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Microfinance for Poverty Alleviation in Myanmar

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Abstract

Microfinance has become a significant global phenomenon, as an effective means of providing financial services to poor and low-income people who don't generally have access to these services from formal financial institutions. In recent years the concept of *Financial Inclusion* has become increasingly widespread in the realization that the underserved population requires a broad range of such services, not merely savings and credit, to enable them to conduct their financial lives more efficiently.

Microfinance assists poor people in gaining access to usefully large sums of money which they require for different purposes. It does so by means of innovations in loan contracts, which allow microfinance institutions (MFIs) to limit losses despite lacking good information on borrowers, and without requiring collateral as security. The main innovation is the "*group lending*" mechanism, to apply social pressure for contract enforcement. Another vital factor that strongly influences repayment is the promise of access to future loans and services.

The two key principles that the industry generally focuses on are *outreach* (the scale of activity in terms of numbers of clients) and *sustainability* (the degree to which the MFI covers its costs). To become sustainable, MFIs charge rates higher than those of formal sector institutions (as their costs are also relatively higher), but well below those informal moneylenders, the main alternative source of credit for poor households. While empirical evidence has not been able to illustrate a significant impact on poverty alleviation, it does show that access to the right financial services helps poor people to build more secure lives by allowing them to more regularly spend resources to cover basic needs and protect themselves from risks.

Microfinance has also had an effect on women's empowerment in terms of increased ownership of assets and an enhancement of their status in the household and at the community level, although this has been partially offset by the new set of challenges women face by bearing the responsibility repaying loans they have taken.

In Myanmar the microfinance sector has developed rapidly since the government enacted a Microfinance Law in November 2011, but MFIs still play a very minor role in the provision of financial services in the country.

The overall level of financial inclusion remains very low, with only 30% of adults using regulated financial services. The rural usage of financial services (53%) exceeds the urban usage (45%), which is a reversal of the normal global pattern. The reason for this is that development assistance to the micro-finance sector was focused on rural areas.

The Microfinance Law has provided an enabling framework for the sector, but certain areas of the regulation may inhibit expansion of credit to priority areas, such as rural and agricultural (interest rate caps, loan size caps and access to capital).

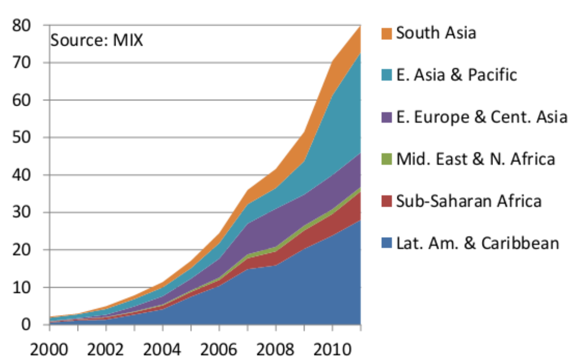
In order to strengthen the sector, it is recommended focus on the areas of policy, capacity development, capital incentives and research and data, with some suggested actions within each of these.

Together with some complementary measures in other sectors, the promotion of a higher level of financial inclusion can offer the chance for poverty alleviation on a large scale in Myanmar.

1. Introduction

Access to capital is a key constraint that poor and low-income people face in many countries. Commonly they don't even have access to basic savings accounts, let alone more advanced financial services. Commercial banks and financial institutions generally do not lend money to low-income individuals, because they are focused on the upper, more profitable segment of the market. Additionally, there are other barriers such as the high transaction costs of processing small loans as compared to larger ones and the absence of reliable information about such individuals. They, in turn, lack the types of collateral that formal institutions normally require. Microcredit provided a solution for these problems by offering a methodology for the provision of small loans to help poor people to engage in productive activities. In the last decade particularly, it has become a significant global phenomenon (see Figure 1).

Figure 1. Outstanding Microloans by Region, 2000–11 (USD billions)



However, credit alone is insufficient. Experience has shown that access to a broader portfolio of financial services (credit, savings, remittances, electronic payments and insurance) is required to improve the welfare of the underserved population. This helps them to conduct their financial lives more efficiently, manage risks, provide the seeds of economic growth and build up wealth over time. The microfinance industry has learned that poor clients are willing to pay for such a variety of financial services and also, contrary to earlier belief, that they already save, informally and in kind (e.g., animals, jewelry, or cash hidden at home). However, such types of savings are risky for clients as assets can be lost or stolen and animals can die, so that putting their savings in an account provides increased security for clients.

