consent to share e-KYC data with FSPs.

Source: FinMark Trust, March 2019, 'Lesotho Digital Financial ID Feasibility Assessment', report prepared by Bankable Frontier Associates.

A further potentially important intervention is in respect of digitising company registry information, including director information, and tax registration information. As discussed above in Section 3.5 above and in Section 4.2.1 below, access to financial services by MSMEs is complicated and slow, partly as a result of KYC requirements. The KYC requirements including a business licence and proof of tax registration, which are capable of being verified online. For example, in Botswana, the register of companies is available online, and businesses are traced there using information on company directors. The Ministry of Trade and Industry in Lesotho has developed a one-stop business facilitation centre in Maseru and has announced a new online registry system for companies, which should be supported. Remote verification of tax registration of MSMEs for KYC purposes is currently being implemented, and this initiative should be supported.



Improvements in credit reference bureau system

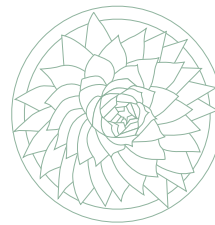
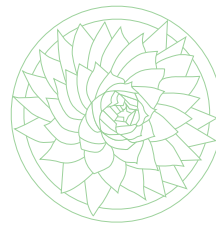
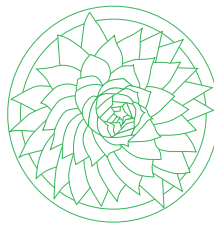
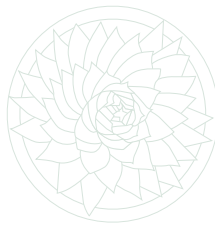
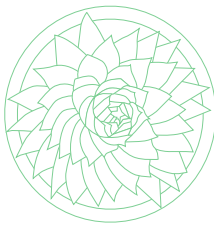
Credit reports from the credit reference bureau in Lesotho, Experian (formerly CompuScan), have improved over time, particularly with the rollout of the national ID in Lesotho, discussed above. In particular, passport numbers are now linked to ID numbers, which has meant removing duplicate records in the credit reference system. The credit reference bureau is now also capable of being connected to the Department of Home Affairs national ID system (there are ongoing discussions on this), which means that Experian can also offer KYC verification ('KYC as a service') capability. The number of credit records is less than 10% of the 1.5 million people aged 15 and over, and so the system has some way to expand to reach all potential borrowers.

An important forthcoming innovation concerns credit scores for microloans, which will soon be provided in Lesotho. This will enable digital lenders, for example, to quickly request a credit score for a consumer, and enable the lender to provide an instant loan. However, currently, mobile operators share information on contract customers only, and not for instance on airtime advance (a form of microloan). Extending the requirements to share credit information is a key means of increasing competition and reducing interest and other loan charges, particularly for smaller loans, and consideration needs to be given to this in the coming years.

There are some limitations in relation to the credit reporting system in Lesotho, particularly relating to MSME credit, duplicate records, the lack of information on borrowings from lenders in South Africa, and charges for accessing credit information systems. In addition, several stakeholders also reported that credit reports are sometimes stale, and do not reflect loans that have been repaid after a problem was reported. There have been improvements in this regard over time, particularly in relation to updating credit reports. Nonetheless, additional credit information sharing is needed in Lesotho, including by means of open application programming interfaces, as discussed in Section 5. In addition, as there is currently only one credit bureau in Lesotho, credit providers have limited choice in respect of credit bureau, and additional competition is needed in this area. This is discussed in Section 3.2.



Extending the requirements to share credit information is a key means of increasing competition and reducing interest and other loan charges.



Supply-side analysis and findings

Banking services

The market for banking services is concentrated. There are currently only four banks in operation – Standard Lesotho Bank, First National Bank (FNB), Nedbank and the Lesotho Post Bank (LPB). Between the four banks operating in Lesotho, there are 51 branches across the country. In 2020, there were 198 ATMS and 2,119 POS devices available in Lesotho, according to submissions to this MAP refresh study (see also Figure 17 below). Standard Lesotho Bank, FNB and Nedbank are the main providers in the industry with Standard Lesotho Bank being the largest.

The dominance of key banks is declining but the sector remains uncompetitive.

The Lesotho Post Bank ('LPB'), owned by the Lesotho government, has the mandate of tackling the challenge of financial exclusion by attempting to bring financial services to both rural and urban populations. By market share, the four banks account for 100% of total assets. Comparatively speaking, LPB's market share is lower than the market shares enjoyed by the other three banks, but it has been increasing since its inception in 2005. In 2013, its market share was 2.75% which increased subsequently to 8.46% in 2018. In 2019, foreign-owned banks controlled 92% of the banking industry's assets. However, it is clear that FNB, Standard Lesotho Bank, and Nedbank account for the majority of ownership of assets. According to the Central Bank of Lesotho, the banking sector is characteristically uncompetitive and highly concentrated with a Herfindahl-Hirschman Index (HHI) of 3,559 in 2019.

There was however a decline in the dominance of the largest two banks with market share decreasing from 78.8% to 76.5%, which saw a decrease of 7.9% in the HHI from 3,712 to 3,559. It is surprising that banks have not responded more aggressively to competition from the mobile network operators in Lesotho, who are driving financial inclusion through mobile money. In other countries, such as in Zimbabwe and Kenya, the banks responded to mobile money providers by introducing low cost interoperable payments, for instance. A new payments switch that might facilitate this is currently being planned in Lesotho, as discussed below.



According to the CBL, the banking sector is characteristically uncompetitive and highly concentrated with a Herfindahl-Hirschman Index (HHI) of 3,559 in 2019.

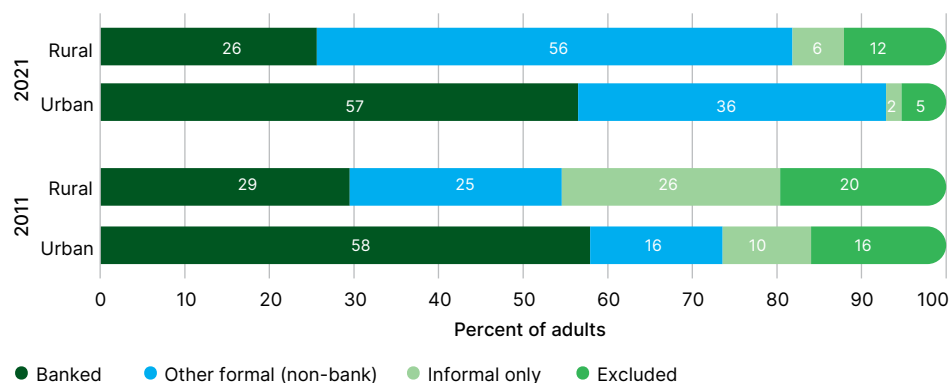


Figure 15: Financial access by location

Source: FinScope 2011 & 2021

Access to banking services is still concentrated among middle-to-upper income clients. In terms of accessibility and financial inclusivity, there is an understated bias of commercial banks towards the more affluent and urban situated client. Lower income consumers that tend to reside in rural areas are less profitable and thus banks are unlikely to go serious lengths to cater to these sub-populations. By international standards, penetration levels are low as is access to banking services – attributable to the limited banking infrastructure in rural areas. Interestingly, Figure 15 shows that the proportion of banked individuals in both rural and urban areas has decreased since 2011, but banking penetration in urban areas (57%) is more than double that of rural areas (26%). Given the growth in the proportion of the population living in urban areas, overall banking penetration has increased from 38% to 39%. Furthermore, 10% of urban adults access credit through banks while only 2% of rural adults do. The dominance of the banks in relation to the provision of credit was cited as a major problem resulting in banks focusing on corporates and high net worth individuals as opposed to the broader mass market.

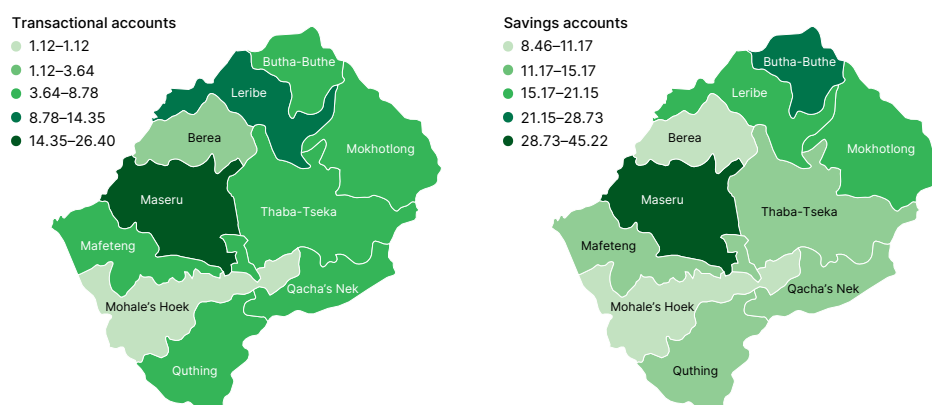


Figure 16: Transactional (including cheque) and savings accounts per 100 people in Lesotho, by district (2021)

Source: Acacia analysis of submissions from banks



The banked population varies significantly by district in Lesotho. Submissions to this MAP refresh indicate that the number of transactional and savings accounts vary significantly by district in Lesotho (Figure 16). Assuming that consumers do not hold more than one account, the total number of savings accounts reported by the four commercial banks show penetration of between nine and 11 accounts per 100 population in Berea and Mohale's Hoek respectively, compared to 45 in the Maseru district.

Monthly bank tariffs are relatively high in Lesotho. This has remained the case since the 2014 diagnostic report, which cited cost as a major factor inhibiting Basotho citizens from opening bank accounts. The three foreign based banks (FNB Lesotho, Standard Lesotho Bank, Nedbank Lesotho) have the highest monthly management fees. For a general current account, FNB charges between M65 and M78, Standard Lesotho Bank charges M94 while Nedbank charges between M95 and M133. These fees are exceedingly high, compared to mobile money accounts that do not attract monthly fees, as discussed below in Section 3.2.

Lesotho Post Bank has the lowest maintenance fees, charging only M31.8 for a general account – aligning with their mandate of trying to achieve greater financial inclusivity. With regard to youth (student) accounts, Nedbank offers the lowest tariff making it free for students, while Standard Lesotho Bank charges M16. Interestingly, LPB has the highest tariff for students charging M30 a month. Bank fees for students are an important issue given the low levels of repayment of tertiary bursaries, discussed above in Section 2.9. In terms of changes over time, bank management fees have increased, albeit marginally, for the 2021 financial year compared to the previous year. For example, Standard Lesotho Bank increased the tariff on the youth account from M16 to M16.83 and the achiever account from M94 to M99. FNB also increased its tariff on the mid-market Gold account from M62 to M65. At the same time, the Banking Association of Lesotho has introduced a free account for low-income Basotho known as 'Bothebelele account', in around 2018. This product came about to implement a directive from the CBL. All four banks offer Bothebelele accounts, which have no monthly fees. However, card swipes for the account are sometimes charged for. Nedbank, for instance, charges M4.50 per card swipe for the Bothebelele account, while FNB charges M3.50 for card swipes.

Mobile wallets are an important trend but need risk-based KYC and digital verification. Several banks have rolled out mobile wallets, such as Post Bank's Khetsi product, and FNB's eWallet. FNB, for instance, allows bulk payments (such as by employers) into eWallets. However, the banks are not allowed to follow a risk-based approach for low-value accounts, as mentioned above in Section 4.1., and so there is a skewed competitive environment adverse to the banks at this stage. This is reflected in the relatively low levels of bank account penetration, discussed.



Lesotho Post Bank has the lowest maintenance fees, charging only M31.8 for a general account – aligning with their mandate of trying to achieve greater financial inclusivity.



Similarly, KYC requirements for MSMEs are significant, and the lack of a collateral registry or other financial documentation affects SME lending. Requirements include, tax registration, a business licence, and individual KYC information for beneficial owners of MSMEs. This can result in significant delays in signing up new MSMEs. As a result, MSMEs remain a small market for the banks. One of the four banks, for example, has a total of only 200 MSME customers. Linked to this is the lack of a collateral registry in Lesotho, and also the fact that many MSMEs do not have good financial records that can be used for lending.

In general, open access to customer transaction level information via application programming interfaces (APIs) should be studied in the coming years. One submission to this MAP refresh, indicated, in relation to lending to MSMEs, that uniformity in financial reporting would be useful. This might be linked to introducing open application programming interfaces (APIs) at banks and digital financial services providers.



Linked to this is the lack of a collateral registry in Lesotho, and also the fact that many MSMEs do not have good financial records that can be used for lending.

