DEEPENING THE MICROFINANCE SECTOR IN MALAWI

Final Report

SEPTEMBER 2009

This publication was produced for review by the United States Agency for International Development. It was prepared by Chemonics International Inc.

DEEPENING THE MICROFINANCE SECTOR IN MALAWI

FINAL REPORT

Contract No. GEG-I-00-02-00013-00, Task Order No. 804

CONTENTS

EXECUTIVE SUMMARY

Despite its status as one of the world's poorest countries, Malawi's economy has grown an average of 7 percent per year for the last three years, a trend that is expected to continue in 2009. In pursuit of economic growth objectives and encouraged by the Government of Malawi's initiatives to promote the development of micro, small, and medium-sized enterprises (MSMEs), USAID/Malawi commissioned a microfinance sector assessment in 2003. The resulting report pointed to constraints around demand, supply, and technical services, recommended ways to address constraints, and begin to build an inclusive financial sector. In the context of these findings, USAID/Malawi designed the Deepening the Microfinance Sector (DMS) project.

One of the project's key achievements has been to catalyze the growth of the microfinance sector, mobilizing stakeholders, breaking down information barriers, and introducing lessons from elsewhere that can be adapted in Malawi. The project has helped demonstrate that microfinance is no longer a frontier development tool but a mainstream commercial activity and an integral part of the country's financial sector.

A More Inclusive Financial Sector

When the project began in 2004, the sector supported about $15 million in microloans. In just five years, loan volume has reached almost $100 million.

DMS focused on three areas: microfinance industry capacity building, facilitation of access to capital, and improving the enabling environment. The project helped increase the capacity of microfinance institutions (MFIs) and banks to serve the MSME market and provide access to increasing amounts of commercial capital, much of it sourced for the first time from the private sector. Nevertheless, serving this market on a competitive and sustainable basis remains a challenge for future implementers. The final chapter of this report includes some ideas for future assistance that could help Malawi's microfinance sector prosper.

DMS offered all qualifying players equal chances of access to support. At the retail level, DMS partnered with five major private sector MFIs and provided them with technical assistance through its staff and through local, regional and international service providers. DMS assistance aimed to increase MFIs' sustainability through improved portfolio quality, product diversity, and improved staff and customer retention.

DMS Partners

DMS emphasized a demand-driven, capacity building approach and helped create a common platform where all stakeholders grow in support of each other. The project's MFI partners were FINCA Malawi, PRIDE Malawi, OIBM, MUSCCO, CUMO, and the Malawi Microfinance Network.

At the sector level, DMS partnered with the Malawi Microfinance Network (MAMN) to generate concrete, organized information that the public and stakeholders could use to determine the performance and state of the sector. The information was used to bridge gaps between value chain actors and financial service providers, and between financial service providers and development partners. The information also resulted in increased access to commercial capital, especially by rural and agricultural enterprises.

As a result of the DMS project's interventions, partners and stakeholders have reported significant changes. The microfinance sector has grown dramatically. The number of depositors has increased by more than 60 percent between December 2004 and June 2009, and the value of portfolio outstanding has increased by a factor of six. Private sector lending also has registered substantial growth. Comparing the increase in private sector loan portfolio, which has seen a near-tenfold increase during the life of the DMS project, with the significantly lower rate of growth among public suppliers demonstrates the power private capital can have in helping to close the supply and demand gap.

At the macro level, DMS led other stakeholders in helping the Government of Malawi develop appropriate microfinance policies, laws, and regulations. When these laws are passed later in 2009, they will open new sources of funds for the sector and provide security for deposits, even in microfinance institutions.

PROJECT IMPACT

Capacity Building

- Increased the sector's visibility and established a better balance between sector and institutional development, leading to a more unified sector.
- Increased MFI capacity as demonstrated by increased outreach, improved portfolio quality, increased sustainability, product diversity, changed governance structures, improved feasibility, reduced customer complaints and staff turnover, and transformation plans.
- Fostered sustained MFI/bank and MFI/technical service provider relationships.
- Increased rural and agricultural lending.

Increasing Access to Finance

- Helped MFIs access new credit lines worth approximately $4 million.
- Produced demand and credit supply studies in the coffee, tea, and cotton sectors, creating the opportunity for 1,922 smallholder tea farmers to access loans totaling $136,003.
- Facilitated the creation of a $13 million Development Credit Authority loan guarantee facility. Three banks — Standard, Opportunity International Bank of Malawi, and INDEBank — have subscribed to the facility with initial loans already injecting more than $1,400,000 of business capital into agriculturally linked MSMEs.

Strengthening the Enabling Environment

- Facilitated a revision of the government policy, under which it has agreed to facilitate the sector's growth and refrain from providing direct microfinance services.
- Led a collaborative effort among donors and the microfinance sector to assist the government in drafting a Microfinance Bill and Financial Cooperative Bill, expected to be passed in late 2009. These laws will allow certain categories of licensed MFIs to mobilize deposits.

Lessons Learned

The DMS experience demonstrates the usefulness of a holistic, capacity building approach that covers all key players — investors, regulators, financiers, and technical service providers. Such support has promoted cohesion within the sector and a common platform where all stakeholders are unified and grow in support of each other.

> **The Importance of Capacity Building**
>
> "For sustainability and quality provision of services, the sector needs capacity building, particularly training of boards of directors and management staff for both existing and potential players. This should be an ongoing initiative so that in-house training remains a revolving exercise. It improves management quality, accounting, bookkeeping, and customer service."
>
> *— Reserve Bank of Malawi*

Because Malawi's microfinance industry is still taking off, it will continue to require support in various forms, in helping institutions pursue diversification, use modern technologies, explore new markets, and meet regulatory requirements. Once a stronger enabling environment exists, regulators also will require support to ensure the proper application of new laws and regulations and to support the introduction of new technologies and partnerships. Support will also be required in working to persuade legislators of the need to pass the new laws.

DMS has demonstrated the value of some simple principles that can be applied in other countries seeking to build an inclusive financial sector. First, all key players must have access to appropriate information, so that every player has an equal chance to spot business and partnership opportunities in the economy. Second, demand-driven support is more sustainable in the longer term, as the stakeholders own the whole process and work in a participative manner to identify needs and define priority interventions.

CHAPTER ONE
THE NEED FOR THE DMS PROJECT

An estimated 85 percent of Malawi's population of 13 million lives in rural areas, surviving mostly on agriculture-related activities. For the majority, who live in severe poverty on less than a dollar a day, life is hard, responsibilities are many, and the need for financial services is great. Before the Deepening the Microfinance Sector project was launched, access to financial services — credit and savings, insurance, money transfers, and other products that economically active citizens need to start or build businesses — were beyond the reach of most small-scale businesses in Malawi.

Before 2004, there were few credit supply and demand studies for MSMEs describing the nature, volume, and repayment statistics. Those that existed lacked detail. Value chain finance studies were nonexistent, and potential opportunities to improve value chain efficiencies through providing demand-driven credit went unnoticed. Formal financial institutions, such as banks and most microfinance institutions, operated mainly in urban or peri-urban centers. Malawian banks, historically reluctant to loan to MSMEs, were closing their rural branches, claiming that the cost of delivering financial services to rural clients and communities was too high, the infrastructure was poor, and the risk of servicing the market too high.

In the past five years, however, many of these objections have been overcome, and significant progress made to deepen and broaden the supply of financial services to previously underserved segments of Malawi's population.

Microfinance Sector Assessment Findings

In 2002, the Government of Malawi drafted and approved a Microfinance Policy Statement that described its vision for the development of microfinance. In 2004, encouraged by the government's efforts, USAID/Malawi commissioned a comprehensive assessment of the microfinance sector, which examined market supply and demand; the sustainability and outreach of MFIs; donors and other support structures present; and the legal, regulatory, and economic environment for microfinance. The report identified constraints to the development of the sector and recommended ways to advance microfinance as an integral part of Malawi's financial system.

> **A Burgeoning Market**
>
> A 2000 baseline survey estimated that there were 747,000 MSMEs in Malawi employing 1.7 million people, only a fraction of which had access to finance.

The assessment found that there was a large, unmet demand for microfinance services in Malawi, especially in rural areas. At the time, microfinance consisted of a mixture of trade finance and agricultural credit, most of which was extended by government-owned firms and controlled by a handful of players. Client dropout levels among most MFIs were more than 50 percent, and loan default rates for the sector were unsustainably high. Rigid loan methodologies limited the variety of loan products and terms available, and there were few secure microsavings options. Overall, the weak capacity of Malawian MFIs, their long-term dependency on subsidies and grants, and their inability — because only registered banks can mobilize savings — to collect and on-lend savings made it difficult for the microfinance sector to expand to close the large gap between supply and demand.

The assessment proposed a comprehensive way forward that addressed constraints at all levels, based on the following assistance principles:

- Demand-driven capacity building must be responsive to the individual needs of MFIs and other financial sector actors committed to following best practices.

- Emphasis should be placed on high-value interventions that maximize the use of resources and impact.

- Local support capacity, including internal training sources within institutions, should be strengthened to increase sustainability.

- Assistance should be provided on a cost-sharing basis to ensure that only high-priority needs are selected and that institutions are able to follow through with implementation.

It was within this context that USAID/Malawi designed the DMS project.

DMS Project Design

In September 2004, building on the findings of the microfinance sector assessment, USAID launched the DMS project to deepen Malawi's financial sector by expanding access to sustainable financial services for microenterprises and low-income households. Originally designed as a three-year project, in 2007, DMS received a funded extension to September 30, 2009, bringing its total contract ceiling to $4,529,538.

DMS had three main components:

- *Microfinance industry capacity building,* to improve the sustainability and outreach of microfinance institutions through a self-sustaining system of continual improvement and retail-level capacity building.

- *Facilitation of access to capital,* to promote greater flows of loan capital at commercial rates through targeted capacity building, linkages, and brokering.

- *Improving the enabling environment,* to help build a more supportive regulatory, supervisory, and legal framework for microfinance.

The next four chapters describe the DMS project's approach to, and accomplishments in, each of these components. Targeted demand-driven skills training strengthened MFIs' institutional capacity, while sector studies on high-value agricultural value chains and implementation of the Development Credit Authority loan guarantee facility encouraged new lenders to enter rural markets. DMS worked simultaneously with all sector stakeholders, including the Government of Malawi, the Malawi Microfinance Network, and the Reserve Bank of Malawi.

The final chapter highlights opportunities for future high-return support for Malawi's microfinance sector. Although the project and its partners achieved significant impact on Malawi's microfinance sector, there are substantial opportunities on the horizon to build on the solid base that DMS helped to establish. Throughout this report, stories and snapshots illustrate the project's impact on individual MSMEs and on the financial sector as a whole.