The concept of Financial Inclusion is a way to look at the financial system that has become increasingly widespread. An inclusive financial system is one that will support the full participation of lower income households and microenterprises in the formal financial system, rather than merely using existing informal options. This means reaching out to poor and low-income clients and providing them with financial services tailored to their needs, at a cost affordable to the customer and sustainable for the provider.

This brief will look at Microfinance as one of the elements that constitute financial inclusion.

2. Methodology

One of the problems poor people often face is that their incomes are low, irregular and unreliable, so they don't easily have access to usefully large sums of money. They need these to deal with big expenditures (e.g. marriage, homemaking, education, enterprise), emergencies, or just to ensure that their basic needs are met every day and not just when income is earned.

Two ways to get access to such lump sums is by "saving up" or "saving down"[1]. While saving up is the regular way of accumulating savings, saving down is another way of looking at borrowing, because repaying loans also depends on the act of saving. The only difference is that the lump sum becomes available before, rather than after, a series of savings.

The standard narrative of microfinance is that these lump sums are used for and repaid from an investment project. However, in practice, microfinance installments are paid from a combination of wage income, self-employment income and whatever other money can be got together by households. This is because the revenue from an investment may not match the usual weekly installment structure of microfinance repayments, and some investments do not start generating revenue until long after loan repayments have started. Microfinance institutions are

[1] *Rutherford, 2000*

thus effectively lending against expected household cash flows rather than a specific enterprise.

The key to making microfinance work has been the development of innovations in loan contracts, allowing microfinance institutions (MFIs) to limit losses despite lacking good information on borrowers, even without requiring collateral as security.

One of the problems that these innovations address is that of moral hazard, which arises when borrowers lack incentives to repay their debts. When not required to pledge collateral, borrowers are more likely to take imprudent risks. The other problem is that of adverse selection, whereby, without a collateral requirement, many prospective borrowers are those least likely to be able to repay loans.

The way that these problems are solved in microfinance is by essentially outsourcing the costly jobs of vetting and monitoring customers to communities. This is done by means of "group lending" in which multiple borrowers from the same locality obtain separate loans, but are jointly liable for each other. The logic is that borrowers do have good information about their neighbors and can apply social pressure as a contract enforcement mechanism that is not available to banks.

Another vital factor that strongly influences repayment is the promise of access to future and progressively larger loans (and the threat of losing future access).By achieving a remarkable level of transparency and standardization with regard to customer transactions, microfinance institutions have succeeded in many places in creating a high degree of institutional reliability and credibility, allowing borrowers to trust the process.

Box 1: Brief History of Microfinance and Evolution to Financial Inclusion

1970s

- *Subsidised agricultural credit; emphasis on poverty alleviation led to large-scale losses.*
- *In Bangladesh, Grameen Bank pioneers banking services for poor.*

1980s

- *Rise of the "financial systems" view and shift in the paradigm from subsidized credit delivery to commercial financial services.*
- *MFIs to be operated in a more business-like way to become sustainable, charging prices to cover cost and holding borrowers accountable for repayment.*
- *Realisation that microfinance could provide large-scale outreach in a profitable way.*

1990s

- *Shift from microcredit to microfinance as it became clear that poor people need a variety of financial services, not just loans*
- *Microfinance starts to develop as an industry.*
- *Development of appropriate regulation and supervision for licensed microfinance institutions.*
- *MFI rating agencies began operation.*
- *Worldwide networks of microfinance practitioners were formed for disseminating information about best practices in commercial microfinance*

2000s

- *Further commercialization with greater for-profit orientation: investment funds, commercial banks, MFI IPOs.*
- *Further product development: micro-insurance, remittances, housing loans, mobile banking.*
- *Concept of Inclusive Financial System with a variety of retail financial service providers, meso-level financial infrastructure and enabling policy framework at macro-level.*
- *2005 - UN Year of Microcredit.*
- *2006 –Grameen & Prof. Yunus win Nobel prize*

3. Key Concepts in Microfinance

In Microfinance the two key principles that MFIs (and funding organisations) generally focus on are **outreach** and **sustainability**.

