MAKING ACCESS POSSIBLE

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Malawi

DEMAND, SUPPLY, POLICY AND REGULATION

Malawi Country Diagnostic Report

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

At country level, the core MAP partners, collaborate with Government, other key stakeholders and donors to ensure an inclusive, holistic process. MAP Malawi was funded by FinMark Trust and produced by Cenfri.

This document sets out the comprehensive diagnostic findings which feeds into the Roadmap developed in collaboration with the MAP Malawi steering committee. A Summary note of these findings is available which sets out the findings of this diagnostic in an abridged format.

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donor agencies for their time, the critical insights that guided this research and their efforts to extend financial services to the excluded.

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List of Abbreviations and Acronyms

ACE	Agricultural Commodity Exchange
ACH	Automated Clearing House
ACHX	Auction Holdings Limited Commodity Exchange
ADB	Authorised Dealer Banks
AFDB	African Development Bank
AGORA	Access to Global Online Research in Agriculture
AHL	Auction Holdings Limited
AIDS	Acquired Immune Deficiency Syndrome
AML	Anti-Money Laundering
ASWAp	Agriculture Sector Wide Approach
ATM	Automated Teller Machine
ATS	Automated Transfer System
B2B	Business to Business
B2G	Business to Government
BAAC	Bank of Agriculture and Agricultural Cooperatives
BIS	Bank of International Settlements
CCBG	Committee of Central Bank Governors
CDC	Centres for Disease Control and Prevention
CFF	Central Financial Facility
CFT	Combatting the Financing of Terrorism
CFTC	Competition and Fair Trading Commission
CGAP	Consultative Group to Assist the Poor
CMA	Common Monetary Area
COMESA	Common Market for Eastern and Southern Africa
COMSIP	Community Savings and Investment Promotion
CPC	Consumer Protection Council
CPI	Consumer Price Index
CPL	Continuous Processing Line
CSD	Central Securities Depository
CUMO	Concern Universal Microfinance Operations
DEMAT	Development of Malawian Enterprises Trust
DSTV	Digital Satellite Television
ECCH	Electronic Check Clearing House
EFT	Electronic Funds Transfer
ESCOM	Electricity Supply Corporation Of Malawi
ETC	Electronic Transactions and Communications
FAO	Food and Agriculture Organisation of the United Nations
FCDA	Foreign Currency Denominated Accounts
FINCA	Foundation for International Community Assistance
FISP	Farm Input Subsidy Programme
FIU	Financial Intelligence Unit
FMB	First Merchant Bank
FNB	First National Bank

FOREX	Foreign Exchange
FSDS	Financial Sector Development Strategy
FSP	Financial Service Provider
FSTAP	Financial Sector Technical Assistance Project
FUM	Farmers Union of Malawi
GDC	German Development Cooperation
GIS	Geographic Information System
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GSB	Growing Sustainable Business
GSLA	Group Savings and Loan Association
GSM	Global System for Mobile Communications
HIV	Human Immunodeficiency Virus
HSS	Household Support Services
HSSP	Health Sector Strategic Plan
IAM	Insurance Association of Malawi
IBWI	Index Based Weather Insurance
ICT	Information and Communication Technology
ID	Identification Document
IDA	International Development Association
IFC	International Finance Corporation
IFPRI	International Food Policy Research Institute
IMF	International Monetary Fund
INGO	International Non-Governmental Organisation
IPA	Innovation for Poverty Action
ITU	International Telecommunications Union
KPI	Key Performance Indicator
KTB	Krungthai Bank
KYC	Know Your Customer
LFC	Leasing and Finance Company of Malawi
LIFT	Livelihoods and Food Security Technical Assistance Project
MACRA	Malawi Communications Regulatory Authority
MAMN	Malawi Microfinance Network
MAP	Making Access Possible
MARDEF	Malawi Rural Development Fund
MASAF	Malawi Social Action Fund
MASM	Medical Aid Society of Malawi
MCTU	Malawi Congress of Trade Unions
MEDI	Malawi Enterprises Development Institute
MERA	Malawi Energy Regulatory Authority
MFI	Micro Finance Institution
MGDS II	Malawi Growth and Development Strategy 2
MIGA	Multilateral Investment Guarantee Agency
MITASS	Malawi Inter-Bank Transfer And Settlement System
MM4P	Mobile Money for the Poor
MMAP	Mobile Money Accelerator Programme
MNNSS	Malawi National Net Settlement System