Small Loans, High Yields

An MFI expands to new rural markets with market research and training from the DMS project

DMS / Ezikiel Phiri

Arich Khoza, a smallholder tea grower from Nalipiri Block in Mulanje District tends his well cleared tea plantation.

In February 2008, Arich Khoza obtained a loan of $78 from CUMO Microfinance Limited, with which he purchased five hoes and hired labor to clear his field of tea. He hopes to harvest more tea this coming season as a result of having cleared his field in good time.

Arich, who is 68 years old, is a smallholder tea grower who benefited from CUMO's pilot program in the tea sector in Mulanje District of Malawi. CUMO launched the program after reviewing a value chain finance demand and supply study produced with the support of the Deepening the Microfinance Sector project.

The studies indicated that there were financing opportunities in the tea, coffee, and cotton sectors, where smallholder farmers remained largely un-served.

"Since I started growing tea, no financial institution had been available to support us smallholder farmers. In fact, one commercial bank kicked us out of its offices because there were no loans for people like us … Without CUMO's support, I would not have cleared my plot on time. Unlike fertilizer loans, cash loans grant us maximum flexibility to address various needs on our farms," Arich declared.

Arich intends to request subsequent loans as CUMO expands its operations to include more smallholder tea growers in Mulanje and Thyolo Districts.

CHAPTER TWO

THE DMS APPROACH

The DMS project's main objective was to help expand MSMEs' access to capital by deepening Malawi's microfinance sector. It combined a traditional financial sector lens approach to industry development with a value chain approach that identified and supported financing opportunities in several key agricultural market segments. DMS intervened at all three levels of the microfinance sector and targeted its activities accordingly, strengthening actors at each level and the linkages between them. It was market-driven and focused on strengthening institutions by employing local business support services and building the training capacities of partner MFIs.

A Promising Entry Point

Financing of value chain actors is supplied by a variety of formal and informal sources, from one actor to another as well as through financial institutions. Mapping value chain finance supply and demand often leads to the creation of more efficient and effective markets that can dramatically boost a sector's development.

At the *micro, or retail,* level, DMS helped increase MFI demand for sustainable capacity building services by partnering with five promising private sector MFIs that requested project assistance, helping them to expand outreach through new product development, maximize efficiency, improve their core operations and financial performance, and strengthen management skills. DMS training and technical assistance were based on best practices adapted to the Malawian context. In addition, DMS consulted regularly with other MFIs and commercial banks interested in the MSME market to engage them in key issues confronting Malawi's financial sector. One outgrowth of these consultations was the establishment of a $13 million Development Credit Authority (DCA) multi-bank loan guarantee facility targeting agriculturally linked MSMEs.

At the *meso, or sector-wide,* level, DMS strengthened support structures for the microfinance sector, boosting the capacity of organizations such as the MAMN to help institutionalize best practices within the industry and play an intermediary role between the Government of Malawi and MFIs. At this level, DMS worked to fill the information gap between value chain actors and financial sector players through sector studies and the introduction of credit enhancement mechanisms such as the DCA. These efforts resulted in a greater mobilization of commercial capital to fund businesses and a reduced reliance on non-sustainable and distortionary subsidies to marginal businesses and institutions.

At the *macro, or national,* level, DMS helped the Government of Malawi build an enabling policy and a legal, regulatory, and supervisory environment for microfinance. Working with other sector stakeholders, DMS promoted a role for the government as a proponent of expanding the microfinance sector to build an inclusive financial sector based on commercial principles.

The DMS project embraced the following key principles:

- *Demand-driven technical assistance*. Although DMS sponsored sector-wide training to share knowledge and know-how on microfinance best practices and promising agricultural sectors, the project focused on MFIs and service providers that sought project assistance.

- *High-value interventions.* To maximize resources and impact, DMS focused on high-value interventions. The project team selected agricultural value chains for sector studies based on their potential for growth and stakeholders' readiness to embrace change.

- *Leverage linkages and share best practices*. DMS developed partnerships with local, regional, and international organizations to leverage resources and expertise and share the latest tools and trends with its partners. DMS also promoted public-private partnerships to create harmonized policies and foster mutually beneficial relationships.

- *Process improvements.* DMS focused on improving processes in MFIs through the development of new policy manuals and staff training to institutionalize best practices.

- *Cost participation*. To leverage project resources and gain buy-in from senior management, DMS insisted that partner organizations share the cost of training and technical assistance.

- *Women's participation*. DMS promoted a stronger and more productive role for women, encouraging the participation of women in skills-building opportunities and taking their needs into account in planning and scheduling interventions.

- *Environmental awareness.* DMS promoted compliance with Malawi's environmental laws to assess and limit the potential impact of financed activities on the environment.

Over the five years of the project, DMS established memoranda of understanding (MOUs) with the Malawi Microfinance Network and five MFIs, and developed strong working relationships with the other MFIs and stakeholders. Together with its partners, DMS made significant achievements to deepen the microfinance sector and help secure a strong base for its future expansion.

CHAPTER THREE

INCREASING THE CAPACITY OF THE MICROFINANCE INDUSTRY

Malawi's economy remains predominantly rural. Although the gap between the demand for financial services and the supply was large in 2004, it has been reduced significantly over the past five years, due in part to the DMS project's efforts to increase sector capacity and promote best practices at all levels.

One of the project's primary objectives was to increase the volume of loans extended to micro, small, and medium-sized enterprises on a commercial basis and to encourage more private sector capitalization of MSME loan portfolios. The table to the right illustrates a dramatic increase in microfinance supply in the past five years, much of it created by private sector financial institutions. This increase was especially pronounced for microsavings mobilization, due largely to the activities of Opportunity International Bank of Malawi (OIBM) and the Malawi Union of Savings and Credit Cooperatives (MUSCCO), both of which received targeted assistance from DMS.

Microfinance Sector Growth Over the Life of the DMS Project

		Microloans	Microsavings
Total Microfinance Sector	Dec. 2004	175,583 ($15.2 million*)	392,431 ($12.1 million)
	June 2009	654,257 ($98.95 million)	634,718 ($41.6 million)
Private MFI Market Share	Dec. 2004	50% (43% of value)	50% (57% of value)
	June 2009	57% (67% of value)	53% (92% of value)

** 150 MK = 1 USD*

Since 2004, nearly every MFI expanded its loan portfolio, and many of the largest reported substantial improvement in the quality of their loan portfolios. A significant number of NGO credit programs, such as Concern Universal Microfinance Organization (CUMO), Touching Life Fund, and the Microloan Foundation, made the transition to mainstream microfinance by establishing companies limited by guarantee, in anticipation of new microfinance bills that DMS was instrumental in drafting. In addition, the market witnessed the entry of several large private sector companies specializing in payroll lending and business loans. Taken together, these new lenders now account for nearly 25 percent of Malawi's microfinance market, just two years after start-up.

Sustainable Capacity Building Services for MFIs

Soon after start-up, DMS conducted a series of "information days," meeting in groups and individually with all of the key actors in the microfinance sector to announce the project's objectives and begin forming relationships with potential partners.

For MFIs interested in receiving direct assistance, project technical specialists assessed their commitment and capacity to adopt best practices and their willingness to charge full cost-recovery interest rates and fees, adhere to transparency in reporting, and commit to cost-share assistance provided by DMS. Institutions meeting these criteria were then prioritized according to the scope and immediacy of assistance needed and the amount and timing of DMS project funding obligations received from USAID.

Over the life of the project, DMS established MOUs — spelling out the type of assistance, each party's obligations, and performance indicator reporting requirements — with six core partner institutions:

- Finance for International Community Assistance Malawi (FINCA Malawi)
- Malawi Union of Savings and Credit Cooperatives (MUSCCO)
- Promotion of Rural Initiatives and Development Enterprises Malawi (PRIDE Malawi)
- Opportunity International Bank of Malawi (OIBM)
- CUMO Microfinance Limited (CUMO)
- Malawi Microfinance Network (MAMN)

Responding to its partners' expressed needs, DMS supplied targeted training and skills-building activities to address a wide range of needs in financial performance, loan quality, client satisfaction, new product and staff development, internal training capacities, strategic planning, risk management and operating manuals. The project team used a blend of resources to deliver assistance, including DMS technical specialists; international, regional, and local experts; and participation in conferences and training. The project and its partners jointly developed scopes of work, recruited consultants, monitored deliverables, and approved payments. Whenever possible, international or regional consultants were paired with local consultants. In all cases, MFI partners assigned one or more staff members to co-implement the activity with consultants. DMS insisted on workplace follow-up for all technical activities, to help ensure that the knowledge and skills acquired were actually applied.

Some highlights of DMS's training and technical assistance activities include:

New product development. New entrants into Malawi's microfinance sector, including commercial banks, have forced MFIs to become more efficient and revamp their product mix to remain competitive, even as they try to reach scale and cover costs. Suppliers had to become more attentive to client preferences as MSMEs demanded alternatives to the traditional group loan packages with loan ceiling limits and rigid repayment schedules. With DMS technical assistance, FINCA Malawi and PRIDE Malawi surveyed client needs, developed typical business profiles, and then redesigned their loan products based on projected business profits and cash flows. The exercise helped introduce new demand-led products and identified new bankable borrowers, while decreasing loan delinquency and client dropout rates. In just two years, the value of FINCA Malawi's new individual loan portfolio increased from zero to more than $700,000.

Martha Chisati is a proud owner of several businesses in Ndirande, Blantyre. She has benefited from small loans from FINCA over the last 10 years and has recently graduated from a group loan to an individual business loan. She owns two rental houses in Ndirande, operates a knit wear business, and recently started a private nursery and primary school. "FINCA has given me an opportunity to improve my life and the lives of others in my community."

Branding and marketing. Institutional assessments at DMS project start-up revealed that branding was weak for many Malawian MFIs. The project supported the development and implementation of comprehensive branding and marketing strategies. As a result, some partners, such as the community savings and credit cooperative (SACCO) described below, introduced revised logos and brand identities, increased branch signage and polished their public image.

In 2005, with DMS support, MUSCCO sent two managers to the School of Applied Microfinance in Kenya. When the training was complete, one of the managers was transferred to a community savings and credit cooperative that was struggling with limited growth prospects. Equipped with knowledge from his recent training, the manager reengineered the SACCO's branding and marketing. The SACCO recovered and prospered, growing from 1,600 members in 2005 to more than 20,000 in 2009. It now serves as a model for other SACCOs in Malawi.

New technologies. New technologies are helping transform financial markets in emerging economies by increasing efficiency, broadening outreach, and bringing about economies of scale. Conversely, poor information technology systems can increase all types of risk, expose MFIs to fraud, and contribute to inaccurate reporting and poor decision-making. DMS supported technology upgrades for PRIDE Malawi and FINCA Malawi. With project assistance, PRIDE was able to upgrade its headquarters' local area network with new workstations, server, printers, and a robust security and backup system. As a result, timely data storage, analysis, and reporting has led to accurate information and improved decision-making, particularly between the branches and the head office.