Outreach refers to the scale of activity and reference is made to both the breadth and depth of outreach. Breadth measure the numbers of clients reached while depth indicates their level of poverty. Most MFIs aim for *'broader'* and *'deeper'* outreach. Sustainability measures the degree to which the MFI covers its costs and is defined on three levels:

- Level one: MFI is highly dependent on subsidies and hence unsustainable.
- Level two: Operational self-sufficiency where an MFI covers all non-financial operational expenses (salaries, overheads, administrative

expenses, depreciation of fixed assets, loan losses, etc.) from its interest income and other revenues.

- Level three: Full self-sufficiency where an MFI covers both operational costs and financial costs of loan capital from revenues.

To reach self-sufficiency, MFIs have to charge interest rates at the appropriate level to cover their costs and a criticism of microfinance that is often heard is that this level is 'too high'. However, it needs to be considered that the costs of 'doorstep delivery' of small-scale financial services are relatively high. Furthermore, sustainability is not an end in itself.

Sustainable MFIs can achieve independence from donor funding, which is anyway limited, and gain access to much larger amounts of commercial capital, such as bank loans and equity investment. This in turn allows them to expand their operations and reach many more clients. For clients, the value proposition of a sustainable MFI is that it is in a better position to offer continuous access to affordable financial services over the long term.

Microfinance interest rates are often wrongly compared to those charged by banks and other formal sector institutions. As noted above, poor households generally do not have access to the services of such institutions. Instead they often have to approach informal money lenders and the comparison should be with the rates that they charge, which are generally significantly higher than those of MFIs.

4. Impact of Microfinance

The microfinance movement has achieved notable successes, in terms of increasingly efficient microfinance institutions providing a growing number of clients with a broader range of financial services, especially since the late-1990s, but it has also faced some challenges and criticisms[2]. The main criticism concerns the impact of microfinance. Countless studies have tried over the last two decades to assess the impact of microfinance on poverty reduction with little conclusive evidence. More recent empirical evidence is emerging by using methodologies similar to medical trials. Access to specific new services is randomly assigned, and the impact of a change in access on one customer group is compared to a second group without that same access. The results of these studies are consistent in finding no impact on the various dimensions of poverty.

However, while microfinance cannot be relied upon address poverty, a growing body of empirical evidence shows that access to the right financial service at the right time helps households build assets, generate income, smoothen consumption, and increase their capacity to manage their exposure to risks. This amounts to giving households control over key parameters that can affect their livelihoods. This is development as freedom[3]in the sense of people expanding control over their circumstances[4].

This also relates to another impact of microfinance that has been much studied and debated, which is on women's empowerment. A distinctive characteristic of microfinance is that globally, women are the predominant clientele. This is primarily the result of the observation that they tend to spend their earnings more on family welfare as compared with men. While a number of studies have shown that access to financial resources can have a positive impact on women's empowerment[5], it is not always the case.

It is true that women participation in microfinance services has often led to an increase in women's control over savings and income generated from business, their participation in household decision-making, their household ownership of assets, their self-esteem, and their mobility. This in turn has led to an enhancement of their status at both the household and the community level as well as greater participation in activities outside the home. However, making money available to women has also created a new set of challenges for women, thus balancing the experience of empowerment with the experience of extra burdens[6]. For example, the responsibility and accountability for repaying the loans often cause

[2] *Roodman, 2012*

[3] *As expounded by AmartyaSen, including political freedoms and freedom of opportunity and economic choices.*
[4] *Collins, et. al. 2009*
[5] *Littlefield, et.al. 2003*
[6] *Kulkarni, 2011*

women increased levels of stress and even dependency, as they may need to borrow from other sources to repay, leading to indebtedness[7].The socio-cultural context is also significant in this regard, as 'empowered' women become more willing to challenge established gender norms, which can lead to social tensions.

Financial inclusion may never create the self-employment revolution which originally inspired policymakers and investors, but it might rather be the foundation that billions of poor families need to build more secure lives on their own terms.

