Government of Malawi

MINISTRY OF FINANCE
FINANCIAL SECTOR DEVELOPMENT UNIT
ECONOMIC AFFAIRS DIVISION

The Malawi National Strategy for Financial Inclusion (2010-2014)

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Contents

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The bigger part of Malawi's population still lacks access to basic financial services. As of December 2008, for instance, just slightly less than 9 percent in a population of 12.4 million had access to a safe and secure place to store their savings. And less than percent of the population had access to credit (see Table 1, below), with just 3 percent holding an insurance policy of any kind.

Table 1: Access to Credit in Selected African Countries

Country	Depositors per 1,000 adults	Loans per 1,000 adults	No. of branches per 100,000 adults
S. Africa	788.13	296.94	8.03
Namibia	466.18	355.9	7.25
Botswana	481.38	79.66	6.91
Zambia	293.12	19.43	3.54
Rwanda	201.8	2.37	3.15
Uganda	153.69	20.75	1.94
Malawi	124.07	16.9	1.79
Kenya	296.23	70.42	1.03

Source: CGAP Access 2009

Yet in a list of eight African countries where access to financial services has been analyzed systematically in the last five years—as per the table shown above and immediately below, Malawi would appear not to be as disadvantaged as Kenya as the country with the least number of bank branches per every 100,000 adults. It would also seem to be the country where the second least number of adults per every thousand individuals has loans after Rwanda.

Interestingly, these same facts also indicate that Kenya, which has less number of branches per 100,000

Table 2. State of Financial Exclusion in Malawi versus Neighboring Countries

Country	Formal Bank	Formal - Other	Informal	Financially Excluded
RSA 2008	63%	2%	11%	24%
Namibia 2007	45%	2%	2%	51%
Botswana 2004	44%	5%	5%	46%
Nigeria 2008	21%	2%	24%	53%
Malawi 2008	**19%**	**7%**	**19%**	**55%**
Uganda 2006	18%	3%	17%	62%
Kenya 2006	17%	2%	38%	43%
Zambia 2005	15%	12%	11%	62%
Rwanda 2008	14%	7%	27%	52%
Tanzania 2006	9%	2%	35%	54%

adults than Malawi, has more than twice the number of adults that store their savings with safe and secure intermediaries for a similar number of adults. In another seemingly confounding example, Zambia which has nearly as many depositors per a thousand adults as Kenya has, on one hand, nearly 4 times less the number of adults with loans than the former country. Lastly, drawing from the same Table 1, it would also seem obvious that Botswana which has more bank branches per every 100,000 adults (at nearly seven times more than Kenya) and more depositors (at 481.4) per a thousand adults, should also have more adults with loans. But this is not so.

Clearly, there seem to be other factors at play in determining access to finance in the different countries, other than the mere availability and presence of intermediaries alone. The more obvious and commonly addressed ones to expand access in the region have included affordability, quality of services and convenience or delivery channel. Yet, in many countries the same studies show that there are huge numbers of people who opt not to take advantage of existing financial products and services due to misconceptions, fear or

just ignorance of benefits accrued.

● Avoid consequences of financial

In Malawi, for instance, in terms of the demand for safe and secure places to store savings, about 65 percent of the presently financially excluded adults could have access but do not, i.e., they are not too poor. In addition to this market segment, there is one percent that presently has access but is self-excluded for various reasons, either based on facts or just perceptions (see Figure , below).

Figure 1: Access Frontier for Savings Accounts in Malawi

Source: FinMark Trust, March 2009

And the majority of those not too poor to save but cannot access financial services are either the less educated or households with low levels of financial literacy. As noted by Shawn, Sampson and Zia (2009)2:

> *"… individuals with lower levels of literacy may also have lower levels of education, but less interested in financial matters, be poorer or have different discount rates…"*

Napier (2007) notes that financial literacy enables clients to:

exclusion;

- Be able to identify products that best suit their needs at the best price;
- Be able to know where to get advice or where to complain and on what basis;
- Ensure that consumers understand their responsibilities and obligations, as well as their rights;
- Create a more competitive, innovative and appropriate quality of service provision as consumers exercise choice;
- Enable people to become less dependent on state provision, and;
- Reduce personal and, therefore, societal anxiety.

Indeed, evidence from the just-concluded Micro-finance Sector Assessment Report, recent 2009 FinScope Malawi Demand-side and Supply-side Surveys, the Malawi 2005 Integrated Household Expenditures Survey and a study by Paul Mosley (1998) supports the fact that the most financially excluded households, individuals or informal economic activities in Malawi

are the less educated and poorer group (see Table 3 below).

Table 3: Percentage of Households with Financial Access in Malawi

For instance, the agricultural sector overall contributes 85 percent of total employment, 90 percent of exports and between 35 and 40 percent of GDP. This sector is the key for transforming the country from being a

	Overall Population	Poorest 10% below by income poverty line	
2008			
2005	13	13.1	8.3
1992	12	8	1.9
1998	8.1	5.6	0.9

Source: 2005 Integrated Household Expenditure Survey; Paul Mosley (1998)

Further evidence of regrettable financial exclusion is obvious between urban and rural areas, and between large-scale and smallholder agriculture.

predominantly importing and consuming economy to a predominantly manufacturing and exporting economy. However, of the total financial sector lending, the outstanding loan portfolio channeled to the agricultural sector is estimated to be only 8.5%.

Similar negative discrimination also disproportionately affects the largely rural-based micro- and small-scale economic activities that provide much of the livelihood for the population, and are reportedly responsible for nearly two-thirds of overall business turnover.[1]

[1] The Malawi Growth and Development Strategy (MGDS)

1. Objective and Rationale of an Inclusive Financial System

Government believes that inclusive finance is an essential instrument for increasing agricultural productivity and production, starting or expanding micro and small enterprises, creating employment, increasing household income and smooth consumption, among others. It is also essential for meeting objectives of government's development strategies. Expanding and im-

Development Strategy (FSDS) and other macro-economic and various sectors' policies. Although government should lead the process, the commitment and participation of all stakeholders at all levels (micro, meso, macro and client levels) is a corner-stone for success and for moving the strategy forward. Donors are also important actors in supporting and facilitating the implementation of the national strategy.

proving the quality of financial inclusion is also an important tool for achieving the Millennium Development Goals (MDGs).

The national strategy is a long-term plan of action designed to facilitate the development of financial inclusion in Malawi. It is designed to: (i) establish a shared vision for the sector; (ii) define guiding principles for the development of inclusive finance in Malawi and the support required; (iii) stipulate the core elements needed to promote financial inclusion; (iv) define the role of stakeholders in implementing the strategy; (v) identify the targets and specific results to be achieved within the next five years; (vi) indicate the strategic interventions and action plans; and (vii) coordinate the activities of various sectors during implementation of the strategy.

The national strategy is drafted by key stakeholders themselves through a participatory and consultative process. The strategy is owned by the stakeholders in Malawi who will drive its implementation. The Ministry of Finance will be the lead institution responsible for guiding and monitoring implementation of the strategy.
The National strategy for financial inclusion in Malawi is an elaboration of Pillar II (Financial Inclusion) of the Financial Sector Development Strategy (FSDS). Since inclusive finance is part and parcel of the wider financial sector, the Ministry of Finance will be in a better position to align the national strategy with the Financial Sector

1.1 The Role of Inclusive Finance and Overall National Aspirations

The existence of a stable, liquid, competitive and efficient inclusive financial system in Malawi is one of the preconditions for expanding agricultural production, micro and small enterprise operators, creating employment and increasing household income in a sustainable way. The provision of financial services, particularly to the excluded, would increase income in the wider economy by mobilizing savings and providing loans which can be used to support the creation of small businesses in urban and rural areas. The development of inclusive finance in Malawi can also play an important role in reducing risk and vulnerability, and in increasing the ability of Malawians to access basic services like health and education through financial intermediation, thus having a more direct impact on growth, employment and poverty reduction.

