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%

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 three UNDP microfinance projects implemented through three INGOs in order to have access to more liquidity. The village interviews revealed that the husbands of the women members of the UNDP microfinance 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 microfinance and its various lending technologies. There is no linkage between MADB and the INGOs that could have provided it important information on microfinance. 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 organised women groups (many are wives of farmers).

97. MADB does not plan to engage in microfinance 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 microfinance. It believes that the NGOs are more suitable for providing microfinance 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 microfinance. 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.

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

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.

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

[19] Taylor (2001).

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

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 programme. From the interviews with the three INGOs, it was gathered that the average loan of clients before they joined the microfinance 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 three INGOs before they joined the project.

102.The observations made in the field with regard to this experience indicate the great potential of sustainable microfinance 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 microfinance 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	Ampung-kan	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 Programme	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 localised 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 microfinance 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 microfinance 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 Ayeyawaddy 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 programmes that promise a lot of benefits to the poor people in those remote areas provided that sustainable microfinance 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 microfinance are well recognised. This is supported by the practical experience of successful MFIs that has always indicated market-oriented interest rates as a necessary condition for sustainable microfinance. Flexible or market-oriented interest rates characterise the microfinance operations of the three INGOs supported by UNDP, some of the local organisations/ associations providing micro-credit and the microfinance 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 Myanma 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 microfinance loans to poor borrowers.

108.Private banks that have expressed their interest in microfinance 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 microfinance 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 microfinance 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 microfinance in the country. It is becoming apparent that microfinance programmes and projects need flexibility in financial management, more particularly in interest rate setting in order to be sustainable. Microfinance projects operate with flexible interest rates only because of the special agreement between UNDP and the government. Thus, officially, only the three INGO microfinance projects are authorised to charge "market" rates of interest.

110. The expansion of microfinance operations is a desirable policy objective in view of their positive impact on poverty alleviation. Those microfinance 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 microfinance operations and the establishment of more of such operations will be effectively constrained.

111. It is noted that there are other "microfinance 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 microfinance programmes shows that organisations with sole focus on microfinance 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 microfinance 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 realisation 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 microfinance 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 microfinance to expand and serve a greater number of poor households, the microfinance 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 microfinance, there is a great deal of uncertainty regarding its passage and approval[21]. The uncertainty about the regulatory and legal framework on microfinance is not beneficial to microfinance development. However, amidst a plan by both UNDP and the authorities to institutionalise the three INGO projects into formal MFIs, great care must be taken to have a regulatory and legal framework that is conducive to sustainable microfinance. The legal frame should categorically allow the operation of a microfinance 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 microfinance 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 microfinance development as will be argued section VI of this chapter.

5.6 The Attraction of Institutionalisation and Localisation

116. Institutionalisation means the establishment of a legal entity to implement microfinance programmes. The three 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

[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).

institutionalisation.

117. The issue of institutionalisation will have to be dealt with through legal action as may be allowed under current Myanmar laws. Is it possible to organise and register a microfinance institution under existing laws? What could be a permissible legal structure for the three INGO microfinance projects? If the present legal framework may not be able to provide an avenue for the institutionalisation 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 institutionalisation, that is, if this is understood to be organisation and registration as a formal entity with the authorities. It seems that under current laws, those microfinance projects may be organised as cooperative societies or finance companies. This suggestion is analysed in more detail in Section VI of this Chapter. The organisation or institutionalisation as private banks seems possible but this is not realistic for several reasons. The capitalisation requirement of a private bank may be beyond the reach of potential microfinance institutions. For microfinance purposes, innovative lending techniques and market-driven interest rates should be initiated.

119. Institutionalisation is separate from, although in some ways linked to, localisation. 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 microfinance.

120. Field visits of the three INGO microfinance projects and interviews with local managers and staff members indicate that those projects are not yet ripe for localisation. They may be ready for institutionalisation, 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 microfinance 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 institutionalised, i.e., organised 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 organisation (NGO) is a private voluntary organisation 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 organise a non-governmental organisation 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, microfinance, 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 mobilises donor funds from international organisations, bilateral institutions, local institutions and individuals.

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

[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.

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 microfinance. 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 programmes and their willingness to learn from their INGO trainers. They have all expressed a great desire to improve their knowledge and skills in microfinance.

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 microfinance. They have to complement their current advantage of being able to charge market-oriented interest rates with appropriate training in best practices in microfinance 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 microfinance 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 three INGOs revealed that they have an average of only 4 years of experience in microfinance.

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 microfinance 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 microfinance 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 microfinance 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.

Table 11. Selected Key Staff Members of three 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"

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 programme for various levels of personnel. At present, expatriate consultants make all key personnel decisions.

130.Personnel issues are now surfacing. The most sensitive of these was the variation in scale of salaries of local staff members of the three 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 organisation, 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 institutionalisation/legalisation. A lower financial remuneration may compel the local staff members to leave the local NGOs/MFIs, thereby creating disruption in microfinance 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 microfinance 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 microfinance institutions. Most of them are graduates of social and applied sciences such as chemistry, geology and history, among others. Experience in a successful microfinance institution such as CARD Bank in the Philippines, has shown that when the microfinance 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 realising 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 microfinance methodologies. It was later found out 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 microfinance lending technologies to suit local conditions.

136.However, the three microfinance projects have to mature in time. They are still in an embryonic stage. The experience of successful microfinance 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 microfinance project but without actual experience in this regard, it will be difficult to say that localisation and institutionalisation 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 microfinance virtually useless.

5.12 Lack of Performance Standards

138. The lack of performance standards is due to the embryonic stage of microfinance in Myanmar. The INGOs that have been contracted to implement the UNDP Microfinance Project have made it a point to introduce best practices in microfinance 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 microfinance institutions in the future. The transparency and discipline that follow from the establishment and adherence to performance standards are necessary elements of sustainable microfinance.

5.13 Local Authorities' Response to Localisation/Institutionalisation

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 localisation and institutionalisation. While they are in full support of the microfinance 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 institutionalised. 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 legalisation or institutionalisation 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 legalisation or institutionalisation of the three INGO Microfinance Projects. As earlier discussed, the call for a legal framework for MFIs has arisen because of the realisation that continuing operation of the three INGO Microfinance Projects may face a legal challenge at the end of the project period. The Microfinance Projects do not have a legal charter authorising 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 Microfinance Projects terminate. Thus, the idea of institutionalising or legalising the Projects into MFIs gained currency.

142.Interviews and analysis made by the study team have indicated that several possibilities to legalise or institutionalise the three INGO microfinance 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 microfinance. 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 microfinance 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 microfinance institution organised 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 organisation.

143.Registration as cooperative societies will bring the microfinance 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 microfinance 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 legalisation 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 microfinance institutions.

145.There is a need for a serious study of present legislation affecting the financial sector and the organisation of entities such as finance companies, banks, co-operative societies to shed light on the problem of legalisation 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 microfinance.

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 microfinance activities in Myanmar. However, legalisation issue certainly merits attention. Having a secure legal identity is an important first step in the development of microfinance in Myanmar. Legal recognition and legitimacy of NGOs and other types of financial intermediaries in microfinance 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.Legalising or institutionalising a microfinance institution can not be separated from the need to have policy consistency between pricing microfinance 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 microfinance 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 legitimisation for microfinance. 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 microfinance is not as simple as it appears although there is precedent to this approach[23]. However, having a separate law on microfinance, e.g., Microfinance Law as proposed by UNDP or an amendment of the present Financial Institutions Law to accommodate microfinance 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 microfinance, 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 microfinance. 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 "microfinance 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 microfinance 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 microfinance and a host of other issues.

150.In due time in the future, Myanmar will need an appropriate regulatory and supervisory framework for microfinance institutions and private banks that are involved in microfinance[24]. The essential point that bears repetition is that it is premature to craft a regulatory framework at this stage of Myanmar microfinance. But it is helpful to try to paint the broad strokes or elements that may inform an appropriate regulatory framework for microfinance in Myanmar.

[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 recognising 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)."

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 mobilisation 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 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. Microfinance 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 microfinance 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 behaviour of managers and owners of MFIs. As in a typical financial intermediary, managers and owners of MFIs have the incentive to maximise their profits through risk-taking. The job of the regulator is to minimise 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

[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.

has yet to be developed given the embryonic stage of microfinance in Myanmar.