MNO	Mobile Network Operator
MoF	Ministry of Finance
MPC	Malawi Posts Corporation
MSB	Malawi Savings Bank
MSME	Micro, Small and Medium Enterprises
MTA	Money Transfer Agents
MTL	Malawi Telecommunications Limited
MTML	MSME-Targeted MFI Lenders
MUSCCO	Malawi Union Of Savings and Credit Cooperatives
NASFAM	National Smallholder Farmers' Association of Malawi
NBM	National Bank of Malawi
NBS	New Building Society
NGO	Non-Government Organisation
NPL	Non-Performing Loan
NPS	National Payments System
NSO	National Statistics Office
OIBM	Opportunity International Bank of Malawi
P2B	Person to Business
P2G	Person to Government
P2P	Person to Person
POS	Point Of Sale
PWP	Public Works Programme
RBM	Reserve Bank of Malawi
REPSS	Regional Payment and Settlement System
RICA	Regulation of Interception of Communications and Provision of Communication-related Information Act
ROA	Return on Assets
ROE	Return On Equity
RoR	Rate of Return
ROSCA	Rotating Savings and Credit Association
RTGS	Real Time Gross Settlement Systems
RTL	Real Time Line
SACCO	Savings And Credit Co-operative
SADC	Southern African Development Community
SCTP	Social Cash Transfer Program
SEDOM	Small Enterprises Development Organisation of Malawi
SIM	Subscriber Identity Module
SIRESS	The Southern-African Development Community Integrated Regional Settlement System
SMEDI	Small and Medium Development Institute
SMS	Short Message Service
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TAMA	Tobacco Association of Malawi
TBH	Thai Baht
TNM	Telekom Networks Malawi
UBALE	United in Building and Advancing Life Expectations

UNCDF	United Nations Capital Development Fund
USD	United States Dollar
USSD	Unstructured Supplementary Service Data
VSLA	Village Saving and Loan Association
WFP	World Food Programme
WHO	World Health Organisation
WTO	World Trade Organisation
ZAR	South African Rand

USD/Malawi Kwacha 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

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.

85% of adults live in rural areas

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 Area 5: EFFECTIVE CONSUMER EMPOWERMENT AND EDUCATION

64% of adults have never heard of an ATM, 58% have never heard of a savings account

Overview of Financial Access in Malawi

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

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

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. The MAP diagnostic informs a roadmap that provides detailed and actionable steps to achieve the financial inclusion priorities.

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].

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, rural population 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 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

[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.

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 finalisation 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 longer term • Support MFIs as the primary formal providers of MSME and agricultural finance • Improve credit information through credit reference bureaus • 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. Introduction

1.1. What is MAP?

Making Access to Financial Services Possible (MAP) is a multi-country initiative to support financial inclusion through a process of evidence-based country analysis. It is a partnership between the United Nations Capital Development Fund[3] (UNCDF), FinMark Trust[4] and the Centre for Financial Regulation and Inclusion[5] (Cenfri). In each country, it brings together a broad range of stakeholders from within government, private sector and the donor community to create a set of practical actions aimed at extending financial inclusion tailored to that country[6]. Financial inclusion is achieved when consumers across the income spectrum in a country can access and sustainably use financial services that are affordable and appropriate to their needs.

MAP incorporates a comprehensive analysis of the country context as well as of the demand and supply of financial services and the regulatory environment in order to identify key barriers and opportunities to increased financial inclusion across four core product markets:

	***Credit***
	***Payments***
	***Savings***
	***Insurance***

Table 1: Four core product markets

Source: Authors' own

Why focus on financial inclusion? The MAP approach sees financial inclusion as a means to an end – the end being improved welfare and an impact on the real economy, namely those activities that contribute to GDP and economic growth[7]. Economic theory suggests that financial intermediation can fuel real economy impacts at the macroeconomic level by mobilising savings for investment purposes (including capital allocation for business development), reducing transaction costs and increasing efficiency, thereby contributing to employment generation and growth. At the microeconomic or household level, financial inclusion can impact people's welfare directly by reducing their transaction costs, enabling them to more efficiently manage risks, allocating capital for productive use and

[3] **UNCDF** (www.uncdf.org) is the UN's capital investment agency for the world's least developed countries. It creates new opportunities for poor people and their communities by increasing access to microfinance and investment capital. UNCDF focuses on Africa and the poorest countries of Asia, with a special commitment to countries emerging from conflict or crisis. It provides seed capital – grants and loans – and technical support to help microfinance institutions reach more poor households and small businesses, and local governments finance the capital investments – water systems, feeder roads, schools, irrigation schemes – that will improve poor peoples' lives.

[4] **FinMark Trust** (www.finmark.org.za) is an independent non-profit trust whose purpose is 'Making financial markets work for the poor by promoting financial inclusion and regional financial integration'. The trust was established in March 2002 with funding from the UK's Department for International Development (DFID).

5 **Cenfri** (www.cenfri.org) is a non-profit think-tank based in Cape Town. Cenfri's mission is to support financial sector development and financial inclusion through facilitating better regulation and market provision of financial services. They do this by conducting research, providing advice and developing capacity building programmes for regulators, market players and other parties operating in the low-income market.

