FINANCIAL SERVICES ASSESSMENT

Constant Gardening: A Study of Malawi's Enabling Environment for Microfinance

Patrick Meagher
IRIS Center, University of Maryland

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ABOUT THE PROJECT

The *Financial Services Assessment* project is designed to examine the impact of financial services on the lives of poor people across the developing world. This project is funded by the Bill & Melinda Gates Foundation, which is committed to building a deep base of knowledge in the microfinance field. The IRIS Center at the University of Maryland, College Park, together with its partner Microfinance Opportunities, will assess a diverse range of innovations in financial services. The results of this project will shed light on the design and delivery of appropriate financial products and services for the poor, and the potential to scale up successful innovations to reach larger numbers of low-income households.

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CONTACT IRIS

IRIS Center
University of Maryland
Department of Economics
3106 Morrill Hall
College Park, MD 20742 (USA)

E-mail: info@iris.umd.edu
Phone: +1.301.405.3110
Fax: +1.301.405.3020
Web: www.iris.umd.edu

CONTACT MICROFINANCE OPPORTUNITIES

1701 K Street, NW
Suite 650
Washington, DC 20006 (USA)

E-mail: info@mfopps.org
Phone: +1.202.721.0050
Fax: +1.202.721.0010
Web: www.microfinanceopportunities.org

ABOUT THE AUTHOR

An Associate Director of IRIS since 1994 and current Senior Fellow, Mr. Meagher has straddled the academic and policy worlds. His research and advisory work deals with regulatory reform, institutional frameworks for medium- and small-scale finance, anti-corruption mechanisms, and decentralization – across the developing and post-socialist world. His writings have appeared in several journals and books on law, economics, and development. He co-authored the 2004 volume Devolution and Development (Ashgate). Mr. Meagher has been sought out repeatedly to provide rigorous "outside the box" thinking on emerging issues such as how to support enterprise development and public service provision in conflict-prone "Fragile States." In the latter field, he presented a paper in 2005 that formed the basis of a multi-donor policymaking effort on Service Delivery in Fragile States, under OECD auspices, and is currently writing synthesis documents for that workstream. In 2004, Mr. Meagher led the Asian Development Bank's Country Governance Assessment for Uzbekistan, and in 2002, he served on a panel of distinguished advisors to East Timor on the design of its Ombudsman institution.

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ABSTRACT

This baseline study examines the key elements of Malawi's enabling environment for microfinance. It deals with several challenges in Malawi's enabling environment as it relates to financial services, with the central focus on those issues most relevant to the innovations being rolled out by Opportunity International Bank of Malawi (OIBM) with the support of the Bill and Melinda Gates Foundation. We compare the quality of the enabling environment, its overall costs and benefits in comparison to alternatives with similarly situated countries. We analyze a few of the enabling environment challenges, including but are not limited to; an adverse credit culture, conservative banking sector, governance challenges, regulation of microfinance, lack of national identity documentation and of information systems supporting commercial finance.

OTHER NOTES

An exchange rate of 147.910MKw/US$ was used in this report.

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Abbreviations

AIDS	Acquired Immune Deficiency Syndrome
AML/CFT	Anti-money Laundering/ Combating the Financing of Terrorism
APIP	Agricultural Productivity Investment Programme
ATM	Automated Teller Machine
BMGF	Bill and Melinda Gates Foundation
CUMO	Concern Universal Microfinance Organization
DEMAT	Development of Malawian Enterprises Trust
EE	Enabling Environment
FI	Financial Institution
FINCA	Foundation for International Community Assistance
FMB	First Merchant Bank
GDP	Gross Domestic Product
GSM	Global Systems for Mobile Communications
HIV	Human Immunodeficiency Virus
ID	Identification
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IT	Information Technology
KPMG	Klynveld Peat Marwick Goerdeler
LRR	Liquidity Reserve Ratio
MACE	Malawi Agricultural Commodity Exchange
MAMN	Malawi Microfinance Network
MARDEF	Malawi Rural Development Fund
MF	Microloan Foundation
MFI	Microfinance Institution
MFO	Microfinance Opportunities
MIS	Management Information System
MKw	Malawi Kwacha (Currency)
MRFC	Malawi Rural Finance Corporation
MSB	Malawi Savings Bank

MUSSCO	Malawi Union of Savings and Credit Cooperatives
NBS	New Building Society
NGO	Non-governmental Organization
OI	Opportunity International
OIBM	Opportunity International Bank of Malawi
POS	Point of Sale
RBM	Reserve Bank of Malawi
SACCO	Savings and Credit Cooperatives
SME	Small and Medium Enterprise
SSA	Sub- Saharan Africa
T-Bills	Treasury Bills
TNM	Telecommunications Network Management
UN	United Nations
UNDP	United Nations Development Programme
US	United States
USD	United States Dollar
VAT	Value Added Tax
VS&L	Village Savings and Loans

Introduction

Seeds, soil, and gardeners depend on each other. If one of them fails, the crop will not flourish. This study forms part of a larger effort to evaluate grants or 'seed money' to discern their impact on poor microfinance clients. Since at least the Parable of the Mustard Seed, people have understood the importance, both literally and figuratively, of seeds falling on fertile ground. And the soil only proves fertile in the right conditions: in the presence of nutrients, rainfall, and the like. But between the elements and the growth of plants from seed, a gardener intervenes to water, nourish, and protect.

Anyone who has been to Malawi knows that it is a garden (not only figuratively but literally). There, grants – like seeds – yield the desired results where the situation is conducive. In a garden, the ground itself is a given, along with the weather, the pests, and the course of the nearest stream. In the same way, grants are used in a national (and local) context, one not made by grantor or grantee, but *exogenous*. Here we note such inherited conditions – resource endowments and existing indicia of human development – where they have significant effects on the outcomes, but they are not our focus.

In the figurative sense, we concern ourselves here with the gardener and her techniques. She plants the seed and ensures as best she can that the crops flourish whether outside conditions help or hinder that goal. In similar fashion societies, their people and especially their leadership, translate the givens of their situation into outcomes such as wealth or poverty, conflict or consensus. They use the tools at hand – political decisions, institutions, investments and services of various kinds. These things are *endogenous* to the society and comprise the enabling environment or EE.

This baseline study assesses enabling factors in Malawi that affect microfinance – and the outcomes of innovation grants in that sector. Those contextual factors may make it easier or harder for financial institutions (FIs) to provide services to the poor and for prospective clients to benefit from such services. For convenience, we group enabling factors according to whether they operate at the *meso* level of organization and infrastructure, or the *macro* level of policies and institutions. These elements constrain, amplify, and shape the outcomes of microfinance innovations. Understanding this is important for assessing overall impact accurately and for setting targets and expectations concerning future investments in the microfinance field.

We analyze those factors affecting a particular initiative, the mobile banking innovation carried out by Opportunity International Bank of Malawi (OIBM) with the support of the Bill and Melinda Gates Foundation (BMGF). The discussion follows the framework advanced in our Concept Note on enabling environments (Meagher 2010). Microfinance comprises a set of approaches and products adapted to the difficult environments of developing countries such as Malawi, one of the very poorest nations. This study deals with several challenges in Malawi's enabling environment as it relates to financial services, with the central focus on those issues most relevant to the innovations being rolled out by OIBM. This is not to say that the enabling environment in Malawi is nothing but negatives. Policies and institutions often create friction in markets, but the best ones do so for justifiable public purposes that in the end benefit everyone. Problems are also opportunities, and there are very many of these one might talk about. But we have chosen to limit the field to those touching in some way the grant-funded innovations, and those that pose the biggest challenges.

We proceed as follows. The next chapter defines the scope of the study and introduces the context of Malawi. There follow two sections devoted to findings and analysis – the first on meso- and the second on macro-level issues. The final chapter brings the threads of the analysis together, providing a summary of findings and of enabling environment impacts on the OIBM initiative. There follow annexes on methodology, comparative data graphs, and bibliography.

KEY FINDINGS AND CONCLUSIONS

The research presented in this paper fleshes out the key elements of Malawi's enabling environment for microfinance. To give this practical meaning, we also offer international comparisons, using data from similarly situated countries. In general, Malawi faces the kinds of challenges in its enabling environment that are typical of countries at its level of per capita income and its region. In other words, with limited exceptions, BMGF and its grantees would face a similar array of issues in other poor developing countries including Malawi's neighbors in the region.

A few of the enabling environment challenges stand out as being especially problematic and costly for Malawi. An adverse credit culture and a conservative banking sector, facing little competitive pressure to expand, are basic components of the system that have held outreach back. But these conditions are slowly improving. Constraints in the areas of human resources, infrastructure, and public services affect both the supply and demand side of finance, raising costs and squandering opportunity. These too are improving, although availability of skilled employees may continue to be a problem due to the toll of HIV/AIDS (human immunodeficiency virus/ acquired immune deficiency syndrome) and to a lesser degree labor market rigidities.

More intractable and ultimately more costly are the broader governance challenges. With the requisite commitment, Malawi can catch up to regional leaders on indicators in such areas as tax rates, regulatory burden, and investor-friendliness. It even appears to be on its way to offloading much of its backlog of commercial cases onto a new commercial court system. But weak capacity and corruption in government pose harder challenges that will need to be addressed over the medium to long term.

In the area most directly implicated in microfinance activities – local governance – the obstacles appear quite daunting, especially in the near term. It is a hopeful sign that crime has gone down over the years, along with the costs and risks it imposes. But the local power of the chiefs (at the base level known as "traditional authorities") poses difficulties. Knowledgeable Malawians see the strengths and weaknesses of this system. The traditional authorities, on the one hand, offer people valuable services, support, and coping mechanisms. On the other hand, their helpful role is laden with paternalistic intrusion, deference, and limits on local freedom of action. Expert observers cite such concerns as abuse of authority, corruption, illegal property transfers, and harm to the economic status of women, especially widows. At the very least, this approach to authority complicates the efforts of OIBM and others to expand access to financial services.

Other highly challenging areas include the lack of national identity documentation and of information systems supporting commercial finance. But these problems also offer targets of opportunity. Malawi could benefit hugely from a national identification (ID) system and revamped information systems including credit reference bureaux and asset registries that provide uniform coverage. These are undeniably big investments and complex reforms, but they look feasible and are in process.

Another such area is the regulation of microfinance. Reforms here are easily oversold, and there have indeed been questions about the high priority Malawi has placed on this in recent years. But creating new non-bank licenses under the right conditions can bring new dynamism to low-end finance, and enhance the governance and sustainability of providers. Here again, Malawi is moving forward and should soon have new laws and regulations in place. The latter are not in themselves sufficient conditions for success, but they do reflect broader momentum toward a dynamic microfinance system.

In terms of impact, the effects we have mentioned thus far are general. But the interaction of the enabling environment with OIBM's activities also takes a specific form. In examining this interaction, we gain insight, by way of example, into the costs and benefits of the EE for any prospective microfinance provider. This sheds light on the likely outcomes of alternative approaches and investments by BMGF in this setting. We also, of course, gain an understanding of the particular effects of the environment on OIBM and its clients.

In brief, OIBM's interaction with the enabling environment in Malawi follows three patterns: coping, innovation, and confrontation. As the term suggests, coping essentially means conforming operations and expectations to conditions that are seen as unavoidable. For example, taxes, inflation, and the quality of governance are "givens" to be accommodated, with the related costs and savings built into the business plan and passed on in some form to the consumer. Thus, OIBM copes with customs duties on mobile banking vans and automated teller machines (ATMs), and with the structure of political authority from the central ministries to the local chiefs.

Innovation and confrontation each offers an obvious contrast with coping. OIBM innovates, for example, in response to the level of development in Malawi of physical and informational infrastructure as well as low-end banking products. Thus, OIBM deploys branchless banking techniques by means of vans, kiosks, point of sale (POS) devices, biometric cards, and mobile phones. It designs simple financial products for its low-income clients. Some of this innovation is supported by the BMGF grant. As for confrontation, OIBM has been especially active in working to persuade the banking authorities to tailor their regulatory norms in support of new approaches. In other words, the bank has put significant effort into confronting regulatory constraints in order to loosen them. This effort is costly. Moreover, microfinance institutions (MFIs) and their clients in general reap the benefit – including OIBM's competitors.

In sum, our assessment in this paper looks to the quality of the enabling environment, its overall costs and benefits in comparison to alternatives including environments in other countries, and the specific responses of OIBM to its setting. This assessment helps supply interpretive context to the impact survey data that are the core empirical concern of the present project. The picture thus afforded is one of steep challenges – some of them seemingly intractable, others increasingly being met by Malawian leadership and by OIBM's specific efforts.

Scope and Context

In order to delimit the focus of this study, we identify those enabling factors most relevant to the microfinance innovation being assessed. OIBM is testing two types of innovations in Malawi that aim to expand outreach sustainably to poor rural populations – new delivery systems and a new product mix. A short description, adapted from the *Financial Landscape* study produced by the Financial Services Assessment Project, appears in Box 1 below.

Box 1. OIBM's Innovation: Rural Expansion Led by Mobile Bank

OIBM's operations were focused on urban centers until mid-2007, when the bank began expanding into rural areas. OIBM's rural innovation consists of an expansion plan with three stages. The first stage is the roll-out of mobile banks along routes radiating out from Lilongwe, with several phases as different routes are rolled out at different times. These mobile banks are considered an interim strategy, to build up business that can support the next stage of the strategy. The second stage is the installation of POS devices at farm-input suppliers and other vendors in rural locations. The third and last stage is to create a network of ATM kiosks (staffed bank outlets) in the locations of the current mobile bank stops. OIBM estimated that it would take three years for this expansion plan to be fully implemented.

The first phase of OIBM's expansion, the roll-out of the mobile bank funded by BMGF, is underway. The mobile bank makes stops on two routes originating in Lilongwe: (1) Lilongwe to Mchinji; and (2) Lilongwe to Dedza. (Mchinji is a border town located next to Zambia, while Dedza borders Mozambique.) There are two stops along each road, in addition to stops at the towns at the end of each route. The bank is expected to stop once or twice a week in each location. The bank, an armored vehicle, is not able to drive off the tarred road. This is significant because it means that the mobile bank is limited to operating on these two main routes and one side road to a mission settlement.

The mobile bank serves as a roving bank branch that can carry out transactions in real time through the use of technology. ATM transactions are available through a built-in ATM machine (with either real-time uploading of transactions to the OIBM system, or upload at day's end if the connection is not available). Loan products are supported by loan officers who reside in the communities of the bank stops, while loan approvals are done at headquarters, in Lilongwe.

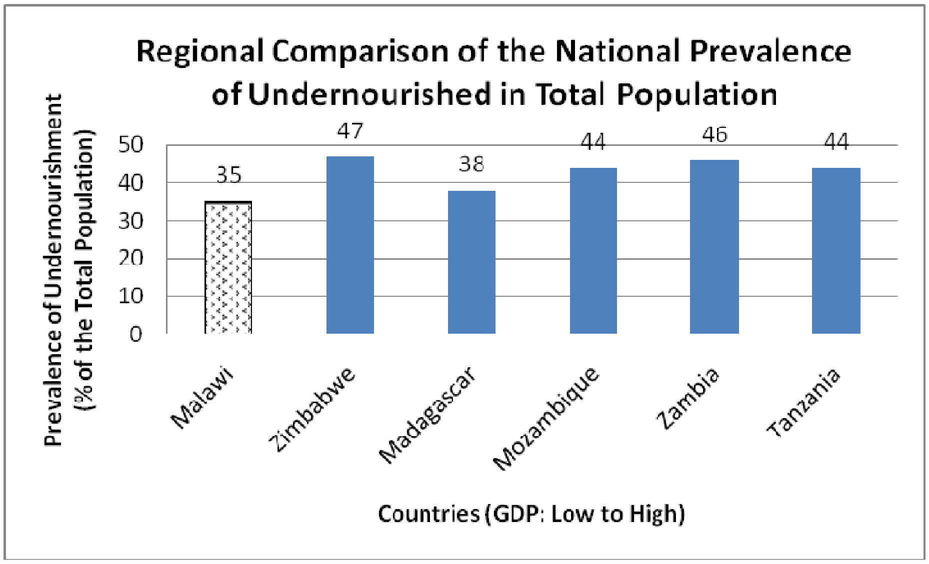
Source: Adapted from McGuinness (2008).

The innovation provides new products and delivery mechanisms. The new *delivery channels* start with mobile banks and will then expand to include satellite branches, ATMs, POS devices, and partnerships with other organizations such as retailers. Bank clients can obtain ATM and smart cards for use at the mobile bank or at other facilities, including satellite branches and partner retail outlets, that will be available in later phases of the expansion. The new *product mix* includes savings, insurance, and flexible loan products as well as the adaptation of Opportunity International's (OI) Trust Bank group lending model to rural areas. Most of these products are now being made available through the mobile bank.

CONTEXTUAL CHALLENGES

Several exogenous factors influence rural microfinance outreach in Malawi. Poverty, a small and dispersed population, long-term structural weaknesses in the economy, and the ravages of AIDS are all part of this picture. The United Nations (UN) ranks Malawi 164th out of 177 countries in its overall score on the Human Development Index – including 174th in per capita income (Purchasing power parity United States (US)$667) and 113th in adult literacy (64%).[1] On the other hand, despite such challenges as its high rate of HIV infection (12-14% of all adults)[2], Malawi scores somewhat better on other health and well-being indicators, in both international scales used by the UN and regional comparisons (see Figure 1 below).

FIGURE 1



Source: African Development Bank, *African Statistical Yearbook* (2010).

Within this broad context, it is worth noting the conditions and risks of the clientele that OIBM seeks to serve through its outreach to rural areas. Rural financial services pose difficult challenges everywhere, but especially in Malawi. There, the rural areas are home to over 85% of the population and 80% of micro/small enterprises. Agriculture claims 80% of the labor force, 40% of gross domestic product (GDP), and 90% of exports. As in other rural contexts, demand for loans is seasonal, with peak lending season occurring in October-January, and repayments due from April-September.[3]

For a financial system to develop sustainable products, the system must be able to handle risk management and pooling, and this in turn means diversification. But in the near term this is well-nigh impossible given Malawi's narrow production base, especially in rural areas. The concerns noted in studies of Malawi include the following:[4]

- Overdependence on tobacco production, while prices and quality have been in decline.

[1] *See* http://hdrstats.undp.org/countries/country_fact_sheets/cty_fs_MWI.html
[2] *See* http://www.usaid.gov/our_work/global_health/aids/Countries/africa/malawi.html
[3] Burritt (2006: 76).
[4] Ibid, 53-5.

- Predominance of small farm holdings: 88% of arable land is held by "smallholder farmers", with 78% of households cultivating less than 1 hectare, and most living below the poverty line.
- Covariant risk, making it difficult to insure against risk at the local or national level, necessitating reinsurance.

Thus, there are a number of systemic risks either primarily affecting the rural sector or arising within it. These include vulnerability to drought and volatility of exchange rates, both of which can seriously affect cash crops such as tobacco. Dramatic fluctuations in market prices for agricultural inputs and outputs are a constant risk, made worse by the lack of diversification – and the latter in turn is perpetuated in part by farmers' small plot sizes. Lastly, the manufacturing sector's dependence upon agricultural inputs increases covariant risk.[5]

These long-term structural weaknesses in the economy pose major challenges to OIBM in its rural outreach. In addition, the global financial crisis of the last two years is taking a toll on economic growth (though less dramatically in Malawi and its region than elsewhere), commodity exports, and especially access to external capital for microfinance provision.[6] We expect that these challenges are being taken into account by OIBM in its planning and design of retail products and services, and indeed that these issues shape the value proposition and outcomes of OIBM's activities. The impacts of these activities will be discussed in the quantitative impact and financial diaries assessments, and so are not the focus of the present study.

ACCESS TO FINANCE

In Malawi, only a minority of people have access to financial services from a bank or other formal provider. For example, it was estimated a few years ago that only 3% of the population had access to deposit services (Burritt 2006: 7). Consistent with this, Malawi's financial sector is quite shallow relative to the rest of the world, though typical for low-income Africa. Financial depth (the ratio of broad money or m2 to GDP) was measured at 20 in 2005, compared to a low of around 15 for the poorest countries and well over 100 for the industrial countries and some middle-income nations.[7]

Not only do financial services have limited penetration, but the types of products on offer are restricted as well. For example, there is only very limited penetration of insurance products in the region, and housing finance is available only to an estimated 1-2% of the population (World Bank 2006b). Further, some two-thirds of Malawian households lack assets such as beds, tables, chairs, and bicycles,[8] which means, among other things, that they have little moveable property that could be used as collateral. In the credit context, the research suggests that interest rates are not the critical issue. Those lacking an important service are more concerned with simply gaining access than with the detailed terms on which such access is given. And where possible, people will use a mix of different products and sources. People access formal finance for enterprise, but informal credit for consumption smoothing (Diagne and Zeller 2001).

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[5] Burritt (2006: 58-60).

[6] *See, e.g.* "The Global Financial Crisis and its Impact on Microfinance," CGAP Focus Note no. 52, January 8, 2009; "Sub-par but not subprime," *The Economist*, March 21, 2009 p. 82; Shin, Annys, "Global Poverty Rolls Projected to Surge," *The Washington Post*, September 17, 2009, p. A 22, col. 1.

[7] *See* http://www.microfinanceregulationcenter.org/resource_centers/reg_sup/micro_reg/country/27/

[8] Burritt (2006: 64).

Options for obtaining credit are especially diverse. They may include borrowing from kin, credit unions, trade credit in such forms as agricultural input supply schemes. Most pervasive are the informal moneylenders or *katapila*. Though they may be deemed exploitative because of their high rates and willingness to enforce collections, research suggests that they provide a useful service. They offer what others have called a financial "taxi," a short-term source of funding for urgent needs. Their presence in or near most localities makes them more convenient than banks and other formal lenders. In light of their relatively easy access, the many small loans they provide, and the savings in travel and other costs to borrowers, moneylenders' rates are not as high in relative terms as they appear on the surface. Moreover, researchers found that the *katapila* base lending decisions on creditworthiness in terms of verifiable income streams rather than on collateral or other factors that would be less favorable to poor rural residents (Agar and Schouten 2006: v). Indeed, acknowledging that the moneylenders have superior information on and relationships with clients, some formal intermediaries have been partnering with them (Burritt 2006: 65).

As for fund transfers, the main service provider had been the Post Office; its successor, the Malawi Savings Bank (MSB) has helped to improve access and competition. Transfer costs were estimated in 2006 at 10% of the amount transferred, and more for amounts under Malawi Kwacha (MKw) 250. Still, most transfers are still carried out physically, the transferor either carrying cash or entrusting it to a friend or relative, due to constrained access to transfer services, lack of awareness of options that do exist, or mistrust of the service providers (Agar and Schouten 2006: vi).

In the agricultural sector the need for new financial instruments is at least as urgent. To date, government has continued to take the lead in managing production and price risks for commodity farmers, using minimum price guarantees and subsidized credit. Lack of functioning warehousing facilities impedes development of an agricultural derivatives market. Hedging instruments such as forward contracts and options have been virtually absent (Burritt 2006: 58-63), at least until recent introduction of crop insurance by the World Bank.[9]

Notionally, the demand for financial services is high for several reasons. These include poverty, the need to manage the complex risks of household and farm management, the limited availability of specialized products such as insurance and hedging instruments, and the shortage of public services such as healthcare, sanitation, and utilities. These deficits leave households and enterprises to carry wide-ranging burdens of self-provision – with the aid of whatever financial services are available. It has therefore been suggested that access to finance itself may not be the central constraint to increasing assets and living standards of the poor. Rather, finance is best addressed in tandem with healthcare, schooling, clean water, and other necessities that tend to drain the resources of poor households (Diagne and Zeller 2001).

ENABLING ENVIRONMENT

As in the Concept Note, we differentiate between (a) exogenous factors or "givens" that are beyond the control of policymakers and actors in the financial sector, and (b) enabling factors that respond to those given conditions and so are in a sense endogenous. Analysis of the EE focuses on the latter. Now, which of the many enabling factors have a substantial bearing on the success of the OIBM expansion program?

[9] E-mail comment by Geetha Nagarajan.

The OIBM innovation has two main axes: new delivery channels and a new product mix. In the case of delivery, the OIBM program responds to such *ex ante* access constraints as the relatively sparse banking and transport infrastructure. These factors helped create a backlog of demand for financial services in the target areas. The rate of uptake will depend in large part on OIBM's ability to deliver services that are not available currently, or at least to deliver them more cheaply, effectively, and conveniently than alternative providers.

A number of factors will influence the result, including bank branching rules and the costs of maintaining the delivery channels – and the latter in turn are influenced by the quality of infrastructure, trained personnel, security, and costs of fuel and vehicle maintenance. See Table 1 below. Note that many of the same factors shape both the OIBM value proposition (the *ex ante* constraint) and the outcomes of the innovations (results *ex post*). Further, whether a capable association exists for this sector of the financial industry determines the likelihood that the sector could either create some of the necessary enabling elements, or lobby government to do so.

ATM and smart cards are also part of the delivery expansion. These will be affected by such factors as communications and information technology (IT) infrastructure, norms of electronic commerce, clearing systems, and the cluster of issues usually summed up in the term "branchless banking" (Lyman et al. 2003).

In the case of the product mix, some of the same factors are at play and have helped create the opportunity for OIBM to expand access. Banking regulation will affect OIBM's ability to provide the new products, and to do so cost-effectively. For example, prudential standards applicable to savings, as well as overall capital and reserve requirements, will influence costs. A broader set of factors will affect the cost of doing this business, and the extent of risk-taking by OIBM. These include the 'credit culture,' time and cost of contract enforcement, level of security, quality of local governance, expense of deterring or counteracting fraud, and existence of co-variant risks. Many of these factors will have both shaped the value proposition and been taken into account in the design of microfinance products (e.g. group lending).

