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The rise of microcredit 'control fraud' in post-apartheid South Africa: from state-enforced to market-driven exploitation of the black community

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ABSTRACT
The end of apartheid in South Africa in the early 1990s did not see the envisaged end to the exploitation of the black South African population, but instead saw simply a shift from state-backed exploitation to market-driven exploitation. This trajectory is especially germane to the country's microcredit industry, which has spectacularly and wilfully enriched a narrow white male elite while simultaneously helping to fragment and destroy the local rural and urban economies of the black poor. As this article demonstrates, a major aspect of this one-sided enrichment process has involved 'control fraud', the process whereby the CEO and senior management of a financial institution use their seniority to defraud customers, shareholders, the government and the general public as they go about maximising their own private short-term financial gains. Already a problem elsewhere in the global South, South Africa has thus joined the growing list of countries that have seen control fraud in the microcredit sector undermine and block progress towards more productive, sustainable and equitable local economies.

KEYWORDS
Microcredit; microfinance; control fraud; local economic development; South Africa

MOTS-CLÉS
Micro-crédit ; micro-finance ; fraude par le contrôle ; développement économique local ; Afrique du Sud

La montée de la « fraude par le contrôle » du micro-crédit dans l'Afrique du Sud post-apartheid : d'une exploitation par l'Etat à celle du marché pour la communauté noire

RÉSUMÉ
La fin de l'apartheid au début des années 1990 en Afrique du Sud n'a pas pour autant mené à la fin, prévue, de l'exploitation de la population sud-africaine noire, mais plutôt à une simple transition d'une exploitation par l'Etat à celle par le marché. Cette trajectoire est particulièrement pertinente dans le cas de l'industrie du micro-crédit du pays, qui a spectaculairement et sciemment enrichi une élite masculine et blanche très restreinte tout en contribuant à la fragmentation et à la destruction des économies des populations noires pauvres, qu'elles soient locales et rurales, ou bien urbaines. Comme le démontre cet article, un aspect majeur de ce processus d'enrichissement unilatéral implique une « fraude par le contrôle », c'est-à-dire le processus par lequel le PDG et autres cadres

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supérieurs d'une institution financière utilisent leur rang afin d'escroquer leurs clients, les actionnaires, le gouvernement ainsi que le public dans son ensemble tandis qu'ils maximisent leurs propres intérêts financiers court-termistes. Déjà un problème dans d'autres endroits de l'hémisphère sud, l'Afrique du Sud a ainsi rejoint la liste croissante de pays qui voient la fraude par le contrôle dans le secteur du micro-crédit saper et bloquer le progrès vers des économies locales plus productives, soutenables et équitables.

Introduction

The end of apartheid in South Africa in the early 1990s was supposed to call time on the state-enforced exploitation of the majority black South African community. With international support, the new post-apartheid South Africa, so the narrative went, would offer opportunity, dignity, equality and material security to all of its constituent peoples. In so many important respects, however, this expectation has been entirely dashed. As John Saul and Patrick Bond (2014) document at length, the state-enforced exploitation that benefited the white South African minority during the apartheid years essentially transitioned into an even more extreme form of market-enforced exploitation, one that now principally benefits an even narrower white South African capitalist elite than before.

An important illustration of the mechanisms and negative outcomes involved in this transition process can be found in the case of South Africa's microcredit sector. Rather than facilitating a major poverty reduction episode in the poorest black communities, as was universally promised by the global microcredit industry at the beginning of the 1990s, the opposite outcome has transpired. Thanks to reckless lending and other unethical and illegal tactics, the large microcredit sector that emerged in the post-apartheid era has inflicted enormous damage upon the majority black constituency that it was supposedly designed to benefit, while the economy and country as a whole have been seriously undermined to boot. Playing a quite central facilitating role in this wanton destruction, perhaps more than in many other countries in the global South, has been the phenomenon of 'control fraud'. This is the term famously coined by William Black (2005) to denote the situation where a narrow elite is willing and able to use an organisation as a fraud vehicle to deceive, dispossess and exploit employees, shareholders, clients and the government.

This article examines the microcredit model as it has developed and impacted in South Africa. I start by providing some brief background to the astonishing rise and fall of the global microcredit model, before turning to the country-specific situation that has emerged since the end of apartheid. I then go on to introduce the concept of control fraud as it applies to the global microcredit model. To set the case of South Africa in global context, I provide three key examples of microcredit from around the globe before I go on to examine control fraud as it has emerged in South Africa's microcredit sector. I conclude by discussing the example of Capitec Bank, now South Africa's largest microcredit bank by some way and, I argue, the largest microcredit control fraud in the country to date.

The rise of the global microcredit model

As is well known (for example, see Armendáriz de Aghion and Morduch 2005), the global microcredit model is most associated with the life and work of Dr Muhammad Yunus – the US trained Bangladeshi economist and co-recipient of the 2006 Nobel Peace Prize alongside the iconic Grameen Bank that he established in 1983. The Grameen Bank microcredit model promoted by Yunus involved the provision of tiny high-interest loans – microloans – that were designed to enable the poor to establish a range of informal income-generating activities, thereby to facilitate an individual escape from poverty (Yunus and Jolis 1998). With the US-led neoliberal model emerging in the 1980s as the dominant organising principle for the global economy and society, it was not surprising that the microcredit model was welcomed with open arms by the neoliberal-oriented international development community and key Western governments (most notably the US government). Here was an intervention based on the promotion and validation of individual entrepreneurship and self-help, factors that neoliberals see as the principal driving force behind economic growth, prosperity and liberty (Hayek 1944; Friedman 1962). The microcredit concept resonated particularly in the USA where it had an affinity with the powerful narrative of the 'American dream'. If it was axiomatic in US popular and political culture that every poor US citizen at the bottom of the pyramid could escape their poverty through individual entrepreneurial effort, self-sacrifice and 'pulling oneself up by one's own bootstraps', no less was to be expected of the average poor individual in the global South.

With the World Bank and International Monetary Fund (IMF) operating in conjunction with the US government's own development agency, USAID, Bangladesh soon had a number of microcredit institutions (hereafter MCIs) in operation, most notably the Grameen Bank. Not long after, formal Grameen Bank-style MCIs were being established all over the global South. However, one important move remained to be taken in the 1990s in order to fully embed the microcredit model within the financial architecture of countries across the South. This was to commercialise, or 'neoliberalise' (Bateman 2010), the microcredit model in order to ensure that it fell into line with a major neoliberal operational imperative – 'full cost recovery', the idea that all institutions must cover their own costs and should never avail themselves of subsidies from governments or from anyone else. Microcredit was thus converted into a self-sustaining profit-seeking business activity. Governments and the international development community would no longer need to subsidise the microcredit sector (as they were doing with regard to the Grameen Bank itself; Morduch 1999). The newly commercialised global microcredit industry soon began to expand very rapidly.

The widespread expectation fanned by the most dedicated supporters of the commercialised microcredit model, notably Maria Otero and Elisabeth Rhyne (1994) and Marguerite Robinson (2001), was that commercialisation would quickly lead to a 'new world' of massive poverty reduction, gender empowerment, reduced inequality and sustainable local economic development. But even before any real evidence emerged one way or the other, the microcredit model was being talked up as the most impactful international development policy and intervention of all time (Clinton 1997). Building on this wellspring of support, the international development community began to shift its resources and technical support even faster into establishing and expanding MCIs,

alongside building the extensively liberalised 'enabling environment' that it was thought best assured their effective operation. Importantly, the funds mobilised to achieve this goal were raised by scaling down support for other types of local intervention, such as support for the financing of small and medium enterprises (SMEs) and SME development programmes.

The fall of the global microcredit model

Notwithstanding the enormous effort that went into its establishment and its subsequent expansion, even long-time advocates now accept that the microcredit model has failed in its declared task of addressing poverty and deprivation in the global South (Roodman 2012; Morduch 2017). Moreover, not only has poverty *not* been reduced thanks to microcredit in any of those locations where it has reached a meaningful scale of operations, the general situation has been made worse. The common side-effects the global poor have had to endure include mass over-indebtedness, lower average incomes, regular 'microcredit meltdowns', increasing inequality, business 'turf wars' and gender disempowerment (Davis 2006; Bateman 2010; Guérin, Morvant-Roux and Villarreal 2013; Guérin, Labie, and Servet 2015; Bateman and MacLean 2017).

