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MICROFINANCE AND POVERTY REDUCTION IN MALAWI: WHAT HAS HAPPENED TO THE MICROFINANCE REVOLUTION?

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Abstract

Microfinance has been one of the strategies for poverty alleviation in developing countries. Following the success of the Grameen Bank in Bangladesh, the microfinance revolution has stormed the developing countries today. Although micro credit programmes in Malawi date from 1992, the proliferation of micro credit scheme or microfinance institutions began after the democratic process in 1994. Today, Malawi has several governmental and non-governmental organizations offering financial services to the poor. Most of these institutions operate localised and targeted programmes, and very few are operating at a national scale. Microfinance institutions in Malawi are largely unregulated and their programmes are not coordinated and accessibility to their services is not universal to the poor. With improvements in the policy environment, the Malawi Microfinance Network (MAMN) has been established as a formal association of microfinance institutions with the objective of developing, promoting, coordinating and regulating micro finance activities among member institutions. However, the financial performance of microfinance institutions and their impact on poverty reduction are not adequately documented and known in Malawi, although the increase in micro credit programmes has been remarkable. This paper attempts to take stock of the microfinance or micro credit revolution in Malawi including assessment of factors of success and failure in the delivery of financial services to the poor and the efficacy and effectiveness of the existing institutional framework on poverty reduction.

1. Introduction

Poverty is one of the major problems confronting developing countries today and is at the centre of development policy. It is no surprise that the World Bank (2001) has chosen the theme of *Attacking Poverty* in its development report in which it is estimated that of the world's 6 billion people; 2.8 billion live on less than US$2 a day and 1.2 billion on less than US$1 a day in the 21st Century. Of the 1.2 billion who live on less than a dollar a day, 43.5 percent are in South Asia, 24.3 percent are in Sub-Saharan Africa and 23.2 percent are in East Asia and the Pacific. The World Bank (2001) also observes that poverty in developing countries is shifting toward South Asia and Sub-Saharan Africa. UNECA (1999) using a sample of African countries, find that 50.54 percent of the population in Sub-Saharan Africa while 22.33 percent in North Africa is below the poverty line, and poverty is higher in the rural areas compared with the urban areas. It is widely accepted that one major cause of poverty in developing countries is lack of access to productive capital, with formal financial institutions mostly excluding the poor in their lending activities. One strategy in many developing countries has been to promote access to credit facilities by establishing government owned agricultural banks and promoting non-governmental organizations that offer credit to the poor. Inspired by the success of the Grameen Bank in Bangladesh in reaching the poor, microfinance institutions using group-based lending are increasingly becoming important institutions in breaking the vicious circle of poverty in many developing countries today.

In Malawi, poverty is the main development problem confronting the government today since the transition from a single party dictatorship to a multiparty democracy. Although the fight against poverty pre-dates independence, efforts toward poverty alleviation have been intensified more recently. In 1995 the Malawi Government produced a policy framework for addressing poverty at a national scale against a background of poverty that was estimated at 54 percent of the population by the World Bank (1995). Similarly, the social and standard of living indicators in Malawi in the 1990s were not encouraging. In 1995, the infant mortality rate was estimated at 133 per live births, 48 percent of infants were stunted, 30 percent of infants were underweight and 48.4 percent of the population with access to safe sources of drinking water (Malawi Government/University of Malawi, 1995).

Against this background of poverty, there are several programmes implemented by the government, local and international non-governmental organizations with the aim of fighting poverty by targeting the most vulnerable groups in Malawi. These interventions include provision of farm input credit, provision of credit for income generating activities, food for work programmes and public works employment programmes. As a result of the policy emphasis on poverty, there has been a substantial growth in the number of microfinance institutions in Malawi offering financial services to the poor on various scales. Most of these microfinance institutions are operating within geographic areas, thereby making financial services not accessible to the poor universally. Despite these developments, recent statistics show little hope of improvement in poverty and development in Malawi. According to the World Bank (2001) in 1999 gross national product per capita in Malawi was estimated at US$190. The National Statistical Office (2000) report on estimates of poverty in Malawi reveals that 65.3 percent of Malawians are poor, with 29 percent barely surviving.[1] These

[1] Four main groups are identified as the most vulnerable in Malawi, namely: rural households with small land holdings, female-headed households, AIDS orphans and their relatives, and those who cannot care for themselves (World Bank, 2001). Machinjili et al. (1999) in a survey on the perception of poverty note that poverty in Malawi is associated with households that lack adequate incomes, employment opportunities, sufficient food, adequate shelter, adequate clothing, security, credit opportunities, adequate infrastructures, entrepreneurship spirit, inputs and transport facilities.

statistics suggesting a worsening situation of poverty in Malawi beg questions on whether the government and various institutions are doing enough in reducing poverty in Malawi.

If the linkage between microfinance and poverty reduction is a strong one, why did Malawi fail to reduce poverty during the past decade in which access to credit might have improved? What is the level of coordination and regulation of microfinance activities and is there a geographic concentration in terms of access to financial services for the poor? This paper attempts to take stock of the microfinance revolution in Malawi. It focuses on issues with respect to accessibility, the institutional framework and the impact of microfinance on poverty reduction and the strategies that may enhance accessibility and effectiveness of microfinance services in Malawi. The next section of the paper provides a brief overview of the theoretical and empirical link that exists between microfinance and poverty reduction. Section 3 discusses the microfinance revolution in Malawi providing a situation analysis before and after the political transition to multiparty democracy, including the policy developments. Section 4 concentrates on targeting and how credit policies and the institutional framework affect accessibility. Section 5 evaluates the performance of microfinance on poverty reduction and addresses the issue of whether the many institutions are doing too tittle in poverty reduction. Finally, section 6 provides concluding remarks and offers some future directions.