5. Microfinance in Myanmar

a) Brief History and Legal Framework

Microfinance operations in Myanmar only started in the late 1990s as part of the UNDP Human Development Initiative (HDI) and while it has grown significantly since, it is still in a nascent stage. It is only relatively recently, in November 2011, that the government of Myanmar approved a microfinance law as a means to address its policy goals of rural development and poverty reduction by achieving a higher level of financial inclusion. The law established the Myanmar Microfinance Supervisory Enterprise (MMSE) under the Ministry of Finance as the regulator and supervisor of the sector. The policy-making body is the Microfinance Business Supervisory Committee (MBSC). It is currently the only financial sector law which permits both domestic and foreign-owned entities to participate in the market.

The Microfinance Law provides for MFIs to extend microcredit to the poor, to accept deposits from them, and to provide remittance and insurance services (although currently only the first two are allowed). The new law gives a distinct legal status to MFIs, regulates the interest rate[8] and enables them to provide a wide range of financial services: credit, savings, insurance and transfer services. The key requirements for licensed MFIs are:

- To have a legal status as a cooperative, an NGO, or as a private local or international company or organization.
- To have a minimum capital of 15 million kyat (US$ 15,416) for non-deposit taking institutions and 30 million kyat (US$ 30,832) for deposit taking institutions.

b) Supply Overview

As of January 2014, a total of 189MFIs have received licenses to conduct business (see Box 2).

Based on data from MMSE, microfinance outreach of licensed MFIs as of December 2013was over800,000 clients nationwide, with a total portfolio loans outstanding of 68.6billion Kyats (US$70million). That data did not include UNDP supported microfinance project clients of about 425,000, meaning that a total of 1.23 million clients at least were receiving loans totaling 144 billion Kyats (US$ 147 million).PACT is the largest, with its 133 branches serving about 50% of all active MFI clients. The largest numbers of clients served by MFIs are in Yangon, Ayeyarwaddy and Magway Divisions. With the major exception of PACT, currently the biggest microfinance service provider in Myanmar, MFIs are generally not found in the more rural, lower-income regions.

Box 2: Licensed MFIs in Myanmar

International NGOs	6
Local NGOs	19
Cooperatives	75
Foreign Companies	5
Local Companies	84
Total	189

Source: MMSE

Myanmar Agriculture Development Bank (MADB) serves some 1.4 million clients through its nationwide network of over 200 branches, primarily with subsidized credit for farmers, however not all these clients are engaged in micro-finance institutions.

The cooperative sector is another large provider of microfinance services. Apart from the 75 licensed MFI cooperatives under the Central Cooperative Society (CCS), other financial cooperatives are organized under the Union of Savings and Credit Federation (tertiary level society), which,in2013,had2,340 primary level societies[9].

[7]*The 'Smart Campaign' works to promote responsible lending practices among MFIs globally.*

[8]*A maximum lending rate of 30 percent per annum or 2.5 percent per month and a minimum rate on deposits of 15 percent per annum or 1.25 percent per month.*

[9]*Chamberlain, et. al. 2013*

As part of the Making Access to Financial Services Possible (MAP) Myanmar initiative, funded by UNCDF and LIFT and implemented as part of UNDP's country programme, are presentative survey, across 5,100 households nationwide, of the demand for financial services in Myanmar (FinScope) was undertaken in 2013.

According to Finscope, commercial banks provide the largest single component of this credit (44%), but serve only 0.4% of clients. The second largest provider category is informal money lenders, who provide 39% of credit by volume and serve 34% of clients. The largest single provider by number of clients is MADB which serves 9% of clients (2% by value). Cooperatives serve 5% of clients and MFIs 4%, each providing less than 1% of total credit by value[10].

c) Demand Overview

FinScope reports that 50% of adults use financial services from either a regulated or an unregulated service provider. A total of 30% of adults use regulated financial services, while 20% use unregulated services only. The remaining adult population use financial services from friends and family (26%) or do not use any form of financial services (24%). It also found that rural usage of financial services (53%) exceeds urban usage (45%), which is a reversal of the normal global pattern[11].

Total informal lending (as a proxy for demand) is estimated at 9.2 million clients with 3.5–5.4 trillion Kyats in outstanding informal loans. Since globally comparative financial access policies target population segments with income of up to USD 15 per day, at least 75% of the Myanmar adult population can be considered as the target market for financial inclusion policies, which makes it clear that there is currently a large gap to be filled.

6. Current Policy Issues/ Constraints

While the Microfinance Law has provided an enabling framework for the sector, there are certain areas of regulation that may discourage and possibly inhibit expansion of credit to priority areas, such as rural and agriculture (interest rate caps, loan size caps and access to capital).

