Making Access Possible

MWK

Malawi

Financial Inclusion Country Report

2014

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PARTNERING FOR A COMMON PURPOSE

Making Access Possible (MAP) is a multi-country initiative to support financial inclusion through a process of evidence-based country diagnostic and stakeholder dialogue, leading to the development of national financial inclusion roadmaps that identify key drivers of financial inclusion and recommended action. Through its design, MAP seeks to strengthen and focus the domestic development dialogue on financial inclusion. The global project seeks to engage with various other international platforms and entities impacting on financial inclusion, using the evidence gathered at the country level.

At country level, the core MAP partners collaborate with Government, other key stakeholders and donors to ensure an inclusive, holistic process. MAP Lesotho represents a partnership between the United Nations Capital Development Fund (UNCDF), the Centre for Financial Regulation and Inclusion (Cenfri) and FinMark Trust for the Development of a Strategic Framework for Financial Inclusion in Lesotho.

This report was produced by the FinMark Trust as part of the larger MAP diagnostic work.

The cover symbol

Through the MAP programme, we hope to effect real change at country level and see the impact of financial inclusion on broader national growth and development. The cover graphic features the Lotus, a flower synonymous with Malawi. The flower symbolises growth and development while the circle represents inclusive growth. Each flower is an example of the successful growth in a unique environment. By combining the flower with the currency symbol of Malawi we represent the characteristics of the country, linking financial inclusion with successful growth.

ABOUT MAP MALAWI

The MAP diagnostic presents a comprehensive analysis of the financial inclusion environment in Malawi as part of the Making Access Possible (MAP) Malawi initiative. This Summary report is derived from the complete diagnostic report and should be read together with that report. The Ministry of Finance formally requested MAP to inform its ongoing financial inclusion agenda. It was agreed that the MAP study will form the basis for the development of a multi-stakeholder roadmap for financial inclusion, in Malawi.

The MAP Diagnostic comprises a comprehensive country context, demand-side, supply-side and regulatory analysis. The supply-side analysis covers the markets for payments, savings, credit and insurance, respectively. Hence the report provides an understanding of access to financial services in a broad context. The demand-side component includes an analysis of access, usage, perceptions and attitudes of financial services by different target groups. The demand-side analysis draws from quantitative data provided by the Malawi FinScope Consumer Surveys conducted in 2008 and 2014, the Malawi FinScope MSME Survey 2012 and qualitative research in the form of individual immersive interviews.

The MAP methodology and process has been developed jointly by UNCDF, FinMark Trust (FMT) and the Centre for Financial Regulation and Inclusion (Cenfri) to improve financial inclusion to improve individual welfare and support inclusive growth.

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Finally, we would like to thank the various people we met with from government, financial services providers, industry bodies, technology providers, telecommunications operators and donor agencies for their time, the critical insights that guided this research and their efforts to extend financial services to the excluded.

List of Abbreviations and Acronyms

AML	Anti-Money Laundering
ATM	Automated Teller Machine
BTCA	Better Than Cash Alliance
CAHF	Centre for Affordable Housing Finance
CFT	Combatting Financing of Terrorism
FMB	First Merchant Bank
GDP	Gross Domestic Product
ID	Identification Document
MAP	Making Access Possible
MFI	Micro Finance Institution
MM4P	Mobile Money for the Poor
MMAP	Mobile Money Accelerator Programme
MNO	Mobile Network Operator
MSB	Malawi Savings Bank
MAMN	Malawi Microfinance Network
MSME	Micro, Small and Medium Enterprises
NASFAM	National Smallholder Farmers' Association of Malawi
NBM	National Bank of Malawi
NBS	New Building Society
NPS	National Payment System
OIBM	Opportunity International Bank of Malawi
POS	Point Of Sale
PPP	Purchasing Power Parity
SACCO	Savings And Credit Co-operative
SMEDI	Small and Medium Development Institute
UNCDF	United Nations Capital Development Fund
USD	United States Dollar
VSLA	Village Saving and Loan Association

USD/MWK Exchange Rate

Foreign exchange. The local currency in Malawi is the Malawi Kwacha (K). The United Stated Dollar (USD) equivalent shown throughout this document was calculated using a 12 month average exchange rate (between 1 January 2014 to 31 December 2014) of K 417/USD.

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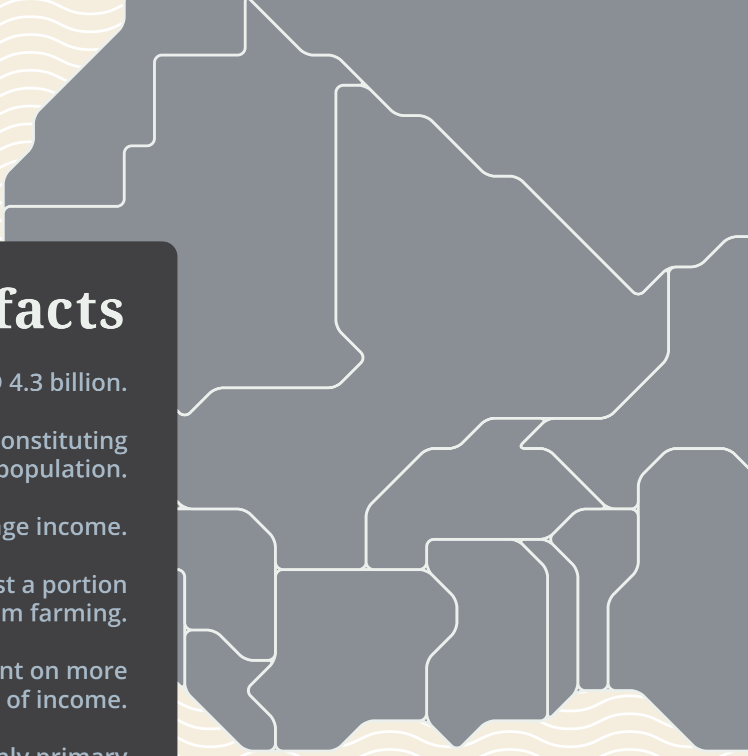
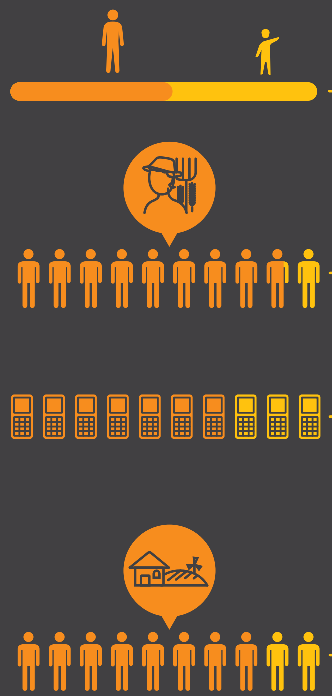


Key facts



Malawi has a GDP of USD 4.3 billion.

Total of 8 million adults, constituting half of the total population.

$1.10 per day average income.

88% of adults earn at least a portion of their income from farming.

Half of all adults are reliant on more than one source of income.

76% of adults have only primary education or less.

69% of adults have access to a mobile phone.

81% of adults live in rural areas.

Overview of Financial Access

34% of adults reported using at least one financial service from a formal financial service provider

2.6% of adults use more than two formal financial services

63% of urban adults use formal financial services compared with 28% of rural adults

14% of adults make use of informal services only

52% of adults report using no financial services

Financial Inclusion Priorities

PRIORITY AREAS 1:
EXPANDING THE REACH OF PAYMENTS
99.7% of all payments are made in cash.

PRIORITY AREA 2:
LEVERAGING VSLAS TO ENABLE SAVINGS
The number of adults saving in VSLAs grew by > 1 million between 2008 and 2014.

PRIORITY AREA 3:
TARGETED FINANCE FOR MSMES AND FARMERS
17% of driven achiever MSMEs have formal credit.

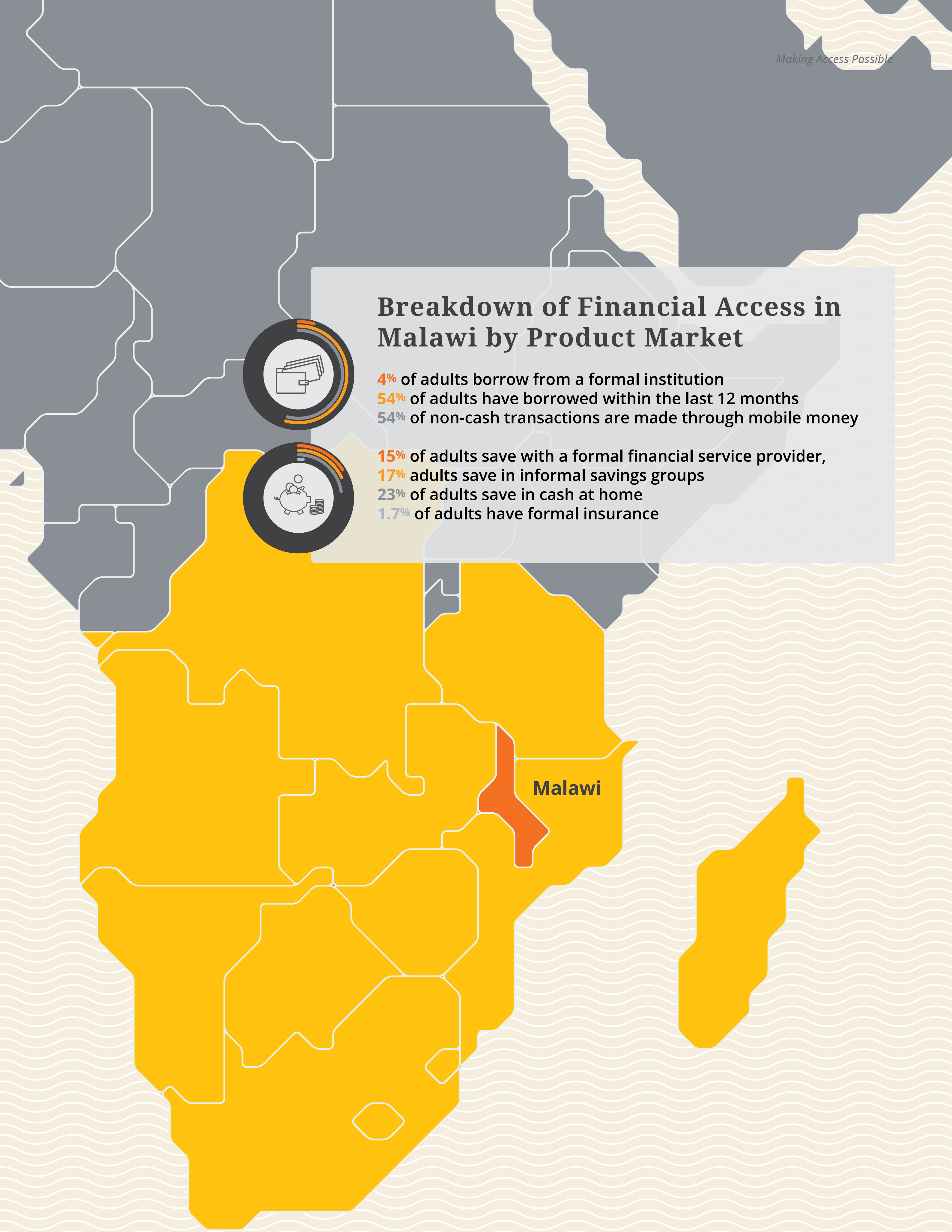
PRIORITY AREA 4:
NICHE INSURANCE OPPORTUNITIES
TO REDUCE VULNERABILITY
Only 11% of salaried employees report having insurance.