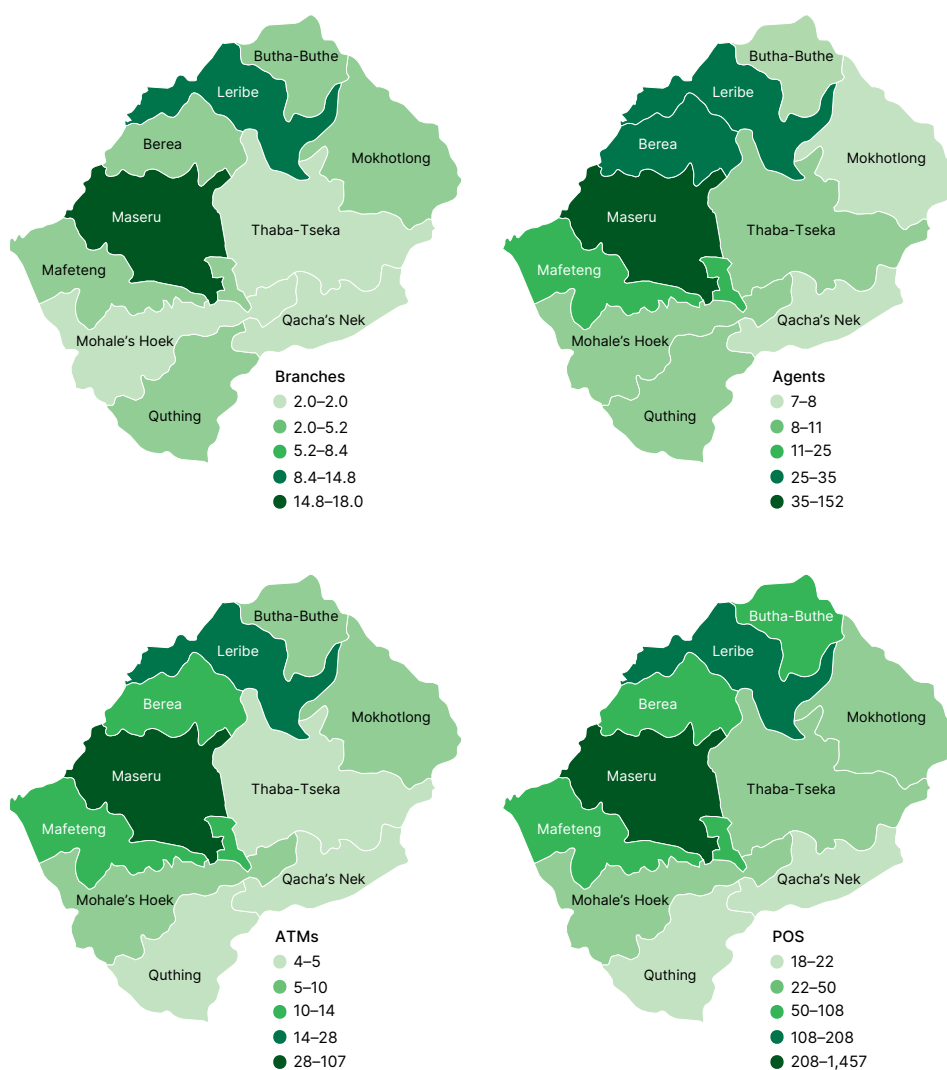
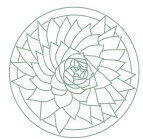


Figure 17: Bank branches, ATMs, agents and POS devices in Lesotho (2020)

Source: Acacia analysis of submissions from banks



Currently, customers may request a bank report from their current bank, that they can then take to a new bank, in order to take out a loan etc. This existing manual system could be digitalised via an application programming interface (API) approach, thus speeding up MSME applications and reducing costs.

There are also regulations constraining agent-based banking. For example, one bank has not implemented agent-based banking, and another is struggling to sign up agents, such as schools and churches, which the RBL has declined as possible agents. Agents are also often retailers and need to be persuaded to sign up with a bank. CBL approval can take two months in some cases, by which time the retailer is no longer interested in the sign-up process. Similar concerns have been raised regarding approval processes for the installation of an ATM. As a result, there are relatively few ATMs and agents in each of the districts in Lesotho (Figure 17). Reform is needed in this area, and in particular allowing banks to take on the risks associated with their agents and ATMs, which is how the mobile operators are regulated.

Banks in Lesotho interoperate through bilateral arrangements, and interoperability with mobile wallets is limited. Interoperability with mobile money operators takes place via bilateral arrangements, and is limited as certain banks are real time, others are not, and some permit bank to wallet transfers, while others do not. This is an important area of reform that can be facilitated by the national switch, for which an RFP issued by the CBL, as explained in Section 3.5. Interoperability was an important action area in the NIFS 2017–2021 as part of the first objective, and while there is progress, considerably more is needed here.

Cross border inter-bank payments slow and expensive. For large payments, of M100,000 or more, cross-border payments are rapid, via a real-time gross settlement system. In respect of at least one bank and remittance corridor, low-value remittances are instant for on-us transfers (transactions within the same bank in both countries). However, for smaller retail payments, this is more limited. There is an opportunity here for Lesotho to participate in the upgrading of the SADC-RTGS, which aims to incorporate standards set out in ISO20022, allowing retail, low-value payments. In this regard, SADC has established two working areas, one for credit EFTs, and one for mobile fund transfers. The new system will also allow payments between bank and non-bank members.

Digital loans are a relatively new feature of banking and should be encouraged. At least one submission to this MAP refresh indicated that invoice lending takes a long time to approve, and MSMEs often need finance quickly. This suggests there is an opportunity for instant, digital lending to MSMEs, including by mobile operators (discussed next), that the banks will need to compete with in future. This may become more possible as improvements in credit scoring through open APIs and the collateral registry are introduced.



SADC has established two working areas, one for credit EFTs, and one for mobile fund transfers. The new system will also allow payments between bank and non-bank members.

Mobile money services

Mobile money is playing a key role in making the financial sector more inclusive.

The usage of mobile money services has grown substantially since the previous MAP report, from less than one million transactions per month in 2014 to almost four million in 2020 (Figure 18). Domestic money transfers, airtime purchases and bill payments are the largest applications, and withdrawals from agents account for relatively fewer transactions. This suggests that mobile money services are contributing to a significant degree of financial inclusion. In Lesotho, the uptake of such services and the quantity of money in circulation are hailed as a triumph for financial inclusivity. In 2019, the Central Bank reported that M230.2 million was in circulation.

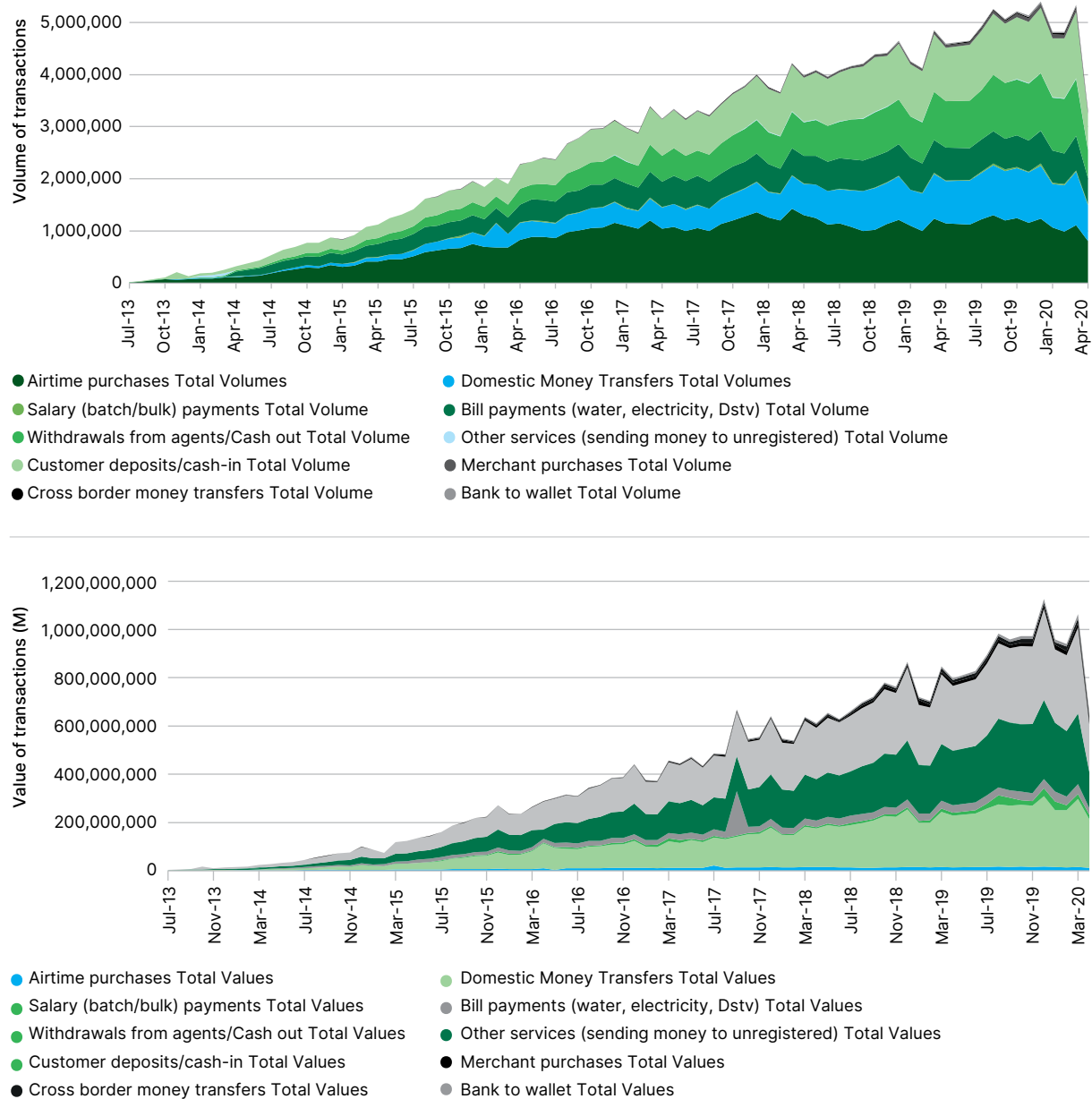


Figure 18: Volumes and values of mobile money service transactions

Source: Central Bank of Lesotho



The mobile money market is dominated by two firms. In terms of market structure, the mobile money market is characterized by a duopoly with only Econet Telecom Lesotho (ETL)'s EcoCash and Vodacom Lesotho (VCL)'s M-Pesa providing mobile money services. In terms of market share, Vodacom served 72% of the subscriber base and 60% of the mobile money customers.

Vodacom's M-Pesa is the dominant player in the market. M-Pesa allows customers to transfer money, make payments (electricity and DSTv) as well as airtime purchases although one can only purchase Vodacom airtime. In future, additional services may be possible, including savings and credit products, insurance, and more nuanced merchant services, as is the case in Kenya for instance. In terms of cash-in services, customers can deposit cash into their wallet at any authorised M-Pesa outlet. The use of mobile money for savings, despite there being no interest paid to consumers, is an interesting development (discussed above in Section 2.1). In terms of mobile money charges, cash-in services are free. However, there is a charge imposed on cash-out services that varies with the amount being withdrawn. The tariff on withdrawals ranges from M1.7 for a withdrawal M10 to M15 to M13.2 for a withdrawal of between M4,001 to M5,000. To transfer money to a registered customer, the tariff ranges from M1.2 to M8.8. For transfers to unregistered customers, customers incur a fee between M2.9 and M21.9.

Econet's EcoCash offers a slightly more affordable service. Econet's EcoCash allows for money transfers across all networks in Lesotho as well as various payments including utilities, DSTv, salaries, funeral services, insurance premiums, school fees and cross-border remittances. Customers can cash-in at any Econet shop, post office or EcoCash agent (in person) with proof of ID and active handset required. Like Vodacom's M-Pesa, cash-in is free but cash-out depends on the amount being withdrawn (up to M5,000). Withdrawal charges range from M1 for withdrawals less than M10 to M11.5 for a withdrawal of M1,001 to 5,000. Money transfers to registered subscribers cost between M1 and M7.5 and between M2.3 and M19 to transfers to unregistered customers.



The use of mobile money for savings, despite there being no interest paid to consumers, is an interesting development.

