Towards a Malawian Social Protection Floor

International Labour Organization

Extracts from the Full Report: Assessment of Social Protection Programmes and Costing of Policy Options

Programme Specific Report: Micro-Finance Programme

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1 Objectives, policy and legal framework

Financial sector development and financial inclusion is considered as an important tool for economic development and poverty reduction by the Government of Malawi (Mandiwa, 2014). In Malawi, as in many developing countries, access of financial services to low income households such as "savings, insurance services, small loans and remittances enables them to benefit from economic opportunities to build up income and assets to lift them out of poverty" (ibid.).

Financial inclusion describes the "delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups" (Mandiwa, 2014) and the Government considers it to be "an essential instrument for increasing agricultural productivity and production, expanding micro and small enterprises, creating employment, increasing household income and smooth consumption" (MF Transparency, 2011).

Demand for loans in Malawi is "highly seasonal, about 80% in rural areas and mostly depend on agriculture", which is why October to January is the "peak lending season and with loans becoming due between April and September" (MFTransparency, 2011). Microfinance supply in Malawi is a "mixture of agricultural credit and business finance carried out in rural and urban areas by a variety of public and private sector firms. Agriculture-related credit is dominant and frequently takes the form of in-kind inputs of fertilizer and seed" (Luboyeski et al, 2004).

Recognizing the importance of an inclusive financial system to the development of the economy, the Government as well as a number of NGOs and international organization support efforts to improve the level of financial inclusion in Malawi. Microfinance has been included in the NSSP for its "role in promoting the poor to move out of poverty, by increasing their access to finance, thereby enabling expansion of their income earning opportunities" (Government of Malawi, 2012). Under this thematic area, the NSSP focusses on "strengthening the outreach capacity of poverty-focused microfinance institutions" and the "strengthening of the operations and management capacity of Microfinance institutions (MFI) to improve efficiency of microfinance services" (ibid). The NSSP states that microfinance clients will be capacitated to access the whole range of microfinance services in addition to capacity building for clients on entrepreneurship and financial literacy. Increased access to microfinance services by moderate and extreme poor adults with viable enterprises in particular in rural areas is another key objective of the NSSP (ibid.).

Despite the Government's and developing partners' efforts to create and inclusive financial system, "a significant proportion of the population has severely limited access to financial services" (Oxford Policy Management & Kadale Consultants, 2009).

MFIs and financial cooperatives operating in Malawi are regulated and supervised by the Microfinance and Capital Markets Supervision Department of the Reserve Bank of Malawi (RBM). The Financial Services Act, 2010 and the Microfinance Act, 2010 are legal frameworks that govern the regulation and supervision of microfinance sector in Malawi.

The NSSP focuses mainly on strengthening the capacity of MFIs, which has been recognized as a key constraint in extending coverage. However, to the authors' knowledge none of these capacity building activities have been implemented and Government guidance of microfinance for Social Protection has been lacking, exemplified by the fact the NSSP technical working group on microfinance does not function.

2 Microfinance institutions

The MFI sector in Malawi is made up of NGOs, Savings and Credit Cooperatives (SACCOs) and money lending companies (MFTransparency, 2011). The Malawi Microfinance Network (MAMN) is a legally constituted grouping of microfinance institutions and institutions that are providing microfinance related services in Malawi. MAMN currently has 26 member intuitions (Malawi Microfinance Network, n.d.). The Malawi Union of Savings and Credit Cooperatives (MUSCCO) is a national, democratically-controlled apex organization of Savings and Credit Cooperatives (SACCOs). The core objective of MUSCCO is to provide savings and credit services to members and to audit the SACCOs on behalf of the Government. In 2010, there were 58 SACCOs affiliated with MUSCCO and total membership in these SACCOS is above 100,000 collectively (MFTransparency, 2011).