Although investment is important for growth which could be generated through local or foreign savings mobilization, the issue lies on the mechanism of converting savings into investments (collecting and allocating savings). This will depend more on the availability of efficient financial institutions/systems than anything else. Thus, the most important prerequisite for growth and development in Malawi is the existence of a sustainable and vibrant inclusive financial system that converts savings into investments and supports private sector development, agricultural devel-

opment and promotion of exports.
Even though Malawi has a variety of micro-finance service providers, there is a huge unmet demand for financial services and a large percentage of the population in rural and urban areas is still without access to financial services. This is caused by a number of problems at macro, meso, micro and client levels. The problems are aggravated by the ongoing “old paradigm” of subsidized and targeted credit co-existing with the “new paradigm” built on commercial and market-oriented micro-finance institutions. A national strategy for inclusive finance in Malawi

is needed to overcome current limitations against expanding outreach, to create sustainable finance providers, delivery of client-centered and affordable financial services and to fill gaps between demand and supply, particularly in rural areas.

1.2 Overall Assessment and Key Recommendations

Financial services in Malawi are not reaching all those that could make use of them. The FinScope Malawi 2008 survey indicated that more than 65 percent of the people would either start up a new business or invest in an existing business if given the opportunity to access financial services. The study further indicated that 78 percent of the adult population was not able to borrow. If these excluded groups were to be included, the financial sector could increase deposits from MK69,480,960,280 (roughly USD 492,772,767) to MK 203,357,573,299 (USD 1,442,252,292) in one year. The volume of lending could also be expanded by MK65,666,029,245 (or approximately USD 465,716,520). This portion of the population is not being reached because of various challenges at macro, meso, micro/institutions and client levels.

The financial sector in Malawi is made up of two broad categories of operators, namely, commercial banks (which also include discount houses and a leasing company) that are regulated by the Banking Act and non-banks which include insurance companies and related players, micro-finance institutions and savings and credit cooperative societies. Outreach by banks and non-banks into rural areas as well as suburbs still remains limited. There is need for the players in the market to develop strategies for reaching out the excluded. The banking and micro-finance sectors together had 1,727,123 saving accounts (13 percent of the country's population) as of 31 December, 2008. The accounts held by both banking and micro-finance sectors represented a total deposit portfolio of MK133,876,612,948 (USD949,479,524) and a total loan portfolio of MK90,000,789,381 (approximately USD638,303,471). The insurance sector's outreach represents only 2.1 percent of GDP.

The provision of financial services, particularly to the excluded, would increase income in the in the wider economy.

The delivery of financial services in Malawi has been directed to sectors that do not drive economic growth and has not promoted productive activities. Lending to the agricultural

A large percentage of the population in rural and urban areas is still without access to financial services

sector has been declining because of high production and marketing risks as well as weak marketing arrangements that do not guarantee the lender control over sales proceeds. Mobilization of savings and improvement of access to credit have been limited by the following factors:

(i) the absence of a regulatory framework,
(ii) Very limited capacity of the regulators,
(iii) A weak legal/court system to enforce contracts, and
(iv) The absence of a national identification system.

Key challenges for expanding inclusive finance in Malawi include the lack of loan capital, limited institutional capacity of inclusive finance providers, absence of demand-driven and client-centered financial products, limited use of ICT to improve Management Information Systems (MSIs) and expand front-office technologies, very weak meso-level support, lack of financial literacy interventions and very limited non-financial support to build the capacity of clients.

Addressing the key challenges of expanding inclusive finance in Malawi requires a deliberate effort to build the capacity of the key players at macro, meso, micro and client levels. The national strategy for financial inclusion is, therefore, an indispensable instrument in helping government, finance providers, technical service providers, donors and other key stakeholders to guide the development and expansion of inclusive finance sector in Malawi.

2. Defining inclusive finance in Malawi's context

Inclusive finance is broadly defined as access to a range of quality financial services such as credit, savings, insurance and payment systems and remittances, provided by diverse financial service providers (banks, micro-finance banks, deposit-taking micro-finance institutions [MFIs] non-deposit-taking MFIs, financial cooperatives, NGOs, etc) by those who are excluded or denied financial access (particularly low-income people) to the mainstream financial system. It should be noted that financial inclusion does not only refer to increasing the number of people who access financial services but also refers to improvements in quality of financial services extended. Quality here refers to:

(i) Affordability (costs such as interest, fees and commissions);
(ii) Appropriateness or product fit (new product development and improving the existing features of the product so that the clients'

special needs are met);

(iii) Convenience (proximity, loan processing time, etc); and

(iv) The provision of financial services with dignity (customer care, consumer protection, etc). In the Malawian context, inclusive finance is part and parcel of the financial sector.

The agricultural sector overall contributes 85 percent of Malawi's total employment

3. The Vision

Consistent with the Malawi Growth and Development Strategy (MGDS) which focuses on transforming the country from being a predominantly importing and consuming economy to a predominantly manufacturing and exporting economy, inclusive finance will have the vision of achieving economic empowerment of Malawians who are excluded or have no financial access from the mainstream formal financial system. To this end, inclusive finance will create opportunities to generate wealth by increasing agricultural production and productivity, reducing vulnerability, ensuring food security, enhancing new and existing business activities (private sector development), increasing the supply of goods, promoting competition, attracting investors, generating employment and increasing income for low-income households in rural and urban areas and aligning inclusive finance with the wider financial sector development as well as other macroeconomic and higher-level sector strategies/policies.

Inclusive finance will create opportunities to generate wealth by increasing agricultural production and productivity

4. The Objective(s)

The specific objectives of the national strategy include reaching out to low-income groups with a wide range of financial services

The overall objective of the national strategy is to develop an inclusive financial system in Malawi within the next five years (2010-2014) and align it with the wider financial sector development strategy and other development pro-

outreach of quality financial services offered by diverse providers to low income people, mainly those involved in production activities;

(ii) Increasing the financial and investment capacity of the private sector in urban and rural areas;

(iii) Creating sustainable finance programs and policies of government. The strategy on financial inclusiveness is an elaboration of Pillar II of the Financial Sector Development Strategy. It will focus on improving the delivery of quality and diverse financial services to the excluded by emphasizing sustainability, accessibility and affordability of financial services. The specific objectives of the national strategy include:

(i) Facilitation and expansion of the viders which are involved in real financial intermediation;

(iv) Promoting innovation in the financial sector;

(v) Supporting the meso level infrastructure;

(vi) Creating an enabling policy and regulatory environment at macro level; and

(vii) Educating society on financial services, money management (removing knowledge barriers) and client protection.

5. Target Groups

The national strategy broadly targets low income people in Malawi who are excluded from the mainstream formal financial system, namely, smallholder farmers engaged in production, processing and marketing of agricultural products; micro, small and medium enterprise operators; women; the youth; the self-employed and disadvantaged groups in rural and urban areas.

6. Specific Targets of the National Strategy

Designing the national strategy for inclusive finance in Malawi starts by setting specific targets that need to be met in five years. Once consensus is reached on the key targets by stakeholders, annual strategic interventions, indicators and the role of key players at macro, meso, micro and client levels are identified accordingly. The specific targets of the national strategy are as follows:

(i) Provide loans to 3.4 million Malawians by the end of 2014;

(ii) Increase the loan portfolio of inclusive finance providers by 88,714 million Kwacha in 2014;

(iii) Increase the volume of savings mobilized to a level of 676,910 million Kwacha (1.44 billion US$) by the end of 2014;

(iv) Support the existing inclusive finance providers to increase outreach and establish 10 new (two each year) inclusive finance providers;

(v) Support savings mobilization and transform five credit-only MFIs into deposit -taking inclusive finance providers;

(vi) Establish two cooperative banks;

(vii) Increase the number of women clients in the sector to a level of 60 percent;

(viii) Eliminate exclusion by improving access to inclusive financial services to the disadvantaged groups; and

(ix) Provide financial literacy education to all.