At FINCA Malawi, DMS supported the purchase of personal digital assistants (PDAs) for loan officers, coupled with a new server to receive data sent from field offices. Loan officers used these PDAs to monitor loan disbursement and repayment and increase accurate and timely reporting.

Several other project-supported MFIs are exploring technology solutions that could enable the delivery of such financial services as mobile money transfers and mobile phone banking.

Rating and institutional assessments. When DMS started in 2005, no non-regulated MFI in Malawi had undergone a formal rating or institutional assessment. DMS raised awareness of the critical role of ratings in promoting best practices and attracting new funding sources. The project funded PRIDE Malawi's application for a MicroRate rating and CUMO's application for a PlanetRating. The DMS technical specialist worked with MUSCCO to customize rating tools to conduct full institution due diligence assessments of member SACCOs. By August 2009, all but a few of its SACCOs had been rated. In addition to these exercises, the project team conducted internal institutional assessments with partners that identified weaknesses in staff capacity, accounting practices, liquidity management, and other areas. Equipped with this information, senior MFI managers developed their own capacity building plans — a first for many MFIs that marked a milestone in self-directed, sustainable development.

"I learned how to conduct competitive analysis and the importance of understanding customer needs to enhance loyalty. We also learned how to manage difficult customers, and other strategies to manage delinquency."

— Participant in a DMS-sponsored customer care training at CUMO Microfinance Ltd.

Increasing MFI Service Provider Capacity

In addition to direct technical assistance to MFIs, DMS worked with MFI service providers to help establish a solid foundation for a sustainable microfinance industry. By involving the private sector in training and service provision and through presentations at annual professional gatherings, such as meetings of the Association of Accountants, the project sought to strengthen the capacity and role of these service providers. These activities helped extend knowledge of best practices and attracted new technical service providers to supply the microfinance market.

DMS engaged local and regional experts and paired them with local consultants, local firms, and staff from the MFI receiving assistance. This step helped ensure that knowledge and know-how were infused in the standard operating procedures of firms receiving project assistance. It also helped establish and develop fully functional training departments at several MFIs, and a larger cadre of local consultants and firms that had worked to support MFIs.

Helping Malawian MFIs Achieve Self-Sufficiency

"When FINCA Malawi first signed an MOU with DMS, we had many challenges, including poor portfolio quality and a low sustainability index. Over the last four years, with DMS support, we have made tremendous improvements. Our portfolio-at-risk has improved to 5 percent overall, compared to 20 percent in 2005. Further, we are now financially self-sufficient. DMS support has helped us build capacity and prepare to become a regulated MFI."

— Ezra Anyango, Country Director, FINCA Malawi

Although it was relatively easy for DMS to find consultants in the region with extensive experience supporting the microfinance industry, it was harder to identify local consultants with specialized microfinance experience. To overcome this limitation, DMS and its MFI partners worked together to draft scopes of work for technical assignments and closely monitored the consultants to ensure that deliverables were of a high quality. After numerous assignments over the past five years, several firms are now well-known in the sector and are hired directly by MFIs, a practice DMS believes will continue well into the future.

Increasing MFI Sustainability and Outreach

To promote sustainability as an institutional objective, DMS organized senior manager meetings and sector forums to stimulate networking and learning opportunities within the microfinance sector. These gatherings emphasized best practices and were geared toward helping MFIs understand and plan for the passage of new microfinance legislation being drafted. Given the role of outreach and client retention in fostering sustainability, DMS also helped MFIs improve marketing and outreach and introduced the practice of regularly conducting client exit surveys as a management tool.

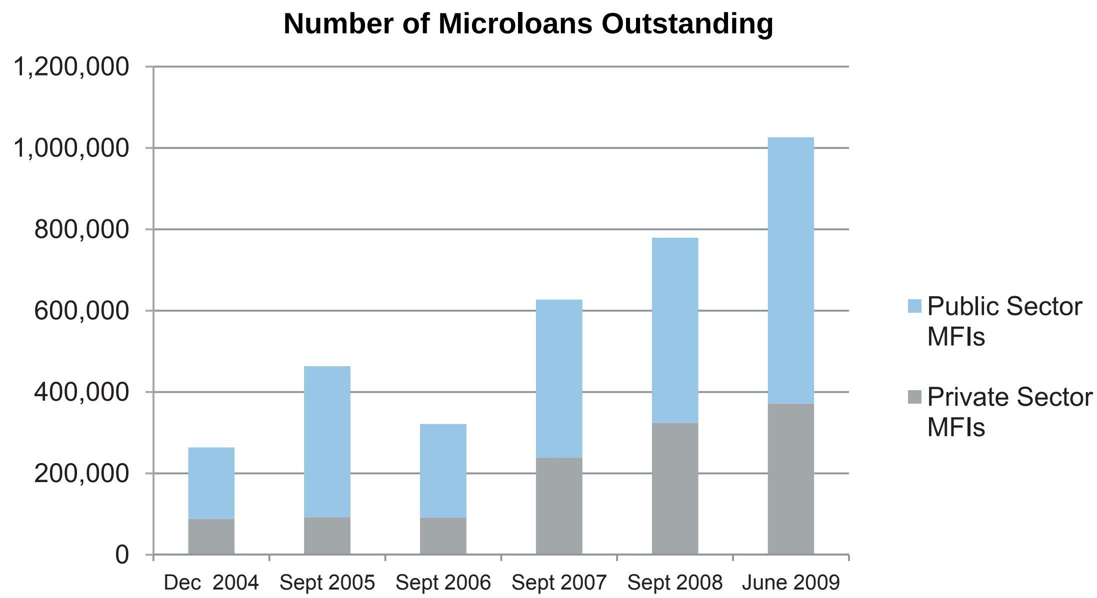
Local MFI Service Firms Subcontracted by DMS

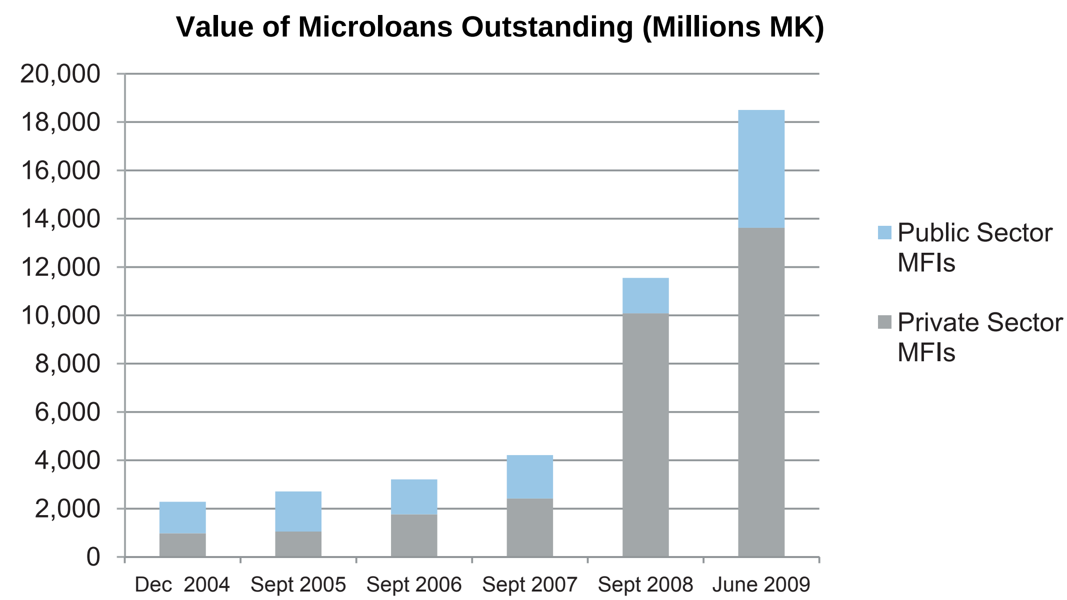
- Afro Management Consultants
- O & M Associates
- Millennium Consultants
- Kadale Consultants
- Dawa Productions
- Malawi Institute of Management

DMS monitored the performance of its MFI partners through capture of quarterly reports, one-on-one review meetings, and client field visits; all other MFIs were monitored by the MAMN. The results of the project's efforts to increase outreach and sustainability are described in the section below.

Aggregate Performance Indicators

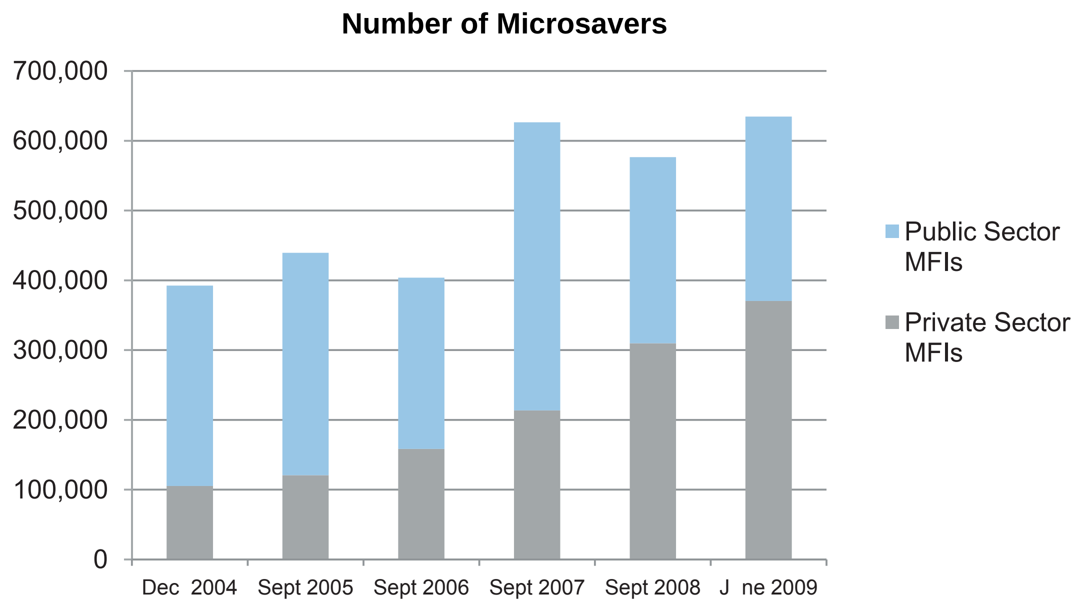
From 2004 through 2009 the microfinance sector grew dramatically, both in terms of the number of microfinance clients and the value of credit outstanding and savings mobilized. Although the growth in the total number of loans outstanding is impressive, the increase in the total value of loans outstanding is even greater. Comparing the growth rates of the private versus public sector microfinance suppliers over this period demonstrates the power that private capital can exert to close the supply and demand gap when it is unleashed.

