SUPPLY SIDE STUDY OF FINANCIAL INCLUSION IN MALAWI

Final Report

OXFORD POLICY MANAGEMENT AND KADALE CONSULTANTS

May 2010
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<tr>
<td>ADB</td>
<td>Authorized Dealer Bank</td>
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<tr>
<td>AML/CFT</td>
<td>Anti-Money Laundering and Combating the Financing of Terrorism</td>
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<td>ATM</td>
<td>Automated Teller Machines</td>
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<td>CDD</td>
<td>Customer Due Diligence</td>
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<td>CUMO</td>
<td>CUMO Microfinance Ltd</td>
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<td>DMS</td>
<td>Deepening Malawi’s Microfinance Sector Project</td>
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<td>FIMA</td>
<td>Financial Inclusion in Malawi</td>
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<td>FMB</td>
<td>First Merchant Bank</td>
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<td>FSAP</td>
<td>Financial Sector Assessment Programme</td>
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<td>FSB</td>
<td>Financial Services Bill</td>
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<td>FSDP</td>
<td>Financial Sector Development Plan</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GoM</td>
<td>Government of Malawi</td>
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<td>HDI</td>
<td>Human Development Index</td>
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<td>IAM</td>
<td>Insurance Association of Malawi</td>
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<td>KYC</td>
<td>Know Your Customer</td>
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<tr>
<td>MALSWITCH</td>
<td>Malawi Switch Centre</td>
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<td>MAMN</td>
<td>Malawi Microfinance Network</td>
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<td>MARDEF</td>
<td>Malawi Rural Development Fund</td>
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<td>MASF</td>
<td>Malawi Social Action Fund</td>
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<td>MASM</td>
<td>Medical Aid Society of Malawi</td>
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<tr>
<td>MPDC</td>
<td>Ministry of Planning, Development and Cooperation (formerly MEPD: Ministry of Economic Planning and Development)</td>
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<td>MFI/s</td>
<td>Microfinance Institutions</td>
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<td>MGDS</td>
<td>Malawi Growth and Development Strategy</td>
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<td>MK</td>
<td>Malawi Kwacha</td>
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<td>MLF</td>
<td>MicroLoan Foundation</td>
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<td>MMT</td>
<td>Mobile phone Money Transfer</td>
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<td>MRFC</td>
<td>Malawi Rural Finance Corporation</td>
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<td>MSB</td>
<td>Malawi Savings Bank</td>
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<tr>
<td>MSE</td>
<td>Micro and Small Enterprises</td>
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<td>MSMEs</td>
<td>Micro, Small and Medium Enterprises</td>
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<td>MUSCCO</td>
<td>Malawi Union of Savings and Credit Cooperatives</td>
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<td>NBFI</td>
<td>Non-Bank Financial Institution</td>
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NBM National Bank of Malawi
NBS NBS Bank
NPC National Payments Council
NPL Non-Performing Loans
OIBM Opportunity International Bank Malawi
OPM Oxford Policy Management
POS Point Of Sale
RBM Reserve Bank of Malawi
RFI Registrar of Financial Institutions
ROSCAs Rotating Savings and Credit Associations
SACCOs Savings and Credit Cooperatives
SEDOM Small Enterprise Development Organisation of Malawi
SCT Social cash transfers
SME Small and Medium Enterprises
VSLA Village Savings and Loans Associations
WOCCU World Council of Credit Unions

Exchange rate used in this report unless otherwise stated: US$1 = MK141.
Executive Summary

1. Background of the study
The Government of Malawi (GoM) recognizes that a more inclusive financial system is critical to the development of the country’s economy. Reforms have been undertaken in Malawi’s financial sector in the past decade; and more recently, innovations have been implemented by various market players in an effort to expand the reach of financial services. Despite these developments, however, a significant proportion of the country’s population still continue to face severe constraints in accessing financial services – including savings, credit, insurance, and payment services.

This study seeks to identify possible barriers to financial inclusion and to provide recommendations based on an analysis of Malawi’s microfinance sector from the side of both supply and demand. On the demand side, the study draws from the results of the 2008 FinScope Malawi survey. The supply side analysis, on the other hand, draws from data and information gathered from various financial sector providers currently operating in Malawi. The analysis draws from primary as well as secondary data sources.

The National Forum on Microfinance in Malawi has proposed the development of a National Strategy and Action Plan for Financial Inclusion in the country. The key issues discussed in this study will be useful in the ensuing consultation process to support the development of the proposed strategy and action plan. The key findings of the study will help to define key goals and objectives, required strategies, and necessary actions for achieving the core objective of financial inclusion.

2. Overview of the economy
The key implications of the developments in the country’s broader macroeconomic environment on financial access may be summarized as follows:

- The relatively buoyant growth of the economy is expected to continue presenting opportunities for the financial sector to expand its client base. However, the country’s dependence on agriculture – as a sector that is vulnerable to weather and other exogenous variables – means that businesses and financial institutions will need to seek ways of mitigating risks associated with the emerging opportunities.
- Uncertainty over the supply of foreign exchange has a negative impact on financial service suppliers as well as local businesses. While the reduced opportunity to generate profits from foreign exchange services may help push some banks to seek other avenues for generating revenue, overall, this uncertainty in the market is affecting the way businesses and transactions are carried out. There are indications that it is leading to higher costs of doing business in the country.
- In recent years, the declining and relatively low real Treasury Bill rates have forced financial institutions to look for better use of their excess liquidity. There are indications that this is helping to fuel product innovation and a heightened interest to explore non-traditional client opportunities by the banks.
- Subdued inflation has seen reductions in savings rates, which are mostly negative in real terms; any notable reduction in lending rates to businesses and consumers has been limited by high spreads (circa 16%). The prospects are that interest rates will remain stable and that increased competition will progressively put pressure on bank spreads.

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1 This Executive Summary is also provided as a separate stand-alone document.
However, the cost of doing business and recovering debts suggests that interest rate spreads and prime rates will still remain relatively high.

- The global financial crisis has made it more difficult for banks and borrowers to access lines of credit from non-domestic sources and to borrow the needed foreign currency. Moreover, the uncertainty in the supply of foreign exchange has also made this a more risky option for many financial institutions.

3. The supply of microfinance services in Malawi

As in other countries, financial services in Malawi are provided by a wide range of financial institutions. These comprise:

- banks that are regulated under the Banking Act (1989) and are supervised by the Reserve Bank of Malawi (RBM), including one leasing company and two discount houses;
- non-bank microfinance institutions (MFIs) under several legal forms and ownership structures, which cover the range of for-profit and non-profit institutions that include (a) companies with (private) shareholders (e.g. moneylenders), (b) trusts (typically NGOs), (c) companies limited by guarantee, and (d) public entities;
- member-owned or member-based organizations such as financial cooperatives or savings and credit cooperatives (SACCOs); and
- informal financial service providers, including individual moneylenders (e.g. Katapila operators).

Apart from these key providers of financial services, there are also a number of other institutions operating in the country – including foreign exchange bureaus, insurance companies, one investment company, one investment trust, eight fund/portfolio managers, three securities firms/brokers and one leasing company (which is part of a commercial bank).

The characteristic strengths and weaknesses of the different groups of financial service providers may be summarized as follows:
• **Banks** – There are 11 licensed commercial banks currently operating in Malawi, which provide a range of services including deposit products, credit facilities, foreign exchange services, payment facilities, bancassurance, etc. Loans and advances form a major portion of the asset structure of the banks. In terms of profitability, the banking sector collectively recorded a net income estimated at MK8.6 billion in 2008, representing a growth of 41% from the previous year. Banks’ income was significantly derived from loans and advances, securities and investments and foreign exchange transactions. Banks still continue to generate margins from investments in government Treasury Bills (T-Bills) and other short-term instruments, though this is generally declining. Nevertheless, this is allowing banks to continue to generate high levels of profitability especially when compared to industry averages in other countries. Although banks admit to facing competitive pressures within the sector and against other types of financial service providers, this level of bank profitability also indicates that there is less pressure (and a lower likelihood) for commercial banks to diversity their client base and develop new markets for their financial services, such as agricultural finance.

Considering the geography and population density of Malawi, bank branches are reasonably spread across the country’s various districts. But bank branch operations still tend to focus mainly on cities and towns, with very limited outreach to the rural areas. Even mobile banks are in most cases restricted to operating in secondary (trading) centres, on tarmac roads and where there is a police station. This tendency for banks to focus on urban areas and larger, more accessible trading centres is consistent with their overall target market orientation. Due to the search for new markets, increased competition in the main urban and primary locations, more banks have been establishing a presence through branches, agencies, point of sale (POS) terminals and bank-on-wheels in areas that were previously of little interest to most commercial banks. While progress is slow, this phenomenon seems to result from the way early entrants (such as NBS and OIBM) have demonstrated that they can generate enough business in areas that are generally poor and considered to be of low potential. Interestingly, the experience confirms that people in rural areas do save when given the opportunity. This highlights the potential strategic importance of rural branches to act as net sources of funds for on-lending by urban-based branches or outlets.

Beyond the issue of location and the accessibility of bank branch operations, banks face other challenges to extending services that meet the needs of low-income households, especially those based in rural markets. Many banks offer products that are not designed for the needs of low-income households. Although balances for many card-based savings accounts start at a minimum of MK1,000 (US$7), and a few at MK500 ($3.50), there are significant costs associated with opening and keeping a bank account that preclude low-income individuals from holding an account.

Banks are also showing significant interest in the use of technologies that enable them to offer more user-friendly services across a broader client base. There is great expectation among many providers that technology-driven products will bring down transaction costs and enable them to service a larger volume of clients, including low-income individuals. These technology-driven products and services – which include smart cards, ATMs, cell phone and internet banking and point-of-sale (POS) devices – have the potential to improve accessibility and provide greater ease in carrying out financial transactions for both providers and users of the service.

• **Privately-owned non-bank microfinance institutions** – The financial sector includes a range of financial institutions that are not (currently) supervised by the RBM. These institutions primarily provide various forms of credit, with emphasis on services provided to people who are not generally served by the banking sector. This group includes quite a
wide range of providers, such as (a) companies with (private) shareholders (e.g. payroll moneylenders), (b) trusts, (c) companies limited by guarantee, and (d) public entities that are either government programmes, trusts or companies that are wholly owned by the government. Within this group of microfinance institutions (MFIs), the variety of institutions covers the range of for-profit and non-profit entities.

Only one of these institutions – the Malawi Rural Finance Corporation (MRFC) – is able to provide savings services to the public, although some collect mandatory savings from their clients as a pre-condition for clients’ access to loans. MRFC is, however, not allowed to on-lend the savings it collects from the public and therefore invests them mainly in government instruments.

An important recent development is the entry of payroll moneylenders – which include institutions like Blue, Izwe and Greenwing. These are for-profit companies that are privately funded and some of them operate in multiple countries in Sub-Saharan Africa. As of December 2008, it is estimated that this group of lenders (comprising a total of five operators) had a total of more than MK1 billion in loans outstanding, representing a 10.2% market share in the total credit classified as microfinance loans.

There are also institutions that are affiliated with, owned or operated by international NGOs, such as FINCA Malawi and CUMO Microfinance Ltd. A number of non-profit institutions also provide microfinance services, such as the MicroLoan Foundation (MLF), which combines a charitable mission with its business of providing financial services to poor individuals. Finally, there are a number of projects operated by NGOs alongside other services, such as The Hunger Project.

Unlike banks and other formal financial institutions, MFIs tend to offer products that are more micro in size: loan sizes can start as little as MK2,000 (US$14) per individual. However, the maximum loan amount, especially following multiple cycles of borrowing, can reach up to MK150,000–200,000 (US$1,050–1,400). Moreover, the institutions within this group often combine individual and group-based schemes and typically target micro-entrepreneurs and small-scale traders. This also helps to explain the upper limit in the size of the loans they offer.

These institutions can be further classified in terms of whether they have an urban or rural bias in their client targeting. For example, while CUMO focuses strongly on rural-based clients, FINCA Malawi targets clients who maintain economic activities in urban and peri-urban trading centres. Many MFIs operate in such a way that they avoid areas where there is no bank and where the roads are in a condition that would make it difficult to access.

The emphasis on urban areas becomes even more pronounced when we consider the payroll moneylenders. These financial institutions primarily provide loans to employed individuals, mostly civil servants (such as teachers, soldiers, government employees, nurses, etc.) at least until the GoM issued a directive that disabled new loans from being deducted from civil service payroll, early in 2009. The loan amounts typically offered to individuals by payroll moneylenders range between MK10,000 (US$70) and MK500,000 (about US$3,500), payable over 6-36 months. To date, the reported mean loan size is estimated in the range of MK45,000–70,000 (about US$300-500).

As MFIs are currently not regulated by the RBM, they are prohibited from collecting voluntary deposits from the public, which explains in part the limited expansion of the scope and scale of their operations. Typically, their portfolios are characterized by loans with very short maturities (less than 6 months), a consequence not only of their financing structure but also of how these institutions tend to respond to the business cycle of micro-enterprises in the urban/peri-urban sector.
It is also important to point out that it is difficult to obtain reliable and regular routine performance data on the sector, since reporting by these institutions is not mandatory and is currently not standardized. Even in the case of payroll moneylenders, performance reporting follows what is prescribed by their parent companies. There is currently no designated authority that licences credit-only institutions, although this is expected to change with the passing of the Microfinance Bill. The designation of such an authority could be an important step in bringing about a higher degree of transparency and standardization of performance assessment among financial NGOs and companies licensed to provide credit.

Related to this need for greater transparency is the issue of building adequate capacity among various financial institutions within this peer group. Even the more established financial service providers (i.e. those that have been operating for more than five years) admit to facing severe constraints in attracting and keeping qualified personnel in their workforce due to limitations in the remuneration packages they can offer. Such capacity constraints also help to explain the tendency for these institutions to face serious loan repayment problems.

- **Publicly-owned non-bank entities** – In Malawi, the public sector plays a significant role in the supply of microfinance services. There are numerous government programmes that have either continued operating as funds or have been registered as trusts or companies (with almost 100% government shareholding).

Among the dominant suppliers within this group is the MRFC that primarily targets agricultural borrowers. MRFC has an extensive branch network that includes six full-service branches, and 20 sub-branches. As of December 2008, MRFC reported a total loan portfolio of MK3.8 billion (US$27 million). 60% of its loans are provided via groups. It continues to maintain a larger proportion of its portfolio in loans to agricultural producers. It, however, states that the number of its (non-agricultural) small and medium business loans has been rising steadily in recent years.

The GoM has also established the Malawi Rural Development Fund (MARDEF) in 2004, providing credit to groups in rural communities, especially to agro-processing activities. MARDEF offers group-based loans from MK150,000 (about US$1,100) to as much as MK300,000 (US$2,200), with a maximum of MK10,000 per group member. From the time MARDEF began operations, it has faced challenges due to the nature of its establishment and the public’s perception and expectation of soft terms on its loans. These challenges are depicted in the way MARDEF prices its loans: the interest rate charged does not allow the institution to fully recover its costs.

The Small Enterprise Development Organisation of Malawi (SEDOM) is another provider in the category of public non-bank entities. SEDOM was established as a government trust supported by government and a host of donors. Like other institutions within this category, SEDOM faces significant challenges in the repayment of its loans.

Interestingly, PRIDE-Malawi is considered by many in the industry to be a public entity, though not by its management. PRIDE focuses on micro-enterprises in urban and trading centres, and provides standard working capital loans to mostly female borrowers. It is increasingly targeting SMEs and salaried individuals. It is keen to transform and apply for a banking license in due course.

Sustainability is a key challenge for most public institutions: given that these institutions are motivated by an interest to offer ‘low cost loans’, they are unable to charge interest rates that are cost-covering.
• **Savings and credit cooperatives (SACCOs)** – Another group of financial service providers are the savings and credit cooperatives (SACCOs). In some other African countries, SACCOs are more like traditional social structures that have embedded within them strong social and economic networks. In Malawi, however, SACCOs are not commonly found in the local communities and there are relatively few of them. The Malawi Union of Savings and Credit Cooperatives (MUSCCO) – which is the established apex institution for SACCOs – has only 59 member-SACCOs (as of June 2009), of which 45 are stated to be active. MUSCCO estimates that outside the confines of its membership, there are less than 10 other SACCOs operating, some of which are former MUSCCO members that voluntarily left it or, in a few cases, have been expelled. There are also rural-based SACCOs that operate as multi-purpose cooperatives – i.e. financial services are offered alongside other types of services.

There is quite a variety in the size of SACCOs operating in the country. Some are relatively small, having less than 70 members, whilst the largest has a membership of almost 25,000, with total assets of MK650 million (about US$4.6 million) and MK37 million (about US$260,000) in deposits. Based on the data collected by MUSCCO from its member-SACCOs, most of the remaining SACCOs tend to be large: 42% of them have 301-1,000 members; while another 40% of them have 1,001-5,000 members. The mean membership size is roughly 1,300. This is an important characteristic of SACCOs in Malawi, as it is crucial to have economies of scale in order to support sustainable financial operations: a number countries in Africa are struggling to develop SACCOs of a sufficient size to be sustainable, so Malawi is in a comparatively favourable position in this respect.

The SACCOs interviewed in this study offer a variety of savings and loan products. Regular savings accounts can be made with MK1,000 ($7), while there are special savings products that start from as low as MK500 ($3.50). Loan amounts range from MK1,000 ($7) to as much as MK2 million ($14,200), depending on the loan purpose. The wide range in loan amounts offered suggests that SACCOs tend to cover a broad spectrum in their membership base. For all types of loans, some form of security is required by the SACCOs. However, SACCOs accept alternative forms of collateral that are not typically accepted by other financial institutions like banks – such as moveable property, including household and business assets, stock of goods, livestock, etc.

The characteristics of the products offered by SACCOs are important to consider when discussing the accessibility of their services. Not only is there ease of entry for clients given the size of loans and savings amounts, but it is also relatively easy and inexpensive for an individual to become a member of a SACCO. The typical requirements – which consist of an application fee and an initial purchase of shares – cost an individual about MK1,000 ($7).

Interestingly, there are a number of SACCOs that also accept deposits from non-members, and this seems to be a common feature of those that operate in peri-urban areas characterized by economic activity but which are, however, at some distance from the nearest bank. One of the SACCOs interviewed in this study, for example, Bvumbwe SACCO, estimates that about 20% of its deposits are from non-members: these tend to be individuals who conduct their business close to the SACCO branch; these non-members are interested only in having a safe place to store their savings or their cash surplus at the end of a business day, and they are not willing to travel long distances to make deposits to a bank. They are not interested in accessing loans and therefore do not become members, although Bvumbwe SACCO tries to convince them to. This implies that there are unmet opportunities for drawing deposits in unbanked peri-urban areas of the country, even if only overnight or very short term.
A large majority of MUSCCO’s members have reported profitable operations as of March 2009. However, five members incurred net losses totalling almost MK8.4 million (about US$60,000). Across the range of SACCOs, however, most are facing challenges in terms of loan recovery. Even the ones that are considered star performers within the sector usually have about 15-20% of their outstanding loans in arrears greater than 30 days, and they report loan recovery rates of only 80-90%. This reflects the main challenge of SACCOs operating in Malawi: they generally have very weak management and institutional capacity, which MUSCCO is trying to help build.

The picture tends to be even worse for those SACCOs that are rural-based and operate as multi-purpose cooperatives. Some of them face even more serious problems in the recovery of loans: some multi-purpose SACCOs manage to recover only about 60% of the loans they disburse to their members.

- **Informal sources of finance** – In addition to the banks, non-banks and SACCOs that operate in the microfinance market, financial services are also supplied by a range of informal operators. These include individual moneylenders (Katapila) and village-based savings and loans associations (VSLAs) or rotating savings and credit associations (ROSCAs) where small groups of individuals save small amounts periodically and each member receives a lump sum payment at some point during the cycle.

  **Katapila operators** are private individual moneylenders that provide loans at short notice, for short terms, at relatively high interest rates without necessarily requiring security. Loans are typically payable in just a few weeks or one to two months and repaid in one single instalment. Borrowers are usually known to these moneylenders, which therefore gives Katapila operators informational advantages to assess the risks associated with lending to a particular individual. The moneylenders are also usually based locally or within close proximity to their borrowers, allowing them to see or observe the circumstances of the borrower that are relevant in considering the likelihood of loan repayment. Lending is based on ability to repay, with the lender taking little interest in the use of the funds, be it economic (e.g. for a business), social (e.g. to cover medical/funeral expenses) or even recreational. The interest charged on loans is very high compared to formal sources: if an individual borrows MK1,000 (US$7), he is expected to pay back a total of MK1,500 (US$11) or MK2,000 (US$14) the following month. But borrowers agree to these terms as the loans are easier to access (i.e. quickly and with hardly any questions asked) and more so because no other alternative sources exist at the time of need.

Although the interest on a Katapila loan is high, it should be noted that due to the proximity of Katapila operators in most communities, the transaction costs of accessing such a loan are low even when compared to other sources of micro-loans, whether from MFIs or banks. Because loans from a Katapila operator are made available very quickly, they can have considerable value (e.g. during emergencies) versus the longer periods required to process loans from other sources.

Interestingly, there are also rural-based Katapila operators that behave like input suppliers of credit and transact in kind (as opposed to cash) by distributing food and inputs, and receiving repayment in cash. These moneylenders, for example, distribute maize to cotton farmers during the lean periods and provide pesticides between December and February, a critical period for cotton growing. By borrowing maize and chemicals, poor rural households may not need to supplement their income through casual work on other farms (referred to as ‘ganyu’ labour), and can therefore concentrate their work in their own fields. The inputs also enable higher crop productivity and income.
Apart from individual moneylenders, there are also **village-based savings and loans associations (VSLAs)** operating in the informal sector. VSLAs are organized by CARE International Malawi and its partners, and typically target those individuals who are based in urban slums or more remote rural areas. VSLAs typically comprise of 15-25 individuals that come together to form an association (that may or may not be registered) primarily to facilitate savings within the group. While loans are provided as part of the services that a member can access, the VSLA model follows a savings-based approach: it builds on a model of rotating savings and credit associations (ROSCAs), where a self-selected group of people pool their money into a fund from which members can borrow. These small pools of capital are intermediated at a local/village level to satisfy household cash management needs for those who live in areas where banks and MFIs do not have a presence. The money lent out is paid back with interest, which allows the fund to grow. The regular savings contributions made by the members to the group are deposited with a specified end date for distribution of all or part of the total funds (including interest earnings) to the individual members. Members of VSLAs receive a return on their savings that is typically higher than that offered by banks, and members are able to save whatever amount they wish and whenever they need to. The methodology is designed to provide access to basic financial services to the poor and the very poor.

While the VSLA methodology is simple, it involves a very carefully structured system of training. The groups undergo training sessions for 9-12 months in order to facilitate the formation of the group, elect officials, design their system of savings, etc. These groups start a system of savings and lending, whereby they are initially supervised by CARE field staff who ensure that procedures and systems work properly and that the groups can function independently thereafter.

In Malawi, CARE and its partner organizations are facilitating the formation and training of VSLAs in all regions, currently covering six districts. They started with 174 VSLAs in 2006; this number has grown to almost 2,600 by the end of 2008. They are currently reaching about 13,000 individuals, with a mean average savings balance of MK4,260 (about US$30) per member. With additional funding from its donors, CARE is targeting to reach 400,000 individuals by 2017. Interestingly, CARE is also planning on facilitating linkages between more established VSLAs and other financial service providers. At least one of the banks (OIBM) has already expressed an interest to work with some of the VSLAs in operation.

- **Insurance companies** - The insurance sector in Malawi consists of eight non-life insurers, three life insurance providers, and a number of brokers and other agents. The total annual premiums collected were estimated at MK11 billion (US$ 78 million by the Insurance Association of Malawi (IAM).

The provision of insurance services is still very much under-developed: insurance products tend to be very limited in range and target a very limited segment of the country’s population. The most common product offered is motor vehicle insurance. As the IAM has observed, insurance products largely target the needs of those who own large assets or of salaried individuals with high disposable incomes. There are early developments though related to insurance products being progressively offered by a number of institutions that allow low-income individuals and households to better cope with health and funeral expenses and other livelihood risks (weather and livestock).

In terms of health insurance products, a key player is the Medical Aid Society of Malawi (MASM). MASM offers medical insurance to its members, of which about 80% are employed. As of July 2009, MASM had about 105,000 members. MASM’s products, however, are still limited to better off (mostly employed) individuals: their cheapest health insurance package requires contributions of MK520 ($3.70) per month, which is too
expensive for most low income households. Moreover, they are only able to offer health insurance products to those in close proximity to registered medical service providers.

MASM considers it very challenging to address the need for health insurance products for low-income households: affordability is a key issue, but so is the need to ensure greater understanding of what insurance products are and their benefits especially among those who are rural-based and with very little education. Not only do these individuals have a higher risk profile (i.e., they tend to be more prone to falling ill or facing accidents), but there are also serious challenges to providing services in a cost-effective and sustainable way.

In Malawi, nearly 90% of individuals depend heavily on agriculture for their livelihoods. There are, however, significant risks associated with agricultural activities that drive the highly irregular patterns in production and income flows, especially for smallholder farmers who have few or no other income sources and concentrate on single crop production. To respond to this need, a weather-based (rainfall index) insurance scheme has been piloted and is currently being offered in a limited number of areas in the country (close to monitored weather stations). This insurance product seeks to reduce the vulnerability of farmers to incidents of drought. The insurance scheme can be combined with a loan facility for seed inputs and agricultural implements. The institutions involved in the pilot include OIBM and MRFC.

- **Agricultural buyers** – The supply of credit to farmers for agriculture has been a major problem identified in policy documents and studies over many years. Banks and non-bank financial institutions (NBFI s) have made several attempts to lend to farmers over the last two decades, but most of these institutions have not been successful in doing so, even after having promising results at the initial stages of extending services. As a result of these and other factors, bank and NBFI lending to agriculture has waxed and waned. For agri-businesses, notably processors, the lack of finance from banks and NBFI s to farmers has been a major problem. In the absence of bank and NBFI finance to farmers, many agricultural buyers/processors stepped in to provide finance to farmers to fill the gap.

Processors and in some cases farmer organisations in sectors such as tobacco, sugar, tea, cotton, paprika, groundnuts, dairy and coffee, have all engaged in lending to growers of the produce they want to buy. In 2006, after facing significant losses, rather than abandon the farmers, two tobacco processors intensified their support to contracted farmers, adding maize inputs and even regular hungry season cash payments. A significant change was introduced with the involvement of commercial banks as the source of the finance in this set-up. The banks felt more confident to lend to farmers given the following reasons:

(a) The farmers selected for financing had access to productivity enhancing inputs with considerable agronomic support from the buyers in a proven crop production system with higher yield and higher quality.

(b) The buyers guaranteed to buy the crops based on a pricing formula, which helped to address some of the inherent risks.

(c) The support package was well designed with key measures such as including inputs for maize to avoid the common problem of diversion of tobacco inputs to the food crop, as well as cash payments during January to March to remove the need to sell tobacco to get cash during this period (when food is in shortage and farmers are vulnerable to offers from traders to buy at highly discounted prices).
(d) The tobacco marketing system has a mechanism to deduct the loans from payments by buyers to sellers when they buy the crop through the auction.

The experience so far points to the following: (i) Agri-businesses have been an important source of credit for smallholders, where banks and NBFIs have been unwilling to fill the gap. (ii) Where there are sound contract farming schemes, or closed marketing arrangements where loan repayment can be deducted from proceeds, then banks and NBFIs have been willing to participate in the process and provide credit to farmers. (iii) However, for many crops, arrangements that have been tried have broken down due to a mixture of poor product design, high levels of side-selling by farmers to avoid repayment and in some cases, inadvertent side effects of agricultural policy decisions.

4. The policy, legal and regulatory environment

Malawi’s national priorities are spelt out in the Malawi Growth and Development Strategy (MGDS). The MGDS recognizes the problem of poor access to micro-credit and high default rates, for example, under the fifth sub-theme (sustainable economic growth), but analysis of the financial sector and measures for its development are mostly absent.

In November 2002, the GoM approved a Microfinance Policy and Action Plan to assist in the development of the microfinance sector. The policy seeks to promote the development of a sustainable microfinance industry in the country, by creating an enabling legal and regulatory environment as well as overall economic policies conducive to the development of microfinance; improving the capacity of implementing institutions and their clients and other key actors such as the Malawi Microfinance Network (MAMN), the RBM and the Ministries of Industry and Trade, Finance and Economic Planning; promoting best practices in the industry among MFIs, government agencies and the donor community; and enhancing the co-ordination between the various actors in the microfinance sector.

The policy recognizes that overall, the existing legal environment is not deemed hostile to the development of microfinance in the country, but collaborative efforts among various stakeholders are envisaged to help improve the environment and make it more friendly through the review, revision, amendment and repeal of those laws and regulations to promote the sector’s development.

Important measures have already been undertaken by the GoM, RBM and other key stakeholders to strengthen the financial sector and create an enabling environment for financial service provision. In particular, there have been renewed efforts to finalise a suite of amendments to the financial services law in the country. These amendments centre on updates to the Banking Act and the introduction of an overarching Financial Services Bill (FSB), a Microfinance Bill and a Financial Cooperatives Bill, a Credit Reference Bureau Bill, and a Payments System Bill (amongst others).

With the passing and implementation of these new pieces of legislation, non-bank forms of financial institutions should be granted licenses to operate. The institutions cover a wide range of institutional types and MFIs in particular would be regulated as deposit taking, non-deposit taking or purely credit-granting institutions. Thus, many financial institutions expect that the passing of these bills will pave the way for greater legitimacy within the sector, which is in the interest of those better performing institutions that are not necessarily willing or able to transform into a full commercial bank.

These new reforms are a welcome and important step towards developing a robust but targeted regulatory system. In particular, the explicit recognition of different types of financial institutions (e.g. MFIs and SACCOs amongst others) should allow regulation of NBFIs to
develop in a way that is sensitive to the different risks posed by those sectors, thereby allowing the regulatory system overall to be more effective.

However, the new legislation places a large number of duties on the Registrar, including prudential regulation of many, relatively small, financial operators. In anticipation of this change, the RBM is progressively implementing a risk-based approach to regulation. It will be important to ensure that the Registrar’s office is properly resourced to avoid creating a bottleneck and a barrier to the development of the financial sector as a whole. In particular, much of the detail of the new regulatory system will be prescribed in regulations, not in the statute. This is a common and effective way to help make a regulatory system more flexible. It is, however, important to point out that if such regulations are not developed and implemented in a consultative, transparent and coherent way, they can cause complications and confusion in the law.

5. The support infrastructure: meso-level institutions

Malawi’s payments system has undergone significant developments in recent years with the establishment of the National Payments Council (NPC). In 2001, the RBM, the Bankers Association of Malawi (BAM), and the NPC endorsed the ‘Malawi National Payment Systems Vision and Strategy Framework’, which serves as the blueprint for all national payments system modernization projects in the country. Under the guidance of this strategy framework, the RBM has spearheaded further developments, including financing the establishment of a frame relay-based national network infrastructure and a transaction switch called Malawi Switch Centre (MALSWITCH). This is considered a major milestone in the modernization process. Through MALSWITCH, links between commercial banks and discount houses onto a common network platform are facilitated, providing a number of electronic based payment, clearing and settlement facilities. The modern electronic facilities include a real time gross settlement system, which allows high-value inter-bank funds transfer transactions to be settled in real time. MALSWITCH has also introduced a chip-based card scheme which uses biometrics in addition to the personal identification (PIN) code.

While these reforms and developments have improved the functioning of the financial sector, there are still a number of issues that remain to be resolved. Central to this discussion is the role of MALSWITCH, which was implemented in order to link all the banks and allow electronic cheque clearing and real-time settlements between them. Beyond this role, MALSWITCH was also envisaged as a platform for a range of electronic payment, fund transfer and banking products. In practice, however, the use of the MALSWITCH systems to support fund transfer services has reportedly been low, as only a limited number of banks have installed electronic interfaces with MALSWITCH that enable card users to use any ATM machine, regardless of bank branch or location.

The NPC is pushing for interoperability between the cards and systems and hopes to have an integrated system very soon. The practicability of having such an interoperable system hinges upon coordinated efforts between all stakeholders involved, ensuring the harmonization of the systems that are in place between the different financial institutions operating in the country. Moreover – and relevant to the issue of expanding the reach of access points – electronic banking that may be facilitated by a truly interoperable system will require a reliable communications infrastructure that is linked to POS or ATM devices.

In terms of the support institutions, there are currently two support institutions playing a key role in Malawi’s microfinance sector: Malawi Microfinance Network (MAMN) and the Malawi Union of Savings and Credit Co-operatives (MUSCCO). Support institutions are crucial to the development of the financial sector as they help to facilitate the exchange of useful experiences, ideas, innovations and information among sector players.
MAMN began as an informal network of MFIs and was formally established in 2000 as a professional association of Malawi’s MFIs aimed at coordinating activities in the sector and fulfilling self-regulatory functions for its 20 member-institutions (as of June 2009). It aims to develop and promote microfinance activities, ensuring good governance and practices are adhered to by its members and helping to ensure their sustainability. MAMN has a Secretariat, housed at the MRFC offices in Lilongwe. It has been able to run a number of training programmes with support from various donors. Based on its self-assessment, MAMN recognizes that the biggest challenge facing its member institutions is in loan portfolio management. MAMN admits, however, that its ability to undertake more direct engagement with member-institutions has been limited by staff and resource constraints. While it has been able to gradually establish a stronger presence and facilitate improved co-ordination within the sector, it has yet to reach its full potential as a support organization.

MUSCCO, on the other hand, is an apex organization comprising 59 SACCO-members. It provides its members with access to its Central Finance Facility (CFF) and other services, including audit and training. MUSCCO keeps track of members’ performance via monthly reports that members are required to submit, along with monthly visits by its field officers. MUSCCO also delivers more structured training programmes that are attended to by the key officers of member-SACCOs. MUSCCO admits that there is much left to be done in order to help SACCOs build their internal capacity, especially since many of these institutions do not hire personnel with banking qualifications.

6. Analysis of demand-side data and its implications for the supply of financial services in Malawi

The results of the FinScope Malawi 2008 study are considered for the light they shed on shortfalls in the supply of financial services.

The overall access strand for Malawi shows that while the level of bank penetration is towards the top end of its peer group of countries (i.e. taking into account Malawi’s low per-capita GDP), the overall level of financial inclusion is low given the limited additional reach of NBFIs. Overall, the demand-side data in FinScope Malawi 2008 presents a fairly typical picture for a country in Africa that is at the same level of development as Malawi’s.

- Firstly, the proportion of those financially excluded remains high at 55%. Those who are excluded tend to be rural-based, female and with little or no education.
- Less than one in every five adults has access to a bank account, and formal financial services are accessed by only one in four adults.
- The reach of the informal sector (25% of adults) is as large as the combined reach of banking and other formal institutions. It is, however, important to point out that the informal sector does reach a different segment of the market: only a fifth of the informally served also access formal financial services.
- Not surprisingly, formal access is much lower in rural than in urban areas and a bit lower for women than men. Formal access also tends to favour the middle-aged and the well educated in the population.

Bank branches and outlets are concentrated in areas with low poverty, with only a few locating their outlets in areas that may be poor, usually where these are densely populated. It is understandable that banks would be less interested in serving poor areas, especially if these areas are also less densely populated, given the implications on banks’ transaction costs. But there is definitely scope to expand banking services to those areas that are poor but have a high concentration of people living in them.
That the use of banking services seems relatively invariant to the number of access points or how rural a district is, suggests that people who live in less densely populated rural areas still make use of financial services. While bank branches indeed largely tend to be more present in urban areas and location of an access point is an important consideration in the choice of an individual to make use of a financial service, these results suggest that other variables still need to be considered – such as, for example, whether financial services being offered are configured to meet the needs of rural people.

In summary, the analysis of the FinScope results suggests that:

- Making a significant breakthrough on access essentially means targeting the poor, as those who are better off are already relatively well penetrated. That said, it is, however, important to qualify what constitutes ‘the poor’ and ‘the better off’ in Malawi. For example, it is estimated that about 87.5% of private sector waged staff in Malawi still do not have a bank account. While private sector employed individuals are generally considered among those who are better off (in most other countries), many employed individuals could still be considered among those who are poor by international standards. It is, therefore, important to consider the levels of cash poverty in the country: and the results in Malawi suggest that while there is scope for expanding access even among those who are better off, there is, at the same time, merit in having an explicit pro-poor strategy that starts by extending financial services to waged individuals. This should be translated into offering different kinds of bank accounts and not just scaling down accounts that target elite customers, because high levels of take-up will only come when products are better suited to or meets the needs of relatively poor waged persons.

- There is a high degree of overlap between those who are reached by banks and other formal financial services. More importantly, the FinScope results indicate that the big jump in access comes between being formally and informally included and not between being banked or otherwise formally reached. The non-bank microfinance sector, still does not reach significant numbers of people that the banks do not, and nor does it fundamentally change the mix of who is reached even though NBFIs have access points in districts where banks have none. Thus, while the provision of microfinance services in its broadest sense – i.e. covering the services provided especially by non-banks – helps expand access for the poor especially in the rural areas, this is so far not enough to change the fundamental access levels of the unserved.

- The analysis of FinScope results against supply-side data also shows that geographical accessibility is less of an issue. Bank branches and outlets tend to be more present in areas characterized by low poverty, regardless of population density. It is the less densely populated areas that are also poor that tend to have less access points. The analysis points to the scope for exploring the expansion of banking services to those areas that may be poor but have a high concentration of people living in them.

- Related to this last point, it will be meaningful to consider that there is quite a strong income effect that emerges from the analysis of urban and rural populations. In urban areas, the relationship between income and accessing bank services is strongest. There is a steady rise in penetration of banking services through the lower income bands in both numbers and percentage terms. It peaks at about 75% or so when declared incomes rise above the food poverty line.

- Moreover, while location of an access point is an important consideration in the choice of an individual to make use of a financial service, these results suggest that other variables need to be considered – such as, for example, whether financial services being offered are configured to meet the needs of rural-based people. Some banks are already finding that in rural-based branches, clients tend to be most interested in savings products.
Thus, being relevant and responsive to the needs of the poor (and those who are rural-based) matters just as much as affordability.

- Lastly, in rural areas, when informal sources of finance are included, the proportion of adults with financial access almost doubles, whereas in the much better formally served urban areas access only increases by about a fifth. Clearly informal suppliers do something that opens up finance to huge numbers of the rural poor who currently do not and quite probably cannot access formal financial services.

7. Summary of barriers to financial access
The key barriers to financial access in Malawi can be summarized as follows:

- **Accessibility of financial service points (branches and outlets)** – Branches and outlets especially of banks tend to be more present in areas characterized by low poverty, regardless of population density. Moreover, the less densely populated areas that are also poor tend to have less access points. Interestingly, the analysis of access to banking services at district level by population density and poverty suggests that the use of banking services is relatively invariant to the number of access points or how rural/sparsely populated a district is; although, as expected, the poorer a district is, the lower the level of bank penetration generally tends to be. It is relatively easy to explain why bank branches tend to concentrate in areas with low poverty, with only a few locating their outlets in areas that are poor, but densely populated: setting up operations in poor areas, and especially if these areas are also less densely populated, have implications on banks’ transaction costs. Areas that are poor are often characterized by deficient support infrastructure (such as electricity and telephone lines) crucial to branch operations.