7. Guiding Principles for the Strategy

Instead of re-inventing the wheel, the Malawian national strategy for inclusive finance would benefit from existing experiences within the country and the rest of the world. Thus, the national strategy will be guided by internationally accepted inclusive finance guiding principles and paradigms which will give direction to those seeking to enter market and/or those already operating in the sector. These include:

(i) Clear distinction and separation of charity (welfare policy) from finance, ensuring that financial discipline is in place in the sector;

(ii) The need for increasing outreach to provide financial services to larger numbers of poor households;

(iii) Striking an appropriate balance between the social and economic (financial) objectives of inclusive finance providers;

(iv) The use of market-based pricing (avoiding subsidized interest rates) which can also promote savings mobilization, foster competition and reduce barriers to entry and exit. Sustainable inclusive finance providers should cover their full cost from the interest income they collect and, to this end, microfinance providers need to separate responsibilities of financial services from non-financial obligations;

(v) Setting in place an appropriate regulatory and supervisory framework to ensure effective oversight on the activities of inclusive finance providers, adoption of best practices and stability of the financial system;

(vi) Building institutional and managerial capacity of inclusive finance providers;

(vii) Mobilizing loan capital for inclusive

As at December 2008, less than 9 percent of Malawians had access to a safe and secure place to store their savings

accessible, flexible and affordable and responding to the needs of the excluded;

(ix) Developing transparent governance, management, accounting, internal control and information systems;

(x) Aligning inclusive finance with the wider financial sector development strategy;

(xi) Securing the independence of inclusive finance providers from political interference;

(xii) Limiting the role of government mainly to creation of an enabling environment that facilitates inclusive finance and pursuing policies that create incentives for greater private sector participation in the financial market;

(xiii) Adherence to performance standards by measuring outreach, productivity, efficiency, sustainability and portfolio quality of inclusive finance providers; and

(xiv)Agreeing/adhering to internationfinance providers through savings mobilization, commercial funding (national and international commercial lending), donor funding, equity, etc;

(viii) Developing innovative financial products that are convenient,

ally accepted principles developed by CGAP (the Consultative Group to Assist the Poor) and its 28 member donors, and further endorsed by the Group of Eight leaders at the G8 Summit on 10 June 2004 (See annex 1).

8. Specific Strategies to Implement the Objectives and Meet the Targets

In order to realize the vision and objective of the strategy, specific interventions and actions are needed at four tiers, namely, the macro, the meso/institution, the micro and the client levels.

8.1 The Macro Level

Develop enabling policies, strategies, legal and regulatory systems, and infrastructure conducive to deliver quality finance, mobilize savings, expand outreach and promote innovations. The strategic interventions at macro level include:

8.1.2 Creating Enabling Policies/Strategies and Legal System

The success of the national strategy for inclusive finance in Malawi is largely dependent on aligning it with the wider financial sector development policy and macro and sectoral policies/strategies of government. The inclusive finance strategy needs to be integrated with strategies that foster private investment in agriculture and small and micro enterprises. There is a dire need to improve the legal and court system to enforce contracts. Designing a legal framework and registry that would allow the use of movable and non-movable properties as collateral will assist finance providers to deliver loans using individual lending methodologies. Moreover, once the issue of title deeds for land is addressed, it will be much easier to use land as collateral.

8.1.3 Establishing a Functional Regulatory Framework

There are a number of initiatives in the pipeline for improving the regulatory framework in Malawi. Currently there are draft bills awaiting enactment by Parliament. These include the Financial Service Bill, the Banking Bill, the Insurance Bill, the Micro-finance Bill, the Credit Reference Malawi Bill, the Retirement Funds Bill, the Companies Bill, the Bankruptcy Bill, and the Payments, Clearing and Settlement Bill. In the short-run, the intervention is to enact the pending bills. However, having the draft bills enacted by Parliament is not an end in itself. There is need to build the capacity of the regulators and key actors in government to properly implement the laws. Building the capacity of the regulators in the RBM is a priority which should be implemented even before enacting the micro-finance and financial cooperative bills.

8.1.4 Building the Infrastructure

Finance providers fail to expand their rural network mainly due to poor physical infrastructure. Improving roads, warehouse infrastructure, electricity, telecommunications, the national ID system and security infrastructure is associated with reducing the cost of transacting business (lower interest rates and fees) for finance providers. Thus, intervention of government and donors in improving the physical infrastructure will have a positive impact on the expansion of inclusive finance in Malawi.

8.2 The Meso-level

Developing a supportive meso-level infrastructure that accords inclusive finance providers with the required human, financial and information resources is a strategic intervention of the national strategy. The infrastructure enables the providers to come up with quality financial services for the excluded.

The meso-level support includes:

8.2.1 Strengthening the Micro-finance Network of Malawi (MAMN)

Although very young, MAMN has been struggling to provide value adding services to members and key ence Bureau Bill, the Financial Co-operative Bill, the Reserve Bank of

stakeholders in the micro-finance sector. The network needs to be

There is a dire need to improve the legal and court system to enforce contracts

supported by members, government, donors and others in order to build the capacity of inclusive finance providers through training and technical assistance; creating an enabling policy environment through fact-based advocacy; conducting studies to understand the challenges of the sector; discussing and disseminating results of its research activities; knowledge management and disseminating best practices; and monitoring and appraising the performance of inclusive finance providers in Malawi. This support is a prerequisite to ensuring the sustainability of MAMN.

8.2.2 Establishing a Credit Reference Bureau (CRB)

The establishment of a CRB will improve the quality of credit delivery and reduce loan default rates. The bureau will also be a useful tool for increasing outreach and efficiency of micro-finance providers. Establishing a CRB will require conducting a detailed study to assess institutional and legal challenges, management and governance issues and identification of an institution where the bureau should be housed. There is need to support the current initiative by banks of establishing a CRB in Malawi and extending its services to all inclusive finance providers.

8.2.3 Establishing a Micro-finance Training and Research Center within the Country

Improving efficiency and expanding outreach of micro-finance providers depends on the building of the human resource capacity of the sector. Given the lack of micro-finance training providers in the country, the University of Malawi should take the lead by establishing a micro-finance center. Apart from providing training, the center will also be engaged in promotion of and research in inclusive finance. There is also need to support other training providers, including those from the private sector. However, eligibility for support of the training providers will need to be on competitive basis.

8.2.4 Promoting Linkages between Commercial Banks and Micro-finance Providers

The ability of the inclusive providers in Malawi to expand operations over the coming five years also depends on their access to commercial loans (domestic loans and other sources of capital). However, inclusive providers must demonstrate their credit worthiness to banks. Although the strategy recognizes the importance of wholesale funds for inclusive finance providers to expand their outreach, linking inclusive finance providers with banks helps the bankers to channel part of their liquidity to the microfinance sector. Banks also benefit by outsourcing some of the more difficult micro-lending components of their programs to microfinance providers whilst leading to greater coverage of the target groups. To this end, banks in Malawi should have the regulatory space (i.e., capacity to lend to institutions with non-collateralized portfolios without being penalized) to refinance microfinance providers and individuals without property collateral and third party guarantees.

8.2.5 Strengthening FIMA and/or Establishing an Autonomous Apex for Wholesale Lending and Capacity Building for Finance Providers

Supporting the establishment of an apex organization could serve as an appropriate channel in enhancing access to loan capital and credit guarantee mechanisms through government, donor and the other development partners. The apex can also serve as an independent institution to build the capacity of stakeholders at macro and micro level. Eligibility to access loan capital, credit guarantee fund and capacity building support from the apex will require adherence to minimum agreed performance criteria, reporting and achievement of acceptable rating. The criteria set by the apex should be based on international best practices. This will assist in building confidence and increasing levels of government and donor funds channeled through this apex. However, implementing the standardized criteria and verifying of reports will require a database and a regular performance reporting system (industry performance and benchmarks). Currently, FIMA is providing limited institutional capacity building and loan funds to those micro-finance and technical service providers which meet certain criteria. FIMA, funded by UNCDF, UNDP, Cord Aid and the Government Malawi, could be transformed to serve as an autonomous apex body by expanding its current activities. However, this will require a comprehensive study that reviews best practices, proposes the right type of governance, institutional set-up systems and the entire transformation process.

8.2.6 Assist Other Support Service Providers

Government, donors and other development partners should work together in building the capacity of and the market for technical service providers who will offer specialized services in the fields of training, consultancy, accountancy, auditing, management information system development and business development services (BDS). Although micro-finance providers are expected to specialize in the delivery of sustainable financial services, there is need to coordinate and integrate their activities with BDS providers to micro, small and medium enterprise operators. The strategy should give due emphasis and support to the capacity building of non-financial service providers.

8.3 The Micro/Institution Level

The support to institutions delivering quality financial services to

Malawians in rural and urban areas is the core strategic intervention of the national strategy. The specific strategic interventions in the next five years include:

8.3.1 Building Managerial and Institutional Capacity to Increase the Outreach of Inclusive Finance Providers

Managerial and institutional capacity building include the provision of training and education to staff (including the board of directors) of inclusive finance providers and developing systems, procedures and effective governance structures in the institutions. This also includes enhancing mobility, improving the management information system (MIS) and supporting acquisition of appropriate equipment. The capacity building support at micro level should be institution-specific. The institutional and managerial capacity building support to government-owned finance providers should focus on the transformation processes which make them autonomous and financially sustainable. There is also need to transform some of the credit-only finance providers into deposit-taking MFIs. Moreover, special emphasis should be given to inclusive finance providers reaching more excluded and inaccessible target people and in the development of special services and products for the excluded population.