Moreover, the rising volume of microcredit in the global South has given rise to an 'anti-developmental' trajectory, one that has regularly helped to deindustrialise, informalise, disconnect and primitivise those local economies within which the supply of microcredit reached sufficient scale. One aspect of this is that MCIs exist to intermediate scarce resources into typically informal, isolated, no-technology, and ultra-low productivity microenterprises, but this has inevitably meant that potentially higher productivity formal enterprises, especially SMEs, have increasingly been denied financial resources.[1] Another aspect is that informal microenterprises use the advantages of informality to outcompete much more productive formal SMEs, even just temporarily, and thereby stunt their growth into the longer term (Bateman 2010, 2013a, 2019; Bateman and Chang 2012; Bateman, Blankenburg, and Kozul-Wright 2019; Mader 2015).

The final failure of the microcredit model, and highly relevant to the situation that has transpired in South Africa (as we shall see below), is directly linked to its commercialisation in the 1990s and the overarching drive for deregulation and de-supervision that accompanied it. We now know that most neoliberal economists, central bankers and financial analysts completely misunderstood the destructive and unstable nature of the 'financialised' capitalism that began to emerge in the 1970s (see Mirowski 2013). The mainstream neoclassical academic economics profession and neoliberal-oriented policymakers were thus caught completely off guard by the global financial crisis that broke out in 2007. A similarly destructive scenario eventually unfolded in the world of microcredit, and for not dissimilar reasons. Very many of those individuals and institutions that in the 1990s pushed hardest to achieve the commercialisation of the microcredit industry were also very firm believers in the supposed power of free markets, deregulation and the profit motive. This constituency included the World Bank and USAID, and almost all of the world's leading advocates of the commercialised microcredit model. Many of these individuals and institutions would be taken completely by surprise at the mountain of harmful, illegal and 'anti-developmental' actions and trajectories that were unleashed on the poor by the burgeoning global microcredit industry.

We can pinpoint when these commercialisation-driven problems effectively began: in April 2007, with the Initial Public Offering (IPO) of Mexico's largest microcredit bank, Banco Compartamos. For two reasons this event was crucial to our understanding of the way that the global microcredit industry was to develop. First, no evidence whatsoever was forthcoming then (or since) to show that Banco Compartamos had been instrumental in resolving poverty among its poor, mainly female, client base.[2] Second, and even more damaging, the IPO revealed a very high level of private profiteering deliberately engineered by Banco Compartamos's co-CEOs, senior managers and investors (Bateman 2010, 142–152). Thus, in one of the most celebrated MCIs in the world at that time, its objective function was actually contrary to what everyone had been led to believe by the global microcredit industry: Banco Compartamos was not about helping individual clients in poverty so much as enriching the small elite that owned and controlled it.

A highly damaging development that emerged in the aftermath of the Banco Compartamos IPO was that, in the hope of also striking it rich, many more unscrupulous individuals and institutions elsewhere set about *emulating* the financial model and practices it had trail-blazed. The immediate result was a wave of very similar unethical behaviour, reckless lending, extreme profiteering, asset-stripping and outright fraud in various countries across the globe (Sinclair 2012; Bateman et al., 2019). The die was cast.

Save for a small and declining number of non-profit non-governmental organisations (NGOs) working in microcredit, it soon became clear that the global microcredit industry had been hijacked by self-seeking individuals, opportunistic so-called 'social entrepreneurs', aggressive private banks and hard-nosed investment bodies. From this point onwards, arguably, the global poor were now no longer the primary intended beneficiaries of the commercialised microcredit industry, but instead largely just its hapless victims.

Microcredit comes to post-apartheid South Africa

Once the apartheid system was officially dismantled, and the new elected government under President Nelson Mandela was in place, attention turned to the question of how best to quickly address the huge poverty, unemployment, deprivation and inequality that had disfigured the country for so long. Given the excitement being created by the global microcredit model right across the global South at this time, it was not surprising that the microcredit model would be assigned a major role in rebuilding post-apartheid South Africa too.

Important measures were therefore taken as early as 1990 to increase the supply of microcredit. The most important of these was in 1992 in the form of an amendment to the Usury Act that removed price controls on all MCIs and allowed them to charge much higher interest rates on microcredit with a repayment period of less than 36 months. The few small independent non-governmental MCIs that were established under late apartheid, such as the Small Enterprise Foundation, now saw that it was possible to become financially self-sustaining, enabling them to regularise and expand their operations. Many new for-profit commercial MCIs also entered the market, including a good number established by white government officials eased out of their positions in the early post-apartheid years (James 2012). More importantly, the historically white-owned private commercial banking sector began to see an opportunity to profit from supplying microcredit. Very soon the largest banks were offering a growing volume of

microcredit to the poorest black citizens. As a purely business move that generated profit for the commercial banks, this was welcomed by the new government. In addition, because the modern banking sector was very much built on the wealth illegally generated under apartheid, it was also felt that there was an important moral case for the banks to provide this ostensibly pro-poor service to the black community.

By the late 1990s the microcredit sector had achieved the recognised 'holy grail': any poor individual wanting a microcredit loan could relatively easily obtain one. However, it was also perfectly clear that this very rapid expansion of the microcredit sector had been built upon a foundation of reckless lending, defined as the situation where a lender pumps out as many loans as possible, with limited reserves, without any serious regard for the quality of the loans advanced, and with little interest in the eventual consequences of client over-indebtedness. As a result, things were always likely to come to a crashing end, and this is indeed what happened. With over-indebtedness and defaults rising fast, the end point came in 2002 when South Africa's two largest microcredit banks collapsed.[3] South Africa's post-apartheid microcredit sector bubble had essentially burst.

Yet in spite of this damage, the international development community was not about to change its official view regarding the supposed benefits of microcredit. Almost right away an effort was mounted to get the microcredit ball rolling once more (Bateman 2014, 2015). For the US and UK governments in particular, both being in the vanguard of the global neoliberal project, the microcredit model was too important *ideologically* to be allowed to collapse simply because it was shown not to actually work. If individual entrepreneurship was shown not to be the answer to growing individual poverty, the poor might start to mobilise in favour of other more collective and state-centred solutions to poverty, and that was *not* what both governments wanted. The South African government was also mindful that microcredit represented a major opportunity for its corporate financial sector to generate huge profits from engaging with the poorest communities, and it did not want to stand in the way of this becoming a reality. At least before the global financial crisis of 2008, the feeling was that a wealthier corporate financial sector represented a move in the direction of a wealthier economy. With a new motivating narrative conjured up, termed 'democratising finance' (see Porteous and Hazelhurst 2004), the microcredit model was therefore quickly recast as a financial service that, on fairness and equality grounds, still needed to be made available to all citizens. The term 'financial inclusion' was thereafter used as the newly designated goal for the microcredit sector, thus turning what was once merely a metric of performance – outreach – into the object of the entire exercise.

Many new measures were now required to ensure the success of the drive towards 'financial inclusion', including further deregulation, liberalisation, and commercialisation of the microcredit sector. One of the most important measures taken, as Jürgen Schraten (2014) pointed out, was to simplify the loan process to mean simply 'a loan below Rand 10,000'. Garnishee orders (automatic deductions of a repayment instalment from the salaries of borrowers) were also reintroduced and subsequently became very widespread. Finally, deregulation measures were introduced into the National Credit Act in 2007. A National Credit Register (NCR) was also set up. Both measures were meant to ensure a higher level of order and transparency in the workings of the microcredit sector (but did not, as we shall see below).

The result was just what had been hoped for by the South African government and its supporters in the USA and UK: the microcredit market in South Africa did not just recover after the 2002 meltdown, it went into an explosive growth phase. Thanks to the high interest rates and fees that could now be charged on straightforward microloans, and with the greater security provided by garnishee orders, the profit margins to be made from supplying microcredit were found to be far higher than almost any other line of financial business in the country. Microcredit became the new gold rush.

The impact of microcredit in post-apartheid South Africa

With comparatively little economic development in most black townships and rural areas during the apartheid years (see Rolfe et al. 2010), and with a rising supply of microcredit and other incentives after 1990, the widely held view was that the informal microenterprise sector was in a good position to expand very quickly and thus create many new jobs and incomes for the large number of poor and jobless black South Africans.