[6] For more information on MAP visit any of the partner websites listed in the footnotes above.

[7] It goes both ways, however. As the discussion in Section 2 will show, the real economy and broader country context also impact the scope for financial inclusion by determining the realities within which the target market functions.

supporting the accumulation of wealth over time. Financial services can also facilitate access to core services, such as health or education. This can impact growth directly, by triggering service sectors, as well as indirectly, by enhancing productivity.

Figure 1 below summarises the direct and indirect channels through which financial inclusion can impact welfare:

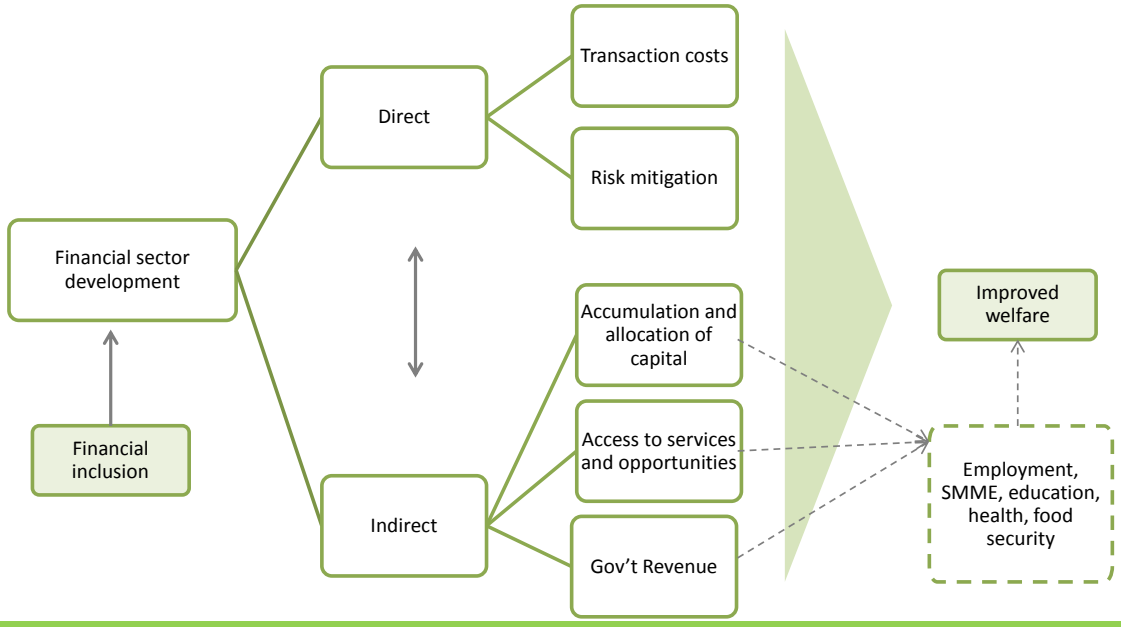


Figure 1: Financial inclusion real economy impact channels

Source: Authors' own, based on Calderón & Liu (2002), King & Levine (1993), and Levine (1997).

The customer at the core. What sets MAP apart from other diagnostic exercises is the fact that the demand-side perspective – the customer and his/her needs – is the point of departure for the analysis and recommendations. Figure 2 illustrates the MAP logic:

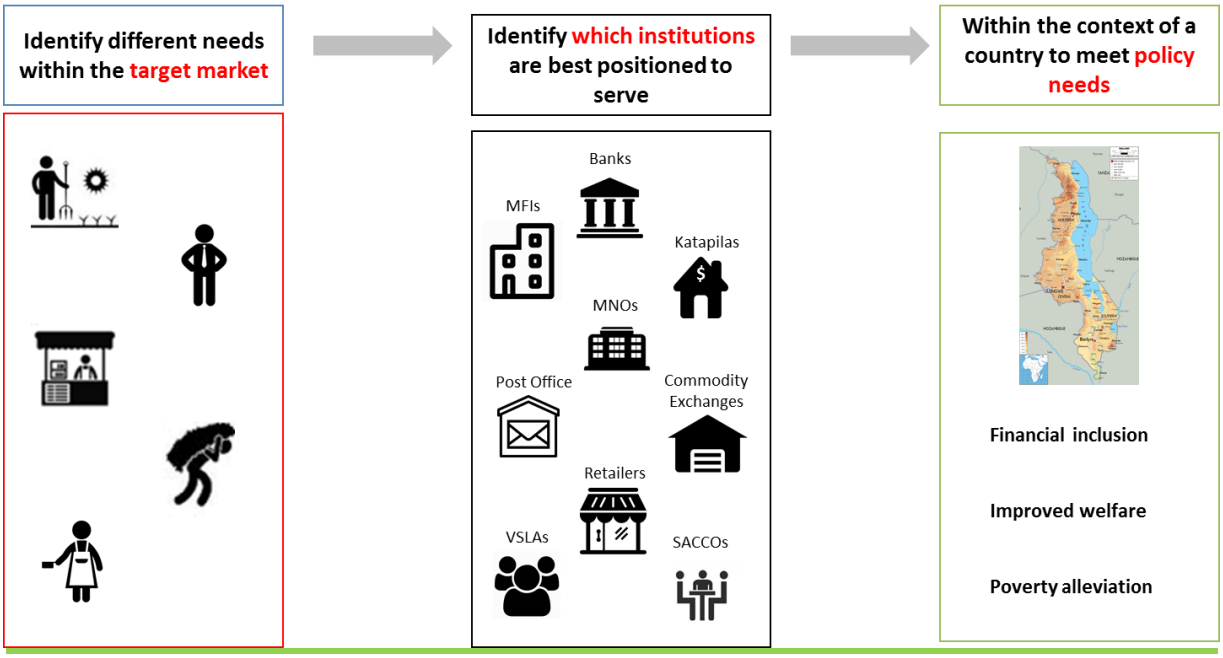


Figure 2: The logic of the MAP process

Source: Authors' own

As the diagram illustrates, the MAP methodology starts by identifying the different needs in the target market. The adult population is segmented into groups of individuals with similar profiles and needs that could form discrete target markets for financial services. With the target markets in mind, the rest of the analysis then seeks to identify which institutions currently serve which parts of the market through which services, as well as what the potential and gaps are for enhanced provision. The analysis is informed by the realities of the context of the country and ultimately seeks to meet the policy objective of financial inclusion as a tool to improve welfare and poverty alleviation.

1.2. 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. Evidence of Malawi's focus on financial inclusion as a policy focus is illustrated by the fact the country has had an official financial inclusion policy 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 (see Appendix 2). The result is that, whilst a number of interventions have been implemented, there is a lack of 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.

MAP as input to new financial inclusion strategy. The previous National Strategy for Financial Inclusion expired in 2014. MAP can be used as an input to the Government's proposed new financial inclusion strategy, forming a strong information-based foundation for any new strategy to be drafted.

1.3. Methodology and process

The MAP Malawi diagnostic is funded by FinMark Trust. It was carried out by Cenfri with the support from the FinMark Trust Malawi coordinator, Imani Development.

Scope. This document builds an evidence base across various areas of analysis. It considers the country context, target market features, regulatory framework, as well as the provision of financial services in four product markets: credit, savings, payments and insurance.

The start of a process. The diagnostic document is the beginning rather than the end of the road, as it provides the basis for an ongoing multi-stakeholder process across government and the private sector to develop a financial inclusion **roadmap** and implement it through an **action plan**.

Box 1. What is a financial inclusion roadmap?

The analogy of a map is central to the MAP approach. MAP is about moving into unchartered territories, in the process mapping the potential routes to get to the end-goal of welfare gains through financial inclusion.

The roadmap is a high-level strategy document that details focus areas and recommendations towards achieving the end-goal. The roadmap will be the foundation for the development of an action plan, which adds further detail to create an implementable and sustainable plan to improve financial inclusion. The action plan will specify specific activities stemming from the roadmap and assign a budget, timeline and responsibilities to each.

The roadmap can be developed into an official Financial Inclusion Strategy adopted by government or simply serve as a consensus document for stakeholders on focus areas and action steps.

Methodology. A MAP diagnostic study is based on analysis of five key sources of information:

- *Quantitative demand-side research*. The analysis draws heavily on the FinScope Consumer Survey Malawi 2014, published by the FinMark Trust in 2014 (henceforth referred to as the FinScope survey). FinScope is a nationally representative demand-side survey implemented by FinMark Trust in a total of 20 countries in Africa and Asia to date. It gauges people's usage, perceptions and interaction with various financial services, as well as barriers to greater financial services penetration. The MAP analysis applies the FinScope survey results to obtain insight into the relative size of different financial inclusion opportunities, as well as the realities, needs and profiles of various target market segments. The FinScope Consumer Survey Malawi 2008 was used to understand trends over time. The FinScope MSME Survey Malawi 2012 was also used to gain a deeper understanding of MSMEs operating in Malawi. FinScope MSME surveys are nationally representative surveys of how small business owners source their income and how they manage their financial lives. The survey looks at owners of micro, small, and medium enterprises, as well as individual entrepreneurs.

  Qualitative demand-side research. Market research firm Uni-Q Insight in association with Bay Technologies was sub-contracted to design and implement qualitative demand-side research as

an input to the analysis. Individual interviews were conducted to get insights into the nature of people's financial lives and their interaction with various financial services. The findings are not representative of the population at large, but complement the quantitative survey results to provide a deeper level of insight into attitudes and other drivers of financial usage behaviour. Fieldwork was conducted in October and November 2014. A total of 46 respondents were interviewed: 29 male and 17 female.

