

THE GOVERNMENT OF
THE UNION OF MYANMAR

JAPAN INTERNATIONAL
COOPERATION AGENCY

Myanmar-Japan Cooperation Programme for Structural Adjustment
of the Myanmar Economy

FISCAL AND MONETARY POLICY WORKING GROUP

STUDY ON THE FINANCIAL SECTOR

Volume II — [1]

Final Report

On

MICROFINANCE DEVELOPMENT IN MYANMAR
TOWARD SUSTAINABLE FINANCIAL SYSTEMS

Executive Summary

January 2003

The Japan Economic Research Institute

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Abbreviations and Acronyms

BRI	Bank Rakyat Indonesia
CARD	Center for Agriculture and Rural Development
CBI	Capacity Building Initiative
CBO	Community Based Organization
CDRT	The Community Development for Remote Townships
FAO	Food and Agriculture Organization of the UN
GRET	Groupe de Recherche et d'Echanges Technologiques
INGO	International Non Government Organization
K	Kyat
MADB	Myanma Agricultural Development Bank
MFI	Microfinance Institution
MNCC	Myanmar National Credit Council
MMCWA	The Myanmar Mother and Child Welfare Association
NGO	Non Government Organization
PACT	Private Agencies Acting Together
SRG	Self – Reliant Group
UNDP	United Nations Development Programme
UNOPS	United Nations Office for Project Services
YMCA	Young Men's Christian Association
YWCA	Young Women's Christian Association

PREFACE

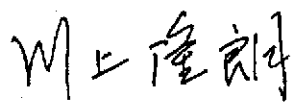
This report describes the results of the study titled Study on the Financial Sector, which covers both the banking sector and microfinance. This is one of the study components of the Fiscal and Monetary Policy Working Group (FMWG) within the framework of the project titled *Myanmar-Japan Joint Study for Economic Structural Adjustment in Myanmar*.

JICA organized a study team led by the Japan Economic Research Institute, headed by Mr. Hirohiko SEKIYA. The study team visited Myanmar seven times between November 2001 and December 2002 to hold a series of discussions and conduct several field surveys, and led a unique microfinance study tour in the Philippines with the kind support of relevant organizations in the country. I would like to highlight that this report is an outcome of joint research, conducted through mutual understanding and close cooperation of Myanmar and Japan's FMWG taskforce members, experts, and the study team.

I hope that this report, including its useful suggestions, will be used practically not only for JICA's future aid programmes but also by the Government of Myanmar, concerned organizations, officials and experts to contribute to further development of the financial sector in Myanmar.

I wish to express my sincere appreciation to the officials concerned in the Government of Myanmar and to other relevant organizations and people concerned for their close cooperation and valuable input in the study.

January 2003



Takao Kawakami

President

Japan International Cooperation Agency

January 2003

Mr. Takao Kawakami
President
Japan International Cooperation Agency

Dear Mr. Kawakami,

Letter of Transmittal

We, hereby, have the pleasure of submitting our report titled Study on the Financial Sector conducted under the Myanmar–Japan Cooperation Programme for Structural Adjustment of the Myanmar Economy. The Study, a component of the research by the Fiscal and Monetary Policy Working Group (FMWG), covers both the financial sector, with particular focus on the banking sector, and microfinance. It describes the results of the study conducted by the Japan Economic Research Institute in accordance with the contract entered into with the *Japan International Cooperation Agency*, integrated with achievements of the Joint Study by FMWG.

This report is an outcome of the joint study of Myanmar and Japan's FMWG taskforce members, their supporting members, and the consultants of both sides between November 2001 and December 2002. The team held discussions with the officials concerned in the Government of Myanmar, bankers and other relevant experts through field studies and workshops in Myanmar. In addition, the team conducted a microfinance study tour in the Philippines with the kind support of government agencies, CARD Bank and other microfinance institutions in the Philippines.

We hope that important suggestions presented in this report will contribute to further development of the financial sector and implementation of relevant policies.

We wish to take this opportunity to express our sincere gratitude to the concerned ministries of Myanmar and other relevant organizations for the kind cooperation they extended to our team, as well as for the warm hospitality provided during our stay in Myanmar. We also wish to express our deep gratitude to your agency, JICA (including the Myanmar Office and the Project Office), as well as the Ministry of Foreign Affairs, the Ministry of Finance, and the Japanese Embassy in Myanmar.

Very truly yours,


Hirohiko Sekiya

Team Leader, Study on the Financial Sector

The Myanmar–Japan Cooperation Programme for Structural Adjustment of the Myanmar Economy

Executive Summary

Part 1 Assessment and Basic Directions and Part 2 Microfinance Institutions and Cooperatives

Potential of Microfinance in Myanmar

1. Access to financial services is constrained in Myanmar, both for the corporate sector and for households, resulting in insufficient or inadequate supply of credit and weak mobilization of domestic savings. Currently, bank and non-bank financial institutions' outreach and capacities to address corporate and individual needs are very limited, and their responsiveness to small economic players is even weaker. As a result, whereas huge demand is observed in the informal financial markets, the constrained institutional capacities on the supply side of financial systems are impeding vigor in economic activities. Above all, a serious worry is the lack of access to credit in rural Myanmar, where about 65 percent of the population resides, as well as among the poor and the potential entrepreneurs who are spread nationwide, including in urban areas.

2. Having a quarter century history over the world, microfinance is perceived to be an effective instrument for poverty alleviation—as a sustainable financial system by which poor and small economic players can leverage their economic activities and substantially improve the quality of their lives. In Myanmar, the demand for micro-loans was roughly estimated by the UNDP to be US\$400 million to US\$600 million, suggesting a huge potential benefit, which the sustainable microfinance can bring to hundreds of thousands of poor households if the proper environment were given. Another beneficial aspect of microfinance is that its highly market-friendly approach promotes establishment of sound financial disciplines among borrowers and lenders, which perfectly fits the current policy directions toward successful transition to a market economy in Myanmar.

Rural Finance

3. With the overwhelming proportion of population being in rural areas, development of the rural economy is requisite to accumulation of national wealth in Myanmar. With the exception of Saving and Credit Cooperative Societies engaged in provision of financial services, Myanmar Agricultural Development Bank (MADB), a state-owned bank, is virtually the only major source of institutional credit for small-scale farmers in terms of relative coverage and accessibility. Due to the ever-growing demand for seasonal credit to boost output of paddy and export crops, MADB's mandate and funding priority has been given to farmers over non-farmers. In addition, the scale and impact of MADB loans to farmers are severely limited in comparison with the funding requirements; from the interviews in Shan State, the Dry Zone and the Delta Zone, it was found that only about 5 to 15 percent of women clients of UNDP microfinance projects are able to obtain loans from MADB—through their husbands. Also, geographical constraints in the rural area make provision of financial services very difficult; the remoteness of villages that are reachable only via mountain paths contributes to very high transaction costs. As a result, there is excess demand for capital in the countryside, which is unsolvable by conventional banking. MADB's lending methodology has shifted from village banking to the use of its branch network, which appears to be inadequate for improving farmers' access to financial services. Currently, MADB, yet unfamiliar with microfinance technologies, has not envisaged changing its business scope that is based on traditional agricultural lending.