A different, overlapping, set of business climate factors affects demand, creating costs, risks, and opportunities for entrepreneurs accessing OIBM financial products. The quality of this climate, and of the governance system that it reflects, influences the ability of OIBM clients to use financial products to generate income – that is, the business climate affects outcomes.

The research presented in the next two sections of the paper follows the logic just presented, and that of the Concept Note. Table 1 (below) identifies the Meso- and Macro-level enabling factors (respectively, state-level institutions and infrastructure) involved in the OIBM innovation. To make the research logic more specific, we generated a series of questions to be answered in the study. These are reflected in the desk research, the field research protocols (see Annex A: Methodology), and the findings of parts 2 and 3 below.

TABLE 1: OIBM Innovation: Enabling Environment Issues

Innovation components	Access issues and value proposition	Implementation steps	Enabling factors: Meso	Enabling factors: Macro
Delivery channels				
Mobile bank	▪ Take services to rural areas where there is little or no banking presence, and limited microfinance access ▪ Microloan Foundation (MF) access reduces poverty – meet emergency needs, consumption smoothing, invest in capital (applies across all component)	▪ Regulatory approval ▪ Equip and staff mobile bank ▪ Security ▪ Operation ▪ OIBM oversight & management ▪ Clients access services, use to meet needs (applies across all components)	▪ Road, telecom, IT infrastructure, transport costs ▪ Qualified personnel availability ▪ Public services & social safety nets ▪ Sector organiza-tion (applies across all components)	▪ Extent of banking competition and financial inclusion ▪ Bank regulations: branching, physical premises, security ▪ Import & tax regime: effect on equipment availability, cost ▪ Local govt., public order, crime
ATM cards	▪ Provide ATM access to unbanked rural clients via mobile bank, and later via satellite branches	▪ Set up ATM: network, electronic protocols, machines ▪ Due diligence re users: documents, records, references ▪ Card issuance	▪ ATM and POS: infrastructure, costs relative to customer volume ▪ IT infrastructure (see above)	▪ Access to payments system (banks, NBFIs, MFIs)
Smart cards	▪ Offer *Malswitch* cards as substitute ID, and later for POS access	▪ Due diligence re users: documents, records, references ▪ Biometric data, fee payment	▪ National ID system, cost of substitutes ▪ ATM and POS infrastructure (see above)	▪ Money laundering law & regs affecting ID requirements
Product mix				
Savings products	▪ Address lack of formal micro-savings products ▪ *Kasupe:* Low minimum deposit account, per-debit fees for rural clients ▪ Fixed deposit accounts for cash crop farmers	▪ Client applications, ID ▪ Set up accounts, take deposits ▪ Meet capital requirements, asset risk management ▪ Reserve Bank of Malawi (RBM) supervision	▪ ID issues (see above)	▪ Banking law and regulation: which financial institutions can take savings ▪ Prudential regulations and bank operating costs: impact on small savings products
Loan products	• Address lack of rural microcredit options • Group Micro Credit: basic MSME loan • *Mthunzi* loan: individual MSMEs • Individual Micro Credit: larger loan using collateral/ guarantor	• Loan applications & client assessments • Group formation • Disbursement, monitoring, collection • Provisioning	• State credit programs and impact on 'credit culture' • Information networks	• Credit access linked to level of banking competition, fixed costs, depth of market • Collateral and collection mechanisms • Business climate on the demand side

Findings and Analysis: Meso Level

The meso-level environment includes infrastructural and organizational factors that could be supplied by either the government, private companies, or the financial sector as a whole (or the microfinance sector specifically). Respectively, one could describe these as public, private, and club goods (assuming access is limited accordingly).[10] These differ from macro-level factors, as the latter consist of institutions and policies, and require public action to change. This distinction is neither hard and fast, nor is it consistently used in the literature, but does offer a convenient breakdown of the issues.

This chapter presents our findings on the meso-level EE. We look at the range of systems, infrastructure, and capabilities just mentioned in the last chapter, considering their effects on the OIBM initiative funded by BMGF. These impacts are reviewed at the end of the chapter.

FINANCIAL SECTOR OUTREACH AND COMPETITIVENESS

We have seen that financial services access is quite limited in Malawi. The enabling environment is heavily implicated, as suggested by Table 2 below. The table provides figures for enterprises' access to finance and the perceived link between constrained access and a weak enabling environment. Note that informal firms reported access to finance as a major constraint at nearly double the rate that formal firms did. Malawi is similar to other low-income countries and to most of Sub-Saharan Africa (SSA) in the limits to financial access, and its figures are similar to those of neighboring countries (World Bank 2006: 23).

TABLE 2: Enterprises' Access to Finance in Malawi

Formal-Sector Firms	• 43% reported *access* to finance to be a serious obstacle to operations and growth • 71% reported *cost* of finance to be a serious obstacle to operations and growth • The *cost* of credit is so high for formal-sector firms that it affects productivity.
Informal-Sector Firms	• 84% reported *access* to finance to be a serious obstacle to operations and growth • 51% reported *cost* of finance to be a serious obstacle to operations and growth
Small Firms in General	• There is no significant relationship between the transparency, performance, or ownership (foreign or domestic) of a small firm *and* its access to finance. • This appears to be due to *deficiencies in the business environment* such as lack of credit registry, weak collateral laws, and law of electronic collateral registry

Source: World Bank (2006: 23, 33, 77, 127).

The financial sector in Malawi includes eleven commercial banks, one leasing company, two discount houses, two pension funds management companies, some insurance companies, and a few other institutions.[11] The commercial

[10] To simplify, public goods are collectively produced and consumed, while private goods are subject to individual control. Club goods are a hybrid, like public goods on a smaller scale but exclusive to group membership.
[11] *See* RBM, "Malawi Economy and its Banking System" (2008)

banks have not been keenly competitive in pursuing underserved clients, and so there is only limited market pressure on prices. Real credit interest rates in Malawi have been much higher than the averages for low-income countries and for most other African countries.[12] This is reflected in the data on interest rates presented in Table 3 below. Note particularly the high interest rate spread given in the table.

These data suggest two main problems constraining outreach by the banking sector. The first is weak incentives arising from a combination of uncertainties about future levels of inflation and government spending, and the dominance of the two main banks that control most of the market.[13] At the end of 2004, National Bank and Standard Bank had over 70% of the commercial bank market share of deposits and loans, and as of 2006, more than 60% of assets are owned by foreign-controlled banks.[14]

TABLE 3: Malawi Interest Rate Data

Interest Rates at Stanbic and National Bank (as of March 2010):[15]	
• *Lending Rates:*	19.63%-27%
• *Current Account Rates:*	20.75% (MKw 250,000 balance)
• *Savings Deposit Rates:*	1%-2.75%
• *Short-Term Call Deposits:*	2.63% (7 days) – 3.63% (30 days)
• *Term Deposit Rates:*	3.75% (2 months) – 3% (2 months)
• *Spread:*	15%-25.3%
Deposit Rates at Malawi Savings Bank:[16]	
• *Savings Deposits:*	5%
• *Term Deposits:*	5.5% (3 months)
Rates for RBM Bills & Treasury Bills (T-bills):[17]	
• *Jan.2009:*	13.04%-13.28% (91 days → 271 days)
• *March 2009:*	10.55%-11.80% (91 days → 271 days)
• *Jan. 2010:*	7.47%-10.01% (91 days → 271 days)
• *March 2010:*	7.34%-10.21% (91 days → 271 days)
Interest Rates for Exporting and Non-Exporting Firms:[18]	
Annual interest rates on bank loans for	
• exporting companies: 8.5%	
• non-exporting companies: 30%.	

Limited banking competition in Malawi means very weak incentives for financial institutions to scale down or indeed to reach beyond their traditional urban, salaried clientele. Financial policy and regulation have played a role in this (see below), as has the banks' ability to invest in large-scale government debt issues at favorable rates. In general, downscaling (apart from OIBM) has been limited to state-backed agricultural credit schemes, along with urban salary-based finance offered by a few commercial banks and others. [19]

Thus Malawi is only beginning to broaden its very limited banking infrastructure. Since late 2003, the number of bank branches has grown from

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[12] World Bank (2006: 28-9).
[13] Burritt 2006: 32-3.
[14] World Bank (2006: 107), World Bank (2006a:28).
[15] *See* http://www.rbm.mw/data/findata/index.asp?content=cbir.
[16] *See* RBM, "Quarterly Economic Review – 4th Quarter 2009", Table 1.14 (http://www.rbm.mw/publications/documents/4q2009.pdf).
[17] *See* http://www.rbm.mw/data/findata/index.asp?content=oir.
[18] World Bank (2006: 125).
[19] The preceding discussion draws on Luboyeski (2004), UNCDF (2006), McGuinness (2008), and field interview data from 2009.

70 to 90, and ATMs from 24 to 41.[20] These figures represent a decline from the early 1990s, when the Malawi Postal Savings Bank alone had some 280 savings windows, and the commercial banks had numerous agency offices in trading centers as well as mobile units with an estimated 100 stopping points overall (Bolnick 1992). Interviews revealed that these number plunged with the massive deterioration in security that swept Southern Africa toward the mid-1990s (following the ending of *apartheid* and the Mozambican civil war), along with Malawi's dismantling of state control of financial services after the close of the Banda regime.

The second factor constraining outreach is crowding out by the public sector. The percentage of total assets in the banking system invested in T-Bills and government securities increased from 19.5% in January 2007 to 23.9% in March 2008.[21] High levels of government borrowing and high rates of return on RBM Bills and T-Bills increased real interest rates and crowded out private investment.[22] As of May 2008, approximately 40% of commercial banks' net domestic credit was directed to the government, compared with about 60% going to the private sector.[23] But treasury rates have come down significantly, and so the banks have begun exploring other uses of funds, including down-market services.

The percentage of assets in T-bills and government securities in fact increased from 2007 to 2008 even though rates of return dropped significantly. Lower inflation[24] could explain this in part but does not account for why domestic private-sector lending decreased over the same period (from 37% of assets to 33%). RBM sets rates for lending and savings deposits, and maintained them with little change through this period. This kept the deposit-lending spread quite high despite the large drop in yield of RBM Bills and Treasury Bills, and the decline in inflation. Movement away from this controlled approach is very gradual – only fixed deposit rates may now be set by the market (as of January 2008).[25] For now, the attractiveness to banks of comparatively safe investments in public debt, perhaps combined with the lesser appeal to the private sector of borrowing at high rates, keeps bank credit to the private sector at a low level.

In the last few years, the financial sector as a whole has become more competitive, with services reaching out to more localities, with more products and access points. It has regained ground lost since the wrenching changes of the mid-1990s. Now, new products and technologies are being adopted in the commercial bank sector, and some downscaling to modest income clients and Small and Medium Enterprise (SMEs) is evident. New players such as the consumer lending companies are also coming in and shaking things up. Thus constrained access opened up competitive opportunities for microfinance providers to capture under-served clients. But expanded outreach has not apparently had much impact on prices (interest rates and fees), nor have services reached the rural poor to any great extent.

Down-market competition:[26] Other financial services providers have stepped into the void at the bottom of the market, including non-governmental organization (NGO) MFIs, Savings and Credit Cooperatives (SACCOs),

[20] World Bank (2006: 22);
http://www.natbank.co.mw/index.php?pagename=atm_locations
[21] *See* RBM, "Quarterly Economic Review – 1st Quarter 2008", Table 1.6.
[22] Burritt (2006: 33).
[23] *See* http://www.rbm.mw/data/monstats/index.asp?content=ms.
[24] See http://indexmundi.com/malawi/inflation_rate_(consumer_prices).html.
[25] http://www.rbm.mw/data/findata/index.asp?content=rbmir.
[26] Source: interviews and focus groups in Malawi, July 2009.

consumer lenders, and informal lenders. The macro-level factors shaping financial sector competition present both opportunities and constraints. Surveying the results in his district, a local official summed up: 'Most MFIs are afraid to reach out and lend to rural areas.'

The non-profit sector includes many of the key players operating throughout Africa, such as CARE, PRIDE, Foundation for International Community Assistance (FINCA) and other operators such as Concern Universal Microfinance Organization (CUMO) and Microloan Foundation. CARE, for example, operates below the legal-regulatory radar as a registered non-profit supporting grassroots microfinance schemes called village savings and loans (VS&L). In the current approach, partners such as local NGOs and religious bodies receive CARE grants to set up savings and loan groups, identifying village agents to sustain and manage them. Members buy shares of the VS&L, and each such group raises and onlends member savings. CARE's intention is to link the most mature VS&Ls to financial institutions, and is in discussions with some of the banks. This appears feasible because financial services is becoming a more competitive market, and banks increasingly see opportunity down-market.

CARE's approach allows it to reach poor farmers, but it also carries costs. In practice, while financial services regulations could be applied to CARE's program, they are not, and the draft Microfinance Bill would exempt VS&Ls in most cases. But VS&Ls that grow larger and link up with banks would be more likely to receive regulatory scrutiny. Further, group-based operations largely obviate the need for collateral and external supervision, but they come at a cost. CARE invests US $25-35 per member for training and support, and it maintains a Management Information System (MIS) to supervise and rate groups. Members contribute between MKw 50 and 200 per week as their shares, and they pay for their training as well as for the cash boxes, stamps, and other tools for running the VS&L.

Group training and maintenance also exacts a time commitment from the members. Focus groups described the typically time-consuming process of group formation and management (in the OIBM context), yet all appeared very willing to incur this cost in order to get access to financial services on the terms offered. Indeed, respondents did not look upon group arrangements as a cost, especially when groups had an obvious antecedent, for example where market stall sellers knew each other and formed the group, or where a pre-existing loan group switched to OIBM. The groups provide a supportive social network whose benefits go beyond credit access.[27]

The Savings and Credit Cooperatives also serve the small-scale market. The apex federation, Malawi Union of Savings and Credit Cooperatives (MUSSCO), supervises this sector comprised of 44 SACCOs and 85,000 individual members as of end 2008. Like many of its counterparts elsewhere, Malawi's SACCO sector was plagued by political intrusion and corruption through the 1980s, and was left as a result with high delinquency rates – approaching 20%. But these have since been brought down to the level of 5-8%. MUSSCO is working to professionalize and consolidate the sector. The draft Financial Cooperatives Bill aims to improve SACCO governance and to integrate them into the regulated financial sector under appropriate norms.

Like NGO microfinance schemes, establishing and operating rural SACCOs carries special costs. 'Sensitization' meetings are held with traditional authorities and local assemblies. A structure is set up, SACCO leadership elected, and shares contributed by the members. Using the cooperative form,

[27] Source: Microfinance Opportunities (MFO) comment.

and keeping member savings in a commercial bank, SACCOs avoid coming within financial regulatory requirements (currently). As in the NGO context, these arrangements also afford advantages. Relations with local authorities mean that the latter can be called on when help is needed, for example, in pursuing defaulters. SACCOs have lower costs than FIs, using low-tech passbooks and simple procedures, which help them provide services 'where the people are,' with branches in townships and villages. The most visible cost savings, which SACCOs have in common with NGOs, is exemption from taxes on business earnings (although expenditures are subject to value added tax and payroll tax).

MUSSCO reports increasingly stiff competition from institutions such as OIBM and FINCA to serve SACCOs and their client base. The SACCOs have been caught a little off-guard, as these competitors have entered rural markets that the SACCOs regarded as their own. Here, the cooperatives are hampered by their own methodology, emphasizing savings before credit, whereas FIs can offer loans straightaway. The SACCOs also work at a disadvantage in terms of technology, since they are far from being in a position to offer ATM, POS, and cellphone access due to their historical low-overhead approach and lack of experience.

Newly entered into the down-market segment are consumer finance companies such as Greenwing and Blue Financial, which focus on loans to those with formal employment, especially in urban areas but also in commodity-growing areas. As in other countries, the activities of these profit-seeking firms has engendered controversy, with established MFIs complaining that they are 'diluting the credit culture,' charging exorbitant rates, and undoing all the transformative work that the microfinance sector has done. Others admit that the consumer credit firms have found an untapped market and are providing a potentially useful service. As always, these lenders have caused problems for themselves with aggressive expansion, sharp practices, and high interest rates (initially as much as 10% per month) that do not appear justified in light of the payroll deductions they require as a guaranteed channel of repayment. In response, some have called for special regulation, even a separate agency. Malawi Microfinance Network (MAMN) initially refused membership to these companies. (See Box 2 below.)

Our focus group discussions indicated that down-market competition is limited but growing. Government providers, NGOs, and MUSSCO stated that their poor clients usually had no realistic alternatives. Only a few relatively affluent focus group members had taken loans from others, including FINCA and PRIDE. One group had been a CUMO group at some time before applying to OIBM. None had personal bank loans (one had inquired but could not meet the collateral requirement) or accounts, although some had family members with accounts – and MFIs such as PRIDE would deposit savings into group accounts at a commercial bank.

Focus group members reported choosing OIBM for such reasons as access to credit, which they had not been able to get elsewhere on feasible terms – or in some cases they received better rates from OIBM. Another factor was OIBM's monthly repayment schedule in contrast to the weekly payments required by others. Some were attracted by more convenient branch locations or mobile bank stops, supplanting the need for trips of an hour or more to distant bank branches.[28] The ability to bank savings was also a draw. Typically, people had kept cash hidden at home – one group included a carpenter who made savings

[28] At the same time, there were complaints that OIBM branches were crowded and attended by slow tellers – requiring 2-3 hours each time for a representative to transact periodic business on behalf of the group.

boxes that had to be broken open to retrieve the money, piggy-bank style. Some members reported not having known about savings accounts, believing banks were only for the rich. Transfers were typically handled by friends carrying cash, or alternatively postal money orders.

Focus groups viewed the alternatives to banks and MFIs very negatively. Some reported going to relatives and friends for money or help, but this has limited value and appeal. As for moneylenders or *katapila*, some group members regarded them as a recourse to be avoided, considering them 'against my religion' or too costly to be of any real financial benefit. Moneylender rates were consistently reported as 100%, although repayment terms varied from one to two months. One of the groups openly discussed the local *katapila*, who were farmers living nearby and who supplemented their income with the side business of moneylending. In this case, the lenders required a signed and witnessed agreement that including an enumeration of collateral such as household goods, bicycles, iron roof sheets, or goats. Families tended to hide their recourse to the *katapila*, with the men, for example, sending their wives to repay or even to negotiate. An analysis from the early 1990s suggested that the only explanation for the *katapila* interest rates of 100% was the exertion of local monopoly power (Bolnick 1992); it is unclear that the monopoly still holds but the high rates remain.

Box 2. Consumer Credit – and Controversy[29]

Greenwing Financial Service is a South African-owned firm that started offering personal and small enterprise loans in 2007. As of late 2008, it was offering personal loans up to MKw 800,000 for as long as 36 months, at an average monthly rate of 4.5% – unsecured.

At that point, government took away the consumer lenders' prime market by cutting them off from the state payroll system. The main rationale was the over-indebtedness of government employees, many of whom were teachers whose loan repayments claimed their entire paycheck. As important as government's concern for their welfare was, it also had an interest in seeing that teachers and other staff had an incentive to do their jobs. There were allegations of abusive lending by the consumer credit firms, collusion and payoffs involving payroll staff lodging deduction requests, and forgery of payroll documentation by some employees. As a result, many of these employees were able to take multiple loans from certain lenders and to take loans from multiple lenders, to the point of over-indebtedness. Government became concerned when it discovered, for example, some 200 teachers on zero net pay, with consequent shirking and resignations. The state cut the lenders off from the payroll system without warning or discussion.

As this is similar to what happened in South Africa, the government's reaction was not unexpected. Now, the lenders are pursuing the repayments owed, marketing to the private sector, and adjusting downward the amounts and loan repayment terms offered – and moving into loans secured on physical assets.

Bank downscaling:[30] Banking competition has increased in the last two years, but is still focused more on capturing clients in the high-level corporate tier and less on downscaling. The view of the microfinance sector is that banks do not really understand microfinance, are too attached to traditional risk management approaches and asset-based lending, and have unrealistic expectations of small-scale enterprises. And the banks dominate credit markets in Malawi more than in other countries that have a more developed

[29] Source: interviews in Malawi, July 2009.
[30] Ibid.

low-end finance sector. One expert in Malawi suggests that 'Competition has forced both banks and MFIs to be sensitive to customer needs.' On their side, customers are becoming more sophisticated. But there has as yet been no discernible effect on prices.

Standard Bank, for example, focuses its business banking on firms with annual turnover of up to US $3 million, and on structured long-term finance. But at the entry level, it has taken on clients graduating from MFIs such as the Microloan Foundation, where maximum loan sizes of top-tier clients do not exceed MKw 200,000. This frees up microfinance capital for serving poorer clients. Standard also lends wholesale to MFIs against real property, bank accounts, and T-bills.

Some other institutions started out with a mandate to serve smaller businesses and poorer households, and are now attempting to continue doing this as full-service commercial banks. One such is New Building Society (NBS), which was formerly a building society. Since its transformation it has continued with a focus on home mortgage loans and savings accounts. Finding these markets saturated, it intends to expand into rural credit and current accounts. Its move to go deeper into small-scale finance is hampered, first, by its relatively modest network of 13 agencies (sub-branches) and its need to bring its shareholders along by moving gradually into SME credit and then eventually microfinance. To help in this move, it is beginning to explore strategic alliances with MFIs. In addition, it inaugurated a mobile banking van in late 2008. The van travels on 'challenging' dirt roads, protected by armor and security guards, according to a set schedule developed on the basis of market surveys. It has some 8,000 small depositors who open accounts with a minimum of MKw 500, of whom 40% take loans starting at a minimum of MKw 2500. This approach has attracted political attention in the form of MPs calling NBS asking it to 'come to my constituency.'

In like manner, MSB began life as the deposit arm of the postal system, then became the Postal Savings Bank until it transformed into a commercial bank with state ownership in the mid-1990s. As a long-standing provider of small savings accounts, it competes with OIBM and the MFIs. Since its transformation it has added services such as loans and fixed deposits, along with forex and transfers (serving as an agent of Western Union). It also now offers consumer loans secured on payroll deductions. MSB has gone more deeply into microfinance through alliances with MFIs, judging that as a commercial bank it would have difficulty setting up the intensive outreach necessary to offer microfinance services directly. It serves as savings bank for MFIs (e.g. FINCA) and parastatals (e.g. Malawi Rural Finance Corporation). It also has entered ventures with tobacco marketing companies to provide inputs and finance. It has set up its own bank branches and agencies, but about half of its 43 outlets are still located in post offices.

STATE CREDIT PROVISION AND 'CREDIT CULTURE'

Malawi has struggled with an adverse "credit culture" abetted by state credit programs that were (and sometimes still are) in many cases badly designed and implemented. These problems are relevant to OIBM's efforts in two important ways. First, OIBM may face competition from government programs with easy credit terms and weak repayment discipline. Second, the poor repayment culture may spill over into OIBM's clientele as a result of either current access by clients to state programs, or from past experience of those programs – direct or reported by others. Contemporaneous access to multiple credit sources is a problem closely linked to information constraints, the next issue to be discussed. Of course, these factors may affect OIBM's competition as well.

Agricultural credit is basically part of the public sector, with registered tobacco farmers benefiting from a large share of formal credit – and therefore also of banking services that go along with it. Government has played the major role in small enterprise credit and microfinance more generally. Two parastatals, Malawi Savings Bank (MSB) and Malawi Rural Finance Corporation (MRFC), hold more than 80 percent of microsavings. [31] The state/parastatal sector provided over two-thirds of all microcredit as of 2003.[32]

Box 3. Microfinance Parastatals – MARDEF and MRFC[33]

The Malawi Rural Development Fund (MARDEF), established in 2005, has its own line in the state budget, with funds committed for support over 5 to 7 years. Its original funding came from RBM. Now, according to MARDEF, its operating costs come from repayments. It reports to Parliament and is said to be audited by the Ministry of Finance and by the accounting firm Klynveld Peat Marwick Goerdeler (KPMG), although no financial reports are readily available. MARDEF makes group loans and places some funds in investments. By its own account, MARDEF has lent out MKw 1.4 billion. Borrower groups have collective savings accounts at MSB, along with insurance policies.

MARDEF began its life in turmoil. It had to lend money but was given no guidelines and no structure within which to work. 'There was trouble…uproar in Parliament..' MARDEF was then suspended till guidelines could be written. Now, loan approvals are published in the newspaper. Still, repayments are affected by seasonal factors – as well as by elections, which lead some voters to believe that a new government would forgive debts.

The Malawi Rural Finance Corporation (MRFC) came into being in 1994, when the World Bank and International Fund for Agricultural Development (IFAD) joined to help the government set up a company to handle agricultural finance, which had till then been directly run by the Ministry of Agriculture. MRFC was financed by the state until 2001, but since then has been run on a financially autonomous basis though wholly owned by government. The Ministry of Finance approves MRFC board members, and its outlets are housed in Department of Agriculture buildings. A United Nations Development Programme (UNDP) grant is financing new outreach mechanisms such as vehicles and POS devices. In short, it does not operate wholly on a commercial basis. MRFC is not a bank, but does collect savings, directing them to commercial bank accounts and treasuries, without onlending.