Whereas traditional moneylenders and banks predominately service urban Malawians, NGO-MFIs often deliberately target the rural poor and "provide loans using a combination of methodologies including group lending, individual lending, village banking, and self-help groups" (Reserve Bank of Malawi, 2010). The RBM report finds that NGO-MFI "operations continued to rely on largely donor support in form of loans with soft terms and grants", although most NGO-MFIs are complimenting donor support with loans from banks (ibid.).

Table 1: Loan market share by MFI category (2010-2009)

Loan market share by MFI category (2010-2009)			
Category	**2010**	**2009**	**% +/- in loan share**
Moneylenders	21%	33%	-36%
State-owned Programs	30%	29%	+3%
NGO-MFIs	11%	8%	+38%
Banks	18%	14%	+29%
Cooperatives	20%	16%	+25%
Source: Reserve Bank of Malawi, 2010			

Opportunity International Bank of Malawi (OIBM) and the Foundation for International Community Assistance (FINCA) are the largest MFI in terms of gross loan portfolio. In terms of numbers of active borrowers, Concern Universal Microfinance Limited (CUMO) and OIBM lead with a market share of 68% (ibid.).

Private payroll based moneylender, state owned MFI programmes and banks had the highest market share amongst MFIs in Malawi in 2010. MFIs run by NGOs only made up 11 percent of the total market share in that year. NGO-MFIs, banks and cooperatives significantly increased their market share in between 2009 and 2010, whereas moneylenders' market share was reduces from 33 to 21 percent (Reserve Bank of Malawi, 2010).

According to the RBM, total assets for MFI grew by 7.4 percent from MK 10.8 billion in December 2012 to MK 11.6 billion in December 2013. However, total net loans decreased by 16.7 percent from MK6.6 billion in December 2012 to MK 5.5 billion in December 2013 because most big MFIs reduced their lending activities due liquidly challenges faced by the payroll lenders arising from delays in remittance of payroll deductions in 2012 (Reserve Bank of Malawi, 2013). Nevertheless, the industry recorded a 26.4 percent increase in total revenues to close the year at MK 6.7 billion from MK 5.3 billion in 2012 (ibid.). In 2010, NGO-MFIs reported an "average net profit of MK12.5 million" but adjusting "profits to cost of funds and inflation reverses the profit outcome" (ibid.). This MFI category also reported a non-performing loans amounting to MK 63.2 million, translating into 4.7 percent of outstanding loans (ibid.)

3 Programme impact

Microcredit is one of the "most visible innovations in anti-poverty policy in the last half-century" (Banerjee et al., 2010) and over the last three decades the population with access to microcredit has grown dramatically. With currently "more than 200 million borrowers, microcredit has undoubtedly been successful in bringing formal financial services to the poor" (ibid.). Between 1997 and in 2010 the total number of "very poor families with a microloan has grown more than 18-fold from 7.6 million in 1997 to 137.5 million" (Banerjee et al., 2015)

Proponents of microfinance believe that by "putting money into the hands of poor families (and often women) [microfinance] has the potential to increase investments in health and education and empower women" (Banerjee et al., 2010). Sceptics, however, see "microcredit organizations as extremely similar to the old fashioned money-lenders, making their profits based on the inability of the poor to resist the temptation of a new loan" (ibid.). Opponents tend to point to the "large number of very small businesses created, with few maturing into larger businesses" (ibid.). Until recently very few rigorous evaluation studies have been conducted, which could reconcile the ongoing argument about the impact of microfinance.

Over the last years, however, this has changed and microcredit schemes have been evaluated through randomized evaluations in different countries and contexts[1]. To the authors' knowledge no rigorous impact of evaluation on microfinance has been conducted in Malawi. However, experiences with microcredit in other developing countries may hold valuable insight for Malawi's microfinance strategy.
Recent evaluations have found that "granting communities access to microcredit has positive impacts on investment in self-employed activities, but no significant impact on overall consumption – or on overall income, when that is measured" (Crepon et al, 2014).