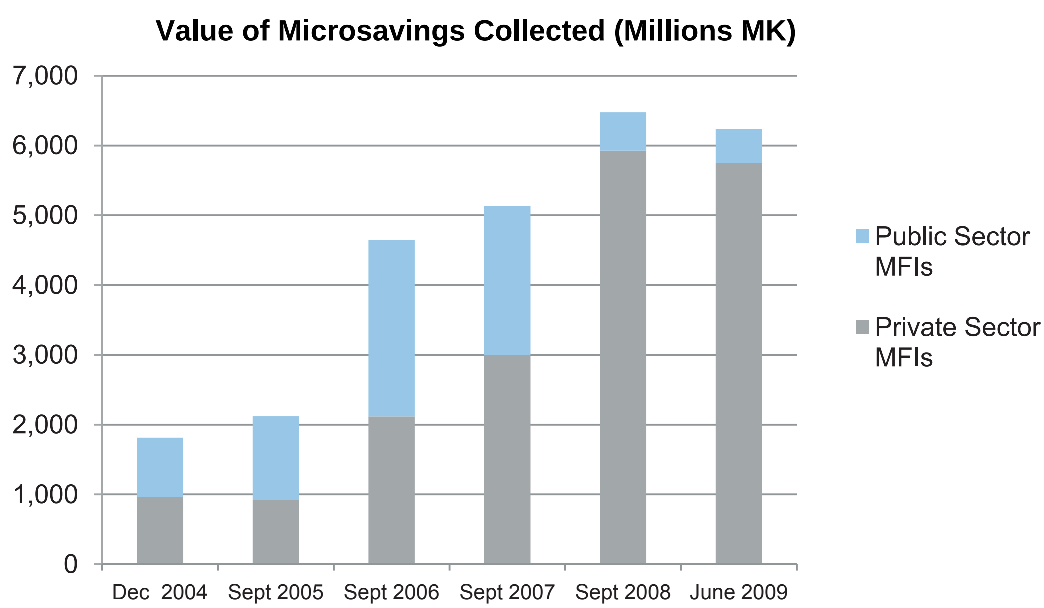




The principal contributors to the large increase in microloans were OIBM, MUSCCO, and the group of payroll lenders. Although DMS did not sign memoranda of understanding with the payroll lenders, the project team brought them into discussions, soliciting and taking into account their feedback on pending microfinance legislation. The project also encouraged them to fully integrate with the community of microfinance practitioners in Malawi. To that end, DMS facilitated discussions involving the payroll lenders group, the Government of Malawi, the Reserve Bank of Malawi, the Malawi Microfinance Network, and others.

On the microsavings side, rapid growth between 2004 and 2007 was caused in part by OIBM's entry into the market. The total number and value of microsavers has remained relatively constant since 2007, due to reported steep declines in public sector provision of savings services. After reporting MK 2,136,000,000 in microsavings held at September 2006, Malawi Savings Bank reported only MK 52 686,098 in savings in June 2009.





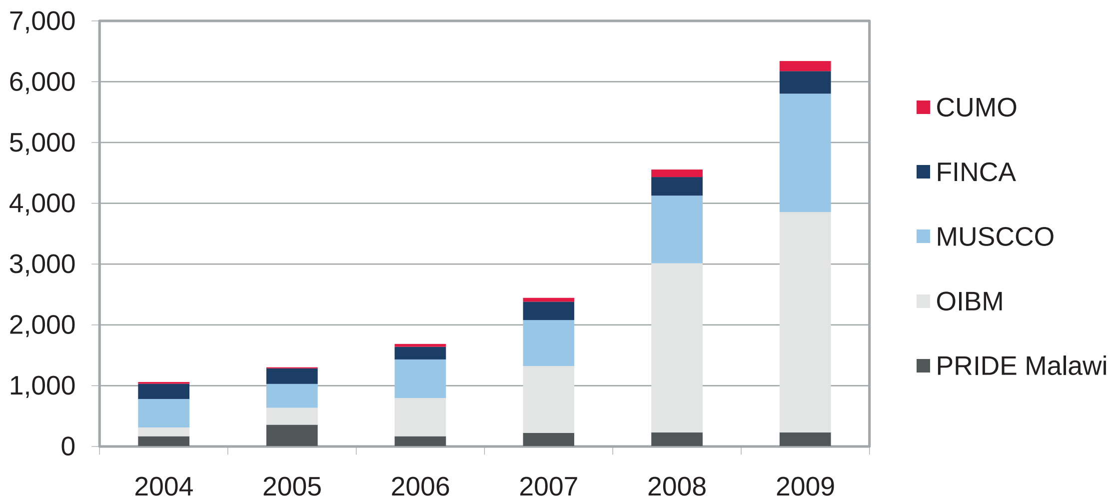
Despite these obvious overall gains, the growth of Malawi's microfinance sector is limited by the inability of most players to mobilize and legally on-lend savings deposits. Where permitted by law, effective savings strategies enable regulated institutions to mobilize deposits from their communities and reinvest them in the form of loans. By expanding deposit services, MFIs in Malawi could fill the need for a safe and secure savings product, increase outreach, reduce dependence on external borrowing, lower their cost of funds, and become full-fledged financial intermediaries. The DMS project took the lead in helping the Government of Malawi draft new microfinance and financial cooperative bills that would open a legal space for qualified MFIs to engage in licensed deposit-taking. These bills are currently awaiting passage by the legislature.

Changes in Partner Outreach and Loan Portfolio Quality

The assistance that the project provided to FINCA Malawi, MUSCCO, PRIDE Malawi, OIBM, and CUMO enabled them to achieve higher rates of operational and financial sustainability and expand their outreach. OIBM and MUSCCO recorded the largest gains in outreach — not surprising, because since both of these MFIs can legally on-lend savings deposits. CUMO also made enviable gains, and both FINCA and PRIDE diversified their loan product mix and improved their loan portfolio quality. The charts below highlight their performance relative to the total market and their individual performances.

Percent of Market Share of MOU-Partner Microfinance Institutions

Growth of DMS Partners by Value of Loans Outstanding (Millions MK)



Last reported data for PRIDE Malawi was September 2008. This data is also used for the period ending June 30, 2009.

Strengthening Malawi's Microfinance Support Institutions

The Malawi Microfinance Network is the sole representative for microfinance institutions in Malawi. It currently has 21 members, four of which do not supply financial services but have a vested interest in advancing the development of the sector. In addition, five payroll lenders submitted membership applications in early 2009.

MAMN members discuss the microfinance bill.

Formed in 1998, the MAMN remains a nascent organization managed by a board of directors and few staff. Its MOU with the DMS project focused on strengthening its capacity to develop the overall infrastructure of the microfinance sector in the long term. In 2007, DMS hired a local consultant to help the MAMN design and articulate a new five-year strategic plan during a retreat that included focus groups to assess member satisfaction and a survey of the network's perceived role. The DMS project team has mentored and worked closely with the MAMN to strengthen its position as champion for Malawi's microfinance sector by jointly organizing sector meetings and field visits of members. One important step was to build the network's capacity to collect and report on the aggregate performance indicators of its members and furnish this data to interested stakeholders. It also supported sector-wide training sessions for members.

After the MAMN's move to new offices, DMS equipped the network's resource center, which serves as a library, training and meeting space for members. The DMS team has submitted a request to USAID to give the MAMN additional equipment at the close of the project. To foster regional linkages, DMS supported the MAMN's participation in annual meetings of the African Microfinance Institutions Network, where its representatives formed relationships with regional leaders and returned with knowledge of best practices to share with stakeholders in Malawi.

Training is the Key to Growth

A commercial bank uses technical support from the DMS project to retain staff and increase productivity


OIBM

Even with a growth rate of nearly 500 percent in staff from 2003 to 2008, OIBM has maintained an employee retention rate of 98.3 percent.

From 2003 to 2008, Opportunity International Bank of Malawi, a commercial bank catering to micro, small, and medium-sized enterprises, grew rapidly, expanding from one office with 60 staff to a 12-branch network employing more than 350 people. This tremendous growth triggered a change in the bank's management. As senior management shifted focus to strategic issues, they relied on a new layer of middle management to oversee bank and field operations. This shift revealed weaknesses in OIBM's salary and grading policies, forcing the bank to examine its job evaluation policies or risk losing good performers.

After researching various models, OIBM sought DMS project assistance to implement the Paterson and Hay Job Evaluation system. With expertise from PE Corporate Services of South Africa, the DMS project led OIBM in an exercise that involved rewriting job descriptions, job grading, and remuneration benchmarking. The new system has been used to benchmark jobs against those of competitors, and has led the bank to develop a robust incentive package.

OIBM's chief executive officer, Aleksandr Kalanda, notes, "With the assistance of the DMS project, we have implemented a management system that has succeeded in retaining highly qualified staff. This has been instrumental to our high productivity and increased profitability."

Growth Indicators	2003	2008
Branches	1	12
Staff	60	357
Depositors	1,051	13,401
Loan Portfolio	$141,390	$22,895, 511

CHAPTER FOUR

FACILITATING ACCESS TO CAPITAL

> **Helping MFIs Manage Growth**
>
> "DMS helped to identify and address weaknesses we had in the capacity of leadership and middle management. They helped us fine tune our plan. After three years, we can see the difference. Now, we need to properly manage the growth."
>
> *— Dickson Chidumu, Head of Operations MUSCCO*

Arich Khoza inherited a two-acre plot of tea from his father, who passed away in 1984. Until recently, however, he was unable to obtain the financing he needed to purchase equipment and labor to clear his fields properly. As a result, his yields were low. Khoza's dilemma — a lack of available financing appropriate for his business needs — is shared by many other small farmers and MSME owners in Malawi. With this in mind, DMS worked with partner MFIs, the MAMN, and banks to increase MFIs' access to capital for loan funds and MSMEs' access to commercial capital. The project's activities contributed to a sustainable increase in access to business financing nationwide.

Increasing MFI Capacity to Absorb Commercial Capital

In 2005, many MFIs in Malawi had some access to commercial lines of credit for on-lending, but they had limited capacity to manage additional capital. In addition, the microfinance sector was dominated by government-subsidized MFIs that had few incentives to increase debt financing.

An important way to increase access to financial services is to ensure that local financial institutions have the strategic vision, business plans, and internal capacity to expand sustainably. DMS conducted institutional assessments that led to new strategies for improving portfolio performance, operating efficiencies, and outreach. Through this process, partner MFIs became equipped to integrate a commercial, market-driven approach in operations with a sharp eye on controlling costs and improving profitability. DMS also helped link commercial banks and MFIs, establishing relationships to encourage MFIs to source commercial capital from banks for short- and medium-term financing.