PRIORITY 5:
EFFECTIVE CONSUMER EMPOWERMENT AND EDUCATION
64% of adults have never heard of an ATM, 58% have never heard of a savings account.

Breakdown of Financial Access in Malawi by Product Market

4% of adults borrow from a formal institution
54% of adults have borrowed within the last 12 months
54% of non-cash transactions are made through mobile money

15% of adults save with a formal financial service provider,
17% adults save in informal savings groups
23% of adults save in cash at home
1.7% of adults have formal insurance



EXECUTIVE SUMMARY

Financial inclusion plays an important role to improve individual welfare and to achieve inclusive economic growth. MAP identifies priority areas to address barriers and leverage opportunities to improve financial inclusion, through a comprehensive analysis of the country context, demand, supply and regulation of financial services[1]. Given the different needs of different types of consumers in Malawi, adults are segmented into five target markets to better inform how financial services can meet needs[2].

Making Access Possible (MAP) is an evidence based multi-country initiative to support financial inclusion, conducted by the United Nations Capital Development Fund (UNCDF), FinMark Trust and the Centre for Financial Regulation and Inclusion (Cenfri), in consultation with the Ministry of Finance-led MAP Malawi Steering committee. MAP draws on extensive provider, government and consumer interviews, mystery shopping, an analysis of FinScope consumer data and a provider financial analysis in addition to secondary reports and data reviewed. The MAP diagnostic informs a roadmap that provides detailed and actionable steps to achieve the financial inclusion priorities.

Contextual challenges drive low levels of financial access. Formal financial access in Malawi is very limited and has seen little improvement over the past five years, over half the population remains excluded, despite a number of initiatives to develop the market. Informal financial service use has significantly increased in response to these challenges. Macro-economic, infrastructural, and political challenges are key drivers of this result and will need to be addressed to make substantial sustainable inroads into financial inclusion. These challenges are largely beyond the control of financial service stakeholders, but have a direct impact on the cost of provision, value of products to consumers and consumers' needs.

Rural provision restricted by poverty, infrastructure and reliance on rain fed agriculture. Lack of proximity to financial services is the key barrier to inclusion in Malawi. However the business case to serve rural people is limited given high levels of poverty, uncertain agricultural incomes and a high cost of distribution given limited infrastructure. The World Bank (2013) estimates that 72% of Malawians live on less than USD 1.25 (PPP) a day. 85% of Malawian adults live in rural areas and 88% of Malawians rely on farming to provide or supplement their income.

Priority needs relate to reliable payments, consumption smoothing and finance for MSMEs and farmers. Across the target markets, access to reliable and accessible payments and consumption smoothing tools are the key emerging financial service needs. Farmers and MSMEs would also benefit from access to finance to enhance their productivity.

Banks dominate, but focus on credit not transactions for revenue. Banks in Malawi dominate the financial services market, providing 92% of total credit and holding 89% of total deposits. Across the industry, banks primarily focus on interest and forex to drive revenue, with just 6% of revenue earned from fees and commissions. Low cost products are widely available, but distribution infrastructure is very limited, even in urban areas, which drives up the effective cost of access. There are 2.5 ATMs and 1.6 bank branches per 100,000 people. High infrastructure costs, low fee revenue on transactions and a lack of interoperability has limited banks' incentives to expand their distribution footprint. The new national switch (Nat-switch) can change this environment if appropriate interchange fees, that incentivise infrastructure investment by banks, are set.

Five priority areas emerge from the analysis of consumer needs and provider realities within the Malawi-specific context:

Expanding the reach of payments critical. 99% of transactions still occur in cash at significant expense to providers. Digitisation will require improved cash networks as an interim step. The lack of payments infrastructure makes it costly and time-consuming to access and use formal financial services. For most Malawians the cost to access bank infrastructure far outweighs the direct cost of a bank account (17% vs 2% of average income). Mobile money agents, the other major payments provider, also rely on payments infrastructure to maintain liquidity. Improving the payment eco-system is required to overcome the proximity barrier to financial inclusion and address affordability concerns across financial services. This requires revisiting bank incentives and partnerships, appropriate interchange fees, improvements in agent models and enactment of the National

Payment System regulation (including a requirement for interoperability).

Leveraging VSLAs to enable savings. Savings are critical in Malawi where formal credit interest rates can exceed 70% per annum. Savings are used to smooth consumption, mitigate risk or build capital for investment (housing or a business). VSLAs (Village Savings and Loan Associations) have had the greatest success in encouraging savings given the limited footprint of other providers. Membership grew by over 1 million adults between 2008 and 2014. In comparison, the number of adults saving in a bank grew by only 115,000 during the same period. Supporting and leveraging VSLA savings addresses proximity and affordability concerns. It also improves rural availability of credit to micro businesses and farming.

Targeted finance for MSMEs and farmers. MSMEs and farmer businesses are hampered by lack of affordable finance. Capital market development, macro-economic stability and judicial process reform relating to collateral realisation are required to bring down the cost of credit. In the interim, credit should be carefully targeted as only the most productive farmers and MSMEs can successfully absorb and use credit without becoming over-indebted. MFIs, as the main providers of such finance, should be further enabled. The credit reference bureaus can also play a role to reduce the cost of information on borrowers, but will be hampered by lack of national ID. Improvements to the MSME and agricultural support environment are key to enable more MSMEs and farmers to become sufficiently productive to benefit from credit. This includes finalising the MSME bill and a focus on agricultural value chain development with related financing for farmers.

Niche insurance opportunities to reduce vulnerability. Low income levels, reliance on rain fed agriculture and limited social safety nets make Malawians particularly vulnerable to risks. Savings will likely remain the primary tool to mitigate risks, given the cost of credit and lack of awareness of insurance. However there are specific opportunities to expand insurance usage, including health and life cover for salaried employees, insuring MFI loan portfolios against disaster risk, and raising insurance awareness. Microinsurance and health finance frameworks are needed to create an enabling environment. Some product and partnership innovations can also improve insurance use.

Effective consumer empowerment and education. Financial literacy levels are very low. Whilst this does not necessarily indicate low levels of financial capability, it does make it more challenging for consumers to engage with formal providers. A number of financial education initiatives have already been undertaken by both government and donors. The primary focus should therefore be to improve the coordination of existing programmes, refine their effectiveness and leverage gateway products such as remittances and VSLAs for education.

Critical institutions needed to drive priorities. Dedicated capacity will be required to drive financial inclusion. This will include addressing contextual factors and coordinating with relevant stakeholders including, amongst others, the Ministries of Agriculture, Telecommunications and Industry and Trade, and a range of donor initiatives.

PRIORITIES	ROADMAP AREAS FOR IMPLEMENTATION
Expanding the reach of payments	• *Develop the payment eco-system* • *Incentivise investment in distribution infrastructure through appropriate interchange fee or tax incentives* • *Develop partnerships to improve distribution* • *Develop mobile money and other agency models* • *Finalise NPS legislation, including interoperability*
Leveraging VSLAs to enable savings	• *Facilitate the establishment of new VSLAs and support existing VSLAs* • *Explore partnerships between VSLAs and formal providers*
Targeted finance for MSMEs and farmers	• *Reduce cost of credit over medium term* • *Support MFIs as the primary formal providers of MSME and agricultural finance* • *Improve credit information* • *Develop skills for MSMEs and farmers* • *Develop supporting environment for MSMEs and farmers*
Niche insurance opportunities to reduce vulnerabilities	• *Develop health finance and microinsurance frameworks* • *Explore partnership to extend distribution* • *Innovate product design, including payments*
Effective consumer empowerment and education	• *Improve coordination of existing programmes* • *Refine the effectiveness of programmes* • *Leverage gateway products such as remittances and VSLAs for education*

1 Rationale for MAP in Malawi

Large excluded population. FinScope (2014) indicates that more than half of all Malawi adults remain without access to any type of formal or informal financial service. This limits the ability of these Malawians to effectively manage their financial lives. It limits the capacity to mitigate against risks, smooth their consumption, accumulate assets and invest in productive activities. Access to financial services not only has the potential to enhance individuals' welfare but also helps to deliver on fundamental policy objectives including economic growth and employment generation, by better facilitating the growth of MSMEs and farmers, and improving human capital, by providing Malawians with the tools to purchase education, healthcare and appropriate nutrition.

Strong financial inclusion focus but lack of coordination. Malawi has had financial inclusion related policies in place since 2002 and is set to compile its third financial inclusion strategy within the next year. Concurrently, a number of donors have invested in a variety of financial inclusion-related projects. The result is that, whilst a number of interventions have been implemented, there is limited coordination and focus. MAP endeavours, by conducting a comprehensive diagnostic of the entire sector, to pinpoint those priority areas that will provide the greatest return on resources invested, for future inclusion strategies.

This note sets out the findings from the diagnostic analysis in order to identify the key priority action areas, given the existing environment, which will achieve the biggest ultimate impact on the attainment of Malawi's overall policy objectives, including household welfare, growth & employment and human capital development. It consolidates and summarises the underlying drivers of and constraints to financial inclusion, discusses the key needs of the different target markets and maps this against the current provider landscape. From this, five core areas are identified as priority areas for action and their role in achieving Malawi's overarching policy objectives is explained.