- *Stakeholder interviews.* In October and November 2014, the diagnostic team met with a total of 75 stakeholders, including regulatory authorities, government departments, financial institutions and support organisations. The purpose was to understand incentives for and constraints to financial inclusion and obtain insights into key market trends and data. Appendix 3 contains a list of institutions consulted.

- *Secondary research.* The stakeholder consultations were accompanied by in-depth analysis of data contained in regulatory databases or obtained from suppliers. In addition, we analysed various institutions' annual reports, conducted a literary review on the country and financial sector context and analysed relevant pieces of legislation and other documents pertaining to the regulatory framework.

- *Mystery shopping.* Lastly, a mystery shopping exercise was implemented to understand product terms and costs, as well as to experience the process of signing up for a financial service from the customer's perspective.

1.4. Guide to reading this document

In order to impact on the real economy and improve welfare, a suite of appropriate financial services are needed that are accessible and provide value to clients. The scope for financial inclusion is conditioned by the country context as well as the regulatory environment within which the financial sector operates. After taking stock of the context and regulatory framework, we consider the needs and realities of various target market segments, as well as the potential, gaps and barriers for financial services across the four product markets to meet those needs. The recommendations are then informed by an assessment of the potential of various financial services to meet the key target market needs.

The document from this point is structured as follows:

- **Section 2** considers the way in which the country context – macroeconomic, socioeconomic, and physical infrastructure – shapes the scope for financial inclusion.

- **Section 3** analyses the relevance of the regulatory framework in Malawi for financial inclusion.

- **Section 4** takes a closer look at the target market for financial inclusion in Malawi It considers the economic realities at grassroots level, the profile and needs of different target market groups, how the target market currently uses and perceives financial services, as well as what stands in the way of greater engagement with formal financial services.

- Mindful of target market needs and the country and regulatory context, **Section 5** then provides an overview of current financial services provision in Malawi to set the scene for the rest of the analysis. It provides an overview of the landscape of providers across product markets and analyses the financial sector infrastructure in terms of the capital market and distribution network.

- **Sections 6.1 to 6.4** consider each of the four product markets that form the backbone of a MAP diagnostic: credit, payments, savings and insurance. For each market, the analysis covers:

    - **Current usage** – the profile of usage in the particular product market
    - **Use cases** - the nature and extent of various use cases for the product (see Box 2 below)
    - **Providers** – an overview of the types and performance of providers serving the particular product market.
    - **Products** – an overview of the suite of available products in the market and their key features from a financial inclusion point of view.
    - **Barriers to access** – determining what stands in the way of greater financial inclusion in the particular product market, be it factors relating to the nature of the target market (such as their perceptions and trust) or the features and accessibility of the product suite.
    - **Regulatory issues** - with a bearing on financial inclusion in the particular market
    - **Gaps and opportunities** – concluding on the key gaps and opportunities for serving target market needs in the particular product market.

- **Section 7** concludes by identifying five key financial inclusion priorities stemming from the target market needs and supply-side analysis and highlights potential actions to unlock the opportunities.

To facilitate ease of reading, each section starts off with a summary box highlighting the key findings or insights from the particular section.

Box 2. What is a use case?

A "use case" is simply an identified need or application for a particular service among the target market, the reason why a particular product is demanded. For each product market, there will be several use cases. The use cases for a particular product will differ across countries, depending on the context and target market features. For example, "to pay bills" or "to send money to rural family members" can both be a use case for payments, while "to provide for education expenses" can be a use case for either savings or credit.

The use cases identified in Section 6 are intended to focus the discussion on the actual or potential needs expressed in the market and the prospective roles that a particular product could fulfil. The use cases for each product market are identified based on the qualitative and quantitative demand-side research, along with an overview of products on the market and insights from provider interviews.

2. Context drivers of market development

The financial sector forms part of a broader economic and social context that shapes market outcomes, demand-side realities and functioning of the financial sector in and of itself. This section unpacks the key contextual drivers of financial market development across the macroeconomic context, socio-economic and demographic context. The key context drivers of relevance to the rest of the analysis are summarised below.

Key findings: context drivers

- Significant macro-economic challenges persist to undermine the business case and value proposition of formal financial services.
- High-levels of poverty reduces demand.
- Infrastructure limitations increase distribution costs beyond viable private provision.
- Agricultural dependence increases the risk to serve the market.
- Role of donors substantial in provision.

2.1. Macroeconomic context

A poor, but growing economy. Malawi has a Gross Domestic Product (GDP) of USD 4.3 billion, amounting to USD 780 per capita (PPP[8]). On this measure it is the poorest country of its neighbours and the third poorest country in the world. The average economic growth rate over the last 10 years has been 5%. However, this rate has been volatile and slumped to 2% in 2012 (World Bank, 2013). The variability in the growth rate was mainly driven by exogenous shocks to agriculture outputs and episodes of donor support withdrawals. Economic activity increased to 5% in 2013 and it is expected that growth would have accelerated to 6% in 2014 (Mwanakatwe, 2014).