Many MFIs are already positioning themselves in anticipation of the passage of new legislation for microfinance institutions and financial cooperatives. Under the new laws, MFIs will be able to apply for permits to accommodate savings mobilization, as long as they meet the conditions for becoming licensed microfinance institutions.

DMS partners' highlights between 2004 and 2009 include:

- Opportunity International Bank of Malawi increased its deposit balance from MK 313,195,581 ($2,087,970) to MK 3,835,218,000 ($25,568,120), increasing its share of the country's total microsavings market from 17.1 to 61.5 percent.

- FINCA Malawi established a $3.4 million line of credit with First Merchant Bank to capitalize its village banking program.

- PRIDE Malawi acquired a line of credit from National Bank of Malawi to expand its loan portfolio.

- MUSCCO accessed for the first time a line of credit from a commercial bank in the amount of MK 50,000,000 ($360,000).

- CUMO Microfinance Limited is in discussions with Standard Bank and NBS Bank for commercial lines of credit to support lending activities.

Increasing the Ability of MSMEs to Access Commercial Capital

Expanding financing for agricultural value chains. In 2004 many MSMEs were unable to access financial services that would help them grow. MSMEs in rural areas were particularly isolated, as financial services providers generally focused on urban and peri-urban markets. The limited financial services that reached rural areas was often targeted to farmers involved in cash crops with well-established market systems (e.g., tobacco), to prevent side-selling to avoid repayment of loans.

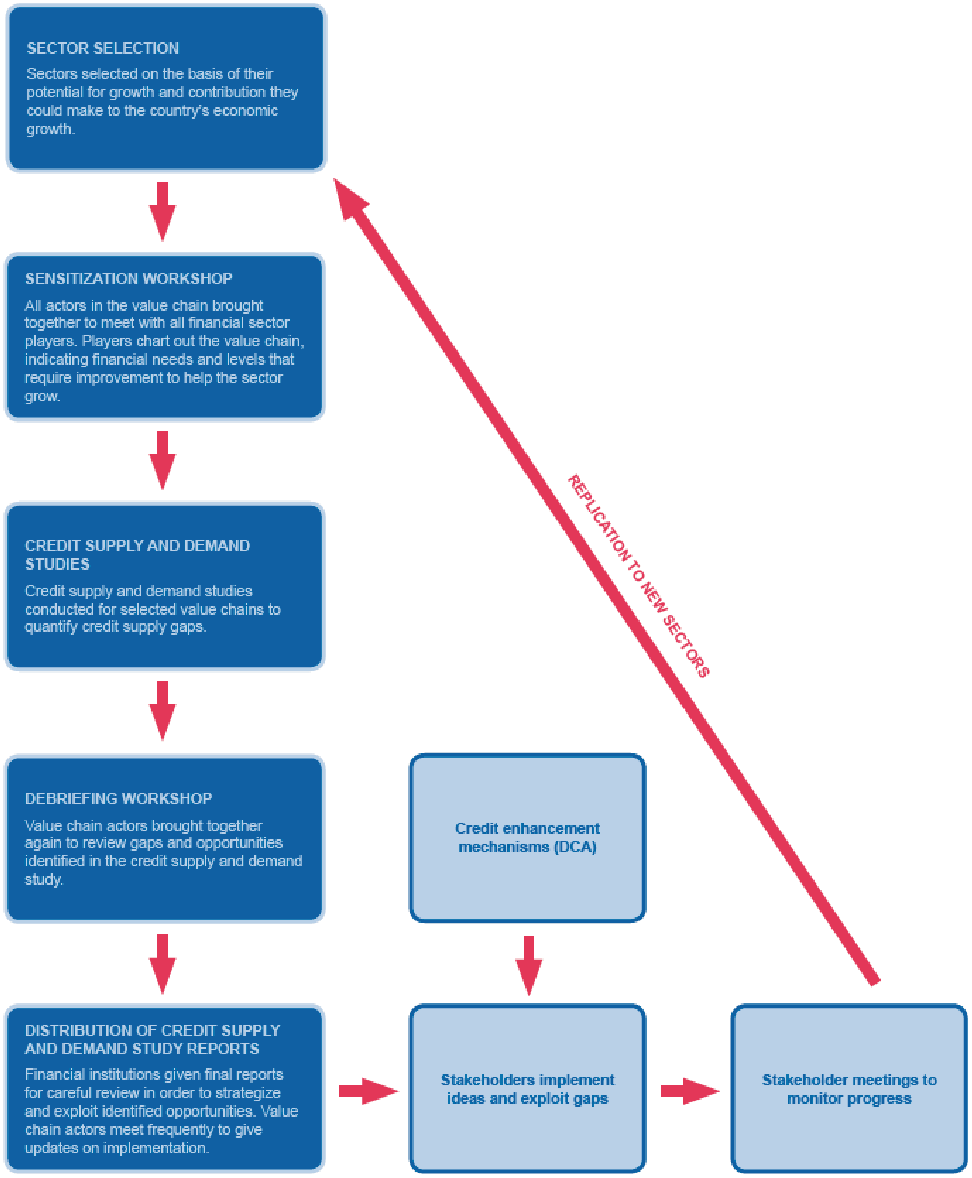
Revealing Financing Gaps

In May 2006, DMS brought together banks, MFIs, input suppliers, processors, and growers from the tea, coffee, and cotton sectors for a three-day workshop on using a combination of a finance sector lens and a value chain approach to perform market analysis. Participants created value chain charts that mapped financial links and supply and demand for credit in each sector. These charts became a tool for identifying financing gaps and generated discussions on how the formal financial sector could fill them more effectively.

Encouraging MFIs and commercial banks to expand lending to MSMEs and rural markets was not an easy task. The cost of delivering financial services in rural areas was perceived to be high. Farmers relied on input suppliers and traders for in-kind credits for inputs. While loan terms were usually "interest free," borrowers often paid dearly through higher prices, limited selection of inputs, and lower prices for their crop. Encouraging private sector expansion into these sectors and into rural areas required a different approach.

DMS initiated a new financing model — a value chain financing approach that focused on breaking down information gaps between producers, processors, and traders and the formal financial sector.

DMS Value Chain Financing Process



The DMS financing model worked by:

- Prioritizing sectors on the basis of their potential for enlargement and the contribution they could make to Malawi's economic growth.
- Bringing actors in a value chain (banks, MFIs, input suppliers, processors, growers, extension workers, research centers, donors) together in workshops to map the value chain and reveal financing gaps.
- Commissioning studies on promising sectors to quantify and qualify the supply and demand for credit.

- Bringing value chain actors back to the table to review credit and supply gaps and discuss opportunities to expand access to financing.

- Sharing final sector studies with financial institutions and other potential investors.

> **The Value of Credit Supply and Demand Studies**
>
> "The real value-added of DMS was the project's ability to gather information on the sector and process it in a way that the various stakeholders could understand. The studies convinced many players … that these sectors deserved a closer look. This was a first for formal financial institutions in Malawi."
>
> *— D.L. Maganga, Managing Director, Afro Management, MSME Support Services*

- Providing financial institutions with an incentive — access to a loan guarantee mechanism — to expand financing to selected sectors.

- Monitoring new lending activity through stakeholder meetings.

The DMS Value Chain Finance Promotion Process

Credit supply and demand studies. The 2006 Value Chain Financing Workshop, organized by DMS, generated high interest among formal credit providers, but they lacked concrete data on the demand and supply of credit in the sectors to move forward with lending. Teaming up with the EU-funded Food Security Joint Task Force and the Malawi Microfinance Network, DMS co-financed credit supply and demand studies for the tea, coffee, and cotton sectors that provided recommendations on addressing financing gaps. These studies were circulated widely through workshops and one-on-one meetings with MFIs and commercial banks.

The project's value chain finance promotion activities are bearing fruit and helping shift perceptions held by actors across the value chain.

- *Banks and MFIs.* Before DMS, inadequate information about value chains made it difficult to see opportunities for investment all along the chain. Now, banks and MFIs see a need to expand their portfolios due to falling treasury bill rates, and view the large volumes of embedded credit extended by traders and processors as an opportunity to expand bank portfolios. Farmers need more than credit services, and banks could provide these services before extending credit. The high risk of default — because farmers were not organized, lacked collateral assets, or because production is subject to climatic risk — can be mitigated by farmer reorganization, direct deduction through processors, index insurance and other crop/livestock insurance products now on the market, or USAID's DCA and other guarantees.

- *Local traders.* Before DMS, these actors perceived banks as too rigid and uninterested. Now, they see bank and MFI involvement in lending to the sector as a means of freeing valuable cash resources for traders and processors.

- *Farmers.* Before the project's value chain activities, farmers saw banks as uninterested, even though loans could be repaid though deduction at the source. Now, they see banks as offering useful services besides credit, and understand that horizontal linkages are essential to opening up access to financial services.

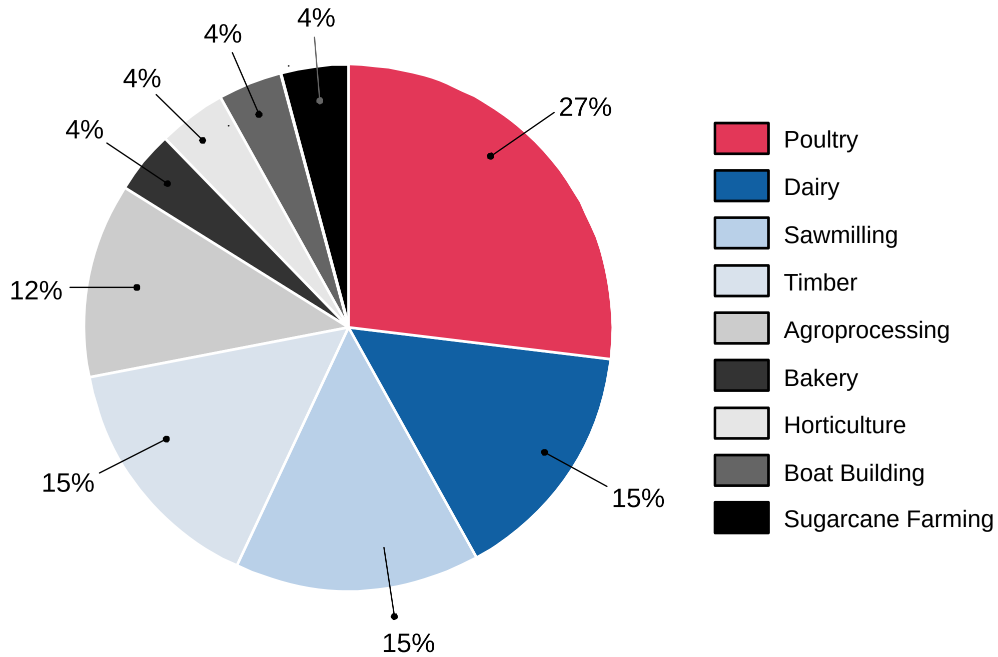
CUMO Microfinance Limited now lends to smallholder tea growers. Interest in targeting the MSME sector has increased. Local commercial banks have set up special lending programs for the agricultural and MSME sectors. NBS Bank established a specialized SME lending department with a focus on agriculture and rural enterprises. First Merchant Bank is also creating a specialized SME lending department with financing from the IFC. Standard Bank and OIBM also lend to the agricultural sector, in part using the Development Credit Authority loan guarantee program established with DMS support. INDEbank, a recent addition to the DCA facility, is targeting SMEs and plans to open a microfinance window.