- **Transaction costs vis-à-vis the viability of financial service provision** – the cost of opening and maintaining a bank account is high for many low-income households. From the analysis of FinScope data, the overwhelming majority of those unbanked respondents who declared their income claim to have cash incomes below MK10,000 (US$70) a year. For urban-based individuals, this constitutes about 70% of the said respondents; while in the rural areas, this proportion is as high as 85%. With minimum opening and maintaining balances of MK1,000 (US$7), a large proportion of the population would find it almost impossible to meet this requirement. It is therefore important to consider introducing low-value savings products similar to those offered by institutions like the MFRC, with lower balances (roughly MK200-300 ($1.50-3.00), that would appeal to the low-income market segment.

Beyond this, there are also other fees and charges imposed – one-off payment or monthly charges – for keeping a bank account, which affect the affordability of savings products for many potential users of these accounts. Assuming that on average an account holder makes four withdrawals per month, he/she has to pay the bank about MK800 (US$6) in fees and charges per month, which is about MK10,000 (US$70) a year. Notwithstanding the one-off costs for purchasing an ATM card or acquiring a withdrawal booklet, or the cost of travel to and from the bank branch, these monthly charges alone would already prevent a significant proportion of the population from having and making use of a bank account.

Even while there is scope for banks to scale back their operations in order to reduce costs (and thereby provide more affordable services), there are limits to how much they can reach down the market given the other dimensions of their cost structure. Making products more affordable will require innovations in the mechanisms used for delivering services to the target group. In environments characterized by poor infrastructure, other ways of delivering services – that make use of technology, such as mobile phone
banking – could prove to be an effective way of reaching clients in more remote locations. In Malawi, many financial service providers eagerly look forward to developments taking shape in mobile phone banking, with the expectation that this will lead to reduced transaction costs, and consequently, more affordable products that will allow institutions to reach a broader client base.

That said, it is difficult for some banks in Malawi to find the right set of incentives to more strongly position themselves in the ‘microfinance market’. Banks that are interested in the microfinance market are concerned about charging higher interest rates/fees and what the implications might be on their reputations. For now, banks are pursuing further developments in delivery mechanisms that are based on technological applications, which would allow institutions to serve a broader clientele with reduced overheads.

It is against this backdrop of the limitations and imperfections in the market that affect suppliers’ transaction costs that the role of other types of financial service providers can also be properly assessed. Institutions like SACCOs and other non-bank entities, which tend to have lower overheads compared to banks, may actually be better placed to serve those unbanked markets that are poor and remotely located. There are, however, other constraints particularly affecting this non-bank group of institutions that need to be considered.

**Capacity constraints** – Smaller and less sophisticated institutions may be less expensive to operate and therefore have the potential to more cost-effectively provide services especially in areas characterized by poverty and lower population densities. Unlike banks, SACCOs and other MFIs, typically do not incur the same level of overheads as banks do. For one, remuneration packages offered by SACCOs and MFIs are well below the banking industry levels. However, it is in this very nature of SACCOs and some non-bank MFIs that the key constraint to operational growth and expansion lies.

While a large majority of SACCOs are operating profitably, most of them are still facing severe challenges in loan recovery. Even the ones that are considered star performers within the sector usually have about 15-20% of their outstanding loans in arrears greater than 30 days, and they report loan recovery rates of only 80-90%. MUSCCO acknowledges that this reflects very weak management and institutional capacity among SACCOs.

Among the other non-bank MFIs the problem of inadequate institutional capacity varies greatly between the different institutions currently operating, as well as between the groups of institutions that are profit and non-profit oriented. But as MAMN observes, the problem of capacity is sector-wide. That many of these institutions are not regulated or supervised, and that there is still much left to be done in standardizing performance monitoring and reporting to existing support institutions, keep many of these institutions from fully developing their institutional capacities.

The problem of inadequate institutional capacity becomes even more pronounced when we consider government-run programmes or microfinance companies. As already pointed out earlier, these providers suffer from having inadequate human resources – whether in terms of having unqualified personnel or inadequate human resources for their programmes. As public entities, these providers are more strongly motivated by purposes other than operating on a sustainable, commercial basis.

**The role of the public sector** – To facilitate greater financial inclusion, there are government policies and interventions that are indispensable to the long-term sustainable broadening and deepening of financial systems. This includes putting in place relevant legislation and other rules that ensure an orderly market consisting of various financial
service providers and other relevant institutions. Considerable progress has been made in drafting new pieces of legislation and amendments to existing laws. Many stakeholders in the financial sector eagerly anticipate the finalization and enactment of these laws, as their absence has constrained investment and innovation. At the moment, the lack of legal clarity keeps some institutions from establishing partnerships with other financial service providers, and also places certain institutions wishing to transform into higher tiers at a standstill.

It is also important to emphasize that a high degree of uncertainty in some policy areas has affected the functioning of the financial market in Malawi, and has constrained economic growth. This uncertainty especially affects the agricultural sector, which is the backbone of the economy. The uncertain conditions create disincentives for bank lending to the private sector, create unnecessary frictions in the agricultural value chain, and ultimately make it more difficult for smallholder farmers and other market players to generate adequate margins. There are certain dimensions of this uncertainty that fall outside of what the government can control – such as, for example, weather patterns. Nevertheless, there are sectoral policies and programmes that can support efforts of farmers to increase their production and profitability, and help to reduce transaction costs in rural financial intermediation. These include: (a) the development of public infrastructure like roads; (b) strategies and policies to encourage better linkages at different stages of the production and marketing cycle between farmers, input suppliers, traders with crop storage facilities, etc.; and (c) land reform that could allow smallholder farmers to have access to title deeds that could be used as collateral.

It will also be helpful for the GoM to consider the impact of inadvertent uncertainties created by policy interventions in the agricultural sector. These include restrictions on imports and exports, setting minimum prices above fluctuating world market prices, and restrictions on who can trade in particular crops (e.g. maize). While the policies may have laudable social and economic goals, they may inadvertently undermine private sector engagement and investment in agriculture and increase the risk of not making a sufficient return. This in turn affects the financial sector’s willingness to lend in agriculture and to agribusinesses, as it adds to the weather, pest/disease and commodity price risks already being faced by the sector.

Beyond the public sector’s role in creating an enabling environment through policies and legislation that facilitate a smoother interaction between users and providers of financial services, it is important to consider as well the role that the public sector plays through its ownership of financial institutions and direct intervention in credit markets. The public sector plays a significant role in the supply of microfinance services, given the existence of a number of government-led programmes and publicly-owned organisations.

Many financial institutions noted that public institutions and programmes providing loans to the public (often at below market interest rates) have had a distorting effect on financial markets. Their experience is that in areas served by public entities, the culture of borrowing tends to be distorted and people are less disciplined to honour their loan obligations. As has already been pointed out in previous studies on Malawi’s financial sector, debt forgiveness by government institutions, as well as the use of subsidies when granting loans, result in poor borrower behaviour. It will be crucial for the government to seriously consider the impact of its own programmes and institutions on overall market development and what it can do to stimulate a financially inclusive sector in the long term.

• **Market coordination** – There is a need for greater coordination among the different players involved, and for harmonization between public and private initiatives that seeks to promote better access to financial services. Careful coordination of various
interventions and their sequencing is important to ensure overall market development. Market coordination is also needed to ensure improved levels of efficiency, allowing information on lessons learned to be shared among a broader set of market participants. Coordination also allows different groups of institutions to take advantage of each other’s strengths in addressing the needs of the unbanked population. Dialogue across sectors helps to generate coordinated policies and programmes that complement each other to meet the specific objectives set out for financial sector development.

The need for enhanced market coordination will rest on having strong support institutions that can support dialogue among stakeholders across sectors to meet the challenges of the financial services industry as it evolves.

8. Response to financial access barriers

A range of measures is needed to effectively address barriers to financial access. These include interventions that (a) help to create greater confidence in the market, (b) provide the incentives for financial institutions to expand into unbanked markets, (c) allow for innovations in product development and testing of new methodologies for delivering services to various target groups, and (d) strengthen capacity of users to undertake savings and debt obligations.

Important initiatives have been introduced by various market players to promote greater financial inclusion in Malawi. This includes activities that fall within the scope of:

- Modernising of the payments system;
- Facilitating and supporting a range of suppliers;
- Improving access through innovative products and better delivery mechanisms; and
- Establishing market linkages and partnerships between various institutions.

The key recommendations to support the development of an inclusive financial system that serves a wide range of market segments including the poor, vulnerable and unbanked populations are summarized as follows.

(a) Address regulatory uncertainty and expedite the approval of relevant legislation – Market participants eagerly anticipate the enactment of the proposed laws as these are expected to provide the needed clarity on the types of institutions and the range of services to be permitted, as well as to encourage greater discipline via the regulation and supervision of non-bank activities, and to allow the entry of new players in the microfinance market.

(b) Progressive withdrawal of the public sector from direct provision of financial services – As has already been echoed in previous financial sector assessments, public entities providing micro-credit almost always distort the market, making it more difficult for other financial institutions to enforce credit discipline and recover the costs of providing small-scale services. It is crucial for the government to consider the impact of its programmes on overall market development and specifically their effect on those financial institutions that are needed in order to create a financially inclusive sector in the long term. It will be helpful to consider the role of government funds and subsidies in assisting early phases of institutional development and the promotion of innovation or testing of new products especially in financial markets characterized by high risk, rather than utilizing these funds in direct provision of financial services that can distort financial markets and create an unlevel playing field.

(c) Continue to build the capacity of financial service providers – Reaching unbanked markets will require the development of financial institutions that are able to offer appropriate
services, and at scale. There have been a number of important achievements in the financial sector in recent years, but capacity constraints are still pronounced. Key capacity building needs include the development of management information systems (MIS) to support financial management especially for institutions like SACCOs and other MFIs; developing institutional capacity for better loan portfolio management; and product development especially in the area of rural/agricultural finance.

(d) Build the capacity of support institutions – Institutions such as MAMN and MUSCCO, as well as the Bankers Association of Malawi (BAM) and the IAM support dialogue among key stakeholders on relevant issues, but also play important roles in addressing capacity constraints at all levels and promoting greater transparency within the sector.

(e) Encourage better performance monitoring and disclosure - While not all institutions providing microfinance services will be under prudential regulation, the development of industry benchmarks for measuring institutional performance is an important step to help professionalize the industry and encourage institutions to operate according to certain standards. In some countries, reporting and other non-prudential disclosure requirements are delegated to an agency other than the regulator or to support institutions. These agencies or support institutions then work together with the regulator. The information that is built within the system thereby allows the regulator to make better judgments regarding applications that are made for bank licensing or transformation into other tiers of regulated financial institutions. The key step, however, will be for the sector to agree on a set of performance indicators that can be tracked over time. Both the reporting institutions as well as those organizations or agencies that they report to will need to be trained on how to measure performance and make use of the information that is collected.

(f) Support the development of new products and delivery mechanisms that respond to the needs of the unbanked market – The microfinance industry is still dominated by loan products designed for traditional borrowers, such as salaried individuals and those engaged in non-agricultural activities. Low-income and especially rural-based households, however, seek a range of financial services that include savings to build assets and manage seasonal cash flow, payment and money transfer services, and insurance services that allow them to manage risk (especially medical and funeral insurance). It is important to consider the specific challenges present in the rural/agricultural environment, which require financial services to be combined with instruments that allow institutions to mitigate risk and to include a range of specialized suppliers. Developing new products that work for the target market will need to be built around reliable and up-to-date market (demand) information. The innovations that have been recently tested and proven effective in Malawi serve as a very crucial starting point for developing more market-driven products. In some cases, given the high risks associated with certain market segments (e.g. the rural/agricultural sector), product innovations in these sectors may warrant the use of or participation of government or donor funds.

(g) Enhance market coordination – Enhanced coordination within the financial sector encompasses the need for (a) a greater degree of harmonization between financial access initiatives of the public and private sectors; (b) sharing of information on lessons learned by a broader set of market participants; (c) allowing cooperation and the formation of partnerships between different groups of institutions to take advantage of each other’s strengths in addressing the needs of the unbanked population; and (d) dialogue across sectors to help generate coordinated policies and programmes that complement each other.

In parallel with the analysis of the supply of financial services, there was an analysis of the political economy of reform in Malawi, with a view to offering suggestions on ensuring that
the policy making process in this area is as effective as possible. The key suggestion arising from this work was the creation of financial roundtables to help build a more stable financial sector and facilitate the reform process. Formed by a relatively small number of members (between five and ten) representing public and private agents as well as relevant development partners, financial roundtables create new opportunities for a heightened level of dialogue, which is central to improved market co-ordination. The roundtables are built following a pyramid structure, with representatives of one particular sector being elected by its own members.

Other suggestions arising from the analysis included:

- The importance of addressing issues related to the capacity and needs of the new regulator at a very early stage;
- The need to ensure tripartite dialogue between government, financial institutions and civil society to smooth regulatory changes;
- The equal need for support coalitions at the inter- and intra-Ministry level to ensure a cost-effective and efficient process for the implementation of the reforms;
- The potential role of an independent financial deepening challenge fund to support innovation in the sector.

Appropriate sequencing of reforms and interventions is crucial to the success of a financial sector reform programme. The correct sequencing of reform can be difficult to get exactly right, particularly in relation to regulation and supervision. Most new markets require regulations and even laws to be revisited and revised as the market develops. A flexible approach is often useful, introducing relatively lightweight supervision when a market begins to develop, keeping a close eye on developments, and introducing tighter regulation as the market matures.

There is also a need for co-ordination of the reform programmes for the various sub-sectors where they are linked, for example, where banks are to provide services for SACCOS through linkage banking schemes, or where weather insurance is to be linked with new input financing products. Some countries seek to ensure this co-ordination through the development of a comprehensive, sector-wide Financial Sector Development Plan (FSDP), and experience in other countries shows that it is crucial to pay attention to the interconnection of reforms to ensure the appropriate sequencing and prioritization. Indeed, in some countries, so much time is spent in developing and agreeing the FSDP that the momentum of reform can actually be significantly undermined by the FSDP process.

In the case of Malawi, discussion of the appropriate sequencing of the initiatives and proposed reforms outlined above will need to be a major element in the wider process leading to the development of the financial sector development strategy.
1 Introduction

The Government of Malawi (GoM) recognizes that a more inclusive financial system is critical to the development of the country’s economy. Reforms have been undertaken in Malawi’s financial sector in the past decade; and more recently, innovations have been implemented by various market players in an effort to expand the reach of financial services. Despite these developments, however, a significant proportion of the country’s population still continue to face severe constraints in accessing financial services – including savings, credit, insurance, and payment services.

The Terms of Reference (TORs) for this study on the supply of financial services in Malawi are at Annex A. The study seeks to identify possible barriers to financial inclusion and to provide recommendations based on an analysis of Malawi’s microfinance sector from the side of both supply and demand. On the demand side, the study draws from the results of the 2008 FinScope Malawi. The supply side analysis, on the other hand, draws from data and information gathered from various financial sector providers currently operating in Malawi.

The National Forum on Microfinance in Malawi has proposed the development of a National Strategy and Action Plan for Financial Inclusion in the country. The key issues discussed in this study will be useful in the ensuing consultation process to support the development of the proposed strategy and action plan. The key findings of the study will help to define key goals and objectives, required strategies, and necessary actions for achieving the core objective of financial inclusion.

1.1 Objectives of the study

As specified in the TORs for this assignment, the intent behind the supply side study is to consider the state of supply of, and demand for, financial services in Malawi from the perspective of access, or financial inclusion. This supply side study therefore builds upon the FinScope Malawi demand side study, which provided useful information on who has access to finance in the country. This supply-side study, therefore, seeks to contribute to an enhanced understanding of Malawi’s landscape of financial access, highlighting the key issues that need to be addressed in order to expand and improve on current levels of financial access.

As has been set out in the TORs, the study:

- provides a comprehensive analysis of Malawi’s microfinance sector;
- identifies the key issues for further debate in the ensuing consultation process leading to the development of the National Strategy and Action Plan for Financial Inclusion; and
- makes recommendations as to how financial inclusion in Malawi can be enhanced.

This report provides a comprehensive analysis of the landscape of financial access – by first discussing the characteristic strengths and weaknesses of various groups of financial service providers, as well as of the environment within which various financial institutions provide their services. While the scope is relatively broad – especially considering the diversity in terms of financial service providers in Malawi and the complex issues that affect the financial services environment at the meso and macro levels – the aim of the study is to draw out the essence of the issues that confront different kinds of financial institutions in their provision of more accessible financial services.
1.2 Method of collecting information

The analysis contained in this report draws from information collected from primary as well as secondary data sources.

- **Primary data sources** – Following an inception visit in June 2009, interviews were carried out of key informants representing various stakeholder groups, as well as of the individual financial service providers. The interviews were guided by a set of quantitative and qualitative questions. Apart from collecting aggregate information on the institutions (i.e. on the entire branch network) to assess their overall performance, questions have also been drafted to provide an institutional profile and cover the various dimensions of measuring performance in terms of operational scale, depth of outreach, financial structure, portfolio quality, profitability, etc. More qualitative information have also been gathered on the kinds of products and services currently being offered (and the terms and conditions attached to them), their mechanisms for client-targeting, borrower appraisal, etc., and the particular issues that confront the different suppliers of financial services.

It is important to note that, except for the banks, the data collected from institutions is self-reported information that may or may not have been audited by an outside agency and was not verified by the team conducting the interview, given overall time constraints in carrying out the survey. Most of the institutions interviewed have been cooperative in replying to requests for information, but many of them do not have the systems or procedures in place to collect all of the necessary information. Nevertheless, the information collected has allowed us to conduct a financial and institutional analysis, and more importantly, provide a clear identification of the key issues, as well as the strengths and weaknesses of various institutions, whether individually or as a peer group. It is also important to mention here that many financial institutions have expressed their concern regarding the confidentiality of the information they have shared in the survey – especially with regard to future plans of individual financial institutions. In such cases, we have therefore practiced discretion in bringing out delicate information in the report, without prejudice to the integrity and overall intent of the study.

- **Secondary data sources** – Alongside the information collected from various financial service providers, the methodology of the study also included a review of literature and available documentation – which includes studies, reports and other relevant references on the financial services market in Malawi. This covers reports on the macroeconomic environment and developments taking place in certain sectors (e.g. agriculture); progress reports of certain financial sector initiatives (e.g. annual reports published by the Deepening Malawi’s Microfinance Sector Project (DMS)); and reports prepared by support institutions such as the Malawi Microfinance Network (MAMN) and Malawi Union of Savings and Credit Co-operatives (MUSCCO), and those of the Reserve Bank of Malawi (RBM).

These secondary data sources are important not only in terms of filling gaps in the information collected from the individual financial institutions themselves (e.g. through aggregate data collected by support institutions); but more so, because secondary data sources help to provide the background (e.g. through historical information and analyses undertaken by other researchers in the past) and the context for undertaking a

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2 A list of institutions covered in the survey is provided in Annex B.2.

3 A copy of the questionnaires used has been presented to the Ministry of Finance and relevant stakeholders, and is also set out in Annex B of this report.
A comprehensive analysis of Malawi's microfinance sector requires looking at a broad range of topics and issues that encompass the macro, meso and micro levels of the financial sector landscape. Consistent with what was proposed in the TORs for this assignment, the discussion and analysis contained in this report covers the following:

- **An overview of the Malawian economy** – providing a summary of the macro-economic context within which financial services are being provided and highlighting significant economic factors impacting on access and usage.

- **Analysis of Malawi’s financial sector** - documenting the characteristics of different providers of financial services, the kinds of products and services they offer, and identifying product and institution-based barriers to financial access. The different groups of financial service providers include banks, insurance companies, a range of non-bank financial institutions (NBFIs) (including commercial moneylenders, the NGO microfinance sector, financial cooperatives (or SACCOs), government initiatives or public sector entities, and providers of agricultural finance), and informal sources of finance such as village-based savings and loans associations (VSLAs) and katapila operators. The analysis includes a critical assessment of how microfinance services are supplied in the country, and particularly, the level of sustainability and the prospects of supplying financial services in the long term.

- **Cross-comparison of supply-side data with FinScope demand-side findings** – highlighting the extent to which the supply side infrastructure, from formal all the way to informal service provision, is able respond to the demand for financial services in the country.

- **Assessment of the legislative and regulatory environment** – providing an overview of relevant legislation (existing and proposed) and the structure of supervision, and highlighting the legal and regulatory barriers imped ing the supply of, and access to, financial services.

- **Identification of the barriers to financial access** – with the view to understand the extent to which these barriers may be negatively impacting on financial access, as well as providing recommendations on how these financial access barriers may be overcome.

- **Documentation of initiatives to promote access** – including those by private and public sector stakeholders that aim to promote financial access, particularly for the lower-income population. In order to develop recommendations that may be considered during the consultation process, we consider it important to identify what resources are indeed most needed – in terms of enhancing the capacity both of providers themselves and of the meso-level and macro-level institutions that will need to support the process. In this respect, the documentation of current and on-going initiatives is aimed at identifying the gaps where further work may be needed either in support of the already existing initiatives or to address specific issues that have not been previously considered in the list of priorities.

### 1.4 Structure of the report

This report is organized as follows:
The following chapter, Chapter 2, provides a brief overview of the Malawian economy, including a summary of the macroeconomic context within which financial services are being provided. Significant economic factors that affect the access to and usage of financial services are described, including national and sectoral growth trends, as well as other risk factors related to the structure of the economy and the market for financial services.

In Chapter 3, the microfinance landscape is described, with an overview of the different groups of financial service providers and an identification of their comparative strengths and weaknesses. The chapter also includes a discussion of the policy, legal and regulatory framework that governs the provision of financial services in the country, as well as the infrastructure supporting the delivery of financial services.

This is followed, in Chapter 4, by an analysis of demand side data and their implications for the supply of financial services. The analysis draws from the results of the recent FinScope study, and seeks to characterize the banked and unbanked in the country, as a prelude to highlighting the key demand-side variables that are considered critical to the development of the supply of financial services.

Chapter 5 identifies the barriers to financial access from a supply angle, drawing from the findings highlighted in the previous chapters.

This is then followed in Chapter 6 by a discussion of what is needed in order to respond to these financial access barriers. The key initiatives and innovations already introduced to promote improved access to financial services in Malawi are also presented in this chapter. The chapter ends with a discussion of what is needed in order to better sequence the proposed reforms.

Finally, Chapter 7 provides a summary of the key issues and findings.
2 Overview of the economy

Overview
Malawi is among the world's most densely populated and least developed countries, ranked 160th out of 182 countries in the 2009 United Nations Human Development Index (HDI). However, Malawi's macroeconomic performance has been buoyant in recent years; the economy realized growth rates of 9.7% in 2008 and 8.7% in 2007. According to the International Monetary Fund (IMF), GDP is expected to grow by 6.9% in 2009 to US$6.9 billion or the equivalent of US$456 per capita.4

Although the economy has been affected by the global financial crisis, the impact has so far been limited. There are early indications that, given the limited exposure of Malawi’s financial sector to sophisticated foreign financial instruments, the global financial crisis will have hardly any direct impact on the country’s financial system.5 However, it will be important to take into account that Malawi has a highly concentrated export basket (consisting of tea, sugar and tobacco exports) and that the country exports to markets that are undergoing contraction (such as the European Union, South Africa and the USA). This has already been seen with lower world prices for tobacco and cotton, as many commodity prices have peaked and fallen in recent months, though these losses are to some extent offset by higher world prices for sugar and tea.6 Thus, while the global economic downturn has had limited negative impact so far, ‘second round effects’ are expected to materialize in reduced demand for Malawi’s exports and lower prices for the country’s export commodities.7

Malawi’s economy remains predominately agrarian, with 88% of the population living in rural areas, according to the 2008 Census. The agricultural sector is the backbone of the Malawian economy: it supports a large majority of the population in terms of livelihood. As of the end of 2008, agriculture contributed about one-third of the country’s GDP and accounted for 90% of the country’s export earnings.8

Other economic sectors such as commerce, distribution and manufacturing are mostly related to the handling and processing of agricultural inputs and outputs. In Malawi, large-scale manufacturing enterprises that are not linked to agriculture remain very few, and the country depends heavily on imported industrial inputs, consumer and capital goods.

Drivers of growth
The economy grew by 4.4% in 2003 and 5.1% in 2004. The following year, 2005, saw a fall in the country’s growth trend, with a growth rate of only 2.1%. The decline in economic activity in 2005 was caused by the drought that hit the country during the main growing season (November to March). However, the following years saw a rise in the country’s growth performance, with growth rates of 8.5% and 8.7% in 2006 and 2007, respectively.

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4 Purchasing power parity (www.imf.org).
6 The rise in tea prices is attributable to the drought experienced in Kenya. World sugar prices, on the other hand, are driven by demand for sugar to produce ethanol.
7 The global economic crisis may also affect the level of remittances, as is being demonstrated in other countries, although the 2008 FinScope Malawi survey revealed that the level of remittances in Malawi is relatively low.
8 Government of Malawi: Ministry of Economic Planning and Development (MEPD).
This strong performance was spearheaded by the agricultural sector – which benefited from having a year of ample rainfall, coupled with the government’s fertilizer subsidy programme. The country’s growth performance in 2008 remained strong at 9.7% and Malawi is projected to continue to grow strongly in 2009.

The agriculture sector is a key driver of growth. As noted earlier, agriculture is an important contributor to the country’s productivity and a highly significant source of export revenues. In recent years the government’s input subsidy programme, combined with ample rains across the country, has resulted in generally good harvests. The government forecasts the sector to grow by 8.5% in 2009. Tobacco remains the single largest source of foreign exchange inflows and typically represents 40-60% of Malawi’s exports, with prices impacting considerably on the actual share, highlighting considerable volatility. The government continues to prioritise agriculture as the cornerstone of its development policy; over 14% of the national budget is currently allocated to the sector (with significant allocations going to the input subsidy programme).

The mining and service sectors will be highly influential in shaping the economic environment in Malawi in the future. The Kayelekera uranium mine, which opened this year, was expected to increase exports by an estimated 25% at its peak production\(^{10}\), though the observed trend in weaker uranium prices suggests this may now be lower. The mining sector is projected to grow by 9.3% in 2009.

Finally, the information and communications sector has been driven by large-scale promotion campaigns by mobile phone operators that have been growing their subscriber base and have seen buoyant phone and airtime sales. The sector is expected to grow by 18.9% and to contribute 3.4% to overall output in 2009.

Box 2.1 Vulnerable groups in Malawi

There are four main groups identified as among the most vulnerable in Malawi. These include rural households with small land holdings, female-headed households, AIDS orphans and their relatives, and those who are not able to care for themselves (World Bank, 2001). These households and individuals lack adequate income to meet basic needs; are not able to have sufficient food, adequate shelter and clothing; and are relatively more isolated from economic activity due to problematic access to services, facilities and infrastructure. The 2005 Integrated Household Survey estimated that in that year, 52.4% of households lived below the official poverty line (MK16,165 per person per year) and 22% of the population were in extreme poverty (below MK10,029 per person per year).

It is important to note that HIV/AIDS is the leading cause of death among adults in Malawi. An estimated 15% of the sexually active adult population is HIV positive (as of 2005).\(^9\) Apart from the serious implications of this disease on the structure of families and communities, it has a strong negative effect on the economy as a whole – affecting enterprises and institutions that need a strong and healthy workforce to help boost productivity and to push the country’s development agenda forward. This is relevant to the discussion on financial inclusion, as HIV/AIDS has implications for the perceptions of risk in financial markets – especially when dealing with individuals and households who are already considered poor and vulnerable. Being affected with HIV/AIDS could mean that already very low incomes become all the more strained, making the prospect of building savings and other assets too difficult or even impossible for many.

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\(^{10}\) This is according to the 2007 Debt Sustainability Analysis of the IMF.
The monetary environment, prices and the currency

The foreign exchange market in Malawi is characterized by a high degree of seasonality. Foreign exchange inflow is subdued during the lean period (i.e. during the first and fourth quarters of the calendar year), but stronger in the second and third quarters during the main crop export season. The policy of the RBM is to intervene to smooth out seasonal fluctuations. All the commercial banks with Authorized Dealer Bank (ADB) status are permitted to transact in foreign exchange with the public.

The financial and insurance services sectors are expected to see 11% growth in 2009 and to contribute 6.4% to GDP. Interest rates have remained steady over the last 12 months, with the RBM's bank rate at 15%, prime-lending rates at 19-20% and the savings rate at 3-6%. The minimum inter-bank rate rose from 2% to 12% between September 2008 and June 2009, whilst the maximum inter-bank rate moved from 11% to 14.95% over the same period. 90-day treasury bill (T-Bill) yields declined from 13.3% to 11.0% in the same period. The minimum rate on mortgages remains fixed by the RBM at 19%.

Although inflation increased in 2008 due to increased fuel and food prices, it remained in single figures. Year-on-year headline inflation averaged 9.7% in the first quarter of 2009 and has fallen further in the second quarter. Food and non-food inflation averaged 8.6% and 11.2%, respectively. This non-food inflation rate is slightly lower than that in the previous quarter, a reflection of the downward adjustment in domestic fuel prices, which was initiated in February 2009. The IMF forecasts full year headline inflation to be 10.1% in 2009. These rates of inflation are dramatically lower than those experienced a decade ago when prices rose by up to 45% per annum.

The Malawi Kwacha (MK) is effectively pegged to the US dollar in the range of MK139-142, with the official policy of maintaining the MK value against the US dollar, ostensibly in a managed float, but more like a fixed peg in practice; a rate of MK141 per US dollar is taken for the purposes of this report. Having weakened to MK300 against the British Pound (GBP) and MK20.5 to the Rand (ZAR) in mid 2007, the MK subsequently appreciated considerably in the third and forth quarters of 2008, reaching levels of approximately MK210 per GBP and MK14 per Rand. The first half of this year, however, saw the MK depreciate back to its mid 2008 levels (~ MK240/GBP and MK17/ZAR).

In 2008 Malawi experienced a substantial terms of trade shock, due to high fuel and fertiliser prices, which led to even greater pressures on international reserves and the national budget. The RBM monetary policy committee minutes show that as of mid-July 2009 foreign reserves declined to US$109.9 million or the equivalent of 0.85 months of import cover. The considerable shortage of foreign exchange meant that the RBM needed to prioritize the use of this limited supply to cover fuel, fertiliser and medical imports. There are many indications from the private sector that the shortages in foreign exchange are negatively affecting businesses (in terms of sales and production), with higher costs that are expected to lead into slower growth and higher levels of inflation.

The fiscal environment

In July 2009, the new Parliament passed the Financial Year (FY) 2009/10 National Budget. The budget has grown from MK205 billion in 2008/09 to MK244 billion (or 32% of GDP) in 2009/10. The government expects the budget deficit to decrease from 3.3% of GDP in 2008/09 to 1.6% in 2009/10. Tax revenues have grown considerably in recent years and now represent 57% of the 2009/10 budget, reducing but not completely eliminating dependence

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11 The recommended level of import cover is three months.
on donor funds. A number of factors contributed to this increased revenue, including better revenue collection efforts, broadening of the tax base and the introduction of incentives to encourage compliance. Considerable tax reform has taken place, which has been generally viewed as positive for investment and revenue collections. However, the country remains heavily dependent on foreign aid; grants are expected to represent 33% of the 2009/10 budget. With regard to Malawi’s debt stock, the ratio of the net present value of debt to GDP is currently 15.7%, comfortably below the World Bank recommended threshold of 40%. This indicates a favourable public external debt situation, resulting from debt forgiveness under the HIPC initiative. That said, the budget's main fiscal anchor is domestic debt repayment – which is currently 1% of GDP – aimed to compensate for over-spending in 2008-09.

The key implications of these developments in the broader macroeconomic environment on financial access may be summarized as follows:

- The relatively buoyant growth of the economy is expected to continue presenting opportunities for the financial sector to expand its client base. However, the country’s dependence on agriculture – as a sector that is vulnerable to weather and other exogenous variables – means that businesses and financial institutions will need to seek ways of mitigating risks associated with the emerging opportunities.

- Uncertainty over the supply of foreign exchange has a negative impact on financial service suppliers as well as local businesses. While the reduced opportunity to generate profits from foreign exchange services may help push some banks to seek other avenues for generating revenue, overall, this uncertainty in the market is affecting the way businesses and transactions are carried out. There are indications that it is leading to higher costs of doing business in the country.

- In recent years, the declining and relatively low real T-Bill rates have forced financial institutions to look for better use of their excess liquidity. There are indications that this is helping to fuel product innovation and a heightened interest to explore non-traditional client opportunities by the banks.

- Subdued inflation has seen reductions in savings rates, which are mostly negative in real terms; any notable reduction in lending rates to businesses and consumers has been limited by high spreads (circa 16%). The prospects are that interest rates will remain stable and that increased competition will progressively put pressure on bank spreads. However, the cost of doing business and recovering debts suggests that interest rate spreads and prime rates will still remain relatively high.

- The global financial crisis has made it more difficult for banks and borrowers to access lines of credit from non-domestic sources and to borrow the needed foreign currency. Moreover, the uncertainty in the supply of foreign exchange has also made this a more risky option for many financial institutions.
3 The supply-side: the microfinance landscape

3.1 Supply of financial services

In this section, we provide an overview of the financial services landscape in Malawi, paying special attention to financial institutions that are currently providing microfinance services, or that have the potential or the intention to provide microfinance services in Malawi.\(^\text{12}\)

As in other countries, financial services in Malawi are provided by a wide range of financial institutions. These comprise:

- banks that are regulated under the Banking Act (1989) and are supervised by the RBM, including one leasing company and two discount houses;
- non-bank microfinance institutions (MFIs) under several legal forms and ownership structures, which cover the range of for-profit and non-profit institutions that include (a) companies with (private) shareholders (e.g. moneylenders), (b) trusts (typically NGOs), (c) companies limited by guarantee, and (d) public entities;
- member-owned or member-based organizations such as financial cooperatives or savings and credit cooperatives (SACCOs); and
- informal financial service providers, including individual moneylenders (e.g. Katapila operators).

Apart from these key providers of financial services, there are also a number of other institutions operating in the country – including foreign exchange bureaus,\(^\text{13}\) insurance companies, one investment company, one investment trust, eight fund/portfolio managers, three securities firms/brokers and one leasing company (which is part of a commercial bank).

The financial sector in Malawi is relatively small compared to other countries in the region with similar characteristics.\(^\text{14}\) The Financial Sector Assessment Programme (FSAP) in 2007 estimated the total assets of the financial system to be roughly US$ 1.5 billion, of which about 60% are in the country’s banking system.

In the following sections, the characteristics of different groups of financial service providers are described, namely: commercial banks, non-bank microfinance institutions, SACCOs, insurance companies and informal providers. In view of the importance of the role played by agricultural buyers, especially in the provision of financial services to smallholder farmers, this section also includes a discussion on the characteristics of this particular category of provider and how they operate in the rural areas.\(^\text{15}\)

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\(^\text{12}\) In this report, ‘microfinance services’ refers to savings, credit and other financial services that are appropriate to and accessible to poor and low-income people. This definition is consistent with that used in the Malawi Microfinance Policy and Action Plan (2002).

\(^\text{13}\) A recent development has been the closure in August 2009 of foreign exchange bureaus that are not part of an authorised dealer bank (ADB).

\(^\text{14}\) The RBM describes the industry as being small, relatively underdeveloped and with excess capacity for new entrants. See Reserve Bank of Malawi (2008): The Malawi Economy and Its Banking System.

\(^\text{15}\) It is important to take note of the fact that although agricultural buyers play an important role in rural finance (in cotton, tea and sugar), these are not considered to be ‘financial service providers’ as this is not their primary service.
3.1.2 The banking sector

Sector performance and operational highlights

There are 11 licensed commercial banks currently operating in Malawi, which provide a range of services including deposit products, credit facilities, foreign exchange services, payment facilities, bancassurance, etc. According to the RBM, the total assets held by the banking system as of March 2009 was estimated at MK181 billion (about US$1.28 billion), of which more than 65% is concentrated in the country’s three largest banks, National Bank of Malawi (NBM), Standard Bank and NBS Bank. According to the RBM, deposits held in the banking system have increased considerably: private sector deposits were estimated to be MK114.4 billion at the end of December 2008, representing a 34% increase from the previous year. Table 3.1 summarizes the performance of the banking sector.

At the end of December 2008, total capital for the entire banking sector amounted to MK18.1 billion. This represented a 48.5% increase from the previous year. Overall, the banking sector has remained well capitalized. Both core capital and total capital ratios increased to 16.2% and 21%, respectively, by the end of 2008, which may suggest that the banking sector is strong enough to withstand the effects of the current global financial crisis.

Loans and advances form a major portion of the asset structure of the banks. In terms of the quality of assets, the total non-performing loans (NPL) of the banking industry was estimated by the RBM at MK2.6 billion in 2008, representing an increase of 44.4% from the previous year. The vast majority of banks interviewed in this study have NPL ratios that fall below the 5% mark, with only one bank registering a high figure of 18%. RBM considers the overall asset quality of the banking system to be satisfactory. The industry wide ratio of NPL to gross loans slightly declined from 3.4% to 3.2%, while the NPL ratio to total assets remained constant at 1.4%.
In terms of profitability, the banking sector collectively recorded a net income estimated at MK8.6 billion in 2008, representing a growth of 41% from the previous year. Banks' income was significantly derived from loans and advances, securities and investments and foreign exchange transactions. Banks still continue to generate margins from investments in government T-Bills and other short-term instruments, though this is generally declining. Nevertheless, this is allowing banks to continue to generate high levels of profitability especially when compared to industry averages in other countries. The return on average assets for the sector stood at 4.8% and return on average equity was estimated at 43.6% at the end of 2008.\footnote{This compares very favourably to the level of profitability of banks operating in other countries in Africa. For example, the return on assets in Zambia is 4.5%, in Tanzania 2.9%, and in Uganda 3.9%; while the return on equity is 50% in Zambia, 25% in Tanzania, and 26% in Uganda. A return on equity of more than 40% is staggeringly high especially when compared to observed trends in developed economies, where the ROE is roughly 15% on average.}

Although banks admit to facing competitive pressures within the sector and against other types of financial service providers, this level of bank profitability also indicates that there is less pressure (and a lower likelihood) for commercial banks to diversify their client base and develop new markets for their financial services, such as, agricultural finance. Interestingly, recent developments in the agricultural sector related to the disruption in tobacco and cotton sales have led to delays in loan recovery for those banks engaged in agricultural lending. A number of lenders have expressed their intention to steadily reduce their exposure to agricultural lending given weak repayment of agricultural loans, particularly by tobacco and cotton farmers. This is unfortunate considering that several banks have begun to expand their agricultural lending after generally avoiding this sector, following periodic entry and losses in the past.

Table 3.1 Malawi banking sector performance

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Minimum regulatory requirement</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital Ratios</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Core</td>
<td>6%</td>
<td>25.8</td>
<td>23.0</td>
<td>21.8</td>
<td>17.7</td>
<td>15.5</td>
<td>17.2</td>
</tr>
<tr>
<td>ii Total</td>
<td>10%</td>
<td>32.3</td>
<td>28.0</td>
<td>26.3</td>
<td>21.8</td>
<td>19.6</td>
<td>22.0</td>
</tr>
<tr>
<td><strong>Asset Quality Ratios</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Gross Loans/Total Assets</td>
<td>N/A</td>
<td>2.1</td>
<td>2.3</td>
<td>1.8</td>
<td>2.2</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>(ii) Non performing/Total Loans</td>
<td>8.4</td>
<td>8.0</td>
<td>5.3</td>
<td>5.0</td>
<td>3.4</td>
<td>3.2</td>
<td></td>
</tr>
<tr>
<td><strong>Profitability:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Return on average assets</td>
<td>N/A</td>
<td>5.2</td>
<td>3.6</td>
<td>3.2</td>
<td>4.2</td>
<td>4.9</td>
<td>4.8</td>
</tr>
<tr>
<td>ii Return on average equity</td>
<td>41.0</td>
<td>27.8</td>
<td>25.6</td>
<td>36.0</td>
<td>39.9</td>
<td>43.6</td>
<td></td>
</tr>
<tr>
<td>iii Net Interest Margin</td>
<td>17.3</td>
<td>14.4</td>
<td>13.7</td>
<td>13.7</td>
<td>13.9</td>
<td>12.0</td>
<td></td>
</tr>
<tr>
<td><strong>Liquidity:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquid assets to Deposits and short term liabilities</td>
<td>30%</td>
<td>86.1</td>
<td>75.4</td>
<td>72.8</td>
<td>55.9</td>
<td>56.5</td>
<td>53.6</td>
</tr>
<tr>
<td>Loans to Deposit ratio</td>
<td>N/A</td>
<td>36.8</td>
<td>40.1</td>
<td>42.6</td>
<td>62.0</td>
<td>59.5</td>
<td>62.1</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of Malawi.