Agriculture biggest contributor to GDP. Figure 3 illustrates that agriculture is the main sector comprising 32% of total economic output. The second biggest sector is the wholesale, retail trade and accommodation sector comprising 18% of GDP, followed by the financial and real estate services sector (14%) and manufacturing sector (10%). Each sector's share of GDP has remained fairly constant in the last 5 years.

[8] Purchasing Power Parity (PPP) conversion factor is the number of units of a country's currency required to buy the same amount of goods and services in the domestic market as a USD would buy in the United States (World Bank, 2015). It makes the comparison of economic values across countries more accurate.

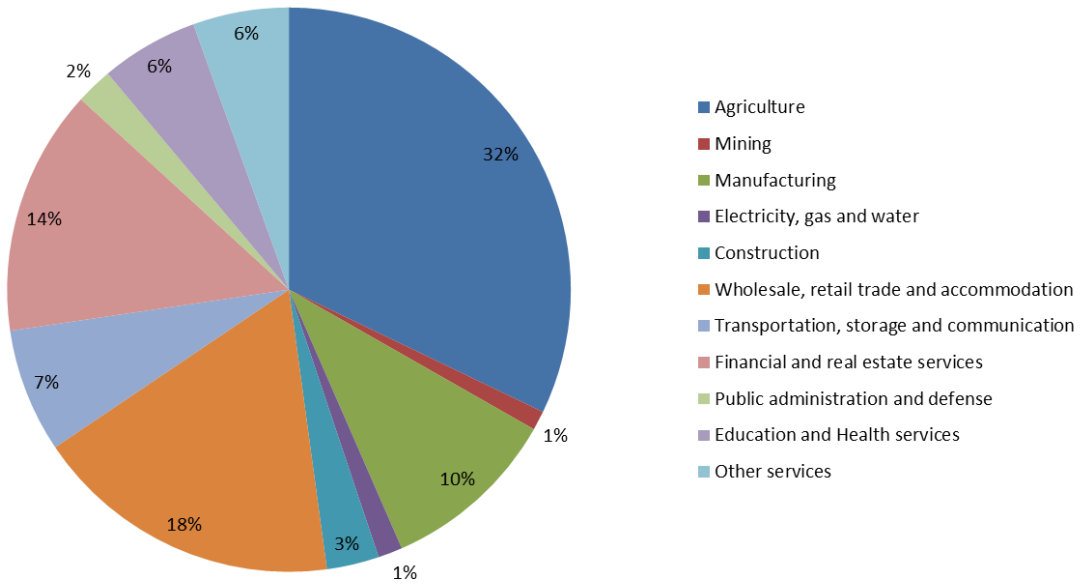


Figure 3: GDP breakdown per sector, 2013

Source: Ministry of Finance, Economic Planning and Development, 2014

Reliance on agriculture makes economy vulnerable to exogenous shocks and external price setting. The importance of agriculture to the Malawian economy leaves the Malawian population very exposed to exogenous risk events such as natural disasters. Droughts and floods can be potentially catastrophic for the livelihoods of Malawians since 86% of the population are engaged in farming for food security (National Statistics Office, 2012). Furthermore, the importance of agricultural produce for exports implies that low crop yields resulting from adverse weather conditions will depress exports revenues and therefore economic growth. Similarly, external price setting on agricultural produce inappropriate for the Malawian context has the potential to have disproportional distortional effects because of the large share of the sector in the economy.

Potential for strong growth in resources due to oil discovery. The overall contribution of the mining sector remains limited at 1% of GDP. However, the sector has been growing significant over the last few years albeit from a small base. The main mining commodities is Uranium[9], accounting for the largest share of the value of mining output in Malawi. Other major mining commodities include rock aggregate used in the production of concrete, coal and agricultural lime (Ministry of Finance, Economic Planning and Development, 2014). The mining sector has the potential to become a significant contributor to GDP in light of the potential oil discovery that was made in the Northern district of Malawi. No definite reserves have been found as yet.