Eliza Kasakula, who operates a small grocery shop in Falls, Lilongwe, joined Fincoop Community SACCO in 2007. She was attracted by Fincoop's new branding, and thought this small bank would be better than a nearby commercial bank whose interest rates were too high for her. She borrowed $250 from Fincoop, which she used to stock her grocery shop and start a small food business. "Fincoop is good," she said, "they have encouraged me to save on a regular basis, and they allow me to use the savings as security for the loan."

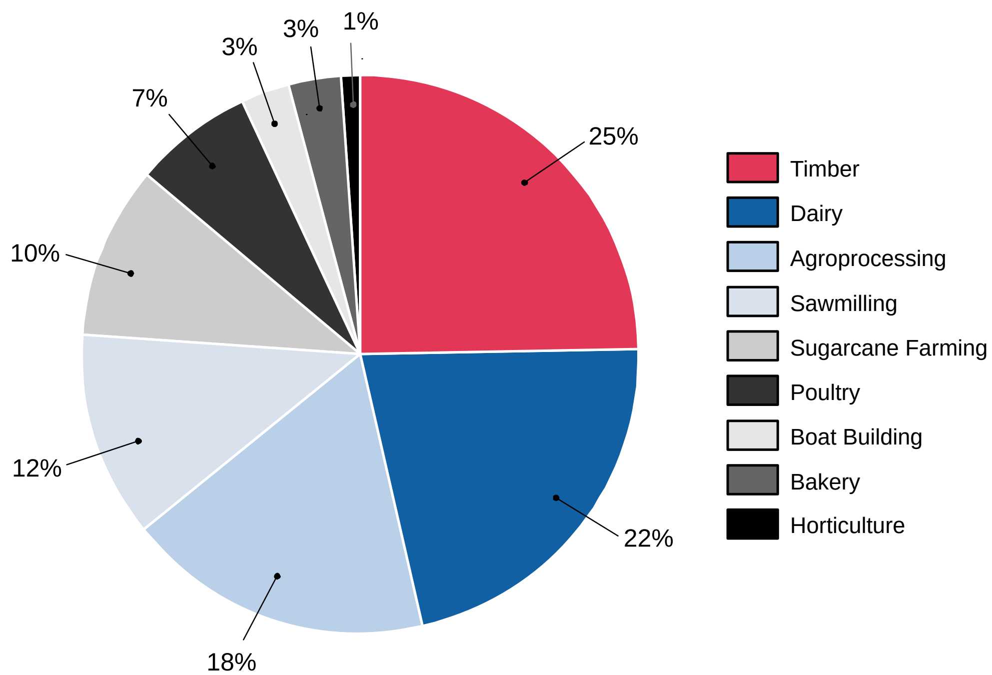
Establishing the Development Credit Authority loan guarantee. To encourage local commercial banks that were reluctant to risk lending to agriculture sectors, DMS facilitated the creation of a $13 million Development Credit Authority multi-lender loan portfolio guarantee facility. The new facility covers 50 percent of the risk of lending to agriculturally linked enterprises. Average loan sizes are $35,000, with an estimated 520 loans issued over the life of the guarantee.

At the end of September 2009, Standard Bank and OIBM had made 27 loans worth more than $1.5 million under the DCA facility to MSMEs in the dairy, sugar, and renewable timber sectors. A third bank, INDEbank, joined to subscribe for $3 million of the facility. To promote best practices in loan portfolio management and risk mitigation, DMS organized regular training on risk management and credit monitoring systems. The charts below illustrate the distribution of loans placed under the guarantee. In terms of numbers of loans, poultry is the largest sector followed closely by wood products processing, dairy, and agroprocessing. In terms of loan value, wood products and dairy lead the way, due to the larger capital investment required of SMEs in these industries.

Percent of DCA Loans by Sector (June 30, 2009)



Percent Value of DCA Loans by Sector (June 30, 2009)



Although the DCA facility is relatively new and many of the loans under the guarantee have been active for less than six months, there are indications that the loans are generating significant new employment opportunities. Since receiving financing, borrowers report that they have hired 213 new permanent employees in nine sub-sectors:

- Timber: 44 jobs
- Agroprocessing: 34 jobs
- Poultry: 28 jobs
- Dairy: 28 jobs
- Sawmilling: 27 jobs
- Boat building: 21 jobs
- Bakery: 20 jobs
- Sugarcane farming: 7 jobs
- Horticulture: 4 jobs

DMS Impact on Value Chains

Cotton. The DMS project's sector study revealed a cotton value chain that is poorly organized at the smallholder level and characterized by low off-farm prices for cotton. Large ginners have historically provided in-kind loans of simple starter-packs to farmers at "zero" interest rate with loan repayments deducted at the time of sale. Negative profit margins discouraged production and encouraged side-selling to avoid loan repayment. Needless to say, formal financial institutions avoided the sector, except at the corporate level. The study revealed the potential for technological innovations to provide non-credit financial services to the sector. Opportunity International Bank of Malawi has started focusing on savings mobilization to cotton farmers in Salima, using a smart card system that provides identification and a means of transmitting payments. In addition, loans for enhanced input packages can increase margins by more than 300 percent.

Tea. In February 2008, CUMO teamed with Malawi Savings Bank, the Smallholder Tea Growers Association, and Eastern Produce Limited to introduce a new loan product targeting smallholder tea growers affiliated with Eastern Produce Limited. Under the agreement, CUMO extends cash loans to smallholder tea farmers and Eastern Produce repays the loans from proceeds of green leaf purchases from farmers. Unlike previous in-kind loans of chemicals and fertilizers from estates such as Eastern Produce, smallholders can use cash loans to finance in-planting (filling gaps in a tea plantation) of tea fields or other income-generating activities to diversify revenue streams to their families. After deducting loan repayments, CUMO deposits the remaining funds into the farmer's savings account at Malawi Savings Bank. The Small Holder Tea Growers' Association helps confirm farmer identification. Recently, OIBM and NBS Bank have begun to pursue payroll-related services and other financial products using mobile banking technologies.

CUMO Microfinance Limited

Since 2008, 1,922 smallholder tea growers have received loans totaling $136,003. For most of the smallholder farmers, the loan from CUMO was the first loan they had received from a formal financial institution. As of June 2009, repayment rates are at 100 percent.

Coffee. The DMS value chain analysis revealed the need for input and equipment finance for the Smallholder Coffee Trust and smallholder farmers. The sector study piqued the interest of Italian ETIMOS Bank, which visited Malawi to explore opportunities in the agricultural sector, and Standard Bank, which now finances the Smallholder Coffee Trust. The study also motivated the Savings and Credit Cooperatives (SACCOs) operating in the coffee sector to explore joining MUSCCO's national network to access credit and acquire capacity building assistance.

Local Cattle Feed Fuels Business

Loan guarantee facility introduced by the DMS project extends capital to new markets

DMS / Ezikiel Phiri

USAID's DCA Facility for Malawi operates through three local banks. To date, 26 enterprises have accessed loans totaling $1,440,554. The facility runs through 2014.

For a long time, Malawi has been a net importer of milk products. The milk shortage was partly a result of a low dairy cow population, but the problem was exacerbated by a lack of nutritious supplementary feed, essential for animal health, herd size, and milk yields.

In 2007, DMS introduced a DCA facility to encourage commercial banks to lend to small businesses in agriculturally linked sectors. The facility provides a partial guarantee of loans made to qualified businesses within the target group. In 2008, using the DCA facility, Standard Bank of Malawi made a $24,647 loan to Ndatani Investments Limited to support the production of cattle feeds and licking blocks. In the past, such types of feeds were only imported.

Ester Kalowekamo, 59, of Lumbadzi in Lilongwe, is one dairy farmer who has benefited from Ndatani's cattle feeds. A mother of 10, Ester owned one dairy cow, which she used to earn income for her family. Due to a lack of supplementary feeds, her cow ate only hay, producing low milk yields.

Using Ndatani cattle feed, Ester's milk yields have more than tripled, increasing from 2-8 liters to 15-30 liters per day. Licking blocks purchased from Ndatani have helped her herd calf more rapidly. She now has four cows.

"Since I started giving my cows Ndatani feed and licking blocks, they have remained healthy and give me much more milk than before." Ester said. With the increased income, she has acquired a 2-acre forest from which she fetches poles for repairing cattle pens and three plots of farm land on which she grows maize to feed her family.

CHAPTER FIVE

SUPPORTING AN ENABLING ENVIRONMENT

By expanding access to capital for MSMEs, DMS sought to invigorate the economy by helping to build inclusive financial markets that would offer financial services to all segments of the population and extend into rural areas. Simultaneously, DMS supported the creation of an enabling policy, legal, and regulatory environment to increase the participation of formal financial sector players in microfinance. An enabling environment is essential for enhancing transparency, promoting expansion, and establishing the rules of engagement for MFIs. The DMS team advised policy-making bodies on updating Malawi's Microfinance Policy Statement and strengthening the legal, regulatory, and supervisory environment for microfinance, to enable licensed MFIs to mobilize deposits. Through meetings and direct contact, DMS encouraged all stakeholders to participate in forums and suggest ways to improve the policy and draft bills. The project's work increased collaboration among donors and national support institutions in advocating for effective government policy that will build a sustainable, robust microfinance industry.

Strengthening the Legal, Regulatory, and Supervisory Environment

> **Shifting Government's Role in Microfinance**
>
> With the growth of private sector MFIs, the Government of Malawi's market share in the microcredit sector has declined, from a high of more than 50 percent of loans outstanding in 2004 to 33 percent in June 2009.

Although the Government of Malawi's passage of a microfinance national policy statement in 2002 was an indicator of its support for the sector, its position as the dominant microfinance supplier prevented the industry from achieving its full potential by raising the specter of market distortions and politically motivated decision-making. One of the project's strategies was to inform policy makers of the progress that could be made by shifting government focus from supplying microfinance to creating an enabling environment. To that end, from the DMS project played the lead role in drafting groundbreaking legislation for Malawi's microfinance sector, keeping stakeholders fully informed and engaged in the process.