2 Drivers of financial inclusion

"The Malawi adult population is not a homogenous group."

What drives financial inclusion in any environment is determined by what consumers need and what providers are able and willing to provide. The nexus between supply and demand is the central foundation of any market, but these both exist within an overarching environment which shapes the needs of consumers and shapes and constrains provision. This section looks at the demand and supply for financial services in Malawi within the contextual environment in which they coexist. This allows the identification of unmet needs which can feasibly be addressed with the Malawian environment, in other words the key potential opportunities for increasing access to finance.

2.1. Target market needs

Priority focus areas determined by consumer needs. The needs of consumers guide the prioritisation of interventions. These are the financial services that in an unconstrained environment are most needed by Malawian adults. In reality, the market is constrained and this is considered in the final prioritisation of opportunities.

Disaggregation enables focus. The Malawi adult population is not a homogenous group. Needs and circumstances differ across various segments of the population. Figure 1 to the right indicates the demographic and financial access profile of the five financial services target markets that were identified by MAP.

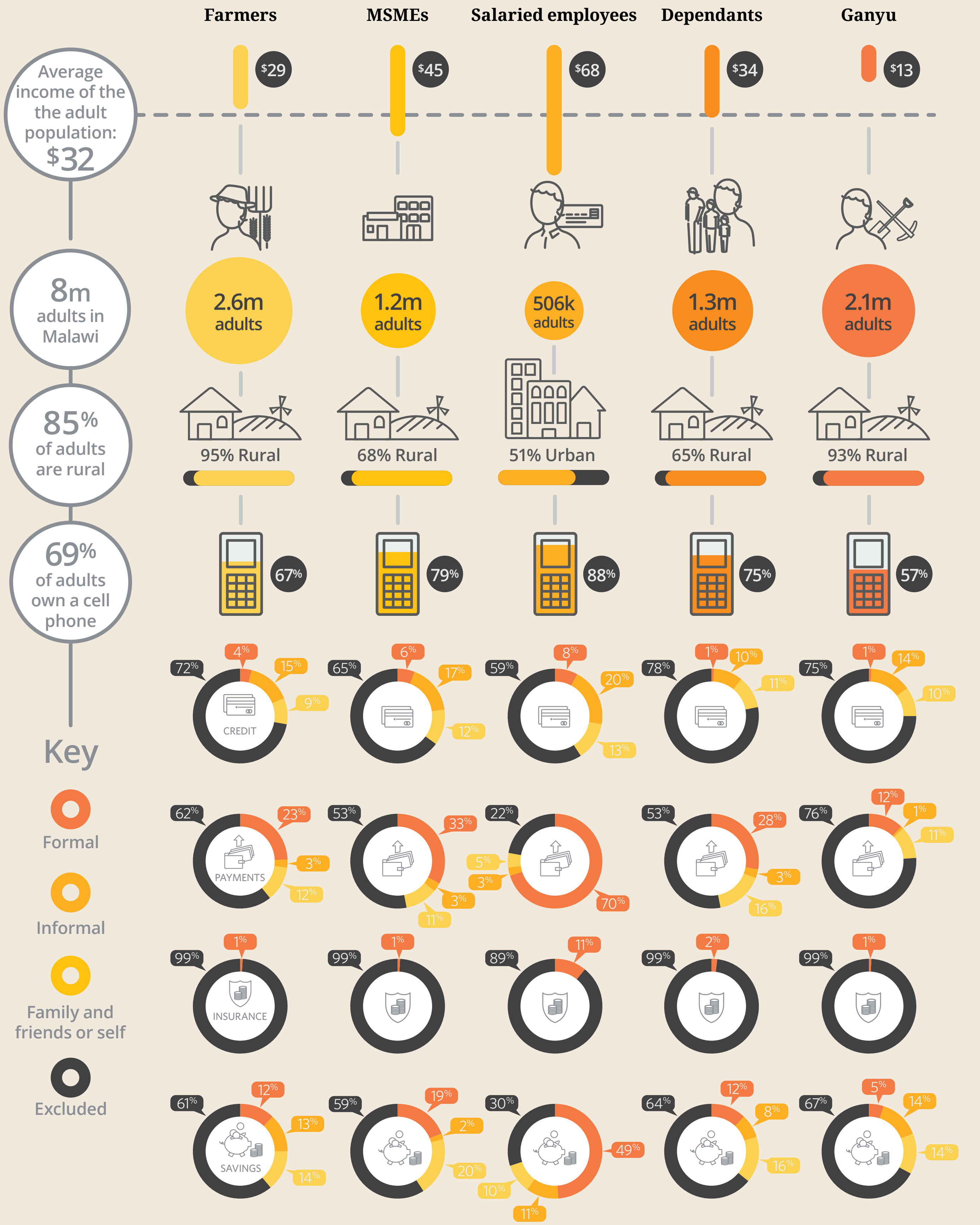
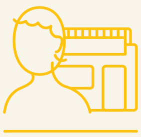


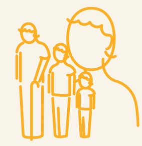
Figure 1: Target market infographic
Source: Malawi FinScope Consumer Survey 2014

• **Farmers** – are adults that obtain their income from farming or fishing activities. They are the biggest target market (33%) and mainly consist of small scale, non-commercial farmers.



• **MSMEs** – are adults that derive their main source of income from owning and running business. They are the second wealthiest target market and comprise approximately one sixth of the adult population.

• **Salaried employees** – are adults whose main source of income is salaried from a private or public institution. They are the wealthiest target market and live mostly in urban areas. This target market has the highest levels of education attainment and is the smallest in size.



• **Dependents** – are adults whose main source of income is from family and friends. This group mainly consists of adults who are dependent on a household member to pay their expenses or give the money. Also included in this target market are adults that receive money from friends or family outside of Malawi.

• **Ganyu** – are adults that engage in piecework for their main source of income. Similar to farmers, ganyu live mostly in rural areas.

This disaggregation allows us to focus on the different needs of different adult groups. The interventions to prioritise are based on what will meet the currently unmet needs of the largest number of Malawians balanced against the impact the intervention will have on the real economy.

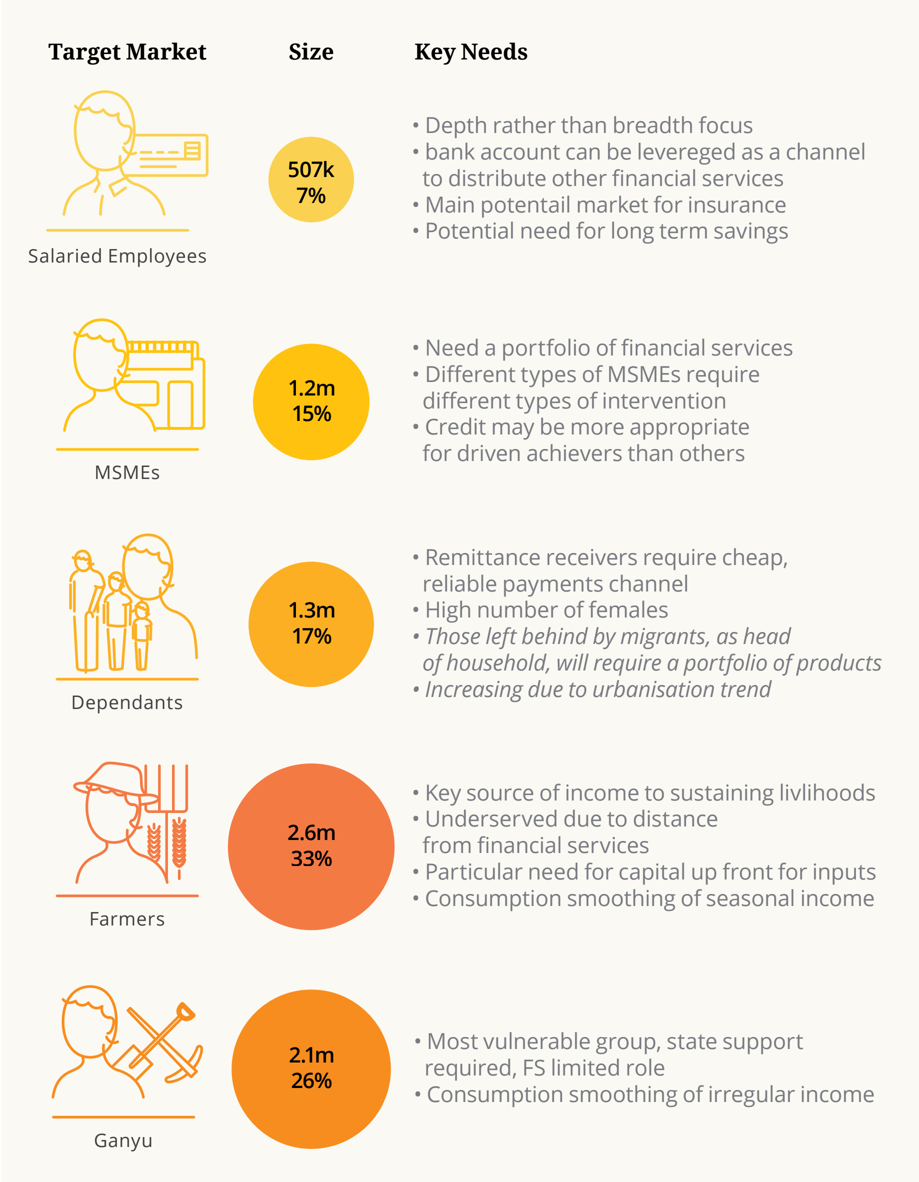


Figure 2: Key target market needs
Source: Authors' own

Different target markets have differing key needs. Figure 2 above summarises the key financial service needs of the different target markets. From this summary, it shows that the different target markets require different interventions and there are specific niche opportunities within each of the different target markets. However, the key needs consistent across a large number of Malawians and/or would have the greatest impact on the broader economy include:

- ***Reliable payments.*** Salaried employees, MSMEs, dependents and farmers all need reliable, affordable and accessible payments mechanisms in order to receive salaries and other income, pay suppliers or pay employees.
- ***Consumption smoothing.*** Both of the largest two target markets, the farmers and ganyu, require tools to smooth consumption between irregular or seasonal income as a key need. Many members of other target markets, such as dependents and MSMEs, would likely also benefit from consumption smoothing tools particularly in cases where remittances are irregularly received or business revenues are seasonal.
- ***Finance for MSMEs and farmers.*** Many MSMEs and farmers would benefit from capital financing, such as through the extension of credit, to enable them to invest in assets and inputs to enhance their productivity. This also has a contributory effect to the macroeconomic objectives through the contribution to GDP and employment generation from greater productivity.