2. The Relationship between Microfinance and Poverty

Microfinance has become an important instrument for poverty alleviation in developing countries today. In many developing economies lack of savings and capital make it difficult for many poor to engage in self-employment and undertake productive employment-generating activities (Khandker, 1998). The widely held argument in the development economics literature is that formal credit markets tend to fail the poor due to the collateral requirements that the poor cannot satisfy and due to the belief that the incentives to repay for the poor are limited given the associated asymmetric information and high monitoring costs of micro individual borrowers (Hulme and Mosley, 1996; Ray, 1998).

Often, the poor rely on informal financial markets such as moneylenders and rotating savings and credit associations that have simpler terms of credit. However, the high cost of credit from the informal sector implies that the poor cannot gainfully invest in productive income-increasing activities. Interest rates charged by moneylenders in developing countries are several times higher than those in the formal financial market. For instance, Chipeta and Mkandawire (1991) observe that interest rates in the informal financial market in Malawi range from 300 to 1200 percent per annum, much higher than the interest rates in the formal financial sector. Coleman (1999) also notes that moneylenders in developing countries often charge annual interest rates of more than 100 percent.

Institutional credit or microfinance institutions provide a bridge between formal and informal financial markets in most developing economies by using innovative ways of delivering financial services to the poor. The innovations in the credit market introduced by the microfinance institutions include simpler delivery mechanisms and simple forms of collateral (or no collateral), the concept of peer group lending and joint liability, the promise of ongoing and increasing access to credit for borrowers who repay in time. Most institutions offer credit at highly subsidized interest rates, although in exceptional cases they match those of the informal markets.

Khandker et al. (1998) note that the objective of micro-credit programmes is to ease the credit constraints of households or to provide them with capital to invest in an activity; thereby increasing their income and consumption. Zeller and Sharma (2000) observe that there are three ways in which access to or lack of financial services can influence income and food consumption (food security) of households. The first is through income generation in which access to credit provides additional capital to enhance the level of the household's existing human, physical and social capital so as to earn more income or by increasing the risk-bearing capacity of households by investing in more risky and more profitable income generating activities. Secondly, improved access to financial services may reduce the holding of assets with lower risk-adjusted returns through more cost-effective assets and liabilities that reduce the cost for self-insurance. Finally, credit can directly be used to finance immediate consumption needs of the household. Households may stabilize their consumption in bad states of nature by adjusting their disposable income or liquidity through borrowing for consumption or borrowing for investment with the fungibility of credit the borrowed funds may be diverted to immediate consumption. Hulme and Mosley (1996) also demonstrate the link that exists between credit and poverty reduction is from new investments to the pattern of income change to poverty alleviation. Such a positive relationship depends on the profitability of the projects financed by the credit and their ability to generate direct and indirect employment.

World Bank (2001) notes that access to credit may help the poor avoid distress sales of assets and replace productive assets destroyed in a natural disaster. Thus, microfinance programmes help the poor households diversify their sources of income and reduces their vulnerability to income shocks. It is also noted that most of the micro-credit programmes are targeted at women or households headed by women (Otero and Rhyne, 1994; Hulme and Mosley, 1996; Khandker, 1998; Murdoch, 1999b; World Bank, 2001).

Although most microfinance institutions are far from achieving financial self-sufficiency, there is evidence that poor households participating in micro-credit programmes are benefiting in terms of positive effects on incomes and poverty, but seem to have limited effects on employment and technology (Otero and Rhyne, 1994; Hulme and Mosley, 1996b; Khandker, 1998; Murdoch, 1999b). Zaman (1999) in a survey of 1072 households of member and non-member borrowers from BRAC in Bangladesh finds that borrowing beyond a certain threshold increases income and reduces poverty. Pitt and Khandker (1998) examine the impact of participation in the Grameen Bank in Bangladesh on labour supply, schooling, household expenditures and assets, and find that household consumption expenditure increases by 18 units and 11 units for every 100 additional unit borrowed by women and men, respectively.

Khandker et al. (1998) further find evidence that the three main micro-credit programmes in Bangladesh have positive impacts on income, production, and employment, particularly in the rural non-farm sector. However, Coleman (1999) finds that programme loans have little impact on borrowers when self-selection and endogenous program placement biases are corrected and conclude that ignoring these biases significantly overestimate the impact of micro-credit on the livelihoods of borrowers.

There is a general agreement in the literature that most microfinance institutions target the moderate poor and vulnerable, and often households that are extremely poor are excluded from these innovative financial services. World Bank (2001) observes that most micro-credit programmes reach clients just above or just below the poverty line and expanding the client base to poorer households remains a challenge. Johnson and Rogaly (1997) contend that the appropriateness of micro-credit as a strategy for poverty reduction in the case of the poorest people is questionable. Hulme and

Mosley (1996) find that seven of the twelve micro-credit schemes had less than half of the borrowers below the poverty line. Park and Ren (2001) conclude that in the non-governmental organization programme the very rich are effectively excluded, but among eligible households rich and poor are equally likely to participate. However, in the mixed (non-governmental and government) programme eligibility restrictions do not seem to improve targeting of the poor, but the rich are likely to self-select out of the programme.