The early figures showed that there was an increased inflow of new microenterprises in the early post-apartheid era. However, it soon became clear that only a very modest *net* increase in employment in the informal microenterprise sector had actually been registered. These dashed expectations were attributable to one important, but all too often overlooked, factor: the high level of 'job churn', the situation where the jobs created by new microenterprise entry are offset by the job losses that quickly result from the displacement of jobs in incumbent microenterprises and the exit of both new and incumbent microenterprises soon after (Nightingale and Coad 2014). If the 'job churn' phenomenon has been identified as a key debilitating factor in similar post-system-change conditions as experienced in South Africa since 1994 (notable examples would include post-Communist Poland after 1990 and post-war Bosnia after 1995 – see Bateman, Ojeda Suris, and Sinković 2018), and it has also been identified in almost every African country too (Page and Söderbom 2012; Nagler and Naudé 2014), it was almost inevitable that it was also going to surface in the South African economy.

The World Bank (2000, 12–17) was one of the first organisations to accept that 'job churn' was a major problem in post-apartheid South Africa, finding that many new-entrant microenterprises quickly exited and also, in the meantime, pushed out of the local market many other long-standing informal microenterprises and self-employment ventures. Importantly, the World Bank also pointed out that (according to its survey data) by far the most important constraint facing all local businesses trying to survive and grow was the sheer lack of local demand, not any perceived lack of start-up or expansion capital. This lack of demand factor is an issue that all too often gets overlooked for ideological reasons (to avoid blaming the capitalist economy model by putting the blame for its underperformance on individuals instead; Amsden 2010).

After a weak start, the situation did not improve later on. Von Broembsen, Wood, and Herrington (2005) reported on the extent to which in the early 2000s job churn was responsible for far fewer jobs being created than the entry figures during this time period would suggest. And between 2008 and 2015, there was still only a small net growth in the microenterprise sector as a whole (Bureau for Economic Research 2016, 21). Traditionally the largest sectors in which informal microenterprises operate, notably 'trade and accommodation' and 'manufacturing', actually saw a *decrease* in the

numbers of units operating (*Ibid*., 20). With an austerity policy in place since 1994, and with few serious redistribution measures established after the end of apartheid, the black community continued to suffer from a lack of purchasing power, which meant that it could offer little support for microenterprises established by its own members.

Thus, in spite of an enormous and successful effort after 1994 to increase the rate of entry of informal microenterprises and self-employment ventures, an effort involving various South African government agencies, the international development community and the local NGO sector, large numbers of sustainable jobs were not created. Thanks mainly to job churn, the net increase in employment was therefore very modest. Moreover, what little net growth there was in the numbers of informal microenterprises that was actually achieved began to plateau quite quickly from the 2000s onwards. Microcredit support for new microenterprises and self-employment ventures was thus found to be not the answer to sustainable job creation.

But this was not all. In addition to limited job creation, there was a dramatically negative impact on the average incomes of South Africa's black community. As competition for the limited demand in the poorest black communities became more and more intense as a result of 'poverty-push' new entry, local prices inevitably began to soften. This price effect reduced the incomes of incumbent microenterprises as well as those new to the local market. In addition, because demand was now increasingly distributed across a somewhat larger number of (often merely temporary) informal microenterprises, turnover in the average individual microenterprise also began to fall. Unit costs therefore began to rise, which in turn helped to depress average incomes even further.

This scissors combination of lower prices and lower turnover resulted in significant downward pressure on the level of average incomes earned in informal microenterprises and self-employment ventures. Casale, Muller and Posel (2004, 13) demonstrated that 'In 2003 average real earnings among this group of the employed stood at less than a third of the 1995 value.' From 1997 to 2003 there was an 11.4% per year decline in self-employment incomes, and real wages in the informal sector as a whole fell by 7.8% per year (Kingdon and Knight 2005, 3). Importantly, Kingdon and Knight attribute much of this very dramatic yearly decline in average informal sector incomes they find to

> The growing divergence between labour supply and demand [which] inevitably had a depressing effect on market-determined real wages. [This resulted in …] the burden of adjustment […] on […] the self-employment sector, *especially that part of it which had relatively free entry*. (Kingdon and Knight 2005, 3, my italics)

This very dramatic fall in average incomes was arguably the most important factor that explains the rising poverty experienced in post-1994 South Africa. Notably, average incomes fell because of the ultra-competitive pressures created by the relentless new entry of informal microenterprises (*Ibid*.), a process that was driven forward by official support for microcredit. In short, very many of those engaging with the informal microenterprise sector financially were made considerably worse off.

Going even further, by programmatically creating an ultra-competitive capitalist local economy in the poorest black communities, and thanks to the World Bank's austerity programme implemented at the same time, a number of negative 'race to the bottom' outcomes also emerged across numerous economic and social categories. For instance, there were many more business 'turf wars' involving groups of struggling businesses

attempting to protect their market share by illegally forcing competitors out of the market (e.g. via threats and violence, bribery of local officials). Informal microenterprises were increasingly forced to fight for business survival by any means necessary. This inevitably drew many into adopting a range of unethical and often illegal business strategies that have come to dominate the local economy. Lower levels of local tax collection also ensued as many formal microenterprises moved back into the informal sector in an attempt to lower costs and restore profitability. Worsening working conditions also became the norm as health and safety provisions were cut back. The culmination of this trajectory was entirely predictable: rising social violence as participants in the informal sector found life increasingly unrewarding, humiliating and dangerous. More recently, as Jonathan Crush and Sujata Ramachandran (2014) have shown, this 'turf war' problem has become especially pronounced across ethnic boundaries, which has stoked up considerable resentment, often breaking out into serious inter-ethnic violence.

Finally, when in the mid 2000s it began to become clear to many potential clients in the poorest communities that most informal enterprises were unable to generate a decent regular income, a worrying new trajectory began to emerge. Growing numbers of poor black South Africans began to take on more microcredit simply in order to boost their immediate spending on needed consumption items. The forlorn hope was that some random lucky event in future – a lottery win, an inheritance – would help repay the accumulated debt. Many also hoped that their constant juggling of rising household debts and the growing repayment of instalments due on old microloans by taking out new microloans – termed 'loan bicycling' – could be successfully managed until such times as a decent employment opportunity came along. Thus began the rapid build-up of household debt after 2002, as shown in Figure 1.

The one clear result of the massive rise in the supply of microcredit was that by 2016 South Africa had become the most over-indebted country in the world: an astonishing 86% of the population took loans in 2015, with Iran in second place at 80% and Kenya

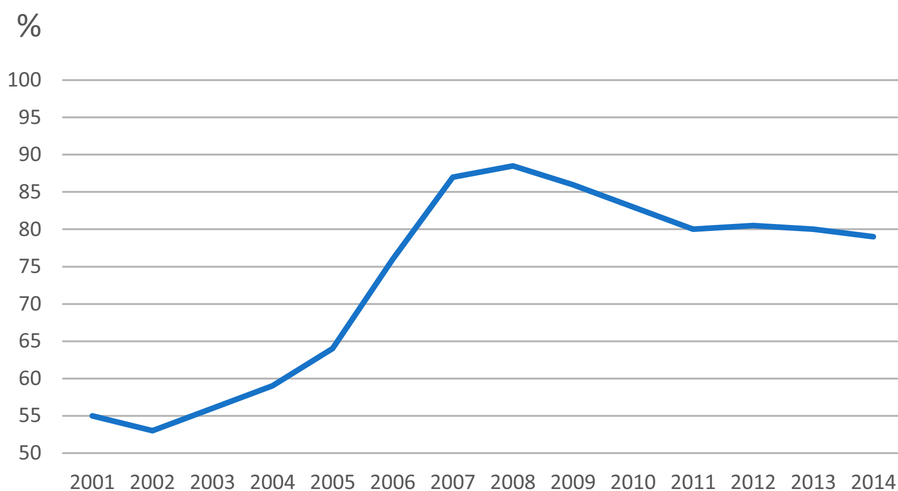

Figure 1. Household debt to net income in South Africa. Source: South African Reserve Bank, reproduced in Bateman (2016, 76).

third at 76% (Demirguc-Kunt et al. 2015). This growing indebtedness is now widely seen as out of control and seriously damaging the economy and society. Above all, and not coincidentally, a few years later it was announced that the country was now by some considerable way the world's most unequal country (OECD 2018). Put simply, those at the top of the business world in South Africa have been doing magnificently since 1994, which, as we shall see below, very much includes the owners, managers and investors in the microcredit sector. Meanwhile, those at the bottom of the economic order have been doing much worse since apartheid ended, not least thanks to the huge levels of debt the poor have racked up in a desperate, but largely unsuccessful, attempt to retain some semblance of a decent life, if not simply mere survival. By the mid 2010s, therefore, the promise held out by Muhammad Yunus and others that microcredit would contribute to the resolution of South Africa's huge poverty, unemployment, disempowerment and racial inequality had been quite dramatically shown to be an empty one.

