PART I

ASSESSMENT OF AND BASIC DIRECTIONS FOR MICROFINANCE IN MYANMAR

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Chapter 1

Microfinance Development in Myanmar
Toward Sustainable Financial Systems

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1. Overview

1-1. General Background

1. Micro-finance is perceived to be a critical instrument in poverty alleviation as borne by the experience of several developing countries that have promoted its use in the last few years. In Bangladesh, considered by some "the mecca of micro-finance", per capita GDP in 1996 was estimated to be only $212 in 1987 US dollars. Poverty is a very serious problem but its incidence was reported to have declined from over 70% in the early 1980s to less than 50% by the early 1990s. This decline was attributed to a broad based growth that occurred through improved agricultural technology, labor-intensive industrialization, and rapid growth of the informal service sector (Asian Development Bank 2000).

2. The ADB contends that a strong financial NGO sector emerged as a result of the poor quality of public services in Bangladesh. It was estimated that there might be as many as 1,000 micro-finance organizations that provide loans. Some mobilize savings and many provide non-financial services such as training, consciousness raising and skills development. Most use the group lending technology popularized by Grameen Bank while some work with much larger groups. The majority of those micro-finance organizations are small, serving only a few hundred persons, while others are huge. As of December 1997, the four largest are BRAC, PROSHIKA, ASA and SWANIRVAR Bangladesh with combined membership of over 7.6 million and loans outstanding of 21 billion Taka (Development Forum, 1997).

3. As of February 1998, Grameen Bank, which is a specialized Bank for the poor, had 1,128 branches located in 38,951 villages. It had disbursed a total of US$2.3 billion in loans to 2.3 million borrowers, ninety four percent of which were women. Equally impressive, it was able to generate cumulative savings (Group Fund) amounting to over US$170 million. Grameen Bank's remarkable performance in terms of repayment (over 95%) and impact has attracted various attempts at replication in many parts of the world. A total of 223 Grameen replication programs have been established in 58 countries in Asia, Africa and Latin America during the last ten years.

4. One such replication, albeit with significant modifications, is the Center for Agriculture and Rural Development in the Philippines. Started as a community development organization offering balloon-based repayment loans, it began a phased transformation of the NGO into a bank in 1997, a pioneering effort in the Philippines, providing a demonstration model for other MFIs in the country. It became the first private bank specializing in micro-finance in the country. Embarking on a massive scaling-up during the last four years, CARD is now the largest private MFI in the Philippines, reaching more than 50,000 poor women in hundreds of economically depressed villages through 30 branches. In 1999, two island bank branches were established. As of December 31, 2001, the combined loan portfolio of the NGO and the Bank was valued at P378.99 million with a repayment rate of 99.95%. With the bank's opening, savings mobilization from the public was legalized, bringing the value of savings close to P80 million from more than 84,000 accounts (CARD Annual Report 2001).

5. Bank Rakyat Indonesia is a state-owned commercial bank whose traditional mission has been the provision of banking services to rural areas of Indonesia. BRI is Indonesia's largest bank,

and its Unit Desa, or local banking system, is the leading provider of sustainable micro-finance in the world. Until 1983, the Unit Desa system had mobilized deposits of only $17 million; the system now holds more than $2 billion in deposits (BRI Internet posting, 2002).

6. In 1997, there were 2.5 million loans outstanding at the BRI units, with an average account size of $650. About 87.9% of all loans are in the range of less than US$900. Savings growth is also impressive, especially since all Unit savings are voluntary. Today the units have $3B in total savings from 16.2 million savings accounts. Without exclusively targeting the poor, the BRI units have assisted hundred of thousands of households in lifting themselves out of absolute poverty over the past decade. Without exclusively targeting women entrepreneurs, the Units have helped finance more than 500,000 businesses run by women. By efficiently intermediating between small savers and borrowers, the Units are an important force for equitable development in Indonesia.[1]

7. Despite the economic crisis in Indonesia in 1997, BRI''s Unit Desa continues strong. As of December 1998 it served 2.5 million borrowers, 21.7 million savers, and had a loan portfolio valued at more than $585 million. More than 96 percent of BRI units were profitable in the third quarter of 1999 (BRI Internet posting, 2002).

8. In Myanmar, the lack of access to credit and savings is a serious constraint on the development of the countryside and on the ability of poor households to improve their economic situation. The poor households' traditional source of credit is the informal moneylender who charges interest rates of between 10 to 15 percent per month without collateral, although in some instances, field visits revealed that some form of collateral is required but lower interest rate is charged at 5 to 10 percent per month.

9. In this light, the advent of micro-finance to Myanmar offers a strategic and cheaper alternative to the informal credit sources for the majority of poor households and micro-enterprises. It also provides a potential for mobilizing savings from hundreds of thousands of households who keep their surplus in the form of gold, jewelry or livestock. Although there are twenty licensed private banks in the country, they mostly operate in the urban areas. The state-owned banks operate in both rural and urban areas but their reach is also limited.

1-2. Objectives of the Study

10. The chapter provides a global picture of micro-finance in Myanmar in order to have a firm understanding of its present status and performance and in particular, to determine what further interventions might be necessary to further its development. It discusses not only the three UNDP-funded INGO micro-finance projects but also other minor micro-finance projects or operations implemented by other institutions, e.g., local associations and other INGOs. Micro-finance in Myanmar is still in an embryonic stage and is mainly limited to three projects within 3 areas and 11 townships implemented by the United Nations Development Programme (UNDP) and the United Nations Office for Project Services (UNOPS).

[1] Sugianto (1997)

11. The pawnshops and cooperative societies were included in the discussion of this chapter because field observations indicated that these institutions also provide micro-credits to the small borrowers. Other international NGOs are also currently involved in providing micro-credits to target borrowers. Some private banks have expressed interest in micro-finance, hence, their inclusion in the discussion.

12. At the outset, it must be pointed out that the pawnshops, cooperative societies, local associations and other international INGOs such as World Vision, etc., implement micro-finance projects that lack the scale and scope of the micro-finance projects of the three INGOs under contract with and funding from UNDP. While their current scope of operation and funding is quite limited and minor, nevertheless, they have the potential to grow into sustainable MFIs given a policy environment that is conducive to their growth and development.

1-3. Research Methodology

13. The study used descriptive analysis as a general method to arrive at the conclusions and recommendations. It made used of available secondary data as well as primary data generated from two field visits (November-December 2001 and January-February 2002). Key informant interviews and focused group discussions were the instruments used to generate primary data and related information. In-house discussions with other team members of the Fiscal and Monetary Policy Working Group (Study on the Financial Sector) that is part of the Myanmar-Japan Cooperation Programme for Structural Adjustment of Myanmar Economy contributed insights and refinement of ideas and analysis. An annex lists the persons interviewed in the course of the research.

14. The main drawback of the discussion is the limited availability of data on financial performance of microfinance projects and program implementation. The main reason for the limited data is the lack of a monitoring and reporting system on microfinance activities and operations that tracks performance on a regular basis. Notwithstanding this limitation, the authors of this chapter made use of the rich information derived from several field visits over the duration of this study and the secondary data made available by the interviewees to the extent possible. Focused group discussions yielded precious insights into micro-finance operations in the country. This approach enabled the study team to piece together a comprehensive discussion and analysis of the development of microfinance in Myanmar.

2. Demand for Microfinance

15. To give an idea of the scale of demand for microfinance on a worldwide basis, it is best to refer to recent data from the World Bank's inventory of microfinance institutions. That inventory show that as of September 1995, about US$7 billion worth of loans to more than 13 million individuals and groups were outstanding in 206 respondent microfinance institutions. Those micro-finance institutions have mobilized over US$19 billion in deposits in 45 million deposit accounts[2].

[2] Paxton and Cuevas (1996).

16. In Myanmar, the demand for micro-loans was roughly estimated to be US$400 to US$600 million. [3] This approximation was based on the micro-finance operations of the 3 INGOs supported by UNDP that reported an average penetration rate of 40 to 60 percent of households in their areas of operations. It was further assumed that an average loan outstanding of US$100 would be required by 40 to 60 percent of an estimated 10 million households. Apart from this rough attempt to estimate the demand for micro-finance in the country, there has yet been no effort to arrive at a more systematic and data-driven analysis. However, the UNDP estimate although rough is important because it gives an idea of the order of magnitude of the potential impact that sustainable micro-finance can bring to thousands of poor households if given the chance to have proper development.

3. Microfinance Providers in Myanmar

17. Micro-finance is an exogenous phenomenon brought to the country by UNDP and several other international NGOs who are interested in using micro-finance as part of their overall package for poverty alleviation. A national strategy and program to promote and develop micro-finance is absent and thus, micro-finance in Myanmar is really in a nascent stage. However, this situation has not prevented various local organizations or associations and the other international NGOs to initiate micro-credit projects, some with a savings component (and thus, technically, can be labeled as minor "micro-finance" projects) but in reality, only the three INGO projects under contract with UNDP can be classified as serious micro-finance projects. This is because it is only the three UNDP-contracted INGOs that are solely focused on micro-finance with a view to institute sustainable microfinance operations in the country.

3-1. UNDP Microfinance Projects

18. The UNDP HDI-E has a micro-finance component. This is the Micro-finance Project whose goal is to assist poor rural households to gain sustainable and adequate livelihood through access to credit. UNDP has contracted three INGOs to implement a project that has provided micro-credit and savings services to the poor since 1997. They are Grameen Trust (operating in three Delta Zone townships), PACT (in 3 townships in Dry Zone) and GRET (present in 5 townships in Shan State).

19. The coverage in terms of number of townships is very small: only three percent of the country's townships are under the Micro-finance Project. However, the relatively small coverage may be explained by the experimental or pilot nature of the Project. Micro-finance is a new approach that has yet to be tested and sustained in a country like Myanmar. Thus, the project areas have been consciously limited to those geographical areas and townships.

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[3] UNDP DraftProject Document MYA/01/004/A/01/31

20. As of December 2001, the UNDP Micro-finance Project has a total active outreach of approximately 105, 908 distributed among the 3 INGOs as follows: Grameen Trust - 32,901; GRET - 23,280; and PACT - 49,727. Although small relative to the total number of individuals or poor households demanding micro-finance services, the cumulative outreach since the Micro-finance Project started almost four years ago, can be considered remarkable considering the relative difficulty of the areas where the three INGOs have been contracted to operate and the lack of experience of the project staff in micro-finance. The covered areas suffer from poor infrastructure and communication facilities. They are some of the poorer areas in Myanmar. For example, in Delta Zone, electricity runs only for 2 to 4 hours daily while the roads are in a sad state of disrepair.

21. Despite these constraints, the INGOs have shown creditable performance. For example, PACT reports that a 6o percent "penetration ratio", defined as the proportion of households to the total number of households in the project site covered by its operation. In the three townships where PACT operates, about 80 to 82 households out of an average of 120 to 130 households in 500 out of 660 villages have been reached by micro-finance operations[4]. This is remarkable outreach performance.

22. Loan size ranges from Ks10,904 to Ks11,809 per borrower and because of the inflationary pressure, the borrowers cannot fully enjoy the benefit of the loan. Micro-enterprise loans of Ks 50,000 repayable over two years are given. Field interviews and secondary data indicate the target households' positive perception of the three INGO Micro-finance Projects as an intervention that can bring a significant impact on their economic situation. The following are the perceived benefits arising from participation in the three micro-finance projects.

- ✓ improvement of the clients' quality of life
- ✓ substantial increase in income
- ✓ increase in savings and asset build-up
- ✓ availability of better food and nutrition to the family
- ✓ improvement of housing conditions
- ✓ basic schooling for the children and
- ✓ lesser dependence on moneylenders.

23. Table 1 shows the comparative performance of the three INGOs according to key indicators as of December 2001:

[4] From Mr. Fukui and Ms. Honda interview with Mr. Fahmid of PACT dated August 2002.

Table 1. Comparative Performance of GRET, PACT and Grameen Trust, December 2001

FEATURE	GRET	PACT	GRAMEEN TRUST
Location	Shan State	Dry Zone	Delta Zone
Covered Areas	5 townships; 374 villages	3 townships; 487 villages	3 townships; 657 villages
Branches	5	13	7
Staff complement	51 staff 1 local credit manager, 8 head office staff and 39 loan officers	170 staff 72 loan officers 1 national project coordinator	79 Staff 1 local project director and 64 loan officers
Loan use	Farming	Livestock Trading	Pig/duck raising; non-farm activities such as selling prawns, vegetables and snacks, fishing nets, row boats, sewing
Active Members	23,280	49,727	32,901
Active Borrowers	14,613	47,087	26,326
Portfolio (in 000 kyats)	Ks 262,219	Ks 587,217	Ks 358,758
Repayment Rate	99%	99.98%	100%
Operational Self-sufficiency[1]	99%	112%	88.8%
Financial Self-sufficiency[1]	58.7%	66.1%	45.2%
Collateral/Guarantees	Solidarity group, Mortgage for individual	Solidarity group	Solidarity group
Duration of loan	6 months, 1 year	6 months, 1 year	1 year
Repayment Frequency	Monthly interest rate, principal end of the cycle	Bi-weekly	Weekly

Interest Rate	3.75% per month, monthly principal at end of cycle=45% per annum	0.9% fortnightly=45% per annum	20% flat=38.5% per annum in 50 equal monthly installments of principal and interest
Average Loan Size	Ks 11,264	Ks 11,809	Ks 10,904
Insurance	None	Beneficiaries Welfare Program, Mar 2000 Ks 50 annual Now Ks75 premium Death benefit: Ks25,000	None
Savings (in 000 Kyats)	8,897	76,642	53,083
Non-financial Service	None	Business extension, training on working capital management, credit methodology Non-formal Business Education	None

1 As of June 2001.

Sources: UNDP/UNOPS December Report, INGO Reports, MCRIL Reports

24. The three micro-finance projects have begun the institutionalization and localization process as envisaged in their respective agreements/contracts with UNDP/UNOPS. All the three INGOs, that is, the Grameen Trust, PACT and GRET have seriously taken the task as they have began working on the documentary requirements for the registration of their projects as local NGOs. One of the authors had the privilege of actually observing the process of forming the local township board of the GRET project in Shan State. In the Dry Zone, the local project staff members have started the process by drafting an organizational structure that reflects the localization process through the creation of a board of directors coming from local people. Likewise, in Delta Zone, the local staff members have now began drafting the articles of incorporation of a local MFI and have proposed to name it as the "Microfinance Delta Association." They envision it to have a seven-member board with two members coming from the private sector and five from the project staff.