2.2. Financial provider realities

Banks the largest providers of financial services. The banks directly provide savings, credit and payment services. Many also act as agents to distribute insurance. Banks account for more than 50% of the total institutional financial assets in the market (including pension funds and insurers). They provide 92% of total credit and 89% of total deposits in Malawi. Furthermore, according to FinScope (2014) banks serve more Malawians adults than any other financial service provider. 27% of adults use banks in some way for their financial services. In comparison, 17% of adults use other, non-bank, formal providers and 25% use informal providers. The result is that banks continue to dominate the financial services market and constitute the core of the provider landscape in Malawi. Hence the structure of this industry has critical direct and indirect impacts on the provision of all financial services.

Banks' business model is focused on interest, investment and forex revenue. The Malawi banking industry earns 57% of revenue from loans, 22% from forex revenue, 15% from investments and just 6% of revenue from fees and commissions. This low return from fees is due to the low fees charged to most customers for most basic banking services, such as cash deposits and withdrawals, and means that the strategic focus of the banks is not on the majority of their consumers but rather on the small number of their corporate clients that account for the majority of loans. The incentive to expand access to additional clients is therefore limited given the relatively small contribution to direct revenue. Collecting small value deposits is also operationally expensive outside of high population areas.

The number of different types of banks creates complexity in the market. Malawi has 11 different banks and these banks each follow different business models and strategies. We have clustered these banks into four different clusters based on these strategies and incentives:

- Cluster 1 consists of the two largest banks: NBM and Standard Bank. These two banks dominate the market and primarily compete with each other for corporate and high net worth individuals.
- Cluster 2 consists of the 2nd tier banks, including FMB, NBS, FDH, Indebank and CDH. These banks have a focus on a similar market to the big 2 banks but due to relative size and efficiency typically compete around the edges of cluster 1 – effectively dividing up the remainder of the commercial market between them.
- Cluster 3 consists of those banks with a developmental focus: MSB and OIBM. MSB as a partially owned government entity and OIBM as a wholly owned donor entity both have a development mandate and target lower income, individual consumers rather than the primarily corporate and high net worth focus of clusters 1 and 2.
- Cluster 4 consists of those banks which are wholly owned subsidiaries of foreign banks including Ecobank and Nedbank. These banks' primary focus is on servicing the needs of their foreign clients with business interests inside Malawi.

Sustainable provision difficult given levels of donor support. The development mandates of some providers risks creating distortion in financial service provision. These providers do not have the same incentives as purely profit-motivated providers. This allows them to provide financial services at relatively lower cost to consumers but also has the potential to distort the rest of the market by undercutting competitors. In Malawi, unsustainably low prices charged on banks' fees and transactions eliminate the business case for unsubsidised providers to invest in new infrastructure and thereby reduces the incentive to focus on expanding the reach of provision. This means that access to most providers entails high travel costs for most Malawians.

Mobile money has potential to extend reach but still reliant on bank infrastructure. The recent entrance of mobile money represents an opportunity to extend the reach of formal financial services more broadly at lower cost than traditional distribution channels offer. Despite initially rapid uptake, the growth in the subscriber base slowed in 2014 and only 20% of subscribers are active users. Two of the primary challenges that the operators face is related to the effective development of the agent network. A limited business case for agents means that as much as two-thirds of agents are dormant, undermining the greatest benefit derived from the service. Secondly, liquidity constraints have limited the reach into the more remote areas of Malawi as agents need access to a reliable source of cash in order to continually manage their cash requirements to meet their customers' needs. Therefore the limited reach of banks' cash infrastructure has constrained the reach of the product and harmed the consumer experience of the product in areas where agents have struggled to maintain sufficient liquidity.

Informal providers are popular financial service providers. As mentioned above, 25% of Malawi adults report using informal financial services (FinScope, 2014). The majority of these are members of Village Savings and Loans Associations (VSLAs). Across all types of financial service providers, VSLAs have had the biggest impact on the extension of financial services over the last 5-10 years.

Low financial literacy increases cost of provision. Across formal providers, the lack of financial literacy amongst consumers is a concern. Low levels of financial literacy increase the cost of provision as providers are then forced to spend more time on each client to explain how the products work and there is a much higher risk of misselling. In the insurance market, FinScope (2014) indicates that 84% of adults are unaware of insurance, which means that effective distribution of the product requires a great deal of education and marketing simply to build basic awareness of the product and its benefits.

2.3. Key environmental conditioning factors

The analysis highlights a number of cross-cutting factors that shape the development path for financial inclusion, as well as its role in achieving broader policy objectives, in Malawi. These factors relate to the distinct target market socio-economic conditions, regulatory environment and the economic realities that shape the interplay between individuals and entities existing in the formal and informal worlds. This provides the context of what kind of interventions may be feasible to extend financial inclusion.

Deficient Infrastructure development. Malawi suffers from inadequate provision of both physical and institutional infrastructure:

- The World Economic Forum (2014) ranked the overall quality of the country's infrastructure 118th out of 144 countries. The road and railway networks are limited, only 8.7% of Malawians have access to electricity (World Bank, 2010), the country's irrigation network reaches 0.53% of all agricultural land (World Bank, 2008) and the telecommunications network is frequently unreliable.
- The established institutional infrastructure is similarly poor. An ineffective judiciary means that cases often take years to be settled, and even when they are judgements are not infrequently ignored. Malawi is ranked 154th out of 189 countries for enforcing contracts (World Bank, 2014). Additionally 90% of land in Malawi is customary land and there are currently no defined laws that oversee the property rights of customary land (CAHF, 2014). There is also no central population register and as a result no national ID for Malawi citizens.

The lack of both physical and institutional infrastructure drives up the cost of operations for financial service providers and makes it challenging to reach potential customers, particularly outside of urban areas where most physical infrastructure is located. The costs of extending their own infrastructure is often cripplingly expensive whilst their inability to enforce contracts and find clients, without a national ID, further adds to operating risk and therefore cost for financial service providers. The lack of physical infrastructure also has a direct impact on the cost for customers to access financial services.

Macroeconomic volatility creates uncertainty, increases cost and reduces value of financial products. Volatility in year-to-year GDP growth rates, an inflation rate in excess of 20%, a rapidly depreciating currency and an economy heavily reliant on primary commodities and therefore vulnerable to exogenous price shocks and natural disasters all contribute to a macro-environment of uncertainty and therefore risk for financial service providers. The high inflation rates also undermine the value of savings and the high lending rates make credit unaffordable for Malawians.

Political corruption and inefficiency adds to environmental uncertainty. Illicit activities, particularly related to donor funding has eroded the credibility and authority of the government. Meanwhile, the donor response after each episode to remove funding creates a shock to the economy as a large portion of Government's budget is removed. In 2012, 37% of the budget was funded through grants from various donors, in 2013 this fell to 12%. Improved consistency in policies and coordination across departments is also required to improve certainty.

Widespread poverty, low education and health levels shape Malawian society. The World Bank (2013) estimates that 72% of Malawians live on less than $1.25 (PPP) a day. The broad based nature of this extreme poverty has a number of effects on the society:

- The low income levels adversely affect educational attainment. The direct and indirect costs of education make it unaffordable for many Malawian families. The result is that the adult literacy rate is just 61% (World Bank, 2010) and less than 3% of adults have some form of tertiary education (FinScope, 2014). This limits the ability for Malawians to use and benefit from financial services. This problem is particularly acute for MSMEs and farmers as they lack the skills to effectively benefit from access to finance.
- The inability to pay for healthcare and even basic nutrition harms health outcomes. Whilst a higher level of public resources invested in healthcare has reduced customer's out-of-pocket expenditures and concomitantly improved a number of health indicators, many Malawians struggle to meet these reduced costs or even the transport costs to the closest hospital. Furthermore, this level of poverty has a direct link to the prevalent malnutrition found in Malawi society. Improved access to financial products that enable Malawians to mitigate risk and to smooth consumption can help reduce the impact of major risk events and improve health outcomes
- Crime and social disorder is a growing concern. The struggle to survive from day to day for the majority of Malawians creates an incentive to engage in criminal activities, particularly in the form of petty theft. Additionally, this constant struggle has prompted growing levels of alcohol abuse, which in turn have been linked to a number of major crimes. This creates a need for a secure means with which to easily store value.
- The low incomes also mean that Malawians live on short term budgets with limited disposable income. This makes even inexpensive financial products often unaffordable for many Malawians.

Malawian economy heavily reliant on agriculture. Agriculture accounts for 32.1% of GDP, 80% of exports (Ministry of Finance, Economic Planning and Development, 2014) and 89% of adults are involved in farming or fishing (FinScope, 2014). In other words, agriculture is the pervasive economic activity in Malawi and nearly all adults *"rural Malawians will be forced to move to urban areas or face worsening rural poverty as more people survive on smaller pieces of land."*

are at least partially reliant on it for their income. This has a number of important implications for Malawi's economy and for society:

- The high reliance on agriculture leaves the economy vulnerable to price shocks as prices are externally determined and to the risk of natural disasters locally. The over-reliance on agriculture is therefore the primary cause of macroeconomic volatility.
- The widespread reliance on farming for income means that a portion of most Malawians' income is non-monetised and therefore not captured by income measures. Hence the traditional poverty measures are inflated as most Malawians are able to supplement their basic income with produce they have grown themselves. However, given the vulnerability of the sector to natural disaster, it also raises the need for available coping mechanisms.
- The majority of the population live on farms in rural areas. With most physical financial services infrastructure located in urban areas, this means that the majority of Malawians must incur high transport costs in order to access most formal financial services.
- Restrictions on land tenure and frequent export bans on major crops both reduce the incentive for investment in Malawi's primary industry.

Increasing population pressure in rural areas expected to continue to drive urbanisation and migration. Malawi is the 8th most densely populated country in Africa and the population growth rate is 2.8% p.a. (World Bank, 2015). This places enormous pressure on the land, particularly in such an agrarian economy. The result has been that average farm sizes have significantly decreased in a generation. The result is that increasingly rural Malawians will be forced to move to urban areas or face worsening rural poverty as more people survive on smaller pieces of land. The current rate of urbanisation is 3.75% (CAHF, 2014), indicating a growing migration trend. As the rural population and resulting the pressure on rural areas continues to rise, it is expected that this trend will continue as rural dwellers move to urban areas, both within and outside of Malawi, in search of economic opportunities. One result of this trend will be an increasing need for reliable long distance money transfer payments as migrants need to send income back to dependents left behind. Secondly, those dependents, frequently women, left behind will require an increased portfolio of financial services to meet their needs as the new heads of households.