3. Evolution of Microfinance in Malawi

3.1 Initial Developments in Microfinance in Malawi

Credit outside the formal and informal financial system in Malawi pre-dates the colonial era. In 1958 the Nyasaland African Loans Board was established to offer cash or in kind (seeds and fertilizer) to Malawian farmers.[2] In 1964, the Central Loans Board with a secretariat in the Ministry of Finance superseded the Nyasaland African Loans Board. The launching of four Agricultural Development Projects in 1968 and the National Rural Development Programme (that led to the creation of Agricultural Development Divisions) in 1978 provided the conduit for extending the credit facilities nation-wide as a way of improving agricultural productivity through the provision of input loans. It is within this framework that the Smallholder Agricultural Credit Administration (SACA) was created in the Ministry of Agriculture in 1987. SACA's lending facilities were based on farmer's clubs with an average of twenty-six members with the joint liability concept supplemented by a security fund governing the *modus operandi* of financial services (Buckley, 1996).

The repayment performance of SACA was impressive with repayments rates between 1968 and 1984 being above 96 percent and between 1985 and 1990 being above 79 percent. This impressive performance was disrupted by the political instability in the 1991/92 season that led to the transition to multiparty democracy. The repayment rates in 1991/92 and 1992/93 seasons were down to 22 percent and 15.6 percent, respectively. While the drought in the 1991/92 season had contributed to difficulties in repayment, the political changes that were taking place during the transition period to a multiparty democracy eventually led to the collapse of SACA (Msukwa et al, 1994; Buckley, 1996). Msukwa et al. (1994) note that during political campaigns in the transition to multiparty democracy, opposition parties sent conflicting messages to farmers about the status of SACA credit to serve their political gains. For instance, in some political meetings farmers were told that those loans were supposed to be hand-outs and that there was no justification for farmers to pay back the loans. Chirwa (1997), in an econometric analysis of the SACA repayment crisis, finds strong correlation between the quality of information received by farmers and the probability of credit default in during the 1992/3 season.

Buckley (1996) rightly observes that SACA tended to focus on better-off farmers, typically with land holdings capable of producing a surplus above subsistence needs.[3] This implies that those smallholder farmers with less than 0.5 hectares and 0.5 - 1 hectare of land that produces only 25 percent and 75 percent of their food requirements, respectively, had no access to credit under SACA. This realization of the neglect of the rural 'poor' and 'core poor' motivated the

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[2] Buckley (1996) provides an excellent historical account of agricultural credit facilities in Malawi. Also see Chirwa (1997) and Msukwa (1994).

[3] As an agricultural credit scheme, crop sales from the previous season were assumed to be the principal source of resources to repay the loans.

establishment of a parallel rural finance institution, the Malawi Mudzi Fund (MMF), as a pilot project in Machinga and Mangochi district (Nyanda et al. 1995; Buckley, 1996). The design of the MMF was a replica of the Grameen Bank of Bangladesh and was registered in 1989 and became operational in 1990. Financial services were offered to a group of five women, with five groups forming a Mudzi Centre. The average loan size for a Mudzi borrower was MK222 in 1992. Unlike SACA, MMF in addition to credit provision, savings mobilization was an integral part of the financial services to the poor. Nonetheless, the coverage of this programme was limited due to its pilot nature. In 1990, MMF had 900 registered and active members but membership fell to 170 in 1991. However, in 1992 MMF membership increased to 337 and 617 in 1994 (Nyanda et al. 1995). In 1990, 73 percent of MMF members were female but since 1992 all members of MMF were women. The activities of MMF lasted up to 1994 and its operational activities were integrated into a new institution, the Malawi Rural Finance Company (MRFC), as a Mudzi Rural Financial Services Project (MRFSP) in 1995.[4]

3.2 The Expansion Phase

SACA and MMF were the only micro credit institutions that were available and accessible to the rural poor, with the later only concentrated in specific areas of the pilot districts and the former collapsed in 1992. The microfinance revolution in Malawi can be attributed to several developments. First, the development goal focused on poverty alleviation in 1990 following the implementation of Social Dimensions of Adjustment programme and the multiparty democracy system. The realization that structural adjustment programs need to have a social dimensions implied intervention in markets that were failing the poor. Second, the international popularity of the Grameen Bank and other microfinance institutions in Asia and Latin America in breaking the barriers to financial services for the poor provided the impetus for replication in other countries. Today, there are many micro credit schemes operating on various scales, operated by specialized microfinance institutions or relief-based or development-based non-governmental organization (NGOs) within their normal operations.[5] Although, there has been a proliferation of non-specialized credit granting NGOs in Malawi, the evidence in Latin America (Schmidt and Zeitinger, 1996) suggests that credit granting NGOs are neither efficient providers of loans nor nearer to achieving financial viability. Nonetheless, specialized microfinance institutions in Malawi are not many and even the few that are available do not operate national programmes; hence access to credit by the poor remains a major obstacle in the new democratic era.

Table 1 shows that the number of specialized microfinance institutions increased to five after democratisation from two before democratisation. According to a recent survey of microfinance institutions, MCI (2001) identified 17 organization that offer credit to micro and small enterprises for non-farm activities and 12 organizations offering credit to smallholder farmers for farm activities. Three new entries in the microfinance sector were international microfinance institutions with similar programmes in many parts of the developing world. There has also been emerging interest from international NGOs in the provision of micro credit to target beneficiaries of their integrated development projects. Local NGOs involved in the promotion of business enterprises among women also became involved in the provision of microfinance as an integral part of their

[4] The Malawi Rural Finance Company combined the activities of the Smallholder Agricultural Credit Administration and the Malawi Mudzi Fund.

[5] See Chirwa and Milner (1997) for food security and nutrition intervention projects with micro credit components in Malawi and Schmidt and Zeitinger (1996) the analysis of credit granting NGOs in Latin America.

development activities. However, due to the poor performance in the management of micro credit operations, some of the local NGOs no longer offer credit to their members.