25. The local staff members, respectively in the three UNDP areas, have seen the importance of the registration of a local MFI. They believe that the institutionalization of the Micro-finance Project and its localization through the creation of local NGOs/MFIs will be the vehicle that will allow them to expand their operation to other townships and reach a greater number of clients. The problem though is that the local staff members together with the local managers do not have the requisite expertise and experience to guide the institutionalization and localization exercise. Some of the local staff members have also expressed concern about their ability to handle pressure from local authorities and the international funding agencies that might have their own respective ideas

and agenda in running the local MFI. It seems that they will be dependent yet on systematic and well planned technical assistance in the following areas:

- ✓ setting up of support units at the Head Office Level such as personnel/administration, internal audit, training, and, finance;
- ✓ development and installation of management information systems (MIS) not only at the head office level but also at the branch level;
- ✓ new loan and savings product development;
- ✓ governance of micro-finance programs;
- ✓ improvement on the current credit and savings methodologies especially in the area of dealing with repayment crises and rehabilitation;
- ✓ financial management;
- ✓ strengthening branch management and
- ✓ resource mobilization and donor relationship.

3-2. International NGOs and Other UNDP-supported Micro-finance Projects

26. Other international NGOS like World Vision, CARE Myanmar, Save the Children USA and Save the Children UK are implementing their own micro-finance projects. It was observed that the micro-finance projects of these international NGOs are either on a pilot stage or are now just beginning to expand operations, although still on a limited scale, to other parts of Myanmar as in the case of World Vision. Some of these international NGOs implement their micro-finance projects through a memorandum of understanding (MOU) with a ministry, for example, the Ministry of Health in the case of World Vision. The MOU serves as the legal basis for implementing the micro-finance project in a target area or to serve target clientele by providing them micro-credits at interest rates that are not subject to the ceiling imposed by the Central Bank of Myanmar.

27. There is a wide variation in credit and savings methodologies, i.e., techniques of group formation, repayment schemes, savings schemes and interest rates. Borrowers normally pay interest charges ranging from 0 to 4% per month. The average loan size ranges from 5,000 to 10,000 Kyats with an average loan duration of six months. The loan repayment schedule varies from weekly to end of cycle.

28. One of the more serious international NGO is World Vision that has been into micro-finance for almost four years now. It has a total outreach of 3,676 active clients served by four branches located in four townships. Its total loan outstanding was 102,598,493 Kyats with an estimated portfolio-at-risk of 2.5 percent. It has a full staff complement composed of twenty local staff members and one expatriate. It plans to expand within the next five years to reach 11,000 clients. Table 2 shows the operations highlights of World Vision.

Table 2. Operations Highlights of World Vision as of December 2001

Description	From inception[1] to December 2001
Total number of loans disbursed	14,525
Number of first loan disbursed	7,516
Number of repeat loan disbursed	7,009
Amount of loans disbursed (in kyats)	451,206,000
Average loan size (in kyats)	31,064
Number of active loans	3,676
Value of outstanding portfolio (in kyats)	102,598,493
Payment in arrears > 1 day	1.37 %
Late portfolio (balance of loans > 1 day)	2.81 %
Portfolio at risk > 30 days	2.52 %
Operational sustainability	73%
Percentage of women's receiving loan	69%

[1] From inception-December 1997

Source: World Vision, Myanmar

29. Some of these INGO projects try to adhere to some rudimentary form of performance standards while those that are still in the pilot or experimental stage are more concerned with reaching as many poor households as possible without necessarily adhering to the strict discipline of best practice micro-finance. All the NGOs interviewed have either full time staff members or a full time unit for their micro-finance project. This indicates the seriousness in providing micro-finance services. Nonetheless, these INGOs are fully aware that capacity building in micro-finance is a critical concern, hence, according to Save the Children UK, INGOs are all planning to develop a joint capacity building program focused on micro-finance. Table 3 shows the comparative micro-finance schemes of some INGOs according to key indicators.

30. Thus, the difference between the micro-finance projects of these INGOs and those of the three INGOs under the UNDP/UNOPS Micro-finance Project is that the latter are purely micro-finance operations implemented according to best practices in micro-finance. This means emphasis on viability and sustainability. The former use micro-finance as a component of a larger project, say, health, education or agriculture as a good entry point in the targeted community. The provision of micro-credits supports the livelihood projects of the poor households.

31. Another UNDP-supported project is the FAO Revolving Fund in Shan State, Dry Zone, and the Delta Zone; GRET village banking approach in Chin State; and, the CDRT project. It is worth noting that these UNDP-supported projects also have variations and differences in their micro-finance operations. Except for the GRET project in Chin which also has received financial support from the Japanese Embassy, all the above- mentioned "micro-finance" projects give their loans to the community as grants.

Table 3. Comparative Microfinance Methodology of International NGOs

KEY INDICATORS	SCF UK	World Vision	SCF US	CARE International
Average Loan Size/Borrower	5,000-10,000 Kyats	31,064 Kyats	10,000 Kyats	5,000 Kyats
Interest Rate	4% monthly	48% per annum (flat) + 2% administration fee	4% monthly	0%
Repayment	End of cycle	Weekly	Weekly	End of cycle
Loan Term	6 months	6 months	6 months	6 months
Savings	None	4-5% monthly (35 kyats/week) based on the loan	Voluntary	None
Legal Cover	Agreement with UNESCO	Agreement with Ministry of Health	Agreement with Ministry of Health	Agreement with Ministry of Health
Full time Staff	Yes	Yes	Yes	Yes

3-2-1. FAO Revolving Fund

32. The FAO Revolving Fund adapted the self-help group approach. It has several modalities such as the formation of farmers income generation group (FIGG) and the women's income generation group (WIGG). The FIGG has a membership ranging from 50 to more than 500 individuals in a given village. There are no criteria on income or target client. Thus, a member may be one who is well off or not. FIGG is governed by an executive committee and gets guidance from the village tract advisers representing the local leadership.

33. FAO provides assistance in-kind such as farm inputs, equipment, poultry and livestock. Loan maturity ranges from six months to three years with interest rate ranging from 0 to 20 percent. Some loans are paid in cash; others in kind. All loan repayments are made to the FIGG in order to ensure that the fund revolves in the community.

34. For off-farm projects, FAO provides cash assistance. Members pay the interest rate of 2 percent per month while the principal is paid at the end of one year. Loan amounts range from 600 to 300,000 Kyats with an average amount of 10,000 Kyats per member. Savings are not mobilized. There is a one-time membership fee of 100 to 200 Kyats depending on the group's decision. The whole membership meets every six months.

35. One of the key features of this project is the use of private banks as conduit of the funds for the groups. In Kalaw township in Shan State, one FIGG who now owns the fund claim that they would like to standardize the interest rates charged on loans regardless of project type. In addition,

they are also considering an increase of the interest rate in view of inflation. This demonstrates that members are willing to pay a higher interest rate to preserve the value of their revolving fund.

36. The weakness of this model, however, is that the membership of the groups is not limited to the poor. Better off farmers and some local authorities are said to have cornered the big loans. Worse, some of them did not repay, leading to the collapse of some group funds. Since meetings were held only every six months, the group simply served as a credit delivery structure. This arrangement has not empowered the group members, especially the poor members. The lack of leadership rotation has also reinforced the tendency of the group toward elite capture. The result was often the domination of and dependence on traditional leaders who are members of the local elite.

37. An important development is the emerging informal tie-up between Kambawza Bank, a private commercial bank and the Community Based Organizations (CBO) under the FAO Revolving Fund Project in the Dry Zone. FAO organizes those CBOs that are encouraged to have capital build up through savings in a private bank. Under the tie-up, the bank gives loans to some 20 CBOs at the rate of 15% per annum against their savings deposit with the bank. The leveraging ratio is 1:4. For every one Kyat deposited, the bank gives a loan of 4 Kyats. It is also interesting to note that CBOs re-lend to their members at the rate of 4% per month. It appears that CBOs borrow from Kanbawza Bank for re-lending to their members who cannot individually borrow from the bank because of their limited incomes and their lack of creditworthiness from a private bank's perspective. The Project Management Office of the FAO Project reports that twenty villages have been linked to the private bank through this approach. What is encouraging to note is that another private bank, Yoma Bank is now also involved in giving loans to the CBOs using the latter's deposits as guarantee or security to the loan.

38. The future evolution of this Project[5], i.e., after the support from FAO has stopped, points to the opportunity of creating a village cooperative or another form of micro-finance institution, that will provide micro-finance loans to members at interest rates that are higher than the Central Bank-sanctioned rate of 15%. It is worth noting that the CBOs are now de facto charging commercial rates and this practice apparently has the blessing of the local cooperative township officer. Interviews revealed that in the local areas the village cooperatives are allowed to charge commercial rates if permitted to do so by the local cooperative township officer. The prevailing attitude seems to be that commercial rates are necessary to ensure cost recovery for the village cooperatives and that it is access to micro-credit, not strictly speaking the interest rate charged, that matters to local borrowers. The local cooperative township officer in a village that was visited affirmed that it is possible for a village cooperative to implement commercial-oriented micro-finance provided that the by-laws of the cooperative is amended to reflect it. The responsibility of approving the by-laws rests with the local cooperative township officer.

[5] The Project started in 1994. The first phase was for the period 1994-1996; the second phase covered 1997-1999. The third phase covers the period 2001-2002.

3-2-2. GRET Village Banking in Chin

39. Developed by FINCA Founder John Hatch, village banking is a means of delivering financial services, made unique by the way responsibility and autonomy are given to borrowers in running their banks and in its emphasis on community, as well as, individual development.

40. Village banks are community-based credit and savings associations of 25 to 50 low-income individuals who are seeking to improve their lives through self-employment activities. The participants themselves choose their members, elect their officers, establish their by-laws, distribute loans to individuals, and collect payments and savings. Their loans are backed not by goods or property, but by moral collateral: the promise that the group, in solidarity, stands behind each individual loan.

41. The GRET Village Banking in Chin State has the following key features:

- ✓ Each village bank is composed of 10 to 30 solidarity groups with membership of five per group.
- ✓ Local management is through a credit committee composed of a chairperson, treasurer and secretary. The credit committee is elected from the management committee composed of the group leaders.
- ✓ The management committee meets every month while the whole village bank membership normally meets at the end of every loan cycle.
- ✓ The first loan amount starts at 5,000 Kyats per member and is gradually increased in the succeeding loan cycle.
- ✓ The interest rate was initially at 4 percent per month. This was later reduced to 3.75 percent per month.
- ✓ Loan maturity is one year. Interest is paid monthly while the loan principal is paid at the end of the loan term.
- ✓ Members are allowed to get refinancing on the interest that is collected every month but they have to pay at the end of the regular loan cycle.
- ✓ The village bank started to collect savings equivalent to 3 percent of the loan value in December 2001.

42. Started in 1995, GRET Chin Village Bank has a total outreach of 8,115 clients organized into 83 village banks in three townships of Chin State. It has a loan portfolio of 69,542,845 Kyats. The reported operational self-sufficiency is 118.8 percent. It has 20 full-time staff members and a full-time expatriate manager. Table 4 shows the operations highlights of GRET Chin Village Bank as of December 2001[6]

43. The GRET Chin Village Bank certainly has some strengths and apparent weaknesses. One of its strong points is the development and strengthening of local community organizations. This allows the village bank members to work together for community projects and, thus, promote cohesion and solidarity.

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[6] During the field interview, it was claimed that the loan repayment rate was more than 95%. This will have to be validated in future field work in view of the non-availability of pertinent data.

Table 4. Operations Highlight of GRET Chin as of December 2001

	Hakha	Tedim	Falam	State Level	Total
Number of villages	33	18	27	-	78
Number of VC's	36	20	27	-	83
Number of households	2,996	2,608	2,511	-	8,115
Number of members	2,533	2,478	2,291	-	7,302
Number of groups	513	455	461	-	1,429
Number of active borrowers	2,303	1,837	2,099	-	6,239
Penetration ratio	84.5%	95%	92.15%	-	90%
Women involvement	42.6%	33.27%	36.5%	-	37.6%
Loans outstanding (kyat)	30,035,312	15,426,908	24,080,625	-	69,542,845
Operating cost coverage	130%	155.2%	131.3%	94.2%	118.8%
Field staff	5	3	4		12
Portfolio per field staff (kyat)	6,007,062	5,142,302	6,020,156		5,795,237
Members per field staff	507	826	573		609

44. As per interviews with the clients, the GRET Chin approach has improved their lives economically since they were able to access credit that was very difficult to secure before GRET Chin came in. Most of them could not access loans from the MADB because they do not own land. With virtually no moneylenders in the areas, sources of credit were the Christian church that provides only emergency loan and relatives and friends for small loans to pursue income-generating activities. The majority of those interviewed reported significant increase in their income and was able to reinvest their profits for business expansion. Some also reported improved food intake of the children and improvement in housing conditions.

45. There are also some weaknesses in the model, namely: the value of savings was not inculcated at the very start of the program. This explains why the revolving fund did not increase significantly. The Village Bank relied primarily on interest income and donor funding. Secondly, the village bank membership is too large to be managed and monitored effectively. It is difficult to get everyone's active participation if membership goes beyond fifty. Thirdly, leadership rotation

was not practiced, giving rise to dependence on and domination by traditional leaders. Fourth, membership composition is mixed, mostly dominated by men. The irony is that experience has shown that the best clients in micro-finance are poor women.

46. GRET Chin has started its localization and institutionalization process since May 2000. GRET Chin already has local governing boards both at the state and township levels although these are not yet legally registered. GRET Chin local staff members are still debating whether to register as a local NGO under the Ministry of Home Affairs or under the Ministry of Cooperatives. The local board at the state and township levels meets regularly (monthly, quarterly).