The microcredit industry and the rise of 'control fraud'

The turn to neoliberal thought in the 1980s, and the subsequent neoliberal restructuring of the economic structure and political economy, provided a decisive impetus behind the global rise of corporate fraud across a range of sectors (Whyte and Wiegratz 2016; Wiegratz 2016). This change towards neoliberalism was crucial in two respects: it first *enabled* fraud, because it gave rise to extensive deregulation and de-supervision of the economy and financial sector; it then also *socially validated* it, because of its manifest acceptance of runaway materialism (colloquially known as 'greed is good') and the adoption of a permissive attitude towards high concentrations of wealth and the often unethical techniques and strategies that wealthy individuals and institutions deploy to amass this wealth. The result of this changing regulatory and moral climate from the 1980s onwards, as James Galbraith (2014, 149–168) shows, is that under neoliberalism financial fraud has once more become a major corporate strategy. Neoliberalism creates the best possible criminogenic environment for fraud to flourish. This essentially repeats the mistakes made in the 'Roaring 20s', when almost identical market fundamentalist policies and associated social mores arose to dominate Western society and the business sector (especially in the USA), thereafter precipitating the Great Depression that began in 1929 (Galbraith 1954).

Control fraud has become one of the most ubiquitous yet unrecognised forms of corporate fraud flourishing in the neoliberal era. An explanatory concept developed by William Black (2005), the world's leading systematic analyst of the relationship between financial crime, financial structures and incentive mechanisms, control fraud is both the *individual* perpetrating the act of fraud and the *process* whereby a financial institution is used as a weapon to defraud shareholders, employees, the government and clients. The motive that underpins any control fraud is typically the CEO's desire to maximise his or her own private short-term financial gains. In the US corporate financial sector, accounting control fraud has become almost endemic in recent years, particularly with regard to the creation of fictional profits that allow for the paying out of performance-related bonuses to the CEO and high dividends to shareholders.

For example, massive accounting control fraud lay behind the 1980s savings and loans crisis in the USA (Black 2005), and it was also one of the principal causes of the global financial crisis that erupted in 2008 (Black 2012a). In the very worst-case scenario, as

Akerlof and Romer (1993) famously showed in their pioneering article 'Looting: the economic underworld of bankruptcy for profit', major financial institutions have been deliberately piloted into bankruptcy in order for the CEO to extract the maximum personal financial return in the meantime. It has also not helped that the major global auditing companies that should have exercised their legal duty to root out and uncover accounting control frauds were actually found to be thoroughly complicit in their execution, notoriously so in the famous cases of Enron and WorldCom (Brooks 2018; Christensen 2016). Accounting control fraud has thus proliferated and, as a result, has greatly undermined the modern capitalist economy (Galbraith 2014).

Microcredit and control fraud

The control fraud concept has particular applicability across financial institutions. In general, Black (2005) points to essentially four steps a financial sector CEO takes in order to optimise accounting control fraud: (1) grow extremely rapidly by (2) making bad loans at a premium yield, while (3) employing extreme leverage; and (4) providing only grossly inadequate reserves against the inevitable losses.

As Black (2012b) himself points out, all of these operational aspects of accounting control fraud have emerged in the global microcredit sector in recent years. Indeed, given that control fraud has been identified in so many of the most important and supposedly well-functioning microcredit sectors across continents (as in Latin America – see Butcher and Galbraith 2015), and in many individual countries (see below), and that it has involved so many of the very highest profile and supposedly most reputable 'role model' MCIs, the global microcredit sector is actually a leading illustration of the accounting control fraud concept. Since the link between accounting control fraud and the microcredit sector will be seen as something of a novelty to many, before dealing with the situation in South Africa let me first briefly discuss three of the most high-profile country examples of microcredit control fraud that have been exposed to date.

One of first major examples of control fraud in the global microcredit sector emerged in Bangladesh, the spiritual home of microcredit. The origin of the microcredit sector in Bangladesh is linked to the high-minded quest for poverty reduction in a post-conflict country. But from the early 2000s onwards, its by then world-leading MCIs, very much including the iconic Grameen Bank, began to seriously deviate from their founding goals. While accepting in the 1990s that every MCI had to achieve financial self-sustainability, the CEOs of Bangladesh's leading MCIs clearly decided to go a lot further than this. An important new private goal began to come quietly into focus, one that was based on the CEOs' desire to maximise their own salaries, bonuses and other financial and reputational rewards (e.g., publishing opportunities, international awards) available to the leading lights in the exciting 'new world' of commercialised microcredit. Importantly, this new private goal could best be achieved by growing the MCI and its revenues as fast as humanly possible. Growing revenues and short-term profits would provide the resources for the desired higher salaries and bonus payments, as well as provide the important public justification – size and supposedly good operational performance – for such higher rewards. After slowly growing to reach a base of just over eight million borrowers by 2003, the big MCIs thus changed their way of working and embarked on a drive

towards ultra-rapid growth. Success was forthcoming: by 2008 the sector had expanded to reach a remarkable total of nearly 19 million borrowers (Chen and Rutherford 2013, 2).

Importantly, this massive expansion in the supply of microcredit in Bangladesh was *not* a response to a predominantly genuine increase in the demand for microcredit: it was instead an exercise in reckless lending that involved putting huge pressure on millions of poor individuals in Bangladesh to take on far more microcredit than they could use or could easily repay. The work of Lamia Karim (2011), Kasia Paprocki (2016) and Mathilde Maitrot (2019) is especially instructive here in teasing out what happened on the ground. These and other authors show that in the early 2000s the leading MCIs began to instruct their loan officers to crank up what was to become one of the largest reckless lending schemes in the country's history. Crucially, the incentives for the loan officers to act in this unethical manner were no different to those incentivising the CEOs themselves: the possibility to enjoy a significant hike in salary, regular bonuses and other financial and non-financial rewards.

In spite of already high levels of client over-indebtedness by the early 2000s, loan officers were nevertheless instructed and individually incentivised to pull in new clients in any way, from wherever they could, and with no regard to the ultimate consequences. For example, loan officers took to canvassing particular poor neighbourhoods in order to 'round up' as many new clients as possible. Often the terms and conditions attached to any new microloan were misrepresented in order not to deter potential clients from signing up. Existing MCI clients were also targeted with the ubiquitous 'top-up' microloan, an additional microloan provided to a client who was often not even halfway through their original loan term. Constantly taking on a new, and often larger, microloan in this way was seen by the MCIs as a way of keeping clients permanently in debt so as to ensure a constantly rising client base, and thereby also rising revenues and profits. Similar unethical techniques were used when attempting to collect the instalments due from clients. Enormous pressure and naked threats were routinely used to ensure that potentially defaulting clients could always come up with their regular instalment. Lamia Karim (2011) reports that women clients were routinely 'shamed' into making repayments and, if they could not, they were likely to see their simple household assets taken from them by loan officers, often in front of other members of the village.

The inevitable result of this spasm of reckless lending and unsustainable growth was that by 2008/09 the entire microcredit sector in Bangladesh was on the very edge of collapse. It was a 'train crash' about to happen, as one of the leading CEOs of one of the big four MCIs (ASA) famously warned (Chen and Rutherford 2013). But then something made the big four MCIs pull back from the brink and a complete meltdown of Bangladesh's microcredit sector was narrowly averted. While the precise details of why these long-running reckless growth strategies were so quickly abandoned remain unclear, knowledgeable analysts in Bangladesh believe that the international development community was forced into quietly intervening to pull the country's microcredit sector back from the edge (personal communication). The collapse of Bangladesh's iconic microcredit sector would have been a catastrophe not just for Bangladesh, but for the reputation and ideology of the global microcredit industry too.

Reflecting on the massive extent of reckless lending and its near-death experience, David Hulme and Mathilde Maitrot (2014, 2) concluded that the crux of the problem in Bangladesh (and by implication elsewhere in the global South), lay in the fact that

'the values of neo-liberal mainstream finance in the rich world ha[d] spread to microcredit in the villages of Bangladesh', which meant that (*Ibid*., 4) 'microfinance ha[d] lost its moral compass.' Coming from Hulme especially, one of the most influential development economists in the world and a major specialist on the Bangladesh economy, this was an extremely damning assessment of the way that the country's microcredit sector now operated.