8.3.2 Building the Financial Capacity of Inclusive Finance Providers

Compared with the supply side, there is huge demand for loans in Malawi. In the short-run, since the micro-finance providers cannot mobilize savings to on-lend to clients, there is need for institutional, operational and/or technological solutions to help the providers with loan capital. However, this should not discourage savings mobilization and distort financial markets. The loan capital that is made available for all inclusive finance providers should also meet specific eligibility criteria, tied to performance and outreach.

8.3.3 Developing New Products and Improving the Existing Financial Services

Capacity building for developing quality financial products that respond to client needs of households (particularly for the excluded) by giving due focus to loans, savings, insurance, payment systems and remittance products is a key intervention package. There is need to build the capacity of the financial institutions to design and deliver financial products to the excluded. Inclusive finance providers should use innovative approaches such as value-chain financing and warehouse receipts systems to provide financial services to smallholder farmers and those engaged in productive activities in rural areas. The support on product development should focus on four products:

(i) Loan products: These products include financial services for diverse activities in both rural and urban areas. The loan products will address the working and investment capital needed by clients and should match with the financial needs of smallholder farmers, micro and small enterprise operators, the youth, women and disadvantaged groups such as those living with HIV and AIDs. The market for loans includes agricultural and micro-enterprise activities focusing on productive areas, housing loans and consumption loans.

(ii) Saving products: These products help in developing the savings culture of clients and allow finance providers to generate resources for on-lending and be involved in real financial intermediation. Savings products should be accessible in terms of proximity, attractive in terms of pricing, safe and secure, simple in features and convenient (provided with good customer service).

(iii) Micro-insurance: The poor or excluded are able to utilize financial services such as loans when basic household risks are mitigated. In Malawi, where more than 85% live on agriculture, production and market risks are very high. There is, therefore, need to develop appropriate micro-insurance products such as crop insurance, livestock insurance, deposit insurance, credit life insurance or asset insurance to protect both the clients and the finance providers. A lot of civic education will be necessary to motivate the rural masses to purchase insurance products.

(iv) Payment Systems and Remittances: The aim of this product is to reduce the physical handling and labor costs associated with an ever-expanding volume of paper money, cheques, deposit slips and the like, as well as to provide increased convenience and service to the public. Some of the more advanced payment mechanisms have been due to technological advances including ATM machines, cash cards, debit cards, point-of-sale terminals, mobile phones and home banking over the internet. The other technology-related innovations include direct deposit and direct bill payment schemes.

There is need to offer incentives to inclusive finance providers involved in piloting new innovations. One of the interventions would be the creation of an innovation fund to promote new products, systems and approaches which are aimed at including the excluded. Institutions and individuals at various levels should access this fund on a competitive basis.

8.3.4 Optimal Use of Back and Front Office Technology Platforms

The use of ICT reduces the cost of delivering financial services to clients and brings banking and micro-finance services to new clients in remote areas which were previously beyond the practical reach of traditional financial channels. Malawi has several pioneers experimenting with technology-based financial products or approaches. The strategy should support the following interventions to scale up similar pilots:

(i) Developing the appropriate infrastructure for taking advantage of technological advances;

(ii) Implementing efficient organization of payment systems through inter-technology inter-operability;

(iii) Promoting branchless banking (deliver financial services by mobile phones and point-of-sales terminals) to substantially reduce transportation and transaction costs;

(iv) Promoting affordable card-based payment instruments (smart, debit and credit cards); and

(v) Developing the right regulatory framework to promote technology-based financial products.

8.3.5 Promote Competition in the Sector

The micro-finance sector in Malawi is young and there are very limited finance providers competing in the market. Lack of competition has a negative impact customer service and prices (for example, interest rates) charged by the finance providers. There is, therefore, need to attract and increase the number of finance providers by providing incentives and building their financial and managerial capacity.

8.3.6 At the Client Level

On top of financial access, there are a number of non-financial support services required by the excluded

(people with low income), which strengthen financial knowledge, technical skills, business and financial skills or client protection.

The key interventions at client level

include:

(i) Development of Financial Literacy

This intervention would involve a series of capacity building activities focused at increasing knowledge of financial concepts, skills and attitudes amongst the poor and translating this knowledge into behaviors that result in good financial outcomes for finance providers and users of inclusive financial services. Financial literacy has a primary objective of providing knowledge and skills to manage financial resources effectively (money management skills). There is a dire need to educate Malawians on developing a saving culture, management of finances (savings and loans), management of cash-flow or management of relations with lenders. Such education needs to involve regulators such as the Reserve Bank of Malawi, MUSCCO, MAMN, the finance providers themselves, the Ministry of Education, Science and Technology and/or the media.

(ii) Client Protection

Client protection should be a mandatory activity for all stakeholders. It is a very useful instrument for promoting greater transparency and appropriate use of financial services. The inclusive finance providers should avoid over-indebtedness of clients through multiple loans from multiple sources; have transparent pricing, appropriate collection practices, ethical staff behavior, proper mechanisms for addressing client grievances and maintain confidentiality of client information.

(iii) The Integration with other Programs

There is need to educate Malawians on developing a savings culture

The provision of technical training and business development services through complementary programs is a critical intervention in building the capacity of the clients. Although finance providers are expected to specialize in delivering financial services to their clients, there is need to align and integrate their activities with other development strategies/programs that focus on the building of the capacity of the clients.

9. The Role of Government

The Government of Malawi is an enabler and facilitator that creates the right environment and incentives for inclusive finance. It creates a favorable or friendly macro-economic environment and a suitable or reasonable legal, regulatory and infrastructural development framework in support of the operations of inclusive finance providers. Government has to support the development of sustainable inclusive finance providers, meso-level players and clients. The Ministry of Finance should be the leading institution to monitor the implementation of the national strategy. A specific unit under the ministry needs to be established to oversee and support the development of inclusive finance in the country. The Government of Malawi is currently the largest provider of microfinance services and has a relatively good presence in rural areas. However, there is need to transform the government-owned finance providers (companies and state-owned financial service providers) into financially-sustainable institutions. Government can provide capacity building support instead of "subsidizing" interest rates which distort financial markets. Government can also provide fiscal incentives to those meeting the eligibility criteria. This could stimulate the emergence of new finance providers in excluded or remote areas.

Finance providers fail to expand to rural areas mainly due to poor physical structures, including roads

10. The Role of Development Partners and Other Donor Agencies

Donors have an essential role to play in inclusive finance development in Malawi, but this role needs to adapt itself to the evolution of the sector and to the implementation of the National Strategy for Inclusive Finance. Donors are expected to have common principles, coordinated activities (and preferably cooperate on joint funding) and to have clear exit and back-up strategies. Donors need to focus on building the capacity of the stakeholders at macro, meso, micro and client levels; promoting best practices and facilitating networking with the rest of the world. Building the internal capacity of donors to support inclusive finance is also a critical intervention. Donors should shift from the support of microfinance through credit components and targeted lending (piece by piece funding) towards a coordinated approach of building the inclusive financial system in the entire country with focus on improving access for the out rightly ignored, neglected or poorly served and those requiring much social and economic assistance.

SACCOs are a major vehicle for developing a savings culture in Malawi

11. Implementation Arrangements, Monitoring and Mitigation of Apparent Risks

11.1 Implementing and Monitoring the National Strategy

The implementation and monitoring of the national strategy for inclusive finance in Malawi depends on the commitment and capacity of all stakeholders, particularly government. Regular interactions and exchange of information among stakeholders is essential for proper implementation of the action plan. All stakeholders and the core team steering committee or taskforce, with the support of FIMA, should take the lead in monitoring and evaluating progress and measuring the impact of the national strategy. However, it will be the responsibility of the Ministry of Finance to oversee and monitor the implementation of

volved in innovative activities.

11.2.2 Inappropriate Micro-finance Methodologies: Failure to adopt sound best practices and methodologies can affect institutional sustainability and outreach of inclusive finance providers.