Box 3. Agriculture sector context

Land mainly used for agricultural purposes. Sixty per cent of land in Malawi is used for farming activities. The agricultural sector can be divided into two sub-categories: the estate (commercial) agricultural sector and the smallholder sector. Smallholder farmers mainly focusses on producing staple crops such as maize, with many

[9] The launch of the Kayelekera Uranium Mine in 2012 saw the mining's sector output sore by 14.9%. Growth in 2013 was a bit more constrained at 7.6%. This was mainly the result of lower levels of output and low uranium prices at the international market. In fact, the combined effect of the depressed uranium price and higher production costs forced Paladin Energy Ltd to temporarily close the Kayelekera mine (Ministry of Finance, Economic Planning and Development, 2014).

farming for subsistence. It is estimated that only 15% of maize is marketed. The smallholder sector accounts for approximately 60% of agricultural output and the majority of farmers. Therefore, the estate sector accounts for approximately 40% output, with significantly fewer farmers This implies that the agricultural sector is decentralised with many individuals engaging in farming activities. Production levels from these smallholder farmers is constrained by the size of their land under cultivation, which restricts their ability to be commercially viable (Chirwa & Matita, 2012). In 2011, it was estimated that the average smallholder farmer utilizes less than 1 hectare of cultivated land. Given the trend in the population growth rate, it has probably decreased further since then (Ministry of agriculture and food security, 2011).

Agriculture in Malawi is critically dependent on rainfall. 99% of agricultural land remains under rain-fed cultivation. Consequently, agricultural production is very susceptible to adverse weather conditions, such as droughts. This has significant implications for Malawi's food security and the survival of the extreme poor in the country (Ministry of agriculture and food security, 2011).

Farm input subsidy programme (FISP) key to food security. Throughout its history, Malawi has always been vulnerable to food insecurity. The industry is exceedingly at risk to exogenous shocks due to adverse weather conditions (as discussed above) and lack of risk mitigation infrastructure such as irrigation. As a consequence, government resorted to an input subsidy as a tool to raise productivity and achieve acceptable levels of food reserves as an insurance against food shortages. This initially focused on a wide range of crops, but has recently narrowed to focus on maize and legumes. Notably, Malawi has only ever produced surplus maize when the government provided fertilizer subsidies. While the promotion of maize is important for food security, there has been a caution that the subsidy could detract from farmers focusing on higher earning cash crops. (Pauw & Thurlow, 2014).

Table 2 below indicates the total production and area of land used to cultivate each of the 8 main crops[10] in Malawi.

Crop	Harvest area ('000 ha)	Metric ton production
Tobacco	120	132,849
Sugarcane	27	2,900,000[11]
Oil seeds	680	156,554
Pulses	770	621,613
Tea	26	54,000
Cotton	185	158,826
Groundnuts	363	380,800
Maize	1,677	3,639,866

Table 2: Area and production of difference crops in Malawi (2013)

Source: FAO, 2013

Unmanufactured tobacco is essential for Malawi's international trade. Despite the total of production output of tobacco being relatively small compared to the other crops, it contributes more than half to total exports in value. In 1992 tobacco production was liberalised, which led to an increase of smallholder farmers growing the crop. (Chirwa & Matita, 2012). The entry of smallholder farmers into the tobacco market, reduced farming productivity and increasing logistical costs initially caused tobacco crop yields to decrease substantially

[10] Main crops are defined as the crops making the largest contribution towards exports and/or food security. The crops are ranked according to 2014 export value.
[11] FAO estimate (FAO, 2012)

(Jaffee, 2003). However, in recent years, tobacco crop yields have recovered from its slump and increased to 1.1 metric ton per hectare in 2013 with evidence of a rising trend (FAO, 2013).

Maize is Malawi's most important crop from a subsistence perspective. It is the primary crop planted in Malawi to ensure food security and currently is under an export ban to ensure the usage of the crop for this domestic need. As a result of the high incidence of subsistence farming, Malawi is deemed food insecure if maize supply is below the minimum food requirement. As indicated in table 1, the area on which maize is cultivated far exceeds that of any other crop. This is due to most smallholder farmers cultivating maize in at least a small area of their land for sale or consumption (Chirwa, 2013).

Sugarcane is, after tobacco, economically the most valuable crop in Malawi. It holds the second highest export value (more than twice that of tea which is ranked third). It also the crop with the second highest export volume, after maize, and it beneficiation has been targeted by the NES as a priority. In the last ten years, the area on which sugarcane is grown has increased by 35% and production has increased by 38% (FAO, 2014).

Tea is becoming an increasingly important crop for Malawi. The area on which it is grown has increased by 37% and production by 43% in the last 10 years. It is contributes the third most to total value of exports of agricultural commodities, after tobacco and sugar (FAO, 2014).

Oil seeds are identified as one of the key areas for agricultural growth in the National Export Strategy (NES) of Malawi. In the last 10 years, production has increased by 178% and the area on which oil seeds are grown have increased by 85%. This indicates a significant rise in the yields of oil seed crops.

The remaining main crops, amongst others, have been prioritised by the Malawian government for export and/ or agro-processing as part of an overall drive to increase the productivity of the agricultural sector.

Current account deficit driving a focus to reshape production. The current account deficit for 2013 was estimated at 15% of GDP. This is indicative of a country that is heavily reliant on importing goods and services. It is primarily driven by a wide, negative trade gap[12] of 23% of GDP. For this period, imports were more than double that of exports (Mwanakatwe, 2014).[13] Figure 4 below indicates that the majority of Malawian exports is agricultural goods, which mainly consists of raw tobacco (56%). In contrast, imports are widely diversified ranging from basic food stuffs to final goods. This disparity, as well as the large trade gap, has led to the development of the National Export Strategy.