47. The grant from the Japanese Embassy, i.e., the Japanese Grassroots Fund is currently being put to good use in building the capacities of the local board and staff in the areas of governance and management of the micro-finance project. This is a very crucial intervention by the Japanese government in view of weak local capacities in micro-finance and the emphasis on building capacity will result in quality project implementation in the future. Sustainable micro-finance rests to a great extent on the quality of management and project implementation by micro-finance institutions.

48. The authors' interaction with the local project staff members indicates that the local staff members are very confident and excited to have their own local NGO. However, they realize that they will still need technical assistance from GRET Chin and support from the Japanese government in the areas of organizational and financial management, resource mobilization, improvement of their existing credit methodologies to adhere to best practices and product development. The major worry of the project staff members now is the termination of the project contract with UNDP on February 2002. More than the funding constraint that will ensue, it is the legal cover to operate as a micro-finance institution that is the real source of concern. It is noted that GRET Chin Village Bank has decided to continue its micro-finance operations even without UNDP's funding assistance.

49. Another issue that needs to be addressed when the partnership between GRET Chin and UNDP ends is the ownership of the loan fund and the fixed assets. Can GRET Chin or the local organization that will be registered become the owners? Can GRET Chin carry on by having a Memorandum of Understanding with UNDP to manage the existing project as an interim legal cover until such time that the local NGO is legally registered?

3-2-3. Community Development for Remote Townships Project

50. The Community Development for Remote Townships (CDRT) project is funded by UNDP. CDRT is an integrated project with several components, namely, health, education, water supply, agriculture and income generating activities through self-reliant group (SRG). The project operates in ten townships in the border area states of Rakhine, Chin and Kachin. The Project's Terminal Report (2002) indicated that at June 2002, 1,005 self-reliant groups (SRGs) had been formed. They covered 15,674 households or 68% of the target population. Total savings mobilized amounted to Kyats 56.4 million. A SRG is composed of 15 to 20 poor women, self-selected through a process of wealth ranking. The group is provided an awareness training after which each member starts weekly savings of 5 to 15 Kyats for a period of 1 to 2 months. Based on her savings and attendance

performance, a member who becomes qualified for a loan is given a loan of 20,000 Kyats through the SRG. The UNDP provided US$458,658 as capital grants that were then on-lent to the members.

51. Peer pressure is an important feature of the credit delivery mechanism, with members of the SRG receiving their loans only after the other members have proven their credit worthiness. Peer pressure is used to guarantee loan repayment among members. The members of the SRG receive their loans only after the other members have repaid their own loans.) The members pay 2 to 3% interest rate per month depending on the project type, loan amount and the group's decision. The loan maturity varies from 3 to 12 months depending on the project and group decision. Loan repayment modality is either weekly, monthly or at the end of loan cycle.

52. The UNDP Terminal Report (2002) lists the following as the strengths of the SRG approach:

- ✓ The SRG approach focuses directly on poor households and has a very strong affinity, participation, shared vision, organization, capacity building and capital accumulation.
- ✓ SRGs have a social function as well as an economic function. SRGs act as a social safety net for the poor and the groups are more empowering and supporting than traditional micro-finance approaches.
- ✓ The SRG approach focuses on women and promotes gender equality.
- ✓ The SRGs are based on mobilizing small periodic savings and the capital belongs to the SRG members and not with a NGO or micro-finance institution. Interest repayments cover inflation and costs and members are trained and required to maintain financial accounts.
- ✓ The SRG approach, being community owned and managed, can provide flexible loan periods, interest rates and repayment schedules and more effectively meet the needs of its members.
- ✓ The SRGs provide social support that enables the poor to overcome their risk averse behavior and having access to flexible, low cost loans backed by a supportive environment, gives the confidence for the initial investment in activities that promote livelihoods.
- ✓ The SRG approach better meets the needs of the remote communities as well as the project objectives. It does not require or depend upon changes in government legislation to become sustainable.

The Terminal Report listed the following as weaknesses of the SRG approach:

- ✓ Groups require strong initial support for training and capacity building.
- ✓ For scaling up of activities, groups need to be linked to the banking (or formal micro credit sector) for long term growth and expansion.
- ✓ An external organization such as a project or NGO is required to promote, train and support the new groups.

53. The SRG approach is still in its infancy. It insures the inclusion of the poor in the program and promotes group solidarity, savings mobilization and client empowerment through training. However, the weakness lies in the common knowledge that the loan funds that are on-lent by SRGs to members came from a capital grant to the community from a donor (UNDP). Thus, there is the possibility of non-payment by some borrowers since the loan came from a grant from a donor. This might erode credit discipline among the rest of the members. The fact that members of SRGs are free to set the loan maturity schedule, the interest rate and loan repayment modality may create moral hazard problems to the sustainability of the SRG micro-credit scheme. On the other hand, clients of GRET Chin village banks who are aware of the SRG approach are now comparing their

micro-finance project with that of the CDRT and are complaining why they have to repay their loans while the SRGs do not. While this complaint may not be an accurate reflection of SRG micro-credit practices, there is need for community members to have a clear understanding of both approaches and their attendant loan conditions. Otherwise, there may be confusion in the community as indicated in the interview of GRET Chin village bank members.

3-3. Local Microfinance Operations

54. A number of local organizations or associations are also involved in micro-finance activities. These also have full time staff for the implementation of their micro-finance/micro-credit projects. They are legally registered with the Ministry of Home Affairs. They are the YMCA, YWCA, Myanmar Women's Entrepreneur Association and MCCA, among others. Each of these local organizations or associations implements its own micro-finance/micro-credit projects mostly on a pilot basis. The interest rates being charged by most of these local organizations or associations range from 0 to 4 percent per month. The average loan per member ranges from 5,000 to 10,000 Kyats. The primary focus of assistance is the poor women. Loan repayment modality is either monthly or at the end of the loan cycle.

55. Some try to operate along the key principles of sustainable micro-finance, e.g., charging interest rates that cover operating costs and risks, etc., but others stand to gain from a wider exposure to best practices in micro-finance in order to vest some degree of viability and sustainability in their respective operations. Most, if not all, of them has micro-credit provision as a minor component of a larger project that has objectives other than making credit available to target clientele. It is also worth noting that local NGOs interviewed have either a part-time or full-time staff for their micro-finance project.

56. One notable local organization that has potential for best practices is the YWCA that has an outreach of 1,100 active clients and is operating in 2 townships. It delivers credit through solidarity groups, charges 3 to 4% per month interest rate on loans provided, payable monthly in 6 to 10 months. YWCA is also promoting weekly savings mobilization of 25 Kyats per member. It has full-time staff members who have working knowledge on financial and organizational sustainability of their micro-finance project. The YWCA obtains technical and financial support from international donors to build institutional capacities.

57. The Women's Entrepreneur Association is another local organization that is presently trying to build its capabilities using best practices. It has a total outreach in the key Bazaar of Yangon of around 300 women. Total loan portfolio is 3.1 million Kyats. The vision of the institution is to establish a women's bank to cater to the needs of women entrepreneurs.

58. The Mother and Child Welfare Association (MWCA) is not directly engaged in micro-finance operations at the head office level. Its micro-finance operations are done through its local chapters at the township level where a committee is in charge of mobilizing and managing its micro-finance project. The local chapters generate funds from members and local people and these are used for lending to members. Table 5 shows the micro-finance operations of the MCWA network. Table 6 shows the comparative micro-finance methodology of selected local NGOs operating in Myanmar.

Table 5. Microfinance Operations of MCWA at the Different State and Division Levels

	State/ Division	MWCA			
		Chapters in Township		No. of borrowers	
		1999	2000	1999	2000
1	Kachin State	6	6	62	74
2	Kayar State	1		10	
3	Kayin State	2	6	9	54
4	Chin State		3		27
5	Sagaing Division	26	25	247	330
6	Tanintharyi Division	10	10	454	578
7	Bago Division	5	12	54	187
8	Magywe Division	26	17	2,312	1,761
9	Mandalay Division	30	31	25,372	14,506
10	Mon State	10	9	680	441
11	Rakhine State		2		
12	Yangon Division	44	45	2,695	4,905
13	Ayeyarwaddy Division	26	26	1,169	4,818
14	Shan (South)	3		10	
15	Shan (North)	2	7	34	78
16	Shan (East)	10	10	196	142
17	**TOTAL**	**201**	**209**	**33,124**	**27,907**

Source: MCWA Reports

Table 6. Comparative Microfinance Methodology of Local NGOSs

KEY INDICATORS	Women Entrepreneur Association	YMCA	YWCA	MCWA (through local chapters)
Average Loan Size/Borrower	5,000 Kyats	20,000-30,000 Kyats	1,000-10,000 Kyats	5,000-10,000 Kyats
Interest Rate	3% monthly based on declining balance	0%	3-4% monthly	2%
Loan Term	5 months	8 months	6-10 months	1-2 years
Repayment	Monthly	After 6 months (daily)	Monthly	Monthly or end of cycle
Savings	For pilot testing	none	25 Kyat/week	Not required
Full time Staff	4	2	Unit	Local committee (no full time staff)

Source: WEA, YMCA, YWCA, MCWA

3-4. Banks/Pawnshops

59. Some private banks in Yangon have expressed an interest to be involved in micro-finance projects since they see not only the potentials of micro-finance as a new loan product but they also see it as a way to contribute in the poverty alleviation program of the government.

60. Yoma Bank, First Private Bank and Asia Wealth Bank have expressed interest as a financier of or wholesaler of loans of micro-finance operations. In the case of First Private Bank, the condition for its participation in micro-finance is a either a collateral or guarantee or cash deposit to be provided by UNDP as security for its loans to micro-finance operations. They are all in search of an investment outlet for excess liquidity in the short-term. There is lack of investment opportunities in the traditional credit markets. Some private banks are apparently reluctant to lend to firms in view of high non-performing loans. Hence, their interest in micro-finance operations as a potential profit centers for the banks' idle funds.

61. Myanmar Oriental Bank is thinking of providing wholesale lending to MFIs to build its image as a bank with social orientation. MOB is open to the possibility of providing loans with no collateral nor security after it has assessed first the operations and capacities of the MFIs but MOB expects the INGOs to approach the bank formally. This means that MOB and INGOs should discuss areas of collaboration. INGOs can provide the technical assistance while MOB can take care of the credit funds. On the other hand, First Private Bank is also interested to provide micro-finance to local NGOs/MFIs but it doubts the viability of these institutions. This is partly due to its lack of familiarity with micro-finance operations and the lack of track record of the contemplated local NGOs/MFIs. First Private Bank will give loans to MFIs but it needs collateral as security for those loans.

62. As earlier stated, Kanbawza Bank (KBZ) has already begun pilot testing its own micro-finance project in the Dry Zone through linking the qualified CBOs to their bank branch in Kyaukpadaung Township with the assistance of the staff members of the FAO Revolving Fund Project. As discussed earlier, for every one Kyat deposited by the CBO, four Kyats are given as loan to the CBO. The first cycle of this initiative was successful and this has encouraged both the CBOs and Kanbawza Bank to plan the expansion of operations. However, the main issue raised by the Kanbawza Bank is whether the Central Bank of Myanmar will allow private banks to give micro-finance loans at unregulated interest rates.

63. Moreover, KBZ Bank does not know whether the Central Bank will allow KBZ to engage in micro-finance. The pilot testing of the KBZ in the Delta was done through opening a private account to lend to the FAO Revolving Fund Project's CBOs. This is a personal project of the chairman of the KBZ Bank and not a project of KBZ as an institution. Central Bank is yet to adopt a definitive policy towards MF activities and to allow private banks to get involved in MF projects. If ever it will be allowed to deal with micro-finance, KBZ Bank has expressed that it has no systematic HRD program on micro-finance and thus, will need assistance to build its own capabilities.

64. Some pawnshops have also expressed interest in micro-finance. There are two types of licensed pawnshops in Myanmar: private and government. The field interviews indicated that it is possible to have both private and government pawnshops in the same townships. The government pawnshops are licensed under the Ministry of Finance. They only accept gold as a form of collateral. The interest rate is 3% per month. The loan has a maturity of 5 months and can be renewed for as long as the client pays the interest rate due during the five-month period. Loans may be renewed up to three times. If principal and interest due are not repaid by due date, the pawnshop sells the gold to cover the unpaid loan. Any excess from the sale proceeds after collecting the principal and interest is given to the borrower.

65. The private pawnshops can be licensed through YCDC, MCDC or Ministry of Border Area Development. Private pawnshops accept gold, properties like buildings, vehicles, and home appliances, among others, as collateral. The interest rates vary from 3 to 6 % per month. The loan has a maturity of 5 months and can also be renewed[7]. Most of the clients of the pawnshops are from the rural areas particularly the farmers. The loan is normally used to purchase production inputs and for home consumption. The average loan amount borrowed from the pawnshops ranges from 5,000 to 10,000 Kyats. In Kyaukpadaung, the average loan ranges from 10,000 to 30,000 Kyats. Aye Myint Ta Pawnshop in Kalaw on the average gives loans of around 100,000 Kyats everyday to 20 to 30 clients. In a month the average loan outstanding is around 2.5 million Kyats and for 5 months (one cycle), the average is around 12.5 million Kyats. The owner of the pawnshop revealed that he borrows from Yoma Bank at an interest rate of 15% per year and then use the funds to lend to farmers.

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[7] Some pawnshops probably do not allow loan renewals. One interviewee pawnshop does not allow loan renewal. At the end of the loan cycle, a client who is unable to repay the loan, will be asked to remit the difference of the market value of the collateral and the sum of the remaining interest plus principal to his creditor pawnshop. The balance, if any, will be kept by the client.

3-5. Cooperative Bank and Cooperatives

66. The Cooperative Bank Yangon was registered under the Myanmar Company Law in 1992. It received a banking license from the Central Bank of Myanmar on August 3, 1992. The Board of Directors is composed of six cooperative societies, one trading company and a director from the Ministry of Cooperatives who is appointed by the Government. The Cooperative Bank now has nine years of commercial banking experience, a medium-size bank owned by 46 shareholders of which 27 are cooperative societies and 19 are private shareholders. The Cooperative Bank lends to cooperative societies and private individuals. The Bank also maintains a close working relationship with Asia Wealth Bank and Kanbawza Bank through a client referral system. Loan accounts that are too big for the Bank to handle are referred to either bank. Those banks in turn refer medium-size clients to the Cooperative Bank. The Bank claims that it can go into micro-finance "provided the State gives it financial backing and a credit guarantee[8]." Twenty percent of its current loan portfolio comprises loans to cooperatives while 80% are loans to private individuals/firms.