- The interest rate ceiling for loans and the spread between deposits and loans (15 percent per annum) is too low for substantial expansion into rural areas in a sustainable way. The transactions costs associated with serving rural clients are much higher compared to urban areas, due to a lower population density with greater distances between groups of clients and poor infrastructure, making it more difficult to reach them.

- MMSE has recently issued a directive capping loan sizes for MFI clients at 500,000 Kyats. This is related to the policy view of microfinance as serving primarily to alleviate poverty. However, setting such a low cap may actually undermine the outreach, poverty impact and sustainability of the microfinance sector. Firstly, a cap on the size of loans will cut off existing MFI clients who have graduated over time to larger loans from further access, while also excluding small and microenterprise. These clients are still low income with little or no access to other formal sources of credit. A second effect of a loan size cap is that it does not allow MFIs to have a balanced portfolio. A very low maximum loan size limit does not give MFIs the opportunity to balance (cross-subsidise) the more costly small loans with less costly larger loans, which affects their overall profitability, their sustainability and hence their capacity to serve their clients in the long term. International best practice is to institute a limit on average loan amount outstanding across the entire portfolio of an MFI, which preserves overall targeting to poor clients, while still allowing some flexibility by virtue of being an average amount.

- MFIs currently find it difficult to raise capital for expansion and this is at least in part due to regulatory and supervisory restrictions in sourcing both foreign and domestic capital. Deposit-taking MFIs are also limited in their ability to use deposits as funding for loans and in any case, the interest rate minimum for deposits also make this a relatively expensive source of capital, considering the high transaction cost of mobilizing savings through numerous accounts with very small balances.

[10] *Ibid.*
[11] *Ibid.*

- The minimum capital requirements are too low, especially for deposit-taking MFIs[12]. According to global good practices on microfinance to enable depositor protection[13], deposit-taking institutions of significant scale require specific prudential regulation and supervision that ensure these institutions are solvent. The failure of one or more institutions can have devastating effects on the entire sector.

7. Recommendations

The following provides some key recommendations in brief to strengthen the sector as more detailed ones can be found elsewhere[14]. Furthermore, the MAP Myanmar initiative aims to formulate a roadmap and action plan for financial inclusion, which will also highlight the mutually reinforcing links between increasing financial inclusion and other public policy objectives.

- **Policy**: Policies establish the foundation upon which the financial sector is built. There is a need to convene stakeholders in workshops and other forums to review current laws and regulations and ensure that the regulations are enabling the development of financial inclusion, in particular with regard to reaching remote and rural areas. In addition, deliberate efforts to promote financial inclusion would be very helpful in pushing forward the development of the sector, for example by formulating broad financial inclusion policy commitments and targets and translating these into an effective implementation process.

- **Capacity development**: A key need in Myanmar is the capacity development (through technical assistance and training) of human resources, to support the emergence of sustainable retail providers and the strengthening of regulatory and supervisory capacity for the long-term growth in financial inclusion.

- **Capital incentives**: To promote an increased provision of capital, active financial incentives are needed where existing risks present barriers for market creation and growth. Such incentives include targeted smart subsidies and 'patient capital' with a longer term perspective.

- **Research and data**: Although the MAP process will result in a significant improvement in the understanding of the demand and supply-side of financial inclusion in Myanmar, there are still knowledge gaps about un or underserved market segments and areas for further research. At the same time, the microfinance sector is evolving rapidly, as is the financial sector in general, and it is important that effective mechanisms are developed for policymakers and stakeholders to remain up to date.

In the context of Myanmar's recent opening up and reform process, microfinance and financial inclusion more broadly, have been identified by the government as a policy priority. As mentioned earlier, it may not be a sufficient element in helping poor people to escape from poverty, but can certainly play a key role in helping them to better manage their lives. In this way it provides a foundation that, together with measures such as skills training, market access, employment opportunities and improved infrastructure, among others, can offer the chance for poverty alleviation on a large scale.

[12] *For comparison, the minimum capital requirement in Cambodia for deposit-taking MFIs is around US$2.4 million (National Bank of Cambodia 2012).*
[13] *Christen et.al. 2012*
[14] *Duflos, et. al. 2013*

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