May 2010
Table 3.2  Banking sector: sources and uses of funds

<table>
<thead>
<tr>
<th></th>
<th>Dec 2008</th>
<th>March 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sources of funds (commercial banks)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private sector deposits</td>
<td>112,128</td>
<td>115,161</td>
</tr>
<tr>
<td>Public sector deposits</td>
<td>4,962</td>
<td>5,141</td>
</tr>
<tr>
<td>Liabilities to non-residents</td>
<td>4,168</td>
<td>4,294</td>
</tr>
<tr>
<td>Capital accounts</td>
<td>25,232</td>
<td>28,133</td>
</tr>
<tr>
<td>All other liabilities (incl. interbank accounts)</td>
<td>18,245</td>
<td>18,510</td>
</tr>
<tr>
<td><strong>Sources of funds (other financial institutions)</strong></td>
<td>14,486</td>
<td>18,662</td>
</tr>
<tr>
<td>Domestic currency deposits</td>
<td>9,849</td>
<td>14,362</td>
</tr>
<tr>
<td>Foreign liabilities</td>
<td>56</td>
<td>156</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>4,581</td>
<td>4,144</td>
</tr>
<tr>
<td><strong>Total domestic deposits (banks and other financial institutions)</strong></td>
<td>126,939</td>
<td>134,664</td>
</tr>
<tr>
<td>Domestic deposits as % of total sources of funds</td>
<td>71%</td>
<td>71%</td>
</tr>
</tbody>
</table>

**Uses of funds (banks and other financial institutions)**

|                              |          |            |
| Domestic credit to the private sector | 75,683   | 82,281     |
| Credit to the public sector | 31,362   | 34,077     |
| Credit to statutory bodies    | 4,086    | 4,096      |
| Deposits with RBM, plus currency in banks | 11,149   | 18,373     |
| Foreign sector claims on non-residents | 8,157    | 8,876      |
| All other assets              | 48,416   | 41,896     |

Source: Reserve Bank of Malawi

Note: Other financial institutions include NBS Bank, National Finance Company, Leasing and Finance Company of Malawi, Malawi Savings Bank, Opportunity International Bank, Indebank and Nedbank. This separation between ‘commercial banks’ and ‘other financial institutions’ was made by the RBM in their report.

**Accessibility of services and products offered**

Banks operate a range of branches and outlets – which include full-service branches, sub-branches or kiosks, agencies and automated teller machines (ATMs). In the past three years, two banks have also introduced mobile vans that make visits to towns and trading centres to conduct transactions without having to establish a branch or other permanent outlet. Considering the geography and population density of Malawi, bank branches are reasonably spread across the country’s various districts. But bank branch operations still tend to focus mainly on cities and towns, with very limited outreach to the rural areas. This is usually referred to as a ‘mobile bank’ or ‘bank-on-wheels’.

Further analysis of the distribution of access points and population density is provided in the following chapter, Chapter 4, of this report.

Rural areas are officially defined as those that are outside the confines of a city (that has an urban municipal status), and may, therefore, in certain cases, be used interchangeably to refer to some peri-urban areas. For the purposes of this study, we refer to ‘rural areas’ as those outside or beyond secondary trading centres and may therefore, include areas that are peri-urban by other definitions.
mobile banks are in most cases restricted to operating in secondary (trading) centres, on tarmac roads and where there is a police station.

This tendency for banks to focus on urban areas and larger, more accessible trading centres is consistent with their overall target market orientation. Of the nine banks interviewed in this study, only NBS Bank (NBS) and Opportunity International Bank Malawi (OIBM) have made it explicit that they target both low-income individuals and micro, small and medium enterprises (MSMEs). Previous studies suggest that Malawi Savings Bank (MSB) also targets lower income individuals, and has also begun to take more interest in business lending. It is, however, important to note that even these banks generally target clients who have an established economic activity – i.e. those in urban and trading centres and who maintain business premises. One bank stated that it has shifted its strategy to be “slowly moving out of micro and now exploring the SME market”.

OIBM has been strongly focused on the low-income client segment from the time of its inception, as this is central to its mission. According to OIBM, the recent growth in its client numbers has been fuelled by the opening of new branches in the Southern and Northern regions beyond its Central region base, and extending its services via its bank-on-wheels – allowing the bank to reach out beyond the main centres to relatively unbanked locations. Reaching further out to the rural areas remains a key priority for OIBM. Apart from these two banks, First Merchant Bank (FMB), whose primary target market consists of corporations and individuals with high net worth, has also recently expressed an interest to increasingly target lower-income retail clients, including the rural population.

Due to the search for new markets, increased competition in the main urban and primary locations, more banks have been establishing a presence through branches, agencies, point of sale (POS) terminals and banks-on-wheels in areas that were previously of little interest to most commercial banks. While progress is slow, this phenomenon seems to result from the way early entrants (such as NBS and OIBM) have demonstrated that they can generate enough business in areas that are generally poor and considered to be of low potential. Interestingly, the experience confirms that people in rural areas do save when given the opportunity. This highlights the potential strategic importance of rural branches to act as net sources of funds for on-lending by urban-based branches or outlets.

Beyond the issue of location and the accessibility of bank branch operations, banks face other challenges to extending services that meet the needs of low-income households, especially those based in rural markets. Many banks still continue to offer products that are not designed for the needs of low-income households. Although balances for many card-based savings accounts start at a minimum of MK1,000 (US$7), and a few at MK500 ($3.50), there are significant costs associated with opening and keeping a bank account that preclude low-income individuals from holding an account.

In an effort to overcome this constraint, some banks provide services to groups of clients, which enable them to spread the costs across a wider pool of individuals. This includes

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20 MSB has not submitted a response to our questionnaires and has therefore not been included in the survey. The information on MSB presented in this study is based on publicly available resources.

21 This relates to banks’ cost structures and the implications that labour-intensive microfinance operations have on the pricing of products and services offered by banks. This issue is discussed in greater detail in Chapter 5.

22 The costs of opening and maintaining an account are discussed in greater detail in Chapter 5 (under section 5.2).
providing bank accounts to farmer clubs and/or associations, which are linked to the financing of inputs. Interestingly, farmer clubs have no formal legal status and would not be capable of being sued in the event of default, but banks have found workable mechanisms that enable them to enforce agreements, such as through joint and several liability arrangements for the individual members.

On the other hand, despite the relatively high costs associated with the provision of small-scale financial services, a number of banks still demonstrate their interest in expanding into the low-income market segment by offering products that are micro in scale. For example, FMB and NBS offer card-based accounts that start at a minimum balance of MK500 (US$3.50).

Banks are also showing significant interest in the use of technologies that enable them to offer more user-friendly services across a broader client base. There is great expectation among many providers that technology-driven products will bring down transaction costs and enable them to service a larger volume of clients, including low-income individuals. These technology-driven products and services – which include smart cards, ATMs, cell phone and internet banking and point-of-sale (POS) devices – have the potential to improve accessibility and provide greater ease in carrying out financial transactions for both providers and users of the service. For example, several banks have card based products that target tobacco farmers. These enable the farmers to access information regarding their proceeds at the tobacco auction floors and provide farmers with the safest means of getting payment, as they can cash their proceeds at the centre nearest to their home, rather than at the urban auction floors and risk losses along the way. Cards are also being used not just as a means of securing payment but also for farmers to keep their surpluses and even as an identity document.

3.1.3 Non-bank microfinance institutions

The financial sector includes a range of financial institutions that are not (currently) supervised by the RBM. These institutions primarily provide various forms of credit, with emphasis on services provided to people who are not generally served by the banking sector. This group includes quite a wide range of providers, such as (a) companies with (private) shareholders (e.g. payroll moneylenders), (b) trusts (NGOs), (c) companies limited by guarantee, and (d) public entities that are either government programmes, trusts or companies that are wholly owned by the government.

Only one of these institutions is able to provide savings services to the public, although some collect mandatory savings from their clients as a pre-condition for clients’ access to loans. Only the Malawi Rural Finance Corporation (MRFC) has special permission from the RBM to collect savings from the public through a specific exemption. MRFC is, however, not allowed to on-lend the savings it collects from the public and therefore invests them mainly in

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23 For example, NBM has provided services to the National Smallholder Farmers’ Association of Malawi (NASFAM) and its affiliated clubs and associations for cash crop producers.

24 Further details of these innovations are discussed in Chapter 6.

25 An example would be FMB, which has a product called the Makwacha card.

26 This is expected to change as soon as several pieces of financial sector legislation are passed. The legal and regulatory framework is discussed in more detail in the latter part of this section.

27 Community-based organizations such as SACCOs are discussed separately from this non-bank peer group.
government instruments. In other cases, institutions facilitate client savings by linking their clients with banks. This is being done, for example, by the MicroLoan Foundation (MLF) and CUMO Microfinance Ltd (CUMO).

**Privately-owned non-bank entities**

Within this group of microfinance institutions (MFIs), the variety of institutions covers the range of for-profit and non-profit entities.

An important recent development in Malawi is the entry of payroll moneylenders – which include institutions like Blue, Izwe and Greenwing. These are for-profit companies that are privately funded and some of them operate in multiple countries in Sub-Saharan Africa. As of December 2008, it is estimated that this group of lenders (comprising a total of five operators) had a total of more than MK1 billion in loans outstanding, representing a 10.2% market share in the total credit classified as microfinance loans.

There are also institutions that are affiliated with, owned or operated by international NGOs, such as FINCA Malawi and CUMO Microfinance Ltd. A number of non-profit institutions also provide microfinance services, such as the MLF, which combines a charitable mission with the business of providing financial services to poor individuals. Finally, there are microfinance projects operated by NGOs alongside other services, such as The Hunger Project. The project operates by mobilizing operations in a given area until such time that the ‘branch’ is transformed into a SACCO. It combines lending to a pool of SACCO members and non-members that it refers to as ‘partners’ – most of whom are women.

These institutions can be further classified in terms of whether they have an urban or rural bias in their client targeting. For example, while CUMO focuses strongly on rural-based clients, FINCA Malawi targets clients who maintain economic activities in urban and peri-urban trading centres. Many MFIs operate in such a way that they avoid areas where there is no bank and where the roads are in a condition that would make it difficult to access.

Unlike banks and other formal financial institutions, MFIs tend to offer products that are more micro in size: loan sizes start as low as MK2,000 (US$14) per individual. However, the maximum loan amount, especially following multiple cycles of borrowing, is up to MK150,000–200,000 (US$1,050–1,400).

The institutions within this group often combine individual and group-based schemes and typically target micro-entrepreneurs and small-scale traders. This also helps to explain the upper limit in the size of the loans they offer. The use of group-based lending schemes is common and relatively effective in decreasing the costs in appraising and monitoring a high volume of very small-scale transactions. As clients are expected to guarantee one another in a group, the monitoring and enforcement cost that is passed onto the clients must also be within a reasonable scope. Thus, it is not surprising to find many of the MFIs still focusing

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28 CUMO facilitates clients’ voluntary savings through a partnership agreement with Standard Bank, which allows concessions and waivers to enable ‘unconventional’ CUMO clients to maintain group savings through the bank. The waivers cover opening and minimum operating balances, bank charges, market-based interest rates on group savings and others.

29 This is based on data collected by the Malawi Microfinance Network (MAMN), covering the range of public entities, private sector microfinance institutions and MUSCCO-affiliated SACCOs.

30 FINCA Malawi was capitalized through funding from USAID, DFID, Oxfam and DANIDA, and receives commercial bank loans with a donor guarantee.
largely on the urban and peri-urban market: very rarely will one find group lending mechanisms that cover a widely dispersed population.\textsuperscript{31}

The business model of MFIs requires a significant volume of transactions in order to cover operational costs. MLF, for example, notes that it is not cost-effective for institutions to reach areas where clients are scattered. At the same time, the institution acknowledges that care is needed in targeting those areas where several MFIs are already operating, as the institution runs the risk of dealing with clients that are already borrowing from multiple sources.

The emphasis on urban areas becomes even more pronounced with the payroll moneylenders. These financial institutions primarily provide loans to employed individuals, mostly civil servants (such as teachers, soldiers, government employees, nurses, etc.) at least until the GoM issued a directive that stopped new loans from being deducted from civil service payroll, early in 2009.\textsuperscript{32} The payroll moneylender target group is therefore shifting towards private sector employees. Their services cater to the mid to upper-income market segment, as clients of these payroll moneylenders have more stable and reliable monthly incomes. The loan amounts typically offered to individuals by payroll moneylenders range between MK10,000 (US$70) and MK500,000 (about US$3,500), payable over 6-36 months. To date, the reported mean loan size is estimated in the range of MK45,000–70,000 (about US$300-500).

As MFIs are currently not regulated by the RBM, they are prohibited from collecting voluntary deposits from the public, which explains in part the limited expansion of the scope and scale of their operations. Typically, their portfolios are characterized by loans with very short maturities (less than 6 months), a consequence not only of their financing structure but also of how these institutions tend to respond to the business cycle of micro-enterprises in the urban/peri-urban sector. Their funding structure combines the use of concessional and (sometimes) commercial borrowing with grant funds sourced from public agencies or donor groups. Thus, their operations tend to adjust to this constraint not only in their capacity to expand the scale of their services but also where and how their services are provided. For example, the availability of grant funds oriented towards a certain region may limit the geographical reach of the operations of an MFI. In some cases, the availability of grants also allows these institutions to combine the provision of both financial and non-financial services.

It is also important to point out that it is difficult to obtain reliable and regular routine performance data on the sector, since reporting by these institutions is not mandatory and is currently not standardized. Even in the case of payroll moneylenders, performance reporting by institutions follows what is prescribed by their parent companies. There is currently no designated authority that licences credit-only institutions, although this is expected to change with the passing of the Microfinance Bill. The designation of such an authority could be an important step in bringing about a higher degree of transparency and standardization of performance assessment among financial NGOs and companies licensed to provide credit.

Related to this need for greater transparency is the issue of building adequate capacity among various financial institutions within this peer group. Even the more established

\textsuperscript{31} This is consistent with most MFIs that operate in other parts of the world and that make use of the group lending methodology.

\textsuperscript{32} The system employed by payroll moneylenders involves the use of loan collection mechanisms based on payroll deduction, whereby the employer deducts the loan repayment at source, and pays the amount over to the lender directly. According to the payroll moneylenders interviewed in this study, this collection methodology had default rates ranging between 2% and 5% only.
financial service providers (i.e. those that have been operating for more than five years) acknowledge facing severe constraints in attracting and keeping qualified personnel in their workforce due to limitations in the remuneration packages they can offer. The problem becomes even more pronounced for those whose services focus on rural areas: a number of MFIs have expressed the view that there is a very limited number of microfinance professionals and that qualified personnel tend to avoid being assigned to remote areas of the country.

Such capacity constraints also help to explain the tendency for these institutions to face serious loan repayment problems. For example, FINCA Malawi registered a Portfolio at Risk (PAR) >30 days greater than 20% in their early years of operation. FINCA admits that these problems stemmed from institutional shortcomings, which forced them to undergo fundamental organizational restructuring.

On the other hand, while human resource capacity constraints tend to be less of an issue for payroll moneylenders (at first glance), the quality of their loan portfolios still tends to be generally poor. Some payroll moneylenders register PAR>30 that range between 15% and 18%. This may be indicative of the strong emphasis on automated loan collection as the means to ensure the highest likelihood of loan repayment by these institutions, as opposed to paying closer attention to the need to select those borrowers within their target market who are truly credit-worthy. An important selling point of payroll moneylenders is that they are able to process loans very fast (i.e. quoted in ‘hours’) compared to other providers. And they are able to do so because they determine only whether an individual is employed and whether an automatic payment of the loan via salary deduction can be made. Those who satisfy this criterion are of course quite a heterogeneous pool of clients – yet clients’ absorptive capacity for loans will not be determined merely by their being employed or by the size of their salaries. Payroll moneylenders are aware of this risk profile of the clients that they serve, which partly explains the pricing of their services. Properly identifying those who are credit-worthy can be labour intensive, as it requires building specific information about clients. The absence of a Credit Reference Bureau is a key constraint.

Publicly-owned non-bank entities

In Malawi, the public sector plays a significant role in the supply of microfinance services. There are government programmes that have either continued operating as programmes or have been registered as trusts or companies (with almost 100% government shareholding).

Among the dominant suppliers within this group is the MRFC that primarily targets agricultural borrowers. MRFC has an extensive branch network that includes six full-service branches, and 20 sub-branches. As of December 2008, MRFC reported a total loan portfolio of MK3.8 billion (US$27 million). 60% of its loans are provided via groups. It continues to

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33 PAR measures the proportion of the portfolio that is in arrears at any one point, and is regarded as one of the key microfinance indicators. If a borrower is late paying by a set number of days (in this case, 30), the whole of the loan balance is then treated as part of the Portfolio at Risk. A PAR of more than 5% is considered potentially problematic as it indicates the potential for a high level of loan write-offs if not collected.

34 This is considering the nature of these organizations as being privately-funded often from international sources of capital, not to mention their strong bias towards urban-based operations.

35 This becomes even more evident when we take account of Malawi Savings Bank, which is a state-owned bank.

36 MRFC was established following the dissolution of the Smallholder Agricultural Credit Administration (SACA) with technical support from the World Bank.
maintain a larger proportion of its portfolio in loans to agricultural producers. It, however, states that the number of its (non-agricultural) small and medium business loans has been rising steadily in recent years. MRFC considers this consistent with its intent to diversify its portfolio. Its client base used to comprise of 80% rural and agricultural clients; at present, this has reduced to 50%. This is somewhat surprising not only considering the public nature of MRFC, but more so because MRFC states that there is very limited competition in agricultural lending. But the move to non-agricultural markets has been driven by the problems that the institution faced in the past with high default rates on its agricultural loans. According to a study by Chemonics (2004), MRFC’s losses on agricultural loans at that time were close to 50%, and about 47% of all loans issued were later treated as losses. This poor performance has been attributed to both institutional factors as well as the broader issues surrounding the rural and agricultural environment.

As mentioned earlier, MRFC is the only non-bank that has been granted special dispensation to collect deposits from the public. Its minimum savings balance is MK200 (US$1.50) that earns interest at 5% p.a. As of December 2008, it maintained a total of 262,475 savings accounts, with a total savings volume of MK536 million (US$3.8 million), making it one of the largest savings institutions in terms of number of savers. This translates to an average savings balance of roughly US$15, which demonstrates that it is playing a significant role in the market for micro-savings. MRFC could become a licensed bank under the proposed Microfinance Bill, but it has expressed concerns about managing various issues related to the development of savings as a line of business.

The GoM established the Malawi Rural Development Fund (MARDEF) in 2004-5, providing credit to groups in rural communities, especially to agro-processing activities. MARDEF offers group-based loans from MK150,000 (about US$1,100) to as much as MK300,000 (US$2,200), based on MK10,000 per group member.

From the time MARDEF began operations, it has faced challenges due to the nature of its establishment and the public’s perception and expectation of soft terms on its loans. These challenges are depicted in the way MARDEF prices its loans. Currently, it charges a fixed interest of 15% on its loans, which is the lowest nominal rate amongst institutions that focus on rural areas, although there are other costs and charges on the borrowers that increase the overall effective loan cost. Notwithstanding these other costs and charges, the interest rate charged does not allow the institution to fully recover its costs.

Sustainability is a key challenge for most public institutions: given that these institutions are motivated by an interest to offer ‘low cost loans’, they are unable to charge interest rates that are cost-covering. Moreover, MARDEF has also faced other challenges related to the quality of its portfolio that are rooted in its very visible nature as a public entity. Some politicians have been actively involved in the promotion of the scheme, and during the last national election campaign (March to May 2009), MARDEF faced substantial repayment problems.

MARDEF maintains an alliance with the Malawi Savings Bank (MSB), which acts as MARDEF’s banker and fund manager. MSB manages MARDEF’s portfolio using the MSB tracking system and also invests surplus funds through its own treasury operations. MARDEF also works together with other public entities, such as MRFC – which analyzes business plans of MARDEF’s loan applicants, for a fee. MARDEF faces huge hurdles in terms of institutional capacity: it does not have a loan tracking system, and acknowledges

37 Public institutions are often driven by a strong sense of social mission and public financial institutions are often used as vehicles for rural development.
that it does not have sufficient capacity to disburse, collect or properly assess the large number of loan requests received.

The Small Enterprise Development Organisation of Malawi (SEDOM) is another provider in the category of public non-bank entities. SEDOM was established as a government trust supported by government and a host of donors. The original intention was for SEDOM to be a development bank that provided loans with subsidized interest rates to SMEs. SEDOM is highly dependent on government funding and is currently facing financial problems because the funding is limited. This is compounded by uncertainty over proposals to consolidate a number of public sector entities that provide financial services. Like other institutions within this category, SEDOM faces significant challenges in the repayment of its loans.

Interestingly, PRIDE-Malawi is considered by many in the industry to be a public entity, though not by its management. PRIDE focuses on micro-enterprises in urban and trading centres, and provides standard working capital loans to mostly female borrowers. It considers its target market to be similar to that of MFIs like FINCA. PRIDE notes that it is now reaching a plateau in terms of the clients within this category and is therefore increasingly targeting SMEs and salaried individuals. It is keen to transform and apply for a banking license in due course.

3.1.4 Savings and credit cooperatives (SACCOs)

A third group of financial service providers are the savings and credit cooperatives (SACCOs). In some other African countries, SACCOs are more like traditional social structures that have embedded within them strong social and economic networks. In Malawi, however, SACCOs are not commonly found in the local communities and there are relatively few of them. The Malawi Union of Savings and Credit Cooperatives (MUSCCO) – which is the established apex institution for SACCOs in Malawi – has only 59 member-SACCOs (as of June 2009), of which 45 are stated to be active. MUSCCO estimates that outside the confines of its membership, there are less than 10 other SACCOs operating, some of which are former MUSCCO members that voluntarily left or, in a few cases, have been expelled. According to MUSCCO, almost all the SACCOs operating in the country have been initiated by them – i.e. MUSCCO actively promoted and assisted in the start up of these community-

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38 SEDOM has noted, for example, that there are indications of government planning to consolidate or merge several public institutions into one.

39 PRIDE received its initial capital from donors through the GoM. The GoM nominates a majority of PRIDE’s board members though it does not appoint them. Also, unlike other public entities, PRIDE does not operate under any direct mandate from the GoM.

40 Co-operatives or SACCOs are defined as autonomous associations of persons united voluntarily to meet common economic, social and cultural needs and aspirations through a jointly and democratically controlled enterprise. There is a diversity of co-operative institutions across many regions of the world. However, they are united by a set of shared values and principles, the most crucial and definitive is that they are membership-based or member-owned organizations. As such, co-operative financial institutions are distinguished from other financial service providers in that they are owned by members and financial services are commonly targeted at members only. The members of a co-operative are united by a form of social bond, typically determined by their employment, income source, location (community) or economic activity – such as farmers residing in the same village who harvest the same crop/s, or individuals employed by the same organisation.

41 The rest of the member-SACCOs are dormant for various reasons – mostly related to capacity constraints – and MUSCCO is trying to revive them. It is common to find SACCOs experiencing loan delinquency among its borrowers or insufficient revenue to maintain an active executive, which forces some to close.
based organizations. Some SACCOs also trace their history through church initiatives, but these mostly died out as soon as grants ceased. Some have started out as informal savings and loan groups that eventually evolved into and registered as a SACCO.\footnote{This is, for example, the case of ESCOM SACCO.}

SACCOs in Malawi are typically employee-based co-operatives that implement regular savings and payroll-based lending, although many of them have evolved to cover a broader market by allowing membership from an entire community. Thus, they are now often referred to as ‘area or community-based’ SACCOs. Employee-members can typically borrow up to twice the amount of their savings, subject to the availability of funds. On the other hand, a non-employee member can typically only borrow up to 1.5 times the value of his or her savings balance.

There are also rural-based SACCOs that operate as multi-purpose cooperatives – i.e. financial services are offered alongside other types of services. An example would be the Mzuzu Coffee Growers Cooperative Union, which is affiliated with five cooperative societies (three of which have been interviewed in this study). The Union and the various cooperatives are engaged in the marketing of crops (coffee beans and ground coffee), including product processing and quality control, logistics, fund sourcing and disbursement, training of farmers. Out of the coffee sale proceeds, farmers pay 40\% as a management fee to the Union. Of the 40\%, the SACCO/co-operative is given 10\%, which it allocates to cover the cost of its operations. The cooperative offices are in the rural areas close to the farmers, but far from bank branches, in some instances, about 40-45 kilometres away.

### Table 3.3 Aggregate data on SACCOs in Malawi

<table>
<thead>
<tr>
<th></th>
<th>TOTAL MUSCCO SACCOs</th>
<th>Of which, Fincoop</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets (in MK)</td>
<td>2,063,465,007</td>
<td>4,657,815</td>
</tr>
<tr>
<td>Total shares (in MK)</td>
<td>3,045,320,774</td>
<td>3,684,287</td>
</tr>
<tr>
<td>Total deposits (in MK)</td>
<td>267,728,094</td>
<td></td>
</tr>
<tr>
<td>Total loans (in MK)</td>
<td>1,905,739,565</td>
<td>590,652,583</td>
</tr>
<tr>
<td>Profit / Loss (in MK)</td>
<td>88,132,933</td>
<td>136,209</td>
</tr>
<tr>
<td>Membership (#)</td>
<td>155,986</td>
<td>171</td>
</tr>
<tr>
<td>Male</td>
<td>109,376</td>
<td>136</td>
</tr>
<tr>
<td>Female</td>
<td>41,072</td>
<td>35</td>
</tr>
<tr>
<td>Other</td>
<td>5,538</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: MUSCCO, as of March 2009.

There is quite a variety in the size of SACCOs operating in the country. Some are relatively small, having less than 70 members, whilst the largest has a membership of almost 25,000, with total assets of MK650 million (US$4.6 million) and MK37 million (US$260,000) in deposits.\footnote{This is Finance Cooperative Limited or Fincoop (data as of March 2009).} Based on the data collected by MUSCCO from its member-SACCOs, most of the remaining SACCOs tend to be large, as shown in Figure 3.2: 42\% of them have 301-1,000 members; while another 40\% of them have 1,001-5,000 members. Most of the SACCOs’ members (70\%) tend to be male. If we exclude the outlier in this sample of SACCOs (i.e. Fincoop, which has about 25,000 members), the mean membership size is roughly 1,300.
This is an important characteristic of SACCOs in Malawi, as it is crucial to have economies of scale in order to support sustainable financial operations: a number countries in Africa are struggling to develop SACCOs of a sufficient size to be sustainable, so Malawi is in a comparatively favourable position in this respect.

**Figure 3.2  Distribution of SACCOs according to number of members**

![Bar graph showing the distribution of SACCOs according to number of members.]

Source: MUSCCO, as of March 2009.

The SACCOs interviewed in this study offer a variety of savings and loan products. Regular savings accounts can be made with MK1,000 ($7), while there are special savings products that start from as low as MK500 ($3.50). These special savings products are like fixed deposits and are designed for a specified purpose – e.g. saving for school fees or an intended household or business purchase. Despite these efforts to introduce new products, however, the SACCOs interviewed consider it essential to undertake more sensitization of the markets they are currently serving or those that they are trying to reach. According to the SACCOs interviewed, saving in an institution – whether it is a bank or a SACCO – is still not very common to many people in Malawi. The SACCOs believe that a poor savings culture is prevalent in certain sections of the population. To mobilize savings effectively, the SACCOs recognize that the commitment of the client or member is necessary. And eliciting this level of commitment becomes even more difficult when we consider clients or members who are in more remote locations or situated very far from branch operations: these households and individuals tend to be poorer and more sceptical about the future, making it difficult to convince such clients of the benefits of saving in an institution, especially if the institution is not known to them.

Loan amounts range from MK1,000 ($7) to as much as MK 2 million ($14,200), depending on the loan purpose. The wide range in loan amounts offered suggests that SACCOs tend to cover a broad spectrum in their membership base. The interest rate applied to the loans ranges between 22% and 26% p.a., applied using a straight line method, and the typical repayment period is 12-24 months. For all types of loans, some form of security is required by the SACCO. However, SACCOs accept alternative forms of collateral that are not typically accepted by other financial institutions like banks – such as moveable property, including household and business assets, stock of goods, livestock, etc.
The characteristics of the products offered by SACCOs are important to consider when discussing the accessibility of their services. Not only is there ease of entry for clients given the size of loans and savings amounts, but it is also relatively easy for an individual to become a member of a SACCO. The typical requirements – which consist of an application fee and an initial purchase of shares – cost an individual about MK1,000 ($7).

SACCOs can be found in both urban and rural areas. Like most other MFIs, urban-based SACCOs target micro and small-scale traders operating in town centres or markets. The urban-based SACCOs interviewed in this study state that they are competing with other financial institutions, including banks. This is not surprising, considering that there are significant overlaps between the design of their products and those of banks – especially the banks that tend to be active in the microfinance sector – and their target group of mainly salaried formally employed individuals.

Interestingly, there are a number of SACCOs that also accept deposits from non-members, and this seems to be a common feature of those that operate in peri-urban areas characterized by economic activity but which are, however, at some distance from the nearest bank. One of the SACCOs interviewed in this study, for example, Bvumbwe SACCO, estimates that about 20% of its deposits are from non-members. According to the SACCO’s management, these tend to be individuals who conduct their business close to the SACCO branch: these non-members are interested only in having a safe place to store their savings or their cash surplus at the end of a business day, and they are not willing to travel long distances to make deposits to a bank. They are not interested in accessing loans and therefore do not become members, although Bvumbwe SACCO tries to convince them to. This implies that there are unmet opportunities for drawing deposits in unbanked peri-urban areas of the country, even if only very short-term.

According to Bvumbwe SACCO, they are directed by MUSSCO to lend only up to a maximum of 20% of the total savings they are able to collect from members, which is consistent with the standards maintained by the World Council of Credit Unions (WOCCU). Most of the lending is funded through the sale of shares to members.

A large majority of MUSSCO’s members have reported profitable operations as of March 2009. However, five members incurred net losses totalling almost MK8.4 million (about US$60,000). Across the range of SACCOs, however, most are facing challenges in terms of

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44 Fincoop’s Chairperson has also expressed a similar sentiment, in a recent interview cited in an article published by the Business Times last 8 July 2009 entitled, “Commercial Banks Squeeze SACCOs”.

45 It is important to note that the practice by SACCOs of collecting deposits from non-members is considered not in accordance with best practices in the cooperative financial sector. This presents risks to depositors, especially if these institutions are not properly supervised.

46 The World Council of Credit Unions (WOCCU) is the global trade association and development agency for credit unions. It promotes the sustainable development of credit unions and other financial cooperatives around the world as a means to enable people’s access to financial services. It is also involved in advocacy work, representing the global credit union system before international organizations and working with national governments to improve legislation and regulation of financial cooperatives. WOCCU also offers technical assistance programmes to help strengthen credit unions’ financial performance and increase their outreach. It uses the PEARLS Monitoring System (Protection, Effective Financial Structure, Asset Quality, Rates of Return and Costs, Liquidity, and Signs of Growth), which is a financial performance monitoring system designed to offer management guidance for credit unions and other savings institutions. PEARLS is also a supervisory tool for regulators. For more information, see www.woccu.org.
loan recovery. Even the ones that are considered star performers within the sector usually have about 15-20% of their outstanding loans in arrears greater than 30 days, and they report loan recovery rates of only 80-90%. This reflects the main challenge of SACCOs operating in Malawi: they generally have very weak management and institutional capacity, which MUSCCO is trying to help build.

The picture tends to be even worse for those SACCOs that are rural-based and operate as multi-purpose cooperatives. Some of them face even more serious problems in the recovery of loans: some multi-purpose SACCOs manage to recover only about 60% of the loans they disburse to their members. Interestingly, the total loan portfolio of some of these rural multi-purpose SACCOs interviewed far exceeds the total deposits and shares of the SACCO, the gap being filled by wholesale funds from a donor. Having access to such funds changes the very nature of SACCOs, as they then become lending institutions rather than membership-funded institutions that offer loans, built on local savings mobilization.47

3.1.5 Informal sources of finance

In addition to the banks, non-banks and SACCOs that operate in the microfinance market, financial services are also supplied by a range of informal operators. These include individual moneylenders (Katapila) and village-based savings and loans associations (VSLAs) or rotating savings and credit associations (ROSCAs) where small groups of individuals save small amounts periodically and each member receives a lump sum payment at some point during the cycle.

**Katapila**

Katapila operators are private individual moneylenders that provide loans at short notice, for short terms, at relatively high interest rates without necessarily requiring security. Loans are typically payable in just a few weeks or one to two months and repaid in one single instalment. Borrowers are known, which therefore gives Katapila operators informational advantages to assess the risks associated with lending to a particular individual. The moneylenders are also usually based locally or within close proximity to their borrowers, allowing them to see or observe the circumstances of the borrower that are relevant in considering the likelihood of loan repayment. Lending is based on ability to repay, with the lender taking little interest in the use of the funds, be it economic (e.g. for a business), social (e.g. to cover medical/funeral expenses) or even recreational. The interest charged on loans is very high compared to formal sources: if an individual borrows MK1,000 (US$7), he is expected to pay back a total of MK1,500 (US$11) or MK2,000 (US$14) the following month. But borrowers agree to these terms as the loans are easier to access (i.e. quickly and with hardly any questions asked) and more so because no other alternative sources exist at the time of need.

Although the interest on a Katapila loan is high, it should be noted that due to the proximity of Katapila operators in most communities, the transaction costs48 of accessing such a loan are low even when compared to other sources of micro-loans, whether from MFIs or banks. Because loans from a Katapila operator are made available very quickly, they can have

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47 It will be important for development partners to be aware of the repercussions of providing funds for on-lending to SACCOs as this effectively changes the very nature of the SACCO and could lead to a weakening of the institution.

48 This can include the costs of travel to the place of the lender (to apply for a loan), time spent in group formation and being ‘sensitised/trained’, fees for getting key documents on identity or pledging collateral, and the travel costs and time that may be required to collect or repay the loan.
considerable value (e.g. during emergencies) versus the longer periods required to process
loans from other sources. The need may be immediate or extremely urgent (e.g. to pay for
funeral or medical expenses) or there may be a window of opportunity that is only available
for a very limited amount of time (e.g. purchasing goods at a low price). Thus, Katapila
operators are considered to be the providers who can extend loans, at any time of the day or
week. They also offer small ‘bridging’ finance for short periods, with amounts ranging from
MK100-5,000 (US$0.70-$35). It is unlikely that MFIs, and certainly not banks, would be able
or interested to provide loans with such terms, especially in every community.

The Katapila operators interviewed in this study prefer lending to those with steady incomes,
especially those who are employed to avoid repayment problems. The peak period for most
Katapila operators is between November and February: this is the period where households
are in need of funds for farm inputs, school fees, spending related to the Christmas holiday
period, etc.

The loan amounts described by the Katapila operators interviewed are not necessarily micro
in size. One (urban-based) Katapila operator reported having lent as much as MK60,000
(US$425) to one client and the minimum amount he lends is MK10,000 (US$71). Some
moneylenders lend as low as MK100 (US$0.70), but this can be difficult to manage
especially when there may be a need to exert some pressure for repayment. In the past,
some Katapila operators monitored and enforced loan repayment, by keeping client bank
passbooks. Once payday arrived, the moneylender would go with the client to the bank,
allow the client to withdraw his/her salary and then get repaid immediately thereafter. Now
that passbooks have been virtually phased out in favour of card-based accounts, it is more
difficult for them to exert this degree of control. On average, Katapila operators interviewed
report that they are able to recover almost 95% of what they lend, partly because they have
a lot of repeat clients in their portfolio.

In the event of non-repayment, a Katapila operator would not initially confiscate any asset
from the client, as he is aware of the legal ramifications of doing so. He therefore relies
heavily on negotiating with the borrower. 49 Thus, once a client proves to be a bad borrower, a
Katapila moneylender will no longer lend to him/her in the future. This is also known to most
borrowers, which creates a strong incentive for them to do everything possible to repay their
loans especially if they are aware of the likely need to access other loans from this or other
local Katapila operators in the future.

Interestingly, there are also rural-based Katapila operators that behave like input suppliers of
credit and transact in kind (as opposed to cash) by distributing food and inputs, and receiving
repayment in cash. These moneylenders, for example, distribute maize to cotton farmers
during the lean periods and provide pesticides between December and February, a critical
period for cotton growing. By borrowing maize and chemicals, poor rural households may not
need to supplement their income through casual work on other farms (referred to as ‘ganyu’
labour), and can therefore concentrate their work in their own fields. The inputs also enable
higher crop productivity and resulting higher incomes. 50

49 It is, however, important to note that there may be anecdotal evidence showing how some Katapila
operators could also exert greater force in collecting repayment or end up using violence.

50 It will be useful to analyze in greater detail whether the increased productivity necessarily results in
higher income and returns for the farmer considering the cost of financing. This, however, appears to
be a relatively common mechanism for providing inputs mainly to cash crop farmers.
For the Katapila operator interviewed, each farmer is allowed to get a maximum of two bags of maize and is required to pay four bags in return. This is quite a profitable undertaking for the Katapila operator, although it is noted that maize provided in October is worth more than it is during post harvest season in April, and there are transport costs and collection losses that need to be considered. It appears even more profitable for the Katapila operator if borrowers get chemicals from him: for a bottle of chemicals, which costs MK300 (US$2), he gets one bag of maize or 25 kilograms of beans in return, which is valued at MK1,000-1,500 (US$7-11) during harvest time. This may, of course, be viewed as not being favourable to the borrower, who, for lack of other alternatives, is forced to meet these terms in order to have access to financing.

Although Katapila operations are generally profitable, the 2008-09 season has been problematic, particularly for those lending to cotton and tobacco farmers. The lack of agreement between the GoM and the cotton buyers has resulted in a breakdown of cotton buying arrangements. Farmers can only sell to traders buying at well below the official price. The delay in sales has resulted in many farmers selling to any trader who is willing to buy, typically at 25-40% of the official price. As a result, the Katapila operator interviewed has been unable to recover any of his loans for this season, as the farmers have registered insufficient surplus to repay their loans. In such circumstances, the normal practice is to roll the loan over to the subsequent season, but the Katapila operator has had all his capital depleted, with no profit at all in this season. The consequences for the affected farmers are also significant: there may be no funds available for food or inputs from this particular source, which will have implications on productivity and food security.

It is also important to note how some Katapila moneylenders operate quite systematically. In rural settings, they reach out to farmers through the village chief. The farmers are typically organized in groups and as a group they determine their loan requirements and communicate this to the chief. Katapila operators find it easy to engage in this business if the chief is involved: the chief knows his subjects very well and acts as a sorting mechanism by determining those who are reliable borrowers and able to access loans from the Katapila operator. In return, the chief may get some additional benefit beyond a loan.