67. The cooperative movement in Myanmar originated from the promulgation of India's Co-operative Credit Societies Act in 1904. Primarily it was contemplated as a government-sponsored measure to relieve the agricultural indebtedness of the farmers in Myanmar. The first agricultural credit cooperative society was organized and registered in January 1905 and set up in Myinmu Township, Sagaing Division. As the circumstances in political, economic and social conditions changed, so did the cooperative movement.

68. In 1992, a new cooperative law was enacted, giving wider mandate and freedom to the financial cooperatives. Today, the Ministry of Cooperatives reports that there are 1,942 functioning credit cooperative societies in operation with a total membership of 431,000 individuals. Total amount of savings held was 3,851.14 million Kyats and total loan disbursed was 6,336.45 million Kyats. Compared to the 1988-89 data, this represents a decrease of 26% in terms of functioning credit societies, 41% decline in membership, but an increase in savings and loan releases by 706% and 1184%, respectively.

69. Table 7 shows the status and trend of primary cooperative societies for the period 1998-2001. Table 8 presents the income, expenditure, profit and loss of primary savings and credit cooperative societies. As of December 2001, the gross income and expenditure registered was around 661.2 million Kyats and 446.7 million Kyats, respectively. The reported net profit of 214.5 million Kyats in 2001 represents a decrease of 420% from that reported in 1998-1999.

70. The decline in reported membership and net income does not indicate a robust cooperative sector. However, without more data and survey of the reported cooperatives societies, it is difficult to make a definitive statement on their present status and financial performance at this time. The surviving cooperative societies may have a potential role in micro-finance if they can develop the discipline and micro-finance technology to make them sustainable institutions.

71. This point to the need to conduct a systematic study of credit cooperative societies. Their proximity to the target clientele of micro-finance and their being grassroots entities add to their

[8] Interview with the Cooperative Bank Yangon, December 06, 2001.

potential as micro-finance players in the country. However, because of the information void that is now present, it is to the benefit of the entire country to have that systematic study conducted soon. What is available now in respect to their potential role in micro-finance is anecdotal evidence gathered by the authors during their field interviews in the country.

Table 7. Savings and Credit Primary Co-operative Societies, 1988-89 to 2001-02, 3rd quarter December

	Years	No of Societies	No of members in Lakhs	In million		
				Share Contribution	Savings	Loan Amount
1	1988-89	2,641	7.24	19.60	477.55	493.54
2	1989-90	2,372	6.11	15.25	421.98	667.17
3	1990-91	2,372	5.99	15.89	492.77	835.88
4	1991-92	2,374	5.87	15.39	544.47	988.09
5	1992-93	2,346	5.50	19.07	654.69	1,044.50
6	1993-94	2,347	5.52	102.87	655.86	1,283.03
7	1994-95	2,188	5.24	280.53	1,433.66	2,411.38
8	1995-96	2,249	5.05	465.44	918.11	2,690.93
9	1996-97	2,212	4.96	500.35	1,223.83	4,013.48
10	1997-98	2,042	4.24	1,176.89	1,754.74	3,639.59
11	1998-99	2,038	4.18	1,316.56	4,487.88	16,466.93
12	1999-2000	2,098	4.53	1,232.54	3,354.71	9,270.48
13	2000-2001	1,964	4.16	1,104.43	3,696.54	8,483.07
14	2001-2002 Dec	1,942	4.31	1,072.17	3,851.41	6,336.45

Source: A Study on the history of savings and credit cooperative societies in Myanmar, February 2002.

Table 8. Income, Expenditure, Profit and Loss Account of Primary Savings and Credit Cooperative Society Ltd (1998-99 to 2001-2002 Dec) (Kyats in million)

No	Year	Income	Expenditure	Profit and Loss	
				+	-
1	1998-99	1,734.4	619.9	1,114.4	-
2	1999-2000	1,044.5	680.2	364.2	-
3	2000-2001	850.2	655.3	194.8	-
4	2001-2002 (Dec)	661.2	446.7	214.5	-

Source: A Study on the history of savings and credit cooperative societies in Myanmar, February 2002.

72. Field observations in Yangon and Dry Zone indicated the potential of cooperative societies in contributing to micro-finance development in Myanmar. For example, a primary society interviewed in Yangon, the Mahadanan primary cooperative is already implementing a micro-finance program but has modified it by using cooperatives principles. At present, the society has around 3,000 members with reported savings deposits of 1,149 million Kyats and loan disbursement of 742 million Kyats. In the past, the society used to charge interest rate of 5% per month on loans and gives 3% per month on savings. Since the end of 1999, the society has followed the Central Bank regulations that mandated a deposit interest rate of only 10% per annum and annual interest rate of 15% on loans.

73. The society made certain innovations one of which is to use service charges as a cost-recovery mechanism. Thus, its members pay an interest rate of 15% per year plus 21% service fees. It seems that the imposition of a service charge has nothing to do with the government regulation since this is a cooperative society decision adapted by the members. The Central Bank monitors and regulates only the interest rate. Each member can borrow five times his savings but beyond this amount, a member should have a guarantor or collateral. The loan duration is one year. The membership of the society is categorized into three: government workers/staff; pensioners (retired employees); and people working in small/medium enterprises. The society does not borrow from the banks. It was observed that in Yangon there are about 10 credit societies of this type.

74. It seems that some primary village societies have taken the initiative of mobilizing their own savings and re-lending to members at an interest rate ranging from 2 to 4% per month. One primary village society in the Dry Zone was able to borrow from the Cooperative Bank in Yangon and used the loan to on-lend to its members. While the members pay in kind, the computed interest rate ranges from 3 to 5% per month. The village societies believe that the interest rate they charge is lower than the moneylenders' and thus, the benefit of a lower interest rate accrues to the members themselves.

75. Primary village societies and townships societies are unable to borrow loans from government and private banks. The latter requires collateral that inhibits access to this source of liquidity. For example, interviews revealed that cooperative and primary societies under the Kyanyan Township Cooperative Society could not borrow from government and private banks for lack of collateral. Private banks do not like to lend to cooperatives societies because of their bad experiences in the past. Cooperative societies used to borrow from government banks.

76. As a result, the members of the cooperative society resort to the moneylenders who lend at the rate of 8 to 10% per month. What this implies is that those village societies are not able to raise sufficient liquidity from member deposits. Thus, the inability to meet the liquidity demand of members forces those members to depend on moneylenders for consumption and production inputs.

4. Myanma Agricultural Development Bank and Microfinance

4-1. General Background

77. The Myanma Agricultural Development Bank (MADB) is a state-owned bank established in 1953 as the State Agricultural Bank. From 1970 to 1975, it became the Agricultural Finance Division of the monolithic People's Bank System and was reconstituted as the Myanma Agricultural Bank in 1976. It became the Myanma Agricultural and Rural Development Bank in 1990 and the Myanma Agricultural Development Bank in 1976. MADB has a countrywide network of 15 regional offices and 205 township branches with over 3,000 bank staff members providing banking services to farming communities.

78. It is a state-owned bank organized under the Myanma Agricultural Development Bank Law. The Myanma Companies Act does not apply to MADB. It is exempt from registration and payment of stamp duty and taxes on income or dues and levies related to banking operation. However, by law, MADB remits 75% of its net profits to the Government (Table 9).

79. MADB is audited by the Auditor General and submits an annual report to the Government through the Ministry of Agriculture and Irrigation together with its balance sheet and profit and loss statement certified by the Auditor General. The Board of Directors lay down the rules of operation of the bank, the types of loans, repayment and grace period, eligible clients, investment purpose, interest rate, collateral and guarantee requirement and saving mobilization. The Central Bank of Myanmar supervised MADB and regulated its interest rate policy until 1996.

Table 9. MADB Income, Expenditure and Net Profit Allocation, 1994-2000
(In million Kyats)

Year	Income	Expenditure	Net Profit	Reserve Fund	Contribution to Govt	Balance
1994-95	342.12	124.23	199.86	47	152	0.86
1995-96	724.05	218.99	505.06	126	379	0.06
1996-97	981.41	342.23	639.18	159	480	0.18
1997-98	968.23	382.37	585.86	146	439	0.86
1998-99	1,400.88	652.78	748.10	187	561	0.10
1999-2000	1,361.92	713.95	647.97	161	486	0.97

Source: Myanma Agricultural Development Bank

80. MADB's authorized capital is Ks 100 million of which Ks 60 million has been paid up by the Government. A Reserve Fund was also set-up with an initial contribution of Ks 20 million by the Government[9]. As of March 31, 2000, the Reserve Fund was Ks 444 million[10]. This came from transfers from the Bank's profits.

4-2. Sources of Funds

81. MADB's loanable funds come from (i) short-term borrowings from the Central Bank of Myanmar (63% of total sources), which carries an interest rate of 10%; (ii) savings deposits of farmers and rural population (28%); (iii) capital and reserve fund (8%) and (iv) special fund account from the Government (0.8%).

82. Borrowings from the Central Bank of Myanmar (CBM) are subject to a ceiling of Ks 10 billion per year. As of March 31, 2000, CBM borrowings stood at Ks 5.75 billion. In the same year, the special fund account was Ks 95.73 million in the same year. The special fund account is for loans under the Programme for Development of Border Areas and National Races[11]. A rural savings programme was launched in October 1993 to mobilize more savings from farmers and rural population. Savings deposits earn an interest rate of 9%. Savers can borrow farm development loans up to 4 or 5 times their savings. The loans can be used to purchase power tillers and pump-sets. Loans carry a maturity of 4 to 5 years. As of November 2001, there are about 2.07 million

[9] Performance Profile of Myanma Agricultural Development Bank, Ministry of Agriculture and Irrigation, Myanma Agricultural Development Bank, March 2000

[10] Myanma Agricultural Development Bank Balance Sheet as at 31-3-2000.

[11] Performance Profile of Myanma Agricultural Development Bank, Ministry of Agriculture and Irrigation, Myanma Agricultural Development Bank, March 2000.

savings deposit accounts with total savings deposit of about Ks 2.998 billion. The average amount of savings is around Ks 5,000[12].

4-3. Focus on Agriculture

83. The main aim of the Bank is to support the development of agricultural, livestock and rural socioeconomic enterprises in the country by providing banking services[13]. Myanmar has total cultivable land of 45 million acres only 25 million of which are currently under cultivation. About 75% of the population of 51 million people is in the rural areas where agriculture and agriculture-related activities are the main occupations. The agriculture sector contributes 34% of Gross Domestic Product, 23% of total export earnings and employs 63% of the country's labor force.

84. Although there is a lot of private banks and state-owned banks, MADB is still the only major source of institutional credit for small-scale farmers in terms of scale, coverage and accessibility. Due to the ever-growing demand for seasonal credit to boost output of paddy and export crops such as oilseeds, beans, pulses and industrial crops such as cotton and sugarcane, funding priority will continue to be given to farmers over non-farmers in the foreseeable future[14].

4-4. Lending Policies and Procedures

85. Its credit thrusts are geared towards crop production and farm investment. For seasonal loans, farmers have to form groups of 5 to 10 members and accept liability for their own individual loans as well as for the loans of other members of the group. No other collateral is necessary because in Myanmar all farmlands are owned by the State and cannot be offered as collateral for loans. For term loans, MADB Law requires a security consisting of a pledge of savings deposits, cattle, farm machineries or implements bought with the loan proceeds, and two reliable personal sureties[15].

86. A village loan screening committee chaired by the village administrative chief and composed of village level staff of the Land Records Department and the Agricultural Extension Service and a farmers' representative (the committee secretary) certifies the borrower's name, the size of the farm,[16] the kind of crop to be planted and the amount of the proposed loan. All loans are

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[12] Performance Profile of Myanma Agricultural Development Bank, Ministry of Agriculture and Irrigation, Myanma Agricultural Development Bank, December 4, 2001.

[13] Performance Profile of MADB, Ministry of Agriculture and Irrigation, Myanma Agricultural Development Bank, December 4, 2001.

16 Agricultural Credit Policy and Operations, Ministry of Agriculture and Irrigation, Myanma Agricultural Development Bank, October 27, 2001.

[15] Agricultural Credit Policy and Operations, Ministry of Agriculture and Irrigation, Myanma Agricultural Development Bank, October 27, 2000.

[16] The average farm size is 10 to 15 acres.

processed at MADB's township branches and the branch manager gives the loan sanction after working out the demand, need and repaying capacity of each and every farmer.

87. The manager is responsible for full recovery of all loans with due interest at harvest time. In case of delay, he can ask for the village loan screening committee's help. In case of loan default, MADB is empowered to recover those loans as if they were arrears of Land Revenue. Enforcement of the law on loan recovery is also an important factor in ensuring loan repayment. MADB can attach movable and immovable property for non-repayment of loans.

88. It is currently giving loans directly to farmers after it decided to forego village banking in 1998. It uses group liability as security for the loan and has experienced very good loan recovery since then. The loans range in size from Ks 5,000 to Ks 25,000 according to sown crop acreage and the repayment capacity of the farmer borrowers.

4-5. Regulated Interest Rate Policy

89. MADB is neither regulated nor supervised by the Central Bank of Myanmar (CBM) but being a state-owned bank, it follows the interest rate policy of CBM. The Ministry of Agriculture and Irrigation, the chair of MADB, is empowered by MADB Law to determine its interest rate. However, in practice MADB has always followed the interest rate policy set by the Central Bank of Myanmar. CBM lends to MADB at 10% and MADB on-lends to its borrowers at 15% per annum. Interest rate paid on depositors is currently 9%.

4-6. Loan Portfolio Performance[17]

90. The loan portfolio consists of three types of loans. The first is seasonal crop production loans for one year that are provided to various types of crops in 3 separate seasons: pre-monsoon, monsoon and winter. The loans are for the cultivation of 9 main crops such as paddy, groundnut, sesame, mustard, corn, peas and beans, sugarcane, jute and long staple corn. During the financial year 2000-2001, Ks 9.91 billion were disbursed for monsoon crops, Ks 2.05 billion for winter crops and Ks 159 million for pre-monsoon crops. The loan recovery rates are 100% for monsoon loans, 99.83% for winter loans and 100% for pre-monsoon loans.