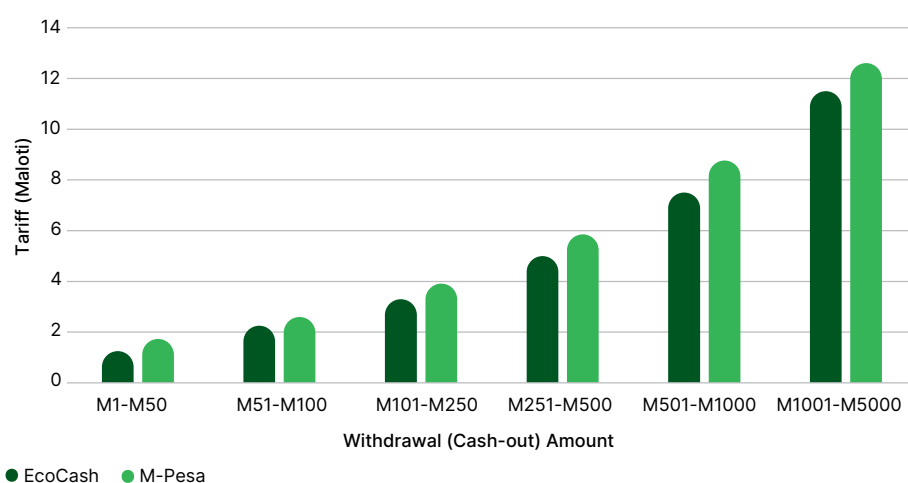


Figure 19: EcoCash and M-Pesa Cash-out Tariff Structure

Data Sources: Vodacom M-Pesa Rates. 2021. Available: Online. Econet's EcoCash. 2021. Available: Online



Additionally, EcoCash gives customers the ability to transfer from their registered bank account to their wallet at a cost of between M0.3 and M1. Based on the prices, Econet offers a cheaper money transfer service than Vodacom.

The use of mobile money services is widespread in Lesotho. In 2021, 66% of Lesotho's adult population used mobile money services. Furthermore, there were only 268,056 90-day active customers in 2015 compared to 554,092 90-day active customers in 2017 – illustrating the positive uptake trend in the mobile money sector.

The lack of interoperability between banks and mobile money providers in Lesotho hampers the expansion of financial inclusion. A report compiled by AFI cited the interoperability between commercial banks and mobile network operators as a major problem slowing the move towards greater financial inclusivity. This was reaffirmed by at least one submission to this MAP refresh, which indicated that certain banks resist transfers between banks and mobile money wallets, as the banks are concerned about competition from mobile money providers. This is an important area of reform, and might be considered as part of the implementation of the national switch, discussed in Section 3.5 above. Current arrangements for interoperability do not involve interchange, and mobile money customers for instance are charged cash-out fees for transferring to a bank, and at least one bank charges approximately 1% of the value of the transfer to send to a mobile wallet (such transfers are instant). These fees need to be considered together with interoperability and interchange arrangements as a whole in Lesotho, possibly as part of the implementation of the national switch.

MNOs are not permitted to offer credit products. Currently, the mobile network operators (MNOs) do not offer credit products. While Vodacom has shown some interest in this area, the Central Bank does not currently permit the MNOs to do so. This affects the sign-up of merchants for payments, for example, since a key benefit of mobile money to merchants is digital credit. This policy may need to be reconsidered in order to allow for greater competition and the expansion of credit offerings in Lesotho.

Interest is not paid on mobile money deposits. SADC issued mobile money guidelines in November 2019, proposing that 'interest accrued in the Trust Account, net of any standard fees or charges related to the administration of the Custodial/Trust accounts can be passed on as a benefit to the Mobile Money Customers.' However, interest is not currently being distributed to mobile money account holders in Lesotho, which is an issue that needs to be resolved in the coming years in order to encourage savings. This is important because 37% of the adult population have savings in their mobile money accounts.

Government can cultivate the adoption of mobile money and digital payment services. Given the size of the government relative to other economic actors in Lesotho, digitization and the use of mobile money by the government is arguably a strong way of inducing take-up of digital payment services. Tax and social transfer payments can benefit from the use of a mobile money payment platform, and this is an important gap in mobile money usage in Lesotho, compared to



Interest is not currently being distributed to mobile money account holders in Lesotho, which is an issue that needs to be resolved in the coming years in order to encourage savings.



other countries, such as Tanzania, where mobile money is extensively used for government to person payments. For example, the Ministry of Finance is currently in the process of digitizing old age pensions. In a cost-benefit study conducted as part of the SIMM project, positive NPVs for the Child grant program were revealed with mobile money yielding the highest return (benefit). Similarly, the Lesotho Revenue Authority E-taxation project also generates positive NPVs.

There is a resistance among smaller merchants to adopt cashless payments.

At least one submission to this MAP refresh reported that smaller merchants resist taking up cashless payments, possibly due to the desire to avoid taxation.

At least one provider in Lesotho provides detailed transaction information to merchants in order to incentivise uptake, and while most merchants sign-up for this, only a small proportion actually use it. Additional features, such as consumers having to pay for the payment to a merchant via mobile money, have also not resulted in merchants signing up. Additional means of expanding merchant uptake may be via interoperable low-cost instant payments in Lesotho, already included in the national switch RFP issued by the CBL, as explained in Section 2.5.

Cross-border remittances

Remittances are an important part of Lesotho's economy and have been harmed by the Covid-19 pandemic. International or cross-border remittances are an important source of income for the Lesotho economy (accounting for approximately 20% of GDP). In the third quarter of 2020, inward remittances were estimated to be around M7.9 billion while outward remittances were estimated to be around M5 billion. There was thus an approximate M2.9 billion net inflow of cross-border remittances into Lesotho. According to the World Bank and a recent study conducted by the European Union, global remittances are expected to decrease in the wake of Covid-19, increasing vulnerability for those dependent on such remittances. The CBL estimates that migrant worker incomes declined by 14% and inward remittances are likely to decline by a similar amount as a result of the pandemic. At the same time, Figure 20 shows that remittances increased by 26% since the last FinScope survey in 2011. We also see a significant increase in the proportion of adults that only use other formal (non-bank) means to remit, from 10% in 2011 to 48% in 2021.

Remittances has shifted from being predominantly done through family/friends, to individuals using more formal methods to remit. Data from the FinScope 2021 survey showed that 40% of Lesotho adults sent money while 64% received money. Moreover, of the 40% of individuals that sent money only 12% sent to someone living in another country while 41% of the 64% received it from someone living in another country. While commercial bank channels are rarely used, remittances via other formal channels have increased substantially over time. The drastic rise can be attributed to a large degree to the expansion of mobile money in respect of domestic remittances, and innovative cross-border remittance platforms, such as Shoprite money transfers, which approximately 24% of adults used for cross-border remittances according to Finscope 2021.



The CBL estimates that migrant worker incomes declined by 14% and inward remittances are likely to decline by a similar amount as a result of the pandemic.

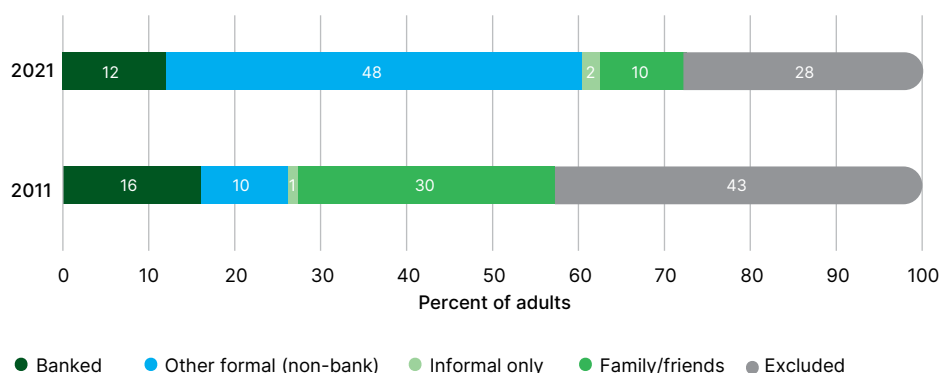


Figure 20: Remittances over time

Source: Finscope 2011 & 2021

Shoprite money has had an especially important positive impact on international remittances, arising as a result of interventions by the MAP / NIFS project. The launch of Shoprite Money Market is offering a more affordable channel through which individuals can remit income. Initially launched with a sending fee of M9.99, the cost remains low at M25 per remittance and M5 cash back, the lowest cost-remittance product available in Lesotho. The service is attempting to address the fact that many unbanked workers from Lesotho use informal and often high-risk channels to send money to Lesotho. The Shoprite Money Transfer service allows individuals to remit up to M5,000 in a single transfer with no cost accruing to the recipient of the funds. The service reached M1 billion in remittance value within three years of being introduced. Finscope 2021 data reveals that Shoprite was used by around 8,000 adults to send money and approximately 83,000 to receive money. Perhaps as a result of these low prices and extensive usage, the Lesotho-South Africa corridor is one of the lowest-cost corridors linked to South Africa (Figure 21). The employment bureau of Africa (TEBA) Lesotho is also a prominent remittance service provider with approximately 25,000 adults using it to receive money. TEBA enables mineworkers to make remittances to their families in Lesotho via two schemes.

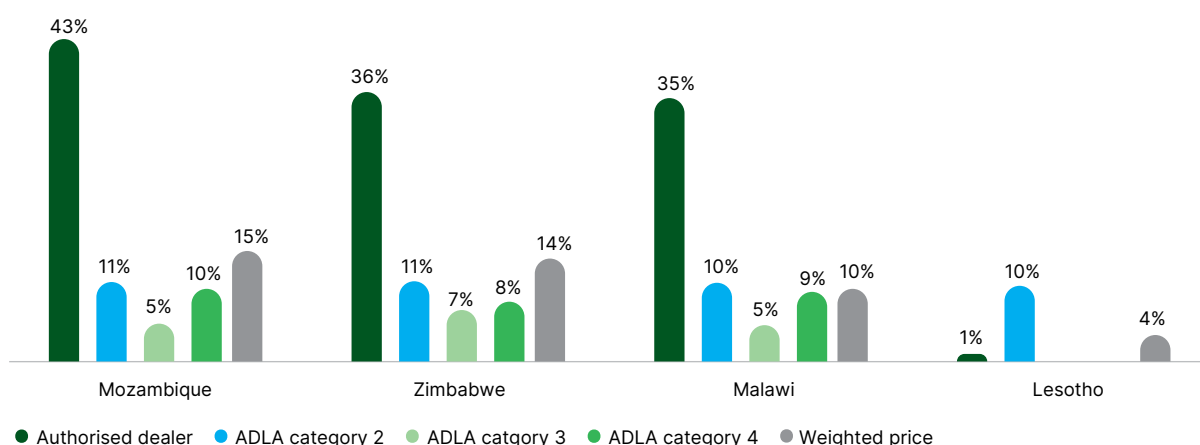


Figure 21: Remittance Pricing (South Africa-Lesotho Corridor)

Data Source: FinMark Trust, 2020, Research findings on cross-border remittances from SA to the rest of SADC 2020



The standard remittance scheme and the cash remittance scheme. The cash remittance scheme enables the worker to send a variable amount at a cost of M42 per transaction. The standard remittance scheme involves the worker to send 30% of net remuneration to their family at a cost of 1.5%. It is also an authorized Ubank agent that provides mineworkers to access services such as cash withdrawal in Rands or foreign currency, alternative account options and cash deposits. Due to declining gold prices and stricter immigration policies among other reasons, the number of Basotho mineworkers in South Africa have declined affecting TEBA Lesotho. Nonetheless, there were 28,000 Basotho mineworkers that made use to TEBA's services in 2018.

There are asymmetries in the way that mobile money and remittance provider agencies are treated. Similar to the situation for banking agents described above, remittance provider agents in Lesotho go through an approval process by the CBL, which raises costs and delays agent rollout. It is not clear why they are treated differently to mobile money providers, who do not go through this process, and this approach needs to be reconsidered.

Microfinance Institutions

Microfinance is a possible means through which developing countries can precipitate higher levels of development. For example, there is some evidence that talented but low-income entrepreneurs may be able to use short-term loans to escape poverty traps. In Lesotho, the microfinance sub-sector has grown considerably. According to the CBL, the sub-sector grew by 23.5% in 2019. MFIs have proliferated, highlighted by the number of registered institutions now operating. In 2018, there were only 16 registered MFIs. In 2019, 43 microfinance institutions were registered and operating in Lesotho. This may be linked to the NIFS 2017-2021, which highlighted the need to bring MFIs into the regulated environment in Lesotho.

The CBL notes that MFIs cater primarily to salaried government and private employees due to the ability to deduct loan repayments at source. Stakeholder interviews confirms that MFIs focus on salaried, government employees. In addition, the Finscope 2021 survey results also show that access to credit is highly limited in Lesotho. This suggests that significant reforms are needed to expand credit in Lesotho, including by MFIs.