154.At the macro level, an appropriate regulatory framework motivates the creation of a competitive market for microfinance. 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 microfinance market more efficient and shall help strengthen the MFIs themselves.

6.3 Distinct Characteristics of Microfinance

155.To understand what an appropriate regulatory framework for microfinance will be, it is important to know the distinct characteristics of microfinance. An understanding of those characteristics or features shall motivate an appropriate regulatory framework for microfinance 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 microfinance[26].

156.The client base of microfinance 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 microfinance 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 microfinance institution anything else other than information about their trustworthiness.

157.Microfinance 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, microfinance institutions are not deterred from lending. Loan security is satisfied through group guarantees, character references, cash flow of the micro-enterprise.

[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.

158. Microfinance 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. Microfinance 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 microfinance market. In other words, the regulatory restriction, specifically on interest rates, constrains the regulated MFIs' ability to efficiently participate in the microfinance market.

161. Given the foregoing, it is clearly unrealistic to push for a regulatory framework for microfinance in Myanmar right after a very short experience with microfinance 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 microfinance 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 microfinance operations;

(c) capacity building of local microfinance projects/efforts toward sustainable microfinance

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

and

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

162.Commercial banks and investment or development banks may not be appropriate for MFIs in view of their larger capitalisation 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 organisations, cooperative societies) like continuing to charge reasonable interest rates (not subsidise) in order that MFIs become financially and organisationally 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 microfinance. 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].

[28] Fukui and Honda (2001)

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.

167.Despite attempts by some authors to provide what they want to call as "a framework for the regulation of microfinance 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 microfinance 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 microfinance in Myanmar is imperative.

6.4.2 On the incentive to formalise the informal credit provision

168.A highly regulated and controlled credit environment discourages the formalisation of informal NGO credit provision even if there may be demand for such transition into a formal institution. Observations on the microfinance sector in the last two decades clearly suggested that the inadequate regulatory environment for financial activities impedes the sustainable operation of microfinance 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 favoured form is gold and jewelry that are considered as a good hedge against inflation.

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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"

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).

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 mobilise deposits from a large number* of the population. However, inappropriate regulation and policy will yield the contrary, 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 microfinance projects in Myanmar and it seems that more microfinance 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 microfinance. Adherence to performance standards will infuse greater professionalism and commitment on the part of a diversity of microfinance players to work hard for sustainable[33].

174.Another perspective for benchmarking and performance standards is that these may help

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

provide an alternative to the untimely proposal to regulate microfinance in Myanmar. In other developing countries like the Philippines, benchmarking and performance standards are seen as complementing an emerging regulatory framework for microfinance. However, for Myanmar benchmarking and performance standards for microfinance will not be a complementary instrument to government's regulatory effort because, as argued in this chapter, regulating microfinance 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 microfinance services.

175. The limited experience so far in microfinance indicates the great potential in having sustainable programmes in the future. It bears well for Myanmar to also consider or search for expanding microfinance operations in other areas provided appropriate donor support could be secured. Quality enhancement and capacity building in microfinance 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 microfinance products, the capacity building of local implementers and the continuing exposure of all concerned to best practices in microfinance.

7. Conclusions

176.Microfinance in Myanamar is an exogenous phenomenon introduced through the UNDP Microfinance Project with three INGOs tasked to implement three different projects in designated areas of the country. To date, the Project has shown encouraging results and now, there is a proposal to institutionalise and localise the three projects and to provide a legal and regulatory framework for microfinance 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 microfinancial intermediation.

177.This chapter concludes that it is really important to vest a legal character to the three 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 legalisation can be done through registration either as finance companies or cooperative societies under the Financial Institutions Law. Registration of a microfinance project as a local non-governmental organisation (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 microfinance project such as those implemented through the three INGOs to have the legal charter to engage in microfinance services. The authorities have to validate this point if only to assure the stakeholders in microfinance that the policy and legal outlook is favourable toward microfinance 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 microfinance in Myanmar. It is far better to (a) work for the registration of microfinance projects, (b) resolve the policy dilemma over regulated interest rates and (c) build local capacities in microfinance implementation and (d) introduce benchmarking and performance standards in microfinance than entertain any proposal to regulate microfinance.

179.The current regulatory environment is meant for the traditional banking business and thus, is not conducive to the promotion and growth of microfinance 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 microfinance in Myanmar: (i) the poor can repay market rates of interest and they do not necessarily need subsidised 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 Microfinance 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 three 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 microfinance 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 microfinance 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 localisation/institutionalisation of the microfinance projects in the 3 areas, it is necessary to emphasise 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 microfinance 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 microfinance 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 microfinance development. The first important step is to craft an overall national strategy on microfinance supported by the government, donor community and microfinance institutions. Private banks interested in microfinance, INGO projects/local NGOs/local associations' projects and cooperative societies can form the three pillars of microfinance development in the country. The main goal is to build project implementation capacities, ensure a policy environment conducive to microfinance development and harness the diverse expertise and resources coming from the donor community to support the development of microfinance in Myanmar. The emphasis should be on improving quality of microfinance 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 microfinance 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 microfinance development that takes into account the local situation as well as the need to harness the forces of the market to ensure sustainable microfinance. While the emerging microfinance institutions are interested in having the legal basis for operation and for charging commercial rates of interest, the authorities are hopeful that microfinance could be an effective instrument for poverty alleviation. These parallel goals are not exactly congruent at the present stage of development of microfinance 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 microfinance will be indispensable. It is the first imperative before any talk of a regulatory framework is entertained.

186.The expansion of microfinance operations as discussed in paragraph 175 above can be the staging point for introducing best practices in microfinance and for laying the groundwork for sustainable microfinance in other areas. This will also be an important mechanism for providing the local population access to microfinance 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 microfinance as an important* segment of the financial sector and to craft an overall national strategy on microfinance that is supported by the government, donor community and the microfinance 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 microfinance institutions if not appropriately addressed. This is in view of the critical role played by market-oriented interest rates on the financial sustainability of microfinance institutions.
3. It is equally crucial to clarify the issue of legal registration of microfinance projects/ operations. The study has shown the extreme importance of having a firm legal basis for microfinance operations.
4. The organisation of a "coalition" or "microfinance development forum" may be an important component of the overall national strategy on microfinance 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 microfinance.
5. There is a need to build both the capacity of local staff of INGOs and the other microfinance projects and the regulator before any proposal for regulation of microfinance is entertained. A critical component of capacity building is the development and installation of performance standards on microfinance and a monitoring system that gives feedback on the performance of microfinance institutions.
6. There is a need to encourage the emerging linkage between the communities and private banks in microfinance as exemplified by the efforts at linkage by the FAO-organised CBOs and a private bank[34]. There is a possibility that credit cooperative societies and local NGOs may also emerge as microfinance institutions. This merits the support of government and donors alike.

188.Proposed Technical Assistance

Microfinance *is a very powerful tool for poverty alleviation and thus, in the context of the* current state of development of microfinance in Myanmar it will be critical to employ a diversity of approaches to ensure that microfinance provides the poor access to credit and

[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.

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 microfinance in Myanmar.

A. Formulating a National Strategy on Microfinance. There is need for a clear and sustainable approach to microfinance development in the country. The technical assistance by Japan will help the Myanmar government articulate its national strategy for microfinance 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 microfinance has to be sustainable in order to realise this objective. The national strategy on microfinance will provide the road map to attain sustainable microfinance.

B. Strengthening of the Coordination of the Different Actors in Microfinance in Myanmar. It may be strategic to have a Ministry identified as an anchor or coordinating body for the promotion of microfinance. The establishment of a "microfinance forum" or "coalition" will be a strategic assistance to the development of microfinance in Myanmar because the forum will bring together various stakeholders to address critical issues on microfinance. 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 Microfinance. The establishment of benchmark and performance standards will provide very useful information on institutional performance of microfinance institutions to practitioners, donors and the government. This informs decisions on building capacity to increase outreach and to make more effective the microfinance institutions.

D. Capacity Building for the Microfinance 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 microfinance 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 microfinance 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 Microfinance in Other Areas. Donor support will be needed to expand or introduce microfinance in other areas. Technical expertise on sustainable microfinance, including capacity building will be indispensable component of the expansion programme.