91. The second type of loan is the term loan for farm development and investment. There are two types of term loan: (i) short term up to 4 years and (ii) long term from 5 to 20 years. This loan is for the purchase of farm implements, pump sets, power tillers, draught cattle, bullock carts, orchard plantation, green tea and orchid, solar salt production, small scale livestock and fish farms and integrated paddy-fish farming projects. As of November 2001, the total term loans disbursed are Ks 6.25 billion. Ks 5.93 billion have been recovered out of the due amount of Ks 5.83 billion. The average loan recovery rate is 101.73%

[17] Drawn from Performance Profile of Myanma Agricultural Development Bank, Ministry of Agriculture and Irrigation, Myanma Agricultural Development Bank, December 4, 2001.

92. The third type of loan is the loan for border area development. MADB lends in five regions for substitution and eradication of poppy plantation and to uplift the living standards of the ethnic nationals in remote border areas. These areas are Chin Hill, Kokang, Shan, Wa and Kabaw Valley regions in Sagaing Division. Total loans disbursed for border area are Ks 59.64 million. Ks 50.56 million have been recovered out of total due amount of Ks 58.42 million for a recovery rate of 86.53%.

4-7. Issues Facing MADB

93. MADB is currently faced with the problem of insufficiency of funds to meet the growing demand for agricultural credit. Its mandate is mainly to provide loans to farmers growing specific crops. The village interviews indicated the limited impact the small loans given by MADB has had on the rural economy. The loans are perceived to be insufficient to meet farming needs. Because of this, rural women have the incentive to join the 3 UNDP micro-finance projects implemented through 3 INGOs in order to have access to more liquidity. The village interviews revealed that the husbands of the women members of the UNDP micro-finance projects have borrowed from MADB in amounts ranging from 1,000 to 10,000 Kyats at an interest rate of 1.5% per month. The average loan size is around 5,000 Kyats.

94. In the past MADB used village banking as a methodology to provide farmers with credit. Interviews revealed that because of managerial problems arising from village banking at the village level, MADB decided to use its branch network to reach target borrowers. Now, farmers have to come to the branch to get and repay their loans. This has increased the transaction costs of farmers who have to travel for long hours to reach MADB branches. An effect of high transaction cost is that access to loans may have become more difficult to the target clients.

95. One of the potential problems of MADB is the mismatch in the funding-lending structure. The proportion of term loans to total assets is very high while the available resource base, that is, equity capital and reserves is relatively small[18]. This is partly resolved by access to Central Bank loan facility but this is not enough assurance that MADB will have the resource base to meet the growing demand for term loans.

4-8. MADB and Microfinance

96. MADB is not familiar with micro-finance and its various lending technologies. There is no linkage between MADB and the INGOs that could have provided it important information on micro-finance. They are parallel lending institutions in the areas where the INGOs have been designated to operate. There does not seem to be any competition between them since MADB only caters to farmers (males) while the INGOs lend to organized women groups (many are wives of farmers).

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[18] This is an observation made by Mr. Fukui.

97. MADB does not plan to engage in micro-finance because of the restriction on the interest rates that it can charge on micro-loans. It also does not have the system and procedure for disbursing loans to the landless and poorest segments of society. It neither has the funds for micro-finance. It believes that the NGOs are more suitable for providing micro-finance services because the NGOs can charge market rates on small-scale borrowers. Interviews with bank officials indicated that it shall continue to focus on agriculture and on farmer borrowers. However, there can be a potential role for MADB in micro-finance. It has an extensive branch network and staff support and has had previous experience in village banking, a form of micro-financing. There are several possibilities, e.g., link with NGOs and provide them wholesale financing so that those NGOs can provide retail micro-loans to small scale borrowers, go directly into providing micro-loans, etc. For this to happen, the authorities would have to deal with constraints such as interest rate restrictions, provision of loans only to landowning farmers, etc.

5. Issues Affecting The Development of Microfinance

5-1. General Situation of the Credit Market and the Rural Economy

98. A previous report noted the general situation of credit market and the rural economy[19]. Credit projects are operating in extremely fragile and rapidly degrading ecosystems due to population pressure, deforestation and the presence of very fragile soils. While focusing on credit provision, there is also a unique opportunity to address the larger issue of poverty and resource degradation. For example, in Shan State majority of loans are used for planting ginger, potato and other cash crops. Soil erosion and declining soil fertility could be exacerbated if attention is not paid on how and where farmers plant. There is a need for a technical review of farm situations to see if they are planting in appropriate places and to check on the environmental impact of loans to be sure that increases in income are not offset by losses in arable area and land productivity. One has to consider the offer of term loans that allow farmers to take on more long-term, environmentally supportive investments such as tree crops, soil conservation, etc. This calls for close coordination among the ministries in charge of agriculture, environment and cooperatives.

99. On the other hand, a more general concern is the fact that it is only MADB that provides formal credit to the rural economy and the amount given is relatively small in comparison with the funding requirements. The result is excess demand for capital in the countryside that is not met partly because of the shift in MADB lending methodology[20]. The current retail credit approach appears to be inadequate to meet the funding requirements of farmers as earlier observed in section IV.

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[19] Taylor (2001).

[20] We owe this comment from Mr. Fukui.

5-2. Informal Credit as Source of Financing of the Majority of Population

100. In general, it may be said that the majority of the rural poor depend a lot on informal sources of credit for their production inputs and consumption requirements despite the great effort exerted by the government and donors alike in providing alternative sources of credit. This is partly due to the weak banking sector and the inability of both government and private commercial banks to penetrate most of the countryside. Farmers who own land have the MADB as source of formal credit but the landless which comprise the majority of the rural population look at informal credit as their only source.

101. However, in their respective areas of operation, it seems that the three INGO projects have provided the poor households an alternative to the traditional moneylenders who give loans at 10 to 15% interest per month if no collateral is given and at 5 to 7% per month if there is collateral. The majority borrowed from moneylenders before they joined the program. From the interviews with the three INGOs, it was gathered that the average loan of clients before they joined the micro-finance projects of UNDP ranged from 5,000 to 10,000 Kyats. Sometimes they can also get loans of 20,000 to 50,000 Kyats from moneylenders but they would need collateral, usually in the form of gold and jewelries. The loans were normally payable after the crop cycle. For emergency loans, the loans are payable within a month. Table 10 shows the extent of borrowings from middlemen, interest rate paid, and average loan amount of the clients 3 INGOs before they joined the project.

102. The observations made in the field with regard to this experience indicate the great potential of sustainable micro-finance to provide a less costly alternative to the poor households. The interviewed household members have all expressed their gratitude to the three INGOs for providing such alternative. They have also stated continuing preference for the micro-finance services provided by the three INGOs.

Table 10. Extent of Borrowings from Middlemen, Interest Rate Paid and Average Loan Amount of the Clients of the Three INGOs

Items	PACT			Grameen Trust			GRET	
Name of Village	Kemphyu	Ampungkan	Hnewet Kyet Kwe	GT Office 1	Kanyin 1	Kanyin 2	Kan Tha	Banyin
Approximate Members Present in the Meeting	120	120	300	120	30	29	26	35
Members Borrowing from Moneylenders before joining the program	Majority	Majority	Majority	Almost All	All	All	Majority	All
Interest Rate Charged Per Month	10%	5-10%	5-20%	5-10%	5-10%	5-10%	6%	7-10%
Average Amount Borrowed	10,000 Kyats	5,000-50,000 Kyats	10,000 Kyats	10,000-50,000 Kyats	10,000-20,000 Kyats	10,000 Kyats	5,000 Kyats	10,000-20,000 Kyats

Source: Field interviews (November-December 2001)

103. The immediate issue here is the need to sustain the gains so far made under the UNDP projects. There must be continuity of the credit provision whether under the present INGO management or under a localized MFI model because uncertainty in the credit environment will leave the villagers in a more precarious condition. Without any certain source of formal credit, they will become subject to the monopoly of moneylenders. Note that in the remote villages the presence of government banks such as MADB is not felt. This is due to the geographical constraints of the areas and the inability of MADB to reach clients other than its mandated clientele, the land-owning farmers. Thus, it is to the advantage and interest of rural households, government and donors alike to have sustainable micro-finance that will address the demand by poor households for liquidity and savings facilities.

104. From the interviews in the 3 areas, it was also found out that only about 5 to 15% of women clients are able to obtain loans from MADB through their husbands. This is due to the requirements of MADB that only farmers who are registered with the Land Record Department may access loan from MADB. As well, the loan amount is limited, often not enough to meet their financial requirements. Moreover, in the Delta regions, interviews of clients whose husbands took rice

production loans from MADB revealed that they were obliged to sell a pre-determined quota to the government at government-set price that was lower than the prevailing market price.

5-3. Geographical Difficulties

105. The immediate problem confronted by micro-finance practitioners in Myanmar is the remoteness of the villages that are reachable mostly through mountain tracks. PACT and GRET projects are located in mountainous areas with about 6,000 to 7,000 feet elevation above sea level where villages are widely dispersed and communication facilities are very deficient. On the other hand, GRAMEEN Trust's project is located in the Delta Zone that is accessible by boat. Land travel to Delta Zone is more difficult than travel along the Irrawady River. Transaction cost is high in the absence of a good infrastructure and communication facilities. The wide dispersion of remote villages also contributes to the transaction cost and GRET has attempted to surmount this geographical constraint by employing the village banking technology in Chin State. However, this has not discouraged the three INGOs in the implementation of their respective projects. As the most recent evaluation has shown, they have been able to implement programs that promise a lot of benefits to the poor people in those remote areas provided that sustainable micro-finance continues to be their norm.

5-4. Regulated Interest Rate Policy

106. A significant problem confronting MFIs is the current interest rate policy. Section 61 of the Central Bank law prescribes a maximum level or ceiling rates for interest rates. The current ceiling is a maximum of 15% on lending that is considered by many MFIs as too low for financial sustainability. The arguments for more flexible interest rates in micro-finance are well recognized. This is supported by the practical experience of successful MFIs that has always indicated market-oriented interest rates as a necessary condition for sustainable micro-finance. Flexible or market-oriented interest rates characterize the micro-finance operations of the three INGOs supported by UNDP, some of the local organizations/associations providing micro-credit and the micro-finance projects of other international NGOs, that is, those not supported by UNDP but by their respective head offices, e.g., World Vision.

107. Comparatively, the private banks and the government's Myanmar Agricultural Development Bank are not allowed to charge above the loan ceiling rate of 15 percent per year. This means that these banks are operating with negative real interest rates that hamper the development of the banking system. With negative real interest rates, they will find it extremely difficult to provide micro-finance loans to poor borrowers.

108. Private banks that have expressed their interest in micro-finance worry about the willingness of the authorities to provide them with the same treatment with respect to interest rates. They have expressed reluctance in having micro-finance loans in their loan portfolios without an assurance that they could charge market-oriented or flexible interest rates without fear of sanctions from the authorities.

109. The field observations and interviews with various micro-finance players and government officials as well as analysis of the available data seem to indicate a current policy dilemma faced by the government concerning the further development of micro-finance in the country. It is becoming apparent that micro-finance programs and projects need flexibility in financial management, more particularly in interest rate setting in order to be sustainable. Micro-finance projects operate with flexible interest rates only because of the special agreement between UNDP and the government. Thus, officially, only the three INGO micro-finance projects are authorized to charge "market" rates of interest.

110. The expansion of micro-finance operations is a desirable policy objective in view of their positive impact on poverty alleviation. Those micro-finance operations need the autonomy to set interest rates in order to be sustainable and have a poverty-reducing effect. However, there is an official policy on capping interest rates. Unless this is relaxed, the expansion of current micro-finance operations and the establishment of more of such operations will be effectively constrained.

111. It is noted that there are other "micro-finance projects or operations" implemented by local and international NGOs (e.g., World Vision, SCF UK, SCF USA, YWCA, Women's Entrepreneur Association) and some credit societies like Mahadanan Cooperative Limited in Yangon that charge "market" rates of interest. The legal cover is that they operate in agreement with and under the supervision of a government ministry. For example, SCF USA implements a health project with a credit component under the auspices of the Ministry of Health. As a project under the ministry, the main focus is on improvement in the delivery of health services. The credit component serves to finance livelihood projects of clients who borrow at "market" rates. However, these operate on a pilot basis with very limited coverage and funding and are not considered to be large enough to create a problem of policy inconsistency since interest rates are officially capped. Experience in countries with sustainable micro-finance programs shows that organizations with sole focus on micro-finance tend to be more successful in providing in a sustainable manner greater outreach to households demanding micro-credit.

5-5. Search for a Legal and Regulatory Framework.

112. The UNDP has taken the initiative in drafting a proposed law on micro-finance after consultations with some stakeholders but it has yet to make a formal submission to the government. The salient features are the following: capital and ownership primarily to be held by beneficiaries; regulation by the Central Bank of Myanmar to be nominal and the MFIs to be granted autonomy to set interest rates on loans and saving.

113. The motivation behind this initiative is the realization that support for those Projects by UNDP and the special status under which they are excluded from coverage of the policy restricting interest rates on loans and deposits, will soon end. UNDP and the three INGOs believe that there is the risk that the legal character of those Micro-finance Projects together with the autonomy in setting interest rates accorded to them through an agreement between the Government of Myanmar and UNDP, might be questioned unless the proposed law is passed.

114. It is also argued that for micro-finance to expand and serve a greater number of poor households, the micro-finance institutions, e.g., NGO granting micro-credit and involved in capital

build up schemes among members, should have a legal basis for operation together with the sought-after autonomy.

115. While there is general recognition about the importance of a law on micro-finance, there is a great deal of uncertainty regarding its passage and approval[21]. The uncertainty about the regulatory and legal framework on micro-finance is not beneficial to micro-finance development. However, amidst a plan by both UNDP and the authorities to institutionalize the three INGO projects into formal MFIs, great care must be taken to have a regulatory and legal framework that is conducive to sustainable micro-finance. The legal frame should categorically allow the operation of a micro-finance institution but without a clear understanding of what it takes to have a sustainable operation, there should be great care in passing legislation that might cause more harm than good on micro-finance development. On the other hand, a market-oriented interest rate policy is one critical component of an appropriate regulatory and legal framework but it is only one of several components that have to be carefully crafted in order to ensure an environment conducive for micro-finance development as will be argued section VI of this chapter.