The performance of state-backed initiatives has suffered from the limited capacities and efficiency of Malawi's public sector. Productivity of state-owned or recently-privatized firms is 98% lower than the productivity of private-sector firms,[34] and a similar weakness spills over into state-run financing programs. Government entities and programs often offer debt forgiveness or provide effective subsidies through acceptance of high default and delinquency rates – in addition to concessional interest rates. This has led to disincentives for prompt loan repayment, which makes it difficult for self-sufficient financial institutions to provide services.[35] State providers have not

[31] World Bank (2006: 22).
[32] Luboyeski et al. (2004: 3)
[33] Source: interviews in Malawi, July 2009.
[34] World Bank (2006: 74).
[35] Burritt (2006: 47).

been financially sustainable; for example, 47 percent of MRFC loans had to be written off. [36] MSB, MRFC, and the Development of Malawian Enterprises Trust (DEMAT) were all subsidy-dependent and had high levels of non-performing assets.[37]

The problems here were partly administrative, but were at least as much due to the adverse incentive effects of badly-designed and politicized initiatives. Heavy government subsidies distorted the market and loans were (and some still are) highly politicized. For example, in-kind credit through the Agricultural Productivity Investment Programme (APIP) provided wealth transfers to the poor. However, analysts suggest it also resulted in market distortions and an adverse credit culture. The MKw 5 billion MARDEF, established in 2005, set up similar adverse incentives, with centralized management in the Ministry of Finance and insufficient attention to the risks of lax risk management and under-pricing of credit. [38] After a few years of experience with MARDEF, observers were suggesting that it was undermining the credit culture with badly-targeted, subsidized, politicized, and therefore unsustainable credit extension.[39]

But the situation currently appears to be less dire than in the past. There have been some positive changes on the government side. As important, it appears that state programs are not competing directly with OIBM or with other microfinance providers except in a very limited sense, as loan amounts in state programs are too small and the procedures for getting them too cumbersome. Focus groups with borrowers and interviews with financial institutions revealed no overlap and no evidence of competition from state programs. On the other hand, some in the financial sector complain of NGOs and financial institutions that receive funds on a non-commercial basis, from governments or foundations, as essentially being subsidized. While this support may afford competitive advantages to recipients such as PRIDE and OIBM, there has been no suggestion that their operations are politicized.[40]

MARDEF[41] currently extends credits averaging MKw 200,000 to 300,000. The funds are shared out among group members per prior agreement – there are no individual credits. MARDEF reports that more loan groups materialized than they had expected; as a result, its limited budget of funds had to be allocated to fewer groups.[42] As its policy is to lend to as many people as possible, it has usually approved loans at about 20-30% of what the groups applied for. This, in turn, means the groups must shift to a different project than originally conceived. According to MARDEF, most of its clients do not qualify for an MFI loan. And, MFIs operate only in certain areas – 'There's only MARDEF in a given geographic area.' The alternative for most borrowers is the informal moneylender (*katapila*) charging interest rates up to 100%.

MARDEF works with authority structures, state and traditional, down to the village level. Loan applications must be endorsed by traditional authorities and then work their way up the chain of command. Groups of 10 to 20 borrowers form and receive training from MARDEF. When savings accounts are set up, the group's signatory needs a formal ID such as a passport, driver's license, or voter card. Credit officers check creditworthiness and groups' fit with MARDEF criteria, which focus on the 'active poor' and also give priority

[36] World Bank (2006: 22).
[37] Luboyeski et al (2004).
[38] Burritt (2006: 38-9).
[39] Author interviews in Malawi, 2007.
[40] Sources: interviews in Malawi, July 2009.
[41] Source: interviews in Malawi, July 2009.
[42] See McGuinness (2008).

to women and the HIV-affected.[43] But the officers each cover some 100-200 groups and so work closely with local chiefs, District Councils and Executive Committees, and others including Members of Parliament. The Ministry of Agriculture oversees MARDEF as well, and its staff assist with loan applications. When loan repayments become a problem, MARDEF calls on political authorities up and down the chain saying: 'The simple truth is it's a revolving fund. [We] can't lend if there's no repayment.'

MARDEF has struggled to 'teach people that this is not a grant…it's a loan.' This 'transformation process' is central to its work, and by its own account, it has gotten repayment rates up close to 100%. But the lack of full transparency sustains widespread skepticism. Informed observers say that MARDEF is 'the biggest distortion.' Its rates of interest are too low, and its lending politicized – but it says all the right things. Thus it is probably safe to say that while MARDEF has improved its management since 2005, its loans continue to be heavily subsidized and inefficiently managed on public sector lines. At the same time, loan amounts are so small and approval procedures so onerous that it offers no real competition to other providers beyond the lowest, entry level of the market.

MRFC[44] operates differently from MARDEF, charging commercial interest rates, seeking funding from savers and lenders, seriously pursuing repayment, and striving (not always successfully) to issue timely financial reports. It is positioning itself as a convenient '1-stop-shop' for micro loans and deposits, and has been competing with MUSSCO, the credit union federation, in the agricultural sector and to some extent with the MFIs elsewhere.

MRFC targets agriculture and business, small and micro enterprises, and the poor with loans of MKw 7,000 and up – mostly group loans. Some SACCOs borrow wholesale funds from MRFC. To sustain itself, it charges in the range of 30% interest per annum on retail loans. Repayments took a dip during the drought of 2005-6, but have otherwise have been satisfactory, according to MRFC. It does appear to be a potential competitor of OIBM – focus groups reported hearing of MRFC or considering it as a source of finance, but none of the members had taken loans from it.

In sum, Malawi has suffered the same problems of unsustainability and adverse credit culture as many other countries, as a result of past mismanagement in state development finance programs. This is always a difficult legacy to overcome. In Malawi, the problem is being addressed by a combination of state providers adhering to market principles and disciplined management (MSB, MRFC), and the non-state providers rebuilding the credit culture through training, group guarantees, insistence on timely repayment, and other means. Politicized, undisciplined credit allocation by the state continues in the case of MARDEF, and the financial cooperatives still struggle with weak repayment discipline due to past mismanagement. But the other developments just mentioned appear to reduce the impact of these problems. The picture is mixed – negative in part but improving.

IDENTIFICATION SYSTEM

Malawi does not have a national ID system. This has several effects on microfinance provision and clientele. Identity systems provide individuals cards and numbers that are keyed to legal rights and documents necessary for economic transactions. These often include vital records, real and moveable property registrations, bank accounts, loans, proof of residence, legal status,

[43] A new MKw 3 billion MARDEF fund will target youth (age 18-30).
[44] Source: interviews in Malawi, July 2009.

credit history, and others. Reliable identification is critical to the flow of information necessary to modern financial services transactions. For example, mortgages, collateral registration, credit checks, and employment and residence verification are central concerns. A unique identifier number is a basic part of these systems in developed economies. The absence of an ID system means that financial services operate with a major information constraint, which raises risks and transaction costs.

Lacking a national ID system, Malawi must depend on a range of alternatives such as personal relationships, social networks, third party guarantees, and identity documents such as passports and drivers licenses, which do not have universal coverage. These partial systems by definition exclude people who do not live in urban areas and are not in the formal economy. As a result, the poor have difficulty in obtaining extant forms of ID. Even when a person may be eligible for banking services, the lack of ID makes this impossible, absent an acceptable substitute. In this case, an individual faces the choice of forgoing financial services or bearing the cost of substitutes such as personal guarantees (e.g. letters from traditional authorities), financial guarantees, or the use of a pawn (the posting of collateral to be held in pledge by the creditor). A driver's license or passport costs approximately United States Dollar (USD) $30, making it too expensive for poor Malawians.[45] A national identity card was supposed to have been introduced in late 2007,[46] but as of this writing this has not yet happened.

Microfinance providers including OIBM have gotten around the ID constraint through the use of substitutes for ID and collateral. OIBM and Malawi Savings Bank use the *Malswitch* biometric smart card for use as ID and access to ATM and POS transactions. This card costs approximately USD $7.[47] The other alternative to an official identity document or a Malswitch card is for the prospective client to go to the local chief or District Commissioner and request a letter to serve as proof of identity. Then, the client can take these letters to the bank and fill out an application form. The process takes many hours, and the client must return to the bank once the application has been approved.[48]

The ID constraint may get worse with the passage of the *Money Laundering, Proceeds of Crime and Terrorist Finance Act, 2006* and its implementing regulations. Section 24 of the Act requires documentation of name, address, and occupation, and requires a "national identity card or passport or other applicable official identifying document . . . ." for financial transactions.[49] As of this writing, implementing regulations have not yet been released. In interviews, OIBM described how it was complying with anti-money laundering/ combating the financing of terrorism (AML/CFT) identification/verification requirements:[50]

- The RBM is permitting OIBM to register customers without official identification papers.
- Due diligence is done on the customers, especially those seeking loan facilities. Customers opening business accounts are asked to produce formal identification papers.
- For future identification of customers, OIBM takes their fingerprints and a photograph and stores them on the Malswitch Card.

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[45] McGuinness (July 2008: 70).
[46] Banda, Jai, "Money Laundering Developments in Malawi, 2004 to 2006" (http://www.issafrica.org/static/templates/tmpl_html.php?node_id=2484&slink_id=4769&slink_type=12&link_id=14).
[47] McGuinness (July 2008: 70).
[48] McGuinness (July 2008: 70).
[49] Section 24(2)(b).
[50] Discussion and e-mail exchanges with Microfinance Opportunities.

Malawi has moved in the direction of ID reform, but the movement has stalled. Lacking as yet are sufficient material resources and political momentum to deal with such a large and complicated undertaking as creating a uniform system for all Malawians. Financial institutions and banks in particular see the opportunities that would open with ID reform: banks would take on more risk, there could be a credit information bureau[51], the system would work faster, and more clients could be served. Banks could also cope more easily with the 'Know Your Customer' standards of the Money Laundering Act.

Yet interviews in Malawi suggest that, while the opportunity costs to Malawi of not having such a system are large and growing, alternatives are so readily available that customers do not report feeling constrained. Banks such as Standard Bank, for example, require an enterprise client to have a business registration and permit. These are available to one holding some form of ID or alternatively a utility bill or tenancy agreement. Malswitch has been a useful alternative to some, such as OIBM, but others find that the card does not fit their needs or is incompatible with standards set by an international corporate parent. NBS issues customers an ATM card with photo, and this requires some form of ID or a letter from a local official or chief. Focus group members who did not yet have the OIBM-issued Malswitch card often had alternatives such as a voter card. Ultimately, borrowers without formal ID depend on relationships with other members of their loan group, cooperative, or village to obtain the necessary reference, approval, or documentation.[52] This raises costs and constraints, but is not an insuperable barrier to financial services access. Even countries that do have ID systems still must link individual identifiers together in a national financial information system.

INFORMATION ACCESS

Highly developed financial services markets depend critically on formal information networks. These are relatively weak in Malawi. No credit bureaux, registries or other formal mechanisms for sharing credit information exist. In this, Malawi conforms to the regional pattern in which its neighbors (excepting Mozambique) received a zero score (out six) from the World Bank on credit information access – indicating that the credit registries within the countries are either non-operational or have coverage of less than 0.1% of the adult population.[53] Nor are there available "risk maps" that can help potential insurance providers to effectively identify and analyze risks (and then set insurance premium prices). Also, since there is high turnover of clients (due to inappropriate products, systemic risks, poor credit culture, etc.), the lack of information about new clients raises costs and discourages MFIs from experimentation.[54] Yet, there is strong demand among MF providers, donors, and policymakers for greater transparency and disclosure, as well as establishment of industry performance benchmarks.[55]

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[51] Assuming other necessary conditions were in place, such as information systems and an accord (or legislation) on confidentiality, information-sharing, and standards.

[52] Source for this and the previous paragraph: interviews and focus groups in Malawi, July 2009.

[53] World Bank Group, *Doing Business* (2009), and *Doing Business*, "Getting Credit in Malawi -- 2008" (http://www.doingbusiness.org/ExploreTopics/GettingCredit/Details.aspx?economyid=118).

[54] Burritt (2006: 65, 68).

[55] Ibid, 112.

As in the case of identification, a number of informal stopgaps and substitutes are used. Commercial banks, in addition to accessing financial statements and public information on assets, habitually exchange information among themselves on borrower creditworthiness. Microfinance providers such as MARDEF rely on a combination of group liability incentives and due diligence by their credit officers. But lenders do typically face risks from borrowers taking loans from multiple sources, including informal moneylenders, and becoming over-indebted. Borrowers may not divulge information on other liabilities, and so the lender does not find out until repayments are missed. Thus, alternatives to a comprehensive system of information on debts and liens are far from foolproof.

Banks, MFIs, and consumer lenders agree that an ID system and credit reference bureau would help solve the problem of over-indebtedness and reduce the risks involved in lending and taking collateral. RBM has been working on a Credit Reference Bill, originally proposed by the MAMN and the Bankers' Association. But two major difficulties are delaying enactment. First, the commercial banks and MFIs have divergent interests and differential ability to bear the costs of such a system, given the disparate size and capital of the two sub-sectors.[56] Second, any such system will have only limited effect unless a national ID system is put in place.[57]

On the demand side, underdeveloped agricultural value chains linking farmers, input markets, traders, processers, and exporters lead to market fragmentation and inefficiencies in the production and sale of goods. Financial services are part of the constraint, but other factors such as transport (see below) and product information are particularly important. Marketing and distribution channels for rural products have been relatively undeveloped and inefficient. As elsewhere in Africa, the state managed the agricultural value chain for tobacco as well as other commodities, but the restructuring of the last 20 years has not yet replaced it with viable market-based links. Continuing parastatal involvement tends to repress markets as well as farmer earnings (Burritt 2006: 40, 54, 57). There has to date been little or no facility for people to gain access to commodity availability and price information at a distance. This necessitates costly and time-consuming travel to check things out on the ground.

Like many things, however, this area has seen positive change in the last two years or so. Information on farm commodity prices is available by cellphone via the Malawi Agricultural Commodity Exchange (MACE), which has a franchise operation with some 14 outlets in Malawi. A competing cellphone information system is also in operation. Access is apparently inexpensive, although our focus group participants did not seem to be aware of it. MACE also provides similar information by television broadcast.[58]

INFRASTRUCTURE AND SERVICES

This area poses perhaps the most obvious constraints to financial services access. Dispersed rural populations are not easily accessible via a paved road system that may stop several miles from their villages. Utilities and public services are not all widely available, though this has not been a major complaint in our discussions with microfinance customers. In terms of general physical infrastructure, Malawi is underserved even as compared to countries in Southern Africa. There are several possible reasons for this, but

[56] Added to this is the reluctance of creditors to share information on their 'good' borrowers, which tends to delay the establishment of a reporting system (comment by MFO).
[57] Source for this and the preceding paragraph: interviews in Malawi, July 2009.
[58] Source: interviews in Malawi, July 2009.

one key constraint here has been the high cost of servicing Malawi's government debt, which reduces the funding available for development of key infrastructure.[59] Some gaps, however, have been narrowing recently.

Electricity and transport infrastructure are of obvious importance to financial services outreach in Malawi.[60] In a World Bank survey of over 300 entrepreneurs (nearly half of them informal), 60% of formal firms and 45% of informal firms cited electricity as a "major" or "very severe" obstacle to business growth. These percentages were significantly higher than the regional average for sub-Saharan Africa and the average for all low-income countries.[61] About 40% of firms surveyed said that improvement to access to electricity would be *the most important* area of infrastructure in need of improvement. In 2004, the median number of days that a firm faced a power disruption was 50 days/year, and for formal firms, median production losses due to power outages and surges were 10%. Firms that both (i) face power outages and (ii) lack generators have on average 64% lower productivity than firms that are not power-constrained. Generators are not an option for small, informal firms, since firms paid on average of USD $11,000 for a generator.[62] In terms of gross electrical power produced, Malawi lags behind several of its neighbors (see Fig 10 in the tables Annex).

Transport infrastructure poses similar challenges. When asked to rate the quality of the transportation infrastructure, firms rated the infrastructure as "poor quality" or "unavailable" according to the following percentages:

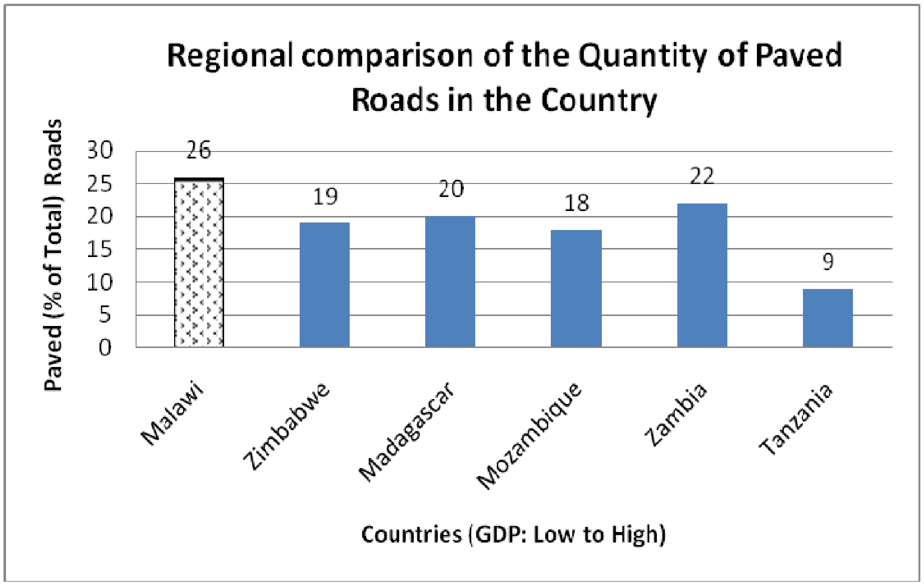
- Provincial Roads: 97%
- National Roads: 87.5%
- Bridges: 82%
- Railways: 70%.

Some 24% of surveyed firms said that improving national roads was the most important infrastructure issue to their operations (with 10% for railways and 7.5% for provincial roads).[63] Transportation costs for exporters are three times higher in Malawi than in South Africa or Zimbabwe. Also, location affects performance: due to transport links and other factors, firms located in Blantyre were found to be more efficient than firms in Lilongwe or elsewhere in Malawi.[64] The Malawi Growth and Development Strategy emphasizes the need to improve rural roads in order to link rural communities with markets.[65] Yet on some more recent measures Malawi compares well with neighboring countries (see Fig. 2 below).

Interviewees in the financial sector identified infrastructure as a major challenge for them. Their concern touches roads, public services, telecoms, and IT. Yet, despite the rough terrain that has made transport difficult, government is said to be building six new roads. In 2 to 3 years, one banker noted 'we will be able to go anywhere.' As work on the roads progresses, electric power will remain a steep challenge. Malawi seeks opportunities to import power from neighbors such as Mozambique.[66]

[59] Burritt (2006: 33)
[60] Unless otherwise noted, all information is from World Bank (2006: 36-39).
[61] Among nations in the comparison group with Malawi (South Africa, Zambia, Madagascar, Uganda, Kenya, and Tanzania), Malawi had the highest overall percentage.
[62] World Bank (2006: 76).
[63] Ibid, 39-40.
[64] Ibid, 76.
[65] Burritt (2006: 38).
[66] Source: interviews in Malawi, July 2009.

FIGURE 2



Source: African Development Bank, *African Statistical Yearbook* (2010).

Regarding access to telephone service, as in other countries in the region, Malawians have very limited access to main (land) phone lines. Of greater importance, mobile cellular phone service is growing rapidly. When compared to neighboring countries, Malawi falls around the median for access to main phone lines, but is considerably behind in the number of citizens subscribing to mobile phones. Regional countries with higher per capita GDP have a substantially higher rate of mobile phone subscriptions (see Figures 11 in the tables Annex).[67]

Malawi suffers deficits of both general and financial services-related infrastructure. This raises costs, making services more expensive for people who are not linked to the financial system by means of local bank branches, road networks, and electronic access to the system. As discussed previously, the financial system infrastructure including branches and ATMs remains quite limited. It has begun to expand from a severely constrained starting point early in the current decade. Each of the above types of infrastructure plays a major role in determining the outreach of financial services, and each is critical to the value proposition of the OIBM innovation.

Besides infrastructure, certain basic services such as healthcare and education are often considered to be collective goods in whole or in part. In global terms, Malawi is not well off, as the discussion (in Part 1) of UN Human Development Indicators shows. In regional terms, Malawi is more in the mainstream though lagging behind some of its neighbors. Official data show 90.6% of school-aged children attending primary school, as compared to 95% for several countries in the region (See Figure 12 in the tables Annex). Healthcare in Malawi compares better, with average life expectancy, along with access to healthcare providers for childbirth, higher than most of the region. Malawi even spends the most on public health as a percentage of the government budget than its neighboring countries (See Figures 13-15 in the tables Annex). The prevalence of HIV in Malawi imposes stress on all sectors,

[67] Statistics reporting 120 mobile subscribers out of 1,000 inhabitants date from 2008. This puts Malawi last among its regional peers. These numbers, of course, change rapidly. An informal estimate by one of the cell phone companies in 2009 was 50% higher.

not least the healthcare system – a fact that makes the system's achievements all the more impressive.

Access to these services plays a dual role in shaping the impact of financial innovations. On the one hand, this affects clients' capacities to make full use of financial services. The sick and the illiterate, other things being equal, have lower capacity to succeed in enterprise than they would otherwise. The ubiquity of funerals in Malawi surely evidences a drain on time, resources, and above all human resources. On the other hand, access to services can directly affect clients' budgets for capital expenditure. In our focus groups, while respondents had access in principle to free healthcare and primary education care of the state, many of them opted to spend money for what they considered acceptable quality from private or non-profit providers. Typically, this meant paying upwards of MKw 20,000 per term for secondary school, and smaller amounts for private elementary school and for healthcare at private sector clinics.

QUALIFIED PERSONNEL AVAILABILITY

Access to trained staff arises as an issue in any undertaking. In Malawi, there are several reasons to expect the supply to be constrained, including the overall paucity of human capital. Although we have not analyzed data specific to the financial sector, it is clear that overall productivity, quality of labor, and education are issues of major concern in Malawi. For OIBM, this constraint is a special challenge. As a non-traditional, microfinance-oriented bank, it is pushing outreach to rural areas where it and others have not operated.

Total factor productivity in Malawi is low relative to neighboring countries, partly due to a weak competitive environment, and partly due to a lack of skilled workers. To date, training programs have been inadequate to address the shortage, and while primary school enrollments have increased, the education system does not produce an adequate skill base. As evidence of this, about half of surveyed firms reported a lack of skilled workers to be a serious constraint, and Malawi scores near the bottom of the region on the proxy measure for skilled labor force – urban males with secondary education. Another adverse factor is the prevalence of HIV infection among Malawian adults – estimated at 14% in 2004. This produces high rates of absenteeism due to the need to care for the worker's own health and especially the well-being of family affected by illness and death (World Bank 2006: 7, 51-65).

Financial sector interviewees reported that maintaining a qualified professional workforce can be a serious problem. Staff are generally trained on the job; weak prior training can make them very rigid in their approach to banking. There is no shortage of candidates as such, since jobs are scarce. But if the goal is to attract, retain, and properly motivate and discipline the most qualified professionals, it is a goal not easily met.

The other major constraint here comes from the rigidity of employment law. Not only is it very difficult to fire staff, but dismissed bank employees tend to bring cases under industrial relations law. One senior bank official said 4 or 5 employees have sued his company, and all obtained judgments in their favor after cases that lasted for years. Judges are not always well-versed in applicable law, and some have shown little comprehension of the cases. As a result, banks increasingly invest in intensive vetting and interview processes, as well as incentive systems, and take pains to adhere to the letter of their human resources standards.

Human resource constraints also affect the demand side. While micro and small enterprises point to credit as the binding constraint, some who work with the enterprise sector say that a more important factor is management capacity. Microenterprises tend to stagnate or fail because they never develop a vision or plan, and use business earnings to diversify or buy consumer goods rather than grow the enterprise. For some, perhaps most, entering business is a kind of coping mechanism, a response to failure, rather than a goal in itself.[68]

SECTOR ORGANIZATION

In order for microfinance providers to secure the necessary enabling conditions – at either the macro or the meso level – they sometimes need to act in concert. This requires some form of sectoral organization, a trade association that can advocate for the needed public goods, mobilize sector resources for desired club goods, and ensure viable markets to supply private goods.

Microfinance in Malawi does not yet have a strong sectoral organization. The cooperative movement is entrenched, and the SACCO (credit union) networks are relatively robust. But especially for non-cooperative-based services, the dominance of parastatals has tended to undercut market viability, and hence the ability (perhaps indeed the rationale) to organize for the good of the sector. Nor is there a strong microfinance network or apex that would provide the needed support for the development of MFIs. A network – the Malawi Microfinance Network (MAMN) – has been established for years but has not yet matured into a capable organization. Early in its life, MAMN was dominated by parastatals, making it difficult for it to effectively lobby the government.[69] This has changed modestly for the better.

There is a chicken-and-egg aspect to this sectoral organization issue. The key point is that a strong sector representative would help to address meso- and macro-level weaknesses, and so the lack of this presence shows in the enabling environment. On the other hand, the sector has yet to develop significant scale, thus a strong rationale and capacity for sectoral coordination are missing – for now.

Interviewees in the financial sector suggest that MAMN has grown in strength and number (membership is now 20) in the past two years. But as an organization, it has little capacity and must struggle for funding and staff to build a secretariat. Members pay dues of US $500 per year, and MAMN has some access to aid donor money. On this basis, it has been able to offer training and equipment to build the microfinance sector, and proposed to establish a credit reference bureau using biometrics. Despite its involvement in microfinance policy discussions, MAMN complains that RBM has not invited its input into the implementing regulations and is not sharing information on them. MAMN has worked to shape the Microfinance Bill that is heading for Parliamentary consideration in the near future (as of this writing). Not all agree that MAMN is useful at this point, and some in the financial sector see it as an ineffectual 'talk shop.'