Informal Credit

4. In general, the majority of the rural and urban poor and small economic players are highly dependent on informal sources of credit for their production inputs and consumption requirements despite the efforts by the government and donors alike to provide alternative sources of credit. Traditional moneylenders in villages give loans at 10 to 15% interest per month if no collateral is given (usually in the form of gold and jewelry) and at 5 to 7% per month if collateral is available.

International and Local NGOs involved in Microfinance

5. Microfinance in Myanmar is at an embryonic stage. It is an exogenous phenomenon brought to the country by international NGOs (INGOs) contracted with the UNDP (funding agency) and UNOPS (executing agency) who are interested in using microfinance as part of an overall package for poverty alleviation. However, this situation has not prevented various local organizations or associations and other international NGOs from initiating microcredit projects, some with a savings component.

6. Currently, there are estimated twenty-three international and local NGOs and projects involved in microfinance in Myanmar. They can be classified into four groups: microfinance INGOs, multipurpose INGOs, local NGOs, and UNDP-assisted projects. The operation of microfinance in these programs typically comes as a sub-component of a larger intervention by the INGO concerned under agreement with respective line ministries, such as the Ministry of Cooperatives, the Ministry of Health, and the Ministry of Social Welfare. This indicates that no government agency in Myanmar has been designated as the sole entity through which to register a microfinance program. According to the *inventory survey* and field interviews conducted as part of our microfinance study, NGOs are present in a total of forty townships, excluding the thirty-one townships covered by special UNDP-assisted projects. The coverage represents 12 percent of the total number of 330 townships in Myanmar. All of the programs target the poor as clients; microfinance INGOs are concentrated in serving the women of rural poor households and other programs serve both rural and urban poor households. Due to the dominance of three INGO projects, rural women represent 95 percent of the total number of microfinance clients. The major sources of funds are foreign donor grants; some small programs operate only with internal sources.

7. The survey captured that the total number of active borrowers of fifteen core institutions is 109,209 and the aggregated loan outstanding is Ks 1.6 billion as of the end of 2001. The savings services are yet limited: less than half of the institutions have adopted compulsory savings and very few have adopted voluntary savings. As to lending methodologies in credit programs, all of the NGOs surveyed employ the group-lending approach without any tangible collateral, about half of them doing so in combination with individual lending. The loan terms range from 6 months to 20 months, mostly concentrating on 6 months to 12 months. Most of the programs adopt cost-recovering or market-based interest rates, although some NGOs apply zero or very minimal interest rates due to the concerns for outreach to a larger number of poor households. The loan vary in size but clearly target poor clients: the minimum ranges from Ks 1,500 to Ks 50,000 and the maximum from Ks 50,000 to Ks 300,000.

8. ***UNDP/UNOPS-supported Projects.*** The three UNDP/UNOPS-contracted INGOs have provided microcredit and savings services to the poor since 1997: Grameen Trust (up to mid-2002) in three Delta Zone townships, PACT in three Dry Zone townships, and GRET in five Shan State townships. Combined, these three INGOs dominate NGO-operated microfinance in Myanmar, constituting 87 percent of the total outreach. They have a view to institute sustainable

microfinance operations in the country. The fact that their geographical coverage is limited, extending to only 3 percent of Myanmar's townships, can be explained by the pilot nature of the projects under the special framework of the overall undertaking agreed by the UNDP and the Myanmar government. However, the cumulative outreach of the three projects, which was 94,724 active borrowers in 1,518 villages as of the end of 2001 (25,102 in the Delta Zone [657 villages]; 49,165 in the Dry Zone [487 villages]; and 20,457 in Shan State [374 villages]), is regarded as nothing less than remarkable, considering that the projects had been operating for only about four years, had covered areas suffering from poor infrastructure and communication facilities (they are some of the poorer areas in Myanmar), and had local staff that lacked experience. The aggregate loan portfolio outstanding at that time was Ks 1,421 million. The three projects have also shown credible performance in outreach of credit delivery; for example, PACT reports that they have been serving an average of 60 percent of the existing households in the villages they cover, which is a surprisingly high penetration ratio. As to savings mobilization, the three projects are still limited, with a balance in total of Ks 185 million.

9. Activities served by the three projects are farming (Shan State) and livestock farming (Dry Zone and Delta Zone), trading (Dry Zone) and other non-farming activities (Delta Zone). The three INGOs have a total of 350 staff members. All three projects have demonstrated high repayment rates (99% to 100%) and low portfolio at risk (0% to 1.2%), which are comparable to international best practices. The operational self-sufficiency reportedly ranged from 117 percent to 227 percent and the financial self-sufficiency from 47 percent to 76 percent (assuming a 35% inflation rate) as of the end of 2001, which are good at this stage of development. Field interviews and secondary data indicate that the targeted households perceive the three projects as positive interventions that can bring significant benefits to their economic situation: increases in income, savings, and asset build-up; availability of better food and nutrition to the family; improvement in housing conditions; lesser dependence on moneylenders; and improvement in the clients' quality of life.

10. *Multipurpose INGOs Projects.* INGOs programs other than those contracted with UNDP, including World Vision, CARE Myanmar, Save the Children USA, Save the Children UK, and the GRET Chin project, are implementing their own microfinance projects for from 6 months to 7 years. Except for the GRET Chin project, they are yet at the pilot stage or have just begun to expand operations. They are mostly under legal cover by a memorandum of understanding with the ministry supervising activities in their fields. The five INGOs that responded to the *inventory survey* have an aggregate number of ninety staff members involved in microfinance operations, with World Vision having the highest, in the nine townships in the Yangon and Mandalay divisions and Chin State. The aggregate active borrowers were 11,021, out of which the GRET Chin project (6,239) and World Vision (3,728) were dominant, as of the end of 2001. According to the survey, three INGOs report repayment rates from 99.2 percent to 100 percent, one reports a rate of 91.7 percent, and the other 79.9 percent.

11. The GRET Chin project started in 1995 with village banking methodologies and is now being operated in three townships with a loan portfolio of Ks 70 million. It is worth noting that the project is showing remarkable progress, with an operational self-sufficiency ratio of 98 percent. Its strong point is the development and strengthening of local community organizations, which has promoted cohesion and solidarity in areas under a very difficult environment. Interviewees reported significant increase in their income and were able to reinvest profits for business expansion. Conversely, the weaknesses of the project are that the value of savings was not inculcated at the start of the program and that some methodological problems have resulted in difficulties in management and control. The Japanese embassy's Grassroots Fund is currently being put to good use in building the capacities of the local boards and staffs, which is a meaningful intervention in view of weak local capacities in microfinance.

12. Local NGOs Microfinance Operations. Mostly registered with the Ministry of Home Affairs, local organizations or associations (YMCA, YWCA, Myanmar Women's Entrepreneur Association, Myanmar Council of Churches, Caritas, Myanmar Baptist Convention, and others) are also involved in microfinance activities for a period of one to eight years in twenty townships of the country. The primary focus of assistance is the poor women. Some try to operate along the key principles of sustainable microfinance, whereas the focus of others remains to be seen. According to the inventory survey, the seven local NGOs reported a total number of forty-seven staff members involved in microfinance programs. The aggregate number of active borrowers was reportedly 3,464 as of the end of 2001. As to performance, five of the local NGOs are reporting repayment rates of 100 percent or close to 100 percent, whereas the remaining two report 60 percent and 75 percent. The relative efficiency of operations of this group is lower than that of INGOs, which is to be expected considering that some of the local NGOs started programs only recently.