Village-based savings and loans associations

Apart from individual moneylenders, there are also village-based savings and loans associations (VSLAs) operating in the informal sector. CARE International Malawi and its partners are organising VSLAs, and typically target those individuals who are based in urban slums or more remote rural areas.\(^51\) VSLAs typically comprise of 15-25 individuals that come together to form an association (that may or may not be registered) primarily to facilitate savings within the group. While loans are provided as part of the services that a member can access, the VSLA model follows a savings-based approach: it builds on a model of rotating savings and credit associations (ROSCAs), where a self-selected group of people pool their money into a fund from which members can borrow. These small pools of capital are intermediated at a local/village level to satisfy household cash management needs for those who live in areas where banks and MFIs do not have a presence.

The money lent out is paid back with interest, which allows the fund to grow. The regular savings contributions made by the members to the group are deposited with a specified end date for distribution of all or part of the total funds (including interest earnings) to the

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\(^51\) The VSLA model was originally developed in Niger in 1991 by CARE International and has spread to 16 countries in Africa, two countries in Latin America and two in Asia, with almost one million active participants worldwide. For more information on the VSLA methodology, please see: www.vsla.net.
individual members. Members of VSLAs receive a return on their savings that is typically higher than that offered by banks, and members are able to save whatever amount they wish and whenever they need to. The methodology is designed to provide access to basic financial services to the poor and the very poor.

While the VSLA methodology is simple, it involves a very carefully structured system of training. The groups undergo training sessions for 9-12 months in order to facilitate the formation of the group, elect officials, design their system of savings, etc. These groups start a system of savings and lending, whereby they are initially supervised by CARE field staff who ensure that procedures and systems work properly and that the groups can function independently thereafter. The experience so far in many other countries in Africa is encouraging: more than 95% of the associations that have been formed continue to operate independently even after their formal training relationship to the implementing organisation comes to an end.

The training required to effectively establish a VSLA means there are significant costs associated with mobilizing and organizing these groups. Institutions that have access to donor funding (like CARE), are able to provide these services free of charge to the communities where they undertake the formation of VSLAs.

### Table 3.4 CARE VSLAs in Malawi: key operational highlights

<table>
<thead>
<tr>
<th></th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
</tr>
<tr>
<td>Total no. of VSLAs formed or working with</td>
<td>174</td>
</tr>
<tr>
<td>Total number of individual members</td>
<td>3,246</td>
</tr>
<tr>
<td>Proportion of female members</td>
<td>90%</td>
</tr>
<tr>
<td>Estimated proportion of membership that is rural-based</td>
<td>100%</td>
</tr>
<tr>
<td>Total volume of savings mobilized</td>
<td>MK 7,645,663</td>
</tr>
<tr>
<td>Total volume of loans outstanding</td>
<td>MK404,340</td>
</tr>
</tbody>
</table>

Source: CARE International Malawi.

The strength of the VSLA methodology lies in the strong sense of ownership that is built within these groups. It does not require the setting up of an institution to handle the funds deposited by the members nor to issue any of the loans; the money collected and distributed is handled solely by the groups themselves and all the net income derived in this operation remains the property of the group. By distributing all or part of the funds at the end of a cycle (typically after 12 months), the members receive a useful cash lump sum, which they can use for their own particular purposes, including purchasing inputs.

CARE and its partner organizations are facilitating the formation and training of VSLAs in all regions of the country, currently covering six districts. They started with 174 VSLAs in 2006; this number has grown to almost 2,600 by the end of 2008. They are currently reaching about 13,000 individuals, with an mean average savings balance of MK4,260 (about US$30) per member. With additional funding, CARE is aiming to reach 400,000 individuals by 2017. Interestingly, CARE is also planning on facilitating linkages between more established VSLAs and other financial service providers. At least one of the banks (OIBM) has already expressed an interest to work with some of the VSLAs in operation.
3.1.6 Insurance companies

The insurance sector in Malawi consists of eight non-life insurers, three life insurance providers, and a number of brokers and other agents. The total premiums collected were estimated at MK 11 billion (US$ 78 million) by the Insurance Association of Malawi (IAM).

The provision of insurance services in Malawi is still very much under-developed: insurance products tend to be very limited in range and target a very limited segment of the country’s population. The most common product offered is motor vehicle insurance. As the IAM has observed, insurance products largely target the needs of those who own large assets or of salaried individuals with high disposable incomes. There are, however, early signs of some institutions progressively offering insurance products that allow low-income individuals and households to better cope with health and funeral expenses and other livelihood risks (weather and livestock).

In terms of health insurance products, the key player is the Medical Aid Society of Malawi (MASM). MASM is a non-profit organization registered as a trust in 1983, owned and operated by its paid-up members through a secretariat led by a General Manager. It offers medical insurance to its members, of which about 80% are employed. As of July 2009, MASM had about 105,000 members. MASM's products, however, target better off (mostly employed) individuals: their cheapest health insurance package requires contributions of MK520 ($3.70) per month, which is too expensive for most low income households. Moreover, it is only able to offer health insurance products to those in close proximity to registered medical service providers.

MASM considers it very challenging to address the need for health insurance products for low-income households: affordability is a key issue, but so is the need to ensure greater understanding of what insurance products are and their benefits especially among those who are rural-based and with very little education. Not only do these individuals have a higher risk profile (i.e. they tend to be more prone to falling ill or facing accidents in their occupations), but there are also serious challenges related to reaching out to these clients. Institutions are still looking for ways to provide services in a cost-effective and sustainable way. The MASM, for example, is now starting to extend its insurance services to tobacco farmers, where farmers' contributions are collected through the auction at point of sales for the next season.

Credit Life insurance is now commonly utilised by lenders in Malawi. This product provides for the repayment of outstanding loan balances in the event of the borrower’s death. Many banks and MFIs now require credit life insurance on all of the loans they offer, built into the cost of the product. On the other hand, member-SACCOS of MUSCCO require insurance on their members' savings accounts. The provision of Credit Life is driven by the institutions' desire to mitigate the risks they face that are associated with the possibility of death among their target clients and difficulties in recovering loans from the estates of the deceased or their families.

Nearly 90% of individuals depend heavily on agriculture for their livelihoods. There are, however, significant risks associated with agricultural activities that drive the highly irregular patterns in production and income flows, especially for smallholder farmers who have few or no other income sources and concentrate on single crop production. To respond to this need, a weather-based (rainfall index) insurance scheme has been piloted in Malawi and is currently being offered in a limited number of areas in the country. This insurance product seeks to reduce the vulnerability of farmers to incidents of drought. The insurance scheme is combined with a loan facility for the purchase of seed inputs and other agricultural implements. The institutions involved in the pilot include OIBM and MRFC.
3.1.7 Agricultural buyers

The supply of credit to farmers for agriculture has been a major problem identified in policy documents and studies over many years. Banks and NBFIs have made several attempts to lend to farmers over the last two decades, but most of these institutions have not been successful in doing so, even after having promising results at the initial stages of extending services.

The opportunity of agricultural lending is potentially attractive to banks and NBFIs because of the agrarian nature of the economy in Malawi and because there is considerable unmet demand, with limited competition. MRFC has been the most significant supplier of credit to the agricultural sector for many years; but it has a strong focus on tobacco farmers and despite relatively large numbers of borrowers (over 80,000, as of 2006), a significant proportion of farming households continue to be outside the reach of financial services. Despite the attraction of a fairly large unbanked market with very little competition, there are a number of problems related to agricultural lending, which keep financial institutions from being more active in this sector:

- Farmers are more widely dispersed, and therefore costly to reach.
- Production of many crops only generate revenue at the end of the production cycle, such as tobacco, cotton and coffee, which presents problems for institutions interested in having regular payments. Some institutions consider it even more risky to offer loan contracts that allow for lump sum payments.
- Agricultural production is highly dependent on weather conditions. The occurrence of droughts is common, which makes lenders open to the likelihood of widespread agricultural loan default in perhaps two out of five years. It has now been nearly five years since Malawi experienced a drought. The relatively good weather since 2005 has encouraged lenders to re-enter the agricultural sector, as the memory of drought-induced loan losses started to fade.
- Agricultural produce is vulnerable to price volatility, as was demonstrated in 2008-09 (for cotton and tobacco). In the last 3-4 years, Malawi has benefited from strong world commodity prices, but there are indications of reduced prices of commodities as a result of the global economic downturn. The impact has so far been felt in terms of the problems associated with lending to tobacco and cotton farmers in the last year.
- Collateral is mostly absent. Moreover, while estates and commercial farm land can be taken, land of smallholders is mostly of limited value and tends to be difficult to sell.

These constraints, therefore, help explain why banks and non-banks tend to have very limited exposure to agricultural lending, as is shown in Figures 3.3 and 3.4 below.
As a result of these and other factors, bank and NBFI lending to agriculture has waned. For agri-businesses, notably processors, the lack of finance from banks and NBFIs to farmers has been a major problem. In the absence of bank and NBFI finance to crop farmers, many agricultural buyersprocessors stepped in to provide finance to farmers to fill the gap.

Note: Other financial institutions include NBS Bank, National Finance Company, Leasing and Finance Company of Malawi, Malawi Savings Bank, Opportunity International Bank, Indebank and Nedbank.
This separation between ‘commercial banks’ and ‘other financial institutions’ was made by the RBM in their report.

### Table 3.5  Share in total agricultural lending (%), by type of provider

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
<td>45.0</td>
<td>52.0</td>
<td>35.0</td>
<td>38.0</td>
<td>38.1</td>
<td>68.9</td>
<td>77.5</td>
</tr>
<tr>
<td>MFIs</td>
<td>47.0</td>
<td>27.0</td>
<td>20.0</td>
<td>22.0</td>
<td>21.3</td>
<td>22.4</td>
<td>15.0</td>
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<td>APIP</td>
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<td>6.0</td>
<td>5.0</td>
<td>8.8</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Projects</td>
<td>-</td>
<td>1.0</td>
<td>-</td>
<td>1.0</td>
<td>1.8</td>
<td>0.9</td>
<td>0.4</td>
</tr>
<tr>
<td>Private sector agribusinesses</td>
<td>8.0</td>
<td>14.0</td>
<td>38.0</td>
<td>34.0</td>
<td>30.1</td>
<td>7.9</td>
<td>7.1</td>
</tr>
</tbody>
</table>


Processors, and in some cases farmer organisations, in sectors such as tobacco, sugar, tea, cotton, paprika, groundnuts, dairy and coffee, have all been engaged in lending to growers of the produce they want to buy. Table 3.6 (above) summarises the sources of lending to farmers, with the data from agri-business collected from five key sectors (tobacco, sugar, cotton, tea and coffee). The table shows that lending by private sector agribusinesses peaked at 38% of total lending in 2003, greater than what was provided by banks. This was undertaken despite indications of significant losses, especially in the paprika, tobacco and cotton sectors, which were attributable to defaults induced by side selling of crops to third parties.

In 2006, rather than abandon the farmers, the tobacco processors intensified their support to contracted farmers, adding maize inputs and even regular hungry season cash payments. A significant change was introduced with the involvement of commercial banks as the source of the finance in this set-up. The banks felt more confident to lend to farmers given the following reasons:

- The farmers selected for financing had access to productivity enhancing inputs with considerable agronomic support from the buyers in a proven crop production system with higher yield and higher quality.
- The buyers guaranteed to buy the crops based on a pricing formula, which helped to address some of the inherent risks.
- The support package was well designed with key measures such as including inputs for maize to avoid the common problem of diversion of tobacco inputs to the food crop, as well as cash payments during January to March to remove the need to sell tobacco to get cash during this period when food is in shortage and farmers are vulnerable to offers from traders to buy at highly discounted prices.
- The tobacco marketing system has a mechanism to deduct the loans from payments by buyers to sellers when they buy the crop through the auction.

Although there is the nominal security of a contract between the farmer and the processor, in reality the parties knew that this was practically unenforceable. Nevertheless, there were sufficient incentives in the scheme and a monitoring mechanism was in place to induce
contract compliance. Linking the farmers to the banks within a contract farming system is reported to have resulted in almost universal full loan and interest recovery by the parties concerned. One bank was even noted to have said that it would only lend to farmers so long as they were part of a contract-farming scheme.

In other sectors, such as tea and sugar, where the farmers and processors need to be closely integrated due mainly to the perishable nature of the crop, it is relatively easy for agribusinesses to extend credit and ensure repayment from crop proceeds. In the tea sector, financing has been provided by the processors themselves, but there has been increasing involvement of banks and NBFIs in credit provision to smallholders in this sector. In the sugar sector, the smallholder companies have been able to access bank finance on the back of their integrated supply arrangements for their members. In these sectors there have not been problems with defaults.

In contrast, other crops, such as paprika and cotton, where the links between processor and farmer are weaker, as production and processing do not need to be integrated, side selling to third parties by the farmer is possible. Selling to a third party buyer is tempting for the farmer as he can completely avoid loan deductions by the buyer to whom he is contracted and who has provided inputs on credit. As the contracts are practically unenforceable, the buyer loses the crop as well as the credit. Following persistent losses, most cotton buyers and the main paprika buyers have either scaled back or abandoned providing inputs on credit. The one exception has been Cargill Malawi which provided inputs to 86,000 cotton farmers, valued in excess of US$1 million (precise figure not available) for the 2008-09 season. This was based on relatively high loan recovery due to building in incentives for repayment, e.g. increased loans in subsequent seasons and higher prices for those who have honoured their debt obligations. Unfortunately, Cargill was unable to buy cotton in 2009 due to the high minimum price that has been set and its international corporate policy of not buying below government set prices. As a result it will have to write off all 86,000 loans in 2009. This therefore creates disincentives for Cargill to extend any credit in the 2009-10 growing season, as it may suffer losses of this scale again.

They key points emerging from the experience of agricultural buyers are:

- Agri-businesses have been an important source of credit for smallholders, where banks and NBFIs have been unwilling to fill the gap.
- Where there are sound contract farming schemes, or closed marketing arrangements where loan repayment can be deducted from proceeds, then banks and NBFIs have been willing to participate in the process and provide credit to farmers.
- However, for many crops, arrangements that have been tried have broken down due to a mixture of poor product design, high levels of side-selling by farmers to avoid repayment and in some cases, inadvertent side effects of agricultural policy decisions.

It will be meaningful for the GoM to look into how it can support genuine contract farming arrangements as a key mechanism for farmers to access credit for inputs that in turn promote higher levels of productivity and help to increase exports from cash crops.
3.2 The policy, legal and regulatory environment

The policy environment

The experience of many developing countries shows that the broader policy and macroeconomic environment has significant implications on the development of microfinance services.

Malawi’s national priorities are spelt out in the Malawi Growth and Development Strategy (MGDS) that has five themes: Sustainable Economic Growth; Social Protection and Disaster Risk Management; Social Development; Infrastructure Development; and Improved Governance. The MGDS recognizes the problem of poor access to micro-credit and high default rates, for example, under the fifth sub-theme (sustainable economic growth), but analysis of the financial sector and measures for its development are mostly absent.

References in other relevant policy and strategy documents are also relatively limited. For example, the Malawi Food and Nutrition Security Policy sets out strategies for ensuring food security of Malawi’s population, specifically with regard to food availability (volume and stability of production of foods as well as food imports); sustainable access to food; and stability of food supply. Increased access to credit by farmers is identified as an output to ensure availability of food in sufficient quantities, quality and variety, but with little indication of how this might be brought about. The Malawi National Fertilizer Strategy sets priority actions to increase fertilizer availability, improve farmer access to affordable fertilizer, improve utilization of fertilizer and related inputs, facilitate improvement of infrastructure and create an enabling environment for public-private sector partnership in the development of the fertilizer industry. Improving fertilizer credit systems is identified as a long term strategy through which access to credit will be improved and wilful default minimized through the establishment of the Fertilizer Agricultural Credit Management Bureau and by lobbying commercial banks to recognize rural facilities as collateral for credit.

In November 2002, the GoM approved a Microfinance Policy and Action Plan to assist in the development of the microfinance sector. The policy seeks to promote the development of a sustainable microfinance industry in the country, by creating an enabling legal and regulatory environment as well as overall economic policies conducive to the development of microfinance; improving the capacity of implementing institutions and their clients and other key actors such as the Malawi Microfinance Network (MAMN), the RBM and the Ministries of Industry and Trade, Finance and Economic Planning; promoting best practices in the industry among MFIs, government agencies and the donor community; and enhancing the co-ordination between the various actors in the microfinance sector.

The policy recognizes that overall, the existing legal environment is not deemed hostile to the development of microfinance in the country, but collaborative efforts among various stakeholders are envisaged to help improve the environment and make it more friendly through the review, revision, amendment and repeal of those laws and regulations in order to promote the sector’s development.

The policy also sets the tone for sector development (especially from the perspective of supply) by recognizing the need to distinguish different kinds of institutions based on the nature of their activities, their scale and funding sources. It specifies that MFIs that mobilise savings would need to be subjected to mandatory supervision and regulation through public intervention. At the same time, it is also recognised that other forms of supervision, including self-monitoring through a peer organisation, will be needed to promote greater transparency within the sector. This will contribute to the improvement of the quality of financial service
delivery especially by those institutions that do not fall under the supervision of public agencies.

Significantly, the policy paper is explicit about MFIs charging sustainable interest rates. This is defined as rates that take account of institutions' administration costs, loan losses, and cost of funds (i.e. that make MFIs financially sustainable and not merely operationally sustainable).\(^5^2\) The policy also explicitly mentions that interest rates shall not be subsidised, in recognition of best practice in microfinance.

In terms of the role to be played by Government, the policy paper considers the importance of the involvement of key state actors, such as the Ministries of Finance, and Economic Planning, the RBM, the Ministry of Agriculture and Food Security, and the Ministry of Industry and Trade. These state actors play a crucial role in ensuring effective coordination among all those involved.

While the broad policies state the importance of access to finance, the development of the country’s financial market has historically been discouraged by the country’s macroeconomic performance, especially in the period up to 2005. In particular, the high fiscal deficit, high rate of inflation, and high real interest rates, have been impediments to financial sector development and to increasing access to financial services.\(^5^3\) However, the improved macroeconomic performance and relatively good weather for agricultural production since 2005 has ushered in a period of considerable growth and development in the economy, in general, and in the financial sector, in particular. There has been an increase in the number of players in the financial sector over the last five years, particularly among banks and other non-bank credit-only institutions, which allows for greater competition within the sector. Moreover, there has been considerable product innovation within this period, such as the introduction of debit cards, the explosion of payroll-based lending, the offering of card based savings and other innovative insurance products (e.g. funeral insurance, weather insurance).

These developments are relatively new. While there are early indications of how these developments can lead to the better functioning of financial markets, their impact on financial access has yet to be demonstrated. As noted earlier, given the country’s dependence on agriculture, the improved economic situation in the country has also been significantly influenced by favourable weather conditions that have resulted in good harvests, but which cannot be relied upon in the future. In the face of this kind of uncertainty, broader development policies play a very crucial role in ensuring that there is less friction between the various market players.

The legal and regulatory framework for financial services
Against this backdrop, important measures have been undertaken by the GoM, RBM and other key stakeholders to strengthen the financial sector and create an enabling environment for financial service provision. In particular, there have been renewed efforts to finalise a suite of amendments to the financial services law in the country. These amendments centre on updates to the Banking Act and the introduction of an overarching Financial Services Bill (FSB), a Microfinance Bill and a Financial Cooperatives Bill, a Credit Reference Bureau Bill, and a Payments System Bill (amongst others). The FSB provides for the consolidation of supervisory responsibility for the financial sector in a single agency, referred to as the Registrar of Financial Institutions that will, in practice, be the Governor of the RBM.

\(^{52}\) For the importance of financial sustainability, see *Key Principles of Microfinance*, CGAP, 2004

\(^{53}\) This is a finding that has also been repeatedly echoed in past studies that analyze the key issues relevant to the development country’s financial sector.
Interestingly, however, the proposed law also makes provision for the Registrar to designate self-regulatory functions in relation to a class of financial institutions. The amendments made to the suite of financial services laws having been finalised, will need parliamentary approval and approval for publication in the *Gazette* before being passed into law. Financial sector stakeholders eagerly anticipate the finalization and passing of these laws by Parliament – as it had already taken a considerable amount of time for these laws to be drafted and presented to Parliament for approval. The descriptions of the amendments made and observations on important provisions of the proposed new legislation are presented in Annex D.

With the passing and implementation of these new pieces of legislation, non-bank forms of financial institutions would be granted licenses to operate. The institutions cover a wide range of institutional types and microfinance institutions in particular could be regulated as deposit taking, non-deposit taking or purely credit-granting institutions. Thus, many financial institutions expect that the passing of these bills will pave the way for greater legitimacy within the sector, which is in the interest of those better performing institutions that are not necessarily willing or able to transform into a full commercial bank.

The legislation is still waiting Cabinet approval (and amendment) to go to Parliament, and some pieces are still being drafted, so certain areas of substance may change. In that respect, it is important to point out that while ‘microfinance services’ have been explicitly defined in the Microfinance Bill – broadly as services that cater to micro or small enterprises (MSEs), low-income customers, and those who are financially underserved – it will be useful to consider how this translates into a working definition of a ‘microfinance institution’. In other countries that have also developed specific legislation on microfinance, useful definitions of a microfinance institution have often included specifications on the proportion of an institution’s business that is microfinance oriented.

These new reforms are a welcome and important step towards developing a robust but targeted regulatory system. In particular, the explicit recognition of different types of financial institutions (e.g. MFIs and SACCOs amongst others) should allow regulation of NBFIs to develop in a way that is sensitive to the different risks posed by those sectors, thereby allowing the regulatory system overall to be more effective.

However, the new legislation places a large number of duties on the Registrar, potentially including prudential regulation of many, relatively small, financial operators. In anticipation of this change, the RBM is progressively implementing a risk-based approach to regulation. It will be important to ensure that the Registrar’s office is properly resourced to avoid creating a bottleneck and a barrier to the development of the financial sector as a whole. In particular, much of the detail of the new regulatory system will be prescribed in regulations, not in the statute. This is a common and effective way to help make a regulatory system more flexible. It is, however, important to point out that if such regulations are not developed and implemented in a consultative, transparent and coherent way, they can cause complications and confusion in the law. In turn, that could undermine investor confidence (particularly foreign investment), prevent the development of new products and services and undermine the efficacy of the regulatory system itself. Resourcing and constant communication with the industry will therefore be key to ensuring that the wide ranging legal reforms work well.  

54 In most other countries, non-bank financial institutions and other types of registered institutions (e.g. those providing microfinance services, and especially those providing credit only) are typically not subject to statutory prudential regulation and supervision by a central supervisory authority, mainly because they do not mobilize retail deposits from the public and intermediate those deposits.
One of the key concerns raised by stakeholders in the microfinance sector during the consultations over the Microfinance Bill and the Financial Co-operatives Bill, was that the cost of regulation could end up being high, especially if the minimum cost for regulatory capacity were shared by the relatively small number of players in the sector. If the cost of the regulator’s operations are not properly controlled and are fully passed on, then this might prove to be an unsustainable burden on MFIs, many of which are marginally profitable, or incurring losses. A high cost of regulation might deter new entrants or deter MFIs from entering categories with higher costs due to the higher level of regulation, perhaps that of deposit-taking institutions. If these were the effects, then far from promoting increased entry and enabling MFIs to move to fuller service provision, the legislation might deter or limit those intentions. Therefore, it will be important to give careful consideration to the level of public funding for the Registrar and the extent to which funds it receives from one section of the financial services sector will be used to support its regulatory activities to another.

In other areas, it is important to mention here that one of the critical issues currently being resolved in Malawi’s financial sector relates to the functioning of foreign exchange markets. As mentioned earlier, there is an on-going legal conflict regarding the licensing and registration of foreign exchange bureaus. To date, new licences for some existing foreign exchange bureaus have not been issued and they have been recently compelled to stop their operations. The main impact of this will be on MSEs that rely on bureaus to access foreign currency for trading purposes. Many of these would not be easily able to access foreign currency through a bank, especially when there are shortages, as has been experienced in recent times. Foreign exchange bureaus also act as recipient points for remittances and places to remit foreign currency, through service providers such as Western Union.

The GoM has demonstrated a high level of commitment to establishing a strong framework for Anti-Money Laundering and Combating of Financing of Terrorism (AML/CFT) (World Bank, 2008). This commitment is made evident in the enactment of the Money Laundering Proceeds of Serious Crime and Terrorist Financing Act (ML&TF Act) in August 2006. An implementation programme is currently under way. The Act addresses key fundamental requirements by imposing AML/CFT obligations on all financial institutions and designated non-financial businesses and professions covered by international standards, except for life insurance companies. Moreover, the RBM has also taken steps to improve its capacity, including examining AML/CFT transactions via training and additional staffing. Banks are already complying with many of the preventative measures of the ML & TF Act. The RBM has issued a Customer Due Diligence (CDD) Directive, which is prompting banks’ compliance.

However, such institutions are still required to adhere to a set of rules and standards with respect to the conduct of their business operations to provide protection for their borrowing customers.

Some of the bureaus have taken the matter up in the High Court for a judicial review. Apparently, they want either the decision to close their operations, or that of failing/delaying to renew licences, to be reviewed.

It is, however, important to note that the FinScope Malawi 2008 findings suggest that the proportion of adults who report receiving international remittances is relatively low in Malawi. Moreover, even when foreign exchange bureaus were in operation, those bureaus that operated Western Union and similar international cash transfer agencies were limited to sending only US$100 at a time, due to exchange control regulations, and were therefore hardly used for sending out cash.
Related to this is the issue of expanding access to finance via domestic and cross-border branchless banking. In a recent study undertaken by OPM/IRIS for the World Bank, the review of financial sector regulations in Malawi concluded that it is not yet clear whether only licensed financial institutions can run branchless banking schemes such as electronic wallets. It also pointed out that as a number of financial sector bills are still waiting to be enacted – especially the Payment System Bill (originally drafted in 2002), being the most relevant to branchless banking. The possibility of cellular network operators becoming licensed to operate payments services also remains only theoretical. It is important to emphasize that the continued absence of an updated Payments System Act means that there is no modern enabling legal framework for payments system in the country, which are still currently regulated under an Act of 1967. The RBM has, however, expressed its commitment to extending access to financial services, and is therefore open to permitting innovative techniques.

The current legal framework is also not clear as to whether the use of agents to conduct financial transactions outside the branches of banks and other financial institutions is permitted, though the draft microfinance legislation does contain provisions for the outsourcing of certain banking functions to agents. While recognizing the inadequacy of the current legal framework, the RBM is very interested in promoting electronic banking and cell phone banking, encouraging it to the extent that they can under the existing laws and regulations. The enactment of the FSB is also expected to help facilitate the needed developments in this area, as it would permit the RBM to issue directives governing outsourcing by financial institutions.

The AML/CFT Act prescribes KYC and CDD rules that include the need for some information and documentation on clients. These requirements might be difficult for migrants and other poor clients to provide, such as production of an official identity document and proof of address. Moreover, financial institutions are also expected to take reasonable measures to establish the source of wealth and source of property of a client. Such requirements, if and when applied strictly to low-value accounts and transactions, could limit access to finance due to the lack of documentation by this particular group of clients. Moreover, the cost of due diligence could make the provision of small-value remittances and transfers prohibitive, and might deter both financial institutions and low-income users of financial services from transacting.

The Act, however, appears to permit (regulated and supervised) agents to perform some of the KYC functions, rather than requiring that full verification of identity be conducted at a branch of a financial institution. Thus, Malawi’s Financial Intelligence Unit (FIU) is currently drafting AML/CFT regulations under the AML/CFT Act that would take a more flexible approach to the subject, including a risk-based approach to CDD. Some of the noted changes include explicitly authorizing the current practice of accepting a letter from the client’s District Commissioner in lieu of a national identity card, passport, or driver’s license.

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3.3 The support infrastructure: meso-level institutions

The payments system in Malawi

Malawi’s payments system was underdeveloped before 2002: inter-bank funds transfer transactions and processing of cheques were done manually. The system was characterized by long clearing periods for cheques, ranging from seven to twenty-one days. This meant a high level of inefficiency as funds were unnecessarily held up in the payments system.

Since then, the RBM and other relevant key stakeholders have established the National Payments Council (NPC) with the aim of modernizing the national payment systems infrastructure. This was also aided by the SADC Payment Systems Project under the auspices of the SADC Committee of Central Bank Governors (CCBG). In 2001, the RBM, the Bankers Association of Malawi (BAM), and the NPC endorsed the ‘Malawi National Payment Systems Vision and Strategy Framework’, which serves as the blueprint for all national payments system modernization projects in the country.

Under the guidance of this strategy framework, the RBM has spearheaded further developments, including financing the establishment of a frame relay-based national network infrastructure and a transaction switch called Malawi Switch Centre (MALSWITCH). This is considered a major milestone in the modernization process. Through MALSWITCH, links between commercial banks and discount houses onto a common network platform are to be facilitated, providing a number of electronic based payment, clearing and settlement facilities. The modern electronic facilities include a real time gross settlement system, which allows high-value inter-bank funds transfer transactions to be settled in real time. Malawi has also introduced a chip-based card scheme that uses biometrics in addition to the personal identification (PIN) code. An electronic-based cheque clearing house was also commissioned in August 2005.

While these reforms and developments have improved the functioning of the financial sector, there are still a number of issues that remain to be resolved. Central to this discussion is the role of MALSWITCH, which was implemented in order to link all the banks and allow electronic cheque clearing and real-time settlements between them. Beyond this, MALSWITCH was also envisaged as a promising platform for a range of electronic payment, fund transfer and banking products. In practice, however, the use of the MALSWITCH network to support fund transfer services has reportedly been low, as only a limited number of banks have installed electronic interfaces with MALSWITCH that enable card users to use any ATM machine, regardless of bank branch or location.

The NPC is pushing for interoperability between the cards and systems and hopes to have an integrated system very soon. The practicability of having such an interoperable system hinges upon coordinated efforts between all stakeholders involved, ensuring the harmonization of the systems that are in place between the different financial institutions operating in the country. Moreover – and relevant to the issue of expanding the reach of access points – electronic banking that may be facilitated by a truly interoperable system will require a reliable communications infrastructure that is linked to POS or ATM devices.58

The support institutions

Support institutions are crucial to the development of the financial sector as they help to facilitate the exchange of useful experiences, ideas, innovations and information among

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58 Access to cellular phones and landline networks, as well as computer penetration is still low in Malawi relative to its neighbours in Southern Africa.
sector players. Experience in other countries also shows that support institutions play a central role in helping build the sector through advocacy on behalf of financial service providers and getting involved in enhancing the capacity of individual institutions.

There are currently two support institutions playing a key role in Malawi’s microfinance sector: Malawi Microfinance Network (MAMN) and the Malawi Union of Savings and Credit Co-operatives (MUSCCO).

**MAMN** began as an informal network of MFIs and was formally established in 2000 as a professional association of Malawi’s MFIs aimed at coordinating activities in the sector and fulfilling self-regulatory functions for its 20 member-institutions (as of June 2009). It aims to develop and promote microfinance activities, ensuring good governance and practices are adhered to by its members and helping to ensure their sustainability. MAMN has a Secretariat, housed at the MRFC offices in Lilongwe.

It has been able to run a number of training programmes with support from various donors, as well as to gather sector data and information, and organise a national Microfinance Conference in 2008. MAMN also works with other support organizations, such as MicroSave, in undertaking studies to better understand the sector. MAMN conducts assessments of the training needs of its member institutions, and on this basis, delivers training programmes that are either carried out by professionals within the network itself or outsourced to external consultants or other service providers.

Based on its self-assessment, MAMN recognizes that the biggest challenge facing its member institutions is in loan portfolio management. A survey undertaken by MAMN in September 2008 showed that the average portfolio at risk for the microfinance sector was greater than 25%. MAMN recognizes that addressing this problem requires that institutions become more transparent and capable of measuring their individual performance.

MAMN admits, however, that its ability to undertake more direct engagement with member-institutions has been limited by staff and resource constraints. While it has been able to gradually establish a stronger presence and facilitate improved co-ordination within the sector, it has yet to reach its full potential as a support organization.

**MUSCCO** is an apex organization comprising 59 SACCO-members. It provides its members with access to its Central Finance Facility (CFF) and other services, including audit and training. The refinancing facility is capitalized by member-SACCOs’ contributions.59

MUSCCO keeps track of its members’ performance via monthly reports that it requires members to submit, along with monthly visits by its field officers. Where possible, these field officers conduct on-the-job training or help to address problems of SACCOs during the visit. Beyond this, MUSCCO also delivers more structured training programmes attended by the key officers of member-SACCOs. The training is often subsidized (up to 50%), in order to provide SACCOs the incentive to participate. Based on its experience so far, MUSCCO notes that training programmes on financial accounting have attracted a lot of interest from members. MUSCCO welcomes this as a positive sign that SACCOs are aware of the need for them to improve financial management. At the same time, MUSCCO admits that there is much left to be done in order to help SACCOs build their internal capacity, especially since many of these institutions do not hire personnel with banking qualifications. On the other

59 The Facility holds the excess liquidity of SACCOs.
hand, there are SACCOs – especially those which are urban-based – that, given their size and years of operation, are more professionally managed and behave like banks.⁶⁰

MUSCCO cooperates with the Ministry of Industry and Trade, as this is the Ministry that is currently in charge of registering SACCOs in the country. It also maintains alliances with other international support institutions and donor programmes, including WOCCU. MUSCCO acknowledges that it needs to continue building its capacity as a support institution in order to better address the needs of its members.

⁶⁰ The comparison refers to how these ‘better managed’ SACCOs tend to be similar to banks in the sense that these SACCOs have better developed and clearly articulated organizational policies, better qualified managers running them, and even own and maintain well-equipped branches and offices.
4 Analysis of demand-side data and implications for the supply of financial services in Malawi

In this section, the results of the FinScope Malawi 2008 study are considered for the light they shed on shortfalls in the supply of financial services. The analysis shows that while levels of access to finance in Malawi are comparable to what can be observed in other developing countries in the region, the level of financial access in Malawi remains inadequate.

4.1 Access to finance for individuals

The overall access strand for Malawi (Figures 4.1 A and B) shows that while the level of bank penetration is towards the top end of its peer group of countries (i.e. taking into account Malawi’s low per-capita GDP), the overall levels of financial inclusion is low given the limited additional reach of NBFIs. The access strand places the Malawian adult population along a continuum of usage of financial services from banks to other formal service providers (microfinance institutions, insurance companies), through those informally served to those who are totally excluded. It gives a picture of where financial service provision is coming from, and draws attention to the adults who claim that they do not use any form of financial service whatsoever. The results show that the proportion of those excluded from any form of financial access is high at 55%. Those who are excluded tend to be rural-based, female and with little or no education (Figures 4.1 C to F).

Figure 4.1 Financial access in Malawi (% of all adults)

A. The financial access strand in Malawi (% of all adults)

<table>
<thead>
<tr>
<th>Overall</th>
<th>Banked</th>
<th>O-Formal</th>
<th>Informal</th>
<th>Excluded</th>
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<tbody>
<tr>
<td></td>
<td>19%</td>
<td>7%</td>
<td>19%</td>
<td>55%</td>
</tr>
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</table>

61 The categories are mutually exclusive. Thus, for example, someone with access to both bank and other informal services will fall into the category of banked and not formal – other; a person who falls into the category of informal will be someone who has no access to formal services. Those who have access to bank accounts or to other formal services are defined as formally served; the formally served together with those with access to informal services are defined as financially included.
B. **Comparison with other countries in the region**

- **Botswana [$12880]**
- **South Africa [$9450]**
- **Namibia [$5100]**
- **Nigeria [$1760]**
- **Kenya [$1550]**
- **Tanzania [$1200]**
- **Zambia [$1190]**
- **Uganda [$1040]**
- **Rwanda [$860]**
- **Malawi [$760]**

**Numbers in brackets are per-capita GDP in 2007 adjusted to purchasing power parity**

C. **Difference by location**

<table>
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<th></th>
<th>Overall</th>
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<td></td>
</tr>
<tr>
<td>O-Formal</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Informal</td>
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D. **Differences by gender**

<table>
<thead>
<tr>
<th></th>
<th>Overall</th>
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<th>Female</th>
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<tr>
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<tr>
<td>O-Formal</td>
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<tr>
<td>Informal</td>
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E. **Difference by age**

<table>
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<th></th>
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<th>56-65 years</th>
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<tbody>
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<td>Banked</td>
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<td></td>
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<td></td>
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<tr>
<td>O-Formal</td>
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</tbody>
</table>
Overall, the demand-side data in the FinScope Malawi 2008 study presents a fairly typical picture for a country in Africa that is at the same level of development as Malawi’s.

- Firstly, as has already been mentioned, the proportion of those financially excluded remains high at 55%.
- Less than one in every five adults has access to a bank account, and formal financial services are accessed by only one in four adults.
- The reach of the informal sector (25% of adults) is as large as the combined reach of banking and other formal institutions. It is, however, important to point out that the informal sector does reach a different segment of the market: only a fifth of the informally served also access formal financial services.
- Not surprisingly, formal access is much lower in rural than in urban areas and a bit lower for women than men. Formal access also tends to favour the middle-aged and the well educated in the population.

The fact that over half of Malawi’s adults are not served at all does not necessarily mean that they do not require financial services; it is far more likely to mean that they are using sub-optimal solutions – possibly characterized by high risks, high costs – such as keeping cash under the mattress, transferring it by taxi, borrowing from family and friends, etc.

Looking at this in more detail, there is a high degree of overlap between those who are reached by banks and other formal financial services. Figure 4.2 shows that nearly half of those who are banked are also using financial services from other formal financial service providers; less than a quarter are using informal services. More importantly, well over half the users of non-bank formal financial services are banked, but only one in five users of informal alternatives also use formal financial services. The big jump in access, in other words, is between being formally and informally included and not between being banked or otherwise formally reached.
The key questions that emerge from this discussion are:

- Who are the formally reached and what are the characteristics of this segment? Conversely, and more importantly, what are the characteristics of those who are unreached by formal financial services and why are they not being reached?
- Why do some people use informal services and others do not?

These questions are addressed quantitatively, using socio-demographic and economic characteristics to give broad indications of the types of individuals who do or do not access various types of financial services. The main focus will be to address whether the lack of outlets in many districts constrains the choice Malawian adults make when accessing finance or whether other factors are at play. This is then backed up with an analysis of the qualitative reasons why people do or do not use banking services.

Implicit in framing these two questions is the fact that, for all the scale and vibrancy of the non-bank microfinance sector, it still does not reach significant numbers of people that the banks do not, and nor does it fundamentally change the mix of who is reached even though NBFIs have access points in districts where banks have none. For this reason, the following analysis concentrates on the formally reached versus those not formally reached, and then moves on to analyzing those who have access to any kind of financial service (i.e. formal or informal) versus the entirely financially excluded.\textsuperscript{62}

\textsuperscript{62} Further analysis of the ‘banked’ versus the ‘unbanked’ is provided in Annex E of this paper.
4.2 Characterizing those reached and those not reached by formal financial services

Figure 4.3 below shows formally served adults on the left of the chart, broken down by key socio-demographic characteristics in absolute terms (‘000s) rather than in percentages. On the right hand side, those adults not reached by any formal financial services are profiled in the same way.