Other approaches to policy advocacy appear to have been more effective than MAMN. Direct approaches to RBM have proven more effective for institutions such as OIBM. The latter's interests as a bank diverge somewhat from the MAMN mandate, and it was concerned that microfinance policies would set up an unlevel playing field in which MFIs and SACCOs would serve the same market as OIBM but be subject to less onerous standards, in particular capital requirements (see the discussion of regulation in Part 3 below). More

[68] Source for this and the previous two paragraphs: interviews in Malawi, July 2009.
[69] Luboyeski et al. (2004: 63, 73)

important to the banks, and more influential in policy development, is the Banker's Association. The latter has set up a fee-based check clearing system and has been deeply involved in banking law, standards, interest and exchange rate policy, and technology. It put forward its own proposed model for a credit reference bureau to which all banks would be connected.

IMPACT OF MESO-LEVEL FACTORS

The elements just reviewed have an important bearing on access to finance generally and on the likely success of the BMGF-funded innovations being put into action by OIBM. All of them affect the costs, business strategies, and outreach of operations of the financial institutions. In the case of OIBM, we have specific information on some of the ways in which the bank is dealing with meso-level factors in the enabling environment.

Box 4: The Emergence of OIBM[70]

OIBM pioneered microfinance banking in Malawi. The approach here is to provide commercially sustainable microfinance by running an institution professionally at scale under a banking license, by serving 'normal' banking customers as well as microfinance clients to provide stability and a margin of cross-subsidy, and also to partner with organizations that help it extend outreach through technology and links into agricultural value chains. This was not the original concept when Opportunity International set up its Malawian MFI, Usuwawata Credit Trust, in the 1990s. The difficulties experienced, leading to mounting loan losses, argued for liquidating the trust and folding it into a larger capital base for a bank. Thus, OIBM did not start out as an ordinary bank, and its founding and capitalization by OI, with the help of various donor agencies (and recently Gates) has made it a hybrid – a commercial bank with owners and supporters driven by a social mission.

Weak competition and lack of pressure to down-scale in the banking sector opened early opportunities for OIBM. It was the first commercial bank in Malawi to move seriously into microfinance. Its initial competitors were MFIs, parastatals, and transformed entities such as NBS and MSB. More recently, other commercial banks have been moving in its direction due in part to saturation in traditional banking markets, the less attractive T-bill rates under current macroeconomic conditions, and in some cases assistance such as the facilities offered by the IFC to encourage banks to expand small and medium enterprise (SME) lending. The overall expansion of credit (including some MKw 15 billion in consumer loans) and stock market equity in recent years both confirms and reinforces this trend.

The innovations funded by Gates conform to OIBM's overall strategy of downscaling through a combination of tailored products and better delivery methods. On the latter point, the financial sector had not made much headway by the time OIBM opened in 2003. Lingering concerns about security may have played a role – and spotty infrastructure was surely a factor.

OIBM was the first institution to re-enter the mobile van banking arena after this shut down in the 1990s. It now has 28 stops, including some that are served by small vans on unpaved roads. The idea here is first to create awareness and stimulate demand by running the van, then to follow this up by establishing a satellite office or kiosk. A senior officer stated, 'Mobile vans have done exactly what we wanted…' The kiosks appear to be unique in Malawi – retro-fitted shipping containers with teller windows, a constant real

[70] Source: interviews in Malawi, July 2009.

time online connection, and solar power. The key advantage here is the cost savings from not having to set up a traditional bricks-and-mortar branch or satellite. Branches require a minimum of 20 staff, and satellites 10, whereas kiosks are handled by three employees.

OIBM's product mix matches its down-market ambitions. It is designed to cope with EE challenges in low-end finance – such as lack of credit reporting systems, identity documentation, and overall credit discipline. Most of its lending is cash-flow based rather than mortgage-based as in traditional banks. Business and consumer loans are available up to MKw 600,000 at competitive rates, with approvals taking about two weeks (faster than the parastatals but not as rapid as the consumer finance firms).

Group loans are made to low-income clients in the 'premium trust banks' program, where groups of 7 to 10 persons form, apply for loans of MKw 5,000 to 40,000 per person (200,000 maximum per group), and undergo 4 weeks of training before disbursement. As groups mature and perform well, their loan amounts move up towards the maximum, and their repayments shift from biweekly to monthly. Credit officers market other OIBM products at group meetings. NGO microfinance programs work with OIBM to graduate their mature groups and link them to higher-grade banking services.

What OIBM does not offer is a checking account – this enables it to manage liabilities conservatively in the interest of its focus on basic financial services. But it also makes it harder to attract the full range of customers, and along with crowded branches and cut-rate service, inconveniences some existing clients.

OIBM has also confronted the difficulties of finding and retaining qualified staff. It started with expatriates in top management, for example, but made an early goal of replacing them with Malawian staff. OIBM recruited at the commercial banks, but had to attract senior professionals as much with the bank's social mission and future prospects as with pay and benefits. According to one of them, 'All who came took a dip in their earnings. I hesitated for a long time...We all had to leave our comfort zone...' To build up a full team of middle managers, OIBM needed to hire young staff (often with few skills) in junior positions, and 'fast-track' the more capable ones, retaining high-level talent with competitive pay and benefit packages as well as training. This approach was not readily accepted at first: 'We had to start talking to the board, to twist their arm on compensation.' But the goal of a high-skill, high-retention professional team appears to have been met. [71]

In sum, OIBM has responded to meso-level challenges through a combination of coping with limitations, expending resources to remove those limitations, and innovating so as to neutralize their impact. Its responses indicate the costs and benefits arising from enabling factors at this level.

[71] Source for this and preceding paragraphs: interviews in Malawi, July 2009.

Findings and Analysis: Macro Level

The macro-level enabling environment is made up of institutions (rules, norms, organizations) and policies that affect microfinance. These reflect decisions at the level of the polity (e.g. nation-state, local assembly) about the provision of public goods such as legislation, regulations, and enforcement mechanisms – and they also reflect less formal social processes that shape behavior across the economy.

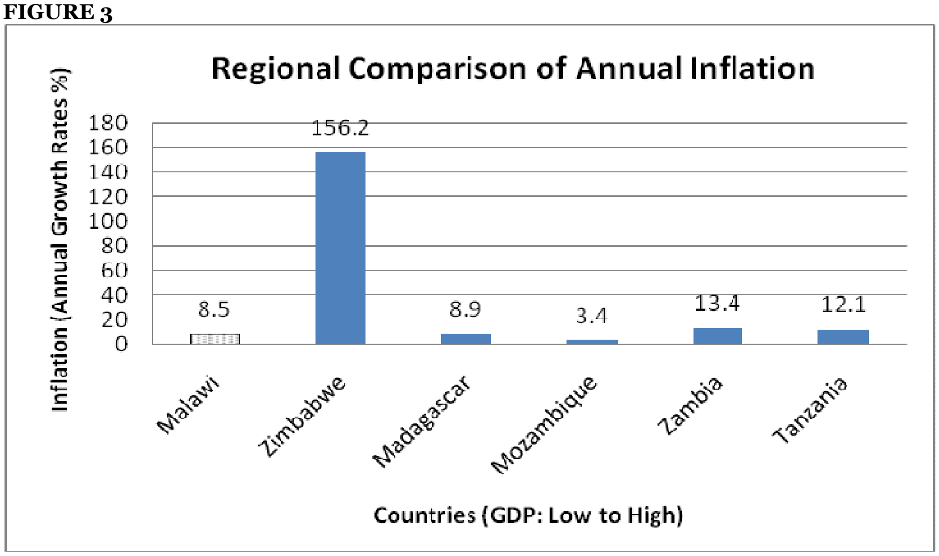
Here, we present our findings on the macro-level factors, focusing more on outcomes than on rules or policies in the abstract. At the end of the chapter we discuss the impact of these conditions, including the ways in which OIBM's operations either confront or cope with them.

MACROECONOMIC MANAGEMENT

A weak macroeconomic environment has limited financial sector development and expansion of access to finance in Malawi, although this is changing. Macroeconomic volatility poses challenges especially in liquidity management, and often leads to risk-averse behavior on the part of both financial service providers and clients. In particular, the following have acted as barriers: high fiscal deficits, high loan interest rates (see below), inflation, and depreciating currency. The International Monetary Fund (IMF) and others have stated that macroeconomic stabilization should precede other financial sector reforms aimed at increasing access to finance.[72]

There are clear signs that Malawi's macroeconomic fundamentals are improving – although it is difficult to say how soon these changes will translate into greater access and more affordability in small-scale financial services. Nominal interest rates for bank lending are still quite high (see below). But inflation has gone down recently, dropping from 45% in 1999 to around 8% in 2007.[73] Its rate of 8.5% over the past year is lower than most neighboring countries (see Figure 3).

FIGURE 3



Source: African Development Bank Group, *African Statistical Yearbook* (2010).

[72] Burritt (2006: 29, 33).
[73] World Development Indicators for 2007.

Depreciation of the currency, the *kwacha*, has also slowed. The average annual depreciation (vis-à-vis the USD) from 2001 to 2006 was nearly 18%. But this dropped below 3% in 2007 and has remained low since then.[74] At the same time, government still has a very substantial presence in the financial sector in terms of both ownership and borrowing, and this appears to retard the outreach of financial services.

BANK OPERATING COSTS, REGULATORY BURDEN

In Malawi, there are high costs associated with banking operations and access to finance. Thus, for example, annual fees for a checking account typically exceed 20% of GDP per capita (World Bank 2006a: 38). The burdens of financial regulation and prudential standards on the banks play a role in constraining the sector, though perhaps not the most important role. In a broader sense, financial regulatory policies have helped constrain the outreach of the financial system as a whole. Varying regulatory treatment for different types of financial providers, separate tax regimes that apply based on the type of organizational charter, and weak oversight of cooperatives are also cited as working against transparency, efficiency, and outreach (Burritt 2006: 9).

Reserve requirements have been a constraint. Until recently, the liquidity reserve ratio (LRR) was set prohibitively high (ranging from 38% to 94% during the 2001-2006 period). It has been reduced to 15.5%. Yet, as of mid-2008, actual liquidity in the banking system stood at 44.9% of total public deposits, nearly triple the required level.[75] It is not clear whether this practice is mainly a hangover from the period of high required reserves, a reflection of current RBM regulatory guidance to individual banks, or an outcome of ingrained conservatism and limited competition in the banking sector.

Other regulations raise the cost of banking and make downscaling more difficult than it would otherwise be – as they tend to do in countries that do not have regulatory niches for small-scale financial services. This is an outcome of the policy trade-off between safety and innovation, a trade-off that is being reconsidered in Malawi as it has been in other countries developing microfinance policies. Importantly, only banks and cooperatives can legally take savings. Among other constraints cited by the banks is the maintenance of exchange controls, with consequent shortages of foreign exchange, and collateral requirements for loans in the lower risk-weighting categories. Ownership and minimum capital requirements for licensing a bank are not onerous[76] compared to other systems, but minimum capital is excessive for most microfinance providers. Standard loan loss provisions are lenient, with no provisioning required in most cases until a loan is at least 90 days overdue.[77]

Banking regulation also specifies the physical and security standards for outlets – branches and agencies – which has a major impact on the cost of outreach. Standard Bank reported needing at least 50 staff for a branch, and a smaller number (as low as four) for an agency, which also has lower security requirements and cash-holding limits. Written approval from RBM is required to open and close branches and agencies[78] – a reasonable

[74] World Development Indicators 2001-2007; *see* also http://finance.yahoo.com/currency/convert?from=USD&to=MWK&amt=1&t=5y.
[75] *See* RBM, "Quarterly Economic Review – 1st Quarter 2008", Table 1.12.; http://www.rbm.mw/monetary_policy/documents/07052008mpc.doc.
[76] Burritt (2006: 118).
[77] *Directive No. D01-06/ASCL on Asset Classification*.
[78] Luboyeski et al. (2004: 21).

requirement for large institutions, but one that could hamper flexible microfinance outreach.

Financial service providers have been very active in finding ways to circumvent institutional constraints needing reform, for example using cellphone, POS, and satellite technology. Moreover, a raft of new legislation is being enacted on financial services, microfinance, financial cooperatives, and credit reference bureaus. The reforms should eventually ease some of the burdens mentioned above, while creating an accommodating regulatory niche for microfinance. The Microfinance Bill, soon to be place before Parliament, will introduce regulatory requirements tailored to the activities, structures, and risks of microfinance providers. Among other things, this will enable the top class of MFIs to accept savings deposits and adjust the minimum capital requirement substantially downward. Microfinance regulations are moving forward in parallel, though there are some complaints that RBM has not sought sector consultation here as it did for the legislation.

OIBM itself does not appear to suffer from undue regulatory burdens – or does not perceive any. First, OIBM is a licensed bank, and so has managed to comply with many requirements that would undermine other microfinance providers. Second, OIBM benefited from regulatory forbearance – for example, as of 2006, it was exempt from the banking reserve requirements.[79] Third, regulatory constraints for MFIs have the indirect benefit of making microfinance outreach and operations more difficult for OIBM's potential competitors.

PAYMENTS SYSTEM AND ELECTRONIC ACCESS

Access to the payments system is limited to banks; as is the case in many countries, non-banks including MFIs are left out. MFIs rely on commercial banks' branches for deposit accounts and on their ATMs for disbursement and repayment of microloans. This dependence is especially clear for microfinance providers in rural areas. [80] While this limitation may enhance safety, it also constrains the efficiency and growth of MFIs.

The banks are taking steps to link microfinance to the payments system, bank deposits, and electronic account access. Banks provide MFIs services as acceptance of cash collateral deposits and loan repayments (deposited to the MFI's account); and cashing checks for loan disbursement. OIBM provides clients with Malswitch cards, which they can use to make withdrawals using ATMs and POS devices.[81] First Merchant Bank (FMB) is opening basic bank accounts that provide clients with a *Makwacha* Card. This debit card can be used at ATMs and 'mini-ATM-global systems for mobile communications (GSM) POS terminals' located in retail stores to purchase goods and withdraw funds. It requires no minimum balance, and it is tied to an FMB savings account.[82]

The difficulty here is that bank branches and ATMs are not accessible in rural areas. Hence OIBM's program to spread access through mobile banking units, ATMs, and POS devices at shops outside the urban centers – and the desire of Malswitch to see a growth in rural access points where new customers can use its smart cards (Agar and Schouten 2006:50). While some bank cards are local or network-specific, others such as those issued by Standard Bank, are Visa cards. This is one response to the issue of compatibility, a problem being

[79] Burritt (2006: 120).
[80] Ibid, 47, 105.
[81] Luboyeski et al (2004: 54, 65).
[82] *See* http://www.fmbmalawi.com/card.html.

flagged by stores such as ShopRite, which has been approached by institutions with different card system but which needs inter-operability to avoid a profusion of terminals.[83]

Cell phone banking represents the wave of the future that no major financial institution or mobile phone service provider can ignore. Both major cell companies, Telecommunications Network Management (TNM) and Zain, are deeply involved, as are the banks increasingly. One approach is bank-based. For example, Standard Bank provides an internet platform accessible by mobile phone, which does not require the bank to work directly with the mobile phone companies and does not trigger scrutiny by RBM unless a transaction involves forex. Better-known is the alternative approach offered by the cell phone providers themselves. As the overall number of mobile subscribers has been rising rapidly, cell phone banking is becoming a viable proposition in Malawi and is moving quickly.[84]

Zain[85] has the largest network and is launching a Malawian version of Zap, its cellphone banking platform. Here, a Zain customer buys airtime that is backed by matching funds in a bank account. The customer can use the money for POS purchases, for transferring between her/his accounts, or for sending funds to another cellphone user with a Zain account. The company aims to make this service available to all the banks and their customers. An RBM taskforce is apparently looking into the regulatory aspects of this branchless form of banking. In this process, Zain is sharing its experiences elsewhere, but has not been and does not expect to be directly subject to financial regulation. The reason is that it acts purely as a technology provider and transaction agent for the banks, and does not itself hold fund balances.

RBM authorization is needed for cellphone banking systems overall, since this involves the payment system and the banks. The central bank refused to approve Zain's holding of fund balances under the initially-proposed model. As a banking agent (in some systems called a 'correspondent') taking and disbursing cash, and handling payments and transfers, Zain is subject to regulatory scrutiny. Ultimately, banks are responsible for their agents, but other countries have stepped in here with rules on agents and branchless banking (CGAP 2008). But by mutual agreement of Zain and the banks, it is the latter who works directly with the regulator.

FINANCIAL TRANSACTIONS—SECURITY AND ENFORCEMENT

An efficient system of secured financing opens up credit options for small firms with modest resources. But the value of such a system depends on well-developed secured transactions laws, collateral registries, collection mechanisms, secondary markets for seized assets, and other conditions.

In this area, Malawi has a few strengths and many weaknesses in its enabling institutions. The framework in practice does not enable the efficient use of a wide range of collateral to secure credits to small enterprise. There is provision for the registration of real property, equipment, and floating charges. But there appears to be little or no use of accounts receivable, crops

[83] Source, here and the remainder of this sub-section: interviews in Malawi, July 2009.
[84] See the data on cell phone subscribers quoted in the previous chapter. A mobile service company official from offered a higher estimate in 2009 – a plausible approximation, but one that could not be confirmed. In this field, Malawi is substantially behind other nearby countries, including South Africa and Kenya, and others. *See* "A special report on telecoms in emerging markets: Beyond voice," *The Economist*, September 26, 2009, pp. 15-18.
[85] Zain, a Kuwaiti company, was recently acquired by Bharti Airtel of India, though it continues for now to operate under its old name.

in the field, or other kinds of collateral used in more up-to-date systems. Lack of collateral is cited by the World Bank as the principal reason why access to finance is so limited for informal-sector entrepreneurs in Malawi. According to a Bank survey, the most common type of collateral, used by about 50% of sampled firms, is land and buildings. In comparison, 13% of surveyed firms use immovable plant and machinery as collateral. On average, domestic firms surveyed by the World Bank had to pledge assets worth 105% the value of loans received (World Bank 2006: 27-8).

The use of collateral reflects the kinds of assets that are available. But it also appears that the nature of the secured transactions system discourages the use of moveable property in favor of safer real estate, and requires pledging assets above 100% of loan value. Equipment is less desirable as collateral due to the following kinds of factors: the legal process to claim secured assets is uncertain and slow, used equipment has a low resale value, and secondary markets for equipment are thin. Lenders demand real property, since it is considered the only reliable form of loan security, and small entrepreneurs typically pledge their homes and farms to meet this demand. But, in the case of rural households, where assets largely consist of land and livestock, credit may be difficult to access because lenders seem to prefer a more diversified asset base (Diagne and Zeller 2001).

Box 5. Retail Credit in the Agricultural Supply Chain[86]

The agricultural supply chain features other variants of collateral and quasi-collateral., Equipment and input suppliers borrow from the banks and supply goods to farmers, sometimes on credit. The goods are generally imported, and so the supplier firm prefers to have them paid in full as soon as possible, and also to peg exchange rates so as to minimize forex risk. In recent years, there has been less risk here, and thus suppliers are better able to offer credit terms of a month or two to preferred customers. The agricultural suppliers sell to farmers and hardware shops, typically for cash but also on short-term credit for good customers (e.g. at a flat rate of 1.5% over three months). Banks will finance inventory, opening letters of credit on the basis of pro forma invoices, then disbursing payments to wholesale suppliers upon proof of purchase and collecting from the supply firms after 1-2 months. But the banks do not offer accounts receivable finance.

Input supplies to small farmers follow a different pattern. Financial institutions and supply firms are both involved, with the suppliers forwarding inputs to farmer groups and invoicing the lenders (in most cases OIBM) against farmer receipts. The banks carry the risk, collecting cash repayments from the farmers upon harvest. The suppliers work out the in-kind input loans in advance with farmers and local authorities. Banks reserve input stocks from South Africa months in advance, but instruct the suppliers not to deliver to the farmers until planting time, lest the inputs be diverted. Repayments from farmers are subject to the vagaries of growing conditions – weather, pests, etc. – and of export commodity prices.

On the retail side, the ability to use security efficiently broadens the range of products a financial institution can offer. This is especially relevant to top-end small and microenterprise credits that help borrowers bridge to formal banking and that also help MFIs and downscaling banks by making possible a tier of relatively profitable, low-unit cost loans. Weaknesses in the framework for secured finance create obstacles here. Another major financing constraint

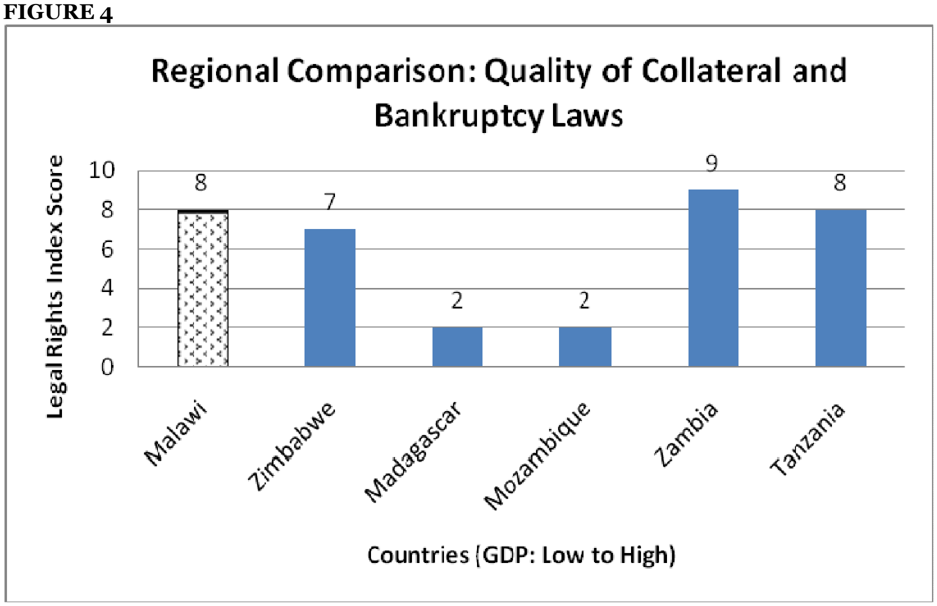
[86] Source: interviews in Malawi, July 2009.

that stems in part from this situation is the lack of trade credit for small and micro enterprises (at least in the absence of long-established commercial relationships). Here again, creditors have made imaginative use of substitutes such as payroll deductions, debit orders, and informal covenants that provide for seizure of designated goods upon default. Credit is available in some specific contexts; for example, Zain provides small loans for customers to buy cellphones.[87]

On the wholesale level, an efficient system for secured transactions expands the range of asset security and reduces the cost of capital. Here, lenders in Malawi face constraints. Some banks such as MSB lend to MFIs at their base (prime) rate – they consider the borrower's balance sheet and real estate security. There are two issues here. Capital is not as readily available as in the past due to improved macroeconomic conditions and thus growing competition for capital by bigger companies. Further, lending against the security of microfinance portfolios is not attractive to the banks. For securitization, efficiency and experience are lacking, and the banks have little interest in holding short-term microcredit accounts. OIBM's wholesale borrowing is mainly international, on commercial terms with shares and accounts as security, and with Opportunity International providing guarantees for a fee. Other banks, especially the multinationals, likely have similar arrangements. For domestic borrowing, OIBM can provide T-bills and longer-term assets as security under a floating charge.

These shortcomings do not appear to be due mainly to the quality of the collateral and bankruptcy laws in place. Malawi receives a relatively high score on this indicator from the World Bank, generally and in comparison to neighboring countries (see Figure 4 below).

FIGURE 4



Source: World Bank Group, *Doing Business* (2010).

The system in practice: Constraining factors are most evident in the legal procedures and practices relating to secured finance. Interviewees reported that a typical secured loan from a commercial bank takes three weeks or more

[87] Source, this paragraph and the remainder of this sub-section: interviews in Malawi, July 2009.

to process, most of which time is spent on the appraisal and registration of real estate to be mortgaged. A World Bank estimate put the average time for registering collateral at a much more burdensome 118 days.[88] If there were a working credit reference bureau, one banker suggested that funds could in some cases be disbursed while the process was ongoing. Using cash in an account as security eliminates most of the delay. With collateral, the risks and uncertainties involved reduce the loan-to-value percentage to 50% in most cases, though this can be higher for some clients. Again, lending is basically done against real estate, since moveables are both difficult to repossess and considered illiquid in Malawi. The cost of seizing and liquidating collateral, in World Bank estimates, is higher in Malawi (about 30% of collateral value) than the averages for Sub-Saharan Africa (about 20%) and low-income countries generally (7%).[89]

For downscaling banks, parastatals, and SACCOs, secured lending tends to focus on commodity producers, especially the tobacco sector. Loans in this field have performed well (99% repayment, according to MSB) despite the fall in commodity prices. Some of the credits are group loans, including some secured on 'group collateral.' There are also individual loans. Rather than collateral, most of these loans appear to be secured by an auction floor stop order, which lodges in the tobacco payment stream in the same way as a payroll deduction for employees. This appears more secure than a pure out-grower contract, where the farmer covenants to sell the produce to the input supplier. In that case, growers have been known to sell on the side, and agreements are difficult to enforce. The stop order provides extra protection, but is not a guarantee that farmers will not divert produce or fail to pay. The handling of stop orders is said by some users to be slow and at times corrupt. Also, a grower may trade and register in multiple names, which makes diversion easier. OIBM addresses this by dealing with farmer clubs associated with reputable tobacco buyers, and by means of borrower character assessment.