13. Other UNDP-assisted Projects. Other UNDP-assisted projects include the Community Development Remote Township (CDRT) project, UN Drug Control Program (UNDCP), UN High Commissioner for Refugees (UNHCR) Committee, and the FAO Revolving Fund (up to 2002). CDRT is an integrated project with several components, such as health, education, and water supply, through a self-reliant group (SRG). Operating in ten townships in the border area of Rakhine, Chin, and Kachin, 1,005 SRGs have been formed, covering 15,674 households or 68 percent of the target population. Total savings mobilized amounted to Ks 56.4 million. Each qualified member is given a loan of Ks 20,000 through the SRG. The UNDP provided US\$458,658 as capital grants that were then on-lent to the members. According to the UNDP, the SRGs act as a social safety net for the poor by strengthening their social functions and providing flexible loan products based on mobilizing small periodic savings. On the other hand, some important tasks remain to be tackled, including a banking or microfinance link for long-term expansion and continuous provision of training to new SRG members. Being still in its infancy, it is too early to access the SRG approach in Myanmar; however, positives would include the promotion of solidarity groups and social bonds, whereas a negative might be the possibility of non-repayment by some borrowers since the loan came from a grant by a donor, which might erode credit discipline among the rest of the members. The fact that SRG members are free to set the loan conditions may create moral hazard in leading to the sustainability of SRG microcredit scheme. Field observations recorded a possible future conflict between the GRET Chin project's cost recovery interest rates and the SRG's zero interest rate scheme.

14. The FAO Revolving Fund was also supporting the development of communities in Shan State, the Dry Zone, and the Delta Zone but the funding was ceased due to project termination. A notable experiment was the use of private banks as conduits of the funds for self-help groups. An informal tie-up between Kanbowza Bank, a private commercial bank, and the community based organizations (CBO) in the Dry Zone emerged within this project; CBOs borrowed from Kanbowza Bank against their deposits as collateral for re-lending to their members. It is worth noting that, de facto, the CBOs were charging commercial rates.

Saving and Credit Cooperative Societies

15. The cooperatives' movement in Myanmar originated from the promulgation of India's Co-operative Societies Act in 1904. Primarily it was contemplated as a government-sponsored measure to relieve the agricultural related indebtedness of farmers. In 1992, as political, economic, and social conditions changed, a new cooperative law was enacted to give a wider mandate and freedom to the financial cooperatives. Today, there are reportedly 1,942 functioning Saving and Credit cooperative societies in operation with a total membership of

431,000 individuals, forming a sector with significant weight in Myanmar. The total amount of savings held is reportedly Ks 3,851 million and the total amount in loans disbursed is Ks 6,337 million. Official statistics indicate that the aggregate savings and loans have increased by 706 percent and 1,184 percent respectively in the last decade, while the number of cooperative societies and members have declined.

16. The extensive field research conducted on selected Saving and Credit Cooperative Societies as well as the collection of numerical information through the *inventory survey* illustrate that such societies have a strong potential to become one of the pillars of the microfinance industry in Myanmar, together with the NGO sector. In Myanmar, there are two types of Saving and Credit Cooperative Societies: open- and closed-type memberships. The open type can accept anybody (from all walks of life) whereas the closed type only accept one type of membership and very exclusive (for example, employees only, factory workers only, etc.). The open type societies include small shop owners, vendors, and micro-entrepreneurs as members and are extending financial services on a small scale. According to the records of the Ministry of Cooperatives, as of 2001 there are about 139 open-type Saving and Credit Cooperative Societies, with total membership of 10,097; however, the actual membership number is estimated to be greater than that.

17. For the purpose of the study, the *inventory survey* was conducted on thirty-four Saving and Credit Cooperative Societies, which represent 24 percent of the sample size. The summary of the findings about institutional characteristics and modalities of the financial services are (i) the thirty-four societies surveyed have, in total, 11,018 members, 7,214 active borrowers, and 10,710 savers, with the Mandalay societies having the farthest outreach; (ii) the average minimum loan ranges from Ks 5,000 to Ks 10,000 per member. Out of the 34 societies, six do not require collateral for loans whereas the rest demand collateral from members in the forms of immovable properties, co-guarantors, or a combination; (iii) the loan duration ranges from one month to four years, with a majority of the programs (83 percent) being for less than twelve months. Though the interests charged vary from society to society, 71 percent of all the programs fall into a range from 25% to 60%, which is reasonable for covering the cost of funds and operating costs; (iv) nineteen of the thirty-four societies pay interest earnings on share capital, ranging from 4% to 36% per annum, with four societies paying 18% per annum; and (v) twenty-two societies have five or more board of director members and the remaining societies each have three or four. All of the surveyed societies have full time staff ranging from one to fifteen depending on the size of operations.

18. Including the findings by extensive field research on nine representative Saving and Credit Cooperative Societies in the Mandalay and Sagaing divisions and Shan State, the following are concluded: (i) the financial landscape for the thirty-four cooperative societies is dominated by nine cooperatives in terms of assets; numbers of members, savers, and borrowers; loan outstanding; savings deposits; and share capital. Of the nine, the Pyin Oo Lwin Market Savings and Credit Society in Mandalay stands out as the best performing and may be in the best financial position to expand into microfinance; (ii) there is a concentration of better performing cooperatives in the Mandalay and Sagaing divisions despite some financial troubles encountered by five cooperatives with significant resources; (iii) cooperatives that operate in township markets are performing better than are cooperatives not similarly situated. Market-based operations are able to capture the fast cash turnover in township markets; and (iv) a notable phenomenon that seems to be unique in Myanmar credit and saving societies is that two cooperative societies have established their own pawnshop businesses (one in the Sagaing division and the other in Shan State), which cater to the poorest sector of the community by accepting collateral of small value, such as old bicycles and appliances. These cooperatives that operate pawnshops perform better in financial terms than do the majority of the Saving and

Credit Cooperative Societies.

Banks and Pawnshops.

19. At least six private banks, including top-ranking ones, have expressed an interest in being financiers or wholesalers of loans for microfinance operations; some banks have already begun pilot testing. They are all in search of an investment outlet for excess liquidity in the short-term, due to lack of investment opportunities in the traditional credit markets or reluctance to lend to firms in view of non-performing loans. Hence, their interest in microfinance operations is centered on the potential for utilizing idle funds. Pawnshops, which are licensed financial entities owned either by the government or the private sector, form a segment of financiers to the poor in Myanmar, with interest rates ranging from 3% to 6% per month. Some of them have also expressed interest in microfinance, and one has drawn funds from private banks to re-lend to farmers.