11.2.3 Unnecessary Government and Donor Interventions: Swarming the micro-finance sector with a multiplicity of subsidized micro-credit schemes may likely contaminate portfolios of financial markets. Furthermore, they exploitation or misuse of micro-finance by the public sector and, specifically the political-class, to buy votes will undermine performance and the strategy.

11.2 Apparent Risks in Implementing the National Strategy
Stakeholders in the inclusive financial system should identify and manage potential risks and ensure that measures are taken to minimize the negative impact of such risks. The major risk areas that affect the development of inclusive finance in Malawi in the next five years include:

11.2.1 Macro-economic Instability: An unstable macro-economic environment such as very high inflation and low input prices can adversely affect the development of inclusive finance in Malawi. On the other hand, if treasury bills yield very high profit, the finance providers, particularly banks, may not have interest in getting into the difficult venture of mobilizing savings and taking the risk of lending to the excluded and those in-outreach. Inclusive finance operators should, therefore, be independent in the governance and management of their operations.

11.2.4 Production and Price Risk: Since a significant part of the loan portfolio of Malawian micro-finance providers is lent for rural enterprises, there is a high risk for a covariant risk caused by recurrent drought. Moreover, the fluctuation of agricultural output and input prices may affect portfolio quality, lowering otherwise excellent loan repayment rates by those who need sustainable services the most, and ultimately undermine the sustainability of the inclusive finance providers.

11.2.5 HIV and AIDS: If the magnitude of the disease is not decreasing it could quickly reverse most of the gains made by finance providers and adversely affect the performance of the entire sector.

12. Action Plan to Implement the National Strategy

The strategy, which is the basis for sound growth of inclusive finance in Malawi, should be accompanied by an action plan that specifies responsibilities assigned to relevant stakeholders (for instance the RBM, the Ministry of Finance, donors, finance providers, technical service providers, etc) with timeframes for each activity identified (See tables 4-7).

Table 4: Proposed Macro Level Action Plan

Objective	Action/activity	Responsible entities		Priority*	Time frame*
		Primary	Secondary		
Coordination of implementation of the national strategy	• Official endorsement of the national strategy and action plan	MOF	RBM	H	S
	• Establishment of a unit under the Ministry of Finance to oversee implementation of the national strategy	MOF	RBM	H	S
	• Discussion of the strategy in various forums, including public awareness	MAMN, FIMA	FIMA	H	S

	campaigns				
	● Monitoring of the implementation of the national strategy	MOF, RBM, MAMN		H	S,M and L
Create the necessary policies and legal framework	● Enactment of the micro-finance bill and the financial cooperative bills	Parliament	MOF, RBM	H	S
	● Revision of the other bills	MOF, RBM MAMN, finance providers		L	L
	● Alignment of the national strategy with other policies/ strategies	MOF, RBM	MOTI, Others	H	S,M and L
Establishing a functional regulatory body	● Establishment of a fully operational specialized unit or department to regulate, supervise	RBM		H	S

Table 4: Proposed Macro Level Action Plan (cont'd)

Objective	Action/activity	Responsible entities		Priority*	Time frame*
		Primary	Secondary		
	inclusive finance under RBM				
	● Building of the capacity of the supervision unit or department	RBM		H	S, M
Building infrastructure	● Building infrastructure, including the introduction of national IDs and improving the security	Government organs other than MOF and RBM	Other government institutions	M	S,M and L

Note: *H=High; M=Medium; and S= Small
**S= Short-term; M=Medium-term; and L=Long-term

Table 5: Proposed Meso Level Action Plan

Objective	Action/activity	Responsible entities		Priority*	Time frame*
		Primary	Secondary		
Support and strengthen MAMN	● Organizing regular technical national and regional workshops	MAMN, Members	FIMA, donors	H	S,M and L
	● Promoting data sharing among inclusive finance providers	MAMN, RBM	FIMA	H	S,M and L
	● Advocating inclusive finance countrywide	MAMN, Members	FIMA, MOF	H	S,M and L
	● Organizing experience sharing visits for all relevant staff of inclusive finance providers	MAMN, FIMA	Donors	H	S
	● Establishing agreed performance indicators and monitor the financial performance of the inclusive finance providers	MAMN, Members,	FIMA, Donors	H	S
	● Promoting services of the inclusive finance sector by using media and others	MAMN, Members	Media, MOF donors, RBM	H	S,M
	● Providing technical assistance and other	MAMN, FIMA	Donors	H	S,M

support				
●Networking with regional and global networks	MAMN, FIMA		M	S,M
●Covering the initial establishment and overhead costs	Donors, FIMA	MOF	H	S
●Enhancing the mobility of the network staff	Donors	MOF	H	S
●Providing logistical support	Donors	Members, FIMA	M	S

Table 5: Proposed Meso Level Action Plan (cont'd)

Objective	Action/activity	Responsible entities		Priority*	Time frame*
		Primary	Secondary		
Establish a Credit Reference Bureau (CRB)	●Conducting feasibility study to establish the CRB	FIMA	MOF, RBM	H	S
	●Establishing database and update regularly	Members	MAMN	H	S,M
	●Covering initial establishment and overhead costs	Donors, MOF, Members		H	S
Promote linkages between commercial banks and MFIs	●Building bankers' awareness on commercial viability of inclusive finance providers	Banker's Association, MAMN		M	S,M
	●Introducing rating of inclusive finance providers to build the confidence of banks	Members	Donors	M	S,M
	●Initiating credit guarantee schemes	MOF, MAMN, Donors		M	S,M
Establish Micro-finance Center under Malawi University	●Conducting a training needs assessment study	FIMA/ University of Malawi	Donors	H	S
	●Providing appropriate technical and skills training	University of Malawi		M	S,M and L

• Conducting and coordinating research activities	University of Malawi	Donors, MAMN	M	S,M and L
• Publishing and disseminating research results	University of Malawi	MAMN	M	S,M and L
• Covering the initial establishment and overhead costs	Donors, FIMA	University of Malawi	H	S

Table 5: Proposed Meso Level Action Plan (cont'd)

Objective	Action/activity	Responsible entities		Priority*	Time frame*
		Primary	Secondary		
Strengthen FIMA and/or establish a completely autonomous apex, taking into account all benefits and costs of each model	• Conducting a feasibility study to establish the apex	FIMA, donors	MOF	H	S
	• Establishing functional and autonomous apex	MOF, donors, FIMA		H	S
	• Assessing the performance of inclusive finance providers	Apex MFIs	MOF, RBM	H	S
	• Establishing clear criteria in accessing funds	Apex, MFIs	MOF,RBM	H	S
	• Delivering loans and capacity building to the stakeholders	Apex, MFIs		H	S,M and L
Assist other technical service providers	• Providing capacity building to auditors, accounting firms, etc	MAMN, donors	FIMA	H	S
	• Supporting business service providers	MAMN, FIMA	MOTI	H	S,M and L

Note: *H=High; M=Medium; and S= Small
**S= Short-term; M=Medium-term; and L=Long-term

Table 6: Proposed Micro or Institutional Action Plan

Objective	Action/activity	Responsible entities Primary	Secondary	Priority*	Time frame*
Institutional and managerial capacity building	● Conducting the training needs assessment	FIMA, MAMN	Donors	H	S
	● Training and re-training all staff of finance providers	FIMA, University of Malawi, Others	MAMN, MFIs, Donors	H	S,M and L
	● Conducting exposure visits to learn from best practices	FIMA, Donors Technical service providers	MAMN FIMA, Donors	H	S
	● Developing systems and procedures based on best practices	Technical service providers	Donors, FIMA	H	S,M
	● Developing Management Information Systems (MIS)	FIMA, MOF	Donors	H	S,M
	● Enhancing the mobility of microfinance providers	FIMA, RBM	Donors	H	S,M
	● Transforming successful credit-only MFIs into deposit-taking MFIs	MFIs	Donors	H	S,M and L
	● Mobilizing and sensitizing communities			H	S,M and L
Building the financial capacity of inclusive finance providers	● Developing savings products and mobilizing savings for on-lending	FIMA, RBM, MFIs	Donors	H	S,M
	● Developing credit guarantee scheme and link with banks	FIMA, donors, banks	MAMN	H	S,M
	● Attracting social investors and others as equity investors	FIMA, MOF, MFIs	MAMN	H	S,M and L

Table 6: Proposed Micro or Institutional Action Plan (cont'd)