Another hugely damaging example of microcredit control fraud emerged in post-war Bosnia and Herzegovina (hereafter Bosnia). At one time the second most important microcredit location after Bangladesh in terms of borrower accounts per capita (Gonzalez 2010), Bosnia's microcredit sector was very widely seen as a huge success. Indeed, it was the one microcredit sector globally that the then president of Women's World Banking, Nancy Barry, proclaimed 'any war-torn country should look to […] as a role model' (quoted in Dolan 2005). However, Bosnia's microcredit sector rose fast but then ignominiously crashed from 2008 onwards as part and parcel of another spectacular case of control fraud (Bateman, Sinković, and Škare 2012; Black 2012b). The problems began, first of all, because in the early 2000s almost all of Bosnia's leading MCIs adopted a reckless lending strategy, the objective of which was to hike up the rewards attributable to the CEO and other senior management. At least in the short term, it worked. MCI growth was very rapid indeed, and revenues were soon very high too. Bosnian media began reporting on the inordinately high salaries and bonuses enjoyed by the leading CEOs and senior managers employed in Bosnia's microcredit sector, which were way ahead of the financial returns enjoyed by officials in the wider financial sector.

However, individual over-indebtedness was rising and defaults too, and it became clear that the party would not last much longer. By 2008 there were obvious signs that the bubble was about to burst, and in 2009 it did. Bosnia's microcredit sector experienced a double-digit increase in the number of non-performing microloans. Defaults began to rise to new heights, and almost double-digit portfolio at risk (over 30 days) was reached. After many years putting aside very little capital in case of rising defaults, loan provisioning had to rise by a massive 250% in just one year alone. The entire microcredit sector then experienced massive losses and, inevitably, it began to shrink very fast. Fearing that the sector was about to collapse completely, the World Bank (2014) stepped in to ensure a managed decline. Its recommendation (*Ibid*., 15) was that in order for Bosnia's microcredit sector to survive even in just a truncated form, the volume of microcredit in circulation had to be pushed down to around US$350 million a year, which was about half the level of the peak achieved in 2009.

Two particularly striking individual instances of control fraud in two of the then most respected MCIs in Bosnia help to illustrate the scale and scope of the control fraud that arose. The first case involves Mikrofin, wherein the CEO and other senior managers were able to asset-strip their own MCI. This was achieved by directing Mikrofin's resources into establishing completely new private businesses in which Mikrofin's CEO and other senior staff had privately invested and which they controlled as private individuals. Importantly, large interest-free loans from Mikrofin were used to make these private investments. By looting Mikrofin's own resources in this manner (and thanks to high salaries and bonuses too), its CEO and other senior officials went on to become extremely wealthy individuals. Pointedly, this form of asset-stripping at Mikrofin was carried out with complete impunity. Indeed, even after the details become widely known within the international financial institutions working in Bosnia, there was no visible reaction

whatsoever from any of Mikrofin's major sponsors, notably including the London-based European Bank for Reconstruction and Development. In addition, Mikrofin's CEO continued to receive a steady stream of offers to participate in highly prestigious international events to speak about the effectiveness of microcredit, suggesting, one can only conclude, that his and his colleagues' behaviour was perfectly acceptable within international financial circles.

More recently the developments at Mikrofin were overshadowed by an even more spectacular control fraud perpetrated at the MCI Prizma. In spite of massive individual over-indebtedness in most Bosnian communities already, including with regard to Prizma's *own* clients, another astonishing episode of reckless lending was instigated at the behest of Prizma's CEO in a brazen effort to further hike up the already generous financial rewards accruing to himself, senior managers and board members. As with all forms of reckless lending, the initial results appeared to be positive: Prizma succeeded in growing its client base from 45,000 borrowers in late 2011 to around 65,000 in just a few years, an astonishing nearly 50% increase in clients in a very short space of time.

Quite predictably, however, a large number of these new borrowers soon found themselves unable to repay. With repayment problems already critical with regard to many of its *existing* borrowers, by as early as 2013 Prizma began to hit the inevitable wall. The default rate began to soar. Prizma entered into a steep decline, and by mid 2014 it had only 18,000 borrowers left. The founder and CEO of Prizma took the opportunity to bank his accumulated earnings and depart ignominiously. Nonetheless, the damage to Prizma could not be undone. By the end of 2014, Prizma's standard 30-day portfolio-at-risk (PAR30) figure was approaching a staggering 60%, and it had racked up a total loss of KM45.34 million (around US$25.5 million) for the year. In the summer of 2015 the Bosnian government finally took the required action to force Prizma to shut down (see Bateman and Sinković 2017). With hindsight it can be argued that the vastly increased risks pertaining to Prizma's viability as a financial institution were of very little concern indeed to those involved. Prizma was, in fact, an example of the CEO wilfully pursuing the most extreme control-fraud-driven outcome famously described by Akerlof and Romer (1993).

The third major episode of microcredit control fraud emerged in the Indian state of Andhra Pradesh. Unlike in Bangladesh and Bosnia, however, this episode of control fraud could not be averted or managed, and instead it went on to almost completely collapse the microcredit industry in that state. The central factor in the rise and fall of the microcredit sector in Andhra Pradesh was an historically unparalleled episode of control fraud involving the 'big six' MCIs and their aggressive CEOs, notably led by Vikram Akula based at SKS, one of these six MCIs. Seeking the fantastic personal financial rewards made possible by an IPO, as demonstrated in the Banco Compartamos IPO, the 'big six' CEOs engineered the explosive growth of the Andhra Pradesh microcredit sector. Vikram Akula did extremely well: when SKS's own IPO took place in 2010 he was spectacularly enriched by selling 25% of his shareholding in SKS for around US$13 million (Bateman 2012a). However, there was little regard for the longer-term consequences for the future of any of the 'big six' MCIs, and there was no regard by any of the CEOs for the vast numbers of clients in Andhra Pradesh who they were pushing into massive over-indebtedness, some of these eventually committing suicide (see Arunachalam 2011: Bateman 2012a).

With the microcredit bubble coming to an obvious head by early to mid 2010, the state government of Andhra Pradesh was finally forced to try to do something to halt the mounting damage. It issued an ordinance in late 2010 that popped the bubble, albeit at the price of essentially collapsing the microcredit sector in the state almost overnight. In terms of the sheer greed, unethical behaviour and outright illegality that were revealed (for a forensic analysis of this case, see Arunachalam 2011), most microcredit advocates describe the Andhra Pradesh crisis as the worst event (to date) to befall the global microcredit movement.

All three of the above high-profile examples of microcredit sector failure or near-failure followed the essential ‘recipe’ for control fraud outlined by William Black, viz.:

(1) all adopted a deeply unethical growth strategy based on reckless lending and wilfully over-indebting the poorest and most vulnerable individuals;
(2) all charged clients comparatively high interest rates, hidden fees and dubious charges, the aim of which was to maximise returns;
(3) all used their own resources to ‘sell’ themselves to the international development and financial communities in order to provide continuing cover for their manifestly unethical and/or illegal behaviour;
(4) all massively leveraged up the amount of microcredit that could be disbursed by tapping into expensive borrowed funds, including from local banks, from international banks and from venture capitalist institutions located in ‘tax-efficient’ countries;
(5) all held only minimal reserves, thus significantly increasing the chances of the MCI going bust, along with the chances that the state and/or international development community would have to intervene to restructure and bail out the offending MCIs.

The rise of microcredit control fraud in South Africa

Control fraud is perhaps the defining operational aspect of the microcredit sector in South Africa. That this is so was first exposed in the case of Saambou Bank. Then South Africa’s large microcredit bank, Saambou Bank collapsed in 2002 following a massive episode of reckless lending, insider profiteering and a variety of ‘get rich quick’ tricks undertaken by its CEO and senior managers (Pretorius 2014, 352). Similar accounting control fraud antics were also uncovered at the same time in Unifer, the South African subsidiary of the giant UK banking group Barclays.