Under the Social Dimensions of Adjustment project, the Malawi Government provided financial grants to government and non-governmental organizations to experiment on innovative ways of providing financial services to the poor while ensuring the financial sustainability of the revolving fund.[6] Mvula et al. (1997) evaluate several poverty-oriented micro credit programmes operated by specialized microfinance institutions and non-specialized credit granting NGOs. Chirwa et al. (1999) observe that many of the micro-credit institutions, particularly NGOs and government departments whose main line of business is not financial intermediation operate inefficiently due to capacity constraints - in terms of qualified human resources, outreach networks, physical and financial resources.

Table 1
Number of Microfinance Institutions and Credit-Granting NGOs in Malawi, Before and After Democratisation [a]

Type of Institution	*Before Democratisation (1964 - 1993)*	*After Democratisation (1994 - date)*	*Current Number in Operation 2001*
Microfinance Institutions			
State-owned MFIs	2	1	3
Private Local MFIs	1	1	1
International MFIs	0	3	3
Credit-Granting NGOs			
Government Departments [b]	3	2	2
Local NGOs	3	0	1
International NGOs	0	6	6
Total	7	13	16

Notes: a. Microfinance institutions are those whose principal service is to provide financial services to the poor or micro enterprises.
b. Facilitates group formation and link groups to Commercial Banks or specialized microfinance institutions.

The Ministry of Gender, Youth and Community Services (MoGYCS) has also been active in organizing women in rural areas and linking them to microfinance institutions or the formal banking system under the Promotion of Micro-Enterprises for Rural Women (PMERW) credit program. Although the program started in 1986 within the context of a development program, a well structured group-based credit program was introduced in 1991 (Diagne et al., 1996). In 1993, PMERW was linked to Commercial Bank of Malawi with the MoGYCS guaranteeing up to 70 percent through a fund maintained at Commercial Bank. PMERW was operated in selected pilot districts of Rumphi, Nkhotakota and Mangochi.

[6] See Mvula et al. (1997) and Chirwa et al. (1999).

Apart from the PMERW, the MoGYCS also established credit guarantee funds under the Women in Development (WID) and Gender and Development (GAD) projects funded by the World Bank and African Development Bank, respectively. The credit guarantee fund under WID was first established in 1996 in Mzimba and Dedza districts and subsequently was expanded to Karonga, Kasungu, Dowa, Mchinji, Lilongwe and Chiradzulu (Mvula et al., 2000). Each district was allocated a guarantee fund amounting to K150,000 deposited in a fixed deposit account with local National Bank branches. Group members were in turn offered loans directly by National Bank, while MoGYCS assumed the role of training and monitoring beneficiaries.

In September 2000 the MoGYCS commenced a ten year Economic Activities Programme (EAP) under the financial support from the Deutsche Gesellschaft für Technische Zusammenarbeit GmbH (GTZ) and the British Department for International Development (DFID). This programme was intended to integrate the previous three programmes. The EAP is a nation-wide economic activities program that replaced the PMERW and links women groups to microfinance institutions and Commercial Bank. It offers extension services including business management training and links the poor in the rural areas to microfinance institutions. The EAP is currently being implemented in eight districts, namely: Rumphi, Nkhatabay, Nkhotakota, Kasungu, Mchinji, Mangochi, Zomba and Thyolo (ECI, 2002).

The underdevelopment of microfinance institutions at the beginning of the multiparty democracy era in 1994, prompted the government to institute desperate measures to address accessibility to micro credit by the poor. First, the government provided K50,000.00 grants to Members of Parliament (excluding Malawi Congress Party members) as a loan fund for their constituency for which the Member of Parliament.[7] These funds have never been accounted for and it is not known to-date the extent to which the funds were made accessible to the poor. According to the ***Weekend Nation*** (2001), there is a general belief among people in Malawi that the money given to Members of Parliament to set up revolving funds in their constituency to promote small businesses never reached the intended beneficiaries partly due to lack of monitoring mechanisms. Indeed, there is no evidence that any of the Members of Parliament has accounted for the fund and reported to Parliament on the continued existence and growth of the revolving fund in their constituency.

Secondly, government established a Small and Medium Enterprise Fund (SMEF) with the Reserve Bank for lending through participating financial and non-financial institutions at highly subsidized interest rates. Despite lessons from the SACA crisis with respect to political interference, SMEF was highly politicized and political expediency, at the expense of financial and credit principles, determined the expansion of the credit scheme. The Development of Malawian Enterprises Trust (DEMAT) was the main institutions for the disbursement of loans. However, as Chirwa et al. (1997) note DEMAT had no previous experience in lending operations and had serious capacity constraints to mount a national credit programme. The Small Enterprise Development Organization (SEDOM) also started the micro finance programme under SMEF. Two main credit-granting NGOs (NABW and WWB) were also involved in lending operations based on funding from SMEF. These NGOs too were grossly wanting in terms of project personnel, branch networks and transport facilities, yet the coverage under the scheme was national. This experimentation led to disastrous consequences,

[7] Apparently, these grants were given silently to some Members of Parliament, but were justified as capital revolving funds accessible to the poor in the constituency when the members of the Press queried the rationale for the money. It is believed that these K50,000 were a reward to Members of Parliament in the United Democratic Front/Alliance for Democracy alliance.

with most loans being written off due to high defaults. Some of the participating institutions could not even account for the funds and some could not even trace the borrowers.