Microfinance represents a small share of the financial system. The growth of the sub-sector saw an increase in asset base value. In 2019, the asset base was M982.8 million compared to M797 million in 2018. It must be noted though that there are currently no deposit taking MFIs and there is a high degree of concentration among the credit-only MFIs with the two-largest MFIs (Letshego Holdings and The Unlimited) holding considerable market shares. Overarchingly, the provision of microfinance in the country is still in its infancy representing only a 4% share of the total financial system. Total assets to GDP for MFIs stood at 11%, which is small considering the total financial assets to GDP was 304.7% in 2019.

43

In 2018, there were only 16 registered MFIs. In 2019, 43 microfinance institutions were registered and operating in Lesotho.



The industry is grappling with several issues. Despite progress, borrower indebtedness and irresponsible lending are a concern. While the CBL has increased the number of registered MFIs to almost 90 in the past two years, more is needed to formalise the sector. At the same time, credit information sharing by the microfinance institutions has improved in Lesotho as a result of the MAP / NIFS project. The CBL ensures that the sector makes extensive use of the Credit Information Bureau in making their credit decisions. Lastly, the MFIs also remain dependent on loan funding, often from parent companies, shareholders equity and other investments – driving up interest rates for consumers.

Competition and better disclosure may be needed. An important question in relation to microlending is whether consumers and MSMEs need greater protection from reckless lending and very high interest rates. There are concerns that expanding MFIs comes at the expense of more developmental approaches to MSME finance, and that the links between human development and greater lending by MFIs are dubious. At the same time, several formal, registered MFIs submitted to this MAP refresh study that recent changes to lending rules, increasing the minimum take-home pay from 20% to 30%, resulted in significant reductions in lending by formal lenders. This is a concern, as this permits 70% of take home pay to be used in debt repayments. At the same time, it appears as though fears about consumers or MSMEs entering into debt-traps, where high interest rates drive the indebted to perpetually borrow more, may be overemphasized and need to be balanced against the need for greater competition between formal MFIs and informal MFIs. Research in other developing countries suggests that small businesses taking on debt carry on doing so even where their debts are repaid in full, and so it may be more important to foster competition between MFIs to drive down lending costs rather than attempting to remove credit from markets. The CBL may therefore need to study the impact of its lending criteria in Lesotho, while taking steps to foster competition between MFIs and perhaps other lenders, including mobile money providers and banks.

A debit order system and greater competition more than one credit bureau is needed in Lesotho in order for MFIs to expand. MFIs currently focus mainly on state employees, since they are able to assess creditworthiness and collect loan payments via the government's SIDAS system. It is difficult for MFIs to expand beyond this market, since collecting loan repayments is currently not possible via debit order, for example. The Experian credit bureau system (the only system available in Lesotho) is relatively new in Lesotho, and has limited information. At least one submission to this MAP refresh raised concerns about the monthly costs of connecting with the credit bureau, added to the costs of developing and maintaining a loan management system. These concerns may be resolved if competitor credit bureau were introduced in Lesotho.



The CBL ensures that the sector makes extensive use of the Credit Information Bureau in making their credit decisions.



Funding for MFIs needs to be considered. MFI submissions to this MAP refresh also reported that they face difficulties in finding funding for their activities from commercial banks, since MFIs compete with commercial banks for customers.

An MFI that attempted to raise funding from the LNDC bank guarantee scheme was not successful. This suggests that funding for MFIs in Lesotho needs to be considered by the CBL, and any competition concerns in respect of exclusion by banks needs to be assessed.

Capital markets

Capital markets are relatively underdeveloped in Lesotho. In 2014, the Government of the Kingdom of Lesotho launched the Maseru Securities Market (MSM) as an initiative to facilitate centralized trading of financial securities. MSM is a non-profit institution that aims to raise medium to long-term capital by giving access and encouraging share ownership of previously privatized companies. Motswedi Securities Lesotho (MSL) became the first registered company to practice as a stockbroker member of the MSM. MSL is involved in the development of Lesotho's stock exchange and the deepening of capital markets. There has been limited progress in the listing of securities on the MSM, however, and more work is needed to assess how best Basotho can get greater access to financial markets, both from investment and capital raising perspectives.

Development finance institutions

The Lesotho National Development Corporation (LNDC), established by an Act of Parliament in 1967, is a development finance institution tasked with funding the industrialisation of Lesotho. More recently, it has been tasked with running a partial credit guarantee scheme and other financing instruments to try and close the development financing gap. However, uptake of the partial guarantee scheme, introduced in 2011, has been limited. For instance, the NSDP II documents that, by 2017, 63 projects had been funded, with approximately M31.3 million in loans, and M15.3 million in guarantees. Microfinance institutions commented during the course of this MAP refresh study that they had attempted to access the partial credit guarantee scheme for their own funding needs but were unsuccessful. At least one submission from a bank suggested that it is not clear where the funds for the partial guarantee scheme will come from.

It may be worth reconsidering the role of LNDC, particularly as far as the power and small-scale water sector is concerned. It may be worth considering redirecting LNDC funds to smaller-scale micro-grid suppliers and pay as you go solar providers (discussed above in Section 3.10.3).

Insurance

The insurance sector, comprising both long-term and short-term insurance providers is highly concentrated. The insurance industry is the second largest industry within Lesotho's financial system accounting for 27% of total financial system assets in 2019. Over time we have seen a decline in the proportion of adults with insurance (formal or informal) from 62% in 2011 to 57% in 2021 of

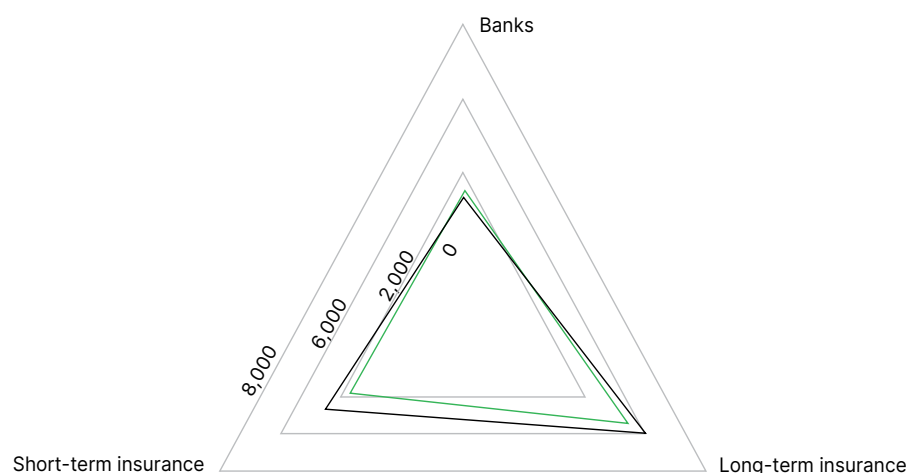


Figure 22: Market concentrations (HHI) for insurance and banking sector in Lesotho (2019)

Source: Central Bank of Lesotho (2019)

which only 49% make use of formal insurance products. This figure has however increased from 40% in 2011. The sector largely serves higher-income consumers, other than in respect of funeral insurance policies. There are currently 10 insurance companies and 52 insurance brokers domiciled in Lesotho. Four insurance companies conduct general insurance business (short-term) while six of the companies conduct life insurance business (long-term). It is a highly concentrated industry in Lesotho – both in terms of short-term and long-term insurance. In 2019, the HHI index for short-term insurance is 4,587 while for long-term insurance, it was 6,118 illuminating the high degree of market concentration. In terms of recent economic performance, the short-term insurance sector collected M451 million in premiums in 2019. Though 56.6% of these premiums were ceded to reinsurers. The industry is supervised and regulated by the CBL and companies operating in the sector adhere to the Insurance Act of 1976.

Low-cost cash funeral plans may provide some degree of protection. Low-cost life insurance, in the form of funeral plans that pay out cash in the event of death, may provide a degree of social protection for families. For instance, the transactor plus bank account from Nedbank, includes embedded funeral cover, for an M10 monthly fee, providing M2,000 in funeral cover. Econet's Ecosure product offers cover of between M10,000 and M50,000 for between M15 and M75 per month.⁹ M-Pesa similarly offers funeral cover in partnership with Alliance. While these policies provide a starting point for social protection of families, it is important to consider means by which social protection may be expanded via insurance. Microinsurance products are an option but have met with limited uptake in many countries.¹⁰ It may be important, rather, to support digital co-selling of financial services products together with insurance, such as the Ecosure and Nedbank funeral policies, given there is some evidence that microcredit, when combined with microinsurance, can help reduce poverty.¹¹

Signing up customers and collecting insurance premiums has become easier over the past five years. At least one submission to this MAP refresh indicated that collecting insurance premiums has become easier for insurers over the past five years, due to mobile money.¹² Survey data shows that of the people who spend

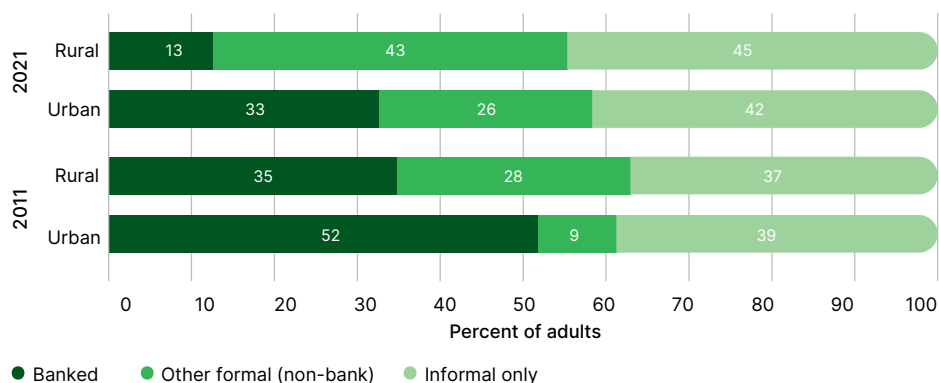


Figure 23: Insurance by location

Source: Finscope 2011 & 2021. Bars may not equal 100% due to rounding.

on insurance and funeral premiums, 6% did so through mobile money and 11% used debit/stop orders.¹³ In addition, due to the rollout of the national ID, KYC rules have also become easier to comply with. This suggests that there has been progress with reducing barriers to expansion of insurers in Lesotho over the past five years.

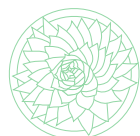
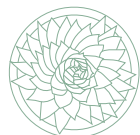
However, over the period 2011 to 2021 total insurance (formal and informal) uptake decreased by 8%, which was largely driven by a decrease in informal insurance. However, only 11% of the insured population have non-funeral formal insurance.¹⁴ The main barriers to the uptake of life cover are “never heard about it” (26%) and “don’t have a regular income” (18%) and for funeral cover, burial society or mpate sheleng they are “don’t have a regular income” (35%) and “don’t have a job (unemployed or retrenched or retired)” (19%).¹⁵ Interestingly, Figure 23 shows that a greater proportion of individuals in rural areas were insured (including informal) relative to urban individuals in 2011, this has now changed as a greater share of urban adults are insured in 2020.

Increase in uptake of formal insurance due to favourable changes to environment. Formal insurance penetration seem to have increased due to favourable changes to the environment. Premium collection has become easier over time with the expansion of mobile money, for example. The submissions to this MAP refresh study did not indicate there are significant problems with know-your-client rules, or with regulatory approvals. Integration with the Department of Home Affairs appears to be progressing smoothly. However, partnerships between insurers and mobile operators are relatively new, and more time is needed for the development of joint products serving low-income

consumers. **There is a need for insurance linked to weather events driven by climate change in Lesotho.** As discussed in Section 2.7, climate change is likely to have a significant impact on Lesotho. In particular, reduced precipitation and higher temperatures are likely to result in less water resources. Drought and extreme rain events are also more likely. It is therefore critical that better data on crop estimates, rainfall etc. are collected in Lesotho, possibly supplemented by the analysis of satellite image data, in order to provide a better understanding of risks and inform the development of relevant insurance products. Technology for providing more nuanced insurance products is evolving, and it may be possible for example to further innovate using satellite image data for vegetation.



Technology for providing more nuanced insurance products is evolving, and it may be possible for example to further innovate using satellite image data for vegetation.