Importantly, rather than seeing these as blatant examples of control fraud to be dealt with and brought to an end, the South African government, the international development community and the local media went to great lengths to avoid making any such connection. Instead, the problems at both Saambou Bank and Unifer were rationalised as one-off developments perpetrated by incompetent CEOs; the sort of thing, in other words, that happens in *any* financial system and which not much can be done about. In truth, the South African state led by the African National Congress (ANC) government appeared (and still is, as we shall see) extremely fearful of the economic and political consequences if it were to be widely admitted that the financial system was unsound and, even more so, that a very small group of mainly white males operating in both microcredit banks had

essentially conspired to inflict yet more pain on the mainly black public. This was one of the main reasons why the government felt it had to cover Saambou's debts to the tune of around R7 billion. The international development community also put pressure on the ANC government not to 'play the race card' and also to try not to tarnish the reputation of microcredit. South Africa's corporate sector also encouraged the government to maintain its support for microcredit, this being seen as a better alternative to statutory wage increases as a possible 'bottom-up' driver of poverty reduction and economic growth. As a result of this combination of self-imposed and external pressure, and in spite of significant evidence of extreme malfeasance (IOL 2008), legal proceedings against the most senior managers of Saambou were deliberately delayed for many years and, when they finally got under way in 2007, were abandoned a year later due to 'lack of evidence'.[4] This reflects a general pattern found in capitalism to the effect that high-profile frauds are often deliberately overlooked, or else downplayed, in order not to call into question the legitimacy of private entrepreneurs and the private business sector that stand at its apex.

In more recent times, the government has had to deal with an even more dramatic case of accounting control fraud in the microcredit sector. This was the case of African Bank. Co-founded in the 1990s by Leon Kirkinis, who regularly claimed altruistic motives and that he was 'on a mission to lend money to those shut out by the apartheid state', African Bank was specifically targeted to serve the vast mass of poor black South Africans. However, in doing so Kirkinis went on to deploy a whole range of control fraud tactics, above all reckless lending, in order for African Bank to reach its one-time position as the largest microcredit bank in the country. In the process, as intended, it catapulted Kirkinis himself into the very top ranks of South Africa's rich, while also very handsomely rewarding other senior managers and its overwhelmingly white community shareholders. However, its reckless lending practices eventually caught up with it in 2014 and it could go on no further. Kirkinis resigned just shortly before African Bank spectacularly collapsed and was forced into an emergency rescue by the South African government, which ultimately cost the state as much as US$1.6 billion (*Eyewitness News* 2014).

For a while African Bank was the emblematic symbol of everything that had gone wrong with the adoption of the microcredit model as development policy in the post-apartheid era. As the CEO of one of the leading asset management companies operating in South Africa, Andrew Canter, accurately described it, the African Bank case showed that the white community-led microcredit industry was now overwhelmingly about

> pumping debt down [people's] throats. It is no longer socially responsible and does not belong in developmental funds. […] The fundamentals are blown and the business model is unsustainable; 70% to 80% of 'new business' is to existing clients. So the trick is to keep them on an indefinite treadmill, always reoffering them a new loan, or reschedule but by lengthening the term to reduce the instalment. (Shevel 2103)

But the case of African Bank was soon to be eclipsed by an even more astonishing example of accounting control fraud, in the shape of Capitec Bank.

The dramatic rise to prominence of Capitec Bank

Emerging alongside its one-time main competitor African Bank, Capitec Bank, was formed in 1998 in Johannesburg by the PSG Group, a noted example of white-owned

finance capital. It was put together after PSG purchased a number of small microcredit businesses, with the new bank renamed Capitec Bank in 2001. As with Leon Kirkinis at African Bank, the group of Stellenbosch businesspeople backing the idea of Capitec recognised that offering microcredit to the previously unbanked black South African community could be a very profitable business. In addition, Capitec was given much encouragement by almost everyone involved in the field of microcredit. For example, South Africa's then leading microcredit advocate, Gerhard Coetzee (2003), was very upbeat indeed about Capitec's establishment and what he thought it would mean for poor black communities.

However, poverty reduction was not something that appeared to play on the minds of Capitec's CEO, its senior management and its key shareholders, so much as achieving rapid loan growth in whatever way this could be done. This narrow objective was achieved by streamlining the business and going after the very poorest and most vulnerable individuals, many of whom were highly unsuitable as clients but who could nevertheless be quite easily enticed and seduced by aggressive marketing tactics into taking out a constant stream of microloans. It helped Capitec that many clients in the rural areas and townships were financially illiterate and so were quite unaware of the high real interest rates, the hidden fees and the other various charges that they were actually expected to pay.

Capitec's initial growth was modest. Partly this was because in the 'bust' period after the collapse of Saambou and Unifer in 2002 there was some limited re-regulation and increased supervision of the sector. This ensured that the demand for microcredit was initially quite slow to recover. However, the adoption of a reckless lending strategy soon saw Capitec expanding at a rapid clip. Normal credit screening of clients and loans was essentially abandoned (Fin24 2016). Capitec also developed a very easy tolerance for multiple lending (where clients take out more than one microloan from competing MCIs), even though this is a hugely risky development because it is widely linked to a higher potential to default. Moreover, even when clients were blacklisted by the South African credit bureau and thus needed sensitive assistance to manage their debts, Capitec was able to find a way to advance these individuals even more microcredit. Capitec's extensive use of the garnishee order was also exposed as being a thoroughly risky practice since so many of the garnishee orders were fraudulent (i.e. not confirmed through the court as required by the National Credit Act and with many obtained illegally by officials demanding R100 to stamp an application).[5] However, a very large proportion of the new clients brought in were at-risk individuals and likely to be very seriously disadvantaged by easy access to finance (Bateman 2015).

Pointedly, and a classic sign of a serious control fraud, the biggest hike in Capitec's growth was to come when it became ever more evident that a vast oversupply of microcredit existed and it was beginning to very dangerously over-indebt the poorest in the black community. Indeed, with the South African population not just already dangerously over-indebted by 2008 (Quantec 2011), but also facing job losses and reduced incomes as a result of the global financial crisis spreading to South Africa, lending into such a volatile market would have required the utmost attention and care in order to lend only to suitable clients. Otherwise, things might be made much worse.

Inevitably, by showing almost no attention to the suitability of clients and the often vulnerable situation they were in, Capitec essentially opted to make things much worse. In just four years (2010–2014), it managed to grow its loan book *sixfold*, going from R5.6

billion to R33.7 billion. This was a simply staggering rate of growth under very difficult circumstances. Such a feat could only be achieved through a textbook case of reckless lending. With local demand falling once more, and with existing informal microenterprises in deep trouble thanks to falling revenues, starting a new informal microenterprise at this time was very risky to say the least, yet clients were able to obtain a microloan from Capitec without any problem whatsoever (Fin24 2016). Moreover, precisely as a result of the very limited business opportunities left for the poor to exploit, as evidenced by the very high failure rate of informal microenterprises in South Africa, many individuals in desperate circumstances chose instead to demand a microloan in order to underpin needed consumption spending; which again Capitec was quick to satisfy. Either way, the sharp increase in the supply of microcredit facilitated by Capitec (and African Bank and others) greatly contributed to South Africa's poorest black individuals and communities being thrown even deeper into debt, poverty and humiliation.

A crucial example of the problems created by the reckless lending policy adopted by Capitec (and others) in the 2010s involved the many mining communities across South Africa that the microcredit industry targeted with gusto. In the important mining city of Rustenburg, for example, in 2012 a total of 81 formal MCIs were found to be providing financial services. African Bank had the largest footprint, with 19 outlets in the town, followed by JD Group with 16, Capitec Bank with 10, Nedbank with 9, StanBank with 7, and Absa with 5 (Citi Research 2012). With around 7% of its entire loan book in the mining communities, Capitec was one of the main players in this market segment. It went on to use the garnishee system, plus savvy marketing and advertising, to put very large numbers of vulnerable and financially illiterate miners into huge amounts of debt. But Capitec accepted no responsibility for the obvious problems this reckless lending approach was creating.

However, with very many of the miners at the Marikana complex miners seduced into taking out far too much microcredit, the MCIs involved could no longer avoid all responsibility: mass over-indebtedness of the Marikana miners was, after all, a programmed outcome of the fact that the two main MCIs – African Bank and Capitec Bank – had established branch offices *in the mining complex itself* (Capitec Bank had two branches on the Marikana mining complex, while African Bank had four branches there [Citi Research 2012]). The miners came round to thinking that the only way out of their predicament was strike action in demand for higher pay. Events eventually came to a tragic head at the Marikana platinum mining complex in the city of Rustenberg on 16 August 2012, when 34 unarmed striking miners were gunned down by police in what turned out to be South Africa's worst act of state violence in the post-apartheid era (Bateman 2012b; Davis 2012; Bond 2013). Notwithstanding having to circumvent such 'problems', by the end of the 2000s, Capitec was one of the two dominant forces, along with African Bank, in the market for unsecured microloans in South Africa.