Objective	Action/activity	Responsible entities		Priority*	Time frame*
		Primary	Secondary		
Product development	● Conducting a study to identify strengths and weaknesses of existing financial products	FIMA, donors, MFIs		H	S
	● Providing training in market research and product development by involving MicroSave Consulting Limited, School of Micro-finance (SAM or MicroSave India)	FIMA, donors, technical service providers	MAMN	H	S
	● Expanding, strengthening FIMA and adding an innovative fund to encourage new products that meet needs of the excluded	FIMA, donors, MOF		M	S,M
	● Piloting new and innovative financial products	FIMA, donors, MFIs	Donors, MOF	H	S,M
	● Refining existing products and scaling up the successful pilots	MFIs		H	S,M
Promote IT-based products	● Developing a roster of best practices in front and back office technology platform	MFIs, Technical service providers	Donors, MAMN	H	S
	● Allocating funding to inclusive finance providers for identifying and securing cost effective IT	FIMA, donors, MFIs, Technical service providers, MOF		M	S,M
Promote competition in the sector	● Building the capacity of inclusive finance providers	FIMA, MOF, donors	MAMN	H	S,M and L
	● Providing incentives to encourage new entrants	RBM, MOF, donors		H	S,M and L
	● Using market approach to increase competition	MOF	RBM	H	S,M and L

Table 7: Client Level Action Plan

Objective	Action/activity	Responsible entities		Priority*	Time frame*
		Primary	Secondary		
Financial literacy	● Conducting baseline study on financial literacy	FIMA, MOF, RBM, donors	MAMN	H	S
	● Developing strategy for financial literacy	FIMA, RBM, Technical service providers	MAMN, Donors	H	S
	● Establishing a national financial literacy network	MFIs, MOF, RBM and other stakeholders	MAMN	H	S
	● Developing tools and training manual	Technical service providers	MOF, Donors	H	S,M and L
	● Providing training	Technical service providers	Donors, MOF	H	S
	● Delivering financial education	Different stakeholders		H	S,M and L
Client protection	● Conducting baseline study on consumer protection	FIMA, MOF, donors, RBM	MAMN	H	S
	● Developing and enacting consumer bill of rights	MOF, FIMA, RBM	MAMN	M	M
	● Establishing a national consumer protection network	MFIs, RBM, all stakeholders	MAMN	H	S
	● Developing tools and training manuals	Technical service providers	Donors, MOF	H	S
	● Providing training	Technical service providers		H	S,M
	● Conducting public sensitization campaign	Different stakeholders		H	S,M and L

Table 7: Client Level Action Plan (cont'd)

Objective	Action/activity	Responsible entities		Priority*	Time frame*
		Primary	Secondary		
Integration and alignment with other programs	● Developing systems of alignment and integration	MOF, FIMA, MAMN		H	S
	● Conducting regular meetings among finance providers and relevant development partners	MOF, Development partners		H	S,M and L

Note: *H=High; M=Medium; and S= Small **S= Short-term; M=Medium-term; and L=Long-term

Annex 1: CGAP Key Principles of Micro-finance

The Consultative Group to Assist the Poor (CGAP) is a consortium of 28 public and private development agencies working together to expand access to financial services for the poor, referred to as micro-finance. The following principles were developed and endorsed by CGAP and its 28 member donors, and further endorsed by the Group of Eight leaders at their Summit on 10 June 2004.

1. **Poor people need a variety of financial services, not just loans**. Like everyone else, the poor need a range of financial services that are convenient, flexible and affordable. Depending on circumstances, the poor want not only loans, but also savings, insurance, and cash transfer services.

2. **Micro-finance is a powerful tool to fight poverty**. When poor people have access to financial services, they can earn more, build their assets and cushion themselves against external shocks. Poor households use micro-finance to move from everyday survival to planning for the future. They invest in improved nutrition, housing, health, and education.

3. **Micro-finance means building financial systems that serve the poor.** In most developing countries poor people are the majority of the population, yet they are the least likely to be served by banks. Micro-finance is often seen as a marginal sector "development" activity that donors, governments or social investors might care about, but not as part of the country's mainstream financial system. However, micro-finance will reach the maximum number of poor clients only when it is integrated into the financial sector.

4. **Micro-finance can pay for itself and must do so if it is to reach a very large number of poor people**. Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs. Cost recovery is not an end in itself. Rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. A financially sustainable institution can continue and expand its services over the long term. Achieving sustainability means lowering transaction costs, offering services that are more useful to the clients and finding new ways to reach more of the unbanked poor.

5. **Micro-finance is about building permanent local financial institutions**. Finance for the poor requires sound domestic financial institutions that provide services on a permanent basis. These institutions need to attract domestic savings, recycle those savings into loans and provide other services. As local institutions and capital markets mature, there will be less dependence on funding from donors and governments, including government development banks.

6. **Micro-credit is not always the answer. It is not the best tool for everyone or every situation**. Destitute and hungry people with no income or means of repayment need other kinds of support before they can make good use of loans. In many cases, other tools will alleviate poverty better, for instance, small grants, employment and training programs or infrastructure improvements. Where possible, such services should be supplemented with building savings.

7. **Interest rate ceilings hurt poor people by making it harder for them to get credit.** It costs much more to make many small loans than a few large loans. Unless micro-lenders charge

interest rates that are well above average bank loan rates, they cannot cover their costs. Their growth will be limited by the scarce and uncertain supply of soft money

a track record of success when designing and implementing projects. The donors should set clear performance targets that must be met before funding is continued.

from donors or governments. When governments regulate interest rates, they usually set them at levels so low that micro-credit cannot cover its costs, so such regulation should be avoided. At the same time, a micro-lender should not use high interest rates to make borrowers cover the cost of its own inefficiency.

8. **The role of government is to enable financial services, not to provide them directly**. National governments should set policies that stimulate financial services for poor people at the same time as protecting deposits. Governments need to maintain macro-economic stability, avoid interest rate caps and refrain from distorting markets with subsidized high-default loan programs that cannot be sustained. Governments should also clamp down on corruption and improve the environment for micro-businesses, including access to markets and infrastructure. In special cases where other funds are unavailable, government funding may be warranted for sound and independent micro-finance institutions.

9. **Donor funds should complement private capital, not compete with it.** Donors provide grants, loans and equity for micro-finance. Such support should be temporary. It should be used to build the capacity of micro-finance providers to develop supporting infrastructure like rating agencies, credit bureaus, and audit capacity and to support experimentation. In some cases, serving sparse or difficult-to-reach populations can require longer term donor support. Donors should try to integrate micro-finance with the rest of the financial system. They should use experts with Every project should have a realistic plan for reaching a point where the donors' support is no longer needed.

10. **The key bottleneck is the shortage of strong institutions and managers.** Micro-finance is a specialized field that combines banking with social goals. Skills and systems need to be built at all levels: managers and information systems of micro-finance institutions, central banks that regulate microfinance, other government agencies and donors. Public and private investment in micro-finance should focus on building this capacity, not just moving money.

11. **Micro-finance works best when it measures and discloses its performance.** Accurate, standardized performance information is imperative, both financial information (e.g. interest rates, loan payment and cost recovery) and social information (e.g. number of clients reached and their poverty level). Donors, investors, banking supervisors and customers need this information to judge their cost, risk and return.

Annex 2: National Micro-finance Policy

Republic of Malawi
NATIONAL MICRO-FINANCE POLICY

Ministry of Industry, Trade and Private Sector Development

institutions. Thus, the sector has been unable to satisfy the demand of these entrepreneurs. The alternative is informal sources of finance, which everywhere tends to be limited in supply, with high costs and risks.

Micro-finance is a relatively new phenomenon in reaching the poor with financial services and Malawi is

November 2006

1. INTRODUCTION

1.1 The Need for Micro-finance

Poverty in Malawi is widespread with an estimated 65 percent of the population living below the poverty line, earning less than one dollar-a-day, according to the Malawi Integrated Household Survey report of 2004/2005. There is great need, therefore, to put into place mechanisms that can reduce or eradicate poverty in the country. One way of doing this is to promote income-generation and employment creation among the poor, while facilitating asset ownership and risk mitigation. Increased access to credit, savings opportunities and other financial services will play a crucial role in meeting this objective.