Key Issues Affecting the Development of Microfinance in Myanmar

20. ***Interest Rate Policy.*** An immediate problem confronting emerging microfinance institutions (MFIs) is the current interest rate policy. Section 61 of the Central Bank Law prescribes maximum level interest rates; the current ceiling is a maximum of 15% on lending, which is considered by many MFIs as impossible for financial sustainability. Currently, three UNDP-contracted microfinance operations and some other INGO projects are *officially* authorized to charge flexible interest rates under special legal cover for their integrated projects; however, the institutionalization of these projects as well as expansion of other microfinance operations requires flexible financial management in order to be sustainable, more particularly in interest rate setting. Also, private banks that have expressed interest in microfinance would not be able to intervene in microfinance if they are not assured the ability to charge flexible interest rates. Today, the requirement of flexible interest rates for microfinance is well recognized over the world as pre-requisite for development of the microfinance industry, and this is also true in Myanmar.

21. ***Legalization and institutionalization.*** The on-going microfinance projects under the support of the UNDP and other international and local NGOs are facing an urgent need for legalization of entities, only by which they can sustain operations even without special legal cover supported by supervising ministries. The issue of institutionalization will have to be dealt with through legal action as may be allowed under current Myanmar laws; therefore, an investigation for a permissible legal structure for those projects is indeed an urgent task. Serious study is needed concerning legal paths for lawfully registering NGO MFIs via amendment of the existing law or via policy declaration. If the present legal framework is not able to provide an avenue for the institutionalization of the INGO projects and other similar projects (including the ones by local associations), it will be important for the government and stakeholders to work together to formulate an appropriate framework.

22. ***Localization.*** Institutionalization is separate from, although in some ways linked to, localization. The link between the two issues is the fact that having a legal entity such as a MFI makes a lot of sense if local staff members can effectively participate in its operation. However, localization should not prevent the benefits to have access to the services and expertise of international experts. Field visits to the three UNDP-contracted projects and interviews with local managers and staff members indicate that those projects are not yet ripe for immediate localization. Localization process is desired to take place, but for the time being international experts should continue providing their experiences and expertise and work toward building the

capacities of local management, targeting a hand-over in the future.

23. *Implementing Capacities of MFIs.* Due to the embryonic stage of microfinance in Myanmar, the following weaknesses have been identified in NGO microfinance projects as issues requiring policy measure consideration for further microfinance development. (i) The relative inexperience of local managers and staff members in almost all of the NGO projects brings about insufficient understanding about the corporate governance required in the course of institutionalization, e.g. the role and functions of boards of directors; (ii) Although the INGOs have been providing training to local staff members, there is an apparent need to conduct systematic training programs to enhance managerial capacities both at headquarters and at branch levels; at present, expatriate consultants make all key personnel decisions; (iii) A look at the educational background of local staff shows that qualified staff members with financial and accounting disciplines are lacking, whereas financial management is a pressing need to maintain the quality of the loan portfolio and improve the management; (iv) Supporting structure for management, e.g. internal audit, is yet to be formed even in the three INGO projects supported by the UNDP; (v) Personnel issues are now surfacing, including some regarding variation in the scale of salaries among local staff members of the three INGOs; and (vi) The local management has yet to prove a capacity to cope with problems emerging when the number of clients begins to increase and as the operation expands to cover more areas and more clients.

24. *Upgrading Indigenous Financial Systems.* The cooperatives sector, particularly the Saving and Credit Cooperative Societies, have a strong potential of becoming one of the pillars of the microfinance industry in Myanmar. However, it must be noted that there also are important challenges ahead that need to be addressed to insure that these societies are able to deliver their services effectively and efficiently to the poor and the micro-entrepreneurs in their community. The challenges include, but not in an exhaustive way: (i) The governance of the board of directors and internal controls are to be enhanced or improved. Also, the external audit by the Ministry of Cooperatives needs to be strengthened; (ii) Since the Saving and Credit Cooperative Societies do not have a standard chart of accounts, the data for the repayment rates, delinquency rates, portfolio at risk and other financial indicators are not too reliable. Different understanding and interpretation of key indicators are prevalent. Bookkeeping systems and financial management need substantial improvement and the development of performance standards is particularly needed; and (iii) A systematic and rigorous human resource development program for boards of directors and staff in the area of microfinance is a requisite.

Implications from Philippines Experiences in Microfinance Development

25. After the pursuit of financial reforms in the mid-1980s, the Government of the Philippines adopted the 1991-1998 Medium Term Philippine Development Plan, under which the implementation of market-based financial and credit policies and the increased participation of the private sector in the financial market were emphasized. Among the reform steps, new credit policy prepared a national strategy for microfinance, with a view to address poverty in the country. Since then, the Government of the Philippines has been aggressively working to create an enabling environment and a legal and regulatory framework for the establishment and growth of sustainable MFIs, and thus the country's experiences provide good lessons for Myanmar, as follows.

26. The government's clear focus on the role of microfinance as an important vehicle for poverty alleviation (as 'Microfinance as a cornerstone in fighting against poverty' in President Arroyo's State of the Nation Address in July 2001) as well as rural development has been a base for policy formation to create an enabling environment. As the coordinating body among the

various ministries and implementing agencies, the National Credit Council (NCC) has set out credit policies to rationalize directed credit programs. Together with the central bank (Banko Sentral Philipinas), NCC carries an important role in promoting microfinance. Another government entity, a wholesale bank (People's Credit and Finance Corporation), has also supported private sector led microfinance. Likewise, the government's overall support is indispensable for microfinance development. As to regulation and supervision of microfinance, the central bank has been taking supportive measures, such as the lifting of the moratorium on the establishment of new banks to allow the entry of new microfinance-oriented thrift banks and rural banks.

27. Private sector-led microfinance services in the Philippines are provided by three pillars: rural banks and thrift banks, NGOs, and credit cooperatives. Active movements for establishing industry standards and thereby commercializing microfinance are being undertaken. Networking and supporting organizations among the private sector, including the Microfinance Council for NGOs, and confederations and federations of credit cooperatives are very active. These structures are functioning to share information among members, promote best practices and innovative technologies through a number of seminars and workshops, and conduct training to enhance the quality of services and institutional capacities of MFIs.

Lessons from Literature Survey on Worldwide Experiences

28. Many issues that Myanmar faces as its microfinance industry is on the verge of taking off have been shared by other countries in the course of nearly a quarter century history of microfinance development in the world. According to the literature survey on worldwide experiences conducted as part of the study, with a purpose to draw lessons relevant to policy formulation at the current stage of microfinance development in Myanmar, the following are summarized: (i) Step-by-step formalization of MFIs through a process that begins with legalization and licensing and progresses to the introduction of explicit regulations is the most appropriate strategy; (ii) The sustainability of microfinance depends on the degree of understanding of microfinance specificities such as risk profiles, which in sum characterized as highly market-oriented approach to the provision of financial access to the poor; (iii) The establishment of sound regulatory environment is a requisite to well balance the growth and stability of the microfinance industry. However, it is impossible to find a 'one-size-fits-all' advice anywhere in the world. To achieve sound regulatory framework, capacity building of policy makers for regulation is a more serious issue than is selection of particular forms of regulation. Over-regulation by insufficient regulatory capacities has brought about serious impediments in many countries' microfinance development. Equally crucial is the appropriate timing for introducing regulations: too early introduction also brings about harmful results; and (iv) As for the mid- or long-term perspective, the integration of MFIs into the formal financial sector appears to be the most effective way to materialize the dual mission of microfinance, i.e., extending the outreach and attaining financial sustainability.