Figure 4.3 Those formally reached and not reached by gender, location & age (numbers expressed in ‘000)

Source: FinScope Malawi

At first sight, the only obvious defining socio-demographic characteristic of those not being reached by formal financial institutions is living in a rural area. But care has to be taken in drawing this conclusion. While being urban-based makes it more likely that a person is formally served, we need to take account of the fact that a vast majority of the adult population are rural-based. While there are significant constraints to accessing financial services in the rural areas, there are in fact more rural-based customers of formal financial institutions than urban-based ones (and this is as true of banks as other formal institutions). It is important to distinguish whether constrained access in rural areas can be explained by geographical inaccessibility or the lack of interest by providers due to perceptions of rural poverty. Furthermore, the next major factor that is worth investigating is the constraint on access that is caused by low levels of income, as being rural-based is also usually a proxy for being poor, given the much higher incidence and depth of poverty in rural areas as compared to urban areas.

Figure 4.4 confirms that a significant socio-economic characteristic of being unreached by formal financial services is having no or little income. Over three quarters of all adults not
reached by formal financial services declare an equivalent annual income of less than MK15,000 (roughly US$105), which equates to roughly US$1 per day at purchasing power parity adjusted world prices. This could also be interpreted as meaning that three quarters of all unreached Malawian adults apparently do not earn enough to lift themselves above the food poverty line (roughly upgraded for inflation since estimates were last published in 2006).

**Figure 4.4 Income profile of those reached and those not reached by formal financial services (numbers expressed in ‘000)***

<table>
<thead>
<tr>
<th>FORMALLY SERVED</th>
<th>ONLY INFORMAL OR EXCLUDED</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Adults</td>
<td></td>
</tr>
<tr>
<td>Declare an income</td>
<td></td>
</tr>
<tr>
<td>Don’t know / won’t declare</td>
<td></td>
</tr>
<tr>
<td>Say they have no income</td>
<td></td>
</tr>
<tr>
<td>Less than K5,000</td>
<td></td>
</tr>
<tr>
<td>K5,000 – K10,000</td>
<td></td>
</tr>
<tr>
<td>K10,001 – K20,000</td>
<td></td>
</tr>
<tr>
<td>K20,001 – K40,000</td>
<td></td>
</tr>
<tr>
<td>K40,001 – K100,000</td>
<td></td>
</tr>
<tr>
<td>K100,001 plus</td>
<td></td>
</tr>
</tbody>
</table>

Source: FinScope Malawi

This might not seem surprising, but what is really striking is that almost two thirds of those who are reached by formal financial services are also apparently not earning enough to keep themselves above the food poverty line. This seems implausibly high, but it is not because the poverty threshold has been wrongly applied. It will be important to consider that some respondents may have a tendency to under-declare their income, and some will be earning below the poverty threshold but may be living with others earning well above it. The conclusions that emerge from this analysis so far are:

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63 Access in the FinScope surveys is quite understandably defined at an individual level because most suppliers provide services to individuals rather than to households. On the other hand, households are the level at which poverty is defined. The pooling of income within a household (i.e. income from several income-earning individuals) could mean that one adult might not have enough income on his own, but when pooled together with the income earned by other household members, there may be just enough to keep the household from being food poor.
• Not being reached by formal financial institutions must have something to do with location (i.e. rural adults being proportionally less served than those who are urban-based).
• Even more importantly, not being reached may be explained by people’s income profiles, but the FinScope Malawi 2008 results suggest that other factors are at play, given that of those being reached by formal financial services, there are twice as many poor adults as there are better off individuals.

4.3 Exploring differences in the reach of formal financial services in rural and urban areas

Even when bringing in income as a possible factor, it is still difficult to be definitive at a national level about the determinants of being reached or unreachable by formal financial services. Geographical location may not be the defining socio-demographic consideration in this case, when compared, for example, to cases of more sparsely populated African countries – though it may still be relevant. Gender may also be a factor; but the FinScope results show that it is not an overwhelming one and similarly with age. On the basis of the declared incomes of respondents to the FinScope survey, low income levels appear to be a constraint. The next step, therefore, would be to explore the coincidence of how geographical location and income level determines financial access.\(^{64}\)

The figure that follows (Figure 4.5) depicts an unambiguous and quite strong income effect that emerges from both urban and rural populations. This visibly manifests itself in various ways.

• Rural penetration of formal financial services, although low, rises steadily from about 10-15% for rural adults declaring no or very little income (i.e. those with under MK 5,000 per year), up to 50% once declared incomes rise above the food poverty line.
• In urban areas – i.e. essentially Malawi’s four main cities – the relationship between income and accessing bank services is even stronger, but because Figure 4.5 above is scaled to show both urban adults and the much larger rural adult population together, the relationship does not appear so visible. It becomes much clearer in Figure 4.6 below. There is a steady rise in penetration of banking services through the lower income bands in both numbers and percentage terms. It peaks at about 75% or so when declared incomes rise above the food poverty line. Interestingly, at this level, access is about the same as would be experienced in an advanced industrial economy.

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\(^{64}\) It is important to note that apart from differences between rural and urban areas, differences might also exist between North, South and Central regions – where there are also pronounced differences in income levels.
Figure 4.5  Income profile of the banked and unbanked by location (numbers expressed in ‘000)

Figure 4.6 Income profile of banked and unbanked urban adults (numbers expressed in ‘000)

What is particularly interesting about this comparison is that peak penetration is not that much lower among relatively well off rural adults (+/- 50%) as it is among relatively well off urban adults (+/- 75%). A 'rural-urban effect' is therefore at play, though it is not a very strong one and certainly not one that should be the prime focus of policy in the area of access to finance.

This is confirmed by what is demonstrated in Figure 4.7, which shows penetration of banking services down to district level, with districts plotted by their population density and the proportion of that population living below the national poverty line. It is a complex chart but one very rich in useful information.

Figure 4.7 Bank access at district level by population density and poverty

Note: A district higher up the chart and further across to the right is a very poor, very rural one. A district further down the chart and towards the left is a much more densely populated one with a better off population (and the four main cities appear in a cluster at the extreme bottom left). The bubble size gives an indication of penetration of banking services among adults (data taken from FinScope) and its colouring gives an indication of what sort of density of bank outlets there is in the district – a dark blue bubble means strong provision of outlets, light blue denotes below average and no colour at all (but just an outline) denotes penetration but no outlets. Dark circles indicate one branch per 30,000 households.
adults or fewer, light circles 30~100,000 adults per branch and empty circles no branches in the district.

Source: FinScope Malawi 2008 combined with supply-side survey data.\(^{65}\)

Branches and outlets tend to be more present in areas characterized by low poverty, regardless of population density. It is the less densely populated areas that are also poor that tend to have less access points. This chart suggests that declared use of banking services is relatively invariant to the number of access points or how sparsely populated or rural a district is (i.e. how far to the right of the chart the circle is centred); although the poorer a district is, the lower the level of bank penetration generally tends to be. The weak correlation between geographical location (i.e. sparsely populated rural vs. relatively densely populated rural vs. very densely populated cities) and the use of banking services is not surprising considering the spatial distribution of Malawi. Unlike in other countries, the country’s rural areas are not so distant from urban centres (or centres of economic activity where bank outlets tend to be located) to an extent that it becomes prohibitively difficult for people to physically travel to branches. It is the less densely populated areas that are also poor that tend to have a less favourable situation when it comes to the number of access points available. On the other hand, while areas with higher density as well as high levels of poverty tend to have more access points and a deeper banking penetration compared to low density–high poverty areas, these areas still have fewer access points relative to those areas characterized by low poverty. In summary:

- Bank branches and outlets are concentrated in areas with low poverty, with only a few locating their outlets in areas that may be poor, but are nonetheless typically densely populated. It is understandable that banks would be less interested in serving poor areas, especially if these areas are also less densely populated, given the implications on banks’ transaction costs. But there is definitely scope to extend banking services to those areas that are poor but have a high concentration of people living in them.
- That the use of banking services seems relatively invariant to the number of access points or how rural a district is suggests that people who live in less densely populated rural areas still make use of financial services. While bank branches indeed largely tend to be more present in urban areas and location of an access point is an important consideration in the choice of an individual to make use of a financial service, these results suggest that other variables still need to be considered – such as, for example, whether financial services being offered are configured to meet the needs of rural people. As stated in the previous chapter, some banks are already finding that in rural-based branches, clients tend to be most interested in having access to savings products – an observation also shared by some of the SACCOs (e.g. Bvumbwe SACCO).

4.4 Characterizing those who have and those who don’t have any access

That the unserved rural poor need financial services becomes very clear when the definition of access is expanded even further to include informal providers – ROSCAs, moneylenders, 

etc. Doing this almost doubles the number of adults reached because there is far less overlap between formally served adults and the informally served. Interestingly, Figure 4.8 shows that the overlaps differ in subtle but important ways between urban and rural areas.

**Figure 4.8  How overall access is constituted in urban versus rural Malawi**

For urban-based adults the overlap between informal and formal is quite low – less than a tenth of urban-based adults who access formal financial institutions also use informal services (compared to a fifth for all adults). On the other hand, two fifths of urban-based adults using informal services also access the formal sector. For those in the rural areas, the overlaps are even more pronounced, which is not surprising given the overall overlap is very even and rural-based adults account for five out of six adults in Malawi.

Thus, an important finding emerging from the study of these survey results is that in rural areas, when we include informal sources of finance, the proportion of adults with financial access almost doubles, whereas in the much better formally served urban areas access only increases by about a fifth.

The charts that follow reproduce the profiles by the same set of socio-demographic and economic characteristics for those with any form of access to financial services (the so-called financially included) and those who say they do not have any form of financial access (or the excluded). These charts make explicit what is implicit in the overlap diagrams above – it is only when informal supply is included that the profile of users broadly mirrors that of non-users. Clearly informal suppliers do something that opens up finance to huge numbers of the rural poor who currently do not and quite probably cannot access formal financial services.
Figure 4.9 Financially included / excluded by gender, location and age (numbers expressed in ‘000)


The earlier analysis suggests that this is not just a geographical issue. Moreover, it also cannot just be an issue of insufficient income. Informal services are rarely low cost: informal...
loans almost always carry very high interest rates; loss rates on lending to friends and family make it a very poor way of saving; risks of default within rotating arrangements are also a significant hidden cost; there are also informal deposit collection costs. Thus, it must be something to do with (a) informal suppliers being able to (or being perceived to be able to) provide services whose features more closely match the needs of the poor as the poor see them and/or (b) informal suppliers being willing to provide a service that formal providers are not willing to supply to this group. The characteristics of the services provided by informal suppliers that may appeal to the low-income target market – as discussed in the previous chapter – include very minimal amount of time involved in the processing of loan applications, quick and hassle-free disbursement of loans, proximity of the lender or of the place where savings are kept, absence of cumbersome requirements (including collateral), etc.

4.5 Cited reasons for not using banking services

The FinScope survey asks potential users of bank accounts – both those who have them and those who do not – questions that give some insight into why they have made their respective choices. These are presented in the table below. The left-hand column includes factors that are both real as well as those that have to do with perception. These are called Mind-Set issues and are to do with whether or not a person sees the point of having a bank account – e.g. “I need it as a safe place to save”; “I don’t have enough money to run an account”; “I need to transfer money safely”; “It’s too complicated for me”, etc. A lot of these issues are to do with affordability and complexity and are very real to the potential customer and may in fact reflect a perception gap in the mind of suppliers. New ways of thinking about service delivery and cost allocation (and therefore pricing) can open up a service to huge numbers of additional customers. Equally, lack of affordability can be in the mind of the customer rather than something in the reality of what it actually costs to use a bank account. For example, there is a growing amount of research showing how the poor pay more to informal suppliers to achieve the same economic end as they would have to pay a bank.

On the right hand side are the so-called operational issues – i.e. issues banks can do something about just by adjusting their current models of service delivery.

Table 4.1 Factors shaping the demand for banking services in Malawi

<table>
<thead>
<tr>
<th>MIND-SET ISSUES</th>
<th>% citing the issue</th>
<th>OPERATIONAL ISSUES</th>
<th>% citing the issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money safe from theft</td>
<td>62%</td>
<td>Receive transfers</td>
<td>28%</td>
</tr>
<tr>
<td>Avoid temptation to spend</td>
<td>33%</td>
<td>Receive salary</td>
<td>20%</td>
</tr>
<tr>
<td>To save for a purpose</td>
<td>27%</td>
<td>Transfer money cheaply</td>
<td>13%</td>
</tr>
<tr>
<td>To save for emergencies</td>
<td>26%</td>
<td>To access loans</td>
<td>10-15%</td>
</tr>
<tr>
<td>To transfer money safely</td>
<td>18%</td>
<td>For business purposes</td>
<td>&lt;10%</td>
</tr>
<tr>
<td>To hide money from family</td>
<td>5%</td>
<td>Convenience of access</td>
<td>7%</td>
</tr>
</tbody>
</table>
What the unbanked say about why they do not use a bank account:

<table>
<thead>
<tr>
<th>MIND-SET ISSUES</th>
<th>% citing the issue</th>
<th>OPERATIONAL ISSUES</th>
<th>% citing the issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Don’t need / no money</td>
<td>54%</td>
<td>Don’t know how to apply</td>
<td>8%</td>
</tr>
<tr>
<td>Income but no spare money</td>
<td>44%</td>
<td>Too difficult to reach</td>
<td>6%</td>
</tr>
<tr>
<td>Can’t maintain balance</td>
<td>19%</td>
<td>Service charges too high</td>
<td>2%</td>
</tr>
<tr>
<td>Don’t see benefits</td>
<td>5%</td>
<td>Cannot fulfil application requirements</td>
<td>&lt;2%</td>
</tr>
<tr>
<td>Don’t understand banks</td>
<td>3%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks not for likes of us</td>
<td>3%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


What is really striking about this is how much the mind-set issues dominate. They far outweigh issues related to branch proximity, tariff structure, application / access requirements, etc. There are two key issues emerging here. Firstly, for the unbanked, the lack of adequate income is an overwhelmingly strong factor influencing their decision not to use a bank account. This is also very closely linked to the issue of the affordability of banking services: while there are undoubtedly those among the unbanked who may be too poor – i.e. those without enough income to generate surpluses, no matter how small, that can be saved – there are, at the same time, those among the unbanked who may indeed have low incomes and decide not to have an account on the basis of their perception of the affordability of banking services. Thus, while it will be meaningful to improve the financial literacy of the poor – specifically enabling them to better understand the different products and services on offer, as well as the variety of institutions providing these services – an improved level of financial literacy will, however, be limited in making the supply of financial services any more accessible unless these services are seen to be priced affordably.

4.6 Implications for the supply of financial services to individuals

This review of the FinScope demand side survey highlights the issues that are critical to the development of the supply side. Over half of Malawi’s adults are financially excluded or without any access to any form of financial service. That does not necessarily mean they do not require financial services; it is far more likely to mean that they are using sub-optimal solutions.

The analysis of the FinScope results suggests that:

- Making a significant breakthrough on access essentially means targeting the poor, as those who are better off are already relatively well penetrated. That said, it is, however, important to qualify what constitutes ‘the poor’ and ‘the better off’ in Malawi. For example, it is estimated that about 87.5% of private sector waged staff in Malawi still do not have a bank account. While private sector employed individuals are generally considered among

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It will be important to consider that price is also dependent on the product design, including the chosen mode of delivery of a financial service. Making financial services more affordable could very well mean more than just reducing an institution’s margins; in many cases, it requires better designed products and innovations in service delivery that reduce the cost of providing the service.
those who are better off (in most other countries), it is important to consider the levels of cash poverty in the country: and the results in Malawi suggest that while there is scope for expanding access even among those who are better off, there is, at the same time, merit in having an explicit pro-poor strategy that starts by extending financial services to waged individuals. This should be translated into offering different kinds of bank accounts and not just scaling down accounts that target elite customers because high levels of take-up will only come when products are better suited to or meet the needs of a relatively poor waged person.

- There is a high degree of overlap between those who are reached by banks and other formal financial services. More importantly, the FinScope results indicate that the big jump in access comes between being formally and informally included and not between being banked or otherwise formally reached. The non-bank microfinance sector, still does not reach significant numbers of people that the banks do not, and nor does it fundamentally change the mix of who is reached even though NBFIs have access points in districts where banks have none. Thus, while the provision of microfinance services in its broadest sense – i.e. covering the services provided especially by non-banks – helps expand access for the poor especially in the rural areas, this is so far not enough to change the fundamental access levels of the un-served.

- The analysis of FinScope results against supply-side data also shows that geographical accessibility is less of an issue. Bank branches and outlets tend to be more present in areas characterized by low poverty, regardless of population density. It is the less densely populated areas that are also poor that tend to have less access points. The analysis points to the scope for exploring the expansion of banking services to those areas that may be poor but have a high concentration of people living in them.

- Related to this last point, it will be meaningful to consider that there is quite a strong income effect that emerges from the analysis of urban and rural populations. In urban areas, the relationship between income and accessing bank services is the strongest. There is a steady rise in penetration of banking services through the lower income bands in both numbers and percentage terms. It peaks at about 75% or so when declared incomes rise above the food poverty line.

- Moreover, while location of an access point is an important consideration in the choice of an individual to make use of a financial service, these results suggest that other variables need to be considered – such as, for example, whether financial services being offered are configured to meet the needs of rural-based people. Some banks are already finding that in rural-based branches, clients tend to be most interested in savings products. Thus, being relevant and responsive to the needs of the poor (and those who are rural-based) matters just as much as affordability.

- Lastly, in rural areas, when informal sources of finance are included, the proportion of adults with financial access almost doubles, whereas in the much better formally served urban areas access only increases by about a fifth. Clearly informal suppliers do something that opens up finance to huge numbers of the rural poor who currently do not and quite probably cannot access formal financial services.

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67 That is, given the assumption of higher wage rates in the private sector and/or regular patterns of income flows for individuals in receipt of wages.

68 This constitutes what is often referred to as ‘the low hanging fruit’ in expanding access to financial services.
5 Summary of barriers to financial access

In many developing countries like Malawi, significant proportions of the population are either financially excluded or face severe constraints in accessing financial services. There are price and non-price barriers to accessing deposit, credit, payment and other financial services. These barriers are usually associated with eligibility, affordability and physical accessibility of services, driven by either demand or supply-side constraints or the combination thereof.

This section draws together the discussion in preceding chapters in summarising the key barriers to financial access in Malawi.

5.1 Accessibility of financial service points (branches and outlets)

As has been pointed out in the previous chapter, branches and outlets especially of banks tend to be more present in areas characterized by low poverty, regardless of population density. Moreover, the less densely populated areas that are also poor do tend to have less access points. Interestingly, the analysis of access to banking services at district level by population density and poverty suggests that the use of banking services is relatively invariant to the number of access points or how rural and sparsely populated a district is; although, as expected, the poorer a district is, the lower the level of bank penetration generally tends to be.

The initial conclusion is that there appears to be a weak correlation between geographical location (i.e. rural vs. urban) and the use of banking services. As noted, this is not particularly surprising considering the spatial distribution of Malawi, where the country’s rural areas are not so distant from urban centres compared to many other African countries.

It is relatively easy to explain why bank branches tend to concentrate in areas with low poverty, with only a few locating their outlets in areas that may be poor, but are densely populated: setting up operations in poor areas, and especially if these areas are also less densely populated, have implications on banks’ transaction costs. Areas that are poor are often characterized by deficient support infrastructure (such as electricity and telephone lines) crucial to branch operations. For example, according to FMB, the cost and unreliability of communication links (due to the absence of fibre optic connections within Malawi) is a major factor hindering the expansion of its services to more remote areas. Even public entities like MRFC, note that poor quality roads (in some rural areas) prevent the institution from establishing a stronger presence in these areas. Related to this is the issue of security: field officers that travel to areas that are relatively more remote and difficult to access run the risk of being robbed, as MRFC has experienced in the past. For institutions like Standard Bank, it attributes the challenge in extending services to those in the rural areas to the high cost of setting up new branches or other distribution channels. Many banks point out that extending their services into new districts is difficult, as start-up costs tend to be high.

Furthermore, the difficulty of setting up branches in underserved and poor areas is also often influenced by the way the people in these areas are perceived by financial institutions. They consider the vast majority of people in these areas to face severe economic constraints to the extent that there would be hardly any demand for financial services. It is, however, interesting to note that while this may be the general sentiment held by banks, some banks are finding that low-income people in rural areas do save and that rural branches therefore
tend to act as net lenders to urban-based branches, playing a strategically important role to the bank as a whole. Low-income people in rural (and urban) areas are generally very interested in having a safe place to keep their savings.

It should also be noted that for banks, the difficulty of setting up branches in areas characterized as rural and poor may be exacerbated by the low level of financial literacy in these areas. For most banks, expanding access to these areas means that they have to invest in helping potential customers to understand better the products and services on offer and to convince them to make use of these services. This might require a significant amount of resources and time by bank staff to train potential customers. In some cases, banks and other financial service providers that have been encouraged by the availability of funding from donors may actually be more willing to undertake this kind of investment in helping build a market for financial services.

The costs associated with establishing new branches have several dimensions. Banks and other financial institutions that offer deposit products need to take account of the size of the potential deposit base in an area when assessing the feasibility of new branch operations. There are significant direct and indirect costs associated with running a bank branch that tend to place banks in a cost disadvantage relative to other types of financial service providers. This cost disadvantage forces banks to want to operate in areas with a larger pool of deposits, over which its fixed expenses may be spread, thereby allowing the cost of the branch system to be proportionately less burdensome.

To help address this cost disadvantage, a number of banks (both in Malawi and in other countries) have initiated efforts to restructure. This has involved rethinking the concept of a branch office, allowing the scaling-down of full-service branches. Interestingly, in Malawi, OIBM saw the need for this scaling-down approach and was among the first to introduce bank outlets that include sub-branches or kiosks. The use of the bank-on-wheels is also another demonstration of institutions wanting to service areas of the country without having to set up costly full-service branch operations, allowing them to more ably recover costs. In other countries (notably in Latin America), banks and other financial institutions have even opted to locate within large retail outlets (supermarkets), operating as an ‘in-store branch’. While it is not yet fully developed in Malawi, a number of financial institutions have already expressed a strong interest in service delivery mechanisms that make use of technology. There is a very strong expectation that these will allow institutions to provide services to a broader market segment in a more efficient way.

5.2 Transaction costs vis-à-vis the viability of financial service provision

There are significant transaction costs on both the demand and supply sides – and these are illustrated in Figure 5.1.

On the demand side, transaction costs go beyond the fees and charges that a client must pay for the use of a financial service and encompass the cost of travelling to the place of business/outlet of the financial service provider, costs of establishing eligibility, and meeting other supply side requirements. The barriers to banking, from the perspective of the user, can include minimum deposits or loan sizes and annual account fees that may be prohibitive.

The largest cost component is typically salaries and compensation to staff and managers.
relative to users’ cash incomes, which can prevent a large proportion of the population from accessing banking services. There may also be certain documentation requirements, which are not readily available to most individuals, such as identity cards.

**Figure 5.1** What constitutes transaction costs of users and providers of financial services

![Diagram of transaction costs]

In Malawi, the cost of opening and maintaining a bank account is very high for many low-income households. From the analysis of FinScope data, the overwhelming majority of those unbanked respondents who declared their income claim to have cash incomes below MK10,000 (US$70) a year. For urban-based individuals, this constitutes about 70% of the said respondents; while in the rural areas, this proportion is as high as 85%. With minimum opening and maintaining balances of MK1,000 (US $7) a large proportion of the population would find it almost impossible to meet this requirement. It will therefore be important to consider the scope for introducing low-value savings products similar to those offered by institutions like the MFRC, with lower balances (roughly MK200-300 ($1.50-3.00)), that would appeal to the low-income market segment.

**Table 5.1** Illustrative costs associated with opening and keeping a bank account

<table>
<thead>
<tr>
<th>Service fee</th>
<th>MK100 / month</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ledger fees</td>
<td>MK500 / month</td>
</tr>
<tr>
<td>Cost of withdrawal booklet</td>
<td>MK50-60</td>
</tr>
<tr>
<td>Purchase of ATM card</td>
<td>US$8-10</td>
</tr>
<tr>
<td>Withdrawal charges (using ATM)</td>
<td>MK50-60 / transaction</td>
</tr>
<tr>
<td>Fees for transfers between accounts</td>
<td>MK 250-1,500 / transaction</td>
</tr>
<tr>
<td>Inter-bank transfer charges</td>
<td>MK750-4,000 / transaction</td>
</tr>
</tbody>
</table>

Source: Tariff sheets of bank respondents to the supply side survey (as of June 2009).
Beyond this, there are also other fees and charges – one-off payments and monthly charges – for keeping a bank account, which affect the affordability of savings products for many potential users of these accounts. A typology of the costs associated with maintaining a bank account in Malawi is shown in Table 5.1 above. Assuming that an average account holder makes four withdrawals per month, he/she will have to pay the bank about MK800 (US$6) in fees and charges per month, which is about MK10,000 (US$70) a year. Notwithstanding the one-off costs for purchasing an ATM card or acquiring a withdrawal booklet, or the cost of travel to and from the bank branch, these monthly charges alone would already prevent a significant proportion of the population from having and making use of a bank account.

Table 5.2 Cross-country comparison of barriers to deposit services

<table>
<thead>
<tr>
<th>Countries</th>
<th>Number of banks responding</th>
<th>Deposit market share (respondents share out of total system) 2004</th>
<th>Locations to open deposit account (out of 3)</th>
<th>Minimum amount to open savings account (% of GDPPC)</th>
<th>Minimum amount to be maintained in savings account (% of GDPPC)</th>
<th>Annual fees checking account (% of GDPPC)</th>
<th>Annual fees savings account (% of GDPPC)</th>
<th>No. of docs. to open checking account (out of 5)</th>
<th>No. of docs. to open savings account (out of 5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malawi</td>
<td>3</td>
<td>82.36%</td>
<td>2.00</td>
<td>17.89</td>
<td>17.89</td>
<td>21.98</td>
<td>3.63</td>
<td>3.65</td>
<td>2.84</td>
</tr>
<tr>
<td>Cameroon</td>
<td>5</td>
<td>83.83%</td>
<td>1.88</td>
<td>68.26</td>
<td>54.75</td>
<td>12.22</td>
<td>4.00</td>
<td>4.00</td>
<td>3.11</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>4</td>
<td>93.73%</td>
<td>1.92</td>
<td>5.50</td>
<td>5.11</td>
<td>0.00</td>
<td>0.00</td>
<td>3.77</td>
<td>2.14</td>
</tr>
<tr>
<td>Ghana</td>
<td>4</td>
<td>69.49%</td>
<td>2.15</td>
<td>21.89</td>
<td>11.99</td>
<td>5.90</td>
<td>0.58</td>
<td>3.62</td>
<td>3.24</td>
</tr>
<tr>
<td>Kenya</td>
<td>3</td>
<td>43.82%</td>
<td>2.78</td>
<td>44.30</td>
<td>41.82</td>
<td>12.82</td>
<td>2.07</td>
<td>3.78</td>
<td>2.86</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>4</td>
<td>100.00%</td>
<td>1.42</td>
<td>44.89</td>
<td>43.56</td>
<td>26.63</td>
<td>0.00</td>
<td>4.02</td>
<td>3.88</td>
</tr>
<tr>
<td>South Africa</td>
<td>3</td>
<td>70.09%</td>
<td>2.27</td>
<td>1.06</td>
<td>0.28</td>
<td>2.13</td>
<td>0.91</td>
<td>3.45</td>
<td>3.07</td>
</tr>
<tr>
<td>Uganda</td>
<td>3</td>
<td>59.27%</td>
<td>2.00</td>
<td>48.62</td>
<td>29.52</td>
<td>24.88</td>
<td>3.37</td>
<td>4.00</td>
<td>3.00</td>
</tr>
<tr>
<td>Zambia</td>
<td>3</td>
<td>46.28%</td>
<td>1.80</td>
<td>7.87</td>
<td>7.87</td>
<td>9.07</td>
<td>7.79</td>
<td>4.28</td>
<td>4.00</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>4</td>
<td>28.24%</td>
<td>2.00</td>
<td>2.06</td>
<td>0.69</td>
<td>10.70</td>
<td>6.55</td>
<td>4.13</td>
<td>4.72</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>5</td>
<td>56.98%</td>
<td>2.00</td>
<td>0.89</td>
<td>0.79</td>
<td>0.00</td>
<td>0.00</td>
<td>4.57</td>
<td>4.57</td>
</tr>
<tr>
<td>Bolivia</td>
<td>4</td>
<td>58.04%</td>
<td>2.00</td>
<td>0.81</td>
<td>3.93</td>
<td>0.83</td>
<td>1.78</td>
<td>2.53</td>
<td>2.33</td>
</tr>
<tr>
<td>Brazil</td>
<td>4</td>
<td>64.35%</td>
<td>2.44</td>
<td>0.10</td>
<td>0.00</td>
<td>0.81</td>
<td>0.03</td>
<td>2.67</td>
<td>2.16</td>
</tr>
<tr>
<td>Philippines</td>
<td>4</td>
<td>41.84%</td>
<td>2.00</td>
<td>11.88</td>
<td>11.88</td>
<td>0.00</td>
<td>0.00</td>
<td>3.17</td>
<td>2.20</td>
</tr>
</tbody>
</table>


A study undertaken by the World Bank in 2007 provides some interesting information on the affordability of deposit products across a number of countries. The data collected for a sample of countries, as presented in that study, is shown in Table 5.2. The three largest Malawian banks that participated in this study account for more than 80% of the market for deposits in the country. The figures on the table show that in terms of minimum opening and
maintaining bank balances, Malawi compares favourably against some countries in Africa, such as Kenya and Uganda, where the required deposit balances represent a much more significant proportion of the countries’ GDP per capita. Except for South Africa, countries in Africa tend to have bank deposit products that have high required balances. On the other hand, in terms of the annual fees charged, the cost of operating a savings account in Malawi is much higher compared to countries like Cameroon, Ethiopia, Ghana, Kenya, Sierra Leone and South Africa.

In a recent study undertaken by Microfinance Opportunities for OIBM (McGuinness, 2008), the study’s respondents were asked to rank the attributes of savings products that are most important to them and which influence their decision on where to place their savings. The study showed that interest paid on deposits, proximity, and customer care were among the attributes considered most important by the market. Interestingly, the study pointed out how proximity appears to be just as important as the price of the product offered, and it was hard to disentangle price from proximity as people often considered the high cost of transportation as part of the cost of the product itself. In terms of the rural population, the proximity of institutions providing savings services was shown to be of greater significance than the cost of the product. Moreover, the importance of proximity was also closely linked to security concerns as travelling to towns and cities in order to carry out bank transactions is considered very risky by many people residing in the villages.

There are also certain documentation requirements imposed by financial institutions, which are not readily available to most individuals, such as identity cards. Almost all the commercial banks require their clients to produce an official form of identification in addition to meeting other requirements. The problem, however, is that Malawi does not yet have a national identification system in place. As such, drivers’ licenses and passports are typically used as official identification, but obtaining these types of documents would cost about US$30. In some cases – such as of institutions like OIBM and NBS – alternative forms of identification are allowed, especially when dealing with lower-income clients organized into groups. In such cases, a written letter of reference from the village chief is enough to establish identity of potential clients. In the case of SACCOs, FINCOOP keeps photographs of its members on file as a form of identification.

OIBM uses the Malswitch smart card as a way to facilitate access to financial services for the poor by reducing eligibility barriers. By relying on biometrics and photos, this card replaces the required official identification and gives OIBM an advantage in terms of the competition for rural-based deposits. However, although the use of the Malswitch card is meant to allow poor people to become eligible for savings accounts, OIBM is finding that the cost of acquiring the card is prohibitive for many individuals, especially those in rural areas: the card costs MWK 1,000 (US$7) each (McGuinness, 2008).

There are also other costs incurred by users of financial services that relate to the need for them to abide by certain procedures imposed by financial service providers. This includes the costs associated with forming groups, attending group meetings, filling out multiple forms (when opening an account or applying for a loan), etc. Meeting these requirements could mean having to make several trips to the branch office or to other locations (e.g. government offices for acquiring certificates of property registration), which could be costly for many – especially those who will need to bear the high costs of transportation.

On the supply side, transaction costs for providing small-scale or microfinance services often tend to be high. Some of the factors affecting suppliers’ transaction costs when dealing with low-income and even rural-based clients have already been discussed in the preceding section: these include (a) inadequate or poor infrastructure and communication networks; (b)
relatively low population densities in certain areas, which may require providers to spend a lot of resources travelling (in order to meet clients, whenever needed); and (c) costs of setting up and maintaining retail branch operations.

As noted in the preceding section, banks tend to face serious cost disadvantages when operating in areas that are poor and rural. In many other countries, some banks have tried to address this cost disadvantage by paying closer attention to possible sources of inefficiencies and by undertaking measures to improve the level of efficiency of their retail operations. For example, branch managers track the anticipated volume of customer traffic in their outlets in order to make better use of staff time and allocate resources more efficiently.  

Even while there is scope for banks to scale back their operations in order to reduce costs (and thereby provide more affordable services), there are limitations to how much they can reach down the market given the other dimensions of their cost structure. For example, it will be important to consider the remuneration structure of banks, which can be very much affected by the skills gaps and shortages that exist in the labour market, generally, and in the financial sector, more specifically. There are also certain regulatory requirements that banks and other formal financial institutions must meet that make these institutions less flexible than others. While these regulatory requirements are imposed on institutions in order to safeguard the public interest, they may keep financial institutions from innovating or exploring new ways of providing services to a broader client base. This is the case of one bank, which tried to set up sub-branches or kiosks at a time when only full-service branches were permitted by the RBM. This required the bank to engage the RBM in discussion to help demonstrate the viability and usefulness of permitting banks to operate sub-branches and mobile banks. The RBM was, of course, concerned about issues such as security. Once the issue had been raised and thoroughly discussed, the RBM became more willing to grant the necessary permission. The end result was positive for both the bank concerned and other banks that eventually decided to follow suit: a directive was issued thereafter allowing for the rolling out of sub-branches, etc. and providing guidelines thereto.

The issue of transaction costs incurred by financial service providers is important especially because of its implications on the pricing of products and services offered. The provision of small-scale financial services tends to be more expensive compared to other products that are larger in size; and in many cases, economies of scale are needed in order to allow institutions to spread their fixed costs. At the same time, many successful microfinance institutions operating in different parts of the world demonstrate the capacity to service a large volume of small-scale transactions by increasing the level of staff productivity. Nevertheless, the provision of small-scale services is inevitably more labour intensive than other services; and for many banks (whose remuneration packages tend to be higher compared to most other financial service providers), this in itself translates into a higher cost of providing services.

Making financial services more affordable

As many other financial institutions in other countries have shown, providing more affordable small-scale financial services is possible and can still be profitable for both small and large institutions. For some institutions, providing small-balance savings accounts may not be

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70 In a recent study undertaken by OPM for the World Savings Banks Institute, some financial institutions, such as savings banks, were shown to be able to provide financial services to a broad spectrum of clients including low-income individuals (and even support socially-relevant projects and programmes that promote local community development), while being able to scale direct local branch costs to broadly fit the income generating potential of different catchment areas. See: Peachey et al (2009).
profitable per se but these could be cross-subsidized with larger accounts. Moreover, the use of more efficient delivery models and having a broader outreach can help to mitigate the impact of greater expenses associated with the provision of small-balance savings accounts.

Affordability is central to enabling more people to access financial services – especially savings services which are crucial to asset-building. Making products more affordable will require innovations in terms of the mechanisms used for delivering services to the target group. In environments characterized by poor infrastructure, other ways of delivering services – that make use of technology, such as mobile phone banking – could prove to be an effective way of reaching clients in more remote locations. In Malawi, many financial service providers eagerly look forward to developments taking shape in terms of mobile phone banking, given the expectation that this will lead to reduced transaction costs for providers of services, and consequently, more affordable products that will allow institutions to reach a broader client base.

Most providers operating in the microfinance sector are aware that services provided to the low-income and rural-based market segment tend to be more expensive relative to other services offered. There is also growing acceptance among many stakeholders of the need to price services in a way that allows financial institutions to fully cover their costs and maintain and even extend sustainable operations – i.e. while also continuously seeking ways of improving institutions’ productivity and efficiency levels. Many stakeholders are of the view that appropriate pricing of financial services is crucial to truly enable financial inclusion – where long term relationships are built between financial service providers and users of those services, and not simply providing access on a one-off, short-term basis.

That said, it is difficult for some banks to find the right set of incentives to more strongly position themselves in the ‘microfinance market’. Banks that are interested in the microfinance market are concerned about charging higher interest rates/fees and what the implications might be on their reputations. For now, banks are pursuing further developments in delivery mechanisms that are based on technological applications, which would allow institutions to serve a broader clientele with reduced overheads.

It is against this backdrop of the limitations and imperfections in the market that affect suppliers’ transaction costs that the role of other types of financial service providers can also be properly assessed. Institutions like SACCOs and other non-bank entities, which tend to have lower overheads compared to banks, may actually be better placed to serve those unbanked markets that are poor and remotely located. There are, however, other constraints particularly affecting this non-bank group of institutions that need to be considered, and they are discussed in more detail in the following section.

5.3 Capacity constraints

Smaller and less sophisticated institutions may be less expensive to operate and therefore may have the potential to more cost-effectively provide services especially in areas characterized by poverty and lower population densities. Unlike banks, SACCOs and other NBFIIs typically do not incur the same level of overheads as banks do. For one, remuneration packages offered are well below the banking industry levels. However, it is in this very nature of SACCOs and some non-bank MFIs that the key constraint to operational growth and expansion lies.
While a large majority of SACCOs (that are members of MUSCCO) are operating profitably, most of them are still facing severe challenges in loan recovery. Even the ones that are considered star performers within the sector usually have about 15-20% of their outstanding loans in arrears greater than 30 days, and they report loan recovery rates of only 80-90%. MUSCCO acknowledges that this reflects very weak management and institutional capacity among SACCOs. To address the issue, MUSCCO encourages SACCOs to invest in building the capacity of its core staff, especially if some of them do not have adequate formal training that may be required for certain functions.

Among the other non-bank MFIs the problem of inadequate institutional capacity varies greatly between the different institutions currently operating, as well as between the groups of institutions that are profit and non-profit oriented. But as MAMN observes, the problem of capacity is sector-wide. That many of these institutions are not regulated or supervised, and that there is still much left to be done in standardizing performance monitoring and reporting to existing support institutions, keep many of these institutions from fully developing their institutional capacities.

The problem of inadequate institutional capacity becomes even more pronounced when we consider government-run programmes or microfinance companies. As already pointed out earlier, these providers suffer from having inadequate human resources – whether in terms of having unqualified personnel or inadequate human resources to meet the scale of their programmes. Some run large credit programmes based on very little experience in lending operations that has led to a considerable volume of loans being written off in the past due to defaults. In extreme cases, some institutions are not able to account for all the funds that they manage and some could not trace the borrowers. For example, one of the public entities interviewed in this study pointed out that the institution is unable to measure its overall performance given the inability within its MIS to assign costs accurately. As public entities, these providers are more strongly motivated by purposes other than operating on a sustainable, commercial basis.

There are serious consequences to the lack of capacity that leads to poor loan collection among many institutions. The more serious among these is the wider effect of creating poor attitudes to loan repayment amongst borrowers, as well as making the market unattractive to private sector players that are more rigorous in their loan collection and who price their services with the aim of operating more sustainably. The direct involvement of the public sector in the provision of financial services that is characterized as unsustainable makes it less attractive to private providers to innovate and extend provision to meet the demand for these services.

5.4 The role of the public sector

Developing financial sector policies, laws and regulations

To facilitate greater financial inclusion, there are government policies and interventions that are indispensable to the long-term sustainable broadening and deepening of financial systems. This includes putting in place relevant legislation and other rules that ensure an orderly market consisting of various financial service providers and other relevant institutions. Considerable progress has been made in drafting new pieces of legislation and amendments to existing laws. Many stakeholders in the financial sector eagerly anticipate the finalization and enactment of these laws, as their absence has constrained investment and innovation. At the moment, the lack of legal clarity keeps some institutions from establishing
partnerships with other financial service providers, and also places certain institutions wishing to transform into higher tiers at a standstill.