3.3 The Policy and Regulatory Environment

The growth of the microfinance sector and the central role it is playing in the development of the micro and small scale enterprises in Malawi had prompted the government to address the questions about a conducive environment for promoting microfinance institutions and the regulatory framework to promote best practice approaches in the provision of financial services to the poor. The Ministry of Commerce and Industry (MCI), which is responsible for the development of micro and small scale enterprises sector, with financial assistance from the United Nations Development Programme (UNDP) through the Enterprise Development and Employment Creation Programme embarked on a consultative process of developing a microfinance policy and the regulatory framework (Makoza et al., 2002). The process began with the National Forum on Microfinance in 1997, with subsequent establishment of the Task Force on Microfinance in 1998 (MAMN, 2001). The main mandate of the Task Force on Microfinance was to develop mechanisms and institutional processes that would guide the sustainable development of the microfinance industry. The Task Force on Microfinance also provided a forum for MCI to review policies affecting micro and small enterprises and microfinance institutions in Malawi. Two major outputs have resulted from this process.

First, the Malawi Microfinance Network (MAMN), which began as an informal network of MFIs in Malawi, was established in 2000 as a membership registered professional association of microfinance institutions in Malawi. MAMN was officially launched in early 2002, and at the time of launch it had 12 MFIs as fully paid-up members. According to MAMN (2001: 5) the objectives MAMN are

> "To develop, promote and regulate microfinance activities so as to ensure good governance and practices among members as a way of ensuring their sustainability and enhancement of their capacities to stimulate and enhance private sector development and be key players in rural economic and social transformation in Malawi; and
>
> To facilitate the exchange of experiences, ideas, innovations, information and technologies to strengthen microfinance operations among member institutions, and build capacity within the sector as a whole."

Secondly, by 1999 the Government had drafted a Microfinance Policy (MCI, 1999). The policy has four main objectives. First, it seeks to improve the legal and regulatory framework and overall economic policies through the development of microfinance legislation and reviewing existing laws and developing regulatory and supervisory framework. Secondly, it seeks to improve the capacity of implementing institutions through the creation of a permanent training facility on microfinance. Thirdly, it seeks to promote best practices in the industry among MFIs, Government and the donor community through the development of a network of MFIs and the code of conduct for best practices, and privatization of government-owned MFIs. Such best practices include adoption of cost recovery interest rates, voluntary savings and aggressive loan collection mechanisms. Fourth, the policy seeks to increase the co-ordination among the various actors in the microfinance sector by encouraging donors to co-ordinate their capacity building efforts in collaboration with the government.

Most of these institutional developments were yet to be implemented in 2002. For instance, although the MAMN was formed in 2000 it was only launched in 2002 and had only 12 members out of an estimated 27 institutions offering micro credit for off-farm and farm activities. In addition, the Secretariat of MAMN was not yet established by mid-2002 and MAMN continued to be managed by the members on voluntary basis. The Microfinance Policy remains largely unimplemented, apart from the establishment of MAMN whose process was facilitated by the government. It is hoped that these institutional arrangements will help facilitate the development of a sustainable microfinance sector in Malawi in which best practices will be a rule rather than an exception.

While attempts to improve the policy and regulatory environment are bringing desirable results, the slow pace in the implementation of policy measures by the government implies that micro finance activities will remain unregulated and their activities poorly coordinated in the short and medium term. While many MFIs are expanding their programmes and many NGOs are including micro credit or savings as part of their integrated development programmes in the rural areas, very little is known about the impact of micro credit on poverty in Malawi. Thus, the proliferation of micro finance in Malawi is proceeding without establishing the marginal contribution of micro credit on poverty reduction.

4. Main Design Features of Microfinance Programs

The innovativeness of poverty-oriented financial intermediaries is manifested in the design of their micro credit programmes to the poor. Table 2 presents major design features and outreach for the main microfinance and credit granting NGOs in Malawi. Malawian institutions share many of the design features that characterize microfinance institutions around the world.[8]

First, almost all microfinance institutions and credit granting NGOs offer training of some sort on business and credit management, with other institutions making completion of training a precondition to access to credit. For example, FINCA only makes loans to new village banks or new village bank members after completion of six weeks training. In other institution, training is not a pre-condition for loans, such as the credit guarantee scheme under the women in development project of the Ministry of Gender, Youth and Community Services (Mvula et al., 2000). However, training is mainly emphasized for group-based lending and covers topics such as group formation and management, group liability and responsibility, loan management, business management and savings mobilization.

[8] See Hulme and Mosley (1996b), Otero and Rhyne (1994).

Table 2
Design Features of Microfinance and Credit Granting Institutions in Malawi, 2001/02

Institutions	Clients	Women (%)	Coverage (Districts)	Lending Method	Loan Schedule	Interest Rate per annum (%)	Loan Size per Client (Malawi Kwacha)	Savings	Client Training
Microfinance Institutions									
DEMAT	3,611	77	6	Group	Monthly	62	4,000 - 20,000	Yes	Yes
SEDOM	5,000	33	27	Group	Monthly	30	5,000 - 50,000	No	No
FINCA	16,561	100	12	Group	Fortnightly	72	3,000 - 8,000	Yes	Yes
MRFC/MRFSP	17,877	39	27	Group	Monthly	48 - 51	4,000 - 15,000	Yes	Yes
PRIDE AFRICA	3,900	35	5	Group	Weekly	40 - 60	5,000 - 100,000	Yes	Yes
UWCT - IO	3,500	85	1	Group	n.a	60 - 66	2,000 - 300,000	n.a	n.a
MUSCCO/SACCOs	66,110	26	27	Individual	Monthly	51 - 60	Variable	Yes	No
Government and NGOs									
MoGYCS	>3,000	100	8	Group	Monthly	53	2,000 - 7,000	Yes	Yes
Chikondano	400	60	1	Individual	Monthly	53	500 - 7,000	Yes	n.a
NABW	1,687	35	10	Group	Monthly	40 - 50	15,000 (max)	n.a	Yes
CARE International	700	100	3	Group	Weekly	120	200 - 5,000	Yes	Yes
Concern Universal	897	49	1	Group	Monthly	48	10,000 (max)	n.a	Yes
ECLOF	1,200	0	27	Group	n.a	57	50,000	n.a	n.a
Project Hope	1,319	100	3	Group	Fortnightly	n.a	1,000 - 5,000	Yes	Yes
SHDI	490	100	1	Group	Fortnightly	26	3,000	Yes	Yes
World Vision	3,500	41	5	Group	n.a	n.a	3,000 - 15,000	n.a	n.a