What does this mean?

Priority focus areas shaped by environmental drivers. The majority of the financial inclusion drivers identified above are situated at the national level. Many constrain the environment in which financial services can be provided and most require major, long-term investment and focus to fully resolve. The approach to expanding access to financial services needs to reduce these constraints and improve the conduciveness of the environment for the provision of financial services. However, much of this is beyond the scope of a financial inclusion policy and therefore this diagnostic identifies those areas that can return the greatest impact on consumer welfare and the real economy, based on consumers' needs and the provider environment, working within these constraints.

Limited distributional reach of financial services providers the primary constraint emerging. The greatest constraint in access identified is the limitations in the reach of formal financial services. Access to reliable payments are identified as a key need across the target markets but due to the rural population, the limitations in infrastructural development and certain market distortions, the distribution network of most formal providers is limited exclusively to the urban areas and therefore the 85% of Malawians that live in rural areas must accrue high travel costs in order to use financial services. This also restricts the ability to send formal remittances to recipients in rural areas as this forces them to travel, at great cost, to receive the payment.

Savings left as the only viable financial service tool for most Malawians. Given the existing macroeconomic volatility and high inflation rate, credit offers very poor value with the high lending rates make credit too expensive for it to have a net beneficial effect on most Malawians in most cases. At best, there is an opportunity to target credit towards niche targets with a greater ability to effectively use it. At the same time, formal insurance products are largely unfeasible for the broader population as the low incomes make it unaffordable. Therefore, in the Malawian environment savings is left as the primary financial services tool available to most Malawians to meet their needs of consumption smoothing, risk mitigation and to build up a lump sum of capital to invest into a business or farming.

3 Financial inclusion priorities

Identifying priorities. Based upon the analysis of consumer needs, the provider realities and working within the environmental constraints identified, this section identifies 5 key priorities that will have the greatest potential impact on Malawians' welfare and the broader Malawi economy.

Five key priorities. The five priority areas identified in which relevant interventions will have the greatest impact, ranked in terms of largest immediate impact on financial inclusion objectives (the number of adults that could benefit from each priority is indicated in brackets), are:

1. Expanding the reach of payments (~3.5m adults[3])
2. Leveraging VSLAs to enable savings (~5.8m adults[4])
3. Targeted finance for MSMEs and farmers (~100,000 MSMEs[5]; ~130,000 farmers[6])
4. Niche insurance opportunities to reduce vulnerability (~60,000 adults[7])
5. Effective consumer empowerment and education

These five priority areas are not the only opportunities for financial inclusion. However, these five areas are likely to have the most far reaching impact, given the environmental constraints and the nature and needs of the target markets. Below we unpack each of these five areas in more detail, considering the nature of the opportunity, the main challenges to be overcome and potential actions to realise the opportunity.

3.1. Expanding the reach of payments

Developing the payments ecosystem to encourage digitisation while facilitating interim access to cash networks through a broader distribution footprint is key to addressing proximity challenges, the most significant inclusion barrier. Raising transaction fees to expand distribution could reduce the effective cost of banking.

Rationale. Access to payments is fundamental to the usage of all other services, both financial and non-financial. In Malawi, most adults are excluded from accessing formal payments, and therefore related services. The strategic focus of the banks is on credit, not on growth through transaction fees. The cost to expand distribution footprints are extremely high, given the lack of infrastructure. The result is that at current ATM withdrawal fees, banks are making losses even on well-used, urban based ATMs. The incentive for banks to invest in new physical cash infrastructure is therefore non-existent. This is exacerbated in rural areas where the lack of infrastructure drives up the operating costs. Therefore, the incentive to extend the reach of cash infrastructure is currently limited for formal providers.

Why is convenient encashment important?

Over the long term, if formal payments channels become a pervasive means of transaction in a given community, encashment will be rendered virtually redundant. However, cash currently remains the overwhelmingly predominant means of payment. BTCA (2013) calculate that 99.7% of all payments made in Malawi are in cash. Therefore, in order for mobile money or any other non-cash based payments mechanism to build up a large enough consumer base to benefit from network effects, it needs to meet the current needs of users, which in Malawi is transferring cash. If providers are not able to provide effective cash out services due to limited reach, limited liquidity or other constraints, the product has almost zero utility except for the sender's convenience, which is translated into the receiver's inconvenience. Therefore, effective agent encashment is critical to the product's initial success to reach the tipping point where the receiver is indifferent, en route to the ultimate universal acceptance.

The result is that all bank infrastructure and most non-bank financial services infrastructure is clustered in urban areas. Consequentially it takes an average of 3 hours travel a day on public transport to transact with a bank for the 85% rural Malawians. So, whilst the basic bank costs for Malawian bank account holders are low, the true cost of using a bank account for most Malawians, when travel time and costs are included in the equation, is unaffordable as indicated below.

Lack of cash infrastructure has also hampered mobile money roll out into rural areas. Despite swift initial uptake, mobile money penetration has slowed and consumers complain of a lack of liquidity. This is exacerbated by other challenges to recruit, train and manage agents, combined with effective market positioning to drive client use.

Opportunity. Over the longer term the payment-ecosystem needs to be built to drive the digitisation of transactions. This will reduce the cost of and expand access to financial services. Over this period encashment mechanisms will be key to drive consumer use. This will require expanded bank infrastructure complemented by bank partnerships to drive deeper rural distribution. This can be seen as a hub and spoke approach, with bank branches at the centre supporting more rural distribution networks, such as agents, mobile money agents or retailer products.

To develop the payment eco-system, banks will need to revisit bank charges and expand their partnership arrangements to include providers such as rural retailers

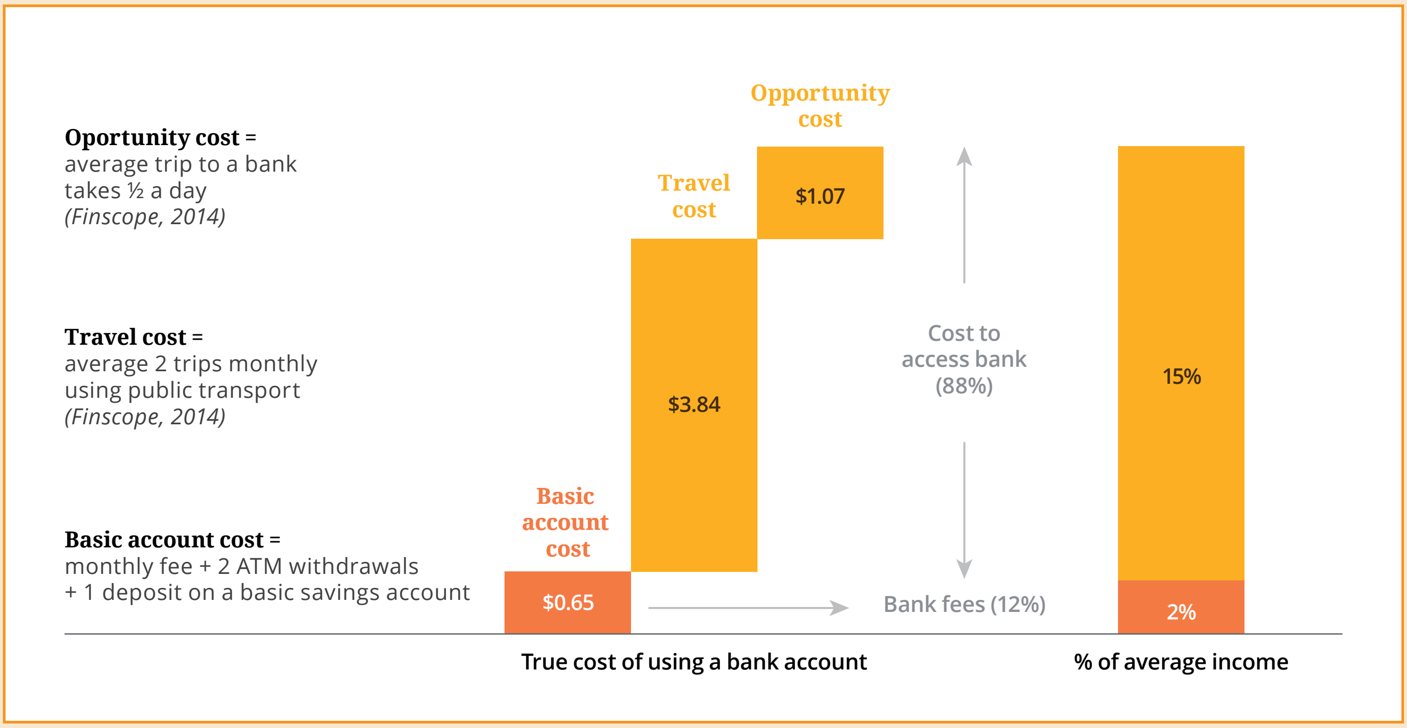


Figure 3: The true cost of using a bank account in Malawi
Source: FinScope, 2014; In-country consultations, 2014

and a more integrated relationship with mobile providers. Bank agency also holds significant potential to reduce distribution costs.

The launch of the National Switch (Nat-Switch) provides an important opportunity to expand the reach of banking infrastructure. Bank interoperability immediately expands the network of ATMs and POS devices available to all bank consumers. Unfortunately, as most of these are concentrated only in the urban centres, this still fails to substantially improve banks' reach to rural customers. However, interoperability does create a business case for banks. Up until now, any new ATM installed needed to serve a sufficient number of their own customers to make it worthwhile (albeit still unprofitable given the charges). With interoperability, banks only need to consider if the ATM will serve sufficient banked customers (from any bank), provided there is sufficient incentive through an interchange fee.

Additionally, the interoperability provided through Nat-Switch establishes a viable business case for the roll-out of POS devices. Currently, the small number of POS devices are largely confined to high end restaurants, hotels, guesthouses and other entities that primarily serve tourists. Nat-Switch will enable any Malawian bank account holder with a card to use a POS device. Increased use of cards will reduce the costs associated with transacting in cash. However, given the overwhelming predominance of cash in the Malawi economy, a widespread shift away from cash is not realistically expected in the short-term.