F. Supporting and Facilitating Legalisation of MFIs in Myanmar. It is vital to provide support to the legalisation of MFIs in Myanmar. The immediate assistance is the facilitation of the registration of microfinance 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 microfinance in the future.

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

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Chapter 2

Lessons Learned from Philippine Experiences in Microfinance

Table of contents

1. Introduction

1. This paper presents what has been observed about and learned from Philippine experiences in microfinance (MF) development, based on the *Study on Microfinance* in the Philippines, March 2002. The MF study programme is a component of the financial study of the Myanmar-Japan Task Force, in line with the important issues reported by the Fiscal and Monetary Policy Working Group (FMWG).

2. The programme was carried out from 3 through 10 March 2002, with the co-ordination of JICA and the CARD Rural Bank in the Philippines. The programme was organised by two prominent consultants to JICA: Dr. Gilberto M. Llanto and Dr. Jaime A. Alip, who, respectively, are the Chairman of the Board of Advisers and the Chairman of the Board of Directors of the CARD Rural Bank Inc. of the Philippines. The 9-member Myanmar study group consists of personnel from Myanma Agricultural Development Bank, the National Planning Department of Myanmar, the Directorate of Co-operative Cottage Industries, the Central Bank of Myanmar, and some prominent scholars of the Ministry of Foreign Affairs and the Yangon Institute of Economics. It was led by U Than Lwin, the deputy governor of the Central Bank of Myanmar, and accompanied by seven Japanese taskforce members and one representative each from UNDP and UNOPS. Please see annex-1.

3. The main purpose of the programme is to make a joint study of Myanmar-Japan Task Force to learn lessons from microfinance development in the Philippines. From the exchange of views on the Philippines MF experiences and the experiences of CARD Bank, which is the largest and best microfinance institution (MFI) in the Philippines, the study group means to produce an identification of key factors for sustainable development of microfinance in Myanmar.

4. As the microfinance development in the Philippines provides a good example for promoting microfinance in Myanmar, the study was carried out in the Philippines, where the Myanmar study team could observe actual situations and operations of MF development. A better understanding of Philippine experiences, of both policy markers and practitioners, provides a wide spectrum of enlightenment regarding microfinance development.

2. Observation on Philippine Experiences in Microfinance Development

2.1 Background of MF Development in the Philippines

- **Pervasiveness of poverty in the economy**

5. One major economic issue in the Philippines is the pervasiveness of poverty, as the number of poor[1] Filipino households registered about 4.7 million in 1994 and 5.2 million in 1999–2000. With a rural poverty incidence of 53.7 per cent, 36 per cent of the total population of 78 million live below the poverty line (US$1 earning per day).

6. A good number of households below the poverty line are engaged in small enterprises, whose perennial problem is the lack of access to financial services, mainly due to lack of collateral and lack of information on possible sources of financing.

7. In the 1970s and 1980s, for poverty alleviation, the Philippine government created some guarantees and directed credit programmes (DCPs), especially in the agriculture sector. These programmes provided massive subsidised loans through government budget appropriations, the central bank's rediscounting window and foreign borrowings. Funds were provided at highly concessionary rates. Unfortunately, the government's direct lending programmes failed to serve the targeted poor households, as the eventual rationing of credit and defaulting on large-sized loans in effect subsidised the non-poor sector. The large loan defaults resulted in huge fiscal costs. Moreover, the availability of cheap loans from the government misled rural banks, causing them to neglect savings mobilisation, thereby weakening themselves as well as national savings overall.

8. Hence, the government pursued financial reforms in the mid-1980s, with the adoption of market-oriented interest rates, termination of central bank rediscounting programmes, consolidation of agricultural credit programmes into the Comprehensive Agricultural Loan Fund and termination of direct lending to the agriculture sector by the government.

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[1] According to President Gloria Macapagal Arroyo's State of the Nation Address on 28 July 2001, "Poverty is hunger. Poverty is lack of shelter. Poverty is being sick and not being able to see a doctor. Poverty is not being able to go to school and not knowing how to read. Poverty is not having a job. Poverty is fear for the future."

9. The government then adopted the 1991–1998 Medium Term Philippine Development Plan, under which the implementation of market-based financial and credit policies and the increased participation of the private sector in the financial market were emphasised. Among the reform steps, new credit policy under the Social Reform Agenda has produced a national strategy for Microfinance, with a view to address the poverty problem in the country.

2.2 National Strategy of Microfinance in the Philippines

- Definition and features of MF

10. Microfinance (MF) is defined as the provision of a broad range of financial services, including deposits, loans, payment, money transfer and insurance, to poor households, especially to microentrepreneurs, so as to help enable them to raise their income levels and improve their living standards. Microfinance services are exclusively for the poor, with a special focus on women. Small, non-collateralised, and cash flow-based loans are provided through MF. In 2001, the President of the Philippines, in Her Excellency's first State of the Nation Address, underscored that microfinance is an important tool to reduce poverty in the economy. Moreover, Her Excellency ensured that the Philippines would make microfinance a cornerstone in the fight against poverty.

11. With the vision of having a viable and sustainable microfinance market in a liberalised and market-oriented economy, the government adopted policy framework, institutional framework, legal framework and a set of strategies.

2.2.1 Policy framework

12. In 1993 the National Credit Council built up the microfinance policy on the following principles,
    - a greater role of the private sector MFIs in the provision of financial services
    - an enabling policy environment that will facilitate the increased participation of the private sector in microfinance and promote efficient financial markets to help MFIs broaden and deepen the MF services
    - market-oriented financial and credit policies, e.g. market-oriented interest rates on loans and deposits
    - non-participation of government agencies in the financing programmes

- provision of innovative financial products
- government support, especially the central bank's support to MFIs in capacity building and in providing the appropriate supervisory and regulatory framework for more viable MF development

2.2.2 Institutional framework

13. Given the policy framework, major institutions and players in microfinance were formed, based on their relative comparative advantages. They include
    - the policy making, regulating and supervising body, i.e. the National Credit Council,
    - the policy supportive institutions, including Banko Sentral Pilipinas (the central bank), People's Credit and Finance Corporation, the Microfinance Council, government financial institutions (GFIs), commercial banks and donors, and
    - the policy implementing institutions, i.e. private MFIs and NGO-MFIs.

1) The policy making, regulating and supervising body

14. The National Credit Council (NCC) was created in 1993 as the main body for formulating credit policy and creating a market-oriented financial and credit policy environment. The NCC is a part of the Department of Finance. It includes nineteen government and private member agencies like BSP, Land Bank of the Philippines, Co-operative Development Authority, Philippine Deposit Insurance Corporation, People's Credit and Finance Corporation, Department of Agriculture, Department of Trade and Industry, co-operatives, Rural Bankers Association of the Philippines, Association of Thrift Banks, National Anti-Poverty Commission, and bank co-operatives. The BSP, Microfinance Council and the NAPC play an important role. The NCC monitors and regulates the reform process in the financial markets.

15. In the mid-1990s, the government reviewed the effectiveness of supply-led DCP finance via government agencies. This was carried out with a view to rationalise the DCPs. In this regard, the Credit Policy Improvement Programme (CPIP) was introduced. The CPIP not only makes assessment on the DCPs, but also identifies barriers to savings mobilisation and plays an advocacy role. The CPIP advocated the creation of the National Credit Council. Since the NCC came into existence, it has used the CPIP for the adoption of market-based credit policies, the Standard Chart of Accounts (SCA), and the performance standards for

co-operatives. The CPIP also paved the way for amendment of the 1949 General Banking Act and for important legal reforms in the late 1990s through 2001. The CPIP is conducted with United States Agency for International Development (USAID) technical assistance regarding the SCA and the performance standards for co-operatives. The composition of the NCC is now being reviewed because of potential conflicts in the policy making process: NCC membership includes both policy makers and policy practitioners.

2) The policy supportive institutions

16. The Banko Sentral Pilipinas was established in 1949 as the central bank of the Philippines (CBP). The BSP had pursued strict monetary and banking policies from 1949 through 1970. In the 1980s, the BSP took reform measures in the banking system, liberalising interest rates in the financial markets, promoting GFIs' capital, and reducing the number of commercial and rural banks. Still, there are 70,000 banks in the Philippines, and creation of new bank branches is controlled. To encourage the participation of the banks in MF, only those who do so are allowed by the BSP to open new branches.