Notes: DEMAT = Development of Malawian Enterprises Trust, SEDOM = Small Enterprise Development Organization, FINCA = Foundation for International Community Assistance, MRFC/MRFSP = Malawi Rural Finance Company/ Mudzi Rural Financial Services Programme, UWCT - IO = Usiwa Watha Credit Trust, MUSCCO/SACCOs = Malawi Union of Savings and Credit Cooperative Organisation/ Savings and Credit Cooperative Organisations, MoGYCS = Ministry of Gender, Youth and Community Services, Chikondano = Chikondano Community Savings and Lending Organisation, NABW = National Association of Business Women, SHDI = Self-Help Development International.
n.a = Information not available.

Source: MCI (2001)

Second, the initial loans made to borrowers are usually small in microfinance institutions. The minimum loan size in 2001 was K200 in the CARE International scheme while the highest minimum was K5,000 for the SEDOM and PRIDE Africa microfinance schemes. In some cases, the small loan size is used as a targeting tool on the presumption that the non-poor are likely to be discouraged by the smallness of credit. In 1995, the average loan per FINCA village bank member was K550 (US$37), with the maximum allowable loan of K5,000. The maximum allowable loan in FINCA was K7,500 - K8,000 (Masanjala, 2002). Similarly, under the credit guarantee scheme of the WID project, Mvula et al. (2000) note that the maximum allowable loan for group based businesses was K15,000 while for individual businesses was K2,000 among the beneficiaries. Under the PMERW, individuals could borrow up to K1,000 from Commercial Bank (Diagne et al., 1996).

Third, there are variations in the need for savings as a precondition to access to credit in microfinance schemes. While in some microfinance schemes savings mobilization is an integral part of the financial services, others particularly credit granting NGOs place less emphasis on savings mobilisation. Actually, in the formal microfinance institutions such as FINCA and Mudzi Financial Services, and the credit guarantee programs of MoGYCS projects savings are made compulsory, before loans are extended to the group.

Fourth, the target groups of microfinance institution are mainly poor women. The loan portfolio of major microfinance institutions is among women borrowers. FINCA, MoGYCS, CARE International, Project Hope and SHDI exclusively offer financial services to women while Mudzi Financial Services offers credit to both women and men although a higher proportion of its clientele are women borrowers. The focus on women is based on the belief that women are discriminated against when it comes to credit allocation in the formal financial institutions and that financial constraints are more prevalent in businesses operated by women than those operated by men. The other reason for focusing on women is that they are more creditworthy than men.

Fifth, group-based lending is a substitute for collateral in many microfinance schemes in Malawi. The nonexistence of collateral requirements in microfinance schemes is the biggest innovation in the microfinance revolution. Access to credit is made difficult for the poor in formal financial institution because of the high collateral requirement such as marketable assets, which many poor people are not able to present to the financial institutions. Microfinance institutions use peer character reference and peer monitoring to secure the loans extended to group members through the concept of joint and several liability for loans contracted by group members.

Sixth, the other feature of microfinance schemes in Malawi is the structure of interest rates. At the beginning of the microfinance revolution in Malawi, there was a presumption that high interest rates will discourage participation in microfinance by the poor. Many of the credit schemes started with subsidized credit, offering credit at rates far more below those in the formal and informal financial markets. However, there has been a gradual shift in the paradigm with many microfinance institutions recognizing the need to sustain the programs through setting realistic interest rates for their services. The credit granting NGOs and the pilot phase of the Malawi Mudzi Fund were trapped in offering cheap credit to their beneficiaries, and as a result such programs were only sustained through massive injections of donor funds. Chirwa (1998) finds that, in order to eliminate the subsidy, MMF was supposed to charge interest rates in the range of 752 percent instead of the 18.5 percent applied on its loans in 1993.

Nonetheless, other microfinance institutions or micro credit schemes started with interest rates equivalent or above those prevailing in the formal financial system, and most microfinance institutions are charging commercial interest rates. For instance, FINCA started with commercial interest rates on its loans which are repayable on fortnightly basis over a period of 16 weeks while Mudzi Rural Financial Services Project (since the incorporation of MMF into MRFC) also charges commercial rates on its loans that are repayable on weekly basis over twenty-five weeks. In 1997 FINCA clients were charged an annual interest rate of 52 percent, while the prevailing interest rate in the commercial banking sector was 48 percent per annum (Masanjala, 2002). Commercial interest rates also applied in the credit guarantee funds in the Ministry of Gender, Youth and Community Services, and loans were repaid on monthly basis over a period of one year with a 3 month grace period. Although some of the microfinance institutions charge commercial rates, the administration costs of offering financial services remain high. For example, FINCA charged 3 percent above the formal financial institutions' lending rate, but the subsidy index implied effective nominal lending rates of 472 percent and 156 percent per annum in 1995 and 1996, respectively (Chirwa, 1999). The other aspect of the design features of micro credit in Malawi is the popularity of monthly repayment schedules. There are a few exceptions, with FINCA, Project Hope and SHDI using fortnightly repayment schedule while PRIDE Africa and CARE International uses a weekly repayment schedule.