Part 3 Road Map and Proposals

Road Map for Microfinance in Myanmar

29. **The Three Pillars Approach.** There is a need for a gradualist but coordinated approach to microfinance development. The first step is to craft an overall national strategy on microfinance supported by the government, microfinance institutions, and the donor community. The three pillars of microfinance development in Myanmar can be international NGOs/local NGOs/local association projects, financial cooperatives, and banks interested in microfinance (This manifest can be abbreviated as NGOs-CO-OPs-BANKs. Note that the role of the MADB in microfinance should be carefully assessed in consideration with agriculture policies and institutional capacities). The main goals are to build project implementation capacities, ensure a

policy environment conducive to microfinance development, and harness the diverse expertise and resources coming from the donor community to support Myanmar. The emphasis should be on improving the quality of microfinance projects/operations by building the capacities of implementers and concerned government ministries, including the Central Bank of Myanmar and the Ministry of Cooperatives, rather than on an aggressive and rapid expansion of microfinance. Expansion is also necessary, but not at the cost of sacrificing quality of implementation.

30. **Country Action Agenda for Myanmar (CAAM).** A national strategy supported by various stakeholders has to have at its core (1) consistent financial and credit policies; (2) an identification of the critical roles of the stakeholders; and (3) a road map for the development of sustainable microfinance. A sketched proposal for such a road map is as follows: (i) A *goal* is to be defined. It may emphasize the ultimate objective of microfinance as a poverty-reducing instrument or mechanism; (ii) A *Vision Statement* is then desired, to articulate the collective mission of all public and private entities engaged in microfinance; (iii) *Basic principles* should denote key characteristics that microfinance entails and that should be further pursued in Myanmar, such as *large and deep outreach, sustainability, client focus, and innovation*; (iv) *Strategies* should elaborate core measures to materialize the vision, and hence achieve the goal. Suggested strategies include (a) maintaining a focus on the poor, (b) facilitating an enabling policy, and a legal and regulatory environment, (c) expanding the institutional capacity of MFIs, (d) building an efficient core of microfinance technicians and training centers, (e) promoting sector-wide performance standards, and (f) promoting sustained linkages to commercial capital; (v) *Roles of each player* are to be defined—in particular those of the government. A set of the first steps for the government includes (a) determination of an anchor ministry; (b) establishment of a preparatory microfinance unit and/or working groups in the government, in order to create a legal structure for registering MFIs and crafting policy declaration allowing microfinance players to charge cost-recovering interest rates (that include or take into account the following: cost of funds, administrative costs, risk, and reasonable margin); and (c) preparation for promoting sector-wide performance standards for microfinance, in collaboration with MFIs and other stakeholders; (vi) *Model projects* of NGOs and Saving and Credit Cooperative Societies, being desirable, are to be implemented; and (vii) *The timeframe* for the overall action agenda stated in the above is to be declared. For example, the government may have to complete formal registration of MFIs and policy declaration on a short-term basis (one to two years), whereas establishment of performance standards takes longer (three to six years).

Legal and Regulatory Framework: Pressing Needs for Legalization of MFIs and Adoption of Flexible Interest Rates Policy

31. Whereas the establishment of a regulatory framework for MFIs involves a complicated process that requires careful designing and capacity building in the long term, the legalization of MFIs is to be resolved immediately to help the microfinance industry to take off in Myanmar. Considering the embryonic state of Myanmar's current microfinance activities, it is very premature to talk of regulation, since the main purpose of regulation is to protect depositors and avoid systemic risk in the financial sector. The social costs of an inappropriate regulatory framework are very high, such as higher transaction costs, limited competition, discouragement of the formalization of informal microfinance, and weakening of savings mobilization. Policy makers should focus on the more important concerns: (i) the legalization of entities as MFIs; (ii) the resolution of policy dilemmas that create uncertainty over the sustainability of microfinance operations; (iii) the capacity building of MFIs and policy makers; and (iv) the facilitation of dialogue between MFIs and policy makers.

32. Given that special memoranda of understanding between the government and some projects

involving microfinance have expiration dates, the question now is whether it is possible to use the current legal framework—Financial Institutions Law, Organization Law, etc.—for the establishment of NGOs and associations that can engage in microfinance. A preliminary review by the study indicates that application of the Financial Institutions Law may be able to immediately clear the path for the entities involved in microfinance to function as legitimate financial institutions, but the MFIs must get exemptions concerning the existing ceiling interest rates and prudential regulations. Another option for the government is to enact a new law allowing the creation of a new category of NGOs for financial service provision. The new law could allow MFIs to function as legitimate intermediaries, charge cost-recovering or flexible interest rates, and engage, perhaps, in a limited deposit-taking activities. With this option, the consequences resulting from limitation of deposit taking as well as potential competition with private banks should be assessed; however, those may not really bring about problems or complaints, since MFIs and banks basically serve different markets.

33. Saving and Credit Cooperative Societies have no problem in terms of legal registration. As such, the Saving and Credit Cooperative Societies may form the main pillar of microfinance development provided that appropriate capacity building on microfinance is pursued. As regards the interest rates, it seems that the interest rate ceiling imposed under the Money Lenders Act (1945) would not apply to Saving and Credit Cooperative Societies. However, to ensure those flexible practices, a policy statement from the government would pave the way for expected involvement of Saving and Credit Cooperative Societies in microfinance without need of changes or amendment of the particular law governing those societies. The second mechanism for cooperative society provision of micro-credits to poor clientele is the establishment and operation of pawnshops that are legally recognized and licensed entities. This is a workable solution, but the ideal situation is for Saving and Credit Cooperative Societies to be directly engaged in microfinance.

Establishment of Myanmar National Credit Council

34. The development of microfinance involves a wide variety of stakeholders. Relevant agencies for provision of small-scale financial services include associations, NGOs, cooperative societies, pawnshops and banks. The end-users of microfinance are varied: farmers, traders, shop-vendors, and any kind of micro-entrepreneur. Rural as well as urban development by enhanced economic activities and reduced poverty through microfinance are the overarching objectives. These multiple facets of microfinance suggest that policy formulation by the government toward successful microfinance needs a coordinated approach among different ministries and public agencies. Thus, as was shown by the Philippine experiences (see paragraph 26), a governmental coordination body that focuses on creation of favorable policy environment for microfinance merits consideration.

35. The establishment of a Myanmar national credit council (MNCC) to coordinate market-oriented financial and credit policies may be envisaged, with close collaboration with the Ministry of Finance and Revenue and the Central Bank of Myanmar. By monitoring the development process of MFIs and their coalition and the evolution of industry standards, such an MNCC would be able to ensure an exchange of information among the different streams of MFIs (for example, between NGOs and cooperative societies), including their successes and failures, and hence contribute to promotion of performance standards for MFIs.

Microfinance Coalition and Establishment of Performance Standards

36. In a number of countries where the microfinance sector has taken off and flourished, stakeholders have solved the problem of inadequate or asymmetric information on the sector by

coming together to form an association composed of practitioners in the field, advocates, regulators and policy makers, and donor agencies. At this stage of microfinance development in Myanmar, there is no institution or agency that functions as a repository of information for microfinance. INGOs have gained considerable experience before coming to Myanmar, while new entrants—that is, local practitioners—have expressed their desire for information on how to deliver microfinance in a cost-effective manner. It is proposed that a network composed of practitioners, advocates, and representatives of relevant government ministries be organized in the country. Depending on the consensus regarding the network's objectives and work program, its functions may include (i) coordinating capacity-building programs; (ii) exchanging information and sharing experiences; (iii) sharing performance data of microfinance players, perhaps through publication; (iv) undertaking research projects; and (v) linking up with international networks to build up a wealth of information for the sake of the Myanmar microfinance industry.