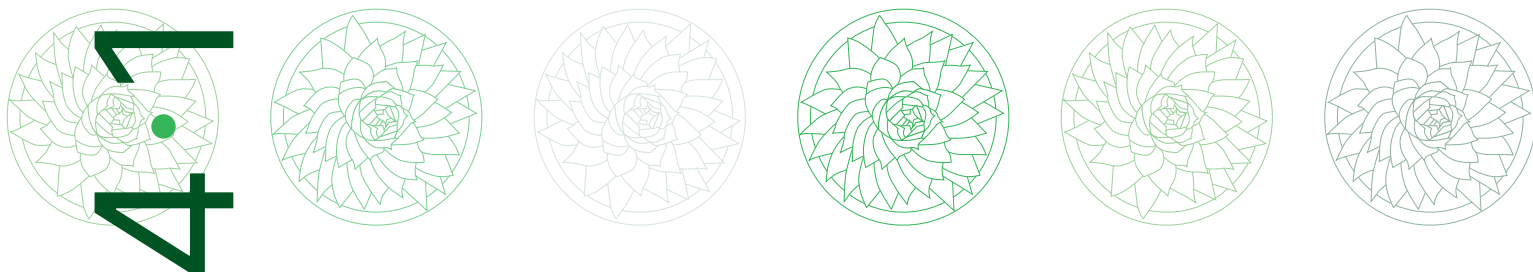
PART 3 NOTES

- 1 Activities in the MAP report not included in the NIFS but nonetheless completed over the five-year period were included in the 75 total activities. There were six activities suggested in the MAP report but not included in the NIFS and not completed.
- 2 FinScope 2021
- 3 McKinsey & Company. 2016. Digital finance for all: Powering inclusive growth in emerging economies. Available: Online
- 4 UNCDF, *Financial inclusion through an inclusive growth lens, MAP Global Insights Series*, Volume 3, Note 1, 2020.
- 5 FinMark Trust, March 2019, 'Lesotho Digital Financial ID Feasibility Assessment', report prepared by Bankable Frontier Associates.
- 6 World Bank Blogs. 2021. *National ID in Lesotho is putting citizens at the center*. Available: Online
- 7 Stakeholder D.
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4

Economic
sectors that
can drive
growth and
employment



Introduction

In order to increase the focus on the real economy, and its linkages with financial inclusion, the MAP refresh project involved selecting four sectors for analysis.

They were selected based on their (i) contributions to GDP, (ii) contribution to economic growth, (iii) inclusion in policies developed through the political process in Lesotho including the NSDP II (2018/19-2021/22), and (iv) links to the SDGs (Table 7).

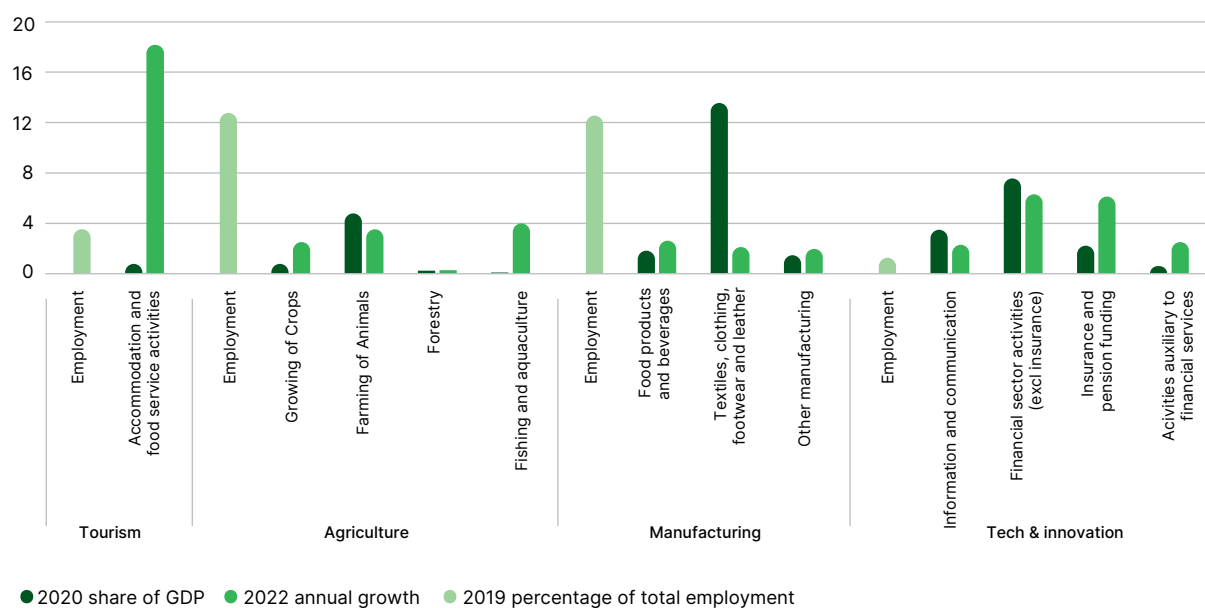
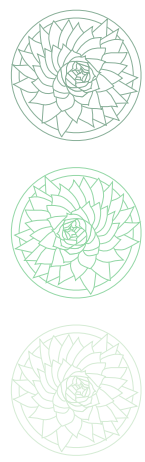


Figure 24: Growth in Lesotho (NSDP II sectors)





Source: Central Bank of Lesotho. Lesotho Economic Outlook 2020-2022. Authors' analysis of Lesotho Bureau of Statistics data (LFS, 2019). Sectors used for employment calculations: Tourism, creative = Accommodation and food service activities; Agriculture = Agriculture, forestry and fishing; Manufacturing = Manufacturing; Tech and Innovation = Information and communication, Financial and insurance activities.

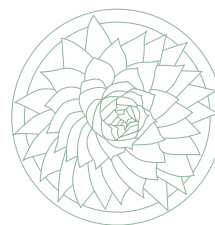
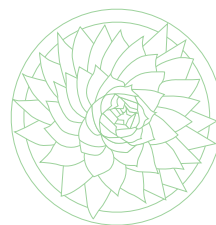
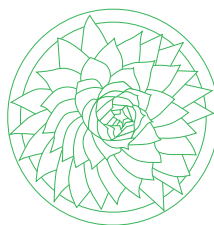
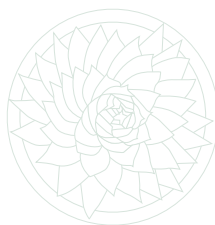
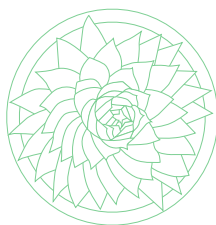


As discussed above, the key sectors selected from growth in the NSDP II are tourism and creative industries, agriculture, manufacturing, and technology and innovation (Figure 24). In 2019 these four sectors together contributed around 30% to total employment in Lesotho. Furthermore, they are estimated to employ 121,799 people in 2020/21, and are projected to employ 127,729 people by 2022/23, according to the NSDP II.

The links between sectors selected and contribution to GDP, NSDP II, and the SDGs are shown on Table 7. We discuss each of the key sectors in the sections that follow.

Table 7: Links between sectors selected and contribution to GDP, National Strategic Development Plan II, and SDGs

	NSDP II	UN SUSTAINABLE DEVELOPMENT GOALS	
Tourism and creative industries	Yes		8 Decent work & economic growth
Manufacturing	Yes		9 Industry, innov. & infrast.
Agriculture	Yes		2 Zero hunger
Technology & innovation	Yes		9 Industry, innov. & infrast.



Tourism and creative industries

Tourism and creative industries are expected to grow significantly in the coming years in Lesotho, benefiting from the natural beauty of the country, 65 World Heritage Sites, and the potential for creative arts and high-altitude sports.

The sector is important as it provides opportunities for local businesses like SMMEs in areas such as accommodation, tours and excursions, food and beverages and transportation. As can be seen on Figure 24, accommodation and food service activities alone are expected to grow by 18% in 2022, albeit off a low base of less than 1% in 2020. Most people employed in the tourism sector are women and youth in both formal and informal jobs. International arrivals are considered to represent exports in a country's services which means it can help with the balance of payments and international tourism receipts (percentage of total exports) for 2018 were 1.9%.¹ The Lesotho Tourism Development Corporation is primarily responsible for the economic development of the sector. The NDSPII highlights the importance of tourism infrastructure needed to support the sector, and good sporting and hospitality facilities.

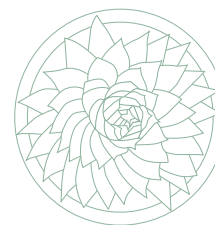
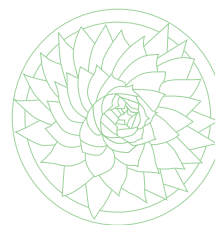
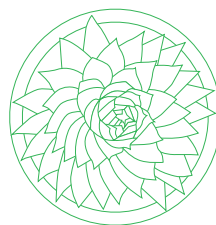
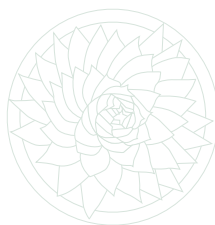
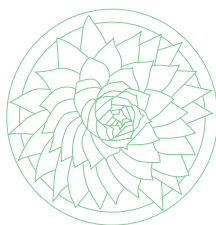
The availability of finance for tourism businesses has been highlighted as a constraint on growth in the sector. At least one submission to this MAP refresh reported that borrowers in the tourism sector are considered high-risk.² This is a concern as considerable investments are needed to improve tourism infrastructure in Lesotho, and funding is needed for this. The infrastructure identified in the NDSPII includes:

- Upgrade and digitize documentation system.
- Identify and develop tourism-related infrastructure to create circular routes linking tourism attractions and facilities.
- Improve access to tourism products and destinations.
- Improve accommodation and hospitality facilities.
- Establish facilities for heritage management such as museums and art gallery.
- Identify sites for tourism investment, declare as special development areas (SDAs) and exempt from any land taxation.

Similarly, in the creative industries, the NDSPII also identifies access to finance as an important intervention. The lack of finance for initiatives in the tourism and creative industries sector is therefore an important area of intervention in the coming years in respect of financial inclusion particularly of MSMEs. Interventions needed in this area are discussed in Section 2.5 and 5.1.

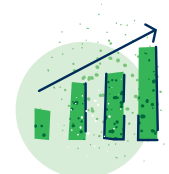


The NDSPII highlights the importance of tourism infrastructure needed to support the sector, and good sporting and hospitality facilities.



Manufacturing: footwear, clothing and textiles

The clothing and textiles sector in Lesotho employs approximately 40,000 people, mainly women, though this has declined from over 50,000 people since 2003, when the sector benefited from preferential market access to EU and US markets under the Multi-Fibre Arrangement.³ This preferential market access has seen textile and related activities contribute significantly to GDP and Lesotho's exports. The sector contributed 13.6% of GDP in 2020 (see Figure 5 in Section 1.2), and 58% of total exports in 2019.⁴ The private sector overall in Lesotho is small, employing perhaps 50,000 people,⁵ and so the footwear, clothing and textiles sector accounts for a substantial proportion of private sector employment. The bulk of employees in the sector work on knit garments and denim (Table 8). There are less than 100 firms in total, some of which are likely to be MSMEs. It is important that these firms are supported as far as possible in order to grow the economy and increase formal employment in the private sector in Lesotho. At least one submission to this MAP refresh reported that they are seeing some growth in manufacturing customers.⁶ However, another reported that the textiles sector suffered significantly due to the impact of the Covid-19 pandemic.⁷ Financial inclusion interventions in support of MSMEs are discussed in more detail Section 2.5 and 5.1.



It is important that these firms are supported as far as possible in order to grow the economy and increase formal employment in the private sector in Lesotho.