The striking finding is could be explained by the instance that:

"*small businesses that the households gaining access to microcredit invest in have low marginal product of capital. Consistent with this hypothesis, these studies[2] often find no significant impact of microcredit access on business profits or income from self-employment activities on average, although several do find an impact on profits for pre-existing businesses or for businesses at the top end of the distribution of profits" (ibid.).*

In 2015, researches published the results of the so far longest running evaluation of the standard group-lending loan product in southern India, which, according to the authors "may prompt a rethinking of the role of microfinance" (Banerjee et al., 2015).

One interesting finding is that demand for microloans is "far from universal" (ibid). By the end of the above mentioned three-year study, "only 33 percent of households borrow from an MFI and this is among households selected based on their relatively high propensity to take up microcredit". Similar evaluations also find relatively low take-up, while "another study in rural South India that focuses specifically on take-up of microfinance also finds it to be low" (ibid.).

The researchers speculate that despite "evidence[3] of high marginal rates of return among microbusinesses, most households either do not have a project with a rate of return [higher than the cost of borrowing] or simply prefer to borrow from friends, relatives, or money lenders due to the greater flexibility those sources provide, despite costs such as higher interest (from moneylenders) or embarrassment (when borrowing from friends or relatives)" (ibid.).

[1] Attanasio et al., 2011; Augsburg et al., 2013; Banerjee et al., 2013; Angelucci et al., 2013
[2] Angelucci et al., 2013; Banerjee et al., 2013
[3] de Mel, McKenzie, and Woodruff, 2008

While microcredit allowed some "to expand their businesses (or to start a female-owned business), it does not appear to fuel an escape from poverty based on those small businesses". In fact, business profits only increased in the upper tail of profitability.

In addition:

"monthly consumption, a good indicator of overall welfare, does not increase for those who had early access to microfinance, either in the short run (when we may have foreseen that it would not increase, or perhaps even expected it to decrease, as borrowers finance the acquisition of household or business durable goods), or in the longer run, after this crop of households have access to microcredit for a while" (ibid.).

Furthermore, authors of the three year study "find that access to microcredit appears to have no discernible effect on education, health, or women's empowerment" in the short or long run. The results "differ from study to study on these outcomes, but as a whole they don't paint a picture of dramatic changes in basic development outcomes for poor families" (ibid.).

The reason that microcredit may not be as effective in reducing poverty as it is sometimes claimed could be that "the average business run by this target group is tiny (almost none of them have an employee), is not particularly profitable, and is difficult to expand even in a high-growth context, given the skill sets of the entrepreneurs and their life situations" (ibid.).

4 Implementation Challenges

- Malawi's Financial Demand-Side Report states that 55% of Malawians are financially excluded, using neither formal financial institutions nor informal mechanisms (Oxford Policy Management & Kadale Consultants, 2009). The 2009 study identified key barriers to financial access, which are:

    i. limited accessibility of financial service points (branches and outlets);
    ii. high transaction costs;
    iii. capacity constraints;
    iv. crowding-out effect of the private sector, and;
    v. the lack of market coordination and harmonization between public and private initiatives seeking to promote better access to financial services (Mandiwa, 2014).

- The Malawian MFI sector has "few institutions that can underwrite portfolios, manage price and production risks for agricultural markets, or provide micro insurance for clients. This severely limits the capacity of the sector to meet demand" (ibid.). Further hindering the provision of microfinance services to large portions of Malawians is the fact that "many Malawian MFIs work in rural areas, where low population density and weak infrastructure result in high operating costs" (ibid). Poor infrastructure is one of the major challenges facing the financial services industry in Malawi. The "persistent power outages, poor road and communication networks have increased the operational costs of institutions" (Mandiwa, 2014).

- In order to "maximise profits, most financial institutions have resorted to operating within the urban areas thereby denying the rural masses access to financial services". The response to poor infrastructure and the resulting high transaction costs have restrained expansion and outreach strategies (Mandiwa, 2014). To overcome these barriers, institutions "continue to seek ways to increase efficiency through better communication, improved lending products, new technology, or some combination of these improvements" (MFTransparency, 2011).