One of the major risks is the possibility of having to enforce a secured debt obligation in court – 'It's hell,' says one banker. Enforcing a typical contract requires 42 procedures averaging 432 days – inefficient in both absolute and relative terms. Going to court and obtaining a judgment takes on average 270 days, and enforcement of the claim takes another 120 days. Enforcement is also prohibitively costly, requiring the equivalent of some 284% of per capita income. Much of the cost is due to the need for an attorney to bring an enforcement action[90] – a requirement that is greatly reduced in more modern systems. But these problems are typical in low-income developing countries, particularly in Africa. Indeed Malawi's system is broadly in line with that of neighboring countries – a relatively high number of procedures and cost but somewhat less time involved in contract enforcement (See Figures 16-18 in the tables Annex.)

Where such cases arise, banks are hoping to move them to the new Commercial Court system, as the regular courts are too problematic. Also, the Chamber of Commerce and other stakeholders have developed a mechanism for addressing unpaid debts through mediation, in order to avoid using the court system whenever possible.[91]

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[88] World Bank (2006: 32, 35).
[89] Burritt (2006: 64).
[90] Doing Business, "Enforcing Contracts in Malawi -- 2008" (http://www.doingbusiness.org/ExploreTopics/EnforcingContracts/Details.aspx?economyid=118).
[91] Burritt (2006: 122).

But the main response to default and enforcement risks is to stick with relationship banking, to monitor debtors closely, and to act immediately in case of late payment. With corporate clients, alternative forms of collateral such as shares and floating liens are available, but company accounts are said to be highly non-transparent and unreliable. OIBM suggests the constraint here lies more in bankers' mentality than with the legal provisions, and it finds that RBM will recognize alternative security such as shares in the right conditions. In order to serve SMEs, which tend not to have records or real estate, OIBM carefully defines debtor covenants, including in them duties to deposit monthly repayments, to pay taxes, to assign proceeds, etc. But out of prudence, it normally does not lend to start-ups.

Alternatives: Where formal security and account deductions are not available, lenders find alternatives. Group guarantees are an obvious choice, at least in some contexts. Other approaches include the use of 'forced savings' or cash collateral in the range of 20% (with reductions for successful repeat borrowers). This is usually supplemented with a group guarantee, or for individual loans, some kind of collateral such as furniture, a vehicle, a motorbike or a bicycle (the debtor signs over the bill of sale). Some borrowers offer real property attested by a deed or affidavit from the local chief, but only in a township or city where it has a resale value. Default cases may be taken to court, but lenders depend more on the 'fear factor' created by the borrower's risk of losing essential goods than on the threat (not very credible in most cases) of enforcement at law.

A further tactic is to fix a maximum limit on credits as a percentage of the attributed value of the collateral, or in the case of SACCOs, a percentage of share value (in either case, this might be, e.g., 150%). The SACCOs inspect farm plots to check repayment prospects or to seize and sell crops if given timely notice of default. Alternatively, the debtor receives a letter followed by a visit, and if payment is not forthcoming, the SACCO seizes items of value such as a television or furniture (as stipulated in the loan agreement) or hands the matter to a collection agent for a fee.

Box 6. Retail Credit without Collateral[92]

Our interviews and focus groups in Malawi shed light on the demand side of credit. Focus group discussions provided the perspective of ordinary borrowers, most of them micro-entrepreneurs. Their circumstances were diverse, some of them having assets such as bicycles, cellphones, or radios, sometimes a refrigerator and occasionally even a television or car. The near-universal mode of purchase was with cash – no credit. Often, buyers used lay-by terms, under which the good is reserved by the retailer for a period of months while the buyer makes installment payments, and then the good is transferred upon full payment. It was also not unknown for individual vendors to sell to a good customer for 50% down, followed by installments. Some group members traveled to Mozambique to buy their goods – for example, bicycles were said to cost only MKw 12,000 there as compared with 17,000 in Malawi.

Lenders tighten their vigilance of debtors because they cannot get reliable information on credit history and do not have confidence in the courts. In priority cases (involving large sums), a SACCO or other lender may take a debtor to court and seek imprisonment as a sanction. The history of debt imprisonment elsewhere shows that this works far better as a deterrent and bargaining chip than as a way of extracting payment once the person is jailed.

[92] Source: interviews in Malawi, July 2009.

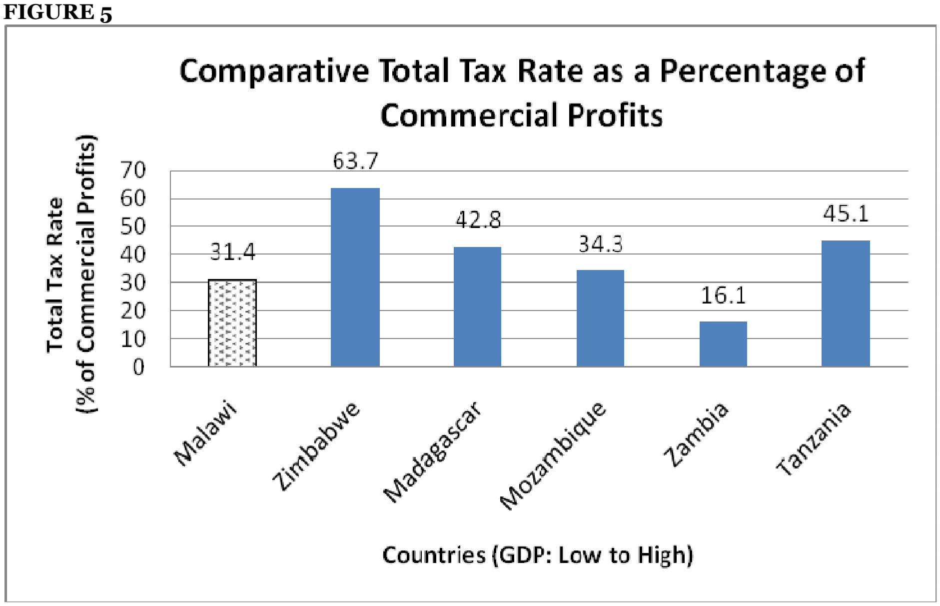
Another recourse is to local chiefs and traditional authorities. There is no longer in legal terms a traditional court system, but the relevant authorities can mediate and pressure debtors. As enforcers, they are not viewed by lenders as being very effective.

TAXATION AND IMPORT REGIMES[93]

Any business, including any financial services provider, feels the effects of tax policies and their administration – whether they incur the cost of compliance or the cost of evasion. Taxes, including value added tax (VAT) and import levies, are likely to be still more important for the OIBM outreach initiative, which depends on ATM technology and transport equipment manufactured abroad.

Malawi's general regime of business taxation is relatively onerous. The percentage of gross profit paid in taxes (56.5%) is high for the region, although aggregate corporate income taxes (approximately 35%) are in line with neighboring countries, indeed lower than most (see Figure 5 below). The number of hours spent complying with tax regulations in Malawi is nearly double the sub-Saharan Africa and low-income country averages (about 750 hours per year compared to 400 for SSA and low-income countries). Firms in Malawi are subject to inspections and visits from tax officials at about twice the rate of other SSA and low-income countries (four days per year versus two). Not surprisingly, then, firms in Malawi officially report a lower percentage of their sales (about 70%) than do firms on average in SSA and low-income countries (approximately 80%).

FIGURE 5



Source: The World Bank, *Paying Taxes* 2009.

As in other countries, microfinance receives differential tax treatment, since NGOs and microfinance groups benefit from exemptions. Even still, a non-profit MFI may be taxed on 'profit' or excess revenue – as in the case of one provider that was required to pay years of back taxes on this basis.

[93] Unless otherwise noted, all information is from World Bank (2006: 40-43).

Since the OIBM innovation involves importing vehicles and machinery, the cost of foreign trade, including regulation and taxation, is potentially important. The World Bank investment climate study (World Bank 2006: 81-106) suggests that the administration of import regulations and access to forex by importers impose undue cost and delay – and the forex constraint arose in several interviews and the newspapers during the field research. The cost of imported goods is also likely to be elevated due to the transport required to Malawi's landlocked points of entry, and perhaps also limited competition. The Heritage Foundation 2008 Index of Economic Freedom[94] ranks Malawi near the bottom overall (120 of 157, lower 50% of SSA countries), but considers its trade policies "moderately free." Various non-tariff barriers such as import controls and licensing requirements, a non-transparent customs process, and corruption reduce the openness of import trade in practice. OIBM does not count import procedures and duties among its major problems, but foresees them in its operating budget. The main inconvenience here is the occasional unexpected delay of import shipments.

PUBLIC GOVERNANCE AND THE BUSINESS CLIMATE

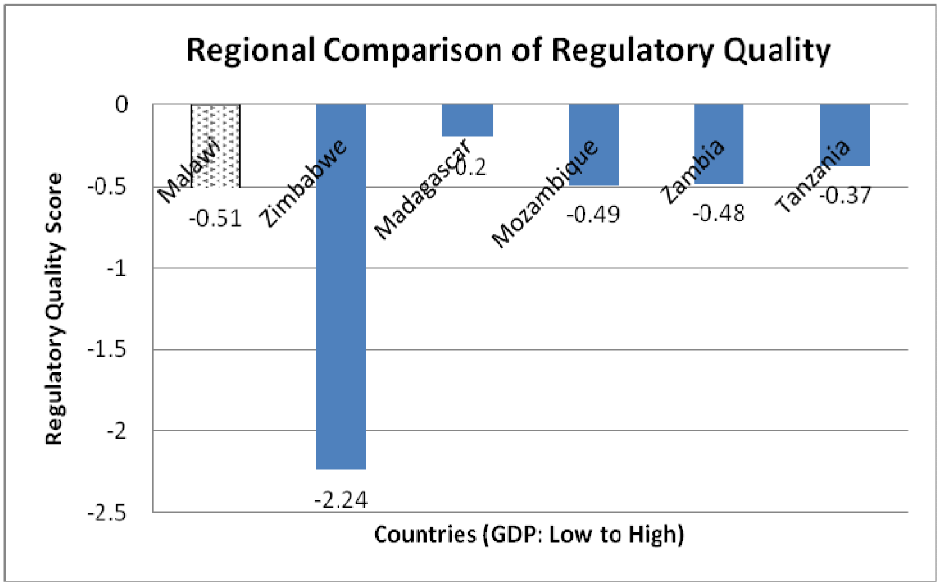
The quality of public governance affects not only microfinance operations but also entrepreneurs' ability to use microfinance for profit. *Governance* in this context embraces a complex of issues, from the quality of administration to the rule of law and the maintenance of security. We have already touched on some aspects of the topic such as tax collection and debt enforcement, as well as several outcomes of governance quality including infrastructure, public services, and the credit culture shaped by state provision of finance.

Among the broad comparative indicators used in the World Bank's governance studies are government effectiveness and regulatory quality, which have clear relevance for microenterprise and microfinance. The first indicator shows improvement in perceptions of government effectiveness in Malawi during the last two years. This reflects the quality of public services, civil service, policy formulation, independence of administrators from political pressures, and the success of government in carrying out policy commitments. This compares well with neighboring countries, most of which lost ground in this area (See Figure 19 in the tables Annex). On regulatory quality, Malawi ranks in the 29.6th percentile worldwide, lagging somewhat behind most neighboring countries (See Figure 6 below).[95]

At the core of public governance are those mechanisms summarized as the 'rule of law,' which play a critical role in such areas as protecting rights, ensuring security, and combating corruption. On the World Bank's Rule of Law indicators, Malawi leads neighboring countries, even though it has slipped a little in the last two years (See Fig. 20 in the tables Annex). A related indicator measures public attitudes toward the laws, contract enforcement, the police service, the judicial system, and the perceived likelihood of crime or violence. Here, Malawi ranks in the 44.8th percentile globally, ahead of most African countries, and comparable to most other nations in its region (Kaufmann et al 2008).

[94] http://www.heritage.org/Index/country.cfm?id=Malawi. The index uses ten indicators to measure the extent o which markets operate free of state controls.
[95] It lost some ground in the last two years (Kaufmann et al 2006).

FIGURE 6



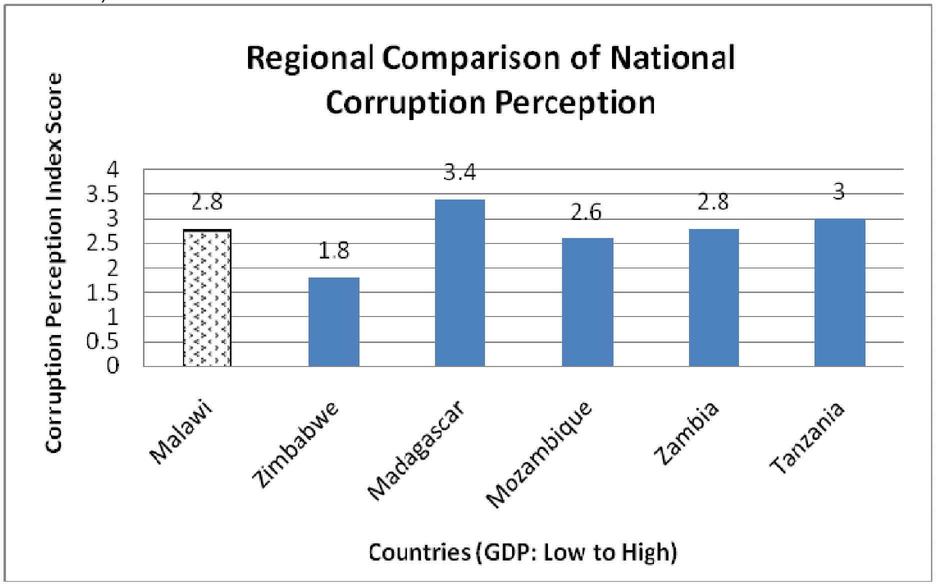
Source: Kaufmann et al (2008).

The incidence of crime, theft, and disorder is a significant factor in the Malawian economy, as it is in many developing countries. In a World Bank survey, the percentage of firms perceiving insecurity to be a binding constraint on operations and growth was higher in Malawi (approximately 45%) than the averages for Sub-Saharan Africa (around 30%) and low-income countries (about 25%). Overall, revenue losses (as a percentage of sales) due to insecurity were significantly higher (over 2% of sales) for Malawi than the SSA (about 1%) and low-income country (less than 1%) averages. Security costs (over 2% of sales) exceeded the average for SSA (approximately 1.5%) but were a bit lower than low-income countries generally (approx. 2.5%). The Bank's figures for Malawi reported a much higher perceived cost of insecurity for large, exporting firms in export processing zones than for smaller firms (World Bank 2006: 44-46). Yet, other research usually suggests that crime, disorder, and related problems affect microenterprises most dramatically. In Malawi for example, OIBM reported that overzealous policing led to the destruction of market stalls, thereby creating the need for special financial facilities to help affected entrepreneurs.[96]

The picture is similar for measures of corruption. Formal sector businesses have a higher level of concern (47% viewed it as an obstacle) than informal firms (18%). The cost of bribes to "get things done" in Malawi (as a percentage of overall sales) is a bit higher (over 2%) than the average for SSA (about 1.5%) and about the same as the average for low-income countries. Bribes for utility connections are actually a bit less common in Malawi than in SSA and low-income countries in general. Yet, as compared to other developing countries, corruption and bureaucratic weakness do not appear to have a great impact on productivity (World Bank 2006: 46-50, 76). Overall perceptions of corruption in Malawi are relatively high in global terms, though in line with the region (see Figure 7 below). The quality of governmental control of corruption in Malawi ranks behind that of neighboring countries and a large majority of other countries surveyed (See Fig. 21 in the tables Annex).

[96] Burritt (2006); McGuinness (2008).

FIGURE 7



Source: Transparency International (2008). Higher score means lower perceived corruption. Global rank for Malawi: 115th out of 180.

Local governance: Factors at the local level, such as the quality of dispute resolution mechanisms and of administration at district level and below, influence both outreach and use of microfinance. Most poor microfinance clients do not have access to effective formal dispute resolution mechanisms. Courts are distant, and consumer disputes are difficult to address because of the lack of clear legal standards (e.g. in purchases of supplies and in retail sales), and the lack of small claims courts. On the other hand, the reduction in insecurity and serious crime over the last several years is notable – and it tends to benefit the poor in multiple ways, decreasing the need for extraordinary protections, reliance on police intervention, and costly risk mitigation methods. Local authorities help organize microfinance groups and resolve disputes. However, the authorities have a great deal of control that does not appear to be subject to any robust form of accountability, and so there are reports of corruption and abuse from that level up the chain of authority.

This situation is partly due to the transitional situation Malawi finds itself in – from traditional systems of authority to modern ones, from rural life to urbanization, and from a centralized state to a much more devolved system of governance. Ambiguities along the way present opportunities for self-dealing and abuse of power, particularly by local and traditional authorities. Government legitimacy has long depended on citizens' access to maize so that they can feed themselves, and this tended to politicize food and agricultural policies. The current Bingu administration has striven to change this, to implement reforms, and to send a strong message against corruption.

Governance reforms since the change of regime in 1994 have complicated the local enabling environment. Decentralization empowers local assemblies to pass bylaws that could include licensing conditions or other constraints on small enterprises (Ellis 2003). Overlaps and conflicts between central and sub-national powers give rise to overreaching and abuse by both sides. For example, the central government has made administrative appointments of personnel who are supposed to be chosen by district assemblies under the constitution and decentralization laws. On the other side, district and local officials have exploited the travails of transition to remain in power unelected, to reap corrupt benefits (according to one interviewee, 'everybody is giving each other kickbacks'), and to impose regulations and taxes on local businesses – some of which have been subject to legal challenge. [97]

Post-independence policies, for example state-mandated distribution of idle tea plantation lands, re-emphasized the chiefs' role in local governance. Their authority centered on the allocation of land based on kin relations and need, but it expanded beyond this and has never been clearly understood or spelled out (Sahley et al. 2005). During the Banda regime, the chiefs and traditional courts were politicized.

Chiefs have sought greater recognition of their role in promoting development and resolving disputes locally (NDI 1995). This has opened opportunities for dynamic chiefs to take positive steps in the development of their localities. But it has also had negative effects. Ambiguities in the chiefs' role, local government powers, and property rights have contributed to the undermining of many women's property rights, especially in cases of family inheritance-grabbing from AIDS widows. This is abetted by the opportunities for corruption locally. The AIDS widow issue is not unique to Malawi, and there as elsewhere effective countermeasures are being taken by advocacy and church groups (Chiweza 2005, VonDoepp 2002).

One expert says 'the chiefs are opportunists,' and many allege that corruption is rife among them. In theory, the chiefs should have little say over land disposition now, but in practice this does not appear to be true. They are known to have arranged sales of rural lands that are legally protected – and this invites bribery. Thus, whereas in the past they accepted chickens and other small tokens of gratitude for their assistance, this in many cases has become a demand for payment – typically MKw 5,000, often collected by a chief at several points in the process of registering land. In addition, a chief may demand kickbacks from developers, even more than one for a given plot of land. Villagers do not complain openly of this behavior, lacking protection and a platform for doing so. Indeed, some appear to view payments to the chief as legitimate – the chief provides real benefits, and besides, others such as development workers receive allowances often without adding any obvious value.[98]

The chiefs are part of the primary justice system extending from the family to the wider community. The traditional courts were abolished in 1994 because they were viewed as carrying out political orders from the center in cases that ranged from minor disputes to murder. But nothing replaced them – the chiefs continue to deal with disputes but are not clear on their role. Disputes are mainly about land, especially where it is sought for development purposes. Chiefs sit on councils and development committees up to the district level, and so combine legislative, executive, and judicial power in one person without formal standards or checks. But there is an alternative – those who are aware of the regular court system and able to travel to the courthouse may bring cases directly to it without going to a local authority first.

[97] Source: interviews and focus groups in Malawi, July 2009.
[98] Source, this paragraph and through the end of the section: interviews and focus groups in Malawi, July 2009.

Box 7. Coping with Local Governance[99]

Interviews with microfinance providers and focus groups with borrower groups provided a clearer picture of the issues and concerns on the ground. Most said crime was not really an issue. Robbery and insecurity have been on the ebb for several years, and this is attributed to a combination of changed circumstances since the crime wave of the 1990s and the political commitment of the current government. Previously, for example, people kept their goats and maize in the house but this is no longer necessary. One of the groups did report two burglaries in recent years. These were reported at the police station, a 20 minute walk away, but this turned out to be less helpful than alerting the chief. Despite the positive security picture, people do take strong precautions to avoid crime, for example having funds counted twice and disbursed in front of the microfinance group as a whole, and crafting elaborate cash hiding places in the home or in clothing when money needs to be transported.

Where disputes arise, the parties have a number of local options. Unpaid vendors will stop supplying goods and bring informal pressure on the debtor. The next step is to go to the chief, who may send men to seize a household good and hold it pending payment in full (whether part of a written agreement or not). Market vendors pay fees for management of the space and can bring disputes to the elected marketplace administrator – with the possibility of going beyond this to the police if necessary. Disputes about the quality of goods are more difficult, and so traders have learned to be exceedingly thorough in inspecting new inventory such as clothing or commodities for sale such as maize. If a defect is found in time, the buyer will argue for a reduction in price. But where such a dispute involves an outside supplier, especially a company or a shop in town, and payment is made in advance – as is often the case with such suppliers – the buyer-entrepreneur has no recourse. Such examples highlight the hazards facing microenterprises transacting outside their local networks, in the absence of established relationships or of a system that affords consumer protection or accountability to a tribunal that both parties can access.

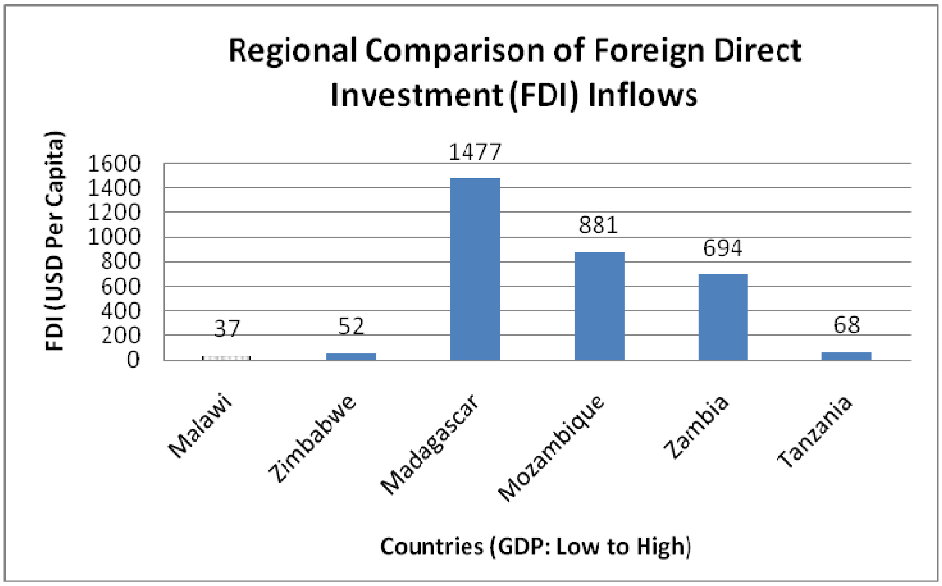
Microfinance activities unfold in this local environment. The mobilization of groups by parastatals, MFIs, and downscaling banks including OIBM require the involvement of local assemblies, administrators, and above all chiefs (including district-level chiefs known as "traditional authorities"). This is a given of African societies and indeed those of most developing countries, where local authority is clothed to greater or lesser degree in traditionalism and paternalism. It is also frequently a key condition for financial access among the poor, especially in rural areas, where identity documents and especially credit histories are little known.

The chiefs help to coordinate the groups and provide reference letters vouching for the members and attesting that a given group exists and is resident in the village of record. The microfinance providers do not bring up corruption as an issue in this context, but say that relations are generally smooth. Political affiliations may come into play – where party affiliations align, local authorities appear more inclined to be actively helpful. The chiefs keep tabs on everyone's business, and this is a major part of the value they provide to the MFIs. The latter recruit the help of the chiefs and local assemblies, conducting 'sensitization' training on the microfinance programs at district, local, and village levels. The chiefs advocate for community-wide interests, raising questions about approach and pressing for an equitable spread of financial and development initiatives. Discussions continue until consensus is reached – at each level.

[99] Source: interviews in Malawi, July 2009.

Business climate: Many of the issues discussed previously are important to the climate for enterprise, including infrastructure, regulatory quality, local governance, and demand-side issues in other areas. Two outcomes of the business climate are worth noting. First, over half of adult Malawians are estimated to be working in the informal sector.[100] Second, Malawi receives the least foreign direct investment per capita in the region (see Figure 8 below) – though admittedly this is due in part to limited natural resource endowments and location.