Table 8: Lesotho textile, clothing and footwear sector

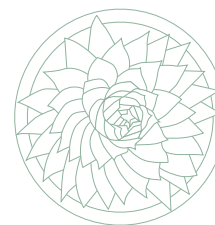
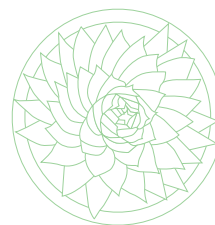
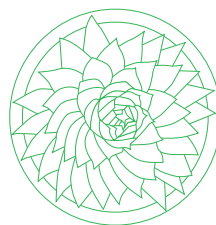
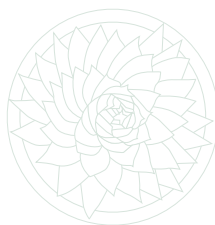
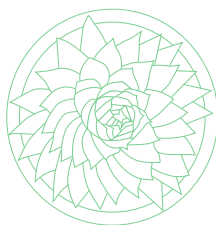
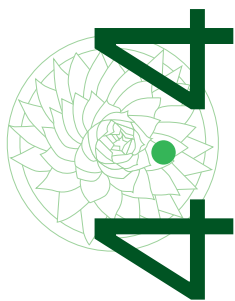
	FIRMS	JOBS	APPROXIMATE UNITS OF BASIC GARMENTS PRODUCED PER ANNUM
Textile	1	1 220	Yarn - 18 000t Fabric - 15.6 million linear meters
Denim (woven bottoms)	9	13,124	23,304,000
Non-denim Woven Fashion	4	1,580	6,360,000
Industrial Workwear	6	4,696	11,003,800
Knit Garments	33	24,513	115,143,600
Footwear	2	1,253	7,200,000 pairs
Supporting Industry	11	218	-
Total	66	46,604	155,811,400 (typical clothing units) 7,200,000 (pairs of typical shoes)



Global trade dynamics are critical to the industry's capacity to effect sustainable growth and inclusive development. There is a question as to how to build on the existing capabilities in Lesotho in the textile, clothing and footwear sector. Dependency on the AGOA agreement is concerning. The preferential market access may not be renewed in 2025, exposing acute vulnerabilities with Lesotho's clothing industry and potentially causing a collapse.⁸ If the agreement is not renewed, Chinese manufacturers, who currently run factories, may simply relocate to other countries that enjoy tariff arbitrage. Thus, while clothing and textile manufacturing remains important for Lesotho, its viability as an industry driving growth and financial inclusion is contingent on the renewal of the AGOA agreement. To a large degree, the success of the sector is dependent on global trade dynamics rather than local interventions. Furthermore, there are only three SMMEs involved in clothing production out of a total of 52 firms with most of the production geared towards export markets. This presents an opportunity for firms (particularly MSMEs), albeit in a limited sense, to cater for the domestic (local) market.⁹ Financial inclusion initiatives to support MSMEs are described in Section 3.5 and Section 6.1.



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Agriculture

The agricultural sector in Lesotho is largely based on informal, subsistence farming, who are exposed to significant climate change risks, as discussed in Section 2.7.

This sector is nonetheless a significant contributor to employment, accounting for approximately 12.8% of the employed (the second largest contributor to employment after household activities). There is a significant wool and mohair industry which contributes to exports from Lesotho, and there is the potential to expand fresh fruit and vegetables, cannabis and trout exports. The role of improved land tenure, digital innovations and regional integration may play an important role in this.

Export products

Lesotho is the second largest mohair supplier in the world, with 50,000 sheep farmers. There is a very large wool and mohair agricultural sector in Lesotho with an estimated 250,000 individuals either directly and indirectly linked to wool and mohair production.¹⁰ Its significance is further accentuated by the fact that 95% of the value of Lesotho's agricultural exports is derived from wool and mohair. However, it has recently been hampered by regulatory interventions that unintentionally caused significant disruptions for farmers.¹¹ This is linked to the development of a monopoly buyer of wool and mohair, the Lesotho Wool Centre.¹² There is also a lack of certification equipment in Lesotho, required by the International Wool Textile Organisation regulations, and wool is typically certified in South Africa. This may be an important area for intervention, linked to overall digitisation of the certification processes, and creating tradable receipts, discussed below. Furthermore, Lesotho changed its agricultural marketing legislation in 2018, deeply affecting credit availability for Basotho farmers and emphasising the need for revolving credit funds.¹³

Lesotho grows and exports Cannabis and related products. Lesotho was the first country in Africa to licence firms to produce cannabis for medical purposes in 2018.¹⁴ Since then, a number of licences have been issued and investments have been made by large companies, attracted by low costs, good water supply and fertile soils. There is a question, however, as to how best to integrate small-scale growers into these value chains, a question that has been worked on extensively in other countries in relation to other cash crops, such as Tobacco in Malawi and Zimbabwe.



There is a very large wool and mohair agricultural sector in Lesotho with an estimated 250,000 individuals either directly and indirectly linked to wool and mohair production.



Fresh fruit and vegetables may present opportunities in the future. For example, 10,761 trees were planted on 10 hectares of land to test the possibilities for apples, peaches, plums, cherries, apricots and blueberries being grown in Lesotho.¹⁵ Moreover, an estimated 550,000 hectares are suitable for orchards in Lesotho.¹⁶ In 2018, a new horticultural market centre was opened, where farmers can sell their produce, including tomatoes, spinach and cucumbers,¹⁷ though the market is not currently operational. Additionally, deciduous fruit production has been incorporated into the NSDPs as a priority sub-sector, despite only a tiny fraction produced for export.¹⁸ It is important to note that vegetable production is viewed through a nutritional lens as opposed to a commercial one. The focus has been to ensure gardens are able to produce a supply of vegetables that is adequate for household consumption. Important aspects of financial inclusion linked to the development of these export products are land tenure, digital innovations, and regional integration, discussed next.

Land tenure

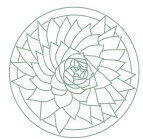
The use of land for collateral in Lesotho is difficult given the lack of a functioning land market.¹⁹ Moreover, the report details that most land transactions (rent) are informal with most of the land owned on a traditional basis by communities. This inhibits the commercial viability of farming practices in Lesotho by creating uncertainty and deterring investment. There may be means of improving land tenure in Lesotho by digitising title deeds and 90-year leases, and thus expanding rights to land.

The role of digital innovations

Various studies show that digitalisation has an important role to play in improving outcomes in the agricultural sector. For instance, information and communication technologies can play a positive role in informing farmers and buyers on what crops to produce and what markets to sell into or buy from by reducing informational asymmetries (i.e. making information available to all market participants) and reducing search costs (the costs involved in visiting different regions to find market information, such as on prices). For example, Aker (2010) shows that the introduction of mobile phones in Niger resulted in a reduction in food price dispersion (or variation between food prices) of between 10 and 16% between 2001 and 2006.²⁰ This effect is stronger where higher transport costs increase the costs of gathering information on which market to sell into or buy from in the absence of real-time digital information (since the alternative would be physical travel with resultant costs). Jensen (2007) similarly found substantial reductions in price dispersion as a result of increased mobile coverage in markets for fish in the state of Kerala in India.²¹ The study showed that both producers and consumers benefit from greater mobile coverage, particularly for fresh produce such as fish. Making mobile technology available more widely assists particularly producers of fresh products. In this regard, device ownership is an important barrier to accessing the internet.²²



Vegetable production is viewed through a nutritional lens as opposed to a commercial one. The focus has been to ensure gardens are able to produce a supply of vegetables that is adequate for household consumption.



There are a number of digital innovations used by farmers in African countries.²³

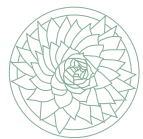
This is important, as at least two submissions to this MAP refresh indicated that lending to the agricultural sector in Lesotho is low.²⁴ For instance, innovative asset-backed finance that provides farming inputs rather than cash appear to be having an impact, and this success may be replicated by other FSPs.²⁵ In addition, digital innovation may provide other means of reducing credit risk. Recent economic research considers how the use of fingerprints could affect farmers' behaviour in relation to credit.²⁶ While the introduction of fingerprinting was found to not have an effect on the rate of loan approval or actual take-ups of loans, where fingerprints were taken, the riskiest borrowers' repayment rates improved dramatically due to voluntarily choosing smaller loan amounts (or not taking out a loan at all), as well as devoting more of the loan to agricultural inputs and thus, the crops²⁷ used for repayments to ensure future access to credit. Borrowers with the highest probability of crop success took out higher loans but never diverted inputs.²⁸ The introduction of fingerprints increased the repayment rates as farmers wanted to maintain the possibility of future credit. Results indicated that fingerprinted borrowers had lower outstanding balances, higher fractions paid, and were more likely to fully pay on time. FSPs therefore might consider means of ensuring that borrower identities are verified by means of biometric information (such as a voice imprint or fingerprints) when a loan is made, in order to increase loan repayments and reduce risks for lenders (and therefore interest rates). Results are suggestive of credit market efficiency, while a cost-benefit analysis suggests the worthiness of implementing the fingerprinting or other biometric system.²⁹ This experiment indicates a possible strategy to not only increase levels of financial inclusion but additionally, a method that could benefit the financial institutions too. There may be opportunities to link such initiatives with the UNDP's planned supplier development programme in Lesotho, or building on a previous programme linking vegetable farmers to markets.³⁰



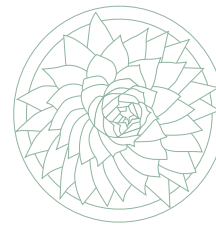
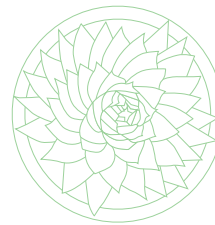
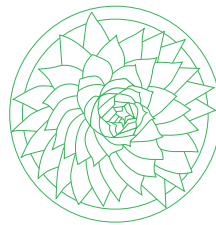
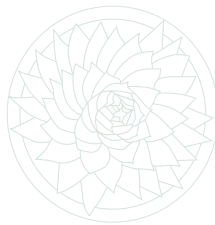
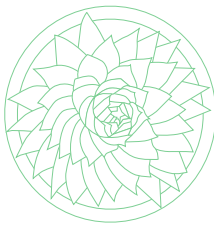
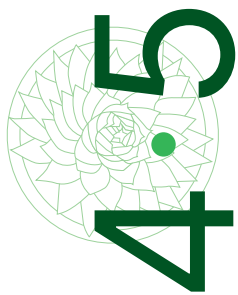
The introduction of fingerprints increased the repayment rates as farmers wanted to maintain the possibility of future credit. Results indicated that fingerprinted borrowers had lower outstanding balances, higher fractions paid, and were more likely to fully pay on time.

Greater regional integration presents an opportunity for the agricultural sector

There may be a range of opportunities to support the development of commodity markets, including as digital marketplaces are introduced.³¹ A further important aspect of the wholesale and retail sector in Lesotho is that regional supermarket chains play an important role in trade patterns.³² It is likely in the coming years that Lesotho will expand access to trade in foodstuffs, including as a result of the role of regional supermarket chains but also as a consequence of having ratified the AfCFTA.³³ This will create greater opportunities for expanding regional value chains between wholesale, retail and food producers. For instance, there are regional value chain bodies that Lesotho may leverage in this regard, including the Regional Network of Agricultural Policy Research Institutes (ReNAPRI).³⁴ Participation in these bodies may help support the Lesotho's integration with regional agricultural value chains and help support the development of innovative financial solutions for farmers in Lesotho. There may be opportunities to



introduce or support the expansion of the application of food standards. In this respect, an important aspect of regional integration is meeting phytosanitary standards, including those imposed by supermarkets.³⁵ Digital certification for products may help facilitate the procurement and logistics aspects of the wholesale and retail sector in Lesotho. The example of the Provenance app in the UK, for instance, linking the fishing industry in South-East Asia with UK supermarket chains, is useful in this regard.³⁶ In general, the formalisation of the agricultural sector is an important objective in the coming years, and there may be opportunities for banks, MFIs, capital markets and digital financial services providers to help register agricultural enterprises, including with tax authorities.

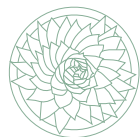


Technology and innovation

The NSDP II emphasizes several activities to support technology development and adoption in Lesotho. First, there are increasing collaborations between government, the University of Lesotho and industry, and this is an objective of the NSDP II. A second area of work is enhancing institutional capacity for research. The NSDP II also calls for the development of industrial parks for innovation, cottage industries supporting locally developed products, and strengthening legal frameworks to protect and develop innovation. These interventions are laudable and need to be supported. There may be links between financial inclusion and development of innovation in a number of areas, including in respect of the development of financial technology companies (FinTech), and in areas such as renewable energy generation, linked to Lesotho's abundant wind, solar and hydro resources.

There may be opportunities to support fintech firms innovating around mobile payments, ecommerce, and retail. Two financial technology ventures in Lesotho, Smartel Money and Chaperone, provide e-wallets, cash-in and cash-out, and merchant payments. This is an important area of innovation in respect of financial inclusion and might extend into 'dropship' e-commerce. For example, Ling Shou Tong offered by Alibaba in China integrates retailers with brands, allowing merchants to order and pay for stock with no transaction charges for the merchant, and has signed up approximately 20% of small, independent retailers.³⁷ This is referred to as 'new retail' by Alibaba. An important feature of this service is that payment service providers are able to keep charges to merchants free by providing ancillary services to merchants and brands. The nascent fintech industry in Lesotho should be supported, and fintech start-ups should be included in consultations on the development of the payments system, including on the current development of the national switch.

It is important to facilitate competition between Fintechs and larger financial services providers in Lesotho. The first issue submitted to this MAP refresh project relates to the CBL requirement for fintech providers to partner with existing regulated entities, such as banks. While this may be prudent, the CBL may need to monitor the requirements and limitations imposed by such partners, who for instance often require the disclosure of strategies of fintech partners, which can hamper fintechs if they feel they need to give away their intellectual



property or might be thwarted by their partner bank copying their strategy.³⁸ The CBL also needs to monitor the conditions that incumbents impose on fintechs, which can hamper their entry and market participation.