17. In 1993, the BSP reformed itself. The name Banko Sentral Pilipinas was taken instead of the Central Bank of the Philippines. The BSP became an autonomous monetary authority, exclusively focusing on formulating monetary policy, and regulating and supervising the banking system. The BSP discontinued its participation in development financing. Its seven-member Monetary Board governs BSP operations. Formerly, the BSP was reluctant to support MF, since it would require changes within itself, e.g. it would need to change its principles from formal supervision to risk-based supervision.

18. As MF was accorded priority as a national concern, the BSP has supported it, starting from the year 2000. In this regard, the BSP amended the General Banking Act to reflect microfinance's non-traditional characteristics. In 2001, the BSP issued three circulars to facilitate MF services. BSP mission activities in MF development can be described as follows.
    - granting licences to rural banks to operate MF
    - encouraging banks to engage in MF
    - supervising the MFIs
    - transforming from formal supervision to risk-based supervision
    - setting up a team of examiners as few of its personnel have training in MF supervision
    - mainstreaming MF into the financial system;

19. The Microfinance Council was formed to continue the formulation of standards for NGOs after the USAID technical assistance project ended. It is a coalition with the following missions.

- setting up performance standards for NGO MF
- evaluating the performance of NGOs, based on certain criteria, namely, outreach, collection efficiency, portfolio quality, portfolio at risk, operating cost ratio, operating-self-sufficiency, financial self sufficiency, equity adequacy/leverage, and current ratio

20. The Microfinance Council places special attention on outreach and sustainability of MF services. According to its study, the tribal minorities' poor and the upland farmers are not reached by the MF services whereas most landless lowland farmers, fishermen, small farm cultivators and urban dwellers have access to MFI assistance.

21. The People's Credit and Finance Corporation (PCFC) was established on 14 September 1995. It has registered with the Securities Exchange Commission of the Philippines to become the government's arm in providing microfinance services to poor, asset-less borrowers. The National Livelihood Support Fund (NLSF), which is under the supervision of the Land Bank of the Philippines, provided P100 million for the initial capitalisation of the PCFC. The capitalisation of the PCFC was raised to P1 billion in 1998, with the additional investment of P900 million by the NLSF.

22. The PCFC is basically a wholesale funder, espousing innovative lending technologies such as but not limited to the Grameen Bank approach(GBA), the approach of the Association for Social Advancement (ASA) and other upcoming technologies for microfinance practitioners. Please see annex-2. The PCFC wholesale funds go to private thrift banks, rural banks, non-government organisations (NGOs), bank co-operatives, and other co-operatives.. In turn, these conduits provide microfinance services to the poor.

23. The PCFC has three significant lending programmes, namely, the HIRAM (Helping Individuals Reach Their Aspirations through Microfinance) programme, the RMFP (Rural Microenterprise Finance Project), and the UNDP-MSP (UNDP Microfinance Support Programme). For the HIRAM programme, initially the PCFC assumed the portfolio of the National Livelihood Support Fund. HIRAM provides conduit investment loans, which are relent to individual borrowers for their microenterprise requirements. It also provides institutional loans to conduits in order to finance establishment of branches and other capacity

building requirements like manpower and equipment costs. Under HIRAM, a total of P1.585 billion has been lent.

24. The ADB-RMFP was funded in 1997 by the Asian Development Bank and the International Fund for Agricultural Development. It aims to provide financing to the poor through the adoption of a modified GBA. This programme has provided P1.32 billion in financing to the poor.

25. In 1998, the UNDP-MSP was initiated to assist in the capacity build-up of MFIs in the Philippines, and the PCFC was tapped to assist in identifying the MFIs in need of technical assistance. In 1999, the PCFC became the executing agency of the programme for monitoring the implementation of the UNDP-MSP. Under this programme, the UNDP finances the training of personnel and other improvement in the service delivery systems of the MFIs. Aside from monitoring the project, the PCFC provides investment loans for the retail lending activities of qualified MFIs. The UNDP-MSP has spent P130 million for the programme.

26. In 1999, the PCFC implemented, on a pilot basis, a direct retail-lending programme to borrowers in the areas where no conduits were operating. The PCFC, through 193 conduits, has lent a total of P3.2 billion to 503,495 borrowers, as of January 2002. The PCFC reports a repayment rate of 98.7 per cent.

- **Commercial banks and private banks**

27. Commercial banks and private banks provide wholesale funds and financial services to MFIs.

- **GFIs**

28. GFIs provide wholesale funds, including those sourced from foreign borrowings, to MFIs that do not have access to funds from private commercial banks.

- **NGOs**

29. Credit-issuing NGOs are governed by volunteer individuals who do not own the respective institutions. Their board members are selected by, and often serve upon the invitation of, the

founding members, usually being chosen for their reputation and expertise. Unlike co-operatives, NGOs are not member-based organisations. A survey done by the Microfinance Council lists the following as characteristics of NGOs.

- capital sourced largely from donations
- low volume of member savings
- limited commercial borrowing sources
- innovative lending techniques
- facilitates linkages between microenterprises, MFIs, and community organisations
- assists in capacity building of target clientele

- Donors

30. Donations are mostly from foreign donors, philanthropic organisations or foundations set up by corporations. Donors assist in development of MF products, training in MF technologies, and upgrading of performance standards, operating systems, procedures, etc.

3) The policy implementation bodies

31. MFIs, the policy implementation institutions, are categorised into three classes in the Philippines: rural banks, credit-NGOs and credit co-operatives. Rural banks are regulated by the central bank, credit-NGOs by the Securities Exchange Commission, and credit co-operatives, by the Co-operative Development Authority.

4) The framework of Philippine MF

32. Sustainable MF development requires close co-ordination among the MF players; therefore, the MF players in the Philippines work hand in hand within an established framework. The framework is illustrated in figure 1, which elaborates that technical services and social services are provided to the MFIs and the MFI client system, and that this is in addition to government and government-affiliated organisations' support of policy via regulation, supervision and provision of wholesales funds. MFIs on-lend funds to their clients for livelihood activities and microenterprise requirements.

2.2.3 Legal infrastructure for MF

33. Starting from 1994, the government has enacted a series of laws to help MF develop. In September 1994, the government issued Administrative Order No. 148 to create the Task Force on Credit for the Poor and to formulate a master plan of operation for the Credit for the Poor Programme.

34. With Memorandum 261 in 1995, the People's Credit and Finance Corporation was established to serve as the government's arm to provide microfinance services to the poor. In 1997, the Social Reform and Poverty Alleviation Act was promulgated to create the National Anti-Poverty Commission (NAPC), which pursues the policies of the National Strategy on Microfinance. 1997 saw the Agricultural and Fisheries Materialisation Act promulgated for the phasing-out of directed credit programmes in the agricultural sector. This act reoriented government credit programmes.

35. In 1998, Memorandum Order No. 11 came out. MO 11 directed the Land Bank of the Philippines to invest an additional P900 million in PCFC preferred shares. Executive Order 138 in 1999 is part and parcel of the government's thrust to rationalise financial and credit policies. The 1949 General Banking Act was amended in 2000, reflecting the central bank's recognition of the peculiar characteristics of MF. The amended GBA allows MFIs to operate non-collateralised, cash flow–based MF lending. Executive Order 241 issued in 2000 was meant for the promotion of mobilisation of domestic savings.

36. In 2001 the BSP issued three circulars. Circular 272 provides guidelines to be observed by MFIs. It prescribes MF features such as the maximum size of MF loans ; the market-based interest rate principle for MF; the exemption of MF loans from central bank regulation; the need to maintain standards, credit policies, and procedures for MF loans; and the need for MFIs to develop systems for loan tracking and daily monitoring. Circular 273 is the approval for a partial lifting of the general moratorium on the licensing of new thrift and rural banks to allow the entry of MF-oriented banks. Circular 282 provides guidelines to rural banks and co-operative banks for the provision of liquidity assistance through the BSP's rediscounting window so as to support and promote MF programmes.
In terms of the operational infrastructure building,

- MFIs are allowed to pursue market-oriented credit policies.
- Information infrastructure development, including Development SCA and Development

of Performance Standards, is being implemented.