5-6. The Attraction of Institutionalization and Localization

116. Institutionalization means the establishment of a legal entity to implement micro-finance programs. The 3 INGO projects are simply "projects" that are created by a donor agreement between the Government of Myanmar and the UNDP. As such, they enjoy special status: they enjoy some degree of autonomy and are can charge market-oriented interest rates but only in the areas where they have been permitted to operate. Beyond those areas, it is difficult to expand without the basis of a legal body. Thus, the great interest in institutionalization.

117. The issue of institutionalization will have to be dealt with through legal action as may be allowed under current Myanmar laws. Is it possible to organize and register a micro-finance institution under existing laws? What could be a permissible legal structure for the 3 INGO micro-finance projects? If the present legal framework may not be able to provide an avenue for the institutionalization of the INGO projects and other similar projects implemented by other INGOs or even by local associations, it will be important for the stakeholders, i.e., the government, UNDP and INGOs to work together in formulating an appropriate framework.

118. Based on interviews of officials and observations in the field, there seems to be no obstacle to institutionalization, that is, if this is understood to be organization and registration as a formal entity with the authorities. It seems that under current laws, those micro-finance projects may be organized as cooperative societies or finance companies. This suggestion is analyzed in more detail in Section VI of this Chapter. The organization or institutionalization as private banks seems possible but this is not realistic for several reasons. The capitalization requirement of a private bank may be beyond the reach of potential micro-finance institutions. For micro-finance purposes, innovative lending techniques and market-driven interest rates should be initiated.

[21] According to a UNDP Technical Evaluation Report (2000), "despite considerable work on draft legislation by UNOPS, there is no indication at the time of writing, that the government is actively considering introducing a legal framework" (p.7).

119. 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 an MFI makes a lot of sense if local staff members can effectively participate in its operation. In other words, absent the capacity of local staff members to manage and run the MFI, there will be continuing dependence on expatriates for expertise and experience. This statement does not mean that it is bad to have expatriates in the MFI. What it means to say is that it will be to the advantage of Myanmar MFIs to have access to the services and expertise of both international and local experts on micro-finance.

120. Field visits of the 3 INGO micro-finance projects and interviews with local managers and staff members indicate that those projects are not yet ripe for localization. They may be ready for institutionalization, i.e., for conversion into legal entities, e.g., MFIs as may be permitted by Myanmar laws but for the time being, international experts should continue to contribute their experience and expertise on micro-finance and work toward building the capacity of local management and staff members for a hand-over in the future. If those Microfinance Projects will be institutionalized, i.e., organized and registered say as cooperative societies, the next question is: will Myanmar laws allow the participation of expatriate consultants as managers or top officers of a local institution? If this were not possible, then the deeper issue seems to be the readiness of local managers and staff members to take over the management and operation of the concerned formal entities.

5-7. Local Staff Understanding of the NGO Concept

121. All the 3 local staff of GRET, PACT, and GT when asked about their understanding and idea of what an NGO is all about, admitted to have only a vague idea. The idea of an NGO is very new to them[22]. They admitted that they would need a lot of exposure and assistance on how to set it up and manage it.

122. A non-governmental organization (NGO) is a private voluntary organization that has a legal personality registered with the appropriate body of the government. In the case of Myanmar, the registering body is the Ministry of Home Affairs. Private individuals who have bonded together organize a non-governmental organization in order to achieve social and economic objectives for the target beneficiaries. Depending on its objectives, an NGO will assume any or all roles such as policy advocacy or provider of interventions on functional literacy, health, community development, micro-finance, agriculture, and environment among others. As a legal personality, it can operate legally by entering into agreements and implementing socio-economic projects. It has a distinct board of directors that acts as policy making and direction setting body. Management and staff are normally hired to perform the agreed roles and functions with the end in view of furthering the NGO's objectives. In order to support its operations and activities, an NGO usually mobilizes donor funds from international organizations, bilateral institutions, local institutions and individuals.

[22] Interviews revealed that the idea of a local NGO registration just came into being only during a mission of a UNDP consultant in August 2001.

5-8. Governance

123. When interviewed about the role of the board of directors of an MFI, all the local staff members from the three INGO projects had a vague idea of what the role and responsibilities are. Though they mentioned about the board's policy-making function, when further probed on what those policies are, they failed to give a clear idea or understanding of the same. Even the composition of the board, the number of members needed to compose it and the criteria for selection are not very clear to them. Further, when also asked how they think the board will react if there is local political pressure, they responded that they hope that UNDP/UNOPS will be there to assist them. This further indicates their lack of preparedness to stand on their own before political and other type of pressure, e.g., donor pressure.

5-9. Local Management Capacity

124. Another significant constraint consists of the relative inexperience of both local managers and staff members in best practices in micro-finance. For instance, there is a need to adopt a more flexible, learning approach, taking into consideration local context when developing loan products and services, e.g., bi-weekly loan repayment for clients engaged in off-farm projects and a different loan repayment scheme for those engaged in farm activities. The three INGOs have conducted training on group lending techniques, project and financial management in view of the low technical and managerial capability of local staff members. The redeeming point is the enthusiastic response of local staff members to the training programs and their willingness to learn from their INGO trainers. They have all expressed a great desire to improve their knowledge and skills in micro-finance.

125. On the other hand, the local associations such as the YMCA, Myanmar Women's Entrepreneur Association and others that are engaged in micro-credit provision, also stand to benefit from formal training in micro-finance. They have to complement their current advantage of being able to charge market-oriented interest rates with appropriate training in best practices in micro-finance so that they may be able to expand their operation and sustain it.

126. At the head office and branch management levels of the three INGOs, the current branch managers and staff members have indicated some degree of familiarity with and practice of the fundamentals of managing and operating a micro-finance institution, respectively. However, a more in-depth assessment has revealed some basic infirmities in the current set up at the head office level of the 3 projects. The head office management is primarily responsible for overall management of the contemplated MFI but there is an apparent lack of managerial capacity. Interviews with the local senior staff members from the 3 INGOs revealed that they have an average of only 4 years of experience in micro-finance.

127. A look at their educational background (Table 11) shows that the majority of them are graduates of social sciences and not the financial and accounting disciplines and related sciences that are crucial for management of micro-finance operations. In addition, the there is also a lack of qualified staff members and support structures.

128. An example of a support structure is the internal audit that is very critical in a micro-finance institution to detect and prevent fraud and ensure the integrity of loan transactions. This type of support structure has still be formed in the three INGO projects. In one of the three projects, it was found out during the interviews that the local staff members could not even differentiate the functions and role of an audit unit from those of a finance unit. This is really worrisome since insuring effective controls is very crucial in micro-finance operations. In another project, the designated local internal auditor is not even a graduate of accounting or related field. It appears that the concerned staff member is learning through a trial and error method.

129. In the same vein, given the magnitude of the operations of the 3 projects and current staffing pattern of around 70 to 150 personnel per project, it seems that there is a need for putting in place a human resource development unit or personnel unit to handle personnel matters, e.g., continuing training, staff promotion, evaluation and development of staff incentive schemes. There is no systematic training program for various levels of personnel. At present, expatriate consultants make all key personnel decisions.

Table 11. Selected Key Staff Members of 3 INGOs and Their Qualifications

Grameen Trust					
Individual	Position	Gender	Years of Experience	Age	Educational Background
A	BM	Male	4	29	Geology
B	BM	Male	4.5	30	History
C	BM	Female	4	27	Chemistry
D	BM	Female	4	25	English
GRET					
E	CM	Male	4	61	BA and Accounting
F	OD	Female	4	31	BSE Math
G	Auditor	Male	4	36	BS Zoology
H	CO	Female	4	28	BS Physics
I	CO	Female	4	26	BA
PACT					
J	TPO	Male	4	60	BA
K	BM	Female	4	30	BSC
L	BM	Female	4	29	BS Botany
M	BM	Female	4	28	BS Botany
N	BM	Female	4	27	BS Botany

Note: BM means "branch manager"
CM means "credit manager"
CO means "credit officer"
TPO means " township project officer"
OD means " operations director"

130. Personnel issues are now surfacing. The most sensitive of these was the variation in scale of salaries of local staff members of the 3 INGOs. The issue is expected to become more complicated even as the project transforms into a local NGO/MFI. At present local staff members are paid salaries denominated in US dollars. As a local organization, the future NGO must situate its salary standard within the local context, which is much lower than what is presently received. The local staff members of the local NGO will presumably receive their salaries in local currency (Kyats) and not in US dollars as they have received prior to institutionalization/legalization. A lower financial remuneration may compel the local staff members to leave the local NGOs/MFIs, thereby creating disruption in micro-finance operations.

131. Nevertheless, efforts are being made by the INGOs to beef up the head office capacities. In one project, the INGO concerned has recruited a seasoned local person to assume overall responsibilities for staff development and training. In general, there is need for developing local management and staff capacity to manage and implement micro-finance operations in a professional way.

5-10. Financial Management

132. The current expatriate consultants who head the three INGO projects have exerted a great effort to develop the financial management capacity of the local management and staff members. However, many of the staff members are not graduates of accounting and related fields, e.g., banking, finance, etc., that are most useful for micro-finance institutions. Most of them are graduates of social and applied sciences such as chemistry, geology and history, among others. Experience in a successful micro-finance institution such as CARD Bank in the Philippines, has shown that when the micro-finance operations expand and bookkeeping system becomes very complicated, the role of accountants in insuring proper records and control systems becomes even more critical. An institution like CARD Bank had to change its policies in hiring and promoting branch managers after realizing that people with the appropriate educational background and experience have to be appointed to the critical functions in the institution.

133. In the past prior to being given a banking license, CARD Bank was not overly concerned about the right qualifications, i.e. educational background, of branch managers. It was thought that any field of study would be all right just as long as the hired persons showed commitment and were willing to be trained on micro-finance methodologies. It was later found out that that some of the problems encountered by the institution arose from those branches where the managers had no accounting background and experience. Thus, it proved to be more costly to train non-accountants in accounting than to recruit accounting graduates and related fields.

134. The INGOs have reported that they find it difficult to recruit graduates in the field of accounting and related fields. But from information gathered from the field, INGOs have preference to get staff members that can speak English. The unfortunate thing is that most of the local accounting graduates have difficulty in communicating in English. Those who were hired were graduates of the social and applied sciences who have greater facility in speaking this language. The irony is that one INGO preferred to hire local graduates who come from the area or state where that INGO operates rather than have staff members from Yangoon where most of the accounting

graduates/related field can be recruited. Moreover, accounting graduates command higher salary rates.

5-11. Methodology and Current Practices

135. In terms of methodology, Grameen Trust has shown a more systematic and rigorous credit and savings scheme. Credit discipline is very evident among the members and because of this, it undoubtedly is reaching the poorest segment of the target villages. In addition, its repayment rate has been consistently high at 100%. On the other hand, PACT and GRET have made modifications and adaptations of micro-finance lending technologies to suit local conditions.

136. However, the three micro-finance projects have to mature in time. They are still in an embryonic stage. The experience of successful micro-finance institutions show that real problems emerge on the fourth to fifth year as the clients begin to get bigger loans and as the operation expands to cover more areas and more clients. The current local management and staff members are yet to experience the problems of a maturing micro-finance project but without actual experience in this regard, it will be difficult to say that localization and institutionalization should now take place.

137. The local management has still to show a capacity to adapt a methodology such as village banking to local realities or conditions. In the field visits, it was found out that two village banks of GRET have loan repayment problems not because the local people do not want to repay their loans. The reason is that those village banks have large memberships ranging from more than 50 to 120 members. Experience has shown that village bank membership should be manageable and this means a membership of not more than 50 individuals. Span of control is, therefore, crucial and this seems possible only up to a threshold of some 50 members. Beyond this size the village bank tends to collapse because of the limited management capacity of village bank leaders and the difficulty of dealing with a very large membership. Group familiarity and solidarity tend to break down in very large groups, making the group lending technology of micro-finance virtually useless.

5-12. Lack of Performance Standards

138. The lack of performance standards is due to the embryonic stage of micro-finance in Myanmar. The INGOs that have been contracted to implement the UNDP Micro-finance Project have made it a point to introduce best practices in micro-finance given their respective backgrounds and performance in it. This is a very crucial decision on the part of the INGOs and the donor institution, i.e., to start with the best foot forward as far as it is practicable. It paves the way for the introduction, development and installation of benchmarking and performance standards for micro-finance institutions in the future. The transparency and discipline that follow from the establishment and adherence to performance standards are necessary elements of sustainable micro-finance.

5-13. Local Authorities' Response to Localization/Institutionalization

139. Another emerging issue that was identified during the field visit in the Shan State is the reported reaction of the local authorities in Kalaw Township to localization and institutionalization. While they are in full support of the micro-finance project, since the township will be the one to endorse (as part of the process for the registration of the local NGO) to the Ministry of Home Affairs, the local political leader of the Township is wondering about his role relative to the NGO to be institutionalized. Will that role be in monitoring the contemplated NGO? Will he have control over it? If something goes wrong, what will be the responsibility of the local authorities? What will be the consequences of failure of the NGO? Admittedly, the local authorities do not also have a fair understanding of what a local NGO is all about and the need to maintain its independence from the local authorities.

6. An Appropriate Legal and Regulatory Framework

140. There are two issues, namely, (a) the legalization or institutionalization of MFIs and (b) the establishment of a regulatory framework for microfinance institutions that have to be carefully handled for the future growth and development of microfinance in Myanmar.

6-1. Need for an Appropriate Legal Framework

141. The first issue is the legalization or institutionalization of the 3 INGO Microfinance Projects. As earlier discussed, the call for a legal framework for MFIs has arisen because of the realization that continuing operation of the 3 INGO Micro-finance Projects may face a legal challenge at the end of the project period. The Micro-finance Projects do not have a legal charter authorizing them to engage in the provision of loans and deposit services to clients, operating only by virtue of the special status accorded to them by an agreement between the Government of Myanmar and UNDP. The special status may come to an end once the UNDP Micro-finance Projects terminate. Thus, the idea of institutionalizing or legalizing the Projects into MFIs gained currency.