Moreover, many stakeholders in the financial sector are unclear about the content of the proposed laws, even though these laws have a direct bearing on their operations and the operations of other relevant market players. There is a need to ensure that there is greater sector awareness of the potential benefits of the policies to broaden access and the laws that are being developed in support of these policies; this will help shift the political equilibrium in the direction of reforms that truly promote the public good.

It is also important to consider the design of regulations, including those that may be directed at achieving goals other than ‘helping the poor’ or ‘improving financial access’. The government (particularly the new Registrar) has a role in ensuring that these regulations take into account the particular needs of users and suppliers of financial services, as well as adhere to international best practice standards. For example, it is noteworthy that none of the proposed laws in Malawi specify interest rate ceilings, which is very positive. There is overwhelming evidence based on multiple country experiences of the adverse effects of interest rate ceilings, and how they are a major disincentive for financial institutions to extend the reach of their services to the unbanked and low-income market segment. Financial institutions need to be able to provide services in such a way that they are able to generate profits that will allow their continued provision of services. It is in the interest of financial service users – and especially of those who have low-incomes – that sustained provision of financial services is enabled; to realize the benefits of having access to financial services, relationships between providers and users need to be developed and strengthened over time.

There are, however, other interventions and legal issues that still need to be further addressed by government. For example, the establishment of a credit registry or credit bureau where lenders share information about their clients’ repayment records, and the development of the national identification system would be very useful to facilitate smoother access to credit. These measures would greatly improve the functioning of credit markets, especially in light of recent events in Malawi involving the payroll moneylenders. While a Credit Bureau has announced that it plans to start operations in Malawi, it is, however, operating in anticipation of the passing of relevant legislation. Without this legal clarity, it may be difficult to resolve certain issues and problems when they occur. On the other hand, the fact that such a credit bureau has already opened / began operations is a strong indication of

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71 The feedback we received from a number of financial institutions is that the proposed new laws have undergone several drafts and some institutions remain unclear about the final versions of the law that are to be presented for approval. Moreover, a significant number of the financial institutions interviewed in this study seem to assume that the enactment of the Microfinance Bill will result (automatically) in MFIs reporting to and being supervised by the RBM.
the market’s demand for credit bureau services, as well as perhaps a strong sense of optimism that the needed legislation will soon be in place.

**Broader policies and other interventions that help reduce market uncertainty**

It is important to emphasize that a high degree of uncertainty in some policy areas has affected the functioning of the financial market in Malawi, and has constrained economic growth. This uncertainty especially affects the agricultural sector, which is the backbone of the economy. The uncertain conditions create disincentives for bank lending to the private sector, create unnecessary frictions in the agricultural value chain, and ultimately make it more difficult for smallholder farmers and other market players to generate adequate margins. This high degree of uncertainty perpetuates a vicious cycle where the high cost of inputs (including credit) prevents farmers and agro-businesses from improving the quality and efficiency of production and trade, thereby leading to depressed margins.

There are certain dimensions of this uncertainty that fall outside of what the government can control – such as, weather patterns. Nevertheless, there are sectoral policies and programmes that can support efforts of farmers to increase their production and profitability, and help to reduce transaction costs in rural financial intermediation. These include: (a) the development of public infrastructure like roads; (b) strategies and policies to encourage better linkages at different stages of the production and marketing cycle between farmers, input suppliers, traders with crop storage facilities, etc.; and (c) land reform that could allow smallholder farmers to have access to title deeds that could be used as collateral.

It will also be helpful for the GoM to consider the impact of inadvertent uncertainties created by policy interventions in the agricultural sector. These include restrictions on imports and exports, setting minimum prices above fluctuating world market prices, and restrictions on who can trade in particular crops (e.g. maize). While the policies may have laudable social and economic goals, they may inadvertently undermine private sector engagement and investment in agriculture and increase the risk of not making a sufficient return. This in turn affects the financial sector’s willingness to lend in agriculture and to agribusinesses, as it adds to the weather, pest/disease and commodity price risks already being faced by the sector.\(^{72}\)

**Assessing the government’s role in the direct provision of financial services**

Beyond the public sector’s role in creating an enabling environment through policies and legislation that facilitate a smoother interaction between users and providers of financial services, it is important to consider as well the role that the public sector plays through its ownership of financial institutions and direct intervention in credit markets. As has been described in Chapter 3, the public sector plays a significant role in the supply of microfinance services, given the existence of a number of government-led programmes and publicly-owned organisations.

The experience in other countries shows how a government’s direct involvement in the provision of financial services has been generally considered problematic, given the evidence of poorly performing government banks, development banks and other financial institutions. The evidence is strong that public entities are not able to deliver broad access, and especially not on a sustainable basis. These public institutions are often riddled with problems that are rooted in their weak governance structures and mixed social and economic objectives.

\(^{72}\) For example, there have been a number of price and policy issues in the cotton sector in 2008-09, which affected loan repayments by smallholder farmers.
Many financial institutions noted that public institutions and programmes providing loans to the public (often at below market interest rates) have had a distorting effect on financial markets. Thus, for example, private financial service providers make it a point that they set up operations in areas where people have not borrowed from public entities or that are not well served by these. Their experience is that in areas served by public entities, the culture of borrowing tends to be distorted and people are less disciplined to honour their loan obligations. As has already been pointed out in previous studies on Malawi’s financial sector, debt forgiveness by government institutions, as well as the use of subsidies when granting loans, result in poor borrower behaviour. It will be crucial for the government to seriously consider the impact of its own programmes and institutions on overall market development and what it can do to stimulate a financially inclusive sector in the long term.

5.5 Market coordination

The review of the broader policy environment shows that the GoM recognizes that sustainable access to finance is an important element in the strategy to reduce poverty. There is, however, a need for greater coordination among the different players involved, and for harmonization between public and private initiatives that seeks to promote better access to financial services. Careful coordination of various interventions and their sequencing is important to ensure overall market development. Market coordination is also needed to ensure improved levels of efficiency, allowing information on lessons learned to be shared among a broader set of market participants. Coordination also allows different groups of institutions to take advantage of each other's strengths in addressing the needs of the unbanked population. Dialogue across sectors helps to generate coordinated policies and programmes that complement each other to meet the specific objectives set out for financial sector development.

The need for greater market coordination and dialogue cannot be more strongly emphasized, given recent experiences with regard to some of the initiatives designed to address problems in financial intermediation, but have, however, resulted in delays and further inefficiencies. A useful example is the experience with MALSWITCH. As mentioned earlier, MALSWITCH was seen as a promising platform for a range of electronic payments, fund transfer and banking products. In practice, however, the use of the MALSWITCH network to support fund transfer services has been low as only a limited number of banks have installed electronic interfaces with MALSWITCH. The problem of having incompatible systems may have been made clear and discussed even before MALSWITCH was implemented. To rectify the situation, the NPC has been trying for several years to establish interoperability between the cards and systems in use and hopes to have an integrated system very soon that will be linked to a Universal Switch.

The need for enhanced market coordination will rest on having strong support institutions that can support dialogue among stakeholders across sectors to meet the challenges of the financial services industry as it evolves. Other countries have benefited from formalizing this dialogue through an organized forum – e.g. via the formation of working groups that consist of key public and private stakeholders, who tackle specific issues on financial access, developments in the payments system (especially in relation to mobile phone banking, use of agents), developments in e-commerce, etc. Although there are already some groups in place, it would be opportune to consider the issues being covered, as well as consider setting up a working group that is specifically focused on financial inclusion.
Enhanced market coordination will also require an industry infrastructure – consisting of technical service providers, practitioners, auditors, etc. – that can support individual financial service providers as well as the regulator in addressing capacity constraints at all levels as well as support efforts for greater transparency within the sector.
6 Response to financial access barriers

A range of measures is needed to effectively address barriers to financial access. These include interventions that (a) help to create greater confidence in the market, (b) provide the incentives for financial institutions to expand into unbanked markets, (c) allow for innovations in product development and testing of new methodologies for delivering services to various target groups, and (d) strengthen capacity of users to undertake savings and debt obligations.

This chapter starts by describing some of the on-going initiatives that have already been introduced by various market players in Malawi in response to some of the barriers to financial access. This is then followed by a discussion of the key recommendations for effectively addressing financial access barriers. The final part of the chapter then provides some recommendations on the sequencing of interventions.

6.1 Initiatives introduced to promote greater financial inclusion

6.1.1 Modernising the payments system

As described in Chapter 3 of this report, Malawi’s payments system has gone through a number of developments in recent years, allowing for the modernization of the national payments systems infrastructure. Significantly, these developments are paving the way for the establishment of a national network infrastructure and a transaction switch (i.e. a Universal Switch). There are still issues waiting to be resolved, which would help finalize plans for the establishment of this Universal Switch. This will allow links between banks and other financial institutions and provide a number of electronic based payment, clearing and settlement facilities. The NPC is pushing for interoperability between the cards and systems and hopes to have an integrated system very soon. Relevant to expanding financial access, further work is needed in terms of determining which business models and applications are affordable for card-based electronic services.

Notwithstanding the issues that still need to be resolved, the modernization of the payments system in Malawi has greatly minimised payment systems risks associated with the former system. The clearing period has been reduced from seven to roughly two days, according to the RBM. As transactions are now settled in real time, credit risk has been minimized between system participants. This increased speed in terms of clearing and settlement is aimed at increasing the circulation of funds and enhancing the implementation of monetary policy. Moreover, banks are provided a facility to monitor their positions in real time and make cost effective investment decisions on the basis of this information that is now more readily available to them. This also allows the RBM to monitor the liquidity positions of all banks on a real time basis.

73 One of the key issues being discussed between the NPC, banks and other key stakeholders is the ownership and management arrangement of the Universal Switch to be established.

74 At the moment, the cost of a MALSWITCH card, for example, is pegged at roughly US$5-7, which is still considered prohibitive to many low-income individuals, such as farmers.
6.1.2 Facilitating and supporting a range of suppliers

In recent years, new players have entered the commercial banking sector in Malawi – though these banks tend to be smaller in size and have limitations in terms of the reach of their networks (at this early stage of development). Thus, it may take some time before real competition is manifested that many hope will lead to bank downscaling and ultimately, result in the introduction of better financial products at more competitive prices.

It is, however, promising that a range of suppliers of financial services already exists in Malawi, which includes non-profit and for-profit companies, SACCOs, commercial banks, etc. The existence of a range of institutional forms helps to promote competition within the microfinance sector. Moreover, the existence of different institutional types also allows the various providers to specialize according to their comparative advantage in providing services to specific market niches. Specialization could either result in a fragmented sector or may facilitate mutually beneficial partnerships between different institutions that will allow them to take advantage of each other’s strengths. Thus, many stakeholders look forward to the passing of financial sector legislation as this is expected to help build a greater degree of trust within a financial system that consists of different institutional forms.

Moreover, there are various on-going initiatives in the country that seek to enhance the capacity of different groups of financial institutions.

- The Deepening Malawi’s Microfinance Sector Project (DMS), funded by USAID, has been a long running project, working through three components, namely: improving the sustainability and outreach of MFIs through retail-level capacity building; facilitating access to greater flows of commercial capital for financial intermediaries through targeted capacity-building, linkages and brokering; and contributing to a more enabling regulatory, supervisory and legal framework for microfinance.75

- As a support organization, MAMN operates several mandates, which include setting best practice standards and guidelines for its member-MFIs; and providing services to its members in terms of information, training, advocacy, and building strategic partnerships.

- As the apex organization of affiliated SACCOs, MUSCCO provides capacity building services and support to its members. One of its on-going projects, funded by Hivos, involves work related to improving due diligence exercises for the SACCOs; executing strategic plan and business planning trainings for SACCOs; installing a Wide Area Network and risk management support systems; as well as support towards building the internal capacity within MUSCCO.

- The United Nations Development Programme (UNDP), in partnership with the United Nations Capital Development Fund (UNCDF), is supporting the Ministry of Finance to implement the project, Financial Inclusion in Malawi (FIMA). The project operates a Microfinance Unit in the Ministry of Finance, and is focused on developing and implementing a national strategy for building an inclusive financial sector in Malawi. FIMA is also actively encouraging innovation in lending and other services, and works with various providers of microfinance services operating in the country as well as supporting mezo level organisations, such as MAMN.

75 The project officially closed on 30 September 2009.
6.1.3 Improving access through innovative products and better delivery mechanisms

Various financial institutions have also introduced a number of innovative products and services that address the needs of the low-income market segment. Innovations have also been introduced in terms of the delivery mechanisms used by institutions to reach different groups of people, including the very poor and vulnerable. Some of these innovations include the following.

- In partnership with OIBM, Old Mutual (an insurance company) has introduced a funeral insurance policy that is aimed at helping clients and their households deal with expenses in the event of death of a household member. Monthly contributions amount to only MK100 (less than US$1) per month.
- The World Bank is supporting the introduction of a Weather Based Index Insurance, which is aimed at helping to reduce rural finance adverse lending. This initiative responds to the lack of adequate products in Malawi for managing the risk associated with agricultural production and price fluctuations. In the case of Malawi, the weather index is based on a model that estimates crop production using rainfall data. Two kinds of products are offered: one which is more macro in terms of coverage and is made available in the event of widespread drought, and another which is sold to individual farmers. Local weather stations have been set up that measure rainfall, and the contract will provide a financial payout if rainfall is below a series of critical points. Donors are supporting this initiative and the premium is being paid by the UK Department for International Development (DFID). One of the key advantages of this type of product is that it will allow Malawi to access funds within days if a payout is triggered by inadequate rainfall. This is favourable, especially taking account of the vulnerability of farmers. Unlike standard crop insurance products, the Weather Based Index Insurance does not require loss assessment and on-the-ground monitoring, which tend to impose a heavy administrative burden.
- The World Bank is also extending support to the development of local savings clubs and associations through the Malawi Social Action Fund (MASAF). MASAF is a project designed to finance self-help community projects and cash transfers to assist individuals and households to better manage the risks they face. Support is particularly targeted towards vulnerable persons. The World Bank support is provided in recognition of the demand for basic savings services, even among the very poor. The aim is to eventually link local savings clubs with MFIs or banks that can provide a safe place for their savings, support intermediation in the economy, and in due course provide access to services that cannot be feasibly or adequately offered by local savings and credit clubs on their own.
- Almost all of the financial institutions interviewed in this study, and especially the banks, have expressed significant interest in the use of technologies that will enable them to offer more user-friendly services across a broader client base. There is great expectation among many providers that technology-driven products will be able to bring down transaction costs and enable banks to service a larger volume of clients, including low-income individuals. These technology-driven products and services – which include smart cards, ATMs and point-of-sale (POS) devices – have the potential to improve accessibility and provide greater ease in carrying out financial transactions for both providers and users of the service. Some notable examples of technology-driven services include:
  - FMB’s Makwacha card product, which targets tobacco farmers - this system enables the farmers to access information regarding their proceeds at the tobacco auction floors. It also provides farmers with a safe means of getting payment, and enables
farmers to keep surplus income on the card, acting as a means to safely store savings.

- The RBM has authorized the NBM, Standard Bank and FMB to carry out SMS/mobile banking. At the moment, stakeholders in the banking sector are still studying the pricing of these services especially in terms of facilitating inter-bank transfers.

- Interestingly, there are also partnerships being created between financial institutions and other service providers outside the financial sector. For example, Zain is partnering with the NBM in launching a new product that allows purchase of air time and bill payments via the mobile phone. At the moment, this kind of service will be undertaken under standard SMS charges. But both Zain and NBM hope that these charges could be reduced in due course in order to make transactions more affordable to the public.

- Concern Worldwide, in cooperation with OIBM has also implemented the Dowa Emergency Cash Transfer (DECT) project, with financing from DFID. This was an emergency relief programme that combines a sophisticated targeting methodology with cash support, disbursed through a form of electronically enabled payment, a smart card-enabled authentication and ‘mobile bank’ system. There are now other social cash transfer (SCT) initiatives that are seeking to work with the financial sector – for example, the World Food Programme is currently working with MSB and UNICEF is exploring the use of alternative cash payment mechanisms through financial sector providers for Government’s SCT programme that is being scaled up for nationwide coverage.

6.1.4 Market linkages and partnerships between various institutions

The introduction of innovative products and better delivery mechanisms, as discussed above, often requires the involvement of several institutions. The experience of many financial service providers in Malawi and in other countries demonstrate the importance of establishing partnerships between institutions that enable them to build on each other’s specialization and strengths.

Partnerships have been established between different types of financial institutions, and between financial service providers and other market players. Some notable examples that have also been mentioned in previous chapters of this report include the following.

- CUMO, a non-bank MFI, has entered into a partnership agreement with Standard Bank, to facilitate group savings for CUMO’s clients. The partnership agreement allows concessions and waivers relating to opening and minimum operating balances, bank charges, market-based interest rates on group savings and others.

- There are also on-going partnerships being established between banks and insurance companies, such as that of OIBM and Old Mutual, and also by NICO and CUMO, which have introduced a funeral insurance product for the lenders’ clients.

- CARE is facilitating linkages between more established VSLAs and other financial service providers. At least one of the banks (OIBM) has already expressed an interest to work with some of the VSLAs in operation.

- Agricultural buyers, e.g. in tobacco, are working together with a number of banks in rolling out contract farming arrangements. The buyers provide the needed inputs for crop production and cash payments, and commercial banks participate by providing financing. In this arrangement, the buyers guarantee to buy the crops on an agreed-price basis and the payment mechanism is pre-determined. Moreover, a support package is provided based on an understanding of farmers’ needs and their vulnerability. Linking the farmers
to the banks within a contract farming system is reported to have resulted in almost universal full loan and interest recovery by the parties concerned. Moreover, it has also proven to be an effective arrangement for banks to more actively engage in agricultural lending.

- The partnership between Zain and NBM also illustrates yet another important form of linkage between financial service providers and other market players. As the development of technology driven products, and specifically of mobile phone banking, gains further momentum in the coming years, it is expected that other similar partnerships between financial institutions and telecommunications companies will evolve in the future.

### 6.2 Recommendations

Building on the discussions in previous chapters, this section sets out the key recommendations to support the development of an inclusive financial system that serves a wide range of market segments including the poor, vulnerable and unbanked populations. The key recommendations are summarized as follows.

**a. Address regulatory uncertainty and expedite the approval of relevant legislation** –
Market participants eagerly anticipate the enactment of the proposed laws as these are expected to provide the needed clarity on the types of institutions and the range of services to be permitted, as well as to encourage greater discipline via the regulation and supervision of non-bank activities, and to allow the entry of new players in the microfinance market.

There is a need to ensure that the regulations will be developed in a transparent and consultative manner to avoid confusion and complications in the implementation process. Moreover, as pointed out in Chapter 3, the new legislation places a large number of duties on the Registrar, potentially including prudential regulation of many relatively small financial operators. It will be important to ensure that that office is properly resourced to avoid creating a bottleneck. Moreover, it will be important that the capacity of the Regulator keeps pace with the new responsibilities afforded to it by legislation soon to be passed. Resourcing and good communication between the industry and the Regulator will therefore be key to ensuring that the wide ranging legal reforms work well.

**b. Progressive withdrawal of the public sector from direct provision of financial services** – As has already been echoed in previous financial sector assessments, public entities providing micro-credit almost always distort the market, making it more difficult for other financial institutions to enforce credit discipline and recover the costs of providing small-scale services. It is crucial for the government to consider the impact of its programmes on overall market development and specifically their effect on those financial institutions that are needed in order to create a financially inclusive sector in the long term. It will be helpful to consider the role of government funds and subsidies in assisting early phases of institutional development and the promotion of innovation or testing of new products especially in financial markets characterized by high risk, rather than utilizing these funds in direct provision of financial services that can distort financial markets and create an unlevel playing field.

**c. Continue to build the capacity of financial service providers** – Reaching unbanked markets will require the development of financial institutions that are able to offer appropriate services, and at scale. There have been a number of important achievements in the financial sector in recent years, but capacity constraints are still pronounced. Key capacity building needs include the development of management
information systems (MIS) to support financial management especially for institutions like SACCOs and other MFIs; developing institutional capacity for better loan portfolio management; and product development especially in the area of rural/agricultural finance.

d. **Build the capacity of support institutions like MAMN and MUSCCO** – Institutions such as MAMN and MUSCCO, as well as the Bankers Association of Malawi (BAM) and the IAM support dialogue among key stakeholders on relevant issues, but also play an important role in addressing capacity constraints at all levels and promoting greater transparency within the sector.

e. **Encourage better performance monitoring and disclosure** - While not all institutions providing microfinance services will be under prudential regulation, the development of industry benchmarks for measuring institutional performance is an important step to help professionalize the industry and encourage institutions to operate according to certain standards. In some countries, reporting and other non-prudential disclosure requirements are delegated to an agency other than the regulator or to support institutions. These agencies or support institutions then work together with the regulator. The information that is built within the system thereby allows the regulator to make better judgments regarding applications that are made for bank licensing or transformation into other tiers of regulated financial institutions. The key step, however, will be for the sector to agree on a set of performance indicators that can be tracked over time. Both the reporting institutions as well as those organizations or agencies that they report to will need to be trained on how to measure performance and make use of the information that is collected.

f. **Support the development of new products and delivery mechanisms that respond to the needs of the unbanked market** – The microfinance industry is still dominated by loan products designed for traditional borrowers, such as salaried individuals and those engaged in non-agricultural activities. Low-income and especially rural-based households, however, seek a range of financial services that include savings to build assets and manage seasonal cash flow, payment and money transfer services, and insurance services that allow them to manage risk (especially medical and funeral insurance). It is important to consider the specific challenges present in the rural/agricultural environment, which require financial services to be combined with instruments that allow institutions to mitigate risk and to include a range of specialized suppliers. Developing new products that work for the target market will need to be built around reliable and up-to-date market (demand) information. The innovations that have been recently tested and proven effective in Malawi serve as a very crucial starting point for developing more market-driven products. In some cases, given the high risks associated with certain market segments (e.g. the rural/agricultural sector), product innovations in these sectors may warrant the use of or participation of government or donor funds.

g. **Enhance market coordination** – Enhanced coordination within the financial sector encompasses the need for (a) a greater degree of harmonization between financial access initiatives of the public and private sectors; (b) sharing of information on lessons learned by a broader set of market participants; (c) allowing cooperation and the formation of partnerships between different groups of institutions to take advantage of

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76 A useful example would be the case of South Africa, where the Micro Finance Regulatory Council (MFRC) was organized by the government to help monitor the performance of non-licensed microfinance institutions. In other countries, industry networks have ‘self-regulatory’ functions, requiring network members to perform according to certain standards; this is typical of cooperative financial sectors. If enacted and implemented, the provisions of the draft Financial Services Bill, particularly section 19, may provide a basis for similar arrangements in Malawi.
each other’s strengths in addressing the needs of the unbanked population; and (d) dialogue across sectors to help generate coordinated policies and programmes that complement each other.

Building a more inclusive financial system requires much more than a narrow focus on ‘microfinance’ (although in some cases, this term may be defined in a much broader sense). While it is important to understand why the poor lack access to financial services and how these constraints might be addressed, it is just as important to understand the constraints faced by other market segments in accessing financial services. There is both a quantitative and qualitative aspect to limited financial access: the quantitative aspect deals with how to enable those who are totally excluded to have access to financial services; while the qualitative aspect tackles the needs of those who may have access but may benefit from improving the quality of access to financial services (whether through better products or new delivery channels that help bring down transaction costs, etc.).

Related to this is the issue of SME finance. In this study, the demand analysis builds on the findings from the 2008 FinScope Malawi survey, which focuses on individuals (rather than on enterprises). It will be important to also undertake measures to better understand the patterns in the demand for financial services among SMEs and the particular constraints that they face in accessing financial services. This is particularly relevant given the interest expressed by a number of banks to be involved in SME financing schemes.

6.3 The political economy of reform: ensuring an effective policy making process

In parallel with the analysis of the supply of financial services in Malawi, interviews were carried out with selected key stakeholders in an effort to better understand the policy-making process behind the reform of the financial system in the country. This analysis was undertaken using a political economy approach. Information was gathered on how decisions are made, what actors get involved in the process, what their motivation and priorities are, and how they interact with other public and private sector agents. A number of key informants were consulted on related issues like the sort of incentives that should be promoted to increase financial institutions’ provision of financial services in rural areas, or potential obstacles that could come to the surface during the implementation of the new regulatory frameworks governing financial services. The goal was to identify relevant tipping points that stand out in the path that leads to more inclusive financial services in Malawi. This section presents some ideas resulting from this analysis.

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77 This section is the outcome of the political economy analysis included in the agreed workplan, in addition to the formal Terms of Reference

78 A tipping point is a small, often seemingly insignificant adjustment that, however, may produce far-reaching changes. See: Pierson, P. (2004) Politics in time, history, institutions and political analysis. Princeton University Press, Princeton.

79 From a political economy perspective, there are multiple of elements to be considered when approaching an assignment like this. Issues like the political culture, the way institutions influence economic development, or the links between international agents, like donors, and local actors are important to understand better the context surrounding the financial sector in any given country. However, results must be presented in a way that may be useful for the recipient of this information. Thus, different actors will require different information: for example, a donor will want to know how policy issues at the macro level may affect its strategies, while the manager of a bank aiming to
Creating new spaces to facilitate dialogue and participation

When approaching financial reforms from a political-economy perspective, the identification of who is championing these reforms is one of the first issues that need to be addressed. By doing so, clues can be found about the motivational forces driving the process, the level of bargaining power the champion of reforms has, its capacity to implement reforms, and its political will to engage with other actors to overcome whatever barriers may appear along the process.

In the case of Malawi, the Ministry of Finance can be seen as the champion of the reforms. However, the political scenario in the country can be somewhat volatile and this, combined with the high level of rotation of personnel in the public sector, may be detrimental to the intensity and consistency of support provided by the Ministry. This situation may contribute to:

- A loss of momentum, as changes in key positions within the Ministry may cause unexpected delays during the decision-making and implementation stages, affecting negatively the timing and sequencing of the process.
- Changes in the direction followed by the reforms, as new staff may have different visions about the best way to fight financial exclusion and/or different priorities.

This situation is aggravated by other key attributes of Malawi’s financial market: its condition as a “laboratory” for new ideas and projects, mostly promoted by international agents and donors. While experimentation and innovations have a very important role, this could contribute to an overall sense of lack of direction and multiple courses of action in the sector, which is exacerbated by poor levels of co-ordination and communication between actors (as described in section 5.5).

A comprehensive, sector-wide Financial Sector Development Plan (FSDP) could act as an overarching guide for the financial reform process, improving co-ordination and therefore mitigating the impact that high rotation of personnel may produce. This is recognised by the GoM, and the process of developing the FSDP is underway. However, as pointed out in Section 6.4, there is always a danger that the development of FSDPs in any country can demand so much energy that they tend to undermine the individual reform processes that they were supposed to strengthen in the first place. Hence, any solution provided must necessarily adopt a flexible and relatively straightforward form.

improve the efficiency of its operations may find that kind of analysis interesting but of little use for his or her purposes. By focusing on tipping points, this section aims to provide practical and easy-to-implement recommendations to public as well as private financial sector actors.

These two issues were frequently mentioned by informants as the most important threats for the stability of the reform process.

The inability of the wide range of un-coordinated activities to sufficiently expand the outreach of financial services in Malawi reinforces one the most important paradigms of political economy in relation to financial reforms – change is not a linear process where the success of achieving one milestone leads necessarily to the next one. On the contrary, changes in financial reforms must be the sum of various simultaneously interconnected processes, where success depends heavily on the capacity of agents to coordinate and complement their actions. See Grindle, M. and Thomas, J.W. (1991): Public choices and policy change: the political economy of reform in developing countries, John Hopkins University Press.

As one of the interviewees put it, a threat that is always present in Malawi is that “too much talking may lead to too little action”.

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82 As one of the interviewees put it, a threat that is always present in Malawi is that “too much talking may lead to too little action”.

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Experience in many countries shows how the creation of “financial sector roundtables” effectively contributes to building more stable financial sectors. Formed by a relatively small number of members (between five and ten) representing public and private sector agents as well as international actors, these spaces create new opportunities for a heightened level of dialogue, which is central to improved market co-ordination.

“Financial sector roundtables” are built following a pyramid structure, with representatives of one particular sector being elected by its own members. Meetings are held periodically, usually quarterly, although monthly meetings can be arranged to monitor progress on particularly important issues at critical times. The advantages of such structure are twofold:

- Upwards, it promotes more effective participation, creating new opportunities for financial institutions to be heard.
- Downwards, it is an incentive for institutions with similar interests to strengthen their links, facilitating intra-sector dialogue and communication (see Section 6.1.4).

These groups play an advisory rather than an executive role, though they may also act as a counterbalance within the decision-making process. By bringing together public and private financial sector agents, as well as donors, these groups could have a positive impact (a) as an arena where financial sector agents can meet to discuss weaknesses and opportunities within the financial sector, providing comments and suggestions to authorities about the best way to overcome the former and enhance the latter; (b) encouraging transparency, good practices and ethical codes; and (c) contributing to the dissemination and exchange of information and encouraging the creation of new bonds of trust between financial sector agents.

Depending on how a financial sector roundtable is structured, it can also have an important function in contributing to improved stability within the financial sector. Suggestions and recommendations provided by these groups, although not binding, may have a “moral suasion” effect over policy-makers, to the extent that they reflect a consensus amid financial sector actors. In the Malawian context, careful consideration would need to be given to ensuring the most effective possible structure and role for the roundtable.

Assessment of the capacity and needs of the Registrar of Financial Institutions

One of the most common mistakes in policy-making is assuming that once a decision has been made it will be automatically implemented. Policy-makers tend to pay insufficient attention to the needs and capabilities of those agents who are charged with implementing their decisions. As a result, implementation is the phase of the project cycle where gaps

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83 One of the virtues of a heightened level of participation in discussing the content of the new financial regulatory framework in Malawi is that it puts new ideas on the table. In countries with very hierarchical structures of power – and informants agree that Malawi is one of them – the system tends to promote uniformity of thinking, which is not always a blessing for a reform process. By incorporating new agents into the discussion of policy reforms, financial roundtables are a good opportunity to bring new, fresh ideas and perspectives into the political debate on financial inclusion.

84 Most experts agree that the level of trust between public and private sector agents, as well as their capacity to communicate in an open, transparent way, is an important factor determining the attractiveness of investing in a country. This report already mentions how public policies, by not actively enforcing loan repayment culture, are negatively affecting the investment policies of commercial financial institutions in rural areas. Poor communication and the uncertainty that it brings with it contributes to increasing this effect, as uncertainty acts as a powerful deterrent for private investors. A change in this area is certainly one of the first steps to increasing private sector lending in agricultural activities.

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between what was originally planned and the final outcomes of a reform process are most likely to happen.

The Financial Services Bill proposes that the Registrar of Financial Institutions has full responsibility for the supervision of the financial sector – this is an extension of the role of the RBM, which is currently restricted by the institutions that are regulated under current legislation. To achieve its objective, a well-oiled, adequately-resourced structure is needed. However, experience shows that most supervisory institutions all across the world are overstretched and under-resourced. When that happens, the scarce resources available are primarily used to supervise banking activity, which is perceived as the cornerstone of the financial system. This results in other financial sectors being neglected or supervised with inadequate procedures. Supervision of MFIs is one of the areas more prone to be neglected as a result of lack of resources. Although it is true that the smaller size of MFIs in relation to banks makes them less likely to involve systemic risk, MFIs can play a decisive role in expanding the frontier of financial services.

An overstretched, poorly-equipped supervisory system could be a major disincentive for MFIs to become regulated.

Assuming that Parliament enacts the FSB, and before it comes into effect, it will therefore be necessary to review issues related to the capacity of the Registrar to fulfil the proposed functions, including the proposed resources to be made available. An estimation of the likely profile of MFIs entering the system will help to calibrate the resources required that will enable the Registrar to accomplish his/her tasks. There are already proposals to include provision for staff training, as personnel within supervisory bodies very often have little knowledge of microfinance activity.  

Uses of the dialogue: easing resistance to regulatory changes and introducing incentives for financial institutions to expand their services

Financial institutions can exhibit a paradoxical combination of conservativism (in relation to regulatory changes) and innovation – sometimes reckless innovation – in relation to their business. As new laws and regulations are currently being passed in Malawi, some institutions will be reluctant to abandon their comfort zones and embrace regulatory changes, even if they represent a clear improvement in the existing legal framework. Although the Government may resort to mandatory compliance through statutory regulation, the objective of the reforms – expanding access to financial services – will be better served through constructive dialogue.

Dialogue will not only improve the always important bonds of trust between public and private agents, but will also allow financial institutions to get a better grasp of the Government’s reasons for promoting reforms. Likewise, it also enables the Government to understand better the issues that financial institutions have to grapple with in their daily operations. At the same time, financial authorities may learn what incentives and changes need to be introduced to make reforms more acceptable to financial institutions, and therefore less difficult to implement.

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85 Where this is not done, it can result in MFIs being supervised following norms more suited for banking institutions. See Microfinance consensus guidelines: guiding principles on regulation and supervision of microfinance, CGAP, 2003.

86 Trust will also be critical to developing other initiatives like credit bureaus, which are quite important to strengthening the market infrastructure for lending to both MSMEs and households.
The experience in Zambia, for example, is showing early signs of how combining the Government (and civil society) and market forces can be effective in pushing more and better pro-poor products. Dialogue needs be the cornerstone upon which a closer relationship between private and public sector is built.

**Encouraging the creation of support coalitions formed by top-level public sector agents**

Improving consensus through enhanced levels of dialogue and co-ordination, as proposed above, clearly contributes to increasing the range of support for changes designed to expand access to financial services.

However, as some informants mentioned, political culture in Malawi is hierarchical, which may tend to discourage non-official as well as secondary public agents from playing a more active role during the decision-making and implementation phase of reforms. By encouraging the creation of support coalitions, where various top-level public sector agents may join forces, it is possible not only to reduce the volatility of the process by increasing the support base for the reforms, but also to improve inter- and intra-Ministry coordination and to promote the development of synergies. These two points, inter- and intra-ministerial co-ordination and creation of synergies, are critical to improving the cost-effectiveness and efficiency of the implementation process for reforms.

The success of such a sort of coalition requires a high degree of consensus not only regarding the objectives of the process, but also in relation to the content of the political agenda and timing to achieve them. Experience shows that a limited number of members increase the internal cohesion of these groups, improving therefore their capacity for lobbying and co-ordination.

In Malawi, a partnership between the Ministry of Finance and the Ministry of Local Government and Rural Development would be a natural one, given that the overall aim of the reform, to achieve a more inclusive financial system, fits perfectly with the objectives of the Ministry of Local Government and Rural Development. As most people who are financially excluded live in rural areas, an expansion of financial services outreach has the potential to contribute to local economic development.

**Supporting innovation: a possible challenge fund**

The combination of a new enabling legal framework and the improvement of dialogue and trust between private and public actors may help banks and other commercial financial institutions to re-think their strategies regarding extending services in the rural areas. However, a new strategic direction will not be enough in itself to increase financial inclusion unless it is also accompanied by adjustments in their current business models, as they are currently better suited to the provision of services in urban areas.

In undertaking such adjustments, there will be particular areas of endeavour that will have qualities of a public good, and where public funds and subsidies may actually play a crucial role.  

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87 As a result of this hierarchical political culture, the support provided by the financial roundtables previously mentioned needs to be consistent and continuous, while subtle. If this support is perceived as too strong, it may produce counterproductive effects – such as the Ministry of Finance considering that its authority is being undermined. That would result in the creation of anti-bodies, thereby reducing the capacity of financial roundtables to contribute to stability and better levels of dialogue and co-ordination in the financial sector.

88 See discussions under Section 3.1 and Chapter 4 of this report.
role – whether in assisting early phases of institutional development, or promoting innovation in delivery mechanism, or testing new products especially in markets characterized by high risk. This kind of support can help to facilitate the development of products by banks and other financial institutions that better match the demands of the unbanked and under-banked in Malawi.

To support such innovations, a challenge fund approach could be considered, along the lines of DFID’s Financial Deepening Challenge Fund, to provide support, on a competitive basis, for initiatives that can become sustainable in the long term but need seed money for development. Such funds are classically set up as independent funds or trusts, managed by specialist challenge fund experts and separate from governmental initiatives. Alternatively, as Section 6.1 suggests, these attributes could be assumed with appropriate technical support by the existing support institutions such as BAM, MAMN or MUSCCO, provided these institutions receive adequate support to build and strengthen their capacity.

### 6.4 Sequencing

Appropriate sequencing of reforms and interventions is crucial to the success of a financial sector reform programme. There would, for example, be little point in introducing a sophisticated real time gross settlement system for commercial banks before the management information systems of a significant number of banks are able to support internal and external electronic clearing. On the regulatory side, the introduction of international accounting standards must obviously be completed before reporting standards based on IAS are imposed. Similarly, the introduction of sophisticated international standards of compliance and supervision designed for mature and complex financial sectors, at too early a stage will hamper the development of that market.

The correct sequencing of reform can be difficult to get exactly right, particularly in relation to regulation and supervision. Most new markets require regulations and even laws to be revisited and revised as the market develops. A flexible approach is often useful, introducing relatively lightweight supervision when a market begins to develop, keeping a close eye on developments, and introducing tighter regulation as the market matures. This is exactly the approach taken, for example, by the Central Bank of Kenya when Safaricom introduced the M-Pesa mobile phone money transfer (MMT) service in 2007, an approach that contributed significantly to the outstanding success of M-Pesa. Building on the experience of the past two years, the Government of Kenya and the Central Bank are now developing a more sophisticated and formal regulatory regime for MMT.

There is also a need for co-ordination of the reform programmes for the various sub-sectors where they are linked, for example, where banks are to provide services for SACCOS through linkage banking schemes, or where weather insurance is to be linked with new input financing products. Some countries seek to ensure this co-ordination through the development of a comprehensive, sector-wide Financial Sector Development Plan (FSDP),

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89 See Johnston, R. Barry and V. Sundararajan (eds), *Sequencing Financial Sector Reform* (IMF, 1999)

90 Thus, for example, many countries in Central and Eastern Europe that passed new Capital Market laws after the fall of communism – such as Hungary, Poland, Romania and Lithuania – found that they need to significantly revise those laws within two or three years of their original passing as the market developed.
and experience in other countries shows that it is crucial to pay attention to the interconnection of reforms to ensure the appropriate sequencing and prioritization. Indeed, in some countries, so much time is spent in developing and agreeing the FSDP that the momentum of reform can actually be significantly undermined by the FSDP process.

In the case of Malawi, discussion of the appropriate sequencing of the initiatives and proposed reforms outlined above will need to be a major element in the wider process leading to the development of the financial sector development strategy.
7 Conclusions

Reforms have been undertaken in Malawi’s financial sector in the past decade. Moreover, important initiatives and innovations have been undertaken by a number of market players in an effort to expand the reach of financial services in Malawi. The experiences of different financial institutions offer important lessons about the kind of incentives that are needed to allow suppliers of financial services to expand their reach into unbanked markets and allow for innovations in product development and delivery mechanisms.

Despite these developments, however, at least 55% of the country’s population still continue to face severe constraints in accessing financial services – including savings, credit, insurance, and payment services. This study identifies the possible barriers to financial inclusion and provides recommendations based on an analysis of Malawi’s microfinance sector from the side of both supply and demand.