- A technical working group (TWG) is being formed to work out the standards particular to credit co-operatives. The TWG includes technicians from the NCC, CPIP, CDA, BSP, the Philippine Deposit Insurance Company, the Land Bank of the Philippines, the National Confederation of Co-operatives, the Philippines Federation of Credit Co-operatives, the Co-operatives Union of the Philippines, the National Market Vendors Confederation of Co-operatives, and the Credit Union Strengthening Project. The TWG has set a number of criteria for evaluating the performances of credit co-operatives, based on their compliance, organisational structure, operational management, and plan and programmes, and on their portfolio quality and their efficiency, stability, operations, and structure of assets, which are referred to as COOP PESOS in short form. Currently, NGO MFIs, credit unions/savings and credit units of co-operatives, and village banks are unregulated MFIs. There is a need to integrate them into the regulated financial system.

2.3 Overall Developments of MFIs in the Philippines

37. The government has recognised MF as an important vehicle for fighting poverty. MF services are exclusively for the microenterprises of the poor, who are characterised by the fact that they
    - do not have access to financial services offered by banks
    - need timely, small-sized loans whose repayment terms coincide with their cash flows
    - do not have a track record with conventional banks
    - do not have the collateral traditionally demanded by banks
    - also have demand for savings services
    - have difficulties associated with both limited access to banking facilities and lack of interest of traditional banks in mobilising small sized deposits

38. These factors contribute to high transaction costs and perceived risk in lending to microenterprises. MFIs serve the demand of small-scale borrowers including market vendors, tricycle operators, petty traders, and microentrepreneurs. The private-led MF services are provided by the three types of MFIs, i.e. rural banks, credit NGOs and credit co-operatives, which are under different supervision entities.
    The following is a general assessment of MF in the Philippines.
    - MFIs in the Philippines have limited outreach. Among MFIs, bank co-operatives and

credit co-operatives have the widest estimated outreach.

- MFIs control assets equivalent to only 4 per cent of those of commercial banks but have twice as many trading outlets.
- Of the commercial banks, only government banks have ventured into microfinance on a wide scale.
- The sustainability of MFIs did not receive any major attention until late 1998.
- A survey done by the Coalition of Microfinance Standards describes the characteristics of NGOs as follows-
  - Capital sourced largely from donations
  - Limited borrowing from commercial sources
  - Limited reliance on members' savings
  - Innovative lending techniques
- Credit co-operatives often report good financial performance but verification is difficult.
- Absence of ownership in NGOs leads to governance and accountability problems, hindering access to commercial financing.

2.4 The CARD Inc, the CARD Bank and Their Experiences

39. The Centre for Agriculture and Rural Development (CARD) Inc. was founded in December 1986 by the fifteen rural development practitioners. CARD Inc. has been registered with the Security Exchange Commission since July 1987 as a non-stock, non-profit, social development foundation. From 1986 through 1996, the mission of CARD Inc. was the alleviation of countryside poverty. CARD Inc. widened its vision in 1997 to create a bank owned and managed by the landless rural women. In 2002, its vision widens to empower the poor by upholding the core values of excellence, competence, stewardship, family spirit and simplicity. CARD Inc. had 307 members in 1990 and the number of the members substantially increased to 50,748 in January 2002.

40. The main functions of CARD Inc. are credit and savings operations, and the provision of training. CARD Inc. has pursued livelihood assistance programmes (providing loans to landless coconut farmers) and certain development projects. It was involved in basic infrastructure projects in Matbe and Laguna, in collaboration with the Presidential Management Staff. It also implemented the Integrated Rural Financing Project with the Land Bank of the Philippines, providing services for institutional development among small farmers. CARD Inc. has emphasised the training of its group members about project

management and organisational development (MF management, bookkeeping, centre management, institutional development training, etc.) and also offers pre-membership training.

41. A landmark programme implemented by CARD Inc. is the Landless Poor Development Fund (LPDF) project. Before that, CARD Inc. had been applying traditional lending methodology, which was not successful. After its chairman visited Grameen Bank in Bangladesh, it pilot tested the Grameen approach and achieved high participation and perfect repayment.

42. Co-founders of Card Inc. are PCFC, Angelo King Foundation, Asian Community Trust, and the Rissho Kosei Kai (a Japanese NGO). Now CARD Inc. is a group of mutually reinforcing institutions, including CARD NGO, CARD Bank, CARD Mutual Benefit Association, and CARD Training Centre. The CARD Training Centre is to be upgraded to become the CARD Training Institute, and two more CARD institutions, namely, the CARD Marketing Centre and the CARD Housing Company are underway.

2.5 The CARD Bank

43. In 1989 CARD Inc. started a pilot programme in San Pablo City based on the GBA, with the aim of transforming CARD NGO into the CARD Bank. The pilot programme included four women associations. It provided small loans (P1,000) to the members, payable in weekly instalment payments at 18 per cent interest per year. P5 per week from every member and 5 per cent of every loan was commited to the Centre Fund of the CARD Bank.

44. The CARD Rural Bank was registered with the SEC on 8 May 1997. The BSP authorised CARD Bank operation in August 1997 and the CARD Bank started its operation on 1 September 1997, with an initial paid-up capital of P5 million, of which 40 percent is by the CARD Inc. and 60 percent by the members' shares. The CARD Bank opened its branches in Masbate (July 1999), Marinduque (December 1999) with two extension offices, Bay (January 2002), and Dolores (January 2002).

45. The CARD Rural Bank provides non-collateral loans to landless rural farmers. The initial loan size was raised from P1,000 to P2,000 in 1996. The CARD Rural Bank created a housing loans window, replacing the former Centre Fund, and new loan products to expand

productive enterprises and finance fixed assets. The CARD Rural Bank was no longer donor dependent in 1994, as it started borrowing larger funds from PCFC at near the commercial rate. It has adopted strict credit discipline on loan repayments, known as "zero tolerance to arrears". The CARD Rural Bank has a staff of 337. To reduce its operating cost, it introduced a new set of performance standards. The CARD NGO owns all the asset of the CARD Rural Bank. The CARD Rural Bank has registered a total loan disbursement of P55 million and a repayment rate of 97 per cent. Its savings reached P174.3 million. It pays 5 per cent gross receipts tax on loans and 25 per cent corporate tax on net income. The deposits mobilised by the bank are subject to a final tax on interest income. A new Management Board was organised with four seats going to CARD NGO Board members. At least two Board members are appointed from the bank's client members. Seventy per cent of the bank's members have risen above the poverty level.

46. The CARD Rural Bank has targeted savings of P200 million and loan disbursements of P1 billion in 2005. The outreach is targeted to reach 1 million in 2010.

2.6 Field Trip Exposure: Visit to two MF Centres

47. The Study Group was separated into two groups of nine members each, in order to visit two different places, the CARD Bank MF at Malanda Buboy village, and the Dolores Branch Santa Lucia MF centre at Balikantan CI.

2.6.1 The visit to Malanda Buboy village MF centre — 40 km from Bay Laguna

48. The Malanda Buboy village MF centre was established on 16 September 1998 with fifteen members, which as of 2002 has increased to 36 members. The village has 252 households, from which all the members are women aged 18–60 years old. The heads of the low-income households are small-factory workers, farmers, and tricycle operators and drivers. Members are formed into eight groups, within which the responsibility for group members' loan repayment is shared. There are three types of loans, namely, regular loans, personal loans, and emergency loans. The initial loan is P2,000, and the maximum loan is P15,000. The centre is required to maintain a repayment rate above 90 per cent. Loan approval is made at the MF centre, but the loan is issued to the borrower at the CARD Bank. The MF centre is administered by the members, sharing responsibility in turn for each assigned position of the centre: chief, secretary, treasurer, auditor and project manager. The MF centre maintains

proper ledger books and accounts. The CARD Bank appoints one loan officer or technical officer (TO) to monitor loan disbursements and repayments. TOs visit customers door to door in order to scrutinise loan proposals and check for proper loan utilisation. The MF centre holds weekly meetings, not only for collecting instalment payment but also for providing an opportunity for the members to discuss plans, map-out activities, report on the status of projects and solve the centre's problems. Each meeting is conducted in the following sequence.