142. Interviews and analysis made by the study team have indicated that several possibilities to legalize or institutionalize the three INGO micro-finance projects without having to amend the law. One legal path that does not need any change of the Financial Institutions Law or any new law is the registration of the UNDP Projects as cooperative societies that engage in micro-finance. Credit societies are defined as engaging primarily in financing individuals who are members, using funds collected in members' accounts. It will be important though to further investigate whether the cooperative structure will be appropriate for the micro-finance institution contemplated by the UNDP Projects. A basic principle of a cooperative society is the "one person, one vote" principle. The number of shares may be variable across individual members but their voting right is anchored on this principle. A member of a micro-finance institution organized as a cooperative might have

the disincentive to put in more shares, that is, invest more capital if he can only secure himself one vote in the organization.

143. Registration as cooperative societies will bring the micro-finance operation under the responsibility of the Ministry of Cooperatives that has the authority to audit and supervise co-operative societies. The problem that may arise is the lack of sufficient capacity in regulating and supervising entities that are co-operative societies cum micro-finance institutions.

144. Another legal path that may be explored is registration as a finance company under the Finance Companies Act. For instance, the capital requirement for a finance company is Kyats 8 million goods and services with funding other than deposits from the public. Both these paths, that is, as a cooperative society or as a finance company, seem to indicate a possible solution to the legalization problem. However, a prior requirement will be for the MFI to register under the Companies Act either as a limited liability company or a shareholding company. The Financial Institutions Law requires that entities doing financial activities should register under the Companies Act. This legal path needs a serious study as well. For example, in the case of the Financial Institutions Law, it is important to determine whether the ownership and equity requirements as provided for in that law will be appropriate for micro-finance institutions.

145. There is a need for a serious study of present legislation affecting the financial sector and the organization of entities such as finance companies, banks, co-operative societies to shed light on the problem of legalization and the appropriate path to undertake. It is best to study the matter very closely because the inappropriate application of a law or particular legislation may result in hindering the growth and development of micro-finance.

6-2. Toward an Appropriate Regulatory and Supervisory Framework

146. It is very premature to talk of regulation at the embryonic state of the current micro-finance activities in Myanmar. However, legalization issue certainly merits attention. Having a secure legal identity is an important first step in the development of micro-finance in Myanmar. Legal recognition and legitimacy of NGOs and other types of financial intermediaries in micro-finance are the basic needs. The combined attention of the government and various stakeholders, including donors should be placed upon these basic needs. Setting up of regulatory and supervisory measures should follow suit appropriately in due course.

147. Legalizing or institutionalizing a micro-finance institution can not be separated from the need to have policy consistency between pricing micro-finance products and granting MFIs the autonomy to set interest rates on the one hand, and the regulating or capping interest rates in general. In short, to have sustainable micro-finance institutions, autonomy should be granted to MFIs to enable them to pursue innovative lending techniques with the use of market-driven interest rates. This may call for separate or specific legitimization for micro-finance. The innovative financing with the use of market-driven interest rates will benefit not only the MFIs but also other financial institutions that can potentially serve the demand for credit of micro-enterprises.

148. Amending the law to put a regulatory framework for micro-finance is not as simple as it appears although there is precedent to this approach[23]. However, having a separate law on micro-finance, e.g., Microfinance Law as proposed by UNDP or an amendment of the present Financial Institutions Law to accommodate micro-finance institutions does not guarantee that the regulatory framework would be effective and appropriate. Without addressing the inadequacy or lack of capacity of regulators to regulate micro-finance, the move to place MFIs under the ambit of the Central Bank's regulatory control might bring about a dampening effect on local initiative on micro-finance. Thus, it is doubtful whether this will create a strategic advantage or the risk of undue and even more restrictive regulation for the MFIs.

149. Ghate and Matienzo (2000) admitted that "micro-finance would have to be carefully defined so that the Central Bank has a justification for exempting MFIs not just from interest rate controls (on both lending and savings rates) but also on reserve and liquidity requirements (effectively at a combined level of about 30 percent for the banks at present), collateral requirements, loan documentation requirements, and so on, and further so that there is public understanding of the rationale for such exemption." The regulatory framework on micro-finance will have to address the need to develop appropriate prudential norms and procedures, monitoring and evaluation capacity of the regulator in order to understand and properly regulate micro-finance and a host of other issues.

150. In due time in the future, Myanmar will need an appropriate regulatory and supervisory framework for micro-finance institutions and private banks that are involved in micro-finance[24]. The essential point that bears repetition is that it is premature to craft a regulatory framework at this stage of Myanmar micro-finance. But it is helpful to try to paint the broad strokes or elements that may inform an appropriate regulatory framework for micro-finance in Myanmar. This is to say that the appropriate regulatory framework is a process in time and although currently, there are many discussions, conferences, researches being done on this topic today, it is impossible to find "a one-size-fits-all advice" for a regulatory framework for a country in view of the diverse situations from country to country[25].

151. The main purpose of that framework is to protect thousands and thousands of small depositors who keep their lifetime savings with the MFIs. The MFIs main clientele are the poor households and they engage in financial intermediation among those households. This involves the mobilization of deposits from thousands and thousands of small depositors and making these available for investment and productive use by borrowers who normally will not be able to access

[23] Ghate and Matienzo (2000) in their Technical Evaluation Report on the three INGO microfinance projects argued that the "simplest solution under most legislative systems would be for the Central Bank to insert a brief amendment in the financial laws exempting recognizing MFIs as a distinct category and exempting them from the operation of the financial laws." They cited this as "the solution adopted by the Central Bank in Cambodia (p.20-21)."

[24] Following convention, regulation of financial service providers consists of the establishment of rules and standards for their safety and soundness. "Supervision is systematic oversight of such providers to make sure that they comply with the rules, or close down if they don't" (Christen and Rosenberg 2000). To avoid repetition of "regulation and supervision", this paper uses the term "regulation" to refer to both "regulation and supervision."

[25] See Christen and Rosenberg on this point.

formal credit for reasons such as their inability to produce the traditional collateral demanded by banks, the lack of adequate assets to inspire confidence about their creditworthiness, and similar reasons.

152. Micro-finance loans are typically without the traditional collateral that can be seized and liquefied in the case of a loan default. Thus, it is critical to ensure the quality of the MFIs' loan portfolio. This is what an appropriate regulatory framework for micro-finance institutions shall accomplish and by doing so keep watch over the safety and soundness of MFIs. The immediate beneficiaries of such a framework are the poor people themselves: those who save expect the safety of their savings and the reward to their postponement of consumption and those who borrow and expect to have continuing access to liquidity from the MFIs.

153. Another crucial dimension of an appropriate regulatory framework concerns the need to monitor and supervise the risk-taking behavior of managers and owners of MFIs. As in a typical financial intermediary, managers and owners of MFIs have the incentive to maximize their profits through risk-taking. The job of the regulator is to minimize the moral hazard faced by the MFIs as management makes decisions on the use of the liabilities in their balance sheet without unnecessarily restraining their effort to reach small borrowers who have been excluded from the traditional credit markets dominated by banks. This will demand adequate and responsive supervision on the part of the regulator, something that has yet to be developed given the embryonic stage of micro-finance in Myanmar.

154. At the macro level, an appropriate regulatory framework motivates the creation of a competitive market for micro-finance. This is important especially for the interest of the target clientele, the poor households. Competition shall bring about a lowering of interest rates on loan and shall provide the households a wider array of products and services from the MFIs. It shall make the micro-finance market more efficient and shall help strengthen the MFIs themselves.

6-3. Distinct Characteristics of Micro-finance

155. To understand what an appropriate regulatory framework for micro-finance will be, it is important to know the distinct characteristics of micro-finance. An understanding of those characteristics or features shall motivate an appropriate regulatory framework for micro-finance operations and institutions. That framework can be not exactly conformable to the traditional frames applied to banking institutions and other types of credit intermediaries but should address the innovations of micro-finance[26].

156. The client base of micro-finance institutions consists of low-income micro-entrepreneurs in the informal sector who cannot provide collateral and who do not have the credentials of traditional borrowers in the formal credit markets. The lending methodology followed by micro-finance

[26] This was the approach taken in crafting the legal basis for microfinance in the Philippines, as provided for in the Revised General Banking Law (2000) and in preparing the Central Bank Circulars that implement the law. The principal author was chief advisor to this effort in his former capacity as Credit Policy Advisor to the National Credit Council, Department of Finance, Government of the Philippines. See Llanto (2001) for a discussion of risk-based supevision for microfinance in the Philippines.

institutions is based on the borrower's cash flow and makes use of information about the character of the borrower to determine his creditworthiness. It is character lending in a pure sense because the borrower or group of borrowers cannot offer to the micro-finance institution anything else other than information about their trustworthiness.

157. Micro-finance institutions do not require collateral, i.e., the traditional collateral such as real estate mortgages, financial statements or elaborate project feasibility studies to be able to reach to their low-income clients. The track record of the borrower is important but if no track record is available, micro-finance institutions are not deterred from lending. Loan security is satisfied through group guarantees, character references, cash flow of the micro-enterprise.

158. Micro-finance loans consist of hundreds, in some cases thousands, of small, short-term loans that are mostly for the working capital of micro-enterprises. There is high turn over rate as hundreds of small borrowers make repeat loans. Administrative costs tend to relatively high because of this feature of the loan portfolio. This type of lending has need for useful information about the risk profile of the portfolio and at any one time about the portfolio at risk.

159. Once regulated, the MFIs should have verifiable and accurate financial information that are accessible to both regulators and depositors. The element of trust is key to MFI's continuing access to the deposit market and in their more developed stage to the capital markets. This trust is premised on the safety and soundness of the institution that cannot be fairly established without verifiable and accurate financial information. However, effective prudential regulation and supervision presupposes the presence of informational, legal and judiciary infrastructures. Where these are inadequate or absent or if present, poorly implemented, one can expect distortion and inefficiencies to affect the development of financial markets and financial institutions alike.

160. Micro-finance institutions (MFIs) tend to have high administrative costs that should be recovered through market-oriented interest rates. Unsupportive legal frameworks that prevent the recovery of costs because of interest rate controls will discourage the growth of MFIs and the involvement of other types of banks in the micro-finance market. In other words, the regulatory restriction, specifically on interest rates, constrains the regulated MFIs' ability to efficiently participate in the micro-finance market.

161. Given the foregoing, it is clearly unrealistic to push for a regulatory framework for micro-finance in Myanmar right after a very short experience with micro-finance and given its current status and the issues affecting its development in Myanmar.[27] Thus, this is not the proper time to consider regulation of the emerging micro-finance effort in Myanmar. At present, the more important concerns are:

(a) the clarification of the legal framework and the registration of the local MFIs so that MFIs may continue to operate with a legal personality;
(b) the resolution of the policy dilemma that creates a lot of uncertainty over the sustainability of micro-finance operations;
(c) capacity building of local micro-finance projects/efforts toward sustainable micro-finance and

[27] The UNDP Microfinance Project started in July/August 1997.

(d) policy dialogue with the government on the requirements of sustainable micro-finance, including building the capacity of the regulatory body to deal with micro-finance institutions in the future.

162. Commercial banks and investment or development banks may not be appropriate for MFIs in view of their larger capitalization requirements. However, as discussed earlier, this needs a close study and serious discussion with and clarification by the authorities.

163. It seems that certain ministries are open to accommodate the existing practices of MFIs (INGOs, local organizations, cooperative societies) like continuing to charge reasonable interest rates (not subsidize) in order that MFIs become financially and organizationally viable. Moreover, the Ministry of Cooperative is also open to amend the articles of incorporation of the cooperative societies to include microfinance activities. If this is done, then MFIs have the option to be registered as cooperative societies.

164. The real danger is that the haste in producing a regulatory framework might yield one that is inappropriate. More directly, the result might be one that does not enhance competition in the financial markets or one that merely increases the transaction costs of MFIs, and thus, is not conducive for sustainable micro-finance. What is the impact of having an inappropriate regulatory framework?

6-4. The Costs of an Inappropriate Regulatory Framework

6-4-1. On the Sustainability of MFIs

165. An inappropriate regulatory framework, including the regulation and control of interest rates shall weaken the MFIs. For example, cooperatives in rural Myanmar appear to be ineffective in reaching the poor.[28] This may be presumed to some extent due to the fact that the interest rate ceiling of 17% per year to cooperatives under the current law constrains their financial sustainability. On the other hand, inappropriate regulation can choke innovation. A pack of rules and standards applied to MFIs may result into higher transaction costs for them or worse, limit competition to a few. What may happen is an attempt at regulatory avoidance to circumvent onerous regulation[29].

166. Inappropriate regulation on MFI entry, licensing and branching will result into a limited number of players to the detriment of competition. Related to this is the question of who should be regulated? Christen and Rosenberg (2000) call this a "contentious issue." They pose the question: Should credit-only MFIs be regulated? What about "member-owned" institutions? What about small ones? The answer to these questions is not readily available.

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[28] Fukui and Honda (2001)

[29] Christen and Rosenberg (20002) had this to say: "If Lstin American NGOs had not been allowed to experiment with microcredit products that were inconsistent with the legal provisions of the regulated financial system, it's hard to imagine how microfinance in the region could have flowered as it did"

167. Despite attempts by some authors to provide what they want to call as "a framework for the regulation of micro-finance institutions[30]", nobody really has the answer because country-to-country situation differs. There is a wide range of regulatory capability from country to country. Thus, given the context of the state of development of the financial sector and the embryonic stage of micro-finance in Myanmar, one has to be extra careful in identifying institutions that should fall under the regulatory umbrella. In other words, a careful and thoughtful study of a regulatory framework for micro-finance in Myanmar is imperative.

6-4-2. On the Incentive to Formalize the Informal Credit Provision

168. A highly regulated and controlled credit environment discourages the formalization of informal NGO credit provision even if there may be demand for such transition into a formal institution. Observations on the micro-finance sector in the last two decades clearly suggested that the inadequate regulatory environment for financial activities impedes the sustainable operation of micro-finance institutions and the development of any prevailing informal systems to address larger population.[31]

6-4-3. On the Mobilization of Savings[32]

169. Saving-in kind is the major way of saving especially in rural Myanmar as evidenced by the responses provided during the field work in three areas: Dry Zone, Delta Zone and the Shan State. The major form of saving among the poor is gold, jewelry, livestock or other agricultural products. The most favored form is gold and jewelry that are considered as a good hedge against inflation.