Government tax or investment incentives should also be considered to encourage rural distribution, given the substantial costs to establish rural infrastructure, even ATMs.

The opportunity related to expanding the cash distribution network goes beyond just providing better value to bank clients. Alternative financial service providers, the largest of which is mobile money, also require access to cash liquidity to effectively service an overwhelmingly cash based economy. One of the critical challenges facing mobile money is the liquidity of agents in non-urban areas. Extending the cash distribution network is therefore central to the effective delivery of mobile money. To play an effective role in distribution mobile money will need to overcome their agency and client communication challenges in addition to the current liquidity constraints.

Remittances sent to dependents in rural areas, which is expected to be a growing trend, requires a cash out point nearby or else the recipients must incur high travel costs to receive the remittance. The alternative, which is currently used by most Malawian remittance senders and receivers, is to use non-formal channels. These channels are less reliable, less secure and often expensive, but the money is at least delivered directly to the recipient.

Challenges. As discussed above, the interoperability between all the banks with the introduction of Nat-Switch provides an opportunity to incentivise banks to expand their cash distribution infrastructure. However, this incentive is determined by the interchange fee that is earned

> ***"The lack of infrastructure in non-urban areas makes the installation, maintenance and running costs of cash infrastructure, such as ATMs, very expensive to install and run."***

by the acquiring bank. Currently, any interchange fee charged is set to accrue to the repayment of the initial World Bank loan (to establish Nat-Switch), rather than to the acquiring bank that has invested in the infrastructure and continues to pay the operating costs. This undermines the incentive for banks to invest in new infrastructure and indeed provides a disincentive to even continue running their existing ATMs as they will effectively pay the running costs to service their competitors' clients.

The lack of infrastructure in non-urban areas makes the installation, maintenance and running costs of cash infrastructure, such as ATMs, very expensive to install and run. The low level of electrification and unstable communications networks both mean that expensive alternatives, such as generators are required, whilst the poor quality of the road network makes cash management both challenging and expensive.

Potential actions to realise opportunity. The primary priority action emerging is to increase the number of formal provider access points to reduce the overall cost of access. This can be achieved through a variety of complementary actions including leveraging partnerships between different providers and actions to incentivise providers to expand their reach. Table 1 to the right lays out the potential actions to realise this opportunity per the different stakeholders.

STAKEHOLDER	POTENTIAL ACTIONS
Banks	• *Revisit bank charges for sustainable rural provision to reduce overall bank access costs* • *Partner to develop infrastructure – ATM, POS and agency networks* • *Partner to improve interoperability with MNOs* • *Evaluate potential for self-stocked and cash accepting ATMs housed with retailers* • *Consider the potential of employing third party service providers to provide services across multiple providers to reduce costs* • *Consider the potential of introducing prepaid cards to pay salaries, grants, harvest payments*
MNOs	• *Partner with banks and super-agents to leverage their distribution network and to develop cash infrastructure to enable effective rebalancing by agents* • *Improve interoperability – with banks and between MNOs* • *Improve agent management approach to ensure sufficient liquidity and viable agent business case to ensure consumer value* • *Measure broader mobile money benefits to drive internal business case*
Retailers and petrol stations	• *Extend role as mobile money agents and super agents* • *Partner with banks to offer customer the opportunity to make payments with cards* • *Partner with cross border remittance providers to send and receive cross border payments*
Post office	• *Partner with banks for cash distribution and savings* • *Develop remittances to allow cross border sending and reduce time to cash out*
Regulators and policy makers	• *Develop a rural payments distribution strategy including incentives for rural roll out (e.g. tax incentives, targeted infrastructure development of communication lines, transport and electricity)* • *Target AML/CFT requirements to address risk of exclusion* • *Finalise NPS bill and include interoperability requirement* • *Collect distribution data to monitor and target access* • *License third party service providers to provide support services to banks* • *Leverage SIRESS to reduce cross border payment costs* • *Evaluate the sustainability of current government and donor provision*
National Switch	• *Encourage distribution infrastructure roll out by setting appropriate interchange fees to incentivise banks to invest in cash distribution infrastructure*

Table 1: Potential actions to expand the reach of payments per stakeholder
Source: Authors' own

3.2. Leveraging VSLAs to enable savings

Savings is the financial service that provides the greatest value to most Malawians in the current economic context. VSLAs have had the greatest success in encouraging savings amongst adults.

Rationale. In the Malawian economic environment, where credit is unaffordable due to the high interest rates and insurance is unrealistic for most adults due to their low incomes, savings is the primary tool available to most Malawians to smooth consumption and mitigate risk. Savings is also important to allow adults to pay for the education of children and is the only tool available to most Malawians to affordably access a lump sum of capital that can be used for investment in business or farming. Therefore, in the existing Malawian economic environment, most Malawians will draw the greatest benefit from access to savings products.

The rapid growth of VSLAs in Malawi since CARE began supporting the formation of these groups indicates the recognition of the value of savings by Malawians. In 2008, 86,000 adults were members of informal savings groups. In 2014, in excess of 1.1 million adults belonged to VSLAs as Figure 4 below illustrates.

Opportunity. The growth in VSLAs suggests that important gains can be made by improving the design of formal savings product, but the greatest potential opportunity lies in supporting the development of more VSLAs to extend coverage to currently unserved adults and leveraging VSLAs as distribution points for formal providers.

VSLAs have the distinct advantage of being proximate to savers, in this case its members. As discussed in priority 1, the travel costs to make small value savings contributions render savings in formal institutions unfeasible for most rural Malawians. VSLAs, due to the long cycle of the group, also represent effective commitment savings devices allowing members to build up a lump sum which can be used to pay school fees or invest in business or farming. When funds are lent out by VSLA members, these are lent at 20% interest per month and therefore the return on savings in VSLAs may also be higher than in formal institutions, where the return on savings is below inflation. Therefore, VSLAs represent a well-established mechanism for Malawian adults to affordably build up savings and hence supporting the formation and development of VSLAs is an opportunity to further extend the reach of financial services and improve the value to savers.

VSLAs can also be leveraged as distribution points for formal providers. Providing tailored formal products for VSLAs to store their float of savings in would enable formal providers to mobilise local savings and enable those deposits to be intermediated nationally. This would also improve the security of group savings.

Challenges. Although there is currently limited evidence of consumer abuse or mismanagement amongst VSLAs in Malawi, informal savings groups are invariably vulnerable to abuse or mismanagement. The low education and skills levels in Malawi make VSLAs more likely to be vulnerable to mismanagement or exploitation. Given their informal nature, VSLAs are not directly regulated. Formalising VSLAs, however, would create barriers and aversion to formation and usage. Therefore, the regulator needs to be able to monitor VSLAs for potential abuses without necessarily formalising or registering them. Donor-funded research and monitoring could potentially help to play this role of keeping the regulator informed of consumer protection concerns arising without requiring them to officially supervise VSLAs.

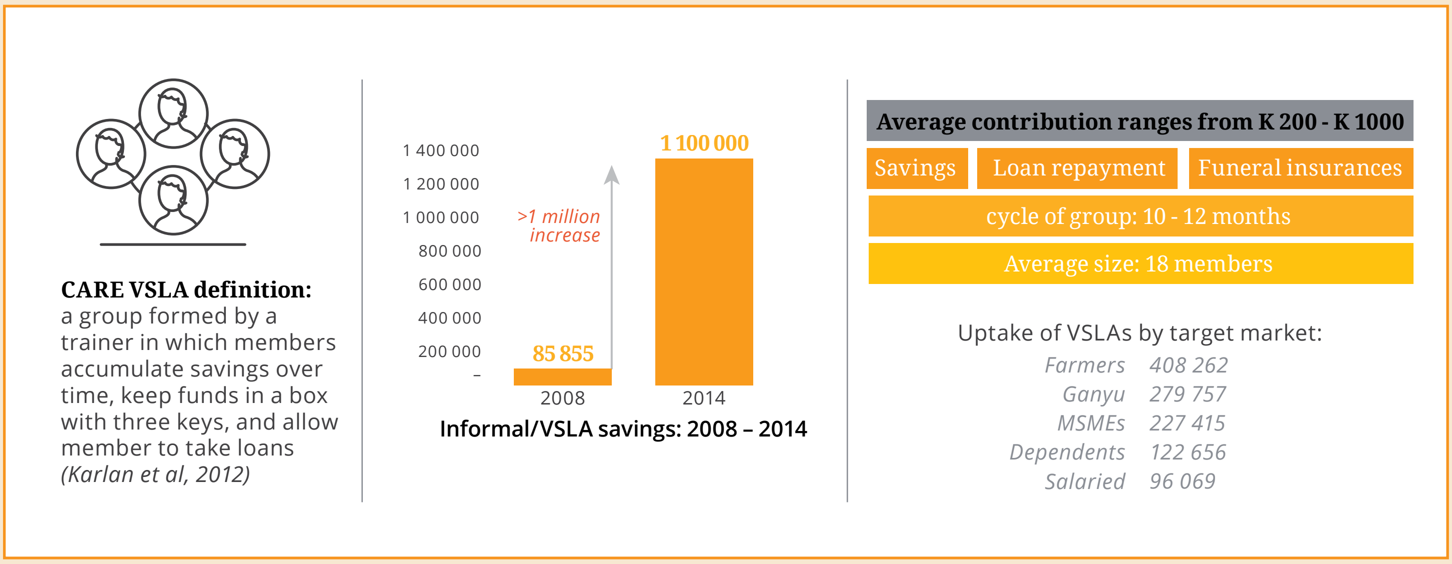


Figure 4: Summary of VSLAs in Malawi
Source: FinScope, 2014; Karlan, et al., 2012; qualitative interviews, 2014

The limited distributional reach of formal providers means that it may be onerous for VSLAs to transfer their deposits into formal accounts if they do partner. Additionally, the informal nature of VSLAs may make formal providers more reluctant to enter official partnerships or agreements with entities that are not officially regulated.

Potential actions to realise opportunity. The key actions to realise this opportunity relate to enabling the continued growth of VSLAs in a sustainable fashion and encouraging partnership with formal providers to provide benefits for both partners. Specific actions are detailed in table below.