From Capitec's point of view, CEO Riaan Stassen saw such reckless lending and other associated short-cuts, and notwithstanding the occasional tragedy, as the ideal way to go forward. Stassen himself and other senior managers and investors were arguably driven by little more than the desire for high personal financial rewards. And this desire was more than realised. Even when set against an already highly unequal distribution of income and wealth in South Africa, the extent of financial gain enjoyed by Stassen, the senior management and key shareholders is notable. Consider that from a modest middle management

beginning in the early 2000s, by the time Stassen was forced out of Capitec in 2013 (see below), he had moved up to become the 58th richest individual in South Africa, personally worth around US$63 million at the then exchange rate (Bateman 2015, 18). The chairman of Capitec, Michiel Le Roux, saw his net worth increase to R2.9 billion in 2011, thanks to his 11% stake in Capitec, moving him up from 26th to 15th position in South Africa's top 100 rich list. In 2014, Le Roux, along with fellow director André du Plessis, sold R424 million of Capitec stock they had accumulated in earlier years. Jannie Mouton was ranked 16th in the top 100 rich list and in 2011 was worth nearly R2 billion, with a good slice of this wealth derived from his position as executive chairman of PSG, the owner of 34.6% of Capitec Bank. The former non-executive director of Capitec, Tshepo Mahloele, managed to accumulate a personal fortune of R270 million by 2011. Finally, thanks to his shares in Capitec, non-executive director of Capitec Chris Otto was able to boost his personal wealth to R239 million by 2011 (Bateman 2015, 19, footnote 38).

This astonishing level of private gain and excess evident at Capitec, and the rampant inequality being generated as a result, finally began to raise some concern in the financial sector itself. One of the most damning summaries of the situation was provided by Clark Gardner, the CEO of Summit Financial Partners, a consumer financial watchdog, who argued in 2018 that

> Our inequality is at [its] greatest it's ever been, and the World Bank and IMF keep on saying that access to credit improves GDP. Of course it does, for the shareholders of Capitec – for the Le Rouxs and the Moutons etc, not the man on the street. It doesn't improve and increase his wealth or her wealth. […] So the man in the street cannot do anything. He is completely disempowered. I call this economic apartheid. That's what we have done. We have just taken society and split it. These guys are just getting 300% to 400% returns. Look at those Capitec shareholders, they are billionaires – and the other lot have just got poorer and poorer in a debt spiral. (Fin24 2018)

In spite of many similar statements by other public figures in politics, business and civil society, the microcredit sector saw no real reason to change its ways. Evidently, the freedom to generate profit and personal reward howsoever one chooses to go about it was enough to trump all considerations of the public good. Attempts to rein in the hugely profitable, but ultimately socially destructive, activities of Capitec Bank and African Bank thus came to nothing in the boom years of the 2000s and early 2010s.

However, finally, as over-indebtedness and related potential default problems began to mount from around 2012 onwards, the stock market began to sense that Capitec's reckless lending model had reached its peak and an inevitable collapse was just around the corner. The control fraud element driving forward South Africa's microcredit sector as a whole, but especially Capitec, was now beginning to alarm the business sector. In 2013, market jitters reached a peak and sent Capitec's shares sharply down in price. Fearing further problems, Stassen was forced to resign as CEO. It was feared that the now hugely wealthy Stassen had engineered something along the lines of Akerlof and Romer's (1993) 'bankruptcy for profit' scenario, and that the collapse was about to happen.

Accordingly, a new management team was quickly invited in with the task to save what could be saved. However, the new CEO, Gerrie Fourie, and his senior management needed a new tactic to keep the party going at least a little longer. The solution found was to adopt a familiar Wall Street 'extend and pretend' technique whereby Capitec's growing number of clients getting into trouble on their repayments were instructed to take out another,

larger, microcredit loan, part of which was used to repay the original microcredit, with any remaining amount used to repay a few of the first instalments due on the enlarged microloan. The old microloan could then be recorded as having been successfully repaid. In addition, issuing the new microloan made it look as though growth at Capitec was continuing, which kept the share price high (Lefifi 2013). This is a well-known technique whereby potentially defaulting debts are automatically rolled over and enlarged, and maturities are lengthened considerably to reduce the immediate repayment burden, thus postponing the problem of over-indebtedness further into the future.

Through these and other problematic Wall Street-style mechanisms it was made possible for the new management team to continue to generate sufficient revenue and growth in the short term to cover the default losses inevitably racked up as a result of its reckless lending policy, and for Capitec to continue to generate large profits. No matter the destruction wrought in the black community as a result of programmed over-indebtedness, the new management team under Fourie appeared determined. But after nearly a decade of reckless lending and spectacular profiteering, a growing number of analysts thought instead that the inevitable destructive collapse could only be just around the corner.

But then Capitec is given a surprise lifeline by African Bank's failure

The year 2014 saw an unexpected event offer Capitec the opportunity to continue further with its reckless lending-based business model. This event was the collapse in August that year of its larger rival in the market for unsecured microloans, African Bank. For a period until African Bank was relaunched in 2016, Capitec had the market for unsecured lending all to itself. It was able to pick up very valuable market share from clients departing African Bank. It was now also the first port of call for individuals in South Africa seeking a microcredit loan for the first time. African Bank's collapse created huge problems for the South African government, its shareholder and its clients, but it was serendipity for Capitec.

With Capitec's immediate survival now just about secured, Fourie took the opportunity to announce that he was going to reposition the bank as something other than a reckless lending outfit. Using its accumulated wealth as the foundation for future sustainable growth, Fourie announced that Capitec Bank was going to transition into a mainstream banking operation, moving out of unsecured microcredit and into more traditional retail banking activities. It began to seek out SMEs as clients. It also announced it was going to take more care to screen out individual clients already in deep debt. To further address the widespread charges that it was a financial institution geared up simply for profiteering at the expense of its clients that were programmatically plunged into deep debt, Capitec also began to mount a number of initiatives to encourage clients 'not to spend so much' – such as a budget cafe in Cape Town where customers bring their own lunch, and a 'swap shop' in Johannesburg where items are traded without spending money.

However, as it happened, abandoning Capitec's long-standing and problematic control-fraud-driven business culture turned out to be impossible: in fact, the above moves made were simply a PR exercise. A new dubious, and demonstrably illegal, aspect of Capitec's then ongoing business lending was revealed, one that worked to extract every last ounce of value from its poor clients. This was a so-called 'multi-loan'

product. Under the terms of the National Credit Act of 2007, all clients offered such a microloan had to be subject to an initial affordability assessment, for which clients were charged a fee and paperwork provided. However, having complied with this regulation, Capitec then very quietly continued to charge such clients a 12% affordability assessment fee each month on the remaining length of the 'multi-loan' even though no further affordability assessments were actually undertaken. Clients were not actually made aware of this continuing charge because no paperwork was involved.

As a direct result of this programmed deception, the 'multi-loan' product became Capitec's most profitable product. But the deception represented by the multi-loan product was then exposed by the media, and Capitec was once more put on the defensive. In the face of growing criticism, in early 2016 it opted to phase out its original 'multi-loan' product, but it cynically replaced it with a nearly identical 'new' product. Financial analysts were largely not surprised at the determination Capitec demonstrated in not wanting to drop what was its most profitable product. However, in the face of a mounting over-indebtedness problem in South Africa, some consumer groups were aggrieved and derided Capitec for its 'pretend' changes. One of these consumer groups – Summit Financial Partners – announced in May 2016 that it was going to take Capitec to court on the basis of its unethical reckless lending practices and its use of the multi-loan product (Fin24 2016). Its explanation for this move was that

> If Capitec stands by the classification of the multi loan as a series of short-term loans, they are in breach of the National Credit Act by failing to do a full affordability assessment for each new withdrawal. If they claim it is a credit facility, then they are in breach by charging multiple initiation fees. Either way, Capitec is not putting consumers first. (JustMoney 2016)

A two-year stand-off then transpired. However, eventually admitting that it did not have the financial resources to compete against the massive legal firepower of Capitec Bank, which from early 2018 onwards had the South African government on its side (see below), in July 2018 Summit Financial Partners was forced to come to a legal settlement. In coming to this agreement, the two organisations announced that they would work together on addressing consumer financial literacy and seeking out meaningful debt relief solutions for Capitec's poor clients. Given its past record, however, it remains to be seen whether or not Capitec has any real intention to meaningfully change its hugely profitable business model lending to South Africa's poor.