To ensure that all stakeholders had opportunity to participate in the various discussion forums, DMS developed and maintained a database of all possible key players and shared this database with lead agencies such as the Reserve Bank of Malawi, the MAMN, and the Ministry of Trade and Private Sector Development. DMS encouraged its partners to be proactive throughout the development and review process. Where resources were a hindrance to partner participation, DMS provided support on a cost-share basis.

Microfinance policy review. Soon after project start-up, DMS, the United Nations Capital Development Fund (UNCDF), and the United Nations Development Programme (UNDP) collaborated with the Ministry of Trade and Private Sector Development to gather stakeholders to review the Government of Malawi's Microfinance Policy Statement. Although the cabinet had drafted and passed the statement in 2002, it was never widely distributed, and many felt that it needed to be updated and re-launched. After a two-day meeting, stakeholders concluded that the statement was relevant and valid but needed to be updated, and that the roles of the stakeholders described within it should be clearer.

> **Clarifying Malawi's Microfinance Policy**
>
> "Had USAID not been available to support redrafting the Microfinance Policy for Malawi, the document would have remained in its original unclear form."
>
> *— Alfred Vilili, Former Director for SME Development, Ministry of Industry and Trade*

Encouraged by this initiative, DMS contracted the University of Maryland's IRIS Center to incorporate input from the 2006 workshop into the policy document and bring it in line with international experience. The revised policy provided guidance on regulations and standards to help formalize the sector, and specified appropriate roles for each type of stakeholder. To support policy implementation, in 2008 DMS collaborated with UNDP/UNCDF to begin drafting a National Microfinance Strategy and Action Plan, including a study tour to Madagascar for a high-level delegation. With UNDP/UNCDF support, the MAMN is leading development of the action plan, which is still in process.

Microfinance legislation. In 2006, the Government of Malawi formed a microfinance legal and regulatory task force, chaired by the Reserve Bank of Malawi. The task force was to supervise a review and analysis of Malawi's microfinance legal and regulatory framework and, if needed, to draft new microfinance legislation. Initial funding for this exercise came from the African Development Bank, and a local consultancy group was awarded a $60,000 contract. Money ran out before the assignment could be completed, however, and only a very rough draft of new legislation was completed.

At this point, the DMS project was asked to take over funding of the exercise and to provide technical assistance by joining the task force. Working closely with DMS, the task force, and other stakeholders, the IRIS Center drafted two bills, one to regulate the operations of microfinance institutions, and a second to regulate SACCOs, also referred to as financial cooperatives. The project provided technical support and shared publications that helped members decide what to include in the drafts, based on lessons from Africa and elsewhere. In the case of the SACCO bill, the World Council of Credit Unions provided substantial technical support through its local affiliate, the Malawi Union of Savings and Credit Cooperatives.

As the bills were being drafted, DMS supported multiple industry symposia and one-on-one meetings to discuss the impending legislation and its probable firm- and industry-level impact. The project team encouraged MAMN members to read the draft legislation, so that they would understand how they might need to transform when the legislation passed. As a result of the exercise, several MFIs, understanding the implications of the proposed law, began to attend forums where they could make their views known. DMS engaged the IRIS Center continuously to ensure that legislation harmonized with international best practices. Once the legislation is passed, microfinance suppliers will apply to the Reserve Bank of Malawi to register their operations under a "three-tiered" system of (i) deposit-taking and (ii) non-deposit-taking MFIs, both of which must be licensed; and (iii) microcredit providers, which need only register with the Reserve Bank.

The proposed laws will open up opportunities for suppliers to develop new products, including micro-housing, micro-leasing, mobile transfers, and mobile phone banking. The laws also will promote transparency and accountability, leading to more responsible lending and safer collateral savings and deposits. The bills specify the role of government entities in MFI registration and licensing, and offer guidance on governance structure, membership, and reporting and capitalization requirements. Under the current system, anyone can engage in microfinance, and SACCOs need only register under the Cooperative Act, which creates no special operating parameters for financial cooperatives, although SACCOs have mobilized nearly $1.2 million in member savings.

Credit referencing. The lack of an adequate identification system and credit referencing mechanism have hindered the expansion of financial services in Malawi. Without credit referencing, financial services providers mitigate risk by lending only to borrowers with whom they are familiar, a practice that typically excludes small or rural enterprises. To help create a legal environment conducive to the establishment of a credit bureau, the Reserve Bank of Malawi drafted a Credit Reference Bill with input from DMS and other stakeholders. DMS has been instrumental in promoting the inclusion of the MAMN and other stakeholders in the Reserve Bank's task force and in reviewing the design of the system. Although the bill is still in draft form, financial service providers (commercial banks and MFIs) are unanimous about the need for credit bureau services. The Bankers Association of Malawi has contracted Credit Reference Bureau Africa, a Kenyan company specializing in credit risk management, to design and set up a credit reference bureau — a welcome development that will enhance the mitigation of credit risk and create opportunities to deepen outreach and reduce lending costs.

Advocating for Effective Government Policy

The DMS project collaborated with the Malawi Microfinance Network, donors, and other organizations in all of its efforts to promote government policies and practices that support the microfinance sector. DMS supported the MAMN in initiating an open dialogue with the government about issues affecting the sector, such as market interest rates, prosecution of loan defaulters, and relocation of vendors from central business districts. Using this participatory approach, the DMS project established a precedent that will ensure the involvement of key stakeholders, especially practitioners, in the development of future microfinance policies and legislation. This approach helps ensure that policies and laws are practical, and do not unnecessarily restrict practitioners. These efforts have unified and increased the advocacy strength of the microfinance industry.

As a result of their participation in drafting new microfinance legislation, several MFIs have begun to reorganize in preparation for the new legislation, scheduled to be enacted later in 2009. In 2007, Concern Universal transformed its microfinance lending unit into a limited liability company, now known as CUMO Microfinance Limited. Project HOPE transformed its lending department into a company limited by guarantee. FINCA Malawi is restructuring to become a licensed deposit-taking MFI. One organization, Participatory Rural Development Organization, has pulled out of microfinance. These movements all define an industry in transition to formalized structures.

In addition to its work to advance enabling policy, DMS promoted the collection and dissemination of industry data to support deepening access to financial services. Many stakeholders have stated that access to industry data through DMS reports was a highly valued service that could not be measured in monetary terms. Several MFIs used the data to identify and benchmark close competitors; some used it to improve their marketing strategies. From October 2008 to March 2009, DMS provided technical input to Malawi's first FinScope study — an extensive survey of financial services demand and supply. The survey provided useful marketing data for financial institutions and revealed the potential to reach rural populations through the use of technology for banking transactions.

Throughout the project, the DMS team facilitated continuous dialogue between government ministries and financial service providers. For example, in response to a government decision to stop supporting payroll (salary) lending, DMS facilitated dialogue between payroll lenders and the government to ensure that the lenders remained solvent. DMS also encouraged payroll lenders to explore other financial products, thus increasing their interest in the microfinance sector and in joining the MAMN.

Demand-Driven Product Retains Customers

One MFI designs a market-driven loan product with technical support from the DMS project

DMS / Teresa Maru

Gerald Mponda received a $1,800 individual loan from FINCA Malawi for working capital for his tailoring business.

FINCA Malawi's individual loan product now accounts for more than one-third of its total loan portfolio and it intends to increase the value of individual loans outstanding by 50 percent in 2009.

In 2006, FINCA Malawi faced a dilemma. New competitors in Malawi's microfinance sector challenged FINCA's methodology of making group loans predominantly to women. New players offering individual loans were poised to lure clients away from FINCA's market base.

To adapt to the changing environment, FINCA explored an individual business loan product. To satisfy market demand while minimizing its risk exposure, FINCA consulted the DMS project for best practice ideas on new product market research, design, and client targeting.

With DMS support, FINCA hired a consultant to survey existing and potential borrowers to identify financing needs, determine break-even points and profit potential, and develop "profiles" of businesses in sectors from carpentry to handicrafts. The survey produced a report of the typical financing needs of high-potential businesses. FINCA's staff was trained to update the profiles on an ongoing basis.

The results of the exercise have been extremely positive. The individual loan product now represents 35 percent of FINCA's total loans outstanding, contributing significantly to FINCA's achievement of operational sustainability for the first time in 2008. In 2007, its financial sustainability was 83 percent; this increased to 108 percent by 2009.

The business profiles also have reduced delinquencies, as loan officers target clients more carefully. FINCA's portfolio at risk for individual loans dropped from 12.53 percent in 2007 to 8.4 percent in 2009.

CHAPTER SIX

LOOKING FORWARD

Malawi's microfinance sector is in transition, as it has been since the DMS project started five years ago. DMS catalyzed this process by mobilizing stakeholders to increase collaboration, breaking down information asymmetries, and introducing global lessons learned that can be adapted to Malawi. The project helped demonstrate that microfinance is no longer a frontier development tool with the potential to reduce poverty. Microfinance is now in the mainstream and works best when it is run as a commercial activity. Over the life of the project, there has been a massive shift in the attitude of stakeholders; microfinance and other non-bank financial services are seen as an integral part of the country's financial sector and a critical area to nurture.

DMS helped stakeholders identify key constraints the sector faces and work together to overcome them. It helped increase the capacity of MFIs and banks to serve the MSME market and provide access to increasing amounts of commercial capital, much of it sourced for the first time from the private sector. Nevertheless, serving this market on a competitive and sustainable basis remains a challenge. This report concludes with a review of lessons learned and some ideas for future assistance that could help Malawi's microfinance sector grow and prosper.

Helping MFIs Find New Markets

"Microfinance is a volume-driven business. DMS revealed the market to us, generating research that was difficult to come by. Armed with the sector studies DMS produced and the best practices they shared, we said, 'Aha! We need to do things differently. What else can we be doing? Where can we have impact?'"

— Aleksandr Kalanda, CEO
Opportunity International Bank of Malawi

Lessons Learned

Employ holistic, integrated approaches. DMS approached the microfinance sector as a system of interdependent elements that required capacity building across the board and worked at the macro, meso, and micro levels to address various components, including policy, legislation, financial service providers, and support structures. The project led the effort to draft groundbreaking microfinance legislation to open up deposit-taking as a means of increasing loan capital, while simultaneously building the capacity of individual MFIs and the sector as a whole to strengthen management, reporting, and financial structures in compliance with the standards the new laws would set. These capacity building activities, in turn, improved the firms' financial performance, which made them more likely to qualify for commercial loans and attract private equity investment.