The proposed interventions to facilitate improvements in the level of financial access in the country include: (a) addressing regulatory uncertainty and expediting the approval of relevant legislation, including building adequate regulatory and supervisory capacity; (b) progressive withdrawal of the public sector’s direct provision of financial services; (c) continued efforts to build the capacity of a range of financial service providers, especially non-bank MFIs and SACCOs; (d) addressing the need for improved capacity of support institutions like MAMN and MUSCCO; (e) encouraging better performance monitoring and disclosure; (f) continued and enhanced support for the development of new products and delivery mechanisms that respond to the needs of the unbanked market; and (g) enhancing market coordination.

The key issues discussed in this study and the recommendations emerging from the analyses of demand and supply side data will be useful in the ensuing consultation process to support the development of the National Strategy and Action Plan for Financial Inclusion in Malawi. In the ensuing consultation process, the key goals and objectives, required strategies and action plan, and their proper sequencing will need to be defined.
References

Agar, Jason and Chiligo, Peter (2008): Contract Farming in Malawi; For the Ministry of Agriculture and Food Security, World Bank Malawi.


“Commercial Banks Squeeze SACCOs” in: Business Times, 8 July 2009, Malawi.

Consultative Group to Assist the Poorest (CGAP) (2004): Key Principles of Microfinance, Washington D.C.


FinScope Malawi (2008).


Malawi Banking Act of 1989 and Directives for Commercial Banks.


Annex A  Terms of reference

TERMS OF REFERENCE:
SUPPLY SIDE STUDY OF FINANCIAL INCLUSION IN MALAWI

1. Background

Malawi’s financial sector has been undergoing considerable reform in recent years, a key aim of which is to create a more conducive environment for expanding financial access. A more inclusive financial system is seen by the Government of Malawi (GoM) as critical to the development of the country’s economy.

Part of GoM’s contribution has been to push forward several pieces of new legislation including a Financial Services Bill, a Banking Bill and a Microfinance Bill (to name but a few). In addition, various donor-funded initiatives are underway, with GoM participation and support, notably:

- the Financial Inclusion in Malawi (FIMA) initiative (UNCDF/UNDP);
- the DMS (Deepening Microfinance Sector) project, funded by USAID; and
- FinScope Malawi (see below), funded by the UK’s Department for International Development (DFID).

Notwithstanding this considerable activity, Malawi continues to lack a comprehensive strategy to deepen financial access. The country’s National Forum on Microfinance has proposed the development of a National Strategy and Action Plan for Financial Inclusion in Malawi, and this was echoed in the recommendations of a Financial Sector Assessment Programme (FSAP) review, conducted in 2007.

Following the FSAP, GoM, in collaboration with the World Bank, initiated a process to develop a comprehensive financial sector strategy and has appointed US-based consulting firm Access to Finance to advise on this. The supply side study contemplated in these TORs is intended to be an important input, with its particular focus on inclusion, into the wider strategy exercise. The findings therefore need to be delivered to GoM by the end of September in order to support this process.

Formed in 2005 and chaired by the Ministry of Trade and Private Sector Development, the Forum comprises representatives of the Malawi Microfinance Network (MAMN), GoM, the private sector and the donor community. The Forum’s key aim is to ensure inclusiveness in the financial sector. It serves as a think tank and reference point for the implementation of an appropriate legal and regulatory framework and conducive environment for microfinance institutions in Malawi.
The study will be conducted under the oversight of Malawi’s Ministry of Finance.

It is envisaged that the recommendations from the supply side study, augmented by insights from the recent FinScope Malawi study, will play an important role in defining key goals and objectives, required strategies, actions and activities for achieving the core objective of financial inclusion, as well as the roles and responsibilities of all the players (formal and informal) engaged in microfinance.

GoM, through the Ministry of Finance, has requested financial and technical assistance from FinMark Trust for this exercise. In recent months, FinMark Trust has been actively involved in Malawi on the implementation of FinScope Malawi, a national study of consumer perceptions of financial services, how they source their income and manage their financial lives – exploring usage of both formal as well as informal financial products. The findings were launched in late March 2009.

2. Multi-stage process

As referred to above, this exercise is part of a wider process leading to the development of a financial sector strategy. Whilst it is probable there will be a consultative process on financial inclusion once the financial sector strategy has been developed, these TORs are chiefly concerned with the research and recommendations. However, in order to enable any subsequent consultative process to get going quickly, the consultants are being asked as part of the deliverables to propose draft TORs for that subsequent process, as well as a budget, even though this will require different funding and management arrangements and a fresh tender. FinMark Trust is not intending to provide further funding after the conclusion of this particular exercise.

3. Supply side study

In order for the recommendations on financial inclusion to be sufficiently comprehensive, they need to be based on a thorough analysis of Malawi’s microfinance sector from both the supply and demand side. FinScope Malawi is expected to provide important insights into the demand side (although it may be considered appropriate or necessary to complement the FinScope findings with other demand side work) but it is expected that the bulk of the analytical work in this exercise will focus on the supply side and, in particular, its historic performance, constraints and opportunities.

Various studies already exist and it is hoped that a considerable amount of the required analysis will take the form of a desk-based review of these. The FSAP Technical Note “Increasing Access to Finance” is particularly comprehensive. However it is also recognized that some of the existing studies are obsolete and additional primary research will therefore be required, especially to record the key institutions involved in the supply of microfinance, their financial profile, and the products and strategies being deployed in the provision of microfinance. Above all no one study adequately describes the roles of all the different players involved in the provision of financial services for the poor – whether these are banks, banks, banks.

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92 For the avoidance of doubt, “microfinance” for the purposes of these terms of reference means financial services for the poor, irrespective of the type of institution providing them (eg commercial bank, microfinance institution, cooperative etc) or whether the products and services are formal or informal.

93 Created with initial funding from DFID and established in 2002, FinMark Trust is an independent trust, which promotes financial inclusion in Africa (www.finmarktrust.org.za). Its mission statement is “Making Financial Markets Work for the Poor”. It is based in Johannesburg and operates across the African continent.
microfinance institutions (commercial or NGO), cooperatives, the informal sector or specialized service providers such as money transfer providers.

The primary objective of the supply side work proposed in these terms of reference is to document Malawi’s financial infrastructure, to establish levels of financial access and usage from a supply perspective, and to provide the necessary context within which the levels and trends in access to these services can be evaluated. The analysis should aim to identify possible barriers to access, fill any information gaps relating to financial access highlighted by the FinScope survey findings and propose indicators by which expected improvements in levels of access to finance can be tracked over time.

Importantly, the intent behind the supply side study is not to provide a comprehensive overview of the market in its entirety but rather to consider the state of supply of, and demand for, financial services in Malawi from the perspective of access, or financial inclusion. By supplementing FinScope findings with relevant data, the review will contribute to an enhanced understanding of Malawi’s landscape of financial access and will allow Malawian stakeholders to benchmark current access and usage patterns with their peers in the region.

In summary, the study should:

- contain a comprehensive analysis of Malawi’s microfinance sector on the basis set out in the Scope of Work below
- identify the key issues for further debate in the consultation process itself
- make recommendations as to how financial inclusion in Malawi can be enhanced.

4. Scope of work

The required analytical work will be based largely on existing documentation, supplemented by primary research (where necessary) and interviews with relevant stakeholders, notably GoM and other members of the National Forum on Microfinance.

The scope is reasonably broad; however, FinMark Trust is seeking analysis that gets to the essence of the issues. Fee proposals should reflect the hoped-for output which is a clear-sighted assessment of the strategic options for broadening Malawi’s financial sector, rather than a report which, though comprehensive, is simply too dense to serve a useful purpose.

The final report will include analysis of the following:

a) A brief overview of the Malawian economy

The study will provide a summary of the macro-economic context within which financial services are being provided and highlight significant economic factors impacting on access and usage, for example:

- growth trends relating to GDP, employment, sectoral growth, and trade
- agricultural policy (eg the fertiliser subsidy programme)
- donor-supported initiatives
- the economic impact of HIV/Aids.

b) Analysis of Malawi’s financial sector
The study will document the current market distribution and usage of products and services within Malawi main financial sectors, based on available documentation. The purpose of this will be to analyse financial access from a supply perspective and identify product and institution-based barriers to access. The data will also enable comparisons to be drawn with the FinScope Malawi findings on key issues relating to access. Where possible, differentiations will be made according to gender, geographical location (i.e. province, rural/urban), and age.

The sectors to be analysed will include:

- Banking (including both commercial and government-owned)
- Insurance (including pensions and contractual savings)
- Non-bank financial institutions (including commercial moneylenders, the NGO microfinance sector, cooperatives (large or small), government initiatives, housing finance or money transfer specialists etc.)
- Agricultural and/or trade finance

Specific data to be collected for each sector (where relevant) will include:

- **Overview and recent history**: Active institutions; significant closures, mergers and take-overs; impact of closures on access to low-income groups; recent efforts to roll out new branches/ATMs; sector/sub-sector assets; overview of institutional market share; analysis of key indicators; levels of liquidity; sources of wholesale funding and constraints (especially in light of global credit squeeze).
- **Products and services**: Range and features offered (e.g. minimum balances, interest rates); eligibility criteria (i.e. KYC/anti-money laundering policies, documentation requirements); distribution channels (i.e. direct vs indirect service provision); number of products/accounts held; production vs consumption lending; use of bank products (i.e. use for basic transactions only); use of savings products (i.e. for savings or transactions); product features and availability for small business; levels of product innovation; geographical product distribution.
- **Client base**: Target groups (including accessibility to lower-income clients); extent and profile of current client base (i.e. salaried vs self-employed, individual vs business); levels of outreach per client group; number of products per client; profile of previous (‘used to have’) clients.
- **Management and capacity issues**: relevant observations on management skills and financial performance of the different institutional types (NB a detailed assessment of financial performance is not required).

To the extent possible, information will also be collected on the extent of informal financial products (i.e. *chipiringanyo*, *katapila*), products that specifically cater for small businesses (MSMEs), and products that are designed to support small-scale agriculture (e.g. outgrower schemes, agricultural cooperatives, NGOs).

c) **Assessment of the legislative and regulatory environment**

The study will include an assessment of the legislative and regulatory environment as it relates to financial service provision. The purpose of this assessment will be to highlight any legal and regulatory barriers impeding supply of, and access to, financial services.

The analysis will include:

- An overview of relevant legislation (existing and proposed) and the structure of supervision
d) Consideration of other barriers to access

The study will identify other potential barriers to access in addition to product, institutional, and legal and regulatory constraints. The purpose of this will be to understand the extent to which these barriers may be negatively impacting on financial access, as well as highlight opportunities for extending outreach through alternative distribution channels.

In particular, the report will include consideration of:
- Payments system issues, including Malswitch
- Cell phone distribution, access and ownership
- Usage of other technology, e.g. Malswitch, internet
- Ownership of identification documentation required to access financial products and services (e.g. national ID, utility bills etc)
- Ownership of title deeds by individuals and small businesses
- Information constraints (e.g. credit information, consumer information)
- Supply and quality of rating services, audit firms, management training, accounting services, for MFIs
- Strengths and weaknesses and needs of industry associations

e) Documentation of initiatives to promote access

The study will document any current government, donor and private initiatives that aim to promote financial access, particularly for the lower-income population. The aim of this will be to identify opportunities for GoM and other stakeholders to collaborate more extensively in order to augment the impact of these initiatives. These may be financial in nature (e.g. loan guarantees) or non-financial (e.g. technology or consumer financial literacy-oriented).

f) Evaluation of the Landscape of Access

The information collected will be used to map Malawi’s Landscape of Access from a supply perspective and highlight key constraints. Comparisons will be drawn with the FinScope Malawi findings, which will reveal that access levels in Malawi are currently low.

As with FinScope, the Landscape of Access will be evaluated and mapped across the four categories:

- Transactions: composite of various transaction products available (e.g. current accounts, credit cards, debit cards, transaction accounts)
- Savings: proportion of people that have a savings product
- Credit: composite of access to bank credit (e.g. overdraft, cards, personal loans), microfinance loans, and loans from NGOs and credit cooperatives
- Insurance: proportion of people that have any insurance product

If possible, the impact of informal products in extending the financial access frontier will also be assessed.

The analysis should be benchmarked against relevant data from other countries in the region.
(g) Cross-comparison with FinScope Malawi

Comparison of the supply side analysis with FinScope Malawi will help to determine the extent to which the supply side infrastructure, and supply-led initiatives, are meeting the stated demand-side barriers as revealed in FinScope Malawi.

5. Deliverables

As indicated above, the key written deliverable is a completed supply side study to contain:
- the analysis referred to above
- identification of the key issues for further debate in any subsequent consultation process
- recommendations from the supply side as to how financial inclusion in Malawi can be enhanced.

In addition, consultants are being asked to prepare a written synthesis document which addresses inclusion from the demand side (FinScope Malawi) but incorporates the supply side findings so that a comprehensive set of recommendations on inclusion can be tabled.

FinMark Trust is prepared to accept a merged single document, rather than two separate written documents, if GoM is happy with this approach, having regard to the interests of other stakeholders.

Other written deliverables, as mentioned above, include:
- a suggested budget for any subsequent consultative process on financial inclusion
- terms of reference for consultant support for this subsequent process

Consultants should provide for the following:
- submission of an draft deliverables by 30th September 2009 to GoM and FinMark Trust to enable comments to be captured and reflected in the final drafts
- a presentation of the final draft deliverables by 23rd October 2009 to (i) GoM and (ii) a wider group of practitioners and other stakeholders in Malawi’s microfinance community
Annex B  Description of methodology used: supply side study

B.1  Methodology

Phase 1 – Review of literature and available documentation (desk-based)
The review of studies, reports and other documentation was the first step taken in this assignment, and covered references providing information relevant to:

- the state of the economy in Malawi – key macroeconomic data on growth, employment, sectoral development especially in agriculture, etc.;
- the patterns in the demand for financial services – establishing how households and enterprises derive their income, the nature of economic activities undertaken, important issues such as land tenure traditions (relevant to property rights and the use of land as collateral), value chains such as in coffee, tea, cotton, paprika and dairy, etc.;
- the experience of financial institutions in the delivery of microfinance services, especially lessons learned in overcoming key constraints and innovations introduced in expanding access or addressing specific financing needs of target markets;
- current policies and progress reports that relate to overriding issues that directly or indirectly affect the way economic activities and the ensuing financial relationships are conducted and how financial services are provided to targeted enterprises and households;
- policy documents and reports covering the national context for the strategy for financial inclusion (e.g. the FSAP note on ‘Increasing Access to Finance’); and
- relevant pieces of legislation and regulation on financial service provision (e.g. the Microfinance Bill, Financial Services Bill and the Banking Bill).

Within this review process, we have also studied the results of the recent FinScope survey in Malawi, which, as described in the TORs, is expected to generate valuable insights into the patterns in the demand for financial services in the country.

Another important part of the desk-based research work was the review and analysis of legislation and regulation of financial services – both for banks and non-banks.

Phase 2 – Field visit and survey
An inception visit was carried out in June 2009, during which an initial meeting with key stakeholders was held at the offices of the Ministry of Finance.

Following the inception visit, interviews were carried out of key informants representing various stakeholder groups, as well as of the individual financial service providers. A list of institutions covered in the survey is provided in the section that follows. The interviews were guided by a set of quantitative and qualitative questions. (A copy of the questionnaires used has been presented to the Ministry of Finance and relevant stakeholders.)
B.2 List of institutions covered in the survey / interviewed

BANKS
1. ECOBANK
2. NBS BANK
3. INDEBANK
4. NEDBANK
5. STANDARD BANK
6. NATIONAL BANK OF MALAWI
7. OIBM
8. FIRST MERCHANT BANK
Note: All Commercial Banks were approached for their participation.

MICROFINANCE COMPANIES, NGO-MFIs and MONEY LENDERS
9. Blue Financial Services
10. Greenwing
11. Izwe
12. CUMO
13. FINCA
14. Microloan Foundation
15. Pelton Finance
16. Touching Lives
17. Malawi Social Action Fund (MASAF)
18. DEMAT
19. SEDOM
20. MRFC
21. MARDEF
22. PRIDE
23. Fountain Financial Services

SACCOs
24. Bvumbwe Community SACCO
25. MUDI SACCO
26. Chiradzulu Community SACCO
27. Mwanza Community SACCO
28. ESCOM SACCO
29. BNkhatabay SACCO
30. Viphya SACCO
31. Fincoop
INSURANCE COMPANIES
32. General Alliance Insurance Co Ltd
33. Life and Pensions Association
34. Medical Aid Society of Malawi (MASM)
35. NICO General Insurance Co Ltd
36. NICO Life Insurance Co Ltd
37. Reunion Insurance Company Ltd
38. AON (Insurance broker)

AGGREGATE DATA FROM MESO LEVEL INSTITUTIONS / ASSOCIATIONS
39. CARE International – for village savings and loans associations (VSLAs)
40. Insurance Association of Malawi
41. MUSCCO – for SACCOs
42. MAMN – for microfinance institutions
43. RBM - Insurance
44. RBM

OTHER RELEVANT STAKEHOLDERS INTERVIEWED
45. World Bank (Malawi)
46. Deepening Malawi’s Microfinance Sector Project (DMS)
47. Zain Malawi
48. Ministry of Industry and Trade
B.3 Questionnaires used

Q1 – Quantitative questions

MALAWI SUPPLY SIDE STUDY: SURVEY OF FINANCIAL INSTITUTIONS

<table>
<thead>
<tr>
<th>Name of Institution</th>
<th>Address</th>
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**Indicate general orientation of branches**

- [ ] Urban
- [ ] Peri-urban
- [ ] Rural

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<tr>
<th>Key Manager/s (Name and Designation)</th>
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Your answers are important to us – as they will help us characterize the financial sector landscape in Malawi and identify the constraints faced by different types of financial service providers in expanding access to financial services. The findings of this study will inform the ensuing consultative process in developing the financial sector development plan as well as the policy paper on financial inclusion in Malawi.

If you have any questions or queries regarding this study, please do not hesitate to contact Jason Agar (Kadale Consultants Ltd) [jason.agar@kadale.com] or Abigail Carpio (Oxford Policy Management Ltd, UK) [abigail.carpio@opml.co.uk].

Kindly send your completed questionnaire to ____________________________.

1a. Please could you give us a list of where your branches, other outlets and ATMs are located. Indicate number per district.

<table>
<thead>
<tr>
<th>Districts</th>
<th>Full branches</th>
<th>Sub branches</th>
<th>Other</th>
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</table>
2. Please indicate how many full time staff you employ (a) in total (b) at Head office

3. Please indicate what products you offer and where can they be accessed across your network.

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<thead>
<tr>
<th>Products</th>
<th>Full branches</th>
<th>Sub branches</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings</td>
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<tr>
<td>Payments and Transfers</td>
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<td>Loans</td>
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<td>Medical and General Insurance</td>
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<td>Pension and Insurance</td>
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</table>

4a. Please indicate the documents that individuals must provide to access:

<table>
<thead>
<tr>
<th></th>
<th>Payments accounts</th>
<th>Deposits / savings</th>
<th>Credit facilities</th>
<th>International remittances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proof of identity</td>
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<tr>
<td>Payment slip</td>
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<tr>
<td>Letter of reference (from chief, employer)</td>
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<tr>
<td>Proof of domicile or utility bill with address</td>
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<td>Others: please specify -</td>
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</table>
4b. Please indicate the documents that businesses must provide to access:

<table>
<thead>
<tr>
<th>Payments accounts</th>
<th>Deposits / savings</th>
<th>Credit facilities</th>
<th>International remittances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registration certificates</td>
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<tr>
<td>Any required operating licenses</td>
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<tr>
<td>Tax registration</td>
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<td>Audited tax accounts</td>
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<tr>
<td>Others: please specify -</td>
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</tbody>
</table>

5. Please indicate the volume of business your institution has done in the latest year:

<table>
<thead>
<tr>
<th>Number of accounts</th>
<th>Value of accounts</th>
<th>Number of transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual deposit/savings accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-individual / business deposit accounts</td>
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<td></td>
</tr>
<tr>
<td>Individual loan accounts</td>
<td></td>
<td></td>
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<tr>
<td>Non-individual / business loan accounts</td>
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<td></td>
</tr>
</tbody>
</table>

6. Please could you give us:
(a) your most recent audited financial statements,
(b) your product list (description of products currently being offered), and
(c) your tariff of fees and commissions plus interest rates charged / paid on your products.

If you do not have a product list available, kindly provide a brief description of your products/services currently on offer. Please indicate:
(a) for savings products – minimum opening and maintaining balances, interest rate paid, other important features;
(b) for loan products - minimum and maximum amounts, terms and conditions, maturity, interest rate and other fees charged, other important features.

<table>
<thead>
<tr>
<th>Savings</th>
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<tbody>
<tr>
<td>1.</td>
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<tr>
<td>4.</td>
</tr>
<tr>
<td>5.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Payments and Transfers</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.</td>
</tr>
<tr>
<td>7.</td>
</tr>
<tr>
<td>8.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>9.</td>
</tr>
<tr>
<td>10.</td>
</tr>
<tr>
<td>11.</td>
</tr>
<tr>
<td>12.</td>
</tr>
<tr>
<td>13.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Medical and General Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>14.</td>
</tr>
<tr>
<td>15.</td>
</tr>
</tbody>
</table>
### SUPPLEMENTARY QUESTIONS

*If information as of May 2009 is available, please provide this separately and indicate accordingly.*

<table>
<thead>
<tr>
<th>1. Total Assets</th>
<th>Includes all asset accounts net all contra-asset accounts, such as the loan loss provision and accumulated depreciation</th>
<th>Year 2006</th>
<th>Year 2007</th>
<th>Year 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Total Loan Portfolio</td>
<td>The outstanding principal balance of all outstanding loans, including current delinquent and restructured loans, but not loans written off.</td>
<td>Year 2006</td>
<td>Year 2007</td>
<td>Year 2008</td>
</tr>
<tr>
<td></td>
<td>Please indicate (where applicable): Total loan portfolio – for group-based lending</td>
<td>Year 2006</td>
<td>Year 2007</td>
<td>Year 2008</td>
</tr>
<tr>
<td></td>
<td>Total loan portfolio – for individual-based lending</td>
<td>Year 2006</td>
<td>Year 2007</td>
<td>Year 2008</td>
</tr>
<tr>
<td>3. Portfolio at Risk</td>
<td>The value of all loans outstanding that have one or more installments of principal past due. (This item includes the entire unpaid principal balance, including both past due and future installments, but not accrued interest. It does not include loans that have been restructured / rescheduled)</td>
<td>Year 2006</td>
<td>Year 2007</td>
<td>Year 2008</td>
</tr>
<tr>
<td></td>
<td>If the above information is not (readily) available, please provide us with a description of how you monitor the quality of your loan portfolio – and the measures recorded under each year.</td>
<td>Year 2006</td>
<td>Year 2007</td>
<td>Year 2008</td>
</tr>
<tr>
<td>4. Total Client Deposits</td>
<td>Balances on accounts held by clients</td>
<td>Year 2006</td>
<td>Year 2007</td>
<td>Year 2008</td>
</tr>
<tr>
<td></td>
<td>Please indicate (where applicable): Total deposits held by individuals</td>
<td>Year 2006</td>
<td>Year 2007</td>
<td>Year 2008</td>
</tr>
<tr>
<td></td>
<td>Total deposits held by non-individuals (incl. groups, businesses, associations, NGOs, etc.)</td>
<td>Year 2006</td>
<td>Year 2007</td>
<td>Year 2008</td>
</tr>
</tbody>
</table>
If information as of May 2009 is available, please provide this separately and indicate accordingly.

<table>
<thead>
<tr>
<th>5. Total Clients</th>
<th>The total number of active clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Total Borrowers</td>
<td>The number of individuals who currently have an outstanding loan balance with the institution or are primarily responsible for repaying any loan outstanding. (This number should be based on the number of individuals and not the number of groups.)</td>
</tr>
<tr>
<td>7. Total number of groups</td>
<td>Total number of groups if institution follows a group savings and/or lending model. (Please indicate/explain the average size of groups (in terms of number of members).)</td>
</tr>
<tr>
<td>8. Client dropout rate</td>
<td>Number of clients exited during period</td>
</tr>
<tr>
<td>9. Operating Revenue</td>
<td>Total operating income from loan interest and fees but not subsidies or donor grants</td>
</tr>
<tr>
<td>10. Deposit Interest</td>
<td>Interest paid on accounts held by clients</td>
</tr>
<tr>
<td>11. Operating Expenses</td>
<td>Operating costs including all administrative and personnel expenses</td>
</tr>
<tr>
<td>12. Profitability (net of all grants or subsidies)</td>
<td>Please state the amount of profit or loss. Please describe what is driving the institution’s performance in recent years.</td>
</tr>
</tbody>
</table>
## Q2 – Qualitative questions

<table>
<thead>
<tr>
<th>Institutional Factors</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>History/Background</strong></td>
<td>Provide some brief background information about the start and foundation of the institution. What have been the motivations for forming the organization?</td>
</tr>
<tr>
<td><strong>Ownership and Governance</strong></td>
<td>Provide a detailed breakdown of the institution’s shareholding/ownership structure.</td>
</tr>
<tr>
<td></td>
<td>Does the institution have a duly appointed board?</td>
</tr>
<tr>
<td></td>
<td>Please describe the composition of the board - what interests do the members represent (e.g. are they leaders in the community, founding members)?</td>
</tr>
<tr>
<td><strong>Alliances</strong></td>
<td>Does the institution maintain any alliances or cooperation with any other local or international organization in the delivery of financial / non-financial services?</td>
</tr>
<tr>
<td></td>
<td>If yes, please provide details (partner’s name, form and coverage of partnership, etc.):</td>
</tr>
<tr>
<td><strong>Management Information System</strong></td>
<td>How does the institution track its performance? Does it keep record of its transactions? Does it make a review of its performance / conduct monitoring and evaluation on a regular basis?</td>
</tr>
<tr>
<td></td>
<td>Does it report regularly to a governing body / agency / association?</td>
</tr>
<tr>
<td></td>
<td>What is the frequency and type of financial reports regularly produced?</td>
</tr>
<tr>
<td><strong>Perceptions of the financial services regulator (RBM)</strong></td>
<td>What are your perceptions of financial services in Malawi? What are your perceptions of financial services regulations (all relevant legislations/acts)? What are your perceptions of RBM?</td>
</tr>
</tbody>
</table>
## Clients and Products

<table>
<thead>
<tr>
<th>Target Group and Client Profile</th>
<th>Does the institution have a clear / specified target market? Or does the institution try to attract members/clients from a certain area?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Describe the clients targeted by the institution in terms of: (a) gender; (b) economic activity / livelihood; (c) income and asset profile (e.g. do they own land, other property?), etc.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financial Products and Services</th>
<th>What are the different products and services offered?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>What is the application process and eligibility for financial services and products?</td>
</tr>
<tr>
<td></td>
<td>For loan products what is the maturity? What are the tracking methods? How does the institution handle delayed payments? What is the loan default penalty? What is accepted as a security? What happens when the borrower dies? (prompt for insurance – credit life, funeral, other, etc.)</td>
</tr>
<tr>
<td></td>
<td>What is the maximum and minimum amount that can be borrowed on each loan product?</td>
</tr>
<tr>
<td></td>
<td>What are interest rates on financial products and how are those rates determined? (check for fixed versus declining balance methods, and if fixed, do they add further interest if late payment) Are any other fees charged (application fee, transfer fee, fess for registering assets, etc.)</td>
</tr>
<tr>
<td></td>
<td>Indicate on average how long it takes to process a loan – from application to actual disbursement.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Innovations / new products or services introduces</th>
<th>What new products and services have you introduced? Explain the operational mechanisms - e.g. are there links/partnerships involved? Is technology utilized?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Who is the target group / user?</td>
</tr>
<tr>
<td></td>
<td>How effective have these innovations / new products been in reaching out to</td>
</tr>
</tbody>
</table>
a greater number of clients? Are these services cost-effective?

<table>
<thead>
<tr>
<th>Non-Financial Services</th>
<th>What non-financial services are provided by the institution (e.g. business training, etc.)? Are they offered for free? How are these services financed?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marketing and Sensitization</td>
<td>What efforts is the institution making to increase its membership? What marketing activities are used to advertise and sensitize potential members on your services?</td>
</tr>
<tr>
<td>Key constraints faced by the MFI</td>
<td></td>
</tr>
<tr>
<td>What factors determine your performance and/or underperformance</td>
<td></td>
</tr>
</tbody>
</table>

**Supplementary notes and observations (by the interviewer)**

**Leadership**

(Answer the following based on your observations about the competence of the institution’s leaders/managers: e.g. Does the manager demonstrate that he has adequate knowledge about the operations of the institution and how well it is performing? What (formal) qualifications does the management of the institution have?)

**Local environment**

Describe the quality / level of development of infrastructure (roads, utilities, telecommunications) in the vicinity where the institution’s premises are located.

What is the distance between the institution’s office location and the nearest centres of economic activities / markets?
Annex C  Summary of information collected from respondents (institutions interviewed)

C.1  General profile of providers of financial services

<table>
<thead>
<tr>
<th>Institution</th>
<th>Ownership</th>
<th>Regulatory status / reporting arrangements</th>
<th>Financial services offered</th>
<th>Prospects for transformation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BANKS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ecobank</td>
<td>Mostly privately owned entities</td>
<td>Supervised by the RBM</td>
<td>Full range of financial services – including savings and loans</td>
<td>n/a</td>
</tr>
<tr>
<td>NBS Bank</td>
<td>Only Malawi Savings Bank (not among the survey respondents) is government-owned</td>
<td>Some banks also provide particular information on their microloan portfolios – e.g. OIBM</td>
<td></td>
<td></td>
</tr>
<tr>
<td>INDEBANK</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NEDBANK</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Standard Bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Bank of Malawi</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opportunity International Bank of Malawi</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First Merchant Bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>NON-BANKS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CUMO Microfinance Ltd.</td>
<td>Privately owned (company limited by guarantee)</td>
<td>Currently does not report to RBM; Submits quarterly returns to MAMN</td>
<td>Microenterprise loans, small enterprise loans, agriculture loans and loans specifically for the tea sector</td>
<td>---</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Operates using solidarity-based lending or village banking methodology</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Also provides Credit Life and Funeral Benefit Insurance; and offers market linkage services</td>
<td></td>
</tr>
</tbody>
</table>

May 2010
<table>
<thead>
<tr>
<th>Institution</th>
<th>Ownership</th>
<th>Regulatory status / reporting arrangements</th>
<th>Financial services offered</th>
<th>Prospects for transformation</th>
</tr>
</thead>
<tbody>
<tr>
<td>FINCA Malawi</td>
<td>Privately owned: owned by FINCA International</td>
<td>Currently does not report to RBM; Submits quarterly returns to MAMN; Reports to the FINCA regional office and the FINCA global office in the US</td>
<td>Provides business loans Village banking methodology (80% of total portfolio), as well as individual loans</td>
<td>Would consider converting to a regulated deposit taking MFI</td>
</tr>
<tr>
<td>Microloan Foundation</td>
<td>Privately owned</td>
<td>Currently does not report to RBM; Submits quarterly returns to MAMN</td>
<td>Credit only (plus non-financial services) Group-based as well as individual loans</td>
<td></td>
</tr>
<tr>
<td>Pelton Finance</td>
<td>Privately owned</td>
<td>Currently does not report to RBM</td>
<td>Salary-based / employer-guaranteed loans</td>
<td></td>
</tr>
<tr>
<td>Greenwing</td>
<td>Privately owned</td>
<td>Not regulated by RBM; But submits reports regularly to RBM; Reports to / monitored by parent company in Johannesburg</td>
<td>Credit only: salary-based loans, business loans, loans to finance education and incremental home improvement, consumer loans (e.g. for cellular purchase)</td>
<td>Exploring the possibility of transforming into a deposit-taking institution after passage of relevant legislation, but not sure whether GW qualifies as an MFI</td>
</tr>
<tr>
<td>Izwe</td>
<td>Privately owned: 80% owned by African Microfinance Holdings (Mauritius based)</td>
<td>Not regulated by RBM; But submits reports regularly to RBM; Reports to South Africa-based MD</td>
<td>Fixed term payroll based loans</td>
<td>Not interested in taking deposits; their funding sources are considered sufficient to cover expansion</td>
</tr>
<tr>
<td>Blue Financial Services</td>
<td>Privately owned</td>
<td>Not regulated by RBM; But submits reports regularly to RBM</td>
<td>Salary-based loans</td>
<td>Keen to apply for a full banking license</td>
</tr>
<tr>
<td>Touching Lives</td>
<td>---</td>
<td>Not regulated by RBM</td>
<td>Provides microfinance loans: group-based</td>
<td></td>
</tr>
<tr>
<td>Institution</td>
<td>Ownership</td>
<td>Regulatory status / reporting arrangements</td>
<td>Financial services offered</td>
<td>Prospects for transformation</td>
</tr>
<tr>
<td>-------------</td>
<td>-----------</td>
<td>------------------------------------------</td>
<td>----------------------------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>DEMAT</td>
<td>• 100% government owned</td>
<td>• Not regulated by RBM; • Reports to MAMN</td>
<td>• Loans (for small scale businesses) and compulsory savings • Group-based</td>
<td>• Expects to become a deposit-taking institution after passage of relevant legislation</td>
</tr>
<tr>
<td>MARDEF</td>
<td>• 100% government owned</td>
<td>• Currently governed by Parliament resolution (operating as a Fund); oversight is provided by the Budget and Finance Committee.</td>
<td>• Credit only: provides business loans • Group-based • Also offers entrepreneurship / business training in partnership with other organizations</td>
<td>---</td>
</tr>
<tr>
<td>MRFC</td>
<td>• Effectively government owned (99%)</td>
<td>• Not regulated by RBM; • Reports to MAMN</td>
<td>• Savings and credit products • Used to be 100% focused on the agriculture sector; now also offering up to medium-sized loans to non-agribusinesses</td>
<td>• Expects to fall under RBM supervision after passage of relevant legislation</td>
</tr>
<tr>
<td>PRIDE</td>
<td>• Company limited by guarantee, initial capitalization from donors; • Government nominates board</td>
<td>• Not regulated by RBM; • Reports to MAMN</td>
<td>• Credit only; starting offer micro-leasing product • Originally focused on micro-enterprises in urban and trading centres, (working capital loans), with bias towards female borrowers; now targeting SMEs (more SEs), employees and farming / fishing households</td>
<td>• Keen to apply for a full banking license</td>
</tr>
<tr>
<td>SEDOM</td>
<td>• 100% government owned (government trust)</td>
<td>• Not regulated by RBM; • Reports to the ADB through the Ministry of Agriculture; also reports to MAMN on a yearly basis</td>
<td>• Credit only: targets SMEs</td>
<td>• Expects to fall under RBM supervision after passage of relevant legislation</td>
</tr>
</tbody>
</table>
### SACCOs
- **Membership-based**
- Currently does not report to RBM;
- Submits returns to MUSCCO
- **Savings and credit**
- Will retain status as SACCOs even after passage of the Bills

### C.2 Scale and outreach of providers of financial services

<table>
<thead>
<tr>
<th>Institution</th>
<th>Scale</th>
<th>Outreach</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td><strong>Total assets</strong></td>
<td><strong>Total no. of clients</strong></td>
</tr>
<tr>
<td><strong>BANKS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ecobank</td>
<td>MK4,579,767,000</td>
<td>2,238</td>
</tr>
<tr>
<td></td>
<td>MK2,770,100,000 in deposits (of which, MK415,515,000 are deposits from individuals)</td>
<td></td>
</tr>
<tr>
<td>NBS Bank</td>
<td>MK20.420 billion</td>
<td>14,488 (total borrowers)</td>
</tr>
<tr>
<td></td>
<td>220 clubs being served</td>
<td></td>
</tr>
<tr>
<td>INDEBANK</td>
<td>MK7,918,320,000</td>
<td>...</td>
</tr>
<tr>
<td></td>
<td>MK3,655,200,000 in loans</td>
<td></td>
</tr>
</tbody>
</table>
## SUPPLY SIDE STUDY OF FINANCIAL INCLUSION IN MALAWI
### Final Report

### Scale

<table>
<thead>
<tr>
<th>Institution</th>
<th>Total assets</th>
<th>Total no. of clients</th>
<th>Business volume</th>
<th>Regional coverage</th>
<th>No. of branches and outlets</th>
</tr>
</thead>
<tbody>
<tr>
<td>NEDBANK</td>
<td>MK7,024,781,000</td>
<td>3,284 (of which, 86 are borrowers)</td>
<td>MK512,287,000 in deposits held by individuals; MK3,661,102,000 in deposits held by non-individuals; MK2,404,708,000 in loans</td>
<td>Operates in Blantyre and Lilongwe only</td>
<td>2 full-service branches and 2 ATMs</td>
</tr>
<tr>
<td>Standard Bank</td>
<td>MK41,017,000,000</td>
<td>---</td>
<td>---</td>
<td>Operates in 12 districts, with an urban focus</td>
<td>8 full-service branches, 12 sub-branches, 39 ATMs</td>
</tr>
<tr>
<td>National Bank of Malawi</td>
<td>MK72,115,000,000 (as of May 2009)</td>
<td>167,502 (as of May 2009)</td>
<td>MK33 billion in loans (as of May 2009); MK48.4 billion in deposits</td>
<td>Operates in 15 districts</td>
<td>11 full-service branches, 14 agencies, and 46 ATMs</td>
</tr>
<tr>
<td>Opportunity International Bank of Malawi</td>
<td>---</td>
<td>33,835 (of which, about 57% are women)</td>
<td>MK3,107,678,453 in loans; MK4.5 billion in deposits</td>
<td>---</td>
<td>5 branches and 7 agencies; also operates mobile banking</td>
</tr>
</tbody>
</table>

### NON-BANKS

<table>
<thead>
<tr>
<th>Institution</th>
<th>Total assets</th>
<th>Total no. of customers</th>
<th>Business volume</th>
<th>Regional coverage</th>
<th>No. of branches and outlets</th>
</tr>
</thead>
<tbody>
<tr>
<td>CUMO Microfinance Ltd.</td>
<td>MK490,988,272</td>
<td>33,873</td>
<td>MK178,966,041 in loans to customers</td>
<td>Operates in 11 districts; with a rural focus</td>
<td>12</td>
</tr>
<tr>
<td>FINCA</td>
<td>---</td>
<td>14,133 (of which almost 80% are women)</td>
<td>MK313,916,250 in loans</td>
<td>Several outlets in all regions</td>
<td>16</td>
</tr>
<tr>
<td>Microloan Foundation</td>
<td>MKW150,833,000</td>
<td>10,677</td>
<td>Total loan portfolio: MKW331,080,000</td>
<td>Peri-urban and rural</td>
<td>20</td>
</tr>
<tr>
<td>Pelton Finance</td>
<td>MKW25,000,000</td>
<td>156</td>
<td>Total loan portfolio: MKW 5.35 million</td>
<td>Only in Lilongwe</td>
<td>1</td>
</tr>
<tr>
<td>Institution</td>
<td>Total assets</td>
<td>Total no. of clients</td>
<td>Business volume</td>
<td>Regional coverage</td>
<td>No. of branches and outlets</td>
</tr>
<tr>
<td>---------------------------</td>
<td>----------------------</td>
<td>----------------------</td>
<td>--------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------</td>
<td>----------------------------</td>
</tr>
<tr>
<td>Greenwing</td>
<td>• MK2.5 billion</td>
<td>• 31,000</td>
<td>• 30,000 loan accounts (at its peak, had 50,000 payroll clients);</td>
<td>• Only urban and peri-urban locations</td>
<td>• 30</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Value of total loans: MKW 2 billion</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Izwe</td>
<td></td>
<td>• 9,282 borrowers</td>
<td>• Total loan volume of MKW481 million</td>
<td>• Only urban and peri-urban locations</td>
<td>• 3</td>
</tr>
<tr>
<td>Blue Financial Services</td>
<td></td>
<td></td>
<td>• MK999,459,175 in loans</td>
<td>• Operates in 6 districts: only urban</td>
<td>• 6</td>
</tr>
<tr>
<td>DEMAT</td>
<td>• MK9,387,855 (as of 2006)</td>
<td>• 1,450 clients</td>
<td>• Total loan portfolio of MK13,321,285 (as of end 2008)</td>
<td>• Operates in 6 districts, with a rural focus</td>
<td>• 6 branches: 3 district offices, 3 regional offices</td>
</tr>
<tr>
<td>MARDEF</td>
<td>• MWK86,732,000 (as of 2008)</td>
<td>• 154,000</td>
<td>• Total loans of MWK669,041,000</td>
<td>• Targets nationwide coverage</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• With emphasis on women</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MRFC</td>
<td>• MKW5,967,993,745</td>
<td>• 262,475 savings accounts</td>
<td>• Total savings volume of MKW536,111,665; • Total loan portfolio: MK3,825,540,469</td>
<td>• Operates in 16 districts</td>
<td>• Total of 6 full-service branches, 20 sub-branches</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Working in all districts except Likoma, Nsanje and Chitipa (all physically remote) and Phalombe</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PRIDE</td>
<td></td>
<td></td>
<td>• 233,024,714 in loans</td>
<td>• Working in all districts except Likoma, Nsanje and Chitipa (all physically remote) and Phalombe</td>
<td></td>
</tr>
<tr>
<td>SEDOM</td>
<td>• MWK141,343,843</td>
<td>• 10,970 borrowers</td>
<td>• Total loan portfolio: MWK53,099,220 (80% of which group-based);</td>
<td>• Operates in 9 districts</td>
<td>• 9</td>
</tr>
<tr>
<td></td>
<td>(as of end 2008)</td>
<td></td>
<td>• Total value of savings facilitated: MWK1,564,244</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Touching Lives Fund</td>
<td>• MK13,738,691</td>
<td>• 800</td>
<td>• MK10,441,677 in loans</td>
<td>• Only in Blantyre and Mulanje</td>
<td>• 2</td>
</tr>
</tbody>
</table>
## Scale

<table>
<thead>
<tr>
<th>Institution</th>
<th>Total assets</th>
<th>Total no. of clients</th>
<th>Business volume</th>
<th>Regional coverage</th>
<th>No. of branches and outlets</th>
</tr>
</thead>
<tbody>
<tr>
<td>SACCOS (MUSSCO members) (data as of March 2009)</td>
<td>MK2,359,552,232 in assets</td>
<td>82,982 (of which, 26.5% are female)</td>
<td>MK138,863,300 in deposits, MK1,905,739,565 in loans</td>
<td>Almost nationwide coverage</td>
<td>59 SACCOS in total</td>
</tr>
</tbody>
</table>

### Additional Information:
- **SACCOS (MUSSCO members)**: MK2,359,552,232 in assets, MK1,629,671,802 in members' shares
- **SACCOs**: Almost nationwide coverage, 59 SACCOs in total
- **Clients**: 82,982 (of which, 26.5% are female)
- **Business Volume**: MK138,863,300 in deposits, MK1,905,739,565 in loans
- **Regional Coverage**: Almost nationwide
- **Branches and Outlets**: 59 SACCOs in total

---

**Note**: The data provided is as of March 2009.
Annex D  Background notes on the legal and regulatory environment

This annex contains the background legal information and analysis which was produced in support of this report. It contains three tables split into two parts. The first part contains a simple tabular index of the legislation which was reviewed. The second part contains two sets of tabular notes on the contents of that legislation.