The second important issue concerns participating more broadly in the financial system, and pro-competitive reforms needed to do so, including introducing open APIs so that fintechs (and other financial services providers) can better measure risks and provide finance, and secondly allowing participation by fintechs in the payments system (including the new payments switch), permitting interoperable wallets for instance.³⁹ This is discussed more in Section 5.1.

Agriculture is another area in which technology and innovation may be supported in Lesotho. See discussion in Section 4.4. Currently, submissions to this MAP refresh indicate that the agriculture sector accounts for a negligible proportion of insurance premiums in Lesotho. This is surprising given the substantial livestock industry in Lesotho, centred around Merino sheep. There is at least one ongoing trial in this area but more work is needed, including potentially in respect of better data collection and dissemination, such as on rainfall, and potentially using satellite imagery.



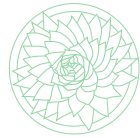
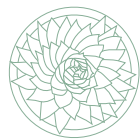
Submissions to this MAP refresh indicate that the agriculture sector accounts for a negligible proportion of insurance premiums in Lesotho.

6.4

Summary

The NSDP II highlights development of the agriculture, manufacturing, tourism and creative, and technology and innovation sectors. There are signs of development particularly in the technology and innovation sectors, with two submissions to this MAP refresh indicating significant growth in this area. The tourism, manufacturing and agriculture sectors also show good prospects for growth, supported by infrastructure development.

It is not clear, however, that efforts to finance these sectors have been successful. The best means of doing so, in the short-term, may be by means of ensuring greater competition among financial services providers, lowering barriers to formalising MSMEs, and improving risk assessments for lending, by implementing the suggested reforms set out in Section 4.

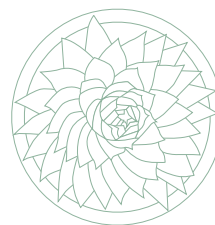
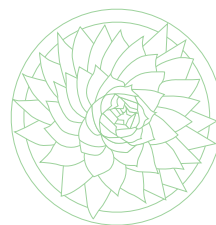
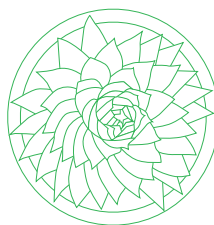
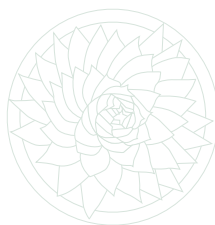
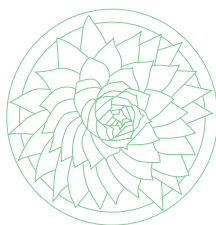


PART 4 NOTES

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- 2 Stakeholder B.
- 3 Tralac. 2017. *Lesotho's textiles, apparel and footwear manufacturing industry*. Available: Online
- 4 Genesis Analytics. 2020. SMME Finance Scoping: Services and Light Manufacturing
- 5 See NSDP II.
- 6 Stakeholder B.
- 7 Stakeholder E.
- 8 Genesis Analytics. 2020. SMME Finance Scoping: Services and Light Manufacturing
- 9 Genesis Analytics. 2020. SMME Finance Scoping: Services and Light Manufacturing
- 10 Imani Development. 2020. *Interim Report – Lesotho*.
- 11 Regulatory interventions in the past years included Agriculture Marketing (Wool and Mohair Licensing) (Amendment) Regulations 2018. See the concerns raised on regulatory interventions here: Online
- 12 Business Day. 2019. *How a Chinese tycoon caused misery for Lesotho's wool farmers*. Available: Online
- 13 Imani Development. 2020. *Interim Report – Lesotho*.
- 14 Engineering News. 2019. *Lesotho wants to export its cannabis to the world*. Available: Online
- 15 See NSDP II, cited above.
- 16 Imani Development. 2020. *Interim Report – Lesotho*.
- 17 International Trade Centre. 2018. *Lesotho opens horticultural market centre to boost business for farmers*. Available: Online
- 18 Imani Development. 2020. *Interim Report – Lesotho*.
- 19 Imani Development. 2020. *Interim Report – Lesotho*.
- 20 Aker, J. C. 2010. Information from markets near and far: Mobile phones and agricultural markets in Niger. *American Economic Journal: Applied Economics*, 2(3), 46-59.
- 21 Jensen, R. 2007. The digital divide: Information (technology), market performance, and welfare in the South Indian fisheries sector. *The quarterly journal of economics*, 122(3), 879-924.
- 22 See, for example, Hauge, J. A. and J. E. Prieger. 2010. "Demand-side programs to stimulate adoption of broadband: What works?" In: *Review of Network Economics* 9.3. See also: Online
- 23 Annan, K., Conway, S. G., & Dryden, S. 2016. African Farmers in the Digital Age. *Foreign Affairs*, Special Issue (February). Available: Online
- 24 Stakeholder B and Stakeholder C
- 25 For example, in nearby Malawi, the One Acre Fund launched its asset-based financing solution in 2017. This service lends agricultural inputs to farmers and allows repayments on any schedule selected by the farmer, provided that the loan is repaid by harvest time. The One Acre Fund estimates that its services have resulted in double the yields of participants: <https://oneacrefund.org/impact/country-detail/>
- 26 Gine, X., J. Goldberg & D. Yang. 2012. Credit Market Consequences of Improved Personal Identification: Field Experimental Evidence from Malawi. *American Economic Review*, 102(6): 2923 – 2954.
- 27 In this study, Paprika was used.
- 28 Reduction in ex-ante moral hazard may encourage better loan repayments by improving farm outputs so that farmers have higher incomes with which to make loan repayments.
- 29 Calculated portrayed a benefit-cost ratio of 2.34.
- 30 World Bank. 2019. *Linking Smallholders to Markets: A Supplier Development Program for Vegetable Farmers in Lesotho*. Available: Online
- 31 Disruptive technologies in agricultural value chains Insights from East Africa, prepared by: Aarti Krishnan, Karishma Banga and Maximiliano Mendez-Parra, dated: March 2020.
- 32 Das Nair, R., Chisoro, S., & Ziba, F. 2018. The implications for suppliers of the spread of supermarkets in southern Africa. *Development Southern Africa*, 35(3), 334-350.
- 33 African Union. *Agreement Establishing the African Continental Free Trade Area*. Available: Online
- 34 The Regional Network of Agricultural Policy Research Institutes. Available: Online
- 35 das Nair, R., & Landani, N. 2020. *Making agricultural value chains more inclusive through technology and innovation* (No. wp-2020-38). World Institute for Development Economic Research (UNU-WIDER).
- 36 das Nair, & Landani 2020, cited above.
- 37 CGAP. 2019. *The new retail revolution*. Available: Online
- 38 Stakeholders R and S.
- 39 Stakeholder S.

5

Conclusions and recommendations



Conclusion

Levels of poverty and inequality are high in Lesotho, and there are relatively few private sector, formal jobs. As a result, there are a significant number of migrant workers, and remittances play an important role in livelihoods.

Social protection is significant, but administration costs are high and coverage could be expanded. Land tenure is largely traditional in nature, which has an impact on women, and their access to finance. MSMEs face considerable barriers to formalisation in Lesotho, driven in part by onerous KYC and CDD requirements for MSMEs. While mobile network infrastructure is extensive (there are high levels of coverage), access to electricity and water are more limited.

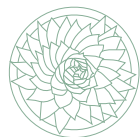
The NSDP II provides the main roadmap for economic and human development in Lesotho, and highlights development of the agriculture, manufacturing, tourism and creative, and technology and innovation sectors. There are signs of development particularly in the technology and innovation sectors, with two submissions to this MAP refresh indicating significant growth in this area. The tourism, manufacturing and agriculture sectors also show good prospects for growth, supported by infrastructure development. It is not clear, however, that efforts to finance these sectors have been successful.

The links between finance, economic growth and poverty are complex. Developing domestic financial markets requires an uncommonly sound grasp of consumers' real economic needs at ground level. By better serving the needs of low-income sectors, countries can leverage a broader portion of the population in developing their domestic financial markets, while also unlocking new opportunities for financial service provision and real economic activity. Financial services can thus, in helping different segments meet their real economic needs, facilitate greater real economic activity, at the same time reducing opportunity gaps between low-income segments and the rest of the population.

There have been considerable improvements in access to financial services in Lesotho. Overall, the percentage of adults (18+) with access to at least one formal product increased from 61% in 2011 to 87% by 2021. This achievement is linked to the expansion of access to financial services geographically, through mobile money and banking agents, which means less time and less cost accessing salaries and wages, and remittances. In addition, consumers are now

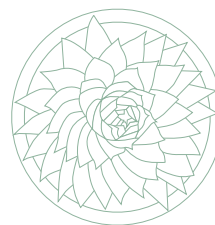
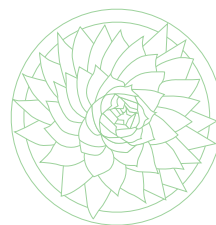
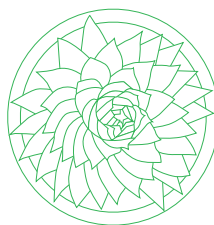
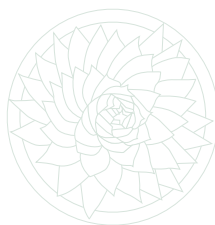
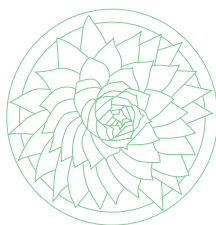


The NSDP II provides the main roadmap for economic and human development in Lesotho, and highlights development of the agriculture, manufacturing, tourism and creative, and technology and innovation sectors.



able to buy electricity and pay for water services using mobile money,¹ which likely improves collections for these important utilities and reduces the costs of transacting for consumers. There has also been increasing competition over time, particularly in respect of remittances, where Shoprite's entry and low charges have resulted in significant savings, an initiative driven as a result of the 2014 MAP diagnostic report and roadmap.²

In the next sections, we present the anticipated benefits arising from research conducted during the course of this MAP refresh, an outline of the roadmap implementation and evaluation, measurement and consideration of risks.



Anticipated benefits

The first anticipated benefit is expanded access to financial services via intensified competition.

THESE BENEFITS INCLUDE:

- It is important to create a more permissive environment, such as by allowing MNOs to offer credit products, and reconsidering lending affordability limits imposed on MFIs.
- It is also important that MNOs should share credit information (in addition to the banks that already do) and should offer interest on mobile money deposits.
- Efforts to develop a collateral registry should also be supported.
- Better credit information sharing, and other means of improving lending risk assessments such as by means of a collateral registry, can help support the expansion of access to basic services, such as pay you go solar, and investments in water and sanitation, in addition to facilitating access to finance in sectors identified for expansion.
- More broadly, the CBL might consider open banking APIs as a means of achieving greater competition, and efforts to achieve interoperability between banks, MNOs and other digital financial services through a national switch should be supported.
- Consideration might be given to funding for MFIs, as there are complaints that banks don't want to fund their MFI rivals.
- Similarly, the relationships between fintechs and their sponsor incumbent financial service providers need to be monitored by the CBL, particularly to prevent incumbents introducing onerous and potentially anti-competitive requirements on fintechs, limiting their growth.
- In addition, lower regulatory barriers to access and expansion can help facilitate competition. This includes reducing regulatory barriers including KYC and licensing requirements for MSMEs.
- There are difficulties with credit records especially for MSMEs currently, linked to the onerous formal requirements for MSMEs participating in the financial sector.
- Restrictions on remittance provider agency establishment should be relaxed in order to enable them to compete – for instance, balance of payments reporting is not necessary for low value transfers.