In Malawi, access to credit, savings opportunities and other financial services remains one of the major constraints to enterprise development and poverty reduction. This is very clear in the case of micro-enterprises which form the vast majority of small-scale businesses and, in particular, those owned by women. The formal financial sector has not served these enterprises because they usually lack traditional collateral guarantees. Also, the cost of delivering credit and savings services to them is relatively high and the small-scale market is unfamiliar to most formal financial just coming onto the scene. In 1997, at the first National Forum on Micro-finance held in Mangochi, Malawi adopted micro-finance as the way forward to increasing access to credit, savings opportunities and other financial services by low-income clients. Malawi formulated and adopted its first National Micro-finance Policy in 2002 and this is a revision of the same.

1.2 Malawian Efforts To-date

Malawi has formally recognized the potentially important contribution of micro-finance to poverty reduction. The Malawi Growth and Development Strategy (MGDS) identifies micro-finance as a key tool for poverty reduction. Vision 2020 recognises the importance of accelerating enterprise development as a strategy for attaining fair and equitable distribution of income and wealth. Specifically, one of the strategies is to make a wide range of credit products accessible to all levels of the population through a variety of lending institutions. Earlier, the government's Policy Framework for the Poverty Alleviation Programme, developed in 1995, called for "*the improvement of access to credit facilities by deepening and broadening the financial sector to assist the poor to diversify their sources of income.*"

To-date, Malawi has carried out these aims largely by means of targeted micro-credit provision. Both government and the private sector in the form of non-governmental

organizations, trusts, financial cooperatives and companies have provided and continue to provide micro-credit to the poor. Special credit programs and schemes have also been implemented, usually with donor support.

The strengths and weaknesses of these programs should be recognized. Most have had some positive impact on the lives of the recipients in terms of increased food consumption, self-employment, savings, access to other basic necessities need for a policy and regulatory framework within which all players operate to ensure sustainability and increased outreach.

1.4 Definition of Micro-finance

"Micro-finance" refers to the provision of financial services to lower-income people, especially the poor and very poor, who are generally denied access to the formal financial system. Thus, micro-finance is understood in an expansive sense, including not only micro-credit but also savings, money transfers, micro-and business expansion. Women who have accessed these schemes have been empowered, while increased income has enabled recipients to have greater control over their lives. However, these gains have come at a high cost, since governmental and donor-supported credit programs are inevitably limited in their reach and efficiency. The priority now is to ensure a deep, broad, dynamic and well-regulated market for all micro-finance services, including not only credit but savings and other financial service facilities as well.

1.3 The Way Forward

World-wide experience shows that, in order for micro-finance programmes to achieve sustainability on a large enough scale, it needs to be treated as a business activity rather than a purely social initiative. This means government and its cooperating partners shall foremost strive to encourage private sector provision of micro-finance and commercial capital investment in the sector by favouring a market-based supply of micro-finance services in all its forms. It is imperative to have an environment that encourages the adoption of universally-acknowledged best practices by those involved in providing these services. This further strengthens the leasing and insurance services. The range of micro-finance institutions (MFIs) goes beyond NGOs and includes commercial banks, state-owned development banks, savings and credit cooperatives (SACCOs) and a variety of other licensed and unlicensed non-bank institutions. Micro-finance clients include the whole range of low-income clients who use financial services to support their businesses, manage emergencies, acquire household assets, improve their homes, improve consumption and fund social obligations.

1.5 Objectives of the Policy

The *vision* of this policy is to bring about a dynamic and inclusive financial sector that provides a full range of micro-finance services to low-income people. This will help create wealth and employment while alleviating poverty in Malawi. The key *objective* of this policy is to create an *inclusive* financial services sector. Specifically, this means ensuring the provision of services including micro-finance *on a sustainable basis* and *following best practices* to the majority of households and entrepreneurs who need financial services but have been unable obtain them through conventional means.

“Best practices” are norms and operating modes derived from the

experience of micro-finance sectors around the world that have been able to achieve significant outreach to the poor on a sustainable basis. “Sustainability” means covering operating costs and moving towards full financial sustainability, in which earnings cover all costs including the cost of capital. The scope of best practices encompasses the activities of MFIs and other providers, micro-finance associations, apex groups, government policy-makers and regulators.

This policy aims to achieve “inclusion” by *broadening and deepening financial services outreach.* Stakeholders – including policy-makers and actors in the micro-

2. STRATEGY

The objectives of this policy will be achieved by all stakeholders pursuing a shared strategy. This strategy consists of the following:

(i) Implementing this policy through reforms: This means creating an enabling legal and regulatory environment as well as overall economic policies conducive to the sound and sustainable development of micro-finance;

(ii) Improving the capacity of relevant actors at all levels, including “micro” (provider), “meso” (associations, apexes, market infrastructure) and “macro” (policy and regulatory) levels. Key actors include the Reserve Bank of Malawi, the Ministry of Industry, Trade and Private Sector finance sector – will endeavor to ensure the extension of services to under-served regions and communities, such as the estimated 80 percent of Malawi's population living in rural areas. Another high priority is to reach the most vulnerable populations, including the very poor, women, the youth, the physically challenged and those affected by HIV and AIDS.

This policy will guide the development of the legal-regulatory framework, public infrastructure, sectoral capacities and practices necessary for micro-finance to reach its full potential in Malawi. Stakeholders are assigned different roles in carrying this out. Government shall focus on measures that ensure sound and efficient market-based development, while using persuasion and non-distorting incentives as needed to ensure the extension of service to the underserved and the vulnerable. The primary responsibility for strengthening micro-finance capacities and practices lies with the MFIs and associative bodies making up the sector.

Development, the Ministry of Finance and Economic Planning, the Malawi Micro-finance Network (MAMN) and the Insurance Association of Malawi;

(iii) Promoting best practices at all levels of the micro-finance sector – including sound MFI governance and operations, as well as increased co-ordination at the meso and macro levels on such matters as policy, standard-setting and supervision; and

(iv)Adhering to the policy of market-based micro-finance development – including the encouragement of competition, free flow of information and investment from domestic and foreign sources as well as avoidance of subsidies, distortions or interest rate restrictions in the market.

3. IMPROVEMENT OF LEGAL AND REGULATORY ENVIRONMENT

Government, in collaboration with MFIs and other stakeholders including the donor community and micro, small and medium enterprises (MSME) shall endeavour to improve the environment for micro-finance. This means ensuring that it is market-friendly, using such methods as the following where necessary:

(i) The review, revision, amendment and even repeal if necessary of laws and regulations that stand in the way of micro-finance development; and

(ii) The development of new policies, embodied in law and regulation that enhance the inclusiveness, efficiency and soundness of the micro-finance sector.

The policy goal is to encourage the development of a diverse array of micro-finance providers operating soundly in a competitive market.

4. NATURE AND PROCESS OF REGULATION

The regulatory framework shall be primarily *functional* or activity-based. Regulatory treatment will depend on the nature, scale and funding sources of the micro-fi-

analysis showing that the development of the micro-finance market would be impaired in their absence, and that the sector will be capable of meeting the costs of regulation while improving outreach and sustainability. All stakeholders will be represented in the process of elaborating laws and regulations and will be given full opportunity to participate. Government shall ensure that sufficient regulatory and supervisory capacities are in place before new rules go into effect and that the scope of regulators' responsibilities is defined (for example, by minimum capital requirements and exemptions for certain categories of MFIs).

4.1 Scope of regulation

For MFIs that mobilise savings from the public, there will be mandatory *prudential* regulation and supervision by the Reserve Bank of Malawi. As necessary, the bank may delnance institution rather than the legal form or designation of the institution *per se*. Thus, banks, finance companies, NGOs, SACCOs and other providers will be subject to the same standards. Regulations must be tailored to take into account distinctive methodologies used in micro-finance such as the absence of conventional loan security. At the same time, such regulations must be harmonized with the overall legal-regulatory framework for financial services to promote integration of micro-finance with the financial sector as a whole.

Legal and regulatory changes, including the authorization of new tiers of financial service providers with tailored prudential norms, shall be carried out in close coordination with market development, in consultation with stakeholders and in line with available capacities for regulatory enforcement and supervision. Changes shall be based on egate this function in whole or in part to another organization deemed competent and independent of the micro-finance sector. Organizations that do not accept savings from the public, that fall under a defined size threshold, or those that limit savings mobilization to a common-bond membership will not be subject to mandatory public supervision. In this case, other forms of oversight, including self-monitoring through a peer organisation combined with limited reporting of financial data, may be used to ensure the quality and transparency of micro-finance institutions. All micro-finance providers, unless exempt, will be subject to *non-prudential* regulation as necessary, including consumer protection and other rules applicable to businesses.