D.1 Legislation Index

The following table sets out the existing statutes and suite of draft Bills that were considered for this report. To help provide an overview of the entire legal package, it also sets out a short description of the general purpose of each piece of legislation.

<table>
<thead>
<tr>
<th>Acts</th>
<th>General Purpose &amp; Expected Revisions??</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking Act (44:01)</td>
<td>Provides the overall regulatory framework for banking activities in Malawi by prohibiting the conduct of &quot;banking business&quot; (i.e. &quot;by receiving funds from the public...or by borrowing from the public or other banks and of employing such funds, in whole or in part by granting loans, advances and credit facilities and by investing or by other means at the risk of the person conducting such business.&quot;) without being licensed as a bank. An entire new Banking Bill is being proposed. This new bill retains the overall structure and general prohibitions / licensing system but is designed to cover banks only &amp; not more general financial institutions, it is also designed at a good mix of ex-ante and ex-post regulation.</td>
</tr>
<tr>
<td>Capital Market Development Act (46:06)</td>
<td>Places responsibility for the regulation and supervision of the capital markets (broadly defined) with the RBM. Includes a number of general regulatory powers. This was promulgated in 1990 in an interim capacity before the introduction of a comprehensive securities law. Planned Securities Bill would replace in entirety.</td>
</tr>
<tr>
<td>Insurance Act (47:01)</td>
<td>Provides basis for licensing and registration of insurance service providers in Malawi but is generally considered to be old legislation which has outlived its usefulness. Planned Insurance Bill would replace in entirety.</td>
</tr>
<tr>
<td>Reserve Bank Act (44:02)</td>
<td>Provides legal basis for constitution and many powers and functions of the RBM, including specifying the principal objectives of the bank (inc. &quot;to promote a sound financial structure in Malawi...&quot;; “to supervise banks and other financial institutions in Malawi”; and “to promote development in Malawi” amongst others).</td>
</tr>
</tbody>
</table>

94 The Buildings Society Act was excluded from this list as it was considered essentially historic.
**Acts**

<table>
<thead>
<tr>
<th>Acts</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money Laundering, Proceeds of Serious Crime and Terrorist Financing Act (Act No. 11 of 2006)</td>
<td>Provides a fairly modern framework for prevention of money laundering activities and for identification and control of other funds generated through illegal activities. The Financial Intelligence Unit (FIU) has recommended some changes to it, but we are unaware of any plans to amend it as yet.</td>
</tr>
<tr>
<td>The Business Names Registration Act (46:02)</td>
<td>Provides overall framework for licensing and registration of business, but is generally considered to be archaic legislation. It is important that the bureaucracy around business registration does not impede business development but we understand that the business registration processes provided in this Act and the regulations provided in the Business Licensing Act are considered to be particularly burdensome by business, including financial services providers and SMEs, but we are not aware of any plans to reform this indirect aspect of financial regulation.</td>
</tr>
</tbody>
</table>

**Bills**

<table>
<thead>
<tr>
<th>Bill (date of latest version seen)</th>
<th>General Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking Bill (03/09/07)</td>
<td>To update the existing Banking Act. The bill retains the overall structure and general prohibitions / licensing system but is designed to cover banks only &amp; not more general financial institutions (for which see Financial Services Bill).</td>
</tr>
<tr>
<td>Credit Reference Bureau Bill (July 2008)</td>
<td>To establish a regulated and reliable credit reference system / bureau in Malawi.</td>
</tr>
<tr>
<td>Financial Services Bill (01/06/08)</td>
<td>To provide a framework for financial regulation overall (other than banks) and to provide the basis for the new regulation of MFI s &amp; SACCOs. To establish the new function of Registrar of Financial Institutions and to provide specific powers of licensing / intervention etc for that Registrar.</td>
</tr>
<tr>
<td>Financial Co-operatives Bill (June 09)</td>
<td>To provide a specific regulatory framework for financial co-operatives, under the umbrella of the Financial Services Bill and administered by the RFI. It follows the WOCCU recommendations to introduce credit union regulation</td>
</tr>
<tr>
<td>Insurance Bill (12/06/07)</td>
<td>To update the insurance regulatory system by making (or clarifying) provision for licensing insurance activities; insurance company solvency &amp; insurance market regulation more generally.</td>
</tr>
<tr>
<td>Microfinance Bill (01/06/09)</td>
<td>To provide a regulatory framework for the provision of microfinance services, under the umbrella of the Financial Services Bill and administered by the RFI.</td>
</tr>
<tr>
<td>Payment Systems Bill (Cannot be determined)</td>
<td>To provide a regulatory framework for the electronic processing of payments etc., inc licensing requirement from the RBM. We understand that this bill is being revisited at the technical level.</td>
</tr>
</tbody>
</table>
D.2 Key Provisions

The first table in this section provides a quick reference guide to key provisions in the three draft bills considered most relevant to the development of the microfinance sector: The Financial Services Bill; the Microfinance Bill and the Financial Cooperatives Bill.

The second table contains some further initial observations in relation to the wider suite of proposed legislation. That table has been created to help pinpoint specific elements of the proposed legislation that would have an obvious impact on (i) financial stability; (ii) creditor rights; (iii) availability of information to the capital markets; (iv) intermediation costs; and (v) future flexibility in the regulatory framework.

**TABLE C.2 (1):**

<table>
<thead>
<tr>
<th>Provision</th>
<th>Financial Services Bill</th>
<th>Microfinance Bill</th>
<th>Financial Cooperatives Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>General purpose</td>
<td>To provide a framework for overall financial regulation (other than banks) and to provide the basis for the new regulation of MFIs &amp; SACCOS. To establish the new function of Registrar of Financial Institutions and to provide specific powers of licensing / intervention etc for that registrar.</td>
<td>To provide a framework for the operations, regulation and supervision of microfinance service providers. To establish procedures for registration and licensing for the MFIs. To establish the functions of the Registrar in the supervision and licensing.</td>
<td>To provide a framework for the operations, regulations and supervision of SACCOS. To establish procedures for registration, license or approval of the Registrar. To establish the specific functions of Registrar in the establishment, licensing and supervision of the SACCOS.</td>
</tr>
<tr>
<td>Types of financial institutions permitted to operate</td>
<td>This Bill defines financial institution as follows: (a) a bank;</td>
<td>Financial institutions permitted to operate include: (a) a microcredit agency;</td>
<td>Financial institutions permitted to operate include: (a) Primary SACCOS; and</td>
</tr>
<tr>
<td>Provision</td>
<td>Financial Services Bill</td>
<td>Microfinance Bill</td>
<td>Financial Cooperatives Bill</td>
</tr>
<tr>
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</tr>
<tr>
<td>(b) each of the following as defined in the Securities Bill: (i) a securities dealer; (ii) a securities broker; (iii) a securities representative; (iv) an investment adviser; (v) a securities exchange; (vi) a securities depository; (vii) a collective investment scheme; (viii) an investment company; (c) a person who provides securities registration services for the purposes of the Securities Bill; (d) each of the following as defined in the Insurance Bill: (i) an insurer; (ii) a reinsurer; (iii) an insurance broker; (iv) an agent for brokers; (v) an insurance agent; (vi) a loss assessor/adjustor; (vii) a claims settling agent; (e) each of the following as defined in the Microfinance Bill: (i) a microcredit agency; (ii) a microfinance institution; (f) each of the following as defined in the Financial Cooperatives Bill: (i) a primary SACCO; (ii) a secondary SACCO; (g) each of the following as defined in the Retirement Funds Bill: (i) a retirement fund; (ii) an umbrella fund; (iii) an administrator of a retirement fund; (iv) an investment manager for a retirement fund or an umbrella fund; (v) a pension broker; (h) a trustee of a collective investment scheme as defined in the Securities Bill or of a retirement fund or an</td>
<td></td>
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<tr>
<td></td>
<td>(b) a non-deposit taking microfinance institution; and (c) a deposit-taking microfinance institution. (d) other licensed financial institutions approved by the Registrar</td>
<td></td>
<td>(b) Secondary SACCOs.</td>
</tr>
<tr>
<td>Provision</td>
<td>Financial Services Bill</td>
<td>Microfinance Bill</td>
<td>Financial Cooperatives Bill</td>
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<td>-----------</td>
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</tr>
<tr>
<td>umbrella fund as defined in the Retirement Funds Bill; (i) an actuary for an insurer as defined in the Insurance Bill or for a retirement fund as defined in the Retirement Bill; (j) a custodian; (k) a friendly society; (l) a medical aid fund; (m) a person who, by way of business, in Malawi: (i) buys or borrows foreign currency from; (ii) sells or lends foreign currency to; or (iii) exchanges foreign currency with a person other than the Reserve Bank; (n) a person who, by way of business, transfers funds to foreign countries, or carries out activities to the same or a similar effect; (o) a holding company; (p) a credit reference bureau; (q) a building society as defined in the Building Societies Act; (r) finance or leasing company; (s) the operator of a financial institution as defined in paragraphs (a) to (r) of this definition; and (t) a person, business or fund declared by Registrar’s directives or by another financial services laws to be a financial institution.</td>
<td></td>
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</tbody>
</table>

**Notable statutory requirements**

The Registrar must approve the class of shares issued by the

<p>| |
|  |
| No MFI shall, without the Registrar’s permission: |
| Limits to insider lending: A licensed SACCO may make loans to |</p>
<table>
<thead>
<tr>
<th>Provision</th>
<th>Financial Services Bill</th>
<th>Microfinance Bill</th>
<th>Financial Cooperatives Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>regulated financial institutions. Except if it is express in this Act, no individual or body corporate controlled by one individual, shall own or acquire more than forty nine percent (49%) of the shares of a prudentially regulated financial institution. Except as approved by the Registrar under such terms and conditions which the Registrar may determine, a trust shall not own more than ten percent (10%) shares in a prudentially regulated financial institution.</td>
<td>(a) grant, or permit to be outstanding any credit facility to any debtor in excess of ten per centum (10%) of its capital base, or such limit as may be determined by the Registrar from time to time; (b) have investments in land, buildings, and other immovable property that in aggregate exceed the sum of its capital and reserves; and (c) own shares in any company, firm, or enterprise that in aggregate value exceed ten per centum (10%) of the sum of its capital and reserves.</td>
<td>its employees and members of its board of directors an amount in the aggregate not exceeding such proportion of its total assets as may be prescribed by the Registrar from time to time. A SACCO shall not, without prior approval of the Registrar, grant or permit to be outstanding any credit facility to any member as may be determined by the Registrar from time to time.</td>
<td></td>
</tr>
<tr>
<td>Licensing</td>
<td>Licensing and registration applications and procedure: The Registrar may, on application: grant a financial institution a licence; register a financial institution; or grant a renewal of such a licence or registration. About the application: it shall be:</td>
<td>The provisions relating to registration or licensing under the Financial Services Act, 2008 shall apply <em>mutatis mutandis</em> to this Act. Any person registered or licensed under this Act may apply to the Registrar to be exempt from the following laws and regulations made thereunder: the Banking Act, the</td>
<td>No person shall engage in the business of receiving deposits, extending credit and providing other financial services to its members as a SACCO unless it is— (a) registered under the provisions of the Cooperative Societies Act, 1998; and (b) licensed under the provisions of the Financial Services Act, 2009 as a</td>
</tr>
</tbody>
</table>

May 2010
<table>
<thead>
<tr>
<th>Provision</th>
<th>Financial Services Bill</th>
<th>Microfinance Bill</th>
<th>Financial Cooperatives Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a) made by the financial institution concerned; (b) made to the Registrar as prescribed; (c) accompanied by such documents, statements and other information as are prescribed; and (d) accompanied by the prescribed fee, if any.</td>
<td>Financial Cooperatives Act; or the Insurance Act. The Registrar shall, within sixty (60) days from the date of receipt of a complete application for registration or license, grant or refuse to grant a certificate, license or approval. In the case of the Deposit-taking Microfinance Institutions, the Registrar shall not license any person as one of this type of institution unless such person is incorporated as a company limited by shares, as defined in the Companies Act. The Registrar shall carry out an inspection of the premises of an applicant for a licence to operate as a deposit-taking microfinance institution to determine minimum standards. A licence shall not be transferred, assigned or encumbered in any way. A registration certificate or license or approval shall automatically expire if the registered person or licensee fails to commence its business within a period of one (1) year following the granting of the certificate, licence or approval. The Registrar may vary the conditions, suspend or revoke the license and registration.</td>
<td>Primary or Secondary SACCO A registered SACCO shall furnish an application for a license, in writing, to the Registrar in a prescribed format. The Registrar shall, within sixty (60) days from the date of receipt of a complete application for registration or license, grant or refuse to grant a certificate, license or approval.</td>
</tr>
</tbody>
</table>
### Capitalization requirements

<table>
<thead>
<tr>
<th>Provision</th>
<th>Financial Services Bill</th>
<th>Microfinance Bill</th>
<th>Financial Cooperatives Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Registrar may make provision about capital and liquidity requirements for financial institutions and financial groups.</td>
<td>The Registrar is in charge of determining the minimum capital or loan fund requirements, whichever is applicable, for different categories of MFIs. This minimum amount can vary from time to time, depending on the Registrar evaluation. The Registrar also can determine ongoing capital requirements for individual MFIs where the supervisory review process reveals risks warranting additional capital.</td>
<td>The Registrar shall, through directives and without prejudice to the generality of his powers under this Act or the Financial Services Act, 2009 determine minimum capital adequacy for SACCOs. A licensed SACCO shall maintain such minimum holding of liquid assets of its members’ deposits and borrowings as may be prescribed by the Registrar from time to time.</td>
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</tr>
</tbody>
</table>

### Stipulations relating to the transformation of institutions

<table>
<thead>
<tr>
<th>Provision</th>
<th>Financial Services Bill</th>
<th>Microfinance Bill</th>
<th>Financial Cooperatives Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

### Stipulations relating to consumer protection (including truth in lending, lender practice requirements, mechanisms for handling complaints, and consumer awareness-raising)

<table>
<thead>
<tr>
<th>Provision</th>
<th>Financial Services Bill</th>
<th>Microfinance Bill</th>
<th>Financial Cooperatives Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>All microfinance service providers shall at all times disclose to the concerned customer, in writing, the terms of any credit or savings products being offered. A microfinance service provider and its staff shall ensure that all transactions are conducted in strict confidence, and that the confidentiality of customers is maintained.</td>
<td>A SACCO shall at all times disclose, in writing, the cost of borrowing, including the interest rate and related fees, to the borrower. A SACCO and its staff shall ensure that all transactions are conducted in strict confidence and that the confidentiality of members is maintained.</td>
<td></td>
</tr>
</tbody>
</table>

### Stipulations on interest rate ceilings

<table>
<thead>
<tr>
<th>Provision</th>
<th>Financial Services Bill</th>
<th>Microfinance Bill</th>
<th>Financial Cooperatives Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

### Stipulations on ‘fraud and financial crime prevention’ (e.g. securities fraud and abusive investment arrangements such as pyramid schemes, and)

<table>
<thead>
<tr>
<th>Provision</th>
<th>Financial Services Bill</th>
<th>Microfinance Bill</th>
<th>Financial Cooperatives Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Registrar may make provision about requirements relating to the deterrence of financial crime by financial institutions</td>
<td>Every microfinance service provider shall present to the Registrar or other enforcement agencies of the Government relevant information for transactions deemed suspicious under the Money Laundering, Proceeds of</td>
<td>Every SACCO shall furnish the Registrar or other enforcement agencies of Malawi with relevant information for transactions deemed suspicious under the Money Laundering, Proceeds of Serious</td>
<td></td>
</tr>
</tbody>
</table>

The Act mentions the coverage of the
<table>
<thead>
<tr>
<th>Provision</th>
<th>Financial Services Bill</th>
<th>Microfinance Bill</th>
<th>Financial Cooperatives Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>money-laundering)?</td>
<td>term ‘money laundering’: it shall cover all activities and procedures designed to alter the identity of illegally obtained money so that it appears to have originated from a legitimate source.</td>
<td>Serious Crimes and Terrorist Financing Act.</td>
<td>Crimes and Terrorist Financing Act.</td>
</tr>
<tr>
<td>Provision for a Deposit Insurance Scheme for financial institutions</td>
<td>None</td>
<td>None</td>
<td>The Deposit Guarantee Fund: The funds constituting the Deposit Guarantee Fund shall be invested by the Board of Trustees in government securities and in deposits with other financial institutions as directed by the Board of Trustees. The Deposit Guarantee Fund shall provide protection for members’ deposits, but not shares, up to an amount as determined by the Board of Trustees, from time to time, and approved by the Registrar. The amount being the aggregate credit balance of any accounts maintained by the member to a licensed SACCO, less any liability of the member to the licensed SACCO, shall be a protected deposit. A member’s deposits shall be used to offset any liabilities owed by the licensed SACCO under liquidation including any liability under a loan guarantee by such member.</td>
</tr>
<tr>
<td>Stipulations on the types of branches or outlets that a financial institution can operate</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Types of institutions to be</td>
<td>The Registrar (Governor of the Central)</td>
<td>All the microfinance services providers</td>
<td>All the SACCOs and their functions</td>
</tr>
<tr>
<td>Provision</td>
<td>Financial Services Bill</td>
<td>Microfinance Bill</td>
<td>Financial Cooperatives Bill</td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>supervised and designated supervisor</td>
<td>Bank) shall be the regulatory and supervisory authority for the financial services industry. The Reserve Bank has the function of supporting the Registrar in carrying out his functions under this and the other financial services laws. Without limiting the powers of the Registrar under this Act to issue directives, the management of every prudentially regulated financial institution shall, unless exempted by the Registrar, appoint an internal auditor suitably qualified and experienced in financial services. The Registrar may examine and investigate, eventually, if the licensed or registered financial institution is complying or has complied the financial service law, the conditions of its license, etc. The Registrar may require an external auditor to report to him on the extent of the external auditor’s procedures in the examination of the annual financial statements of a prudentially regulated financial institution and may direct him to expand the scope of that examination.</td>
<td>must be supervised by the Registrar: - A microcredit agency shall, within four months after the close of its financial year, submit the following information in a prescribed format to the Registrar: (a) annual financial statements; and (b) additional information that the Registrar may determine. - An MFI shall submit to the Registrar information and data on its operations in Malawi, including periodic returns and those of any company which is a subsidiary, affiliate, associate, or holding company. The format of the periodic returns required and periods within which they must be submitted shall be determined by the Registrar and may vary for different categories of microfinance institution. and services provided must be regulated and supervised by the Registrar, in areas such as: capital adequacy and requirements, limits liquid assets, other permissible investment funds, etc.</td>
<td>None</td>
</tr>
<tr>
<td>Provision</td>
<td>Financial Services Bill</td>
<td>Microfinance Bill</td>
<td>Financial Cooperatives Bill</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
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<td>-----------------------------</td>
</tr>
<tr>
<td>The arrangements may, if the Registrar considers it appropriate, involve the delegation of the Registrar’s powers under financial services laws to the self regulatory organization. A self regulatory organization may make rules, not inconsistent with the financial services laws, for or with respect to any matters for which the self regulatory organization has supervisory functions. These rules shall be of no effect unless approved by the Registrar.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### TABLE C.2 (2):

This second table contains some further initial observations in relation to the wider suite of proposed legislation. That table has been added to help pinpoint specific elements of the proposed legislation that would have an obvious impact on (i) financial stability; (ii) creditor rights; (iii) availability of information to the capital markets; (iv) intermediation costs; and (v) future flexibility in the regulatory framework.

<table>
<thead>
<tr>
<th>Bill</th>
<th>Notes</th>
</tr>
</thead>
</table>
| **Banking Bill**   | • The requirement to be a ‘company’ to be licensed as a bank is being changed to a ‘body corporate’ (S.4(2)). As companies (whether limited by shares or guarantee) are only one type of body corporate this change could support different organisations, such as co-ops or statutory corporations, becoming banks. Nevertheless, S.44 applies the Companies Act provisions re: winding up so the usual corporate level of creditor protection provided therein will apply. The provisions requiring licences to stipulate where business must be carried out appear have been removed (S.8(1)). This could support extension of branch network etc; although S.23(f) contains a requirement for RFI permission to open / close branch (amongst other things). Nevertheless such permission may be easier to achieve than a licence modification, so this change could be viewed as supportive of expanding bank branches.  
• Much of the detail on prudential regulation and reporting requirements will be prescribed in directives, etc to be issued by the RFI. This allows greater flexibility and should enable the RFI to react more quickly than if rules were to be prescribed in the statute itself. |
| **Credit Reference Bureau Bill** | • It is expected that this bill will change substantially from the draft that we have seen before being introduced to Parliament.  
• As currently drafted, licensing etc under this statute would be performed by RBM not RFI (and only limited liability companies would be able to be licensed). In practice RFI and RBM are the same but we'd expect this drafting to be clarified to avoid potential legal anomalies.  
• Under this bill, the credit reference licences would specify the place of business and so opening new credit reference branches or offices may be administratively more complex than if the permission style system used under the banking bill were used (see S.9). Perhaps unnecessarily therefore, RBM's consent to new branch opening is also included in the list of consents required in S.21  
• The RBM will have to keep register of licensed credit reference bureaus and to publish new grants / revocations in newspaper / Gazette.  
• The RBM will also specify minimum capital requirements for credit reference bureau businesses (providing a degree flexibility in the future) (S.13). However, any RBM specification can't override statutory requirement that min cap must be not less than the prescribed start up capital (unimpaired by losses), so less flexibility than under the other bills. However it is unclear why credit reference bureaus would require capital adequacy control. As currently drafted, the general position is that credit reference services are only to be provided to licensed financial service providers (not to banks) (S.16). However, there appears to be an exception to that general rule for banks where they have got a customer's explicit... |
approval to access their credit history. The draft bill may yet be amended to extend this service to other bodies, for example utility companies.

- Winding up of a credit reference bureau will require MRMB's consent and will involve various declarations of no outstanding debts / obligations, etc (S.36 et seq). This gives creditors some level of protection but they would not have a free hand - RBM's consent is needed before being able to take the ultimate action against the bureau.
- Broad powers are given to the Minister to make further regulations for better implementation of the Act / its objectives (S.44).

### Financial Services Bill

- This bill is designed to serve as an 'umbrella' to: (i) the Securities Bill / Act; (ii) the Insurance Bill / Act; (iii) the Microfinance Bill / Act; (iv) the Financial Co-operatives Bill / Act and (v) the Retirement Funds Bill / Act. Regulation provided in this statute supplemented by that provided in those proposed bills.
- The objectives that the RFI should seek to achieve when exercising its functions are set out in S.10. These include "stability of the financial system".
- The RFI is given strong unilateral licence varying and revocation powers in Ss.26-28, albeit some appeal mechanism is provided in S.79.
- There is a wide ranging list of areas the RFI may issue more detailed directives in, e.g. conduct of affairs of financial institutions; governance; capital & liquidity; outsourcing; reporting etc (S.34 & others). Changes to such regulation will be more easily effected than if they had been in the statute itself, allowing for greater flexibility in the future. Prudentially regulated institutions under this Act to publish copies of annual audited statements in 2 national newspapers (though 6 month lag) (S.37(1)). Increases availability of information.
- An interesting provision for self-regulating classes of institutions is provided in S.45. This could pave the way for a MFI / SACCO specific regulatory body to be developed, without necessarily requiring further legislation. There is provision for RFI to place prudentially regulated financial institutions under 'statutory management', which would prevent creditors raising actions etc (S.70 et seq). S.73 RFI approval needed for winding up etc.
- Specific KYC obligations are imposed, which may have an impact on financial access by low-income individuals (S.101).

### Financial Co-operatives Bill

- The bill makes a distinction between primary & secondary SACCOs. Minimum membership requirements for primary SACCOs is 300: this may still be too low to ensure operational viability. Consider as well the typical size of SACCOs operating in the country at present: average size of >1,000.
- Restrictions on place of business are contained in S.14. It appears to be limited to only one place and any changes need to be approved by the Registrar on payment of a fee. However, S.19 lists the services a primary SACCO may offer, which includes ‘shared branching among SACCOs’. S.20 also provides list of additional services a secondary SACCO may offer, which includes insurance services (with written permission of the RFI). SACCOs may also draw on RBM's 'liquidity

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95 Prudentially regulated institutions defined for purposes of this statute are: (i) a bank; (ii) a licensed microfinance institution; (iii) a securities exchange; (iv) a securities depository; (v) insurer; (vi) re-insurer; (vii) primary SACCO; (viii) secondary SACCO; (ix) retirement fund; (x) umbrella fund; (xi) trustee of a CIS or a retirement or umbrella fund; (xii) custodian; (xiii) medical aid fund; (ixx) friendly society; (xx) holding company; (xxi) building society; (xxii) anything else declared by RFI / law to be a PRI; and (xxiii) the operator of any of those.
### SUPPLY SIDE STUDY OF FINANCIAL INCLUSION IN MALAWI
Final Report

- There are various provisions for the RFI to issue directives on specifying capital adequacy, liquidity requirements, responsibilities / qualifications to be demanded of management, etc. Changes to such regulations will be more easily effected than if they had been in the statute itself, arguably allowing for greater flexibility.
- Note that there is an ownership limit in that no one member can hold more than 10% of a SACCO (S.34(1)). S.35 explicitly states that SACCOs must “focus on institutional sustainability of financial services to its members”.
- There is an additional list of activities that require permission from the RFI, notably including offering deposit / credit products to non-members (though such activities are, by implication, possible and care would need to be taken to avoid unnecessary market distortions / the creation of an un-level playing field ) (S.38).

<table>
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<tr>
<th>Insurance Bill</th>
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<tr>
<td>- Acquiring a license as an insurance provider (as opposed to an agent, broker or loss adjustor which must also be licensed) will be done on basis of class of insurance provided: the same person cannot provide life &amp; non-life policies. It will be possible to be licensed as a company or as an individual member of a recognised association of underwriters.</td>
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<tr>
<td>- There are various provision (but esp. Ss.12 &amp; 73 &amp; 97) for the RFI to issue directives etc specifying regulations in more detail. This Includes provision re: capital adequacy, forms of liquidity, margins of solvency, fair treatment of policy holders etc. Changes to such regulations will therefore be more easily effected than if they had been in the statute itself, arguably allowing for greater flexibility.</td>
</tr>
<tr>
<td>- Unlike in the other bills, insurers must only give RFI written notice of change of principal office (no requirement for consent or payment of fee) (S.14). However consent is required for opening branches and for introducing new products (amongst other things) (S.80A)</td>
</tr>
<tr>
<td>- Permission is required for insurer to place insurance contract with business outside Malawi &amp; RFI to withhold consent if person in Malawi could provide efficiently &amp; cost effectively (S.15(4)). See also S.72, could act as a general requirement that insurers invest their assets in Malawi.</td>
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<td>- There are various provisions re: creditor ranking / application of Companies Act rules re: bankruptcy &amp; winding up (See Ss.32 et seq, 78 &amp; 79). Interestingly there are various protections of policy holders / beneficiaries from their own creditors &amp; those of insurance company but also provision in S.40(2) for interest bearing payments to be made to an individual's creditors where it can be shown that life policy taken out with a view to avoiding creditor payments. Particular protections are also given to funeral policies, including grace periods, a requirement that the insurer spend time going trying to collect unpaid premiums and, in broad terms, an ability for the RFI to intervene and stipulate different payments to be made where a policy is inadequate (Ss.49 &amp;51).</td>
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<td>- Surprisingly, the insurer (not the executor) is placed under obligation to discover other insurance policies of deceased and withhold estate duty / payment until established (S.36(7)</td>
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<td>- There are requirements for the broker to carry errors / omissions and fidelity insurance (S.54) This will have cost implications (though is presumably not unusual).</td>
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<td>- The RFI has the power to revoke an insurance agent’s licence on public interest / public policy grounds (S.64). There appears to be no corresponding provision relating to brokers.</td>
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<tr>
<td>Microfinance Bill</td>
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| • The definition of 'Microfinance Services' and related definitions are broad and customer-focused.96  
• A distinction is drawn between (i) deposit taking MFIs, to be licensed / prudentially regulated; (ii) non-deposit taking MFIs, to be licensed and possibly prudentially regulated; & (iii) microcredit agencies, only to be registered, not licensed / regulated in the same way. Other licensed financial institutions may offer microfinance services but must keep those operations separate from the rest of their activities (Ss.5(1)-(3)) RFI may determine which type of service may be offered by which type of body.  
• There are various provisions throughout Bill for the RFI to make directions stipulating reporting and qualification requirements, etc. Changes to such regulation will therefore be more easily effected than if they had been in the statute itself, allowing for greater flexibility.  
• RFI approval is apparently (though not conclusively, given current drafting in Ss.10, 11 & 16) needed for new branch opening / use of agent. Unlike SACCOs no fee appears to be required although S.21(2) suggests that a fee may be charged. Prudentially regulated MFIs must be companies limited by shares (Ss.17&19) – this may need to be assessed given relaxing of this provision when it comes to banks (as noted above). Non-deposit taking MFIs becoming prudentially regulated must re-apply for a license. Where an MFI remains non-prudentially regulated (i.e. not a company limited by shares), S.18 includes requirements to put in place extra creditor protection (presumably because usual corporate winding up / creditor protections in the Companies Act might not apply).  
• There is a relatively long list of actions that need positive approval from RFI, including appointment of directors (S.27).  
• There is also provision for the RFI to make directives specifying “minimum standards of good practice” (S.34) – this provides scope for developing the industry without need for further legislation. This, however, requires that the RFI is kept informed of what constitutes good practice in microfinance. The same standards held in the banking industry may not always apply.  
• Section 50 provides a list of reasons for allowing the RFI to apply for the winding up of MFI (in court), including where continued operations of the MFI is not in the best interest of creditors. An understanding of what is in the best interest of creditors will need to be developed. |
| • This bill is being reviewed at the technical level as consultations continue. It will most likely take a while before it is ready as a draft for substantive comment.  
• There are various provision for approval / regulation of payment systems (electronic and non-electronic) by the RBM.  
• This includes various provisions to allow the systems to be kept whole / settlements effected in event of bankruptcy / failure of system provider, which override creditor's usual types of protection (S.30 et seq).  
• However, no restriction is placed on who may apply for winding up of payment system participants, there is simply requirement that they must simultaneously notify the RBM (S.28). |
| • Makes various provisions for regulation of retirement and umbrella funds, including requirement that all funds be |

96 “...the provision of financial services to small or micro enterprises, low-income customers, financially underserved customers, or as prescribed by the Registrar, including the following: (a) microcredit; (b) deposit-taking; (c) micro-insurance; (d) micro-leasing; (e) transfer and payment services, including conversion into electronic payment media (e-money); or (f) any other services that the Registrar may designate."
<table>
<thead>
<tr>
<th>Bill</th>
<th>registered with the RFI and that all trustees; investment managers; custodians; administrators and brokers be licensed by the RFI (Ss.5 &amp; 10).</th>
</tr>
</thead>
</table>

- Contains various rules about statutory covenants those participants must undertake (S.25 – 28).
- The RFI will have the power to issue directives, etc. in a number of areas, including contributions / payments to funds; benefits; annuities; transfers; asset levels and number of trustees / composition of board etc (S.36). Changes to such regulation will therefore be more easily effected than if they had been in the statute itself, arguably allowing for greater flexibility.
- There is a limit placed on investing pension fund assets outside of Malawi in so far as it can only be done in accordance with the Exchange Control Act (S.44).
- Interestingly, s.53 provides that a beneficiary can receive payment from the fund if they change employer or leave Malawi. This may be a result of the tax regime in Malawi, especially if tax relief on pension investments is not given. Usually, where tax relief is granted on pension investments the quid pro quo is that they cannot be accessed early, i.e. must in fact be protected for retirement.

<table>
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<tr>
<th>Securities Bill</th>
<th>Designed to replace the Capital Markets Development Act. Creates a Securities &amp; Exchange Commission with various powers (including functions related to maintaining market stability) to licence brokers, dealers, investment advisors and representatives, and to regulate the registration, etc. of securities.</th>
</tr>
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- Makes various provisions on the conduct of securities businesses generally.
- Establishes a securities compensation fund to compensate those who suffer loss through wrong dealing of licensed brokers etc.
- Clarifies the role / responsibilities of the Malawi Stock Exchange and provides for other exchanges to be licensed.

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<tr>
<th>The National Registration Bill</th>
<th>The Bill is divided into seven parts -</th>
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- Part I makes provision for preliminary issues;
- part II deals with National Registration, including the establishment of a National Registration System;
- part III covers registration of births;
- part IV is on registration of marriages;
- part V deals with registration of deaths;
- part VI deals with matters relating to records and returns; and
- part VII covers miscellaneous provisions.

part V deals with matters relating to records and returns; and
Annex E  Further analysis of demand data: characterizing the banked and unbanked

Figure D.1 below shows banked adults on the left of the chart, broken down by a set of socio-demographic characteristics (in absolute terms rather than in percentages). On the right hand side, the unbanked adults are profiled in the same way.

Figure E.1  The banked and unbanked – by gender, location and age

<table>
<thead>
<tr>
<th></th>
<th>BANKED</th>
<th>UNBANKED</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Adults</td>
<td>1150</td>
<td>4900</td>
</tr>
<tr>
<td>Female</td>
<td>540</td>
<td>2610</td>
</tr>
<tr>
<td>Male</td>
<td>610</td>
<td>2290</td>
</tr>
<tr>
<td>Rural</td>
<td>730</td>
<td>4350</td>
</tr>
<tr>
<td>Urban</td>
<td>420</td>
<td>550</td>
</tr>
<tr>
<td>18-25 years</td>
<td>250</td>
<td>1260</td>
</tr>
<tr>
<td>26-35 years</td>
<td>420</td>
<td>1470</td>
</tr>
<tr>
<td>36-45 years</td>
<td>250</td>
<td>890</td>
</tr>
<tr>
<td>46 and over</td>
<td>230</td>
<td>1280</td>
</tr>
</tbody>
</table>


At first sight the only obvious defining socio-demographic characteristic of being unbanked is living in a rural area. But care has to be taken in drawing this conclusion. Clearly being urban-based makes it more likely that a person is banked. But we need to take account of the fact that a vast majority of the adult population are rural-based. And while there are significant constraints to accessing financial services in the rural areas, there are in fact more rural-based bank customers than urban-based ones. An important area to look at is whether constrained access in rural areas can be explained by geographical inaccessibility or the lack of interest by providers due to (perceptions of) rural poverty. Furthermore, the next major factor that is worth investigating as a potential constraint on access is income, as being rural-based is also often considered a proxy for being poor (i.e. given the higher incidence and concentration of poverty in rural areas as compared to urban areas).
Figure 4.4 confirms that a significant socio-economic characteristic of being unbanked is having no income or very little income. Some 80% of all unbanked adults declare an income of less than MK10,000 (US$71) per year which equates to roughly US¢ 60 per day at world prices. This could also be interpreted to mean that 80% of all unbanked Malawian adults are not earning even 50% of the US$1.25 per day that international development agencies have recently declared as necessary to avoid extreme poverty.

These comparisons are, however, fraught with difficulties. Access in the FinScope surveys is quite understandably defined at an individual level because most suppliers provide services to individuals rather than households, and because the individual survey enables household dynamics to be taken into account. On the other hand, households are the level at which poverty is defined. To get some idea of the relationship between the two there are 2.1 adults in a typical Malawian household and 2.3 children. Therefore, for a household to be above the international extreme poverty line, each adult would be required to earn the equivalent of $2.60 per day at world prices or almost MK50,000 per year. Adjusting this level down by 30% to allow for some production for own consumption or barter (which has to be taken account when discussing poverty) implies that each adult must have cash earnings of around MK35,000 per year. On this basis, over 90% of

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97 MK10,000 per year equals approximately US$70 a year but prices in Malawi tend to be a third of comparable world prices so this is worth just over $200 on a price-adjusted basis or US¢ 58 per day.
unbanked adults are not earning enough to keep their households above the poverty threshold; but then, it appears that the same goes for 75% of those identified as banked.