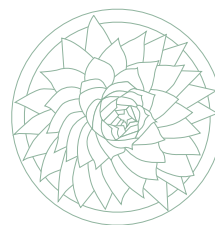
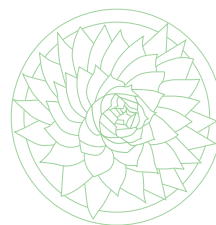
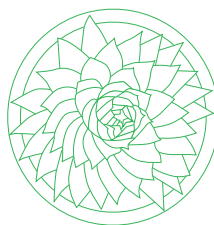
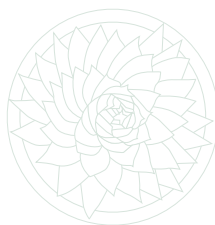
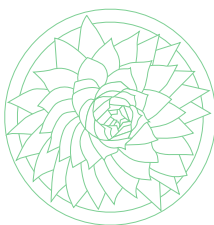


A FURTHER BENEFIT IS IN RESPECT OF DIGITALISATION:

- In particular, the formalisation of MSMEs needs to be emphasized, and the online company registry should be supported.
- Current initiatives to expand digital financial identities (including biometric verification) should also be supported. More effort must be made to remove proof of address verification, not widely possible in Lesotho, and replacing this with biometric verification of identities.
- Consideration might also be given to digital title deeds and 90-year leases.
- The current payments switch initiative needs to include fast efficient payments (including early debit orders for repaying loans).
- Initiatives to develop mobile / digital payments for social protection (including verification via national digital ID) should also be supported, given the very high costs and relatively low coverage at present of social protection systems.
- Current financial technology start-ups offering merchant payments should be encouraged, including by permitting them to participate in instant payments through national switch that is currently being considered by the CBL.
- It is also important that informal m-health community healthcare worker end-user mobile internet connectivity subsidies might be considered.
- Furthermore, better data on crop estimates, rainfall etc. need to be collected in Lesotho, possibly supplemented by the analysis of satellite image data, in order to provide a better understanding of risks and inform the development of relevant insurance products. Technology for providing more nuanced insurance products is evolving, and it may be possible for example to further innovate using satellite image data for vegetation.

WOMEN, YOUTH, AND MSMEs NEED CAN BE FURTHER SUPPORTED, CLIMATE CHANGE RISKS NEED TO BE FURTHER MITIGATED, AND REGIONAL INTEGRATION MIGHT BE LEVERAGED:

- In order to ensure that women are empowered through financial inclusion, regulations on asset ownership need to be reformed and enforced.³
- A tax policy reform for MSMEs might be needed, such as allowing delayed VAT payments and simplified income taxes.
- There is a need to expand labour productivity and youth employment in Lesotho, perhaps through targeted or subsidised loans to the youth, so that more people can complete high school and go on to tertiary education.
- Finally, Lesotho is in a good position to take advantage of regional integration, including in respect of expanded access to markets for agriculture and manufacturing products, and also in respect of regional payments systems.



Roadmap implementation and evaluation

These themes imply several reforms in respect of financial inclusion in Lesotho, set out on Table 9 below:

Table 9: Key activities: 2022 - 2026

EXPANDED ACCESS TO FINANCIAL SERVICES VIA INTENSIFIED COMPETITION	
NIFS 2017-2021 ACTIVITY NOT YET ACHIEVED	<ul style="list-style-type: none"> • Banking fees remain high. • The Post Office might be developed more as a distribution channel. • The payment of interest on mobile money balances may need to be considered. • Mobile money liquidity challenges need to be further dealt with, including through SIMM. • Shoprite, and other digital remittances providers, may need to integrate to a greater degree with other financial services providers. • Improved credit information sharing among FSPs needs to be considered. • Bank transfers are still very expensive. The cross-border regulatory framework needs to be reviewed. • More work needs to be done on formalising informal financial services providers. • Better information tracking progress on aspects of the FI plan, such as prices, may need to be considered. • The impact of regulations needs to be considered.
2021-2025 ACTIVITIES	<ul style="list-style-type: none"> • Create a more permissive lending environment, such as by allowing MNOs to offer credit products. • Reconsider lending affordability limits imposed on MFIs. • It is also important that MNOs should share credit information (in addition to the banks that already do) and should offer interest on mobile money deposits. • Efforts to develop a collateral registry should also be supported. • Better credit information sharing, and other means of improving lending risk assessments such as by means of a collateral registry. • The CBL might consider open banking APIs as a means of achieving greater competition, and efforts to achieve interoperability between banks, MNOs and digital financial services providers through a national switch should be supported. • Consideration might be given to funding for MFIs, as there are complaints that banks don't want to fund their MFI rivals. • The relationships between fintechs and their sponsor incumbent financial service providers need to be monitored by the CBL, particularly to prevent incumbents introducing onerous and potentially anti-competitive requirements on fintechs, limiting their growth. • Reduce regulatory barriers including KYC and licensing requirements for MSMEs. • Mitigate difficulties with credit records especially for MSMEs currently, linked to the onerous formal requirements for MSMEs participating in the financial sector. • Restrictions on remittance provider agency establishment should be relaxed in order to enable them to compete – for instance, balance of payments reporting is not necessary for low value transfers.



LEVERAGING DIGITALISATION

2017-2021

- Digital financial identities may need to be considered.

2021-2025 ACTIVITIES

- The formalisation of MSMEs needs to be emphasized, and the online company registry should be supported.
- Current initiatives to expand digital financial identities (including biometric verification) should also be supported.
- More effort must be made to remove proof of address verification, not widely possible in Lesotho, and replacing this with biometric verification of identities.
- Consideration might also be given to digital title deeds and 90-year leases.
- The current payments switch initiative needs to include fast efficient payments (including early debit orders for repaying loans).
- Initiatives to develop mobile / digital payments for social protection (including verification via national digital ID) should also be supported, given the very high costs and relatively low coverage at present of social protection systems.
- Current financial technology start-ups offering merchant payments should be encouraged, including by permitting them to participate in instant payments through national switch that is currently being considered by the CBL.
- It is also important that informal m-health community healthcare worker end-user mobile internet connectivity subsidies might be considered.
- Better data on crop estimates, rainfall etc. need to be collected in Lesotho, possibly supplemented by the analysis of satellite image data, in order to provide a better understanding of risks and inform the development of relevant insurance products. Technology for providing more nuanced insurance products is evolving, and it may be possible for example to further innovate using satellite image data for vegetation.

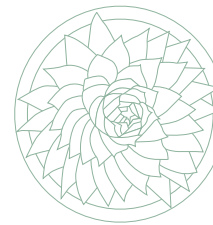
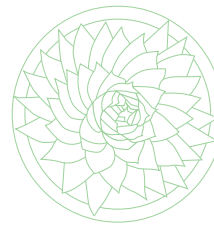
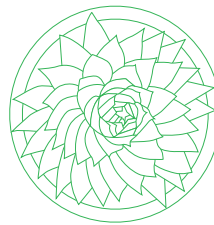
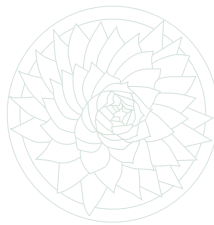
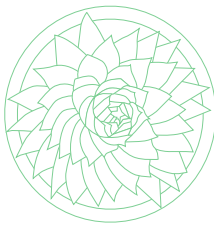
SUPPORT FOR WOMEN, YOUTH, AND MSMEs, MITIGATING CLIMATE CHANGE RISKS, AND LEVERAGING REGIONAL INTEGRATION

2017-2021

- Health insurance needs to be developed.
- Explore the viability of property and agriculture insurance products.

2021-2025 ACTIVITIES

- In order to ensure that women are empowered through financial inclusion, regulations on asset ownership need to be reformed and enforced.
- A tax policy for MSMEs might be needed, such as allowing delayed VAT payments and simplified income taxes.
- There is a need to expand labour productivity and youth employment in Lesotho, perhaps through targeted or subsidised loans to the youth, so that more people can complete high school and go on to tertiary education.
- Lesotho is in a good position to take advantage of regional integration, including in respect of expanded access to markets for agriculture and manufacturing products, and also in respect of regional payments systems.



Governance structure

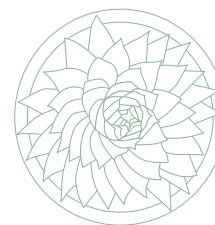
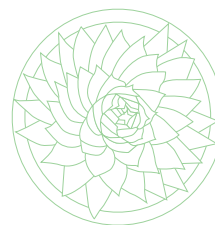
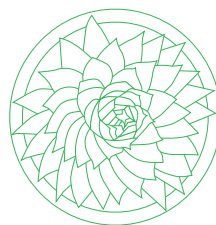
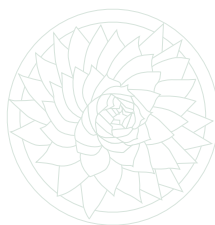
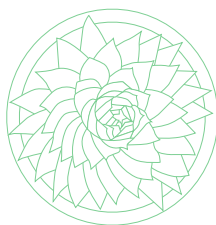
An important aspect of this MAP refresh is that the governance structure for financial inclusion in Lesotho needs to be adapted, with financial inclusion policymakers and stakeholders now needing to participate in real economy and social reform processes.

The current steering committee is led by the Ministry of Finance and includes the key departments of the CBL. While the current structure is working reasonably well, there is a need to consider allocating full time resources from the Ministry of Finance and the CBL to drive the implementation of the proposals set out in this MAP refresh report. This needs to be expanded to include the Ministry of Small Business, which has a financial inclusion function. It would also be very useful for industry association structures to participate in the steering committee, rather than having all licensees send their individual representatives. For instance, in the financial education steering committee, all financial institutions sent representatives, resulting in an unwieldy body. The steering committee needs to comprise a narrower group of committed individuals representing sectors rather than individual organisations.

At the same time, there may be certain forum meetings where individual institutions can be represented. For instance, this was recently requested by the Banking Association for a forum on access to finance for cross-border women traders. It will also be important for the Ministry of Home Affairs (in relation to the digital financial identities) and the Ministry of Trade and Industry (on the registration processes for small businesses) to be included in the financial inclusion forum. Similarly, it may be helpful to also consider including donors such as the IDA (part of the World Bank Group), the largest multilateral donor to Lesotho, as part of the FI forum. The World Bank is currently working on the national payments switch, for instance, and also the digitisation interventions proposed in this MAP refresh are linked to the health and human development funding, which accounts for 74% of donor assistance to Lesotho (discussed in Section 2.2).



The steering committee needs to comprise a narrower group of committed individuals representing sectors rather than individual organisations.



Measurement

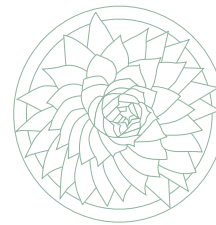
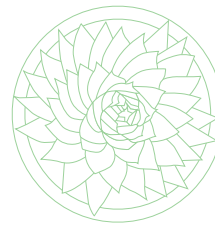
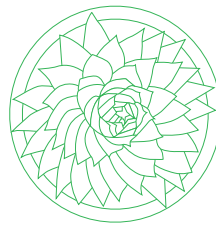
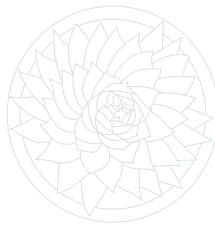
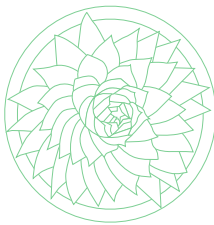
The main measurement aspects of this MAP refresh are outcomes visible in Lesotho.

Table 10: Measurement of outcomes

AREA OF ACTIVITY	MEASUREMENT	DATA SOURCE
EXPANDED ACCESS TO FINANCIAL SERVICES VIA INTENSIFIED COMPETITION	Number of participants in the domestic payments system, including in the new national switch	CBL
	Number of credit records available, and number of credit checks undertaken	Experian
LEVERAGING DIGITALISATION	Number of people registered on Home Affairs database with biometric information	Home Affairs
	Number of verifications of information by FSPs	
	Number of MSMEs formally registered	DTI
	Agriculture insurance products available to market	Insurers
SUPPORT FOR WOMEN, YOUTH, AND MSMEs, MITIGATING CLIMATE CHANGE RISKS, AND LEVERAGING REGIONAL INTEGRATION	Implementation of expanded rights to land among women	Government
	Tax reforms available to MSMEs	LRA
	Lesotho offers to SADC	DTI
	Lesotho participation in real-time cross-border payments	CBL
	Proportion of men and women completing high school and higher education	BoS



Risks



The risks to the key NIFS areas are shown below.

Expanded access to financial services via intensified competition

The key risk here is that incumbent financial service providers may resist competition by undermining reform efforts in this area. This risk can be mitigated by offering transparent, consultative regulatory processes.

Leveraging digitalisation

A key risk in this area relates to the protection of private information, which if not achieved, can undermine trust in the system. This will require considering protection of information legislation.

Support for women, youth, and MSMEs, mitigating climate change risks, and leveraging regional integration

Risks here relate to resistance to change in respect of gender issues, and a lack of adequate preparation for mitigating the effects of climate change. The key means of mitigating these risks are by obtaining broad political support for reform. There is also a risk that national interests resist regional integration. In order to mitigate the risks of this, the benefits of integration need to be clearly outlined.

PART 5 NOTES

- 1 Stakeholder F.
- 2 Shoprite charges approximately M25 per money transfer for cross-border remittances, whereas other cross-border remittances providers charge up to 10% of the value of transfers.
- 3 See, for example: Modern Ghana. 2021. *Financial inclusion for women in Africa: Pathway to economic empowerment*. Available: Online