The outreach of the micro credit schemes is limited given the size of the micro and small enterprise sector in Malawi. This limited outreach results from the limited geographic coverage of these credit schemes. Most operate in a few districts and very few are national programmes, as can be seen from Table 2. Only 4 out of the 16 credit schemes operate national programmes while many operate in less than ten districts. But as observed above, even the programmes that operate at national scale are hardly accessible to micro and small enterprises. Accessibility to financial services for the poor therefore remains the unresolved constraint of micro and small scale enterprises. According to the survey of micro and small enterprises, lack of finance for investments remains the most important constraint of business growth among Malawian micro enterprises (ECI/NSO, 2000). This problem is closely related to lack of accessibility to micro credit, a problem which seems to have worsened over time. For instance, ECI/NSO (2000) observe that 81 percent of micro and small scale enterprises in 1992 compared with 90.1 percent in 2000 had 'never received loans' for their business operations.

Table 3 presents the geographic distribution of micro and small scale enterprises with respect to access to credit facilities. The geographic disparity in accessibility and the extent of accessibility to credit facilities show that universal access to microfinance remains a daunting task in Malawi. Although MRFC operates a national program, the accessibility to its micro credit component is limited, with sample points in some districts without access to Mudzi Financial Services. Only 33 micro and small enterprises had access to credit in the national survey of micro and small enterprises. Similarly, the micro credit programme administered by FINCA is concentrated in the urban areas and peri-urban areas of major commercial cities of Blantyre and Lilongwe by design (Chirwa, 1999; Masanjala, 2002), although recently FINCA has expanded the programme to district towns. From the survey of micro and small scale enterprises, accessibility to micro credit is high in Blantyre and Lilongwe with respect to FINCA financial services. Pride Africa is a new institution in microfinance, and its facilities were only accessible in Blantyre. The role of credit granting NGOs appears to be limited. Of the 197 enterprises that had access to micro credit, 25 percent received credit from NGOs and the geographic distribution shows that most of these programmes are localized in nature.

Table 3
Access to Micro Credit by Micro and Small Enterprises by District, 2000
(Number of MSEs) [a]

District	*Microfinance Institutions*			*Credit Granting NGOs*				*Total*	*Total MSEs*
	MRFC [b]	*FINCA*	*Pride Africa*	*NABW*	*WWB*	*Concern Universal*	*Other NGOs*		
North									
Mzimba	5	4	0	2	0	0	0	11	370
Nkhatabay	0	1	0	0	0	0	0	1	134
Centre									
Kasungu	5	0	0	0	0	0	6	11	264
Salima	1	0	0	0	0	0	0	1	185
Dowa	1	0	0	0	0	0	3	4	86
Lilongwe	6	30	0	0	2	0	3	41	1040
Mchinji	1	0	0	0	0	0	7	8	175
Dedza	0	5	0	0	0	7	0	12	218
Ntcheu	1	8	0	1	0	0	0	10	280
South									
Balaka	1	0	0	0	0	0	0	1	68
Machinga	2	4	0	0	1	0	4	11	312
Zomba	5	5	0	0	0	0	0	10	280
Blantyre	2	44	7	0	0	0	5	58	1479
Mwanza	0	2	0	3	0	0	0	5	106
Mulanje	3	5	0	0	0	0	3	11	142
Total	**33**	**108**	**7**	**6**	**3**	**7**	**31**	**197**	**5,139**

Notes: a. Malawi Rural Finance Company (MRFC) - the Mudzi Rural Financial Services Project (MRFSP), *FINCA* = Foundation for International Community Assistance, *NABW* = National Association of Business Women, *WWB* = Women's World Banking and other NGOs include Farmer's World and Project Hope.

Data refers to the micro credit component of Malawi Rural Finance Company (MRFC) known as the Mudzi Rural Financial Services Project (MRFSP).

Source: Computed from ECI/NSO (2000) data.

Institutional Capacity, Effectiveness and Impact of Microfinance

The institutional arrangements and corporate governance in microfinance or micro credit institutions vary and are conditioned by the degree of specialization. Chirwa et al. (1999) evaluates the institutional setup and the capacity constraints facing the micro credit programs supported under the Social Dimensions of Adjustment project. The major finding in Chirwa et al. (1999) is that in most credit programs corporate governance and management was weak with most credit policies being poorly defined or with management having very little understanding of credit and business management issues. Most institutions with micro credit programs also faced several capacity constraints such as under-qualified human resources, inadequate personnel to match the scale of their programs, limited branch networks, inadequate physical assets and transport facilities and inadequate financial resources (Chirwa et al., 1996 and 1999). These capacity constraints were more severe in credit granting NGOs; partly due to the fact that these pursue multiple development goals and micro credit is a complementary service that is offered to the target group of their integrated development program. The capacity constraints were also evident in the WID credit guarantee scheme where Community Development Assistants (CDAs) with little or no training in the business management and credit management were vested with the role of advising and monitoring business enterprises operated by women (Mvula et al., 2000).

On the other hand, capacity constraints are not significant in specialized micro finance institutions such as FINCA and MRFC-MRFSP. As observed by Chirwa (1999) and Chirwa et al. (1999), FINCA employs project officers that are well qualified and the expansion of outreach is conditional on adequate personnel. This enables project officers to be in regular contact with beneficiaries for business advice and for conducting banking services. Similarly, MRFC maintain adequate personnel, specialized in business and credit advisory services, in their programme. Moreover, the charging of commercial interest rates enables the specialized microfinance institutions to reduce their dependency of donor funds.

The institutional capacity constraints and good corporate governance are reflected in the relative loan repayment performance in credit granting NGOs or government credit guarantee funds and microfinance institutions. Loan repayment performance in many NGO or government departments' credit programs is characterized by high default. Default rates in NGO and government credit programs in 1996 ranged from 57 percent to 84 percent, compared with less than 1 percent default in FINCA, one of the specialized microfinance institutions (Chirwa et al., 1999). Due to poor repayment performance, most of the NGO or government credit programs supported under the Social Dimensions of Adjustment were not sustainable and only two exist today, though operating ineffectively in their credit program.