37. To form a microfinance network (or *coalition*), a step by step approach is recommended. At the outset, it will be good to make membership of such a *coalition* as broad-based as possible. The participants belonging to *Capacity Building Initiative*, the three microfinance INGO project members, some financially sound Saving and Credit Cooperative Societies, and some local NGOs and associations could form the core of the network. Government agencies would be able to attend the network's meetings, seminars, and workshops on their own accord as observers, which is optional because those agencies may not be prepared yet for such involvement. At an opportune time, representatives of government agencies should become involved; they would be instrumental in providing future policy and institutional reform support that would benefit the microfinance industry. If the proposed *microfinance unit* in the government were to materialize, then it could be a regular participant in the evolving microfinance network. Thus, the informal group could later on evolve into a formal microfinance network in Myanmar. To ensure continuity of interest and involvement in microfinance activities, there is need to establish a secretariat or small management unit for the microfinance network.

38. The network's major activities would be (i) identification and agreement on a binding set of core beliefs and principles in the practice of microfinance; (ii) definition of a common work agenda as well as the structure of membership and the operating rules and procedures; (iii) establishment of an accurate database on microfinance practice in Myanmar (its prototype has been initiated as an inventory survey of this study, as seen in Chapter 6); and (iv) formulation and promotion of performance standards for microfinance. It is expected that the members of the network would develop a working attitude of flexibility and proactive social entrepreneurship to advance the interests of both the MFIs and the clients who represent the poor in Myanmar. The activities should be well sequenced to contribute to the establishment of credibility in the microfinance industry in Myanmar.

39. Performance standards will become an indispensable component of the information infrastructure for microfinance in Myanmar, which is needed for its further growth and development. They can be used for the internal purposes of the management of the organizations concerned as well as by external parties such as donors, the government, and other interested parties to monitor the MFIs and determine what assistance may be needed to improve performance. Performance standards can function as an effective *self-supervisory* tool of the microfinance industry until the capacities of regulators fully develop. The process of formulating the standards is preceded by the formulation and adoption of standard charts of accounts, standard financial reporting formats, etc, which may take a period of time. Training of MFIs and advocacy on the recognition and adoption of performance standards are also needed. Covering those demands, donors will have a crucial role in supporting the establishment of performance standards. As for the standards, they may have two key components: (i) indicators

of compliance to administrative requirements and management (such as governance, management, and organizational structure); and (ii) indicators of financial performance (such as portfolio quality, efficiency, stability of operations, and structure of assets). For Saving and Credit cooperative societies, the performance standards may have to be separately developed in view of the difference in the operation of those societies vis-a-vis the NGO MFIs.

Microfinance Model Projects

40. Currently, the natural limitation imposed by the character of microfinance INGO projects under the UNDP and government's agreement constrains further growth and development of microfinance. Also, given that the presence of international donors that provide funds and technical assistance is scarce, such limitation would seriously hamper development of this emerging sector. It is observed that only the GRET Chin project has initiated a specific microfinance focus without affiliating to any specific humanitarian umbrella. To mainstream microfinance projects in Myanmar, an establishment of *model projects* based on an explicit *financial sustainability approach* is therefore recommended. The opportunity for expansion in a financially sustainable manner by implementing *model projects* would further demonstrate and establish best practices in microfinance in Myanmar.

41. In order to attain a greater impact on poor communities, it is proposed that pilot *model projects* be initiated in strategic areas. Through field visits and first- and second-hand information on the performance and potential of MFIs and cooperative societies, the proposed strategic areas are the Yangon Division and the Mandalay/Sagaing Division, based on the following viewpoints: (i) coverage of both urban and rural areas that have a significant number of poor households; (ii) strong presence of local and international organizations that have gained good experience in microfinance and have expressed commitment to the expansion of operations; (iii) ease of monitoring and supervision of the pilot project; (iv) high density of population of poor households; (v) presence of support systems, including training facilities, both from the government and from international organizations; and (vi) openness of practitioners as well as local authorities to implementation or support of microfinance pilot projects.

42. In Yangon District, it is recommended that the pilot test be implemented by an NGO, which can be selected based on a set of criteria to be jointly determined by the government and a supporting donor. There is an indicative pre-feasibility study of a project targeting the poor in Yangon District that was recently conducted by one of the INGOs. According to this study, the project will be able to sustain its operations by reaching more than 56,000 clients within five years, operational sustainability will be attained by the end of year 2, and financial sustainability by the end of year 3. As an implementer of the pilot project, internationally reputable MFI service providers are strong candidates and there are also possibilities for local NGOs to participate in possible donor support, given their growing outreach and improving performance. Candidates among local NGOs include YWCA, MMCWA, etc.

43. In the Mandalay and Sagaing Divisions, it is recommended that the pilot project be implemented by selected Saving and Credit Cooperative Societies since they have attained a measure of success in their microfinance operations even without the benefit of training and technical assistance. Field visits and the *inventory survey* have identified the potential of Saving and Credit Cooperative Societies because of their innovativeness in adopting key best practices, such as levying market interest rates; targeting different market sectors; being flexible in repayment terms; providing graduated loan amounts; having trainable management staff, good governance, adequate records and financial bookkeeping systems; and promoting savings mobilization. Candidates to implement the pilot test may include Shwe Thanlar General

Business and Services (Sagaing Division), Pyin Oo Lwin Market Vendors Cooperative Society (Mandalay Division), and Ya Za Soe Saving and Credit Society (Mandalay Division).