- Signing of attendance sheet
- Opening prayer and recitation of members pledge
- Roll call by the centre's secretary / tech officer
- Reading of minutes of the previous meeting
- Distribution of official receipts of past collection
- Report on group repayment rate and attendance rate
- Discussion of the agenda for the week and the topic of centre development
- Collection of savings and instalment payments
- Group report on group activities
- Reading and signing of attendance sheet
- Closing prayer

2.6.2 The visit to Dolores Branch Santa Lucia MF centre, Balikantan CI

49. The Centre in Bali Kantan was established in 1993 and its members represent 138 of the local 1,600 households . At the start, there were fifty-two members (2 men and 50 women). The centre holds one-hour meetings monthly, and attendance is compulsory. The native language is used at the meetings, which are used to announce individual loans outstanding, collect repayment and deposit, and monitor attendance. During the visit, the centre's members responded frankly to the observer's queries. Loans are disbursed at the CARD Bank, but the centre collects the repayment, at clients' homes. The repayment rate is recorded at 98 per cent. The centre provides efficient loan service; within one day, loan approval is cleared. The centre is operated by its members, on a voluntary basis. Active and close co-ordination among the centre members is one factor of the success of the centre. Among the three areas of MF services at the centre—lending, savings and Mutual funds—lending services are most popular. Also, members prefer the CARD Bank to local moneylenders, because of its many incentives, and are proud of being members,

3. Lessons Learned from Philippine Experiences in Microfinance

50. Based on Philippine experiences in microfinance, the Myanmar study group considers that the following would serve as appropriate considerations for the sustainable development of microfinance in Myanmar.

    i) In a developing country with a huge rural population, rural development is important for the sustainable development of the entire economy. Through microfinance, provision of a broad range of financial services can be made for low-income households, especially in rural areas, to support their small businesses in order to help raise their income and promote sustainable development of their livelihoods. Therefore, microfinance is an important tool for rural development.

    ii) The government's viable support to microfinance plays a crucial role in the realisation of microfinance.

    iii) Without proper regulation and efficient credit management, direct lending and subsidised credit programmes for rural development can be misleading—causing incentive for non-repayment of loans, as well as huge operating losses and ineffective lending that would deny the targeted clients access to credit but would serve the non-poor sector.

    iv) An official policy role is needed in order to create an enabling environment for the smooth functioning of and sustainable development of microfinance.

    v) Built-up legal framework, institutional infrastructure and operational infrastructure are prerequisites for sound microfinance development.

    vi) Since MF is a wide-scale non-traditional type of financing offered to low-income groups, the laws, rules and regulations for traditional financing practices may not serve it well. Moreover, in pursuit of smooth functioning and sustainable microfinance activities, the legal recognition of microfinance businesses and legal identification of microfinance institutions are essential. Therefore, specific law for MF development is necessary. Such law should ensure the sustainability and promotion of MF business. It should also encourage the private banks and domestic and external donors to raise wholesale funds to develop MFIs.

    vii) The National Credit Council in the Philippines can serve as a model for Myanmar. In Myanmar, the Attorney General's office, the Ministry of National Planning and Economic Development, the Ministry of Agriculture and Irrigation, the Ministry of Finance and Revenue, the Ministry of Co-operatives, the Central Bank of Myanmar, banks, credit societies, NGOs and other related ministries and institutions may be considered institutions relevant to the national-level credit organisation.

viii) The Central Bank of Myanmar can play an advocacy role in formulating and implementing microfinance policies, regulating and supervising microfinance institutions and capacity building of MF related institutions, at least up to a sustainable level.

ix) The Central Bank of Myanmar's tangible support to the conduct of microfinance, coinciding with the establishment of an appropriate regulatory framework, is vitally important to the sustainable development of MF.

x) To succeed, MF also requires effective co-ordination and networking among the policy makers, regulators, consultants, practitioners, and donors. Thus, to bring about a sound, effective and efficient MF system of vast domestic and external financial resources, a good network should be formed.

xi) In the process of networking, seminars and workshops on MF should be organised for brainstorming on productive and pragmatic ideas for rural development in Myanmar through MF services. Such forums should include authorities concerned, technicians, scholars, practitioners, and microentrepreneurs from various entities.

xii) Active private sector participation would be a great asset in microfinance development. Therefore, the private sector should be encouraged to extensively participate in MF business.

xiii) The use of innovative lending techniques and market-driven interest rates are part and parcel of MF and its peculiar characteristics. MFIs may be allowed to pursue the non-traditional lending techniques and market-driven interest rates. Due to the extraordinary characteristics of MF business, the existing rules of Central Bank supervision over the financial institutions will be different from those of MFIs. For the proper conduct and development of MF, the MF services have to be appropriately regulated by a particular regulatory body under the policy making body at the national level.

xiv) In order to form a proper regulatory system, accounting standards and best practices for MFIs need to be set by the government. Such regulation should cover the interest rates of MFIs, to maintain harmonisation of interest rates in the MF market. Lending methodologies should be adopted depending on the areas and the types of clients serviced. Adaptation of international MF lending technologies (Bangladesh Grameen Approach, Philippine modified Grameen Approach, ASA model, etc.) has already taken place in various parts of the country through the pilot MF projects by the UNDP/UNOPs and other international NGOs. A thorough plan for harmonious consolidation of the existing pilot MF projects should be worked out—to give them life.

xv) In MF development, donor funds are better used for capacity building of MFIs rather than as sources of subsidised credit.

Annex - 1

Participant List (Myanmar)

No.	Name	Job Title	Occupation
1	U Than Lwin	Leader of Fiscal and Monetary Policy WG	Deputy Governor Central Bank of Myanmar
2	U Sein Than		Director General Cottage Industries Department Ministry of Co-operatives
3	U Tin Lwann		Managing Director Myanma Agricultural Development Bank
4	U Hla Maung	Member of Fiscal and Monetary Policy WG	Advisor Ministry of Foreign Affairs
5	U Ohn Lwin	Expert Study on the Financial Sector	Advisor Myanma Agricultural Development Bank
6	U Kyi Shein	Member of Fiscal and Monetary Policy WG	Advisor Ministry of Finance and Revenue
7	U Kyaw Win		Director Planning Dept., Ministry of National Planning and Economic Development
8	Dr. Khin San Yee	Member of Fiscal and Monetary Policy WG	Associate Professor Institute of Economics
9	Daw Yin Yin Mya	Supporting Member	Deputy Director Central Bank of Myanmar
10	U Hla Phyu Chit	Observer	Programme Manager United Nations Development Programme
11	U Bishnu B. Silwal	Observer	Agency Project Manager United Nations Office for Project Services

Participant List (Japan)

No.	Name	Job Title	Occupation
1	Prof. Takehiko KONDO	Leader of Fiscal and Monetary Policy WG	Dean of Faculty Ritsumeikan Asia Pacific University, College of Asia Pacific Management
2	Prof. Hideki ESHO	Member of Fiscal and Monetary Policy WG	Professor, Hosei University Faculty of Economics
3	Dr. Fumiharu MIENO	Member of Fiscal and Monetary Policy WG	Associate Professor, Hosei University Faculty of Economics
4	Mr. Ryu FUKUI	Member of Fiscal and Monetary Policy WG	Deputy Director General International Cooperation Department Development Bank of Japan
5	Ms. Yoko HONDA	Supporting Member	Research Assistant International Cooperation Department Development Bank of Japan
6	Mr. Hirohiko SEKIYA	JICA Consultant Study on the Financial Sector	Senior Researcher International Bureau The Japan Economic Research Institute
7	Ms. Maiko SUDO	JICA Co-ordinator Study on the Financial Sector	Co-ordinator International Bureau The Japan Economic Research Institute