FIGURE 8



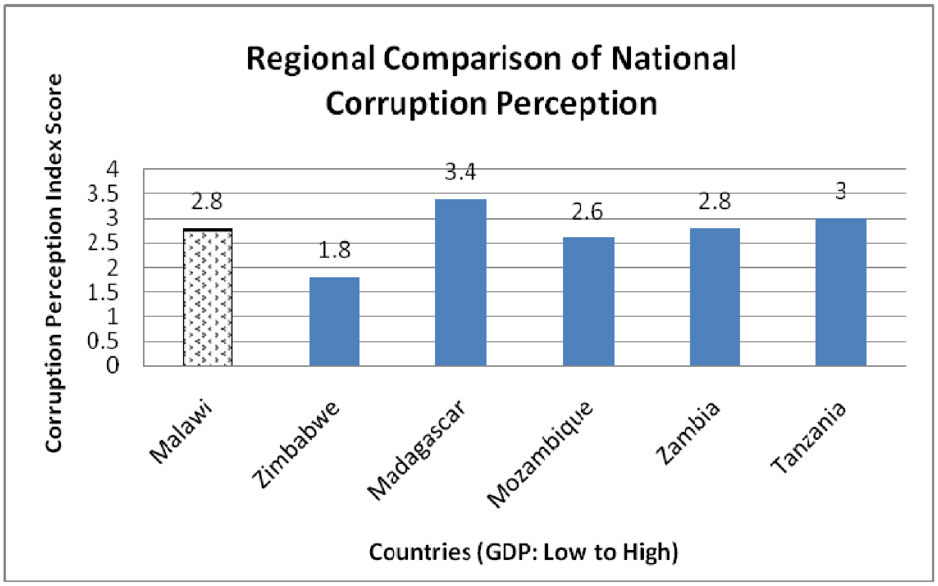
Source: African Development Bank Group, *African Statistical Yearbook* (2010).

A range of policy and institutional factors affect the dynamism of the business sector including microenterprise. For example, public policies relating to the all-important export commodity sectors have a major impact. A change in 1990 to allow Malawian smallholders to grow burley tobacco sparked rural small enterprise growth that was greater than in non burley-tobacco control areas (Liedholm et al 1994) – presumably reflecting both direct and indirect effects.

A further example is the costly barriers to business sector entry. Registering a new business in Malawi costs the equivalent of more than 125% of per capita income, which is high in both regional and global terms (see Figure 9 below). The high cost is in large part due to the price of obtaining a seal, which costs over USD $100. More generally, starting a business in Malawi is comparatively quite costly.[101] In addition, the number of procedures combined with the time required for business start-up (comparatively great) raises the entry barrier (See Figures 22-24 in the tables Annex). The costs might not cause great difficulty for a well-capitalized promoter, but for a small start-up, and especially a microenterprise, they are likely to be prohibitive. This surely also contributes to the high level of informality in Malawi's private sector.

[100] Source: interviews in Malawi July 2009.
[101] World Bank (2006: 110).

FIGURE 9



Source: Transparency International (2008). Higher score means lower perceived corruption. Global rank for Malawi: 115th out of 180.

In addition, interviewees attributed poverty and poor business growth to the lack of an 'enterprise culture,' shortcomings in the capacity and training of business people, and related factors. One of the business management problems observed in microfinance clients is the tendency to either diversify activities too broadly or to spend money too soon on new goods and services. As a result, profits are extracted from the enterprise rather than being used strategically to capitalize the business and set it on a reasonable growth trajectory. Research elsewhere points to the same kind of problem, leading some to state what is perhaps obvious: not everyone is capable of being an entrepreneur.

The majority view of informants was that the business climate had greatly improved in the past five years – there are better roads, telecoms, and IT. Seasonality is still an issue, given the terrain and weather, Malawi's dependence on commodity exports, and the paucity of agricultural insurance products on offer. Though the laws and regulations are seen as not having changed much, the view is, 'There's freedom to enter any business.' But freedom does not mean entry is easy. One worry for observers is that business licensing (for firms under a threshold) is local, under rules established by the local assembly. The assemblies have outlawed some informal businesses, and bylaws in general can be changed by local assembly vote. Informals have the advantage of evading impositions such as the 2% business turnover tax, but they cannot obtain accounts and credits from banks in the name of the business, which rules out enterprise loans.

IMPACT OF MACRO-LEVEL FACTORS

This level of the enabling environment has a major impact on microfinance services and on OIBM in particular. Expectations about inflation, financial regulation, public safety, contract enforcement, administrative governance and the like are built into the approach of each provider. Also, these factors affect the demand side both directly and by means of the MFIs' responses. In the case of OIBM, again we have specific information about the ways in which it copes, innovates, or attempts to influence the macro setting.

Financial services regulation is an element of obvious importance. Here, OIBM's experience in becoming licensed and in gaining regulatory approval of its innovations is instructive. Obtaining a bank license was in some ways OIBM's biggest challenge, one necessitated by its goal of providing commercially sustainable microfinance and intermediating deposits (along with the lack of an alternative MFI license window). At the start, RBM was not familiar with microfinance or with appropriate regulatory frameworks for it – since its experience of financial services focused entirely on commercial banking. After about a year of looking at microfinance issues and sending staff for training, RBM had gained an understanding and appreciation of microfinance.

But RBM's starting point in all its discussions with OIBM was traditional banking oversight, and so the process of becoming licensed caused OIBM 'lots of pain' including the erosion of its capital base and an inability to expand early on. Much of the discussion with RBM focused on capital. The Reserve Bank looked at OIBM's shareholders and strategic plan and 'treated us like any other bank.' RBM also had to be persuaded to accept OIBM's need for faster write-off of microloans. Onerous standards for commercial bank governance and physical security had to be addressed. For example, banking standards require bullet-proof glass and security cameras, but this would have made OIBM's outlets costly if not infeasible, and the requirements for keeping of receipts in banking outlets would have scuttled OIBM's plans to trim the back office and go paperless. Discussions on these matters lasted for days. The issue of identity documentation arose, with the traditional approach being to require a form of ID that showed a permanent address. 'This requirement has in fact kept lots of people out of the system,' according to OIBM, and so it adopted biometrics with RBM approval and safeguards.

After licensing, there were continuing discussions as OIBM innovated and had to seek RBM approval. A major issue was the kiosks and their location. RBM called for brick and mortar buildings in town centers, but OIBM 'told them we're trying to go to the people.' After discussion, RBM licensed the containers, and even adopted OIBM's approach as the standard in a new directive on this. A related argument arose over RBM's initial security standards for mobile vans, which OIBM also managed to counter (reducing RBM's requirement from 8 guards to 2). A second regulatory concern arose at RBM's first inspection of the bank in 2004. OIBM had suffered losses of MKw 90 million. The regulator insisted on conditions, including that OIBM not open any new branches until it made a profit. Here, the donors stepped in to assist, so that OIBM could expand and become sustainable.

Here, OIBM's response to regulatory challenges went beyond its own needs to influence the wider environment. OIBM appears to have had a significant impact in terms of practical, low-profile "reform" of the regulatory system, pressing RBM to adopt new approaches to risk management and service provision more suitable to microfinance.[102] But this did not happen without the help of donors and powerfully networked board members. Competitors were at times uneasy about this. 'Other banks have misunderstood us…We are the first bank to go to the big man [RBM]…to twist his arm…' In response to suggestions that it received special treatment, OIBM responds, 'At the end of the day, the central bank did not take away a single rule.' Now, RBM is very

[102] Outside experts in some cases disagree with this, citing OIBM's lack of participation in microfinance sector discussions of regulatory reform.

responsive to the needs of OIBM and the sector. It attends MAMN meetings and comes to OIBM for advice on how to deal with microfinance.[103]

On another front, OIBM must deal with shortcomings in physical and financial infrastructure, and the need to link customers to electronic banking systems. OIBM has aggressively pursued new technological solutions to grow market share and facilitate its outreach to low-income customers. Its initial partnership was with the electronic systems provider Malswitch. The bank needed a hardware interface (a switch) to link it to digital payment systems, and it outsourced this to Malswitch as a cost-saving measure rather than set up its own system as some more established banks had done. OIBM pays the company fees for providing the switch, managing bank card databases, and maintaining bank computer systems. But Malswitch did not catch on as the industry standard. To ensure a single compatible standard, the sector worked at the level of the Bankers' Association to set up a national switch for all the banks, connecting all their ATM systems together.[104]

In 2006, OIBM decided that it needed cell phone banking solutions. As a result, it worked with cellular service provider TNM to develop Banking *Manja* ('bank in your hand'), a bank-based system that allows it to work with all OIBM clients through either of the mobile phone companies. It is OIBM's cheapest form of outreach, followed (in order of cost-savings) by POS access, ATMs, kiosks, and then satellite outlets or mobile vans. Clients can use their cell phones to transfer funds between accounts and to shops for purchases, and can get cash back. Again, per RBM strictures, cell phone money must be backed by funds in the bank. Money in the system (not yet cashed) is held by OIBM, providing it a 'float' that it can invest. Users must be registered at OIBM and have an account at a commercial bank. OIBM, like other banks using mobile phone platforms, says that the technology is moving too fast for the regulators and that the provisions addressing it in the new financial laws and regulations are already outdated.

OIBM uses other new technologies for retail purchases and account management. Its Bank *Mkonde* platform ('bank on your doorstep') has partner retail chains hosting dedicated POS devices. OIBM had set up 20 of these as of mid-2009, projecting a total of 80 by the end of 2009 and 200 in 3 years.[105] The shops gain from increased traffic and earning of POS fees, while reducing cash-holding. Also, like MSB and perhaps other banks, OIBM uses satellite technology to link client account transactions in the field to the banks' central information system in real time. It uses a cell phone card device that connects field outlets to a server provided by TNM. This system was just getting started in summer 2009. 'It's a major major breakthrough,' according to OIBM.

In yet another domain, in order to cope with the lack of credit information and collateral security in its dealings with low-income clients, OIBM makes use of social coordination mechanisms. For example, it works with groups that self-select within a village or neighborhood and get their local chief to forward a letter or application. The groups set up constitutions and management structures, and receive training. Where the group does not function effectively, it can be pressured and even disbanded.

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[103] OIBM has recommended higher minimum capital than that stipulated in a draft of the microfinance law and regulations, fearing 'chaos' if many weak institutions enter the market. This fits with the bank's niche as a full-fledged commercial bank.
[104] Other issues with Malswitch have arisen, such as its inability to keep pace with burgeoning demand for cards, and the unhappiness of some of the banks with its technology.
[105] In comparison, OIBM estimated the total number of POS in Malawi at 1100 in 2007-8; *see* http://www.procasur.cl/pathstolearning/fotografiafrica/Documentos/casos/ingles/oportunity.pdf

OIBM places great emphasis on the social and spiritual dimension of these groups, as it does within its own staff.[106] The governing idea is transformation, changing the lives of the poor for the better, encouraging leadership, achievement, and a holistic vision of human values. In other contexts, this often means an organization that works within a particular social, ethnic, or religious tradition, but OIBM says that it operates in both Christian and Muslim areas, and across regional and ethnic lines.

In sum, OIBM addresses macro-level constraints through coping, innovation, and active confrontation. In the latter case, it has gone beyond reactive approaches to become itself a driver of change in financial services regulation. In this way, the bank's value proposition, along with its impact on its clients, reflects binding external constraints, opportunities, and the effects of its own responses.

[106] The frequency of collective prayer both in the office and in the field is evidence of this.

Conclusion

This paper endeavors to identify the most salient components of the enabling environment for microfinance in Malawi and to shed light on the impact of that environment on OIBM's efforts to extend financial services access to the poor. Clearly, the enabling factors relevant to microfinance comprise a wide, diverse range. Here we offer a synoptic view of these factors and their effects. We begin with a summary of major EE factors, then proceed to a concluding discussion of their significance for OIBM and for microfinance access in Malawi.

SUMMARY: MESO LEVEL

At this level, we have sought to address the following questions. What collective resources – material, infrastructural, and organizational – contribute to the extension of financial services to Malawi's poor? Where are necessary goods of this kind inadequate or missing? What impact do they have on OIBM's efforts in microfinance?

A major concern is whether the financial sector is competitive and flexible enough to provide appropriate services to low-income clients. From a highly concentrated and inflexible starting point, the financial sector in the last two years or so has seen an upswing in competition and dynamism, with services reaching out to more localities, with more products and access points. Banks still focus largely on capturing the top corporate clients, but some downscaling to small enterprise and lower income households is evident. In this, the sector is regaining ground lost since the wrenching changes of the mid-1990s, in which financial outreach – in large part state-directed – was severely cut back. Now, new products and technologies are being adopted in the commercial bank sector. New players are also coming in, such as the consumer lending companies, bringing potentially disruptive change. But expanded outreach has not apparently had much impact on prices (interest rates and fees), nor have services reached the rural poor to any great extent.[107]

The government has made several attempts to provide savings and especially credit services to underserved poor and rural populations. In the past, these efforts suffered from a range of problems that made them at least as much a public 'bad' as a public good – mis-targeting, inefficiency, political intrusion, corruption. The principal adverse legacy here has been a negative 'credit culture.' State credit programs led people to believe that loans were essentially as 'soft' as grants, and that they were political benefits to be gained through lobbying and skimming. This is a hard legacy to overcome. It still plagues the sector, especially the parastatals and other entities such as the cooperatives (SACCOs) that served as channels, and it has tainted the structures of governance such as local authorities whose power depended on controlling distribution. OIBM and other microfinance providers have invested heavily in overcoming the adverse credit culture among client groups. This involves reversing the old incentives, using a tough, businesslike approach to debt collection, and in the case of OIBM, an effort to inculcate in borrowers a value system favoring responsibility and repayment.

The parastatals have been reformed and are now making efforts to operate on a more sustainable basis. This is more the case with MRFC than MARDEF,

[107] Further discussion of the range of options appears in the financial landscape study (McGuinness 2008).

which still appears to be driven by populist politics. In most areas the parastatals do not compete directly with OIBM and overlap only lightly with the MFIs. They do seem to provide a public option (with all its inconveniences) to poor populations with few if any viable alternatives.

In other areas directly relevant to the poor, Malawi faces steep challenges. It lags behind most of the world and its region in productivity, a result that owes much to the country's weak human resource base. The latter in turn reflects low average levels of education, high incidence of HIV (despite real improvements in the health sector), and – critical in the enterprise context – very sparse training and capacity in business management. These problems affect both microfinance providers on the supply side and the target clientele on the demand side. The providers also appear hampered by rigid labor and industrial relations laws. OIBM has made it a priority to develop – and retain – a cadre of Malawian leaders to manage the organization. This continues to be a challenge, especially as new microfinance initiative present trained staff with alternative opportunities.

A further hindrance to productivity and to financial services outreach is spotty infrastructure. Dispersed rural populations are not easily accessible via a paved road system that usually lies several miles from their villages. Utilities and public services are not all widely available. The former, especially electrical capacity, is cited as a key constraint by financial institutions. The latter was not a major complaint in our discussions in Malawi. Yet poor households clearly suffer from the need for better services in terms of both their earning capacity and the drain on their budgets from buying adequate healthcare and education. Financial services infrastructure and telephone service have also been sparse on the ground.

On most of these fronts, the situation is improving. Roads and bank branches are reaching out while the gap in telecoms is being bridged by cell phone and satellite technology. And financial institutions, OIBM particularly, are taking increasing advantage of IT and communications advances to leap over gaps in outreach. In fact, on most comparative indicators of infrastructure and service provision, Malawi is broadly in line with other countries in its region and income level, even if greatly disadvantaged in global terms.

More than this will be needed to overcome the information gap, a constraint that appears at once the most obvious and the ripest for change. Malawi's financial sector continues to operate without any country-wide systems for personal identification, maintenance of credit histories, or tracking of debtors and their transactions. One could scarcely imagine the devastating impact it would have if, hypothetically, an industrial country such as the U.S. were suddenly bereft of these systems. The mental experiment gives perhaps some idea of Malawi's lost potential owing to this constraint.

The alternatives used in practice are many and creative – but also costly, especially for the poor. Personal relationships and reference letters from local chiefs substitute for ID or are used to obtain biometric cards from OIBM and others. Lack of functional credit reference bureaux and asset registries means that lenders have few options to allay the risks of default and fraud. Further, the ineffectiveness of the legal system in bringing discipline to small-scale credit relations (see below) makes alternative approaches necessary. The main options here: use collateral and guarantees amounting to multiples of loan value, advance small amounts against group guarantees, or retreat within a circle of trusting relationships. All of these are costly in different ways.

But there are changes underway that (eventually) will help, including ID and credit bureau legislation. In the near term, the advance of technology increases the alternatives both on the supply side – mobile phone and POS platforms for banking outreach – and on the demand side – real-time information on commodity supply chains and prices. These new mechanisms are not a quick-fix for everything, nor are they yet accessible everywhere, but they do represent positive change.

OIBM's responses to these challenges – coping, innovation, and confrontation – indicate the significance of their impact on efforts to extend microfinance services. At the meso level, OIBM's responses have mainly involved coping and innovation. In other words, some of the constraints appear fixed, while most others have been addressed through new designs and applications of technology.

SUMMARY: MACRO LEVEL

At this level, we have pursued the following questions. What institutions and policies play important roles in the financial and enterprise sectors? How do these enable or disable financial services access for the poor, and in particular, what effects do they have for OIBM and its clients?

As we have suggested, the financial sector has only limited outreach and competition, though it is becoming more dynamic. There are several reasons for this mixed outcome. Greater macroeconomic stability has begun to erode the banks' risk-aversion, although high public debt continues to offer a safe and attractive investment option. Also, while government is relaxing its interest rate controls, spreads are still very high due to deposit rates that remain fixed for now, and to constrained banking competition that has only begun to open up.

Prudential standards may also play a role here, although there appears to be more concern about bankers' rigid mentality than about rules. Thus, for example, reserves remain high although the excessive reserve requirements of the past have been relaxed. Further, land and buildings are almost uniformly required by the banks, often in addition to other guarantees, even though RBM recognizes some forms of commercial loan security other than real estate mortgages. This results partly from weaknesses in Malawi's framework and procedures for secured transactions, and partly from the 'mentality' arising from old habits and perhaps conservative shareholders as well.

Down market, the SACCOs and NGOs are reaching the poor, but not at the necessary scale. The SACCOs have wide outreach and low costs but continue to struggle with the legacy of poor governance in the past. Some of the microfinance NGOs partner with banks, providing access to deposits and other banking services for clients while giving the banks a presence at the low end. OIBM leads the way in combining commercial banking with microfinance. The parastatals, with the former postal bank, Malawi Savings Bank (MSB), have a presence at the low end, but not nearly as robust as state banks and programs had in the past. The consumer lenders are currently digging themselves out of an over-indebtedness crisis and so are not expanding. Last, the informal moneylenders or *katapila* provide the fall-back at the bottom of the pyramid – short-term loans at a flat interest rate of 100%.[108] In the aggregate, there are a diversity of providers but with spotty coverage and with most potential clients lacking access.

Regulatory constraints explain part of this. In addition to reinforcing conservatism in the banking sector (not entirely a bad thing), the regulatory framework as a whole does not currently provide for regulated non-bank

[108] Thus, for example, a person borrowing 1,000 MKw would owe 2,000 MKw, to be repaid in a term that varies from approximately one week to one month.

institutions designed to serve the poor. As a result, a microfinance provider must either obtain a banking license, with its high minimum capital requirements and prudential and operating standards tailored to commercial banking, or forego the possibility of intermediating public deposits. This basically means operating as a cooperative, a consumer finance company, a pawn shop, or an NGO that assists savings and loan groups but does not hold deposits or offer other banking services of its own. The bigger MFIs currently depend on external capital via parent organizations, and their operational scope is accordingly limited. New legislation soon to be enacted will bring both the financial cooperatives and the NGO-MFIs into regulated status, which is expected to strengthen governance and capital, and probably also encourage consolidation.

OIBM, as a licensed bank, is not affected by the lack of microfinance regulation. But in gaining its status as a commercial bank and in pushing forward its microfinance operations, it has run into regulatory obstacles. From the start, it has worked hard to tutor RBM in microfinance and to persuade it to adjust banking standards in such areas as loan write-off, identity documentation, and physical plant and security to allow its operations to go forward.

Other banks have expressed concern about the appearance of special treatment here. It is true that OIBM's well-connected board, the resources of its parent Opportunity International network, and the timely intervention of donors have given it exceptional leeway. But OIBM insists it did not do anything that other banks would not (or could not) have done. Moreover, it has been an active 'reformer' in bringing RBM to understand microfinance better and to accept suitable regulatory approaches – results that appear likely to benefit microfinance providers in Malawi generally.

Governance arrangements beyond the framework of banking regulation are also important for financial services, especially microfinance. Malawi's performance on comparative standards of government effectiveness and corruption is quite negative, though in terms of its region it does well on rule of law and crime control measures. This has an important bearing on banks' willingness to take risks on small enterprises – for example, extending credit based on cash flow or moveable assets. Inefficiencies in the court system make debt enforcement uncertain, just as illiquid secondary markets discourage repossession and resale of collateral.[109]

In response, banks generally hold fast to traditional methods and high-end clients. Meanwhile, down-market lenders such as SACCOs and consumer lenders develop alternative methods to secure repayment out of client revenue streams. But the middle ground of trade credit and basic small business and agricultural finance is extremely sparse.

On the demand side, clients face serious challenges in financing and operating businesses. The governance weaknesses just mentioned, along with high business start-up costs, keep most small enterprise in Malawi informal. Further, the provision and use of microfinance unfolds in a local context fraught with ambiguity and risk. An incomplete transition toward a decentralized system of government with a wider role for elected councils at district and local levels has left a wide terrain open for traditional authorities to take the initiative.

[109] Several interviewees shared the view that creditors could not extract value from repossessed collateral. One could characterize this in terms of rapid depreciation or a thin resale market, resulting in illiquidity.

Chiefs play a key role in approving most of what takes place within their jurisdiction. They are deeply involved in the establishment and operation of local enterprise, land allocation, and the workings of microfinance groups. They are both a help and a control point, providing approvals and reference letters for microfinance projects and clients. They are not subject to any real accountability in practice, and many are said to engage in bribery and self-dealing. As important, the chiefs provide the first line of dispute resolution for most people. Courts are both distant and of dubious effectiveness, and there are no small claims courts or consumer protection bodies accessible to most communities.

Here again, OIBM pursues a mixed strategy of coping, innovation, and confrontation. Its responses to regulatory constraints emphasize confrontation – not in the sense of violent opposition, but in the sense of direct dialogue with policymakers and regulators in order to change conditions. On the other hand, the bank's responses to outreach barriers have stressed innovation, while its approach to weaknesses in public sector governance has followed prevailing patterns of coping.

BACK TO THE GARDEN

In the context of microfinance access, Malawi faces the kinds of challenges in its enabling environment that are largely typical of countries at its level of per capita income and its region. This summation reflects our approach in this study of combining comparative data with contextual research. The comparisons (across countries, similarly situated, in the same region) make it possible to assess how a given type of grant might have had more or less impact across settings with diverse costs, risks, and enabling mechanisms.

The context-specific material fleshes out the picture of what is happening on the ground, offering nuance and avenues of causal explanation that large-scale surveys cannot provide. Our investigation of Malawi's EE not only shows how relevant factors generally impact – whether positively or negatively – the extension of microfinance access to the poor. It also details the interaction of these factors with OIBM's operations, i.e. specific effects and responses.

This picture of enabling factors and interactions is unavoidably complex. Even looking only at elements directly relevant to a cluster of innovations such as OIBM has pursued requires far-reaching analysis of many structures and influences. To depict this wide array of elements in an image of manageable scale and resolution, we return to the metaphor of the gardener with which we began this paper.

The Bill and Melinda Gates Foundation has many potential domains and locations for its endeavors – many gardens each with a different gardener. Providing grants is like furnishing seed. But in order to do this effectively, it is best to understand the soil and the actions of the gardener – in the present context, the "givens" and the enabling steps that societies take to deal with them.

Or, BMGF could deal directly with the gardener. Perhaps the latter is amenable to external aid and influence that could help her become a better steward, resulting in a more flourishing and productive garden. In our current context, this would mean taking on some aspects of the enabling environment more or less directly. Thus, aid donors and foundations provide support for reform, with the idea that other ways of thinking and doing at the government level ('gardening') may be just as important as the innovation grant (the 'seed').[110]

Now, the U.S. Government or the World Bank, to use two examples, can hector developing country governments and even condition aid and trade on the adoption of particular reforms. But here, the recipient government is placed in an agency relationship to the donor. It is in effect being paid to do what it arguably should have been doing all along (but avoided for political or social reasons that may not be apparent from outside).

In contrast, consider the OIBM grant. The bank's overall strategy and goals, if rigorously pursued, demand that it press the government and the central bank to adopt policies that will enable its program to succeed. This indeed appears to be what is happening. In this case, government is the agent not of a foreign donor but of a domestic organization that comprises and serves members of the electorate.

Obviously, the grantee organization represents its own interests, just as any group, firm, or government would do. Now, these interests may be in large part socially conscious or other-regarding rather than selfish, but they really only target one way of tackling the problem at hand. Take the example of Grameen Bank in Bangladesh. When that bank advanced its interests, Bangladesh ended up with a Grameen Bank Law, not a law for all organizations that sought to provide financial services to the poor.

In Malawi, OIBM understandably wishes to consolidate its own competitive position, having both profit and social mission in mind. Thus, it has pressed RBM to adapt its approach to microfinance, but it has not to date been a major presence in the deliberations of financial sector associations. And, it is leery of the potential competition from the licensed MFIs expected to emerge after the new microfinance legislation has passed.

This is not to say there is any organization better placed than OIBM to advance the goals of the microfinance innovation grant – there is not. But perhaps the possibility of diversifying, matching, or coordinating grantmaking within Malawi (and other countries) in order to advance more well-rounded solutions to enabling environment constraints is worth consideration.

[110] Here, we set aside the fact that the gardener in the parable is a divine authority figure who may not appreciate advice.