Myanmar Microfinance Center of Excellence (MMCE) and Capacity Building Programs

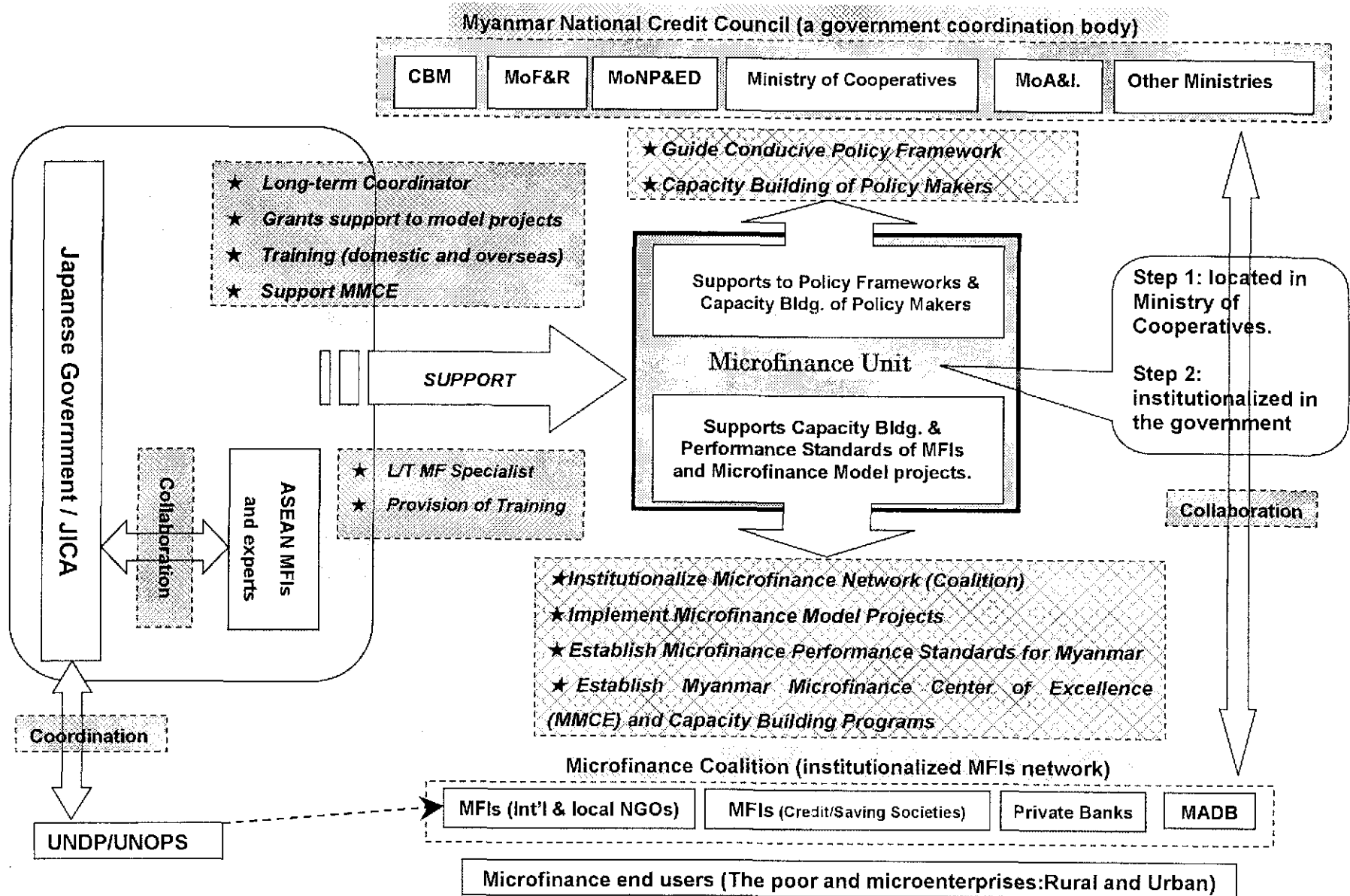
44. Building the capacities of NGOs, cooperative societies, and other potential players is the key to the growth of the microfinance industry in the country. By so doing, the nascent MFIs can expand their outreach and develop cost-effective, sustainable operations. In this regard, the establishment of a Myanmar Microfinance Center of Excellence (MMCE) as the principal resource center for microfinance promotion and development is recommended. Such an establishment would gather the limited human resources for microfinance in the country (i.e., teachers and trainers) in one place, making efficient use of existing fixed assets (e.g. buildings), and allow the nascent microfinance industry to draw on a common knowledge and skills pool across different sectors. Thus, such an MMCE is envisaged to have economies of both scale and scope in capacity building in microfinance industry. The MMCE would become a focal point in a long-term capacity building program where international expertise could be made available, even as the center gradually increased the domestic capacity to provide technical assistance to microfinance programs.

45. Because an MMCE is a long-term strategy, and establishing one would be an evolutionary process, a phased approach is recommended. Phase 1 could focus on building the capacities of existing local training institutions through training of local trainers in the field of microfinance as well as improving the existing structure and facilities of the institutions that would be involved. The recommended institutions include *Yangon Cooperative Degree College* and *Sagaing Cooperative Regional College* (SCRC) in the cooperatives sector, the *Capacity Building Initiative* (CBI) in the NGO sector, and the *Myanmar Bankers' Association* (MBA) in the banking sector. The said two cooperative colleges have facilities such as lecture rooms, computers, and dormitories that can accommodate trainees from the cooperatives sector. Moreover, the location of these colleges is strategic relative to the location of the proposed pilot microfinance projects. It must be noted, however, that the existing facilities need to be improved. The current faculty and training staff of the two colleges may have the potential to be teachers and trainers in microfinance, since many of them have at least 10 to 20 years of actual cooperative management experience. However, their knowledge and experience have to be enhanced by exposure to and training in best practices in microfinance. As to the NGO sector, the CBI is a joint project undertaking of international and local NGOs in Myanmar that aims to provide training for Myanmar nationals and use local knowledge and expertise in Myanmar to design and implement more effective development projects. In 2001, the CBI, in its own office, conducted nine trainings, which were attended by 202 participants from thirty-two NGOs. The CBI has strong potential to be developed as the NGOs' training arm for microfinance. As to the training programs for trainers and practitioners, both basic and advanced management development workshops should be organized through the development of modules. To implement phase 1, it is strongly recommended that a full time microfinance capacity building experts and a core of short-term trainers/experts be mobilized. The capacity building programs will not only be in the form of formal training but will also offer an exposure program and study visits to see good practices in different countries.