An even more damaging criticism of Capitec's business tactics then followed in early 2018. A boutique financial research company operating out of the USA, the Viceroy Research Group (hereafter Viceroy), announced that its own research and due diligence demonstrated that Capitec was actually in very deep trouble (Viceroy 2018a). Viceroy highlighted once again the issue of the various multi-loan products sold by Capitec, agreeing with Summit Financial Partners that they were indeed illegal. An even more damaging claim, however, was that Capitec was far more deeply into the 'extend and pretend' tactic than its published reports were willing to admit to shareholders and to the financial world. In fact, so deep was Capitec into 'extend and pretend' that Viceroy claimed it was a manifestly unsafe financial institution and that, as in the case of African Bank in 2014, 'the South African Reserve Bank & Minister of Finance should immediately place Capitec into curatorship.' Viceroy claimed that Capitec was really a 'loan shark with massively understated defaults masquerading as a community microfinance provider'. Announcing

that it had all the detailed evidence sufficient to show that Capitec had grown very rapidly in the Fourie era thanks to this very specific Wall Street-style form of deception (i.e., accounting control fraud), Viceroy's analysis showed that it would eventually have to face up to very significant losses on its loan book.

A number of analysts grudgingly admitted that Viceroy was correct in the broad gist of many of its statements (as opposed to the nit-picking detail) and that Capitec's business model (i.e., accelerated reckless borrowing) was indeed generating considerable risk. Two issues here were paramount in the critique developed by Viceroy and others. First, that Capitec was failing to write off bad debts when they arose, but was instead consolidating any arrears into a new loan. Worse, although the National Credit Act stipulates that there should be a 'cooling off' period between microloans offered by any bank in South Africa, Viceroy's research showed that very many of Capitec's clients were able to access a new microloan just one day after paying down (including by lending from other sources) their existing microloan with Capitec (Viceroy 2018b). It thus very much appeared that Capitec had somehow 'cured' these potentially defaulting clients. It was then able to increase its loan book into this riskiest set of clients, and it could charge significant fees associated with the disbursement of 'new' microloans. Moreover, the supposed 'growth' of the loan book would reassure investors that all was well. It pointedly did not help Capitec's case here when, suspiciously without any disclosure to shareholders, it had introduced a new way of calculating its loan arrears (*Ibid*., 7).

Viceroy's overarching claim was that Capitec's bad debt was outpacing the growth in its volume of microloans, which is an unsustainable and hugely risky trajectory. Not unlike the situation with African Bank in South Africa, and with Enron in the USA in the 1990s, which for a time was able to artificially hide its massive debts in order to claim robust and growing earnings, Viceroy claimed that Capitec was also hiding the true extent of its bad debts on its microloans in order to keep the financials looking good, and so also the share price rising and senior management rewards flowing as long as possible.

These explosive claims did not go undefended by Capitec. Inevitably, Capitec claimed that nothing of the sort was going on and that comparisons to African Bank – which had indeed for a long time quietly hidden its massive losses before collapsing – were simply inappropriate. It also did not help that Viceroy openly admitted to trading in Capitec stock and that it probably made a sizeable profit by so doing. Nonetheless, Viceroy's claims were taken very seriously and there was for a time a real fear Capitec might go under. But after first claiming that it would happily address each and every claim made by Viceroy, Capitec pulled back and essentially answered none of the claims in detail. Instead, it put most of its effort into petitioning the South African government to 'do something' to get Viceroy off its back. And, as it happened, the government was more than willing to do this. Apparently terrified by the fact that the country's credit status would be marked down to 'junk' status if, no matter how justifiable, Capitec was put into curatorship, the South African government went to extraordinary lengths to reassure the financial markets that all was well with Capitec. In addition, the South African business sector was also encouraged to go the offensive in order to protect 'one of its own'. Business Leadership South Africa (BLSA), a body that lobbies on behalf of the major corporations in South Africa (Capitec is a member of BLSA) commissioned a hastily put together report that mainly attacked the life histories of the personnel employed by Viceroy and the

investment strategies they deployed rather more than it explored the actual claims made with regard to Capitec's control fraud (Intellidex 2018).

Almost irrespective of whether or not Capitec is guilty of having perpetrated an Enron-like accounting deception, as Viceroy claims that it has, we can for sure say that its role in South Africa's reconstruction in the more than two decades after apartheid ended has been hugely destructive, both economically and socially. Capitec's initial uplifting claims that it wished to address poverty and underdevelopment in the previously disadvantaged black communities were simply cruel PR. In practice, it can be argued, the overarching objective of the CEO, senior managers and key shareholders has been to expand their own extreme self-enrichment at almost any cost, taking almost any risk and using almost any unethical instrument in order to generate what even many neoliberals would privately agree are quite obscene levels of private enrichment under the circumstances. This single-minded aim was doggedly pursued, moreover, even though it became clear that the unlimited supply of microcredit was very destructively over-indebting the black population, ultimately to the extent that the World Bank calculated South Africa's population as the world's most indebted (see Demirguc-Kunt et al. 2015). Meanwhile, there is no real evidence of any meaningfully positive net impact arising from microcredit, through informal microenterprise creation and expansion, and so on poverty, deprivation, unemployment and inequality. Instead, in terms of the way it has programmatically over-indebted poor individuals in the black South African communities in order to siphon up their collective wealth and place it in the hands of a narrow financial elite, Capitec has no equal in South Africa, or perhaps even globally. Capitec thus stands out as one of the most important examples of the destructive potential of accounting control fraud in this young 21st century.

Conclusion

The microcredit movement that took root in South Africa after the apartheid system collapsed held out the seductive promise of rapid and sustainable progress for the vast number of black South Africans trapped in deep poverty, joblessness and deprivation. This solemn promise was not kept; on the contrary, the establishment of a large microcredit industry in South Africa has inflicted enormous damage on the economy, politics and society. Not coincidentally, this negative outcome has massively benefited a narrow white male Afrikaner elite, but has gravely harmed, if not destroyed, very many black South African communities in the process. The role of control fraud in perpetrating this economic and social disaster was explored using the example of Capitec Bank, which has established itself as a control fraud of quite spectacular proportions. It remains to be seen when the current epidemic of control fraud will be recognised for what it actually is, still less when it might be brought to an end. Finally, the international ramifications of such levels of control fraud in South Africa also need to be highlighted. Here is yet more concrete evidence that the global microcredit model has morphed into a sub-prime-like 'anti-development' instrument that is massively and fraudulently rewarding capital-owners while subjugating further those instructed to survive by their own individual labour alone. Global neoliberal political and economic elites have thus been very well rewarded, both ideologically and financially, for their ostensibly well-meaning sponsorship of the microcredit model from the 1980s onwards.

Notes

1. For example, this 'stuffed and starved' problem is especially acute in Africa. Because it is a risky and unprofitable market segment to serve, the formal SME sector is in crisis all across Africa because of the serious shortage of start-up and investment capital. Meanwhile, because it is a highly profitable market segment to serve, the microcredit sector has already over-indebted millions of poor individuals in Africa and its problem now is that it can no longer locate enough new clients willing to access a new or larger microcredit.
2. A major impact evaluation of Banco Compartamos carried out by a team of US-led economists and long-standing microcredit advocates (see Angelucci, Karlan and Zinman 2015) found no real transformational impacts (see also Correa and Vidal 2019; Bateman 2013b).
3. This was Unifer, the majority-owned microcredit unit of South Africa's second largest bank, Absa, which was itself a subsidiary of the United Kingdom's Barclays Bank, and Saambou Bank, South Africa's seventh-largest bank and the country's leading microcredit bank.
4. See 'Saambou case thrown out', *Moneyweb*, 7 May 2008. Accessed on August 23, 2016, at http://www.moneyweb.co.za/archive/saambou-case-thrown-out/.
5. See 'Another sell signal for Capitec, Abil – 90% of Garnishee Orders are flawed or fraudulent', BizNews.com, September 6, 2013. https://www.biznews.com/interviews/2013/09/06/another-sell-signal-for-capitec-abil-90-of-garnishee-orders-are-flawed-or-fraudulent/.

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