Annex A- Methodology

The present study uses a qualitative approach, combining desk research, analysis of documents, key informant interviews, and focus group discussions. Field data coding matches the topical organization of the present paper. The whole is informed by the theoretical framework presented in the Concept Note. The research questions and instruments appear below, and our key informants are listed in the Interviewee List.

The main steps in the research are as follows. In the first half of 2009, we compiled a desk study of the microfinance enabling environment in Malawi. That study served as an initial draft of this report and guided our fieldwork in Malawi. Then, during a two week visit in July 2009, we held 22 interviews with key informants in government, the financial sector, private enterprise, donor agencies, NGOs, and associations – mostly in Lilongwe, with some in Blantyre. With the assistance of OIBM, we held 4 focus groups with microfinance groups either in existence or being formed, in the Lilongwe and Dedza areas. In order to follow up with certain interviewees and to contact those whom we were unable to interview, we sent them questions and solicited responses by e-mail.

Enabling Environment Issues and Questions

EE issue: MESO level	Relevance to MF innovation	Questions
State credit provision and 'credit culture'	State programs may weaken repayment discipline.	Do target clientele have access to state programs? What impact for OIBM's costs and risks in rolling out innovation?
Information access	No credit bureau/ register; MFIs must set up substitutes	Where is information constraint strongest for OIBM & clients? Competitors? Estimate the cost of info constraint & coping vis-à-vis an effective system.
Infrastructure	Road conditions & limited ATM, POS, telecom networks constrain outreach, raise costs	To what extent has this constrained competitors and opened a niche for OIBM? How much would improved infrastructure reduce cost/ increase access effects of OIBM outreach?
Identification system	No unique ID numbers, so OIBM uses substitutes – other docs, Malswitch cards	What impact does this have at wholesale and retail level? What overall cost (or reduction of innovation impact) for OIBM & clients vis-à-vis an effective system? What impact of money-laundering legislation?
Public services & social safety nets	Absent adequate insurance, utilities & services, households finance self-provision	Which services and instruments are available to low-income rural communities? What substitutes do households and enterprises self-provide, and what cost/ impact?
Qualified personnel availability	Difficulty and cost of staffing outreach operations	Is this a binding constraint for OIBM outreach efforts? What impact on OIBM and competitors?
Sector organization	MFIs not organized, have little policy influence	Are banking, MFI, or credit union associations having an impact on the EE? What impact on OIBM – does it participate? Impact on competitors?

EE issue: MACRO level	**Relevance to MF innovation**	**Questions**
Macroeconomic management	Inflation & depreciation lower than in past, not as critical	Do these factors continue to affect OIBM, clients, and competitors? How? What methods are used to cope? What cost?
Financial sector outreach & competitiveness	Bank sector downscaling modest, hence pros & cons for OIBM; clients have few options	What impact on OIBM & its innovation – value proposition, effects of outreach program? What would the impact of innovation be in the presence of more a competitive & dynamic banking sector?
Bank operating costs, regulatory burden	Increased cost & inefficiency for OIBM & competitors, but OIBM exempt from some rules	To what extent do these constrain impact/ increase costs of OIBM outreach? What are the specific exemptions, and what impact do they have on OIBM and its competitive advantage?
Payments system and electronic access	OIBM innovation addresses constraint, giving clients alter-natives -- but costly	Estimate by how much this raises costs/ reduces impact of OIBM innovation. If there were no constraint, what would this mean for OIBM value proposition vis-à-vis competitors?
Financial transactions — security & enforcement	Weak systems affect clients & OIBM, raising cost & risk of financing	What are the effects on OIBM and clients at wholesale and retail levels of financing? How much are cost and risk increased? What alternatives are used?
Taxation and import regime	High costs imposed on OIBM & (formal sector) client firms	What are the specific constraints here? Estimate costs for OIBM and clients.
Local government, public order, crime	Weak governance, crime raise cost & risk for OIBM & clients	What are the specific problems here? Which are most important? What costs, competitive effects, and coping mechanisms for OIBM, clients?

Protocol: Semi-Structured Key-Informant Interviews

Malawi EE Study, *Revised* 7-8-09

Interviewees:

Financial sector

- Operational-level people at OIBM
- Officials of MFIs, banks, other institutions involved in small-scale and rural finance
- Representatives of financial sector, microfinance, and credit union networks/ associations

Enterprise sector

- Representatives of business, small enterprise, and farmer networks/ associations

Government and civil society

- Officials of government (national-regional-local) and associations in the impact area.

Introduction:

Thank you for agreeing to speak with us. We are researchers affiliated with the IRIS Center, University of Maryland in the US. Our interview with you is part of a larger project to assess the impact of certain products and activities of OIBM. We will ask some questions about factors ("enabling environment") that may make it easier or harder for institutions such as OIBM to provide services, and for prospective clients to benefit from such services. We are independent of and not hired by OIBM. We will use the information we gather to write a report that will be shared with OIBM and a foundation that works with it (BMGF). But statements will not be identified with any individual interviewee, and our interview records will be kept strictly confidential.

Questions:

Topic	Respondents	Questions
State credit provision and 'credit culture'	All	Do target clientele have access to state credits? Which programs, and on what terms? What repayment rates? To what extent do these credits directly compete with products of MFIs, banks such as OIBM, other FIs? Any impact on these FIs' costs, risks, performance – whether resulting from direct competition or otherwise?
Information access	Financial sector	How do financial institutions – including MFIs, banks such as OIBM, and others – obtain information on the creditworthiness of prospective borrowers? On collateral title and value? What impact does this search for information have, in terms of costs, risk, and credits denied due to lack or costliness of information? Where is this information constraint strongest for OIBM? What substitutes or coping strategies are used when information on creditworthiness is unavailable or costly?
Infrastructure	Financial sector Enterprise sector	Is infrastructure adequate for financial institutions to reach their target clientele? Examples include roads, transport, electricity and other utilities, bank branches and inter-bank communications systems. To what extent has infrastructure enabled or constrained the operations of OIBM? Its competitors? What about enterprises? How much would improved infrastructure reduce the costs or increase the success of these actors?
Identification system	Financial sector	What effects does lack of a national ID system have on the provision of financial services? What alternatives are used? Has this changed due to money-laundering legislation? What overall cost (or reduction of innovation impact) vis-à-vis an effective system – for FIs generally and OIBM particularly?
Public services & social safety nets	Government & civil society	Which services and social programs are available to low-income rural communities? What substitutes do households and enterprises self-provide? At what cost? Do they finance them? What effects does this have on poverty?
Qualified personnel availability	Financial sector	Are qualified personnel readily available for work in FIs? If not, how great is the shortfall? What are the causes? What is the effect of this situation on FIs generally? For OIBM outreach efforts in particular? Where is the constraint most acute? How would activities and costs be different if qualified personnel were readily available?
Sector organization	Financial sector	Are there associations of banks, MFIs, credit unions, or FIs generally? What, if anything, do they do to help improve the enabling environment (EE) for financial services? Do the associations have any influence on the enabling environment? If so, how? If not, why not? What effects does this have for OIBM? Other FIs?
Macroeconomic management	Financial sector	Do macroeconomic factors – e.g. inflation, exchange rates, management of interest rates and money supply – affect OIBM, clients, and competitors? How? What methods are used to cope? What are the costs and other effects? How would this be different if macro policy changed – either for better or for worse?
Financial sector outreach & competitive-ness	All	Is there adequate competition in the financial sector? Adequate outreach to potential clients needing financial services? If not, why not? In these conditions, what are the (likely) net effects of OIBM's innovation on outreach to potential clients? What effects on OIBM's competitors, or FIs generally? Can financial sector reforms create a more competitive and dynamic banking sector in Malawi? Is this feasible? Likely to happen? Realistically, can such reforms have an impact similar to OIBM's programs on financial services access by the poor? Why or why not?
Bank operating costs, regulatory burden	Financial sector	To what extent does the EE – particularly financial services regulation – impose costs that limit FIs' outreach to new low-income clients? How does this affect microfinance, and specifically OIBM? What specific regulatory exemptions were granted to OIBM? What impact do they have on OIBM and its competitive advantage?
Payments system and electronic access	Financial sector	Non-bank FIs do not have direct access to deposits, electronic fund access or transfers, or the payments system. What are the costs and benefits of this for financial services outreach to poorer clients?

Topic	Respondents	Questions
		What would be the effect of removing this constraint? How is this currently changing with new technology and access points? How does this situation affect OIBM's efforts to increase financial services access, either positively (market opportunity for OIBM) or negatively (limited alternatives for clients)?
Financial transactions — security & enforcement	Financial sector Enterprise sector	What are the strengths and weaknesses of Malawi's legal provisions for securing and enforcing debt transactions? Is the system adequate? If not, what are the additional costs and risks as compared to an adequate system? What alternatives are used? What effect does this situation have on financial services outreach to poorer clients? What effects are there at retail and at wholesale levels? What effects are there specifically on OIBM?
Taxation and import regime	Financial sector	What strengths and weaknesses does the tax system have, and what effects on FIs? Do concerns primarily relate to policy (rates, differential treatment across types of FIs and NGO-MFIs) or to administration? What about the regime for importation – e.g. of computer or ATM technology? What are the costs (and benefits?) of this situation for FIs generally, for non-bank providers, and for OIBM specifically?
Local government, public order, crime	All	The quality of local administration, services, and security can be critically important to FIs, households, and enterprises. What are the specific concerns in these areas as they relate to financial services outreach? Which are most important? What are the costs (benefits?) and competitive effects? What coping mechanisms are used by FIs, OIBM, and clients (households and enterprises)?

Protocol: Focus Group Discussions

Malawi EE Study, *Revised* 7-8-09

Interviewees:

Farmers, small/micro-entrepreneurs, and members of low-income households

Introduction:

Thank you all for coming. We are here to learn about how people get access to financial services such as loans and savings accounts, and how they use them. We will be asking you several questions about the services and about things that make it easier or harder to get the services you need and to benefit from them. We do not work for government or for any bank or financial institution. But we will share our findings with people who work in or support microfinance. We will not be taking anyone's name or reporting what any individual says. So, please feel free to be open and truthful. If you have any questions or concerns, please let us know now so that we may address them.

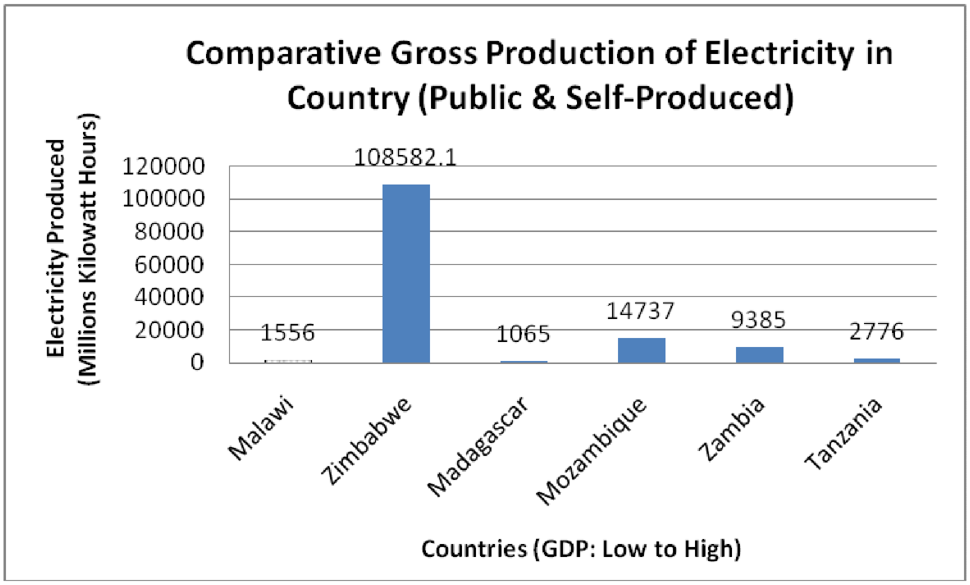
Questions:

Topic	Questions
Financial sector outreach & competitiveness	Where is the nearest bank branch? How long does it take to get there? Does anyone have / Has anyone had: A savings account? *Where?* A loan? *From where?* *Record numbers for each:* A bank? An MFI? Another FI? A credit union? A moneylender? A family member or friend? Other? In each case, how did you apply for and obtain this service? How long did it take? What did it cost? Has anyone tried – without success – to open a savings account or take out a loan? *Where?* Why were you unsuccessful? If you have not tried, why not? *Probe:* Don't want what's on offer? Want something else (What?)? Not appropriate / convenient? Too risky or costly? Does anyone have insurance? Have you sent money to family members elsewhere or received money from them? How, e.g. bank transfer, money order, cash?
Identification system	For those who have tried – successfully or not – to get a ***loan or a savings account***: Were you asked to provide a document showing who you are – an identity card or letter or paper from an authority? *Which one?* Were you able to provide it? What happened? Who has such a document? How did you get it? How long did it take and what did it cost? Why did you need it? How has it helped you? Who has tried – unsuccessfully – to get one? What happened? Why did you need it? Has it been a problem not having one? How?
Financial transactions — security & enforcement	For those who have tried – successfully or not – to get a ***loan***: Were you asked to provide "security," i.e. to pledge your home, your land, livestock, equipment or other goods, crops in the field, trading inventory, or money in an account? Which one and how much? In each case, which kind of lender were you dealing with: A bank? An MFI? Another FI? A credit union? A pawnshop or moneylender? A family member or friend? *Record number of each: type of security, lender.* Were you able to provide the security? Explain. If not, did you find an alternative? What was it? Has anyone obtained a lease – e.g. on a vehicle or piece of equipment? From whom? How long did it take to approve or deny the loan? What did it cost? How much documentation was involved, and did you understand it?

Topic	Questions
	Did the lender say what would happen if you did not repay? Has anyone failed to repay? If so, what happened? If you did get a secured loan or lease, can you compare it to other loans you've had? Did the security / lease help you to get a bigger loan? A better rate? A longer repayment term?
State credit provision and 'credit culture'	Who has access to state credits? Which programs? On what terms – interest rates, repayment period, etc.? How does someone qualify for these credits? *Probe:* Based on need, policy, or political criteria? What are actual repayment expectations? Can someone access these state credits *and also* get a loan from a bank, other FI, NGO, moneylender? Have you or someone you know done so? Which kind of credit is it more important to repay in full? *Ranking: Show of hands for (1) state, (2) financial institution (private), (3) NGO, (4) credit union, (5) moneylender.*
Public services & social safety nets	What kinds of services are available in your community: School? Healthcare (doctor, clinic)? Water tap in or near home? Electricity? Transport, e.g. bus or minibus? Which services does your household use? Where do you access them? Which services are free (are they free for everyone?)? Which do you pay for? If you pay, how much (per month or year)? Have you borrowed money to pay for them? Do you save money to pay for them? Where? If the services are not available, what do you do? Is any kind of assistance to poor or elderly persons available in your community, e.g. pension, food or healthcare benefits, assistance to the unemployed, charity? What about assistance to farmers or small businesses?
Local government, public order, crime	Have you, your household, or your enterprise been affected by crime such as theft or violent attack? What about others that you know? How many instances have you or someone you know experienced in the last year? How well do the local authorities, the government, and the courts do their jobs? Are needs and problems addressed adequately? Promptly? *Probe for examples* – e.g. resolve disputes, collect taxes, provide public services. *Probe:* What experience of incapacity? What about shirking? Corruption? When there are problems in these areas, what do you do? How does it affect you, your household, your enterprise?

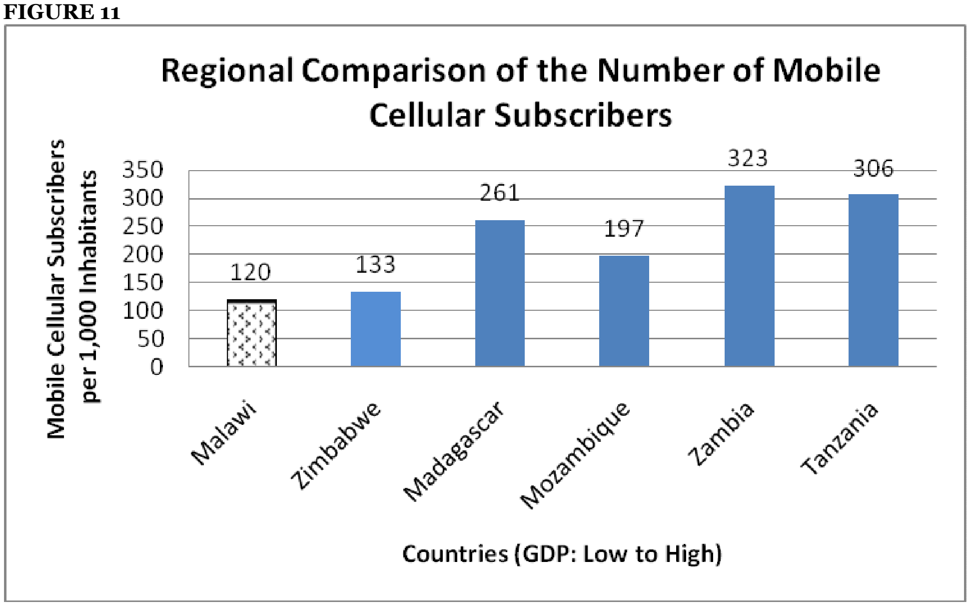
Annex B-Figures:

FIGURE 10



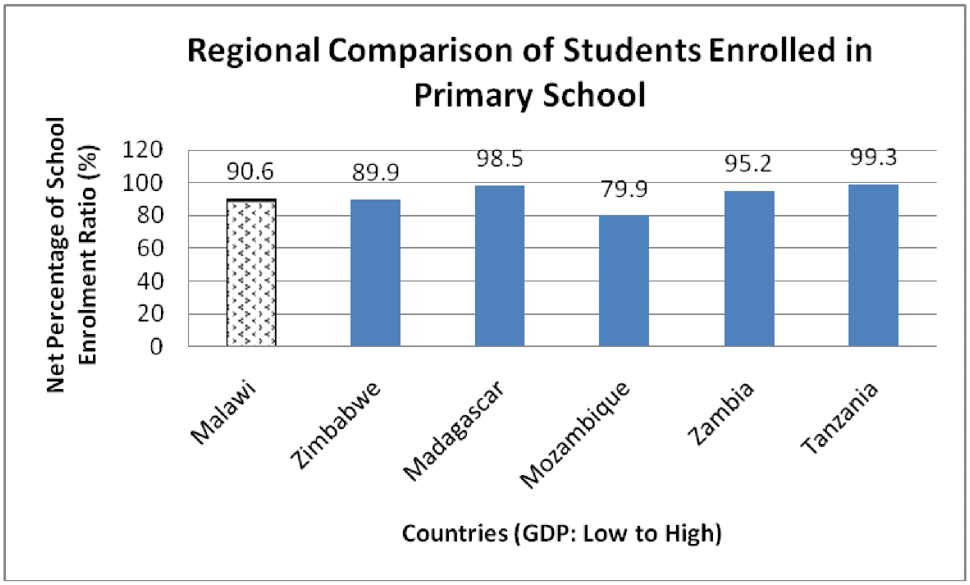
Source: African Development Bank, *African Statistical Yearbook* (2010).

FIGURE 11



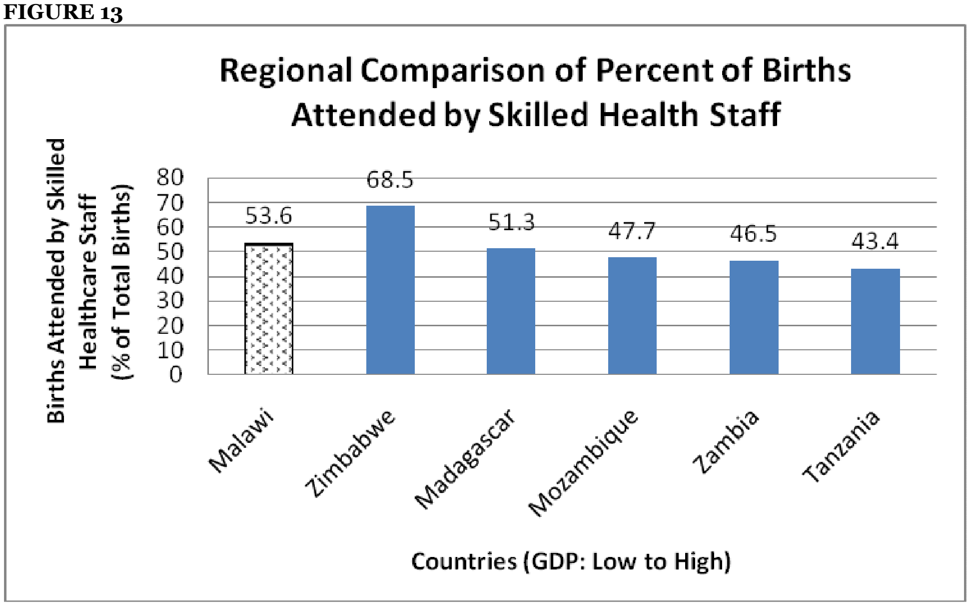
Source : African Development Bank, *African Statistical Yearbook* (2010)

FIGURE 12



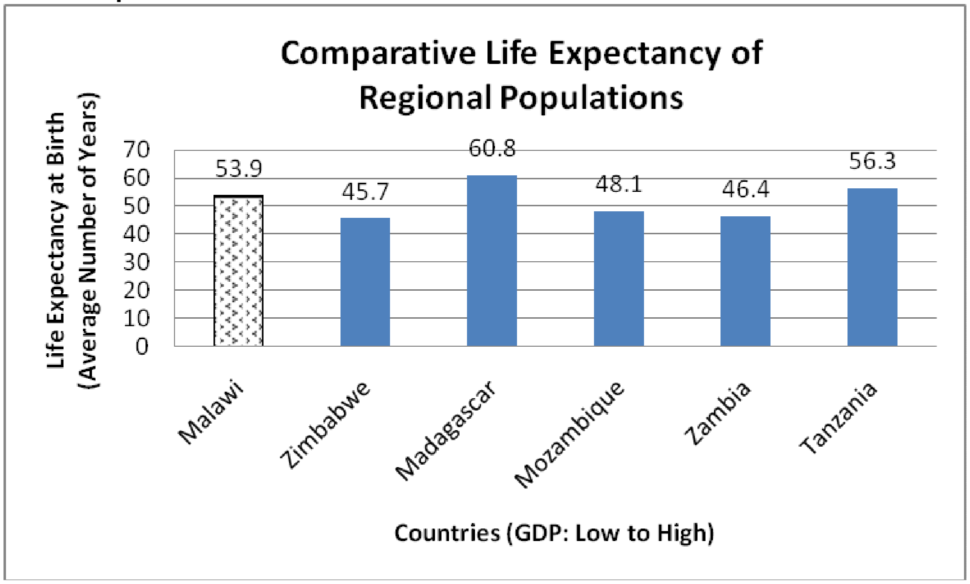
Source: African Development Bank, *African Statistical Yearbook* (2010).

FIGURE 13



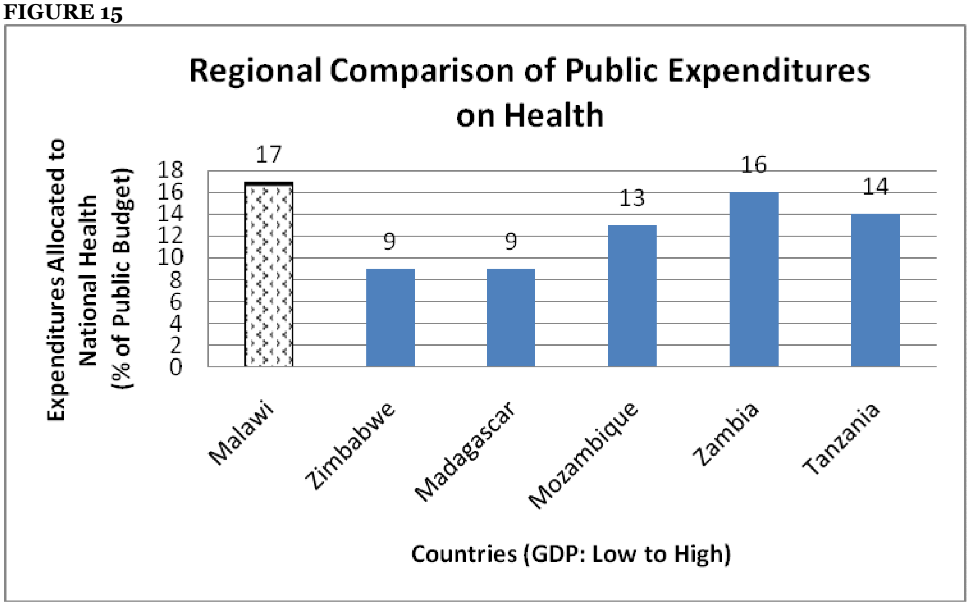
Source: African Development Bank, *African Statistical Yearbook* (2010).