170. Savings habit has not been developed in the rural areas. There are demand-side and supply-side reasons for this phenomenon. On the demand-side, the following factors have surfaced in the field visits: (i) lack of accessibility of banking facilities, (ii) lack of interest by villagers, (iii) low incomes of village households, and (iv) poor service by banks.

171. On the inaccessibility of deposit facilities, field interviews indicated that the MADB branches are generally inaccessible to villagers, requiring villagers to travel for several miles before reaching a branch office. In the Dry Zone village of Kam Phyu, villagers reported that they would have to travel for one-and-a-half hours by car to reach the MADB branch office. Villagers in Amiaungkan said that the nearest MADB branch located in Kyaukpadaung is at least 18 miles away. The poor state of roads and bridges in the countryside and inefficient transportation facilities support this claim of villagers. Thus, the main issues in the Chin State village of Farkhaum are distance and attendant transport costs.

172. Sustainable financial intermediaries should be able to mobilize deposits from a large number of the population. However, inappropriate regulation and policy will yield the contrary,

[30] See the attempt by van Greuning and others (1998) and Gallardo and Randhawa (2001).

[31] Fukui and Honda, p.3.

[32] This section draws from Fukui and Honda (2001).

thus, weakening not just the affected financial intermediaries such as the MFIs, but worse, the entire financial system

6-5. The Importance of Benchmarking and Performance Standards

173. There are now several implementers of micro-finance projects in Myanmar and it seems that more micro-finance projects may be created given the interest and funding support from well-meaning donors. At this early stage, it may be significant to start work on establishing benchmarks and setting performance standards in order to provide vital information on institutional performance that will be made available to various stakeholders, i.e., practitioners, donors and the government. The disclosure of information on institutional performance will help instill a greater sense of commitment on the part of the stakeholders to advance the promotion and development of micro-finance. Adherence to performance standards will infuse greater professionalism and commitment on the part of a diversity of micro-finance players to work hard for sustainable [33].

174. Another perspective for benchmarking and performance standards is that these may help provide an alternative to the untimely proposal to regulate micro-finance in Myanmar. In other developing countries like the Philippines, benchmarking and performance standards are seen as complementing an emerging regulatory framework for micro-finance. However, for Myanmar benchmarking and performance standards for micro-finance will not be a complementary instrument to government's regulatory effort because, as argued in this chapter, regulating micro-finance during its embryonic stage may create more harm than good. Meanwhile, monitoring and reporting on institutional performance will help provide the discipline to maintain the quality of the loan portfolio and ensure the target clients' continuing access to micro-finance services.

175. The limited experience so far in micro-finance indicates the great potential in having sustainable programs in the future. It bears well for Myanmar to also consider or search for expanding micro-finance operations in other areas provided appropriate donor support could be secured. Quality enhancement and capacity building in micro-finance operations are top priority but an expansion in other areas will not be inconsistent with this objective provided there is donor expertise that is brought to bear on the operations. The expansion of operations will benefit the local population in terms of access to micro-finance products, the capacity building of local implementers and the continuing exposure of all concerned to best practices in micro-finance.

7. Conclusions

176. Micro-finance in Myanamar is an exogenous phenomenon introduced through the UNDP Microfinance Project with 3 INGOs tasked to implement three different projects in designated areas

[33] Microfinance Coalition for Standards (1998) reports current effort in the Philippines to establish benchmarking and performance standards for NGOs.

of the country. To date, the Project has shown encouraging results and now, there is a proposal to institutionalize and localize the three projects and to provide a legal and regulatory framework for micro-finance in Myanmar. The proposal anticipates the eventual termination of support from UNDP and attempts to address the issue of the three INGO projects not having the legal charter to engage in micro-financial intermediation.

177. This chapter concludes that it is really important to vest a legal character to the 3 INGO Microfinance Projects and to other similar projects currently implemented by local associations, other INGOs, if warranted by their respective state of development. It seems that the legalization can be done through registration either as finance companies or cooperative societies under the Financial Institutions Law. Registration of a micro-finance project as a local non-governmental organization (NGO) still has to be studied and considered by the authorities. Field interviews indicated that that without any drastic change in existing law, it is possible for a micro-finance project such as those implemented through the 3 INGOs to have the legal charter to engage in micro-finance services. The authorities have to validate this point if only to assure the stakeholders in micro-finance that the policy and legal outlook is favorable toward micro-finance development.

178. The establishment of a regulatory framework should come at the right time in the future. There is no need to hurry regulation given the capacity of project implementers and even of the regulator contemplated by the UNDP, that is, the Central Bank of Myanmar. Inappropriate regulation will do more harm than good given the embryonic stage of micro-finance in Myanmar. It is far better to (a) work for the registration of micro-finance projects, (b) resolve the policy dilemma over regulated interest rates and (c) build local capacities in micro-finance implementation and (d) introduce benchmarking and performance standards in micro-finance than entertain any proposal to regulate micro-finance.

179. The current regulatory environment is meant for the traditional banking business and thus, is not conducive to the promotion and growth of micro-finance institutions which are non-traditional financial institutions. A number of restrictions in the financial laws will make it difficult for the MFIs to attain financial sustainability unless those restrictions are eliminated or MFIs are given exemption from them. Chief of those restrictions is S 61 of the Central Bank Law that prescribes rates of interest (currently, a maximum of 15% for banks and 17% for credit societies) on lending and on deposit taking (currently, a maximum of 10%).

180. Observations and analysis of field situation indicate a number of important lessons that can inform the design of a regulatory framework for micro-finance in Myanmar: (i) the poor can repay market rates of interest and they do not necessarily need subsidized credit; (ii) traditional collateral need not be provided in order for the poor to gain access to credit; (iii) the poor repay their loans and therefore, are good credit risks; and (iii) the poor can and do save when given the appropriate savings vehicle.

181. On the part of the credit provider, it is important to have some degree of autonomy in setting interest rates on loans in order to cover operating costs, loan losses and inflation. The country's annual inflation rate is estimated at between 25 to 30 percent. The INGOs in the UNDP's Micro-Finance Project charge interest rates of 38.5 percent per year (Grameen Trust) and 45 percent per year for GRET and PACT, respectively.

182. From the perspective of the clientele, the 3 INGO Projects have shown that the poor are as creditworthy as any other borrower. Part of the motivation is their appreciation of the relatively lower borrowing costs they have with the INGO micro-finance projects. Continuing access to credit and social pressure are strong motivations for high loan repayment rates. If they do not repay the loan, the borrowers face the prospect of having to deal with the higher priced loans of informal moneylenders. It is not uncommon to see informal lending rates of 10 to 15 percent per month if no collateral is provided. Thus, the villagers indicate they want to have a stable relationship with the INGO micro-finance projects through regular loan repayments, attendance to group meetings and capital build-up.

183. In the light of this chapter's analysis of the direction of localization/institutionalization of the micro-finance projects in the 3 areas, it is necessary to emphasize the importance of local capacity building. The previous phases done by the INGOs were concentrated more on having greater outreach to the poor households and less on local capacity building. Based on experience, there is a trade-off in terms of quality if capacity building and outreach are pursued simultaneously. It really needs a great deal of maturity on the part of the micro-finance institution's management to attain these twin goals with success. Meanwhile, the right path for a young and relatively inexperienced institution or project team is to concentrate on capacity building. It is a far better strategy to first build capacity in the early stages of a micro-finance project rather than be allured to the more politically attractive emphasis on outreach.

184. There is a need for a gradualist but coordinated approach to micro-finance development. The first important step is to craft an overall national strategy on micro-finance supported by the government, donor community and micro-finance institutions. Private banks interested in micro-finance, INGO projects/local NGOs/local associations' projects and cooperative societies can form the three pillars of micro-finance development in the country. The main goal is to build project implementation capacities, ensure a policy environment conducive to micro-finance development and harness the diverse expertise and resources coming from the donor community to support the development of micro-finance in Myanmar. The emphasis should be on improving quality of micro-finance projects/operations by building capacities of implementers and concerned government ministries including the Central Bank of Myanmar rather than on an aggressive and rapid expansion of micro-finance coverage. This does not mean that there is no room for expansion. On the contrary, there should be expansion but not at the cost of sacrificing quality of implementation.

185. It will be very useful indeed to have a clear strategy for micro-finance development that takes into account the local situation as well as the need to harness the forces of the market to ensure sustainable micro-finance. While the emerging micro-finance institutions are interested in having the legal basis for operation and for charging commercial rates of interest, the authorities are hopeful that micro-finance could be an effective instrument for poverty alleviation. These parallel goals are not exactly congruent at the present stage of development of micro-finance in Myanmar. A national strategy supported by various stakeholders that has at its core (a) a consistent policy on financial and credit policies, among others, (b) an identification of the critical roles of the stakeholders and (c) a road map for the development of sustainable micro-finance will be indispensable. It is the first imperative before any talk of a regulatory framework is entertained.

186. The expansion of micro-finance operations as discussed in paragraph 175 above can be the staging point for introducing best practices in micro-finance and for laying the groundwork for

sustainable micro-finance in other areas. This will also be an important mechanism for providing the local population access to micro-finance products for their consumption and business/investment requirements. It is also vital to legally allow MFIs under a separate law, which is different from the existing financial institutions law to enable them to pursue innovative lending techniques with the use of market-driven interest rates.

8. Recommendations

187. Proposed Policy Measures and Sequencing

1. The first important step is to forge a national consensus on micro-finance as an important segment of the financial sector and to craft an overall national strategy on micro-finance that is supported by the government, donor community and the micro-finance projects/institutions currently operating.

2. It is also vital to resolve the policy dilemma over regulated interest rates as this will affect the sustainability of micro-finance institutions if not appropriately addressed. This is in view of the critical role played by market-oriented interest rates on the financial sustainability of micro-finance institutions.

3. It is equally crucial to clarify the issue of legal registration of micro-finance projects/operations. The study has shown the extreme importance of having a firm legal basis for micro-finance operations.

4. The organization of a "coalition" or "micro-finance development forum" may be an important component of the overall national strategy on micro-finance because the forum can be a vital instrument for exchanging views and/or building consensus on the proper action to take over various issues affecting micro-finance.

5. There is a need to build both the capacity of local staff of INGOs and the other micro-finance projects and the regulator before any proposal for regulation of micro-finance is entertained. A critical component of capacity building is the development and installation of performance standards on micro-finance and a monitoring system that gives feedback on the performance of micro-finance institutions.

6. There is a need to encourage the emerging linkage between the communities and private banks in micro-finance as exemplified by the efforts at linkage by the FAO-organized CBOs and a private bank[34]. There is a possibility that credit cooperative societies and local NGOs may also emerge as micro-finance institutions. This merits the support of government and donors alike.

[34] The linking strategy was first adopted in the Philippines and Indonesia in 1987 through assistance from BMZ-GTZ of Germany. This is a mature technology that can be adopted in Myanmar.

188. Proposed Technical Assistance

Micro-finance is a very powerful tool for poverty alleviation and thus, in the context of the current state of development of micro-finance in Myanmar it will be critical to employ a diversity of approaches to ensure that micro-finance provides the poor access to credit and savings services. Failure to identify and support the development of potentially sustainable approaches is to consign the poor to the only alternative available to them- the informal moneylender. The following components of a technical assistance may be critical in sustaining the gains so far made in the development of micro-finance in Myanmar.

A. **Formulating a National Strategy on Micro-finance.** There is need for a clear and sustainable approach to micro-finance development in the country. The technical assistance by Japan will help the Myanmar government articulate its national strategy for micro-finance development. Microfinance has been proven to be an effective instrument for poverty alleviation and has a large role to play in bringing the poor households into mainstream banking system. But micro-finance has to be sustainable in order to realize this objective. The national strategy on micro-finance will provide the road map to attain sustainable micro-finance.

B. **Strengthening of the Coordination of the Different Actors in Micro-finance in Myanmar.** It may be strategic to have a Ministry identified as an anchor or coordinating body for the promotion of micro-finance. The establishment of a "micro-finance forum" or "coalition" will be a strategic assistance to the development of micro-finance in Myanmar because the forum will bring together various stakeholders to address critical issues on micro-finance. The forum will also be instrumental in sharing local and international experiences and technologies and most of all in promoting a policy dialogue with the government.

C. **Setting Appropriate Performance Standards for Myanmar Micro-finance.** The establishment of benchmark and performance standards will provide very useful information on institutional performance of micro-finance institutions to practitioners, donors and the government. This informs decisions on building capacity to increase outreach and to make more effective the micro-finance institutions.

D. **Capacity Building for the Micro-finance Practitioners and the Central Bank of Myanmar and other Concerned Ministries.** The key challenge to the emerging MFIs is to build their capacity to practice sustainable micro-finance even as they seek to expand greater client outreach. The Central Bank of Myanmar and other concerned government ministries should be exposed to current efforts by countries such as Bangladesh, the Philippines and Indonesia and some of the Latin American countries to develop an appropriate regulatory framework for micro-finance in their respective jurisdictions. Staff training, seminars, workshops and publication will all help to build local capacities both at the MFI and governmental levels.

E. **Expansion of Micro-finance in Other Areas.** Donor support will be needed to expand or introduce micro-finance in other areas. Technical expertise on sustainable micro-finance, including capacity building will be indispensable component of the expansion program.

F. **Supporting and Facilitating Legalization of MFIs in Myanmar**. It is vital to provide support to the legalization of MFIs in Myanmar. The immediate assistance is the facilitation of the registration of micro-finance projects either as finance companies or cooperative societies. The establishment of a local NGO should be explored with the government in order to provide an alternative vehicle for developing sustainable micro-finance in the future.

G. **Exposure Trips to Other Developing Countries with Successful Micro-finance Experience.** Key officials from Central Bank, Ministry of Finance, and the Ministry of Cooperatives have to be exposed to various successful experiences in micro-finance because this will broaden perspectives as well provide essential information on a wide range of issues affecting the development of micro-finance.

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