Eliminate information asymmetries. DMS strove to remove information gaps within the sector to help identify constraints and opportunities. The project's sector studies generated data on the coffee, tea, and cotton sectors, and led financial institutions to explore downscaling as a means of testing new markets. Institutional assessments revealed ground-level realities to MFI management, contributing to improved management decisions and product restructuring. DMS identified and shared information on new research findings and opportunities by renowned organizations (including Consultative Group to Assist the Poor, the International Fund for Agricultural Development, and Triodos) with all partners and stakeholders, resulting in new strategic partnerships and investment linkages. Finally, the project's continuous efforts to encourage the microfinance community to review new laws and share their views with policy makers resulted in draft legislation that is more representative of the industry's present and future needs of the industry.

Implement client-focused, demand-driven activities. DMS prioritized technical assistance to high-potential organizations whose senior management exhibited the willingness to commit time and resources to leverage DMS assistance. Partners were brought on to match funding flows, to ensure that support activities occurred as promised. This approach enabled DMS to manage expectations and use scarce resources effectively; the project always focused on solving the most pressing problems with the largest returns. DMS maintained close and continuous contact with all of its key partners and delivered a substantial amount of technical assistance through project staff. These actions established trust at all levels of partner organization, revealed insights that might not otherwise have been seen, and helped ensure follow-up for every technical activity.

Recommendations

Build microfinance sector capacity. Partnerships with other donors, Malawian MFIs, the MAMN, and other financial sector players amplified the assistance provided by the DMS project. Many MFIs have only recently "turned the corner" and showed profits for the first time. Others are entering new markets and introducing new products that could benefit in the short term from further assistance. Targeted, demand-driven assistance will help these institutions build on the strong foundation that USAID established through DMS and continue to expand the sector.

Capacity Building for Growth

"We look at a market of 4.2 million in Malawi. We cannot grow responsibly without capacity building. We need strategies to continue to provide convenience and security to our customers."

— Aleksandr Kalanda, CEO
Opportunity International Bank of Malawi

Technical assistance for the microfinance sector will be particularly crucial to ensure compliance with new regulations when the pending legislation is passed. Assistance is also needed to give a leg up to the few MFIs strong enough to make the changes needed to obtain a license to mobilize and on-lend savings deposit. Should they succeed, they will help satisfy the unmet demand for savings services and obtain a low-cost source of funds to expand their lending operations.

The sector would also benefit from market research and advocacy to drive the introduction of new financial products. For example, facilitating relationships with telecommunications companies and supporting new legislation that addresses electronic payment systems could pave the way for sweeping advancements in mobile money transfers.

Foster an enabling environment. While draft legislation for microfinance institutions and financial cooperatives is pending approval by the Malawian parliament as part of the financial services bill, much more support is needed. The Reserve Bank of Malawi has requested assistance with introducing the key concepts of the pending financial services bill to the new parliament, to facilitate its passage. Should the legislation be approved, technical assistance will help MFIs and savings cooperatives transform themselves into regulated institutions and enable them to benefit more quickly from the legislation. Several MFIs would like to apply for a deposit-taking license, which would mean that they would have to reorganize to become a limited liability company and meet the other requirements spelled out in the proposed bill. SACCOs would also need to meet these requirements.

Emphasize market research. In a changing environment, the financial sector will need to anticipate and respond to shifting market preferences. Commercial banks, MFIs, and financial cooperatives should use market research to design innovative, demand-driven products and services. New technologies, such as biometric smart cards, have already begun to reach rural areas and can flexibly support a wide range of services.

Mobile banking is an information technology innovation that could exponentially increase the microfinance supply in Malawi, as has already happened in other countries. In Malawi, banks and several MFIs are investigating the model and drafting strategic plans to initiate the service. Possible areas of assistance include assessing client demand, researching technologies, and brokering new relationships with software and telecommunications firms to launch new products and services. Likewise, increasing competition will push firms to differentiate themselves and develop new or revised products such as leasing, insurance, and savings.

Introduce DCA. The $13 million DCA credit facility in Malawi has helped expand access to credit to 26 new enterprises. Hundreds more are expected to benefit. Future technical assistance will be important to help banks identify bankable SMEs, become attuned to agriculture-linked markets, and work with bank loan officers to better understand SME borrowers.

ANNEX A

CORE DMS PARTNERS

Finance for International Community Assistance Malawi (FINCA Malawi)
Shafi Nambobi
Private Bag 382
Chichiri, Blantyre 3
+265-1-822256
shafi_nambobi@fincamalawi.org

Malawi Union of Savings and Credit Cooperatives (MUSCCO)
Sylvester Kadzola
P.O. Box 651
Lilongwe
+265-1-756000
skadzola@muscco.org

Promotion of Rural Initiatives and Development Enterprises Malawi (PRIDE Malawi)
Cornelius Majawa
P.O. Box 2131
Blantyre
+265-1-833453
cmajawa@pridemalawi.com

Opportunity International Bank of Malawi (OIBM)
Aleksandr Kalanda
Private Bag A71
Lilongwe
+265-1-758403
akalanda@oibm.mw

CUMO Microfinance Bank Limited (CUMO)
Bola Garbadeen
P.O Box 217
Dedza
+265-1-223604/694
bola.garbadeen@concern-universal.org

Malawi Microfinance Network (MAMN)
Catherine Jamu
P.O. Box 1804
Lilongwe
+265-1-750668
mamn@africa-online.net

ANNEX B

MFI SERVICE PROVIDERS

Local Service Providers

Afro Management
Dick Maganga
P/Bag B306
Lilongwe 3, Malawi
dickmaganga@gmail.com
+265-888-199606

O & M Associates
Alex Mkandawire
P.O. Box 32105
Chichiri Blantyre 3
omassociates@africa-online.net
+265-1-834878 / 01-822902

Millennium Consulting
Stanley Nyirenda
Old Mutual House
Box 30880
Capital City, Lilongwe 3
millennium@globemw.net
+265-1-750-409/406

Kadale
Jason Agar
P.O. Box 2019
Blantyre, Malawi
kadale@africa-online.net
+265-1-872933 / 875520 / 875576

Dawa Productions
Emma Judge
P.O. Box X365, Post Dot Net
Crossroads, Lilongwe
dawa@africa-online.net
+265-999-349-598

Regional Service Providers

Fineline Management Systems
Kamau Kabbucho
Riara/King'ara Roads Junction
P.O. Box 54536
Nairobi, Kenya
fsm@finelinesml.com
+254-2-573165/6

MicroSave Africa
David Cracknell
Box 76436, Yaya 00508
Nairobi, Kenya
david@microsave.org
+254-20-2724801 / 2724806

CD-ROM INDEX

Final Report

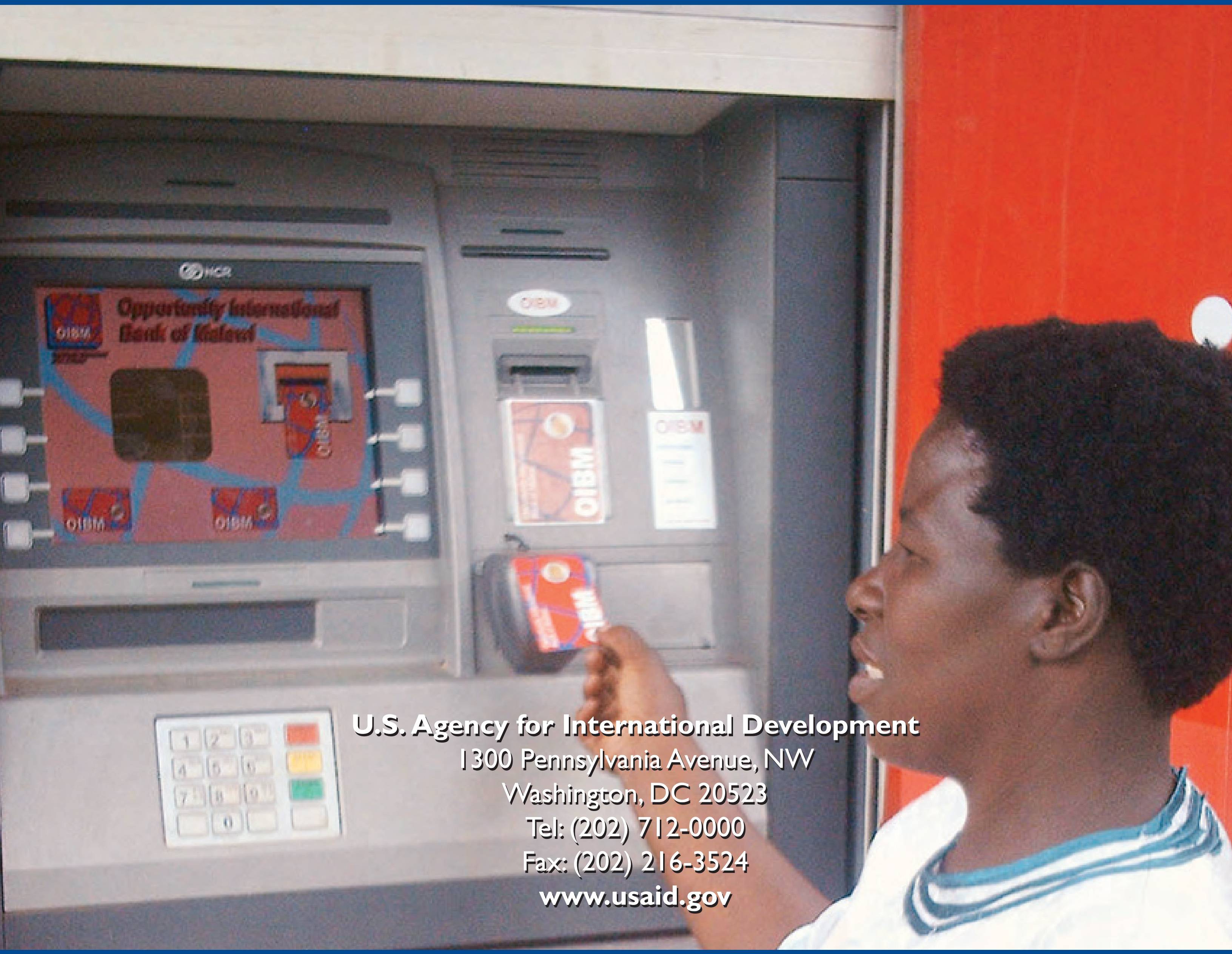
Credit Demand and Supply Study of Malawi's Tea Sector

Credit Demand and Supply Study of Malawi's Coffee Sector

Credit Demand and Supply, Cotton Sector, Malawi

Malawi Union of Savings and Credit Cooperatives – Financial Management and Accounting Systems Manual

Assessment of the SME Sector in Malawi in Preparation for a Development Credit Authority Loan Portfolio Guarantee



U.S. Agency for International Development
1300 Pennsylvania Avenue, NW
Washington, DC 20523
Tel: (202) 712-0000
Fax: (202) 216-3524
www.usaid.gov