STAKEHOLDER	POTENTIAL ACTION
Leveraging VSLAs	• Encourage VSLA usage • Link VSLAs to formal system to mobilise formal savings, provide graduation path and improve security (banks or mobile, training and simplicity key) • Link to deposit taking MFIs which have an existing rural footprint and have trained staff • Graduate large VSLAs to SACCOs at limited cost
Banks & mobile money providers	• Product development for targeted savings products (e.g. saving wallets)
Banks	• Improve customer communication to ensure clients use appropriate products
Other formal institutions	• Potentials for Post Office savings account given the distribution footprint. Ideally through partnership with an existing provider of savings • Expand farmer SACCOs, manage cost and ensure stability
Regulation & policy	• VSLA policy approach needed • Expand VSLA usage – village agent model potential for replication and training • Provide guidelines for use • Develop a legal identity and framework for VSLAs • Develop a graduation path for VSLAs • Avoid legislating small groups to encourage use • Leverage mandatory pensions to allow productive access to credit, e.g. collateral for housing finance • Monitor savings market to encourage access and use

Table 2: Potential actions to leverage VSLAs to enable savings by stakeholder
Source: Authors' own

3.3. Targeted finance for MSMEs and farmers

Credit targeted to a few MSMEs and farmers with the ability to absorb it can stimulate growth, but for most credit remains too expensive and the outcome to credit extension is likely to be harmful.

Rationale. Both farmers and MSMEs operate within a challenging environment in Malawi. The majority of the challenges faced by these groups are beyond the ambit of the financial sector. Nevertheless, both of these target markets require capital financing in order to invest in assets and inputs, which in turn enable greater productivity. However, credit is very expensive in Malawi. This means that credit is only appropriate for the most productive MSMEs and farmers. Whilst other individuals may benefit from lump sum capital, at the current interest rates they would not be able to repay a loan and would end up worse off than before.

Opportunity. There is therefore a niche opportunity to identify those MSMEs and farmers with the ability and motivation to grow and then to funnel subsidised credit to these sub-groups. These groups are expected to have the largest beneficial effect on economic objectives through GDP contribution and employment generation and are the only ones that can effectively absorb credit at the current high interest rates. Other groups of MSMEs and farmers would benefit more from targeted skills development and access to other financial services such as payments and savings (as discussed in the first two priorities).

There is also the potential to extend input credit to farmers through existing value chains. In tight value chains, this reduces the risk to the provider as repayments are automatically deducted at the point where produce is sold. This also suits the farmer as repayment is delayed until they earn revenue. However, many of Malawi's agricultural value chains are loose value chains with prevalent side-selling, thereby increasing the risk for providers that loanees will sell their produce to someone else. Hence, the opportunity for input credit is limited only to specific value chains such as ground nuts.

Finally, improving the broader credit and information sharing environment for providers can help to reduce the uncertainty in the lending market and therefore the risk and hence the cost. Central to this is facilitating fully functioning credit bureaus. A population register and national ID are equally critical to allow lenders to identify and track clients. Overarching credit regulation would also help reduce many of the uncertainties in the market and provide a consolidated framework for the market to operate within.

Challenges. The primary challenge to the provision of credit in Malawi is that the cost, even when it is subsidised, is unsustainably high for all but the most productive loan recipients and therefore offers poor value as a product to users.

“the lack of information that providers have about their clients, with no population register and no credit reference bureau, increases the risk and therefore cost of lending.”

The poor physical infrastructure, political uncertainty and macroeconomic volatility all make Malawi a highly challenging environment for MSMEs and farmers to operate in. Overall, Malawi is ranked 164th out of 189 countries for ease of doing business. The challenging environment makes it more expensive for businesses and farmers to operate and reduces their productivity. Therefore, without a conducive operating environment, credit will generally be ineffective in stimulating growth and the likelihood of a harmful outcome is increased.

The challenging business environment equally applies to the providers of credit and adds to their expenses and reduces efficiency. Furthermore, the lack of information that providers have about their clients, with no population register and no credit reference bureau, increases the risk and therefore cost of lending. This also means that the ability to direct this credit optimally is reduced.

Potential actions to realise opportunity. The primary actions to realise this opportunity relate to the reduction in the cost of credit, both by improving the macro environment and increasing the certainty in the lending market. Additionally, focus should be placed on improving the support to farmers and MSMEs, particularly through skills development, to enable them to better absorb and effectively use credit. Table 3: *Potential actions to maximise positive effect of credit to targeted MSMEs and farmers per stakeholder* below details the specific potential actions per stakeholder.

Table 3: Potential actions to maximise positive effect of credit to targeted MSMEs and farmers per stakeholder
Source: Authors’ own

STAKEHOLDERS	POTENTIAL ACTIONS
Formal credit providers	• Expanded agro-value chain financing, particularly for ground nuts given the number of farmers of farmers engaged in groundnuts production • Increased partnership for credit provision to target appropriate recipients (e.g. NASFAM, MFIs) • Improve disclosure of product information (eligibility, costs and terms) • Support credit information sharing initiatives
MSME initiatives	• Focused initiatives to target skills development and mentoring of MSMEs • Develop alternative capital opportunities beyond debt such as venture capital and private equity • Investigate leveraging VSLAs as a conduit for the provision of formal credit

Regulators and policy makers	• Legislation
	  • Credit information sharing to be enabled
	  • Credit regulatory framework
	  • Prescription of debt legislation to be clarified
	  • Improved contract enforcement to reduce cost of provision
	  • Consumer credit legislation needed to empower consumers
	• Enable payroll lending for business development
	• Introduce national ID to improve loan collection
	• Improve the efficiency of the judiciary to allow providers to more quickly realise loan security
	• Identify appropriate MSME and agricultural development steering committees and coordinate on finance initiatives
	• Strengthen and support associations and coordination bodies (e.g. SMEDI, NASFAM), as well as environmental policies (e.g. MSME policy)
	• Investigate potential of a credit guarantee scheme
	• Avoid politicising credit provision
	• Avoid interest rate caps, not feasible given market constraints
	• Develop capital market and improve macro-economic environment to reduce the cost of credit
	• Develop targeted credit monitoring to effectively supervise for targeted access, abuse and indebtedness
	• Potential for housing finance strategy
	• Introduce longer term treasury bills to establish reference rate for longer term debt

3.4. Niche insurance opportunities to reduce vulnerability

Insurance is an effective tool to mitigate risk. In the Malawian society, with limited disposable incomes, there are niche opportunities to increase insurance penetration.

Rationale. FinScope (2014) indicates a dramatic discrepancy between those adults that would like insurance to mitigate risks and those that actually have access to insurance. Realistically, the majority of Malawian adults are not viable insurance clients due to lack of disposable income. However, they do still experience a myriad of risks and due to their levels of poverty are particularly vulnerable to risk shocks. This shows the imperative for Malawians to have access to effective risk mitigation tools. For most this will likely be in the form of savings as discussed in priority 2, but also raises the potential for insurance to play a greater role in niche areas.

Opportunity. The greatest opportunity for insurance is to provide health and life insurance to salaried employees as this group has the highest and most regular incomes.

Beyond the existing insurance products, there may be an opportunity to provide some type of low value health insurance to help adults cover their out-of-pocket expenses and other ancillary costs such as for transport in the event of a health emergency.

Insuring MFIs' loans against natural disaster risk may be another opportunity. This could help mitigate the risk MFIs in extending credit, particularly to farmers, and it is more viable for providers to insure the MFI directly than providing cover to each of their clients directly.

Challenges. The primary challenge to extending access to insurance is the lack of disposable income of most Malawians, which makes them unable to afford even low cost insurance premiums. There is also very low awareness of insurance amongst Malawians.

The prevalence of natural disasters means that any kind of insurance covering natural disasters or farmers is very expensive.

Potential actions to realise this opportunity. The primary actions to realise this opportunity relate to improving product awareness and innovative product design. The table below lists these potential actions per stakeholder.

STAKEHOLDERS	POTENTIAL ACTIONS
Insurers and distribution partners	• *Development of low value health insurance products such as hospital cash plans and hospital vouchers* • *Explore partnerships with MNOs, pharmacies, agro dealers and SACCOs to extend distribution* • *Expand premium payment options, including allowing the option to pay premiums via mobile and monthly rather than annually*
MFIs	• *Wholesale insurance[8] for natural disasters to improve sustainability*
Regulators and policy makers	• *Develop a health finance framework* • *Consider the potential for a microinsurance framework* • *Monitor insurance data to ensure value is provided to customers (e.g. claims ratio)* • *Publish AML/ CFT guidelines with exemptions for low value insurance to encourage access* • *Develop regulatory framework for medical aid schemes*

Table 4: Potential actions to achieve greater insurance value and penetration by stakeholders
Source: Authors' own

3.5. Effective consumer empowerment and education

Financial education is critical to consumers extracting the optimal value from financial services. Optimising the effectiveness of existing financial education initiatives is therefore a priority.

Rationale. FinScope (2014), together with other studies that have been conducted, find very low levels of financial literacy amongst Malawi adults. However, low financial literacy does not mean low financial capability. The growth and success of VSLAs and the common aspiration amongst Malawi adults to own and run their own businesses indicate a level of financial awareness and acumen. Qualitative interviews also indicated that Malawians may be familiar with financial concepts, like interest, without necessarily being familiar with the terms.

Opportunity. Although Malawians may not, in general, lack financial capability, the low levels of financial literacy do suggest that most Malawians will be at a disadvantage when interacting with formal financial institutions. This increases the doorstep barrier for individuals to engage with formal providers and also increases the likelihood of miss-selling as customers do not understand the terms and conditions of products.

Improved financial literacy and access to information about financial services will stimulate a greater understanding of the value of certain financial products, particularly insurance of which awareness is very low, and so stimulate usage as adults better understand the benefit of using the products. Furthermore, improved understanding and knowledge of financial terms and products reduces the cost of provision as the time and expense required to sell and explain products is reduced.

There is also the opportunity to leverage key places to target financial education at times where it is more likely to be absorbed. This includes leveraging existing institutions to provide financial education and understanding through teachable moments[9]. Additionally, leveraging institutions with a greater reach into rural communities, e.g. VSLAs and MFIs, to extend financial education. Remittance receivers are particularly open to absorbing information at the time when they receive their remittance. As they are dependent on remittances for their livelihoods, they are willing to overcome most usage barriers and learn whatever is required to access that remittance. Particularly if this is through formal channels, it can often act as a first step to greater financial services usages as the initial capability barrier is overcome and subsequent interactions are less daunting for the individual.

Cheap bank statements enable first time users to cost effectively check that their money is still secure. The initial barrier to using a formal institution such as a bank is often substantial. Even if these institutions are broadly perceived as trustworthy, it requires a great deal of faith from first time users to entrust a portion of their savings, particularly in the Malawian context where even a small pool of savings can be a challenge to form due to the low incomes. Allowing them to affordably check that their savings are still secure can help to ease this initial barrier for first time users.