- Capacity building and education is another challenge facing the industry. While several MFIs "implement trainings for their staff, many do not have appropriate and efficient loan tracking systems" (ibid.). Weak capacity of Malawi MFIs and their inability to cover costs poses a major constraint to scaling up the sector. Many microcredit providers "have high covariant risks due to overdependence on crop finance and lack the financial management capacity to manage risk in a macro-environment of declining currency value and inflation" (Luboyeski, 2004).

- Malawi currently lacks a National Identification System. This poses a challenge to the extension of financial services as most financial institutions fail to identify their customers due to the lack of a national ID. The rural poor in particular tend to lack alternative means of identification, such as passports or driver's licenses (Mandiwa, 2014).

- The RBM's 2013 Supervision of Financial Institutions Report states that between 2012 and 2013 "microfinance institutions continued to focus on payroll based lending, mostly to civil servants" and that "lending to entrepreneurs remained low due to challenges of loan collection" (Reserve Bank of Malawi, 2013). From a poverty reduction and economic growth perspective it is concerning that MFI in Malawi currently service predominantly civil servants and focus on payroll based lending rather than providing capital to poor entrepreneurs as envisioned in the NSSP.

5 Recommendations

- Government capacity to oversee, monitor and coordinate social protection is currently limited. Efforts should be undertaken to support Government's capacity and ownership over social protection in Malawi. This should include an analysis of fiscal space and financing modalities to increase Government's contribution to social protection expenditure.

- Malawi's social protection system currently lacks integrated MIS and M&E systems. Developing such systems would be an important step towards improving the coordination and harmonization of the country's social protection system.

- Currently there is little exploitation of linkages between programmes and between programmes and complementary services, such as agriculture, health, and education. It would be important to develop a detailed strategy on linkages to ensure that vulnerable Malawians who are enrolled in programmes also benefit from other important services or received additional support. Linkages to other programmes can provide important support for households to graduate out of poverty.

- Currently the county's social protection programme (MNSSP) is not well aligned with the broader system of social protection, namely the MVAC humanitarian response. It is recommended that stakeholders identify ways to improve the harmonization of the 'regular' social protection interventions with the MVAC to improve impacts and exploit synergies.

- Complex targeting criteria, the prevalence of community targeting, widespread and deep poverty with a very flat income distribution, and strict cut-off points all contribute to inefficient poverty targeting outcomes, as observed in a number of evaluations. It is recommended to re-visit the targeting approaches of MNSSP programmes, as well as the FISP. In the long-term, Malawi may consider more categorical transfers that could be better suited to the country's widespread and mostly uniform poverty.

- The current transfer share of the SCT relative to pre-transfer incomes is 23 percent, which is slightly above the crucial threshold of 20 percent that transfers need to be effective. For all programmes there is a strong need to remain attentive to the real value of the transfers over time in order to safeguard programmes' effectiveness.

- In the short to medium term we strongly recommend to extend the coverage of the current NSSP programmes, in particular the Social Cash Transfer, the School Feeding Programme and the Village Savings and Loans programmes.

- Currently there is little exploitation of linkages between programmes and between programmes and complementary services, such as health services and education. It would be important to develop a detailed strategy on linkages to ensure that vulnerable Malawians who are enrolled in programmes also benefit from other important services or received additional support. Amongst programmes there are a number of positive linkages, such as connecting beneficiaries of the Social Cash Transfer and Public Works Programmes to Village Savings and Loans association, where they can safe their transfers and slowly start making productive investments.

- Village Savings and Loans groups are very popular in Malawi but nonetheless there remains a significant unmet need for such groups. Evaluations found positive impacts the VSL approach. However, there are concerns about sometimes inadequate training of beneficiaries and 'poaching' of VSL members from microfinance providers. It is therefore important for the Government to work closely with VSL associations to improve the literacy and business skills training of beneficiaries as well as to improve the regulation oversight of the VSL and microfinance sectors.

6 References

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