Hosts

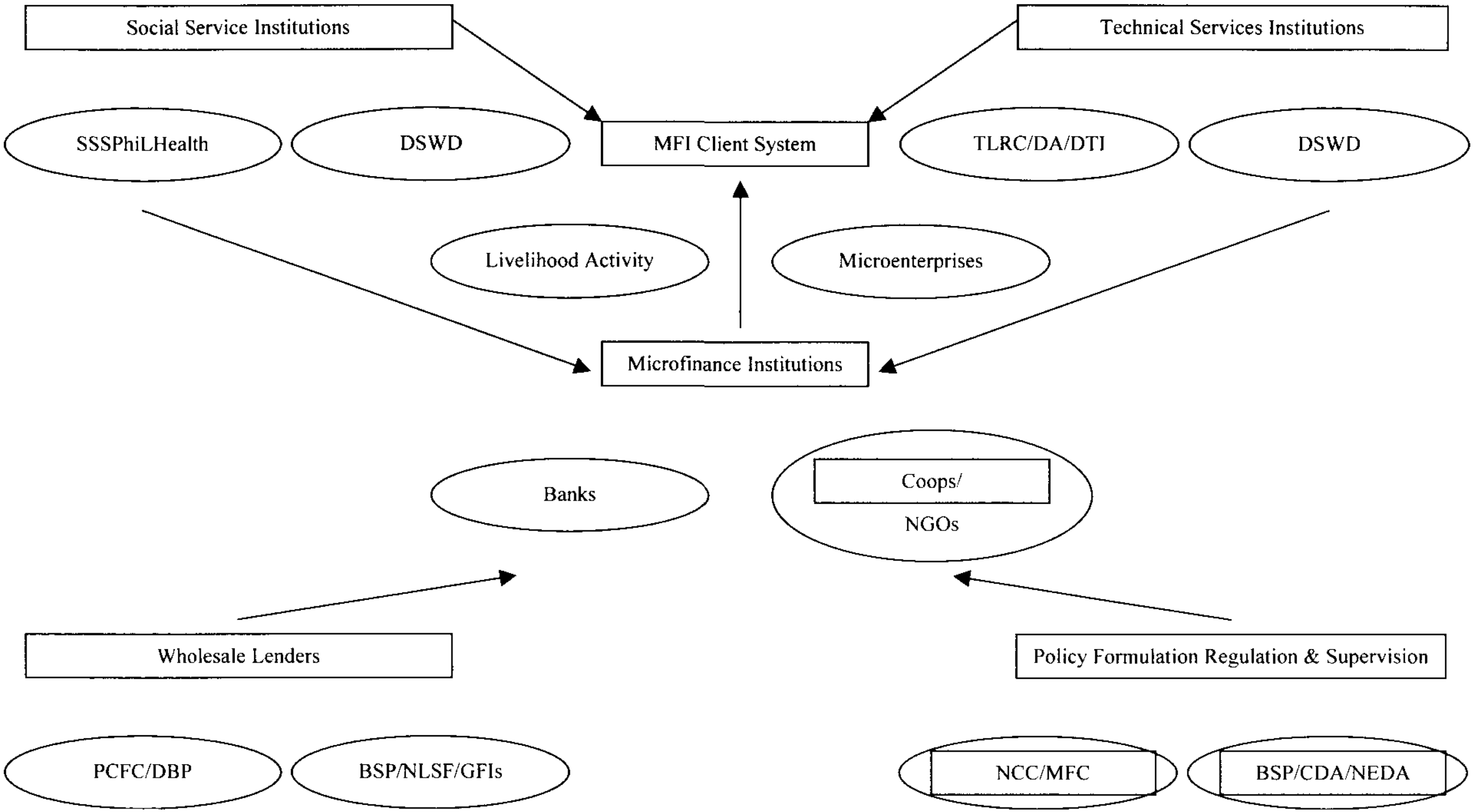
No.	Name	Job Title	Occupation
1	Dr. Gilberto M. Llanto	JICA Consultant Study on the Financial Sector	Chairman, Board of Advisers CARD Bank (CARD Rural Bank, Inc.)
2	Dr. Jaime Aristotle B. Alip	JICA Consultant Study on the Financial Sector	Chairman of the Board CARD Bank (CARD Rural Bank, Inc.)

Annex - 2

Innovative Microfinance Tichnologies

	Grameen	ASA	UPLIFT
Targeting Process	Means test (house, income and asset indices) Income level: P10,000/mo	Population density; simplified means test Income level: P6,000/mo	Area scanning Income level: P6,000/mo
Social Preparation	Compulsory group training & group recognition test	None	Training
Group Size	5	20–30	Individual
Loan Size	P6,000 (initial) increasing gradually up to P25,000	P3,000 (initial); subsequent loans depend on repayment & business requirement	P1,500–P5,000 depending on business requirement
Interest rate	2% per mo.	3.3% per mo.	3% per mo. (declines w/ good performance)
Collateral	Group liability	None	None
Loan Release	Rotation (2-2-1 or 3-2)	Simultaneous to 20–30 clients	Individual
Loan Tenor	6 mos. –1 year	6 mos.	1 yr. max
Loan Collection	Weekly, in centre meetings	Weekly, in centre meetings	Weekly, at doorstep
Capital Build Up	5% of loan payable in 24 weeks; withdrawable upon resignation	P20 per week, withdrawable anytime as long as minimum of 20% of the loan is retained	25% to 100% of loan
Other Funds/ Savings	Emergency programme fund (P20 per week; mutual fund (P200)	None	None

Figure 1 Philippine Framework for Microfinance Development



Chapter 3

Institutionalisation, Governance, and Policy Issues of Microfinance/ *Literature Survey on Worldwide Experiences for Microfinance Development in Myanmar—*

Table of Contents

1. Introduction

Major Issues

1. Microfinance industry has more or less a quarter century history in the world, as far as we define it as an innovative financial system for the poor, which is the definition initiated by Professor Mohamed Yunus of Bangladesh (table 1). Since the 1980s the number of microfinance institutions (MFIs) has dramatically increased in developing countries. MFIs are operated in various forms: local and international NGOs and specialised or commercial banks. A fact across the world draws our attention: The majority of microfinance start from projects, not from within existing financial institutions. So *institutionalisation* is an issue utterly inseparable from all arguments on microfinance. Moreover, the increasing intervention of existing financial institutions into the microfinance market usually involves a set of organisational features that are identical to microfinance and are quite different from the setting-ups for conventional banking; therefore, the organisational transformation is a prevailing issue for those entities (mostly banks). Even in more traditional forms of financial undertakings such as cooperatives and savings and credit unions, organisational and functional transformation is a key for success in incorporating microfinance technology.

2. Second, the diversity of forms of MFIs and social missions that MFIs carry out bring about a wide range of issues on *governance* in the course of institutionalisation. MFIs neither simply pursue profits, even if they are highly commercialised, nor remain in a project permanently, or non-governmental organisations (NGOs), banks, and cooperatives are animals quite different from each other. Thus the varied questions of *governance* form another overarching issue on microfinance.

3. Last but definitely not least, the role of the state and monetary authorities is critical to whether the environment for the industry is favourable or unfavourable. The legal and regulatory framework is an issue that has been discussed quite frequently around the world over the last several years. Policymakers can foster groups of MFIs to become integral parts of financial systems, or they can conversely kill them, even unconsciously, when they are still in the embryonic stage. Also, the creation of a favourable environment is possible only by sharing a common vision among microfinance stakeholders, accompanied by a wide range of policy actions. This aspect is often called *the 'national strategy' for microfinance in a country*. Thus, *policy issues* constitute a set of crucial elements for microfinance

development.

Table 1. World Trend of Microfinance

	Rural or Microfinance Institutions	Major Trends in Rural and Microfinance
up to the 1960s	(e.g. BAAC, Thailand; BRI, Indonesia established in 1966-1967)	- Subsidised rural credit - Targeted crop loans - Agricultural development banks - Credit cooperatives operating
1970s	+ SEWA (1974, India) + Grameen Project (1976, Bangladesh)	- Emergence of microfinance - NGOs emerge
1980s	+ Grameen Bank (1983) + BRI Unit Desa launched KUPEDES (1984) + PRODEM (1986, Bolivia)	- Grameen replications - Financially viable MFIs
1990s	+ Bancosol (1992, Bolivia) + CARD Bank opened (1997, Philippines)	- 1st Microcredit Summit (1997) - 2nd Microcredit Summit (2002)
2000s	+ K-Rep Bank established (1999, Kenya) + ACLEDA Bank opened (2000, Cambodia)	

Objectives of the Chapter

4. Though at its early stage of development, microfinance in Myanmar appears to be facing the first critical moment in its history. UNDP/UNOPS-supported microfinance projects, implemented by international NGOs (INGOs), have shown remarkable track records in outreach and organisational growth. Some other credit provision projects by INGOs and NGOs have begun experiments in urban and rural areas. Some banks are expressing interests in intervening in microenterprise markets, though with a limited scope. Cooperatives that are spread over the country include savings and credit activities of significant size, including services to farmers and poor people, which may imply a potential for incorporating microfinance technologies. On the other hand, Myanmar policymakers are yet at the very entrance of exposure to the microfinance world: No institutional effort has yet been organised in the government, and the lack of information is particularly severe.