FIGURE 14



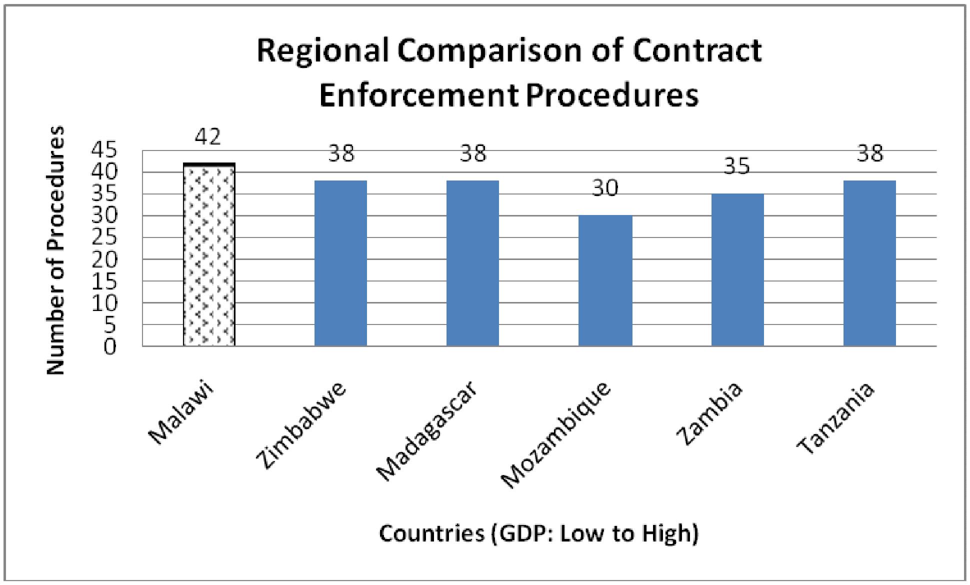
Source: African Development Bank, *African Statistical Yearbook* (2010).

FIGURE 15



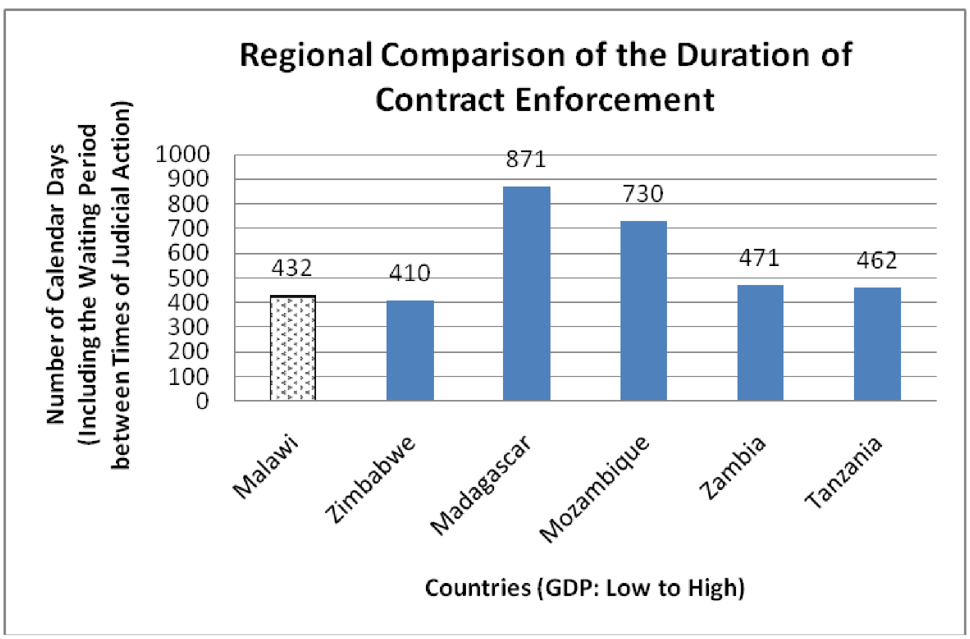
Source: African Development Bank, *African Statistical Yearbook* (2010).

FIGURE 16



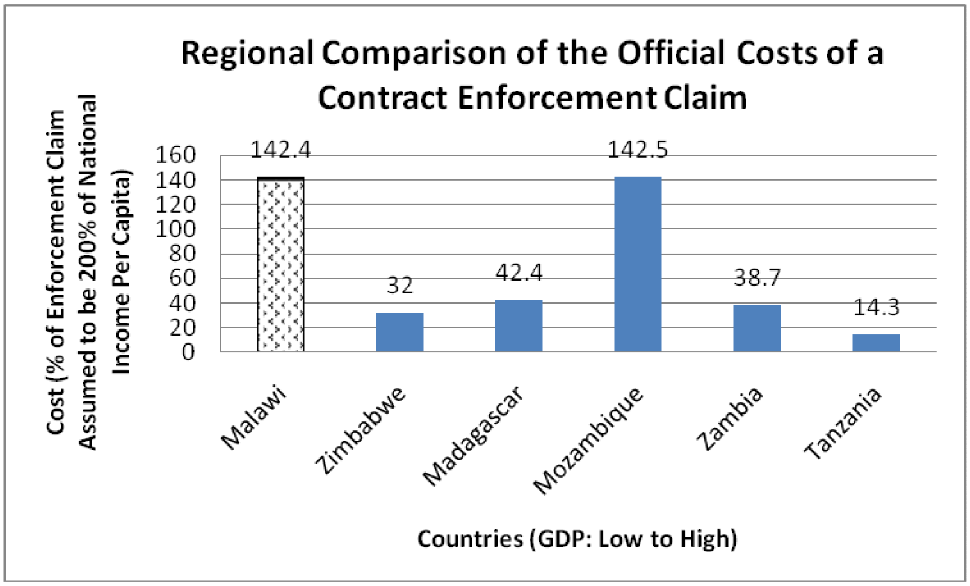
Source: World Bank, *Doing Business 2010* (2009).

FIGURE 17



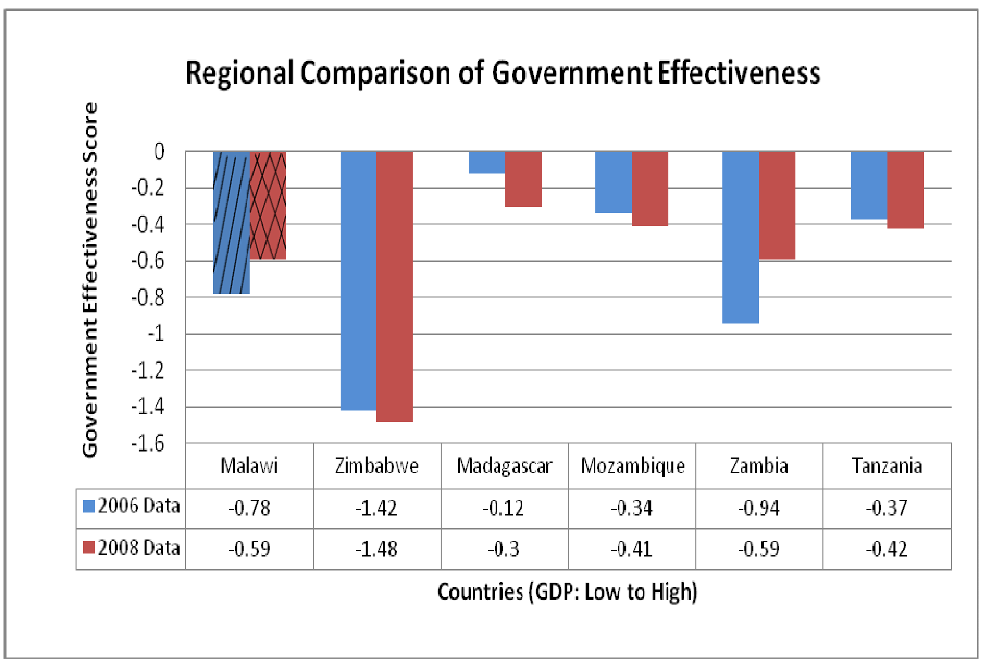
Source: World Bank, *Doing Business 2010* (2009).

FIGURE 18



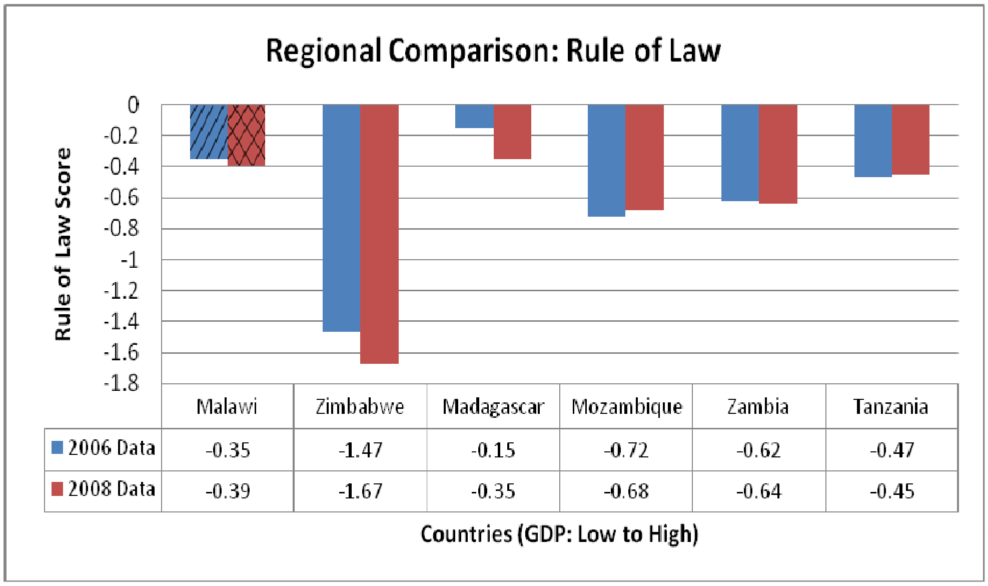
Source: World Bank, *Doing Business 2010* (2009).

FIGURE 19



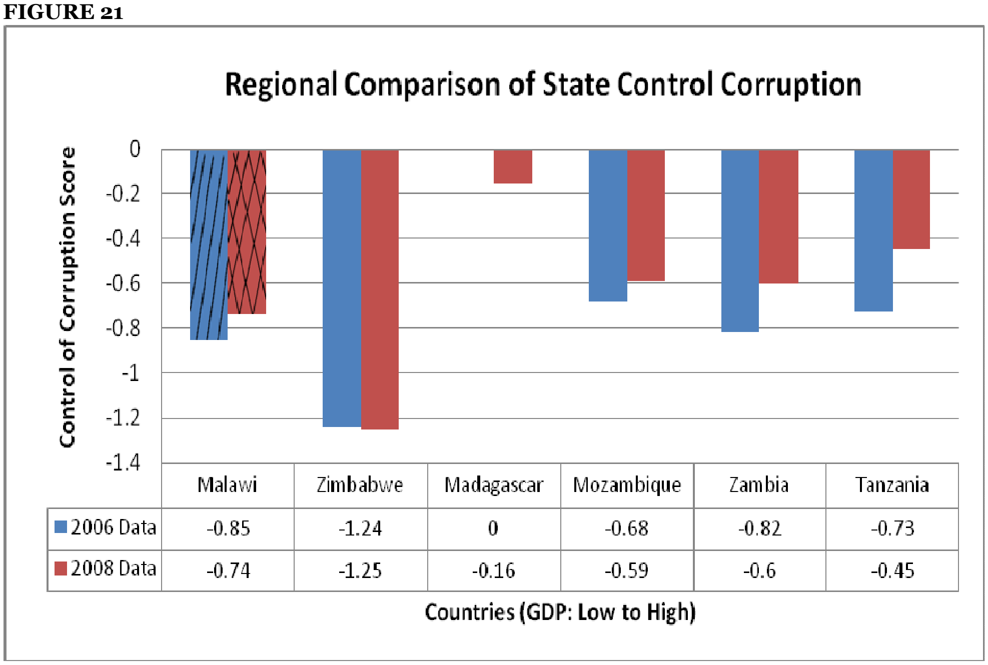
Source: Kaufmann, Kraay, and Mastruzzi, "Governance Matters V: Aggregate and Individual Governance Indicators for 1996-2005" (2006) *World Bank;* Kaufmann, Kraay, and Mastruzzi, "Governance Matters VII: Governance Indicators for 1996-2007" (2008) *World Bank Group.*

FIGURE 20



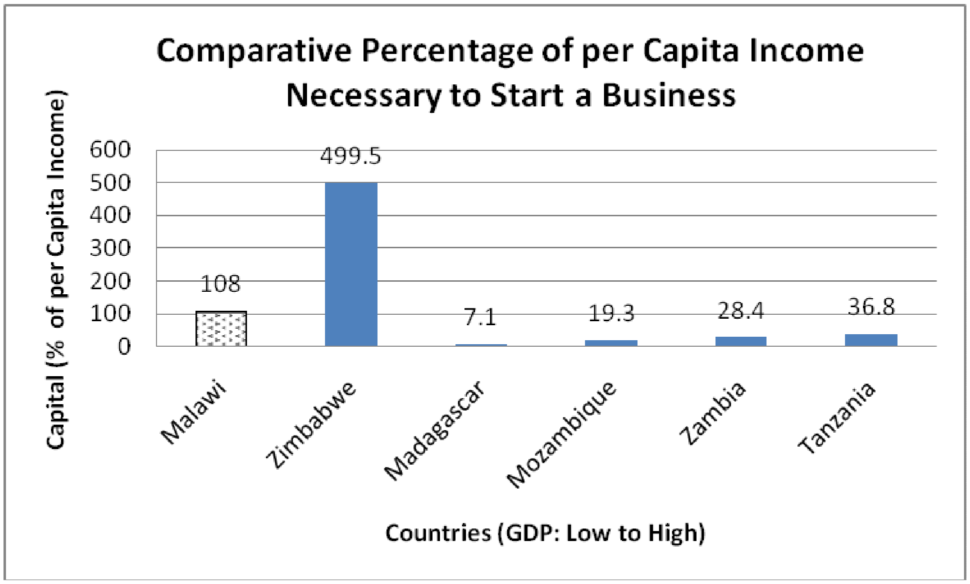
Source: Kaufmann, Kraay, and Mastruzzi, "Governance Matters V: Aggregate and Individual Governance Indicators for 1996-2005" (2006) *World Bank.;* Kaufmann, Kraay, and Mastruzzi, "Governance Matters VII: Governance Indicators for 1996-2007" (2008) *World Bank Group.*

FIGURE 21



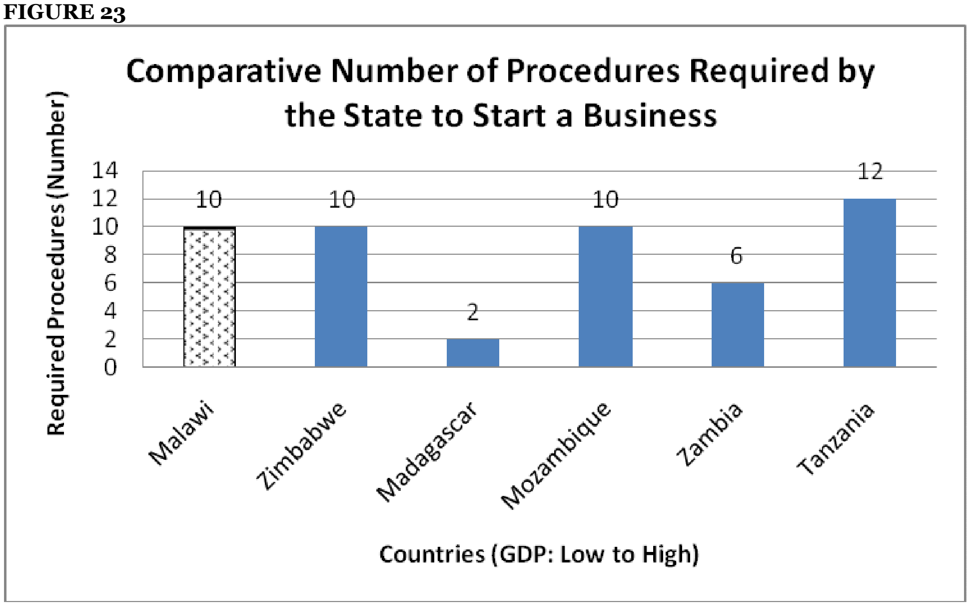
Source: Kaufmann, Kraay, and Mastruzzi, "Governance Matters V: Aggregate and Individual Governance Indicators for 1996-2005" (2006) *World Bank.;* Kaufmann, Kraay, and Mastruzzi, "Governance Matters VII: Governance Indicators for 1996-2007" (2008) *World Bank.*

FIGURE 22



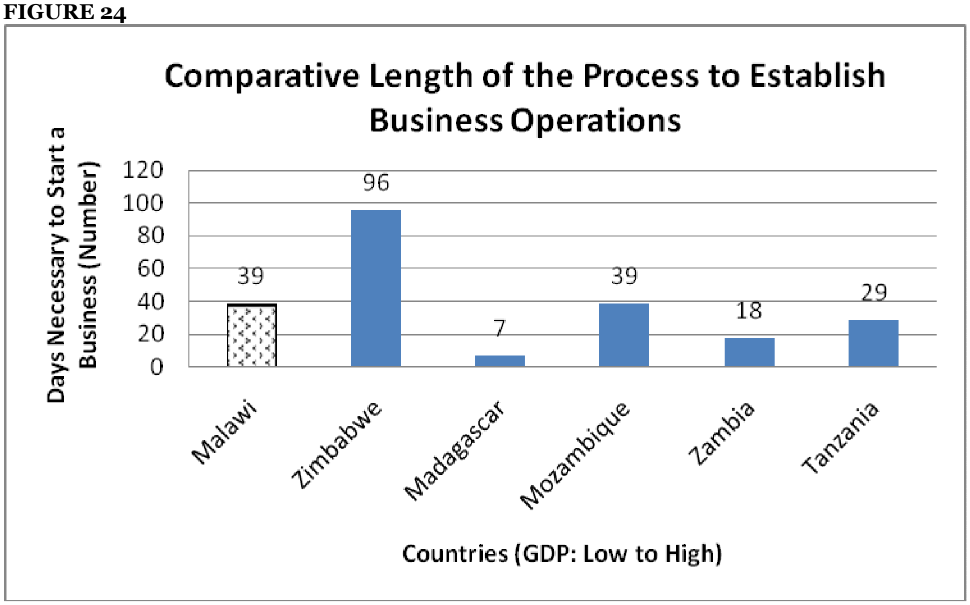
Source: World Bank, *Doing Business 2010* (2009).

FIGURE 23



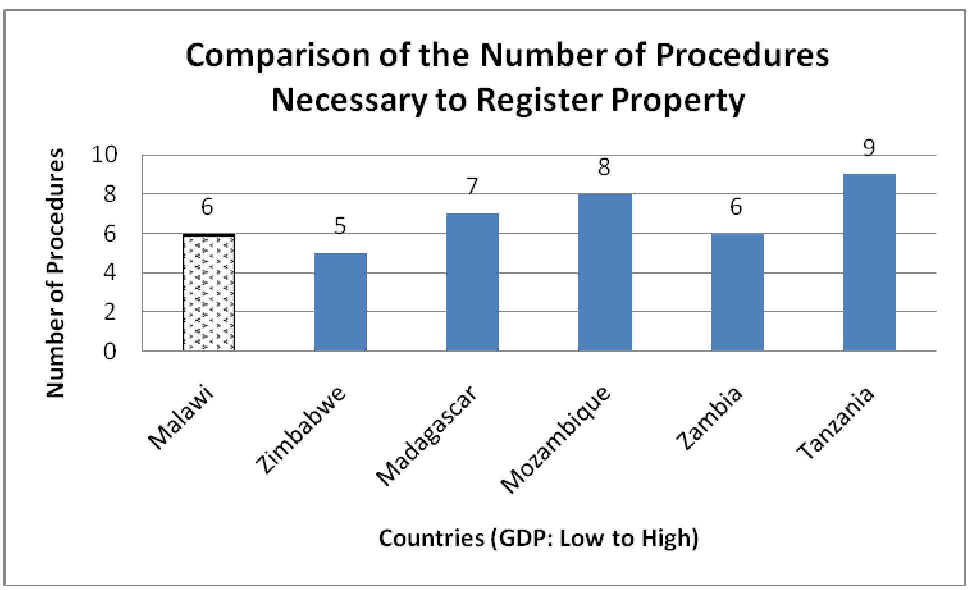
Source: World Bank, *Doing Business 2010* (2009).

FIGURE 24



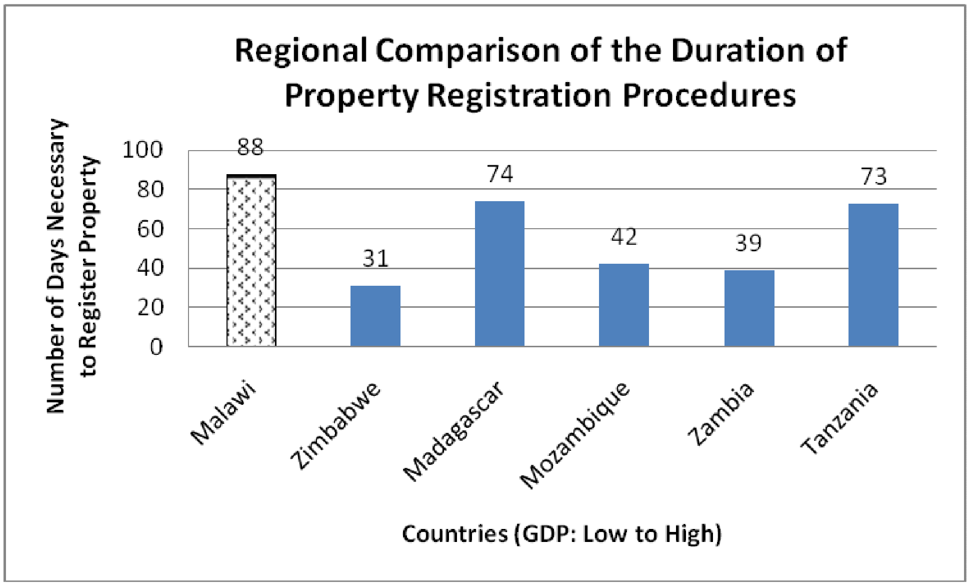
Source: World Bank, *Doing Business 2010* (2009).

FIGURE 25



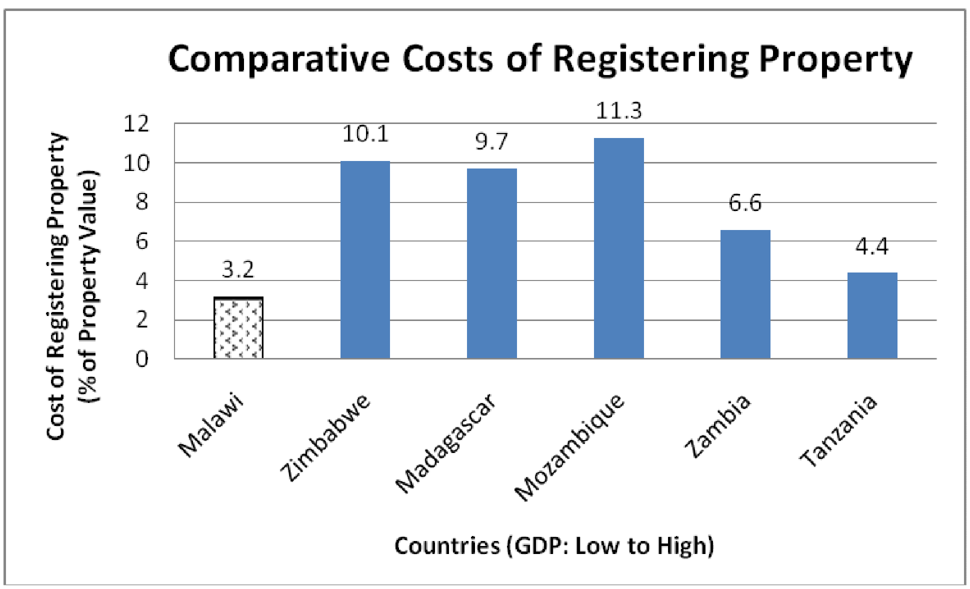
Source: World Bank, *Doing Business 2010* (2009).

FIGURE26



Source: World Bank, *Doing Business 2010* (2009).

FIGURE27



Source: World Bank, *Doing Business 2010* (2009).

List of Interviewees:

1. Matthews G.K. Nyirenda (MARDEF)
2. Allyx Mtengula (MARDEF)
   Ben Wandawanda (Standard Bank)
3. Silas M. Murotho (MRFC)
4. Steven Mgwadira (OIBM)
5. Ephraim Mazizwa (OIBM)
6. Ezekiel Phiri (DMS Project)
7. Teresa Maru-Munlo (DMS Project)
8. Mr. Gwedemula (Department of Planning and Development-District Commissioner's Office, Lilongwe)
9. Mirriam M. Matita (*Gesellschaft für Technische Zusammenarbeit,* German development organization)
10. Joe Mononga (MAMN)
11. Aleksandr-Alain Kalanda (OIBM)
12. Daniel Walusako Ghambi (DEMAT)
13. Lilian Kawaza (New Building Society -- NBS)
14. Mayamiko Kalizang'oma (NBS)
15. George Sibale (Malawi Savings Bank -- MSB)
16. Leroy D. Banda (MUSSCO)
17. Pope Mzumara (Agricultural & Auto Supplies Ltd.)
18. Mussa (TransGlobe)
19. Sam Matemba (Facilitators of Change Intervention-Consultant)
20. Officer (name withheld), Greenwing Financial Service
21. Geoffrey Kumwenda, CARE Malawi
22. Thoko Unyolo, Zain

Focus Groups:

July 23: 7 members of existing OIBM loan group, Lilongwe Area 22
July 23: 7 members of a group seeking OIBM loans, Lilongwe Area 23
July 29: 14 persons seeking OIBM group loans, Ntembwe village, Dedza
July 29: 7 members of existing OIBM loan group, Tete village, Dedza

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