Challenges. The primary challenge to improving financial literacy and education is the low levels of basic education and literacy.

Potential actions to realise this opportunity. A lot of work has already been undertaken to improve financial literacy and education through both state and donor initiatives. The primary actions therefore relate to improving the coordination of already existing programmes and refining the effectiveness of such initiatives. Table 5 below discusses the potential actions per stakeholder to realise this opportunity.

STAKEHOLDER	POTENTIAL ACTIONS
Formal providers	• *Research target audience and train sales team for improved communication during teachable moments* • *Make statements inexpensive and simple to obtain to encourage usage and trust (first time financial service users check balances often)*
Donor organisations	• *Improve coordination of existing financial capability initiatives*
Regulators and policy makers	***Consumer protection*** • *Clarify which is the lead consumer protection regulatory authority* • *Introduce an Ombud to reduce cost and improve access to fair treatment* • *Empower traditional judicial structures to deal with minor financial service regulations* ***Financial literacy*** • *Targeted initiatives which are appropriately designed required to achieve desired impact*

Table 5: Potential actions to improve financial empowerment and education per stakeholder
Source: Authors' own

3.6. Critical institutions and regulatory imperatives to drive priorities

The specific regulatory changes required are detailed under each of the five priority areas. However, beyond these areas, there are certain regulatory imperatives which cut across all of the priority areas related to building institutions, regulatory processes critical to the furthering of financial inclusion in Malawi. These are discussed below:

- Strengthen the unit within the division in the Ministry of Finance, Economic Planning and Development currently responsible for driving financial inclusion. The financial inclusion agenda in Malawi is currently the responsibility of the Financial Sector Policy Section which falls under the Economic Affairs division within the Ministry of Finance. A dedicated unit to financial inclusion provides a central leader of the agenda, but this can be strengthened into a full division within the Ministry of Finance, Economic Planning and Development.
- Improve access to legislation. Establishing a central platform for a comprehensive set of the latest legislation would help provide clarity on the in-force legislative framework.
- Improve judicial and legislative efficiency. The length of time to process contract enforcement cases raises the cost for providers, particularly to realise security on loans. Promoting small claims courts and traditional court jurisdiction for lower value financial transactions can improve efficiency. Review legislative process to increase efficiency and improve cohesion of legislation

3.7. Donor Imperatives

The contribution of donors to Malawi is illustrated by the size and importance of donor financing development. A broad variety of donor driven initiatives exist related to financial inclusion objectives. As a result, there is a considerable need for donors to work together, to pool resources where possible and for greater coordination. A formal coordinating body could play an important role in ensuring that limited resources are not wasted on duplication, existing projects and expertise is leveraged to a greater extent and a consistent and simple message is delivered to central policymakers and government officials.

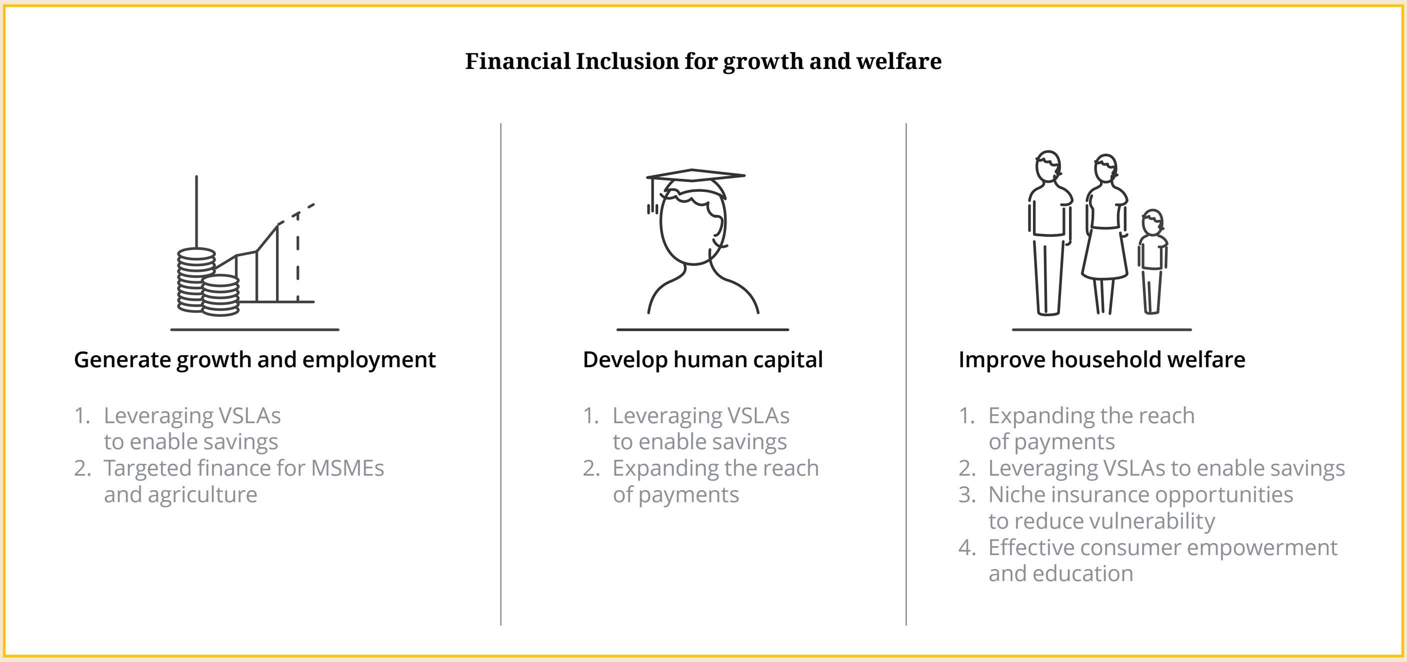


Figure 5: The role of the identified priorities in achieving Malawi's overarching policy goals
Source: Adapted from Bester et al., forthcoming

Already, evidence of this is seen in specific areas, particularly regarding mobile money initiatives where the MMAP and MM4P programmes bring together and coordinate the activities of donors, providers and policymakers. A sector wide coordinating body would play a similar role across a broader range of activities throughout the financial sector.

3.8. Importance of financial inclusion interventions for Malawi

Financial inclusion interventions are not focused on financial inclusion purely for its own sake. Rather financial inclusion can be seen by policymakers as a valuable tool to achieve their overarching policy objectives of growth and employment, human capital development and enhanced household welfare. These five identified priority areas contribute to the attainment of these three overall policy objectives as illustrated in Figure 5 to the right.

Credit and savings facilitates MSME and farmer growth. Growing available savings pools through VSLAs and improved product design enables MSMEs and farmers to more easily build up a lump sum of capital which can be used to invest in assets and inputs to improve productivity, thereby generating economic growth and creating additional employment. Credit similarly provides MSMEs and farmers with a lump sum to invest to improve their productivity. The cost of credit means that only a small portion of MSMEs and farmers can effectively absorb credit, but these are also those individuals that will have the greatest impact on economic growth and employment creation.

Savings and payments enable human capital development. Enabling adults to build pools of savings enables them to build up sufficient funds to afford to pay school fees, other school-related costs and to build up a cushion that can be used in the event of a health risk event. Therefore, the availability of effective savings mechanisms can have a direct effect on the level of human capital development within the country. Expanding the reach of payments also improves the efficiency and ease of paying bills and reduces the extraneous costs, particularly related to travel for individuals.

Cost-effective payments reduce household costs, whilst savings, insurance and consumer education reduce household vulnerability. Malawian adults face high costs in accessing formal financial services. Expanding the reach of payments enables individuals to more affordably transact, pay bills and send long distance remittances. This would therefore have a direct effect on household welfare. Enabling savings provides the tools for individuals to build up savings pools that can be used to smooth consumption and mitigate their risks, thereby reducing their vulnerability. Insurance products similarly allow individuals to better mitigate their risks and reduces vulnerability. Finally, empowered and educated consumers are better able to understand financial products enabling them to extract greater value from their use and to ensure that they are not exploited by financial providers.

4 Conclusion

The Malawi context creates a highly constrained environment for financial services provision to operate. This report highlights the five key priority areas that will make the greatest contribution to the attainment of Malawi's overall policy objectives, including consumer welfare, growth and employment, and human capital development through financial inclusion within the constraints of the operating environment.

Most fundamentally, the distributional reach of formal financial service providers is largely restricted to urban areas, thereby effectively excluding most of the population from access due to the unaffordable transport costs required to use financial providers. Secondly, due to the high cost of credit and the inability for most Malawians to afford insurance, savings represents the critical financial service. Savings are used to smooth consumption, mitigate against risk and access a capital sum to be used to pay for education or invest in business or farming. Beyond these two, opportunities in financial inclusion are limited to niche areas; including targeted credit to those few MSMEs and farmers that can effectively absorb it, specific areas of insurance product development and improvements in financial empowerment and education.

This diagnostic will be used to inform a roadmap that will be developed to give detailed and actionable steps to achieve these financial inclusion priorities detailed above.

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Endnotes

1. MAP Malawi relies on demand side data from three FinScope surveys (FinScope Malawi Consumer Surveys 2008 and 2014, and FinScope Malawi MSME Survey 2012) and 46 qualitative immersive interviews, and supply side data from 75 stakeholder interviews with financial service providers, regulators and policymakers, published annual or interim financial statements and reports and data collected by supervisors.
2. Five target markets were selected based on income source: salaried employees, MSMEs, farmers, dependents and ganyu. Analysis of the different demographics and needs of adults based on geographical area (rural or urban) and gender was also conducted.
3. Estimated number of farmers, MSMEs and salaried employees residing in rural areas and forced to travel to access formal payments.
4. Estimated number of adults not currently saving with formal or informal providers.
5. Driven achiever MSMEs with both motivation and ability to grow.
6. Proportion of farmers with both education and that farm to sell their produce.
7. Salaried employees unserved by formal insurance.
8. Insurance purchased by the MFI to provide risk mitigation at a wholesale levels that covers their full book, rather than individual policies at a retail level.
9. A teachable moment is the time at which learning a particular topic or idea becomes possible or easiest. This is usually related to the point in time when the consumer needs that information.
10. This bibliography includes the references directly quoted in this report. The full diagnostic study sets out a complete set of references used to generate the MAP priorities, including interviews conducted and reports reviewed.

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