5. Such an informational problem in Myanmar appears to be a serious impediment for the emerging microfinance to take off toward a sustainable financial system: Donors and international organisations are absent except UNDP/UNOPS and some INGOs, and in-flows of information as well as resource persons and experts are extremely limited in number. On the other hand, any success or failure in microfinance can nowadays be shared surprisingly

fast among practitioners and policymakers almost anywhere in the world, thanks to the Internet and increased opportunities to learn. In this regard, latecomer countries such as Myanmar, may not be disadvantageous *a priori*; however, they must lag far behind once there is an informational disadvantage.

6. While considering the current phase of microfinance development in Myanmar, this chapter, incorporating findings of a literature survey and the authors' interviews in other countries, explores worldwide experiences and arguments on major issues that arise in the transitional period of microfinance. The ultimate objective is to expose Myanmar policymakers to a set of core issues categorised in two groups: conditions regarded as musts for microfinance development and others that are optional, depending on individual countries' objectives. In the following, section II discusses issues of the institutionalisation process, and section III the governance of MFIs. Section IV deals with policy issues, in particular focusing on the legal and regulatory framework for microfinance, followed by section V, which discusses the importance of national strategy on microfinance development.

2. Institutionalisation Process of Microfinance

2.1 Stages of Development

7. In microfinance, 'project' status of microfinance means that the programme is protected from various risks that are inherent in a particular country's environment—be they political, social, or economic. Legal cover for projects is in place, often under special agreements between the government and donors. Funds are often available through donor grants or at a conssessional interest rate, and often international expatriates either directly lead or supervise the management. These conditions are necessary at the initial stage of project-based MFIs, yet in order to be successful in the long term, microfinance operations need to move from dependence on donorship and toward self-ownership, whether public or private, fully utilising local human resources.

8. From the macro perspective, in order to establish effective financial systems for small economic players, a country needs a significant number of sound MFIs operating in a unique segment. This is only possible when certain development is seen in scale and quality among MFIs. In other words, it is when sizable microfinance operations are in place in one way or another, and their impact, whether economic or social, is significant enough for society, one can say that the microfinance industry is virtually established.

9. Whether or not such an *established* microfinance industry has to be *fully integrated* into the formal finance system in order to be effective in providing financial services to the poor is not necessarily be evident, because there are not yet enough examples of countries where the majority of microfinance services are provided from the formal financial sector. In other words, in most countries the majority of MFIs are still unlicensed NGOs or similar entities. However, the following observations seemingly support well our preoccupation that microfinance will become truly influential in a national economy only when MFIs are legalised, either within the existing legal framework or based on a new identical framework, and are regulated by the monetary authorities.
   - A licensed setting for MFIs, i.e., integration into the formal system in one way or another, is the only way that will permit massive and sustainable delivery of financial services to the poor and microenterprises that do not have access to the traditional banking sector.
   - Empirically, in countries where microfinance is developed, such as Indonesia, Bangladesh, and Bolivia and other Latin American countries, there is an apparent

tendency that MFIs are increasingly integrated into the formal financial sector, accompanied by development and transformation of the existing financial regulations.

10. Obviously, the process of institutionalisation and formalisation of the sector does not happen either over night or in any presupposed sequencing. Even in countries where microfinance programmes flourish with intervention by a number of NGOs, the integration of the microfinance sector into a formal financial system may lag. Conversely, there are some examples where microfinance programmes are relatively few but the effort to integrate MFIs into the formal financial system has begun at an early stage.

2.2 Evolutionary Process

11. For an unlicensed entity that extends financial services to the poor, legalisation is the first step in its transformation. In some countries, there is simply no legal structure under which such groups can lawfully provide loans to poor clients, so loans may be legally uncollectible in a strict sense unless such a structure is developed (Christen 2000, 2). Leaving them unlicensed inevitably brings to a halt their operations and may even lead to a prosecution. In the case of groups that are granted project status under special arrangements by the supervisory authorities, the legal cover will expire when such contractual arrangements come to an end. Thus, there are only two options: an organisation carrying out microfinance should identify a way to conform with the existing legal structure before the critical risk of discontinuation emerges, or the authorities make those entities' activities lawful, by either amending the existing legal structure or creating a new one.

12. Although this legalisation process is imperative, its timing and modalities are varied. Among donor-funded projects, some assume that obtaining a license is predetermined from the onset of the project implementation, and others do not. The means for absorbing microfinance organisations into the existing framework may be a law on NGOs, a law on corporations, a law on financial entities (for example, as finance companies or other non-bank financial institutions), or a law on indigenous groups such as credit unions or cooperatives (including regulations specific to any of them).

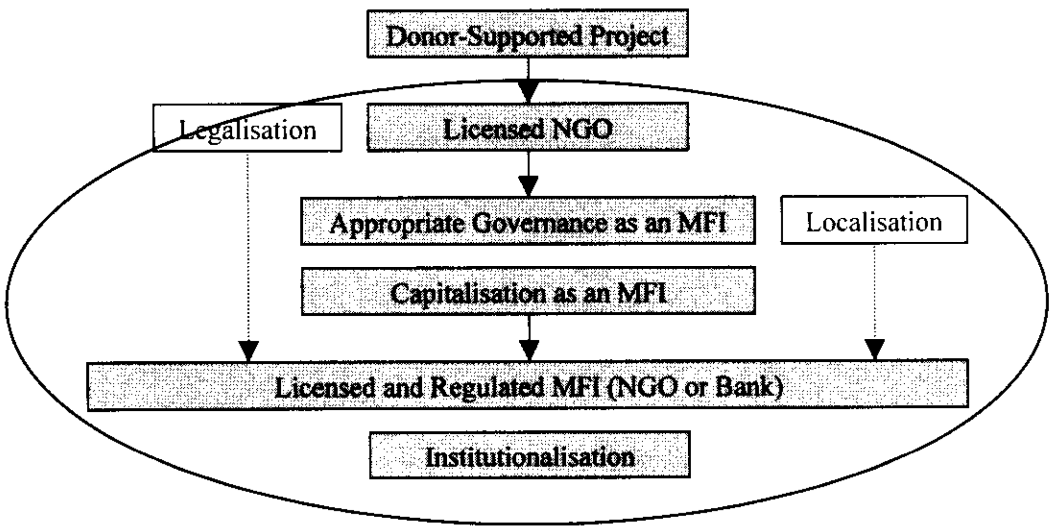
13. When granting legal status to microfinance organisations, important is a distinction between legality that allows them to continue and expand microfinance operations and a more elaborated framework that provides them with a financial licensing that is consistent with

regulations on formal financial institutions. Obviously, the development of legal and regulatory framework in the latter sense requires a lengthy process and capacity building of regulators; it is not realistic at all to expect such a comprehensive framework be built right away in countries where licensing to microfinance operations is not established yet. Moreover, quick creation of specific legal framework should not be envisaged since it most often involves a lot of deficiencies. These issues will be explored in section IV in a detailed manner.

14. Chart 1 illustrates the typical transformation process—we may call the overall process *institutionalisation* of microfinance, from the operator's viewpoint—in the case of an NGO that evolves from a project status funded by a donor toward a formal entity. The legalisation process starts when a microfinance NGO is formerly registered as an authorised entity to provide financial services to the public. *Localisation* proceeds accordingly in many organisational aspects, such as an exit from foreign technical assistance and creation of a board of directors consisting of local human resources, and thus the appropriate governance as an MFI is gradually attained; financially speaking, the capitalisation is to take place to sustain operations as a corporate entity. Once it is finally integrated into the financial system, the fully licensed and regulated MFI (either as a bank or NGO) is sustained.

Chart 1. A Typical Transerformation Process from Project to MFI

(an example)



15. In the current world, regulated MFIs are outnumbered by those unregulated, but the aggregate size of regulated MFIs seems to have already exceeded that of unregulated MFIs. According