5. COMPLEMENTARY POLICIES

Government and its partners will pursue complementary policies and reforms as necessary for the sound development of micro-finance.

These may include provisions on consumer credit, commercial transactions, adjudication of disputes, debt-enforcement or electronic commerce. Taxation and operational regulations will be adjusted as appropriate to ensure neutrality and a “level-playing field” among different kinds of MFIs. Further, government will strive to ensure an economic policy climate that enables micro-finance development. This includes curbing inflation, ensuring exchange rate stability, offering a positive and welcoming environment for investors in the micro-finance sector (both domestic and foreign), avoiding the “crowding out” of the private sector by public borrowing and placing credible limits on government intervention in the market.

6. CAPACITY BUILDING FOR THE MICRO-FINANCE SECTOR

Capacity-building is needed and will be encouraged at all levels of the micro-finance sector, including micro, meso, and macro levels. Government, along with its partner be responsible for enhancing MFIs’ capacities in order to enable them to effectively deliver micro-finance services to their clients. This is best done in a manner that meets the needs of a diverse group of practitioners, each of which has unique characteristics in terms of mission, scale and level of development. The key concerns of micro-level capacity building are quality, transparency and sustainability of micro-finance institutions and services. At the meso-level, supportive infrastructure and services such as credit information and rating will be important. A desirable feature of these efforts is the establishment of a local training facility or even a regional training centre to address the needs of local MFIs.

7. PROMOTION OF BEST PRACTICES

For micro-finance to achieve maximum impact, the adoption of best practices is necessary. Government shall refrain from subsidizing micro-finance, setting interest rates and otherwise distorting the market through policy interventions. The resource agencies (including international aid donors), will build public sector capacity for policy-making and carrying out regulation and supervision. These efforts will place special attention on the role the Reserve Bank of Malawi will play in supervising MFIs.

Capacity building efforts in the industry as a whole and at the level of individual institutions will be encouraged (but not carried out) by government. The weak capacity of micro-finance providers is considered to be one of the main binding constraints to development of the market. Thus, micro-level strengthening deserves urgent attention, and efforts at meso- and macro-levels must proceed in a manner consistent with this priority. The micro- and meso-level actors in the sector will Reserve Bank of Malawi and relevant government agencies shall coordinate to ensure a stable policy environment conducive to micro-finance development, as well as a sound regulatory system with the capacity for effective supervision. A ministry or state agency will be designated by government to coordinate policy-making in this area.

The micro-finance sector, in turn, will encourage best practices through coordinated action by the Malawi Micro-finance Network (MAMN) and other representative industry bodies on standard-setting, capacity-building and provision of infrastructure where possible. Standards will provide the industry with clear guidance on performance expectations and will in particular offer a

transition path for institutions seeking to enter into formal status and regulatory compliance. Essential matters to be covered in the standards include outreach, institutional development and financial performance. Standards may be adjusted over time to account for change.

Micro-finance institutions will follow best industry practices to the greatest extent possible and appropriate in the present context of Malawi. This means, first, understanding the needs of their low-income clients and potential clients and adapting their products and operations accordingly. Best practices also mean adopting full cost recovery interest rates, introducing voluntary savings, adopting insistent loan collection methods, introducing effective incentives to repay loans, expanding outreach, improving efficiency and reducing costs of operation. MFIs will charge sustainable and competitive interest rates, covering costs while passing on savings from efficiencies. Such rates take into account administration costs, loan losses, cost of funds including inflation and capitalisation for growth. MFI management will also adopt best practices in it.

Certain principles follow from the above. Firstly, government shall make all reasonable efforts to provide an enabling environment for micro-finance. This consists of good governance, a sound economic and regulatory environment, effective supervision and regular monitoring and review of the implementation of this policy. Government shall designate an agency to be responsible for this monitoring and review.

Secondly, government shall support and not pre-empt efforts being made within the micro-finance sector. Thus, MFIs and the sector as a whole must be allowed to innovate and compete on a market basis in order to achieve outreach. Government shall implement programmes and regulations that help to increase private sector involvement, encourage innovation and promote healthy competition in the micro-finance sector.

Thirdly, government and all stakeholders shall work together to secure the effective implementation of this policy. Implementation will follow a phased transition timetable that allows the micro-finance sector areas including delinquency control, financial reporting, information management and governance.

8. MARKET-BASED DEVELOPMENT

The implementation of this policy by all stakeholders will support market-based development of the micro-finance sector in Malawi. The sector is now in an early stage of development. It needs a nurturing environment, but it is also vulnerable to harm from interventions that are not in tandem with best practices. This much is clear from global experience. Thus, policy implementation must support and follow the market rather than try to direct or over-rule to adapt without undue hardship. Thus, new laws and regulations will be put into effect *concurrently* with the development of capacity to enforce on the part of the Reserve Bank of Malawi (or delegated supervisory body) and the capacity to comply on the part of the sector. Exemptions from new regulations are to be provided in an even-handed manner to relevant categories of providers such as small, informal, closed-bond organizations. Other micro-finance providers will promptly take the necessary steps to comply, while government affords them a reasonable period and guidance for their transformation with regulated

status.

9. ROLES OF KEY STAKEHOLDERS

Key stakeholders including Government, donors and practitioners will follow microfinance best practices as appropriate for the sustainable development of the microfinance industry in Malawi. A description of their respective roles follows.

9.1 The Role of Government

Government will implement policies conducive to a healthy micro-finance industry consisting of private and autonomous institutions operating according to widely-accepted best practices. As necessary, it will adopt regulations and seek the enactment of legislation to carry out this objective. Government will develop micro-finance policy and regulation, taking into account growth trends in the sector and capacities of the central bank and others to implement the standards adopted. Government will engage in dialogue with stakeholders and take account of their feedback when taking major steps.

Any policies or actions that force MFIs to deviate from the said best practices are considered undesirable for the development of the micro-finance industry in Malawi. Government will, therefore, refrain from interventions such as subsidies and interest rate controls that distort the operation of micro-finance supportive public infrastructure (including transparency provisions, communications and national identification systems). Government takes responsibility for leadership in this area and will coordinate its efforts under a lead ministry or agency and work with stakeholders to ensure success. With regard to more specialized market infrastructure, the financial sector will as much as possible take the lead. Examples of such infrastructure may include micro-finance credit information bureaux and technology platforms for mobile micro-finance services and fund transfers. If private initiative is unable to meet this need, then government will support its provision.

Government will be responsible for ensuring donors' adherence to this policy and will be actively supported in this direction by the micro-finance sector itself.

9.2 The Role of the Reserve Bank of Malawi

The Reserve Bank of Malawi will use the instruments at its disposal to ensure sound and orderly development of the micro-finance sector. It will participate in designing an appropriate regulatory framework for the MFIs in close coordination with the lead government entity, practitioners and industry representatives, to facilitate the broadening and deepening of the finanmarkets. It will ensure that international donor agencies also act according to this policy. It will also from time to time undertake systematic monitoring and evaluation to assess the effectiveness of its policies in the sector.

In order for micro-finance and the activities it supports to flourish, there will be need to maintain a stable macro-economic and political environment and to develop a cial system. The bank will use its regulatory and supervisory authority to follow and support private sector efforts to build the micro-finance market.

9.3 The Role of Practitioners

Micro-finance institutions will provide high quality financial services to low-income clients on a sustainable basis, adhere to universally-accepted best practices and respect the industry-

wide code of conduct. Micro-finance institutions not subject to formal supervision will be encouraged by government to develop capacity for self-regulation and, over time, to participate in a program for formal supervision by the Reserve Bank of Malawi. The primary responsibility for developing this capacity and the relevant performance standards lay with the MFIs and with meso-level industry associations such as MAMN.

9.4 The Role of Donors

International donor agencies will draw guidelines on their support for capacity building, best practices awareness and transparency. Their support to the sector should reflect an appropriate balance of operational and technical support and loan funds, with a preponderance of support in the former categories. Donors will refrain from direct supply of concessional funds and other actions that can distort the market and to undermine its sustainable development. Donor coordination and acknowledgement of international standards in this area will be also be important.

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