Nonetheless, regardless of the degree of financial sustainability, the big question that needs to be answered is whether the micro credit programs in Malawi since the microfinance revolution has brought tangible results in improving the welfare of the beneficiaries. Thus, how effective are micro credit programs in reducing poverty in rural Malawi? Several studies on the impact of microfinance on the welfare of participants in Malawi exist. These studies can be classified into two groups - those that use the qualitative approach and those that quantify the impact.

The studies that qualitatively assess the impact of microfinance seek views, through participatory rural appraisal (PRA), from participants of the program on the changes that could be associated with participation in microfinance. Chirwa et al (1999) find that beneficiaries in credit schemes supported under the Social Dimensions of Adjustment project reported positive impact on food consumption and affordability of basic necessities. Similarly, in a study of the WID credit guarantee fund of the MoGYCS, 73.7 percent and 62.3 percent of the sample beneficiaries reported positive impact of participation on household income and expenditure on food (Mvula et al., 2000).

Apart from the revealed impact of credit programs based on qualitative assessment, there are three notable studies that have quantified the impact of micro credit schemes on welfare in Malawi. First, Hulme and Mosley (1996) in a study of the Malawi Mudzi Fund find evidence of a positive association between access to credit and increase in incomes. For instance, the average increases in incomes of participants in the MMF credit program as a percentage of the average income change of the control group (non-participants) was 117 percent. However, the increase in participants incomes were higher (9.1 percent) in families above the poverty line compared to a decline (-0.1 percent) among families below the poverty line.

Secondly, Diagne et al. (1996) analyse the impact of microfinance on technology adoption, incomes, household food security and household nutritional status in program areas covered by four microfinance institutions in Malawi. In this study, the extent of households' access to credit have positive multiplier effects on both seasonal non-farm (K1.50 additional income per capita for each additional Kwacha of credit) and annual total incomes (a marginal increase in income of K4 per capita). Similarly, in terms of household food security, Diagne et al. (1996) find an increase of 0.8 kcal in per capita daily intake for each additional Kwacha credit made available to the household. The results of the study also show a negative relationship between chronic malnutrition and access to credit.

Thirdly, and more recently, Masanjala (2002) in a survey of 359 participants and 93 nonparticipants in the FINCA find substantial differences in business expenditure and savings between participants and non-participants, with a higher average recorded for the latter than the former. However, the differences in the average business expenditure seem not to have translated into increases in food consumption expenditure. Masanjala (2002) suggests two reasons for the weak relationship between microfinance and food consumption expenditure. First, it is observed that the attrition rate in the FINCA programme is high, with village bank members rarely going beyond the third loan cycle (equivalent to 48 weeks), with the transition rate between the third and fourth cycle standing at 50 percent while over half of those that did not drop out at the end of the third cycle dropped out at the end of the fourth cycle. This high attrition rate implies that most of the participants in the village banks are relatively new, and with the short-term horizon of participation it is difficult to observe significant changes in the impact variable. Secondly, although savings among participants are high due to their compulsory nature, such savings are not freely available to savers for consumption spending during the client's membership tenure in the village bank.

Although, the body of evidence on the impact of microfinance on social welfare point to the positive impact on poverty, the empirical studies suffer from the problems of attribution and fungibility of loan funds, the non-randomness of borrower selection and the non-randomness of program placement. For example, can we attribute the positive impact on income to the amount of credit received or such improvements are a result of some other variables? Hulme (2000) argues that the major methodological problems that confront the impact assessment of microfinance on its main objective of poverty reduction, relate to the fungibility of cash loans meant for business investment and attributing the loans to the income output given the many intervening factors that may influence income.

6. Concluding Remarks

This paper has reviewed the institutional and policy developments that have taken place in the micro finance sector since independence. We have noted that micro credit programmes predate the colonial era and focused mainly on supporting smallholder farmers towards farming enterprises. However, with the international revolution in the use of micro credit in the promotion of non-farm activities, Malawi started piloting micro finance schemes in the late 1980s. Thus, during the one party political system, access to financial services by the poor was rather limited. The change in the political system in 1994 to a multi-party democracy created a conducive environment for the development of specialized micro finance institutions and for NGOs to introduce micro credit as an integral part of their development programmes in the rural areas. The number of specialized micro finance institutions supporting non-farm enterprises grew from 3 in the pre-democratisation period to 7 in the post-democratisation period. Similarly, the number of credit-granting NGOs grew from

6 to 9. The outreach has also expanded with some institutions operating national programmes, although accessibility to micro credit to the poor remains a problem.

In the policy area, the Government has drafted a policy supporting the development of a sustainable micro finance sector that is capable of self regulation and that could coordinate activities so as to maximize the benefits. One outcome of this process has been the establishment of the Malawi Microfinance Network, as a member organization for microfinance institutions with a constitution and a code of conduct for best practice lending and savings technologies for the poor. It is however, too early to tell the significance of such developments and on how they will affect the landscape for the micro finance sector.

While positive developments have taken place in the micro finance sector in the post-democratisation era, the existing institutions are far from satisfying the demand for such services and lack of financial resources will remain a major constraint in the expansion of micro and small business enterprises in Malawi. In addition, the existing micro finance institutions are grossly wanting in terms of human, physical and financial resources to enable them operate national programmes. Nonetheless, what is not known with certainty is the contribution the existing micro finance programmes in the reduction of poverty in Malawi and which micro finance programme design best suits the conditions in Malawi. These are areas that require further systematic research in order to better inform policy makers.

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