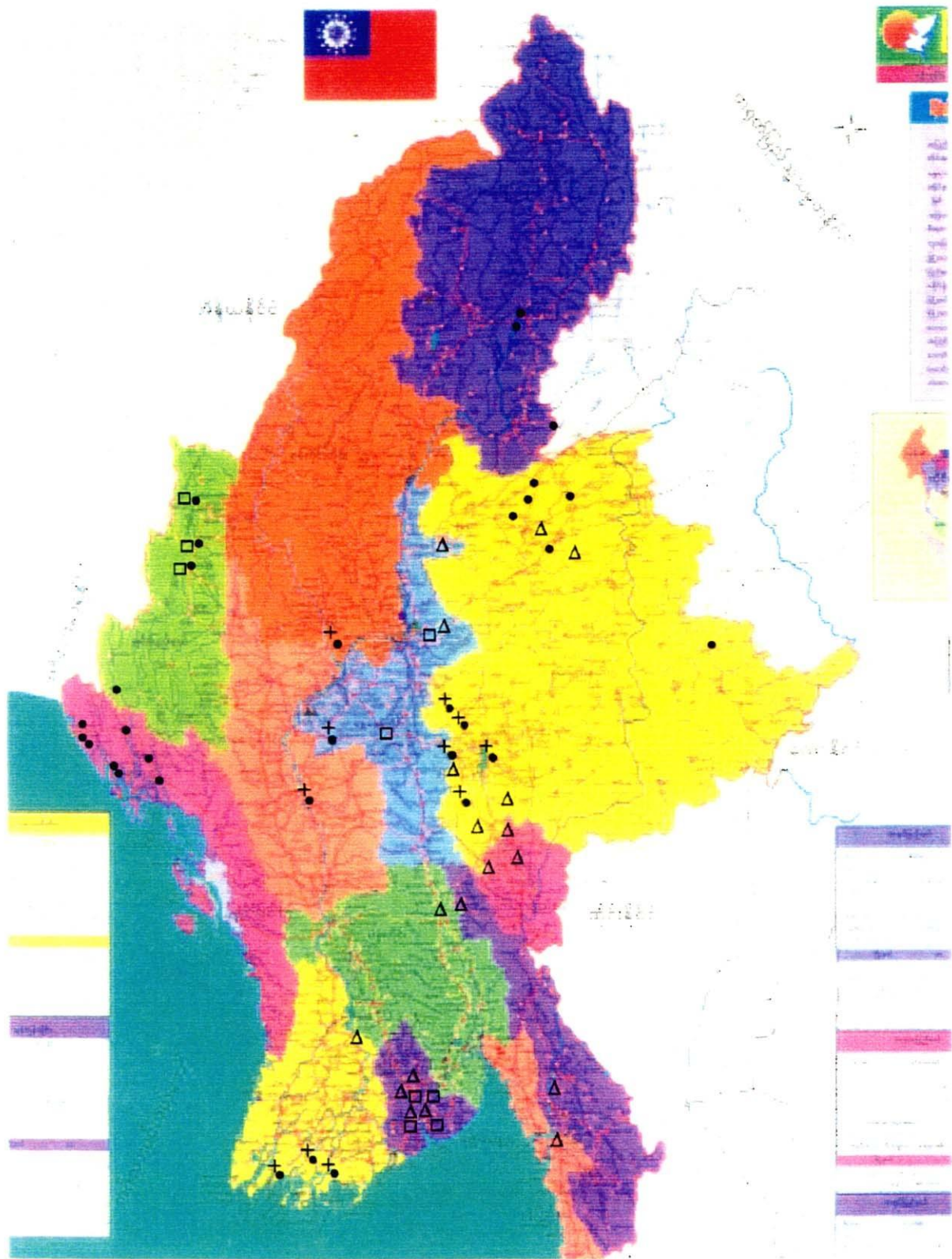
In phase 2, an MMCE would be established as a joint undertaking by the government and a supporting donor. It is envisioned that the said MMCE would have a distinct personality with a full time staff and trainers composed of academicians, policy makers, faculty members coming from the CBI and the two cooperative colleges, and practitioners. To vest it with formal recognition, it may be advantageous to locate it in an academic setting, e.g., in a university such

as the University of Yangon. During the next phase (phase 3), such an MMCE would link with other microfinance institutes in Asia, for example CARD in the Philippines, BRAC in Bangladesh, and BRI in Indonesia, to strengthen its own capabilities and share experiences. It is envisioned that under phase 3 the MMCE would build its internal and international capabilities, and participate in exchanges of faculty members and staff. Publications of training and operations manuals, training kits, case studies, researches about microfinance in the country and experiences of other countries will also be tasked.

Building Sustainable Microfinance Systems in Myanmar
 (Proposed Structure of Follow-Up Project from 2003)



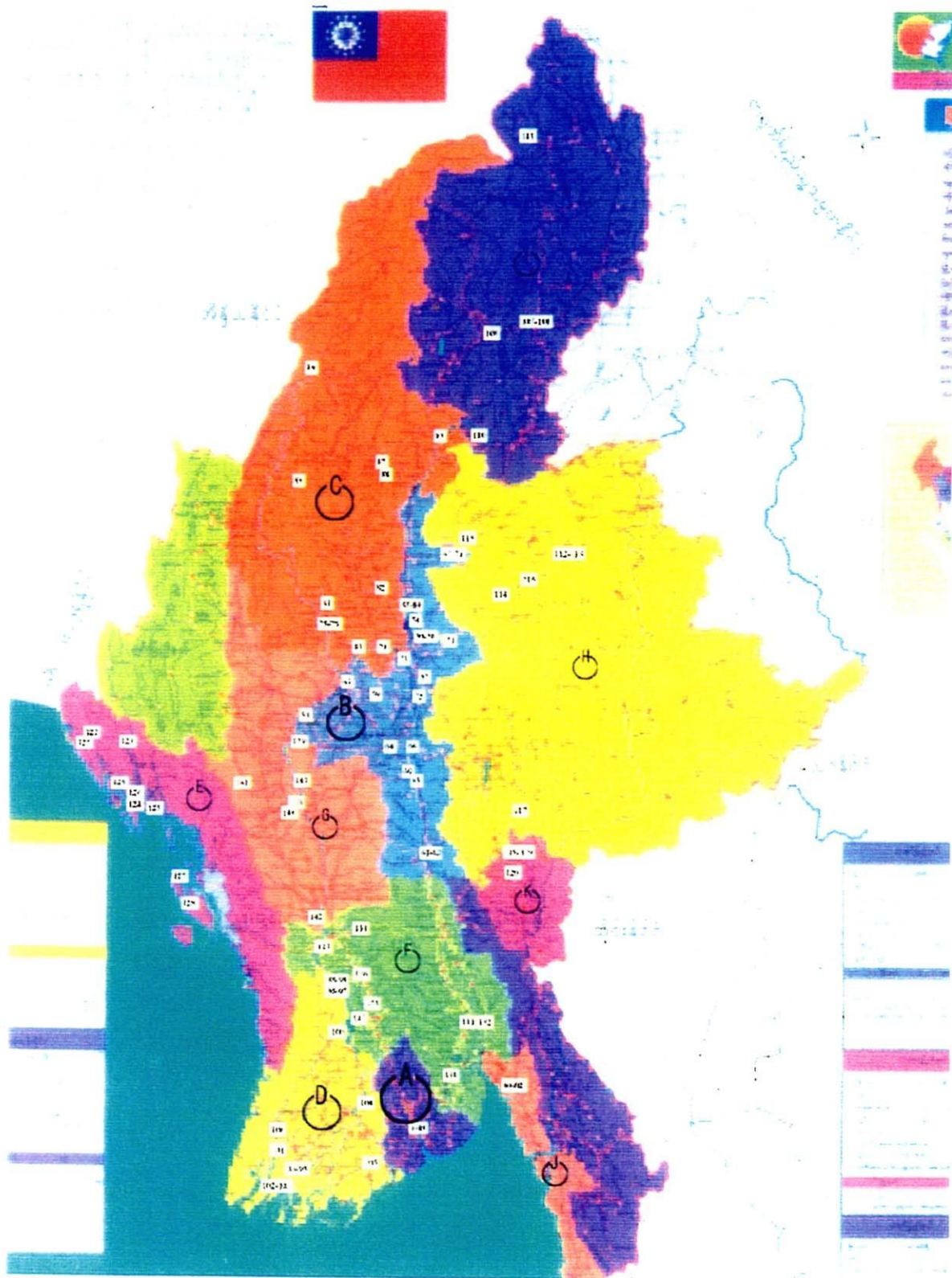
Location of NGOs Involved in Microfinance



Legend

- + Micro-Finance INGO
- UNDP Assisted Project
- Other INGO
- △ Local NGO

Location of Open-type Saving & Credit Cooperative Societies



A. Yangon	- 49 societies	G. Magyay	- 6 societies
B. Mandalay	- 25 societies	H. Shan	- 6 societies
C. Sagaing	- 15 societies	I. Kachin	- 5 societies
D. Ayeyarwaddy	- 14 societies	J. Mon	- 3 societies
E. Rakhine	- 9 societies	K. Kayah	- 3 societies
F. Bago	- 8 societies	Total	- 143 societies

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MYANMAR SIDE

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