[12] A trade gap is the difference between exports and imports.

[13] Malawi's main trade partners are South Africa, the European Union and China. Almost a third of exports are destined for the European Union, making it the biggest importer of Malawian goods. South Africa is the origin of the largest share of imports to Malawi at 22% of total imports (World Trade Organisation, 2013)

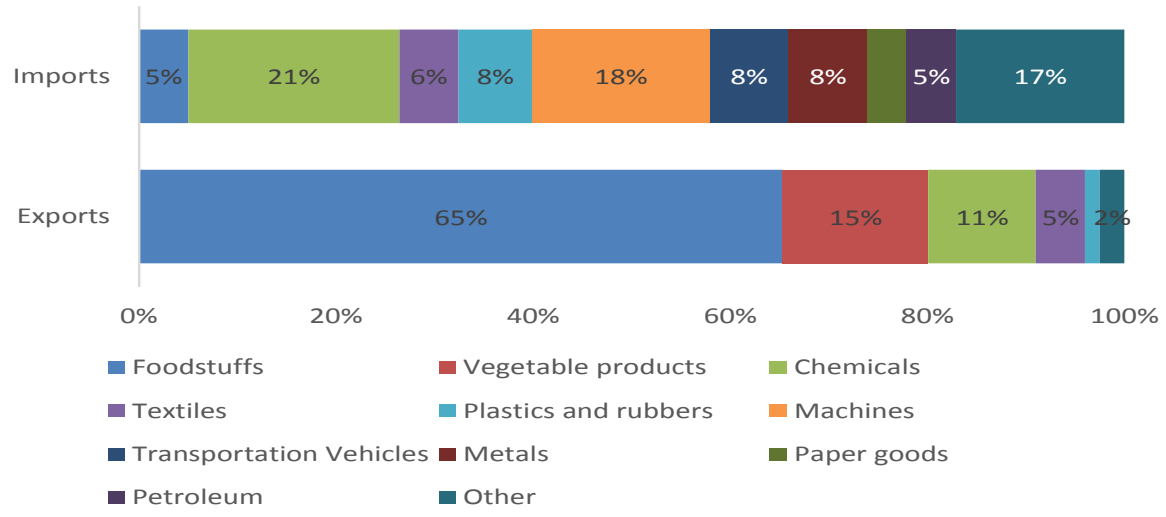


Figure 4: 2013 trade composition of Malawi

Source: United Nations, 2014

Significant constraints to trade due to land-locked nature and poor infrastructure. The government of Malawi is dedicated to transform the economy from a consuming, importing economy to a productive, exporting economy. There are however, major constraints to international trade in Malawi. Malawi's landlocked geography and poor infrastructure drives up trading costs. The World Bank (2014) estimates that, on average, it costs USD 2,200 over 34 days to export a standardized container by ocean transport. These significant costs and burdensome requirements greatly affect the comparative advantage that Malawi may otherwise have in certain goods and services.

Increasing levels of regional integration to foster trade. Malawi is engaged in a variety of bilateral, regional and multilateral trade relations to gain enhanced engagements with global markets. It is a member of the Southern African Development Community (SADC) and Common Market for Eastern and Southern Africa (COMESA) and is a signatory to the COMESA customs union and SADC free trade area. The government of Malawi has committed itself to reducing non-tariff barriers to regional trade. These have contributed significantly in the past to the high cost of trade and restricted the process of export diversification. Coupled with this, it is also in the process of implementing trade facilitation measures within the framework of SADC and COMESA to simplify and harmonize the documentation requirements for regional trade (Mwanakatwe, 2014).

Donor dependence of the public sector being substituted for debt. Figure 5 indicates the composition of the funding of the Malawian government budget. The largest share of the budget is financed from taxes and duties. In 2012, 37% of the budget was funded through grants from various donors. As a result there was limited need for borrowing. However, due to the cash gate scandal in 2012[14] and the subsequent withdrawal of a large proportion of donor funding the 2013 budget was put under significant pressure. Yet, despite the new zero budget policy introduced from 2013, the year of public expenditure increased by 0.7% to 25% of GDP. Consequently, the budget deficit as a percentage of GDP increased from 1.7% to 6%. The combined effect of the withdrawal of donor funding and increased public expenditure pushed the government to delve into the bond market to finance the deficit.

[14] The cash gate scandal refers to a corruption scandal that happened within the Malawian government that involved the looting of large sums of donor money. Many high level government officials, including President Joyce Banda, were implicated. The donor community subsequently withdrew their budgetary support which at that stage funded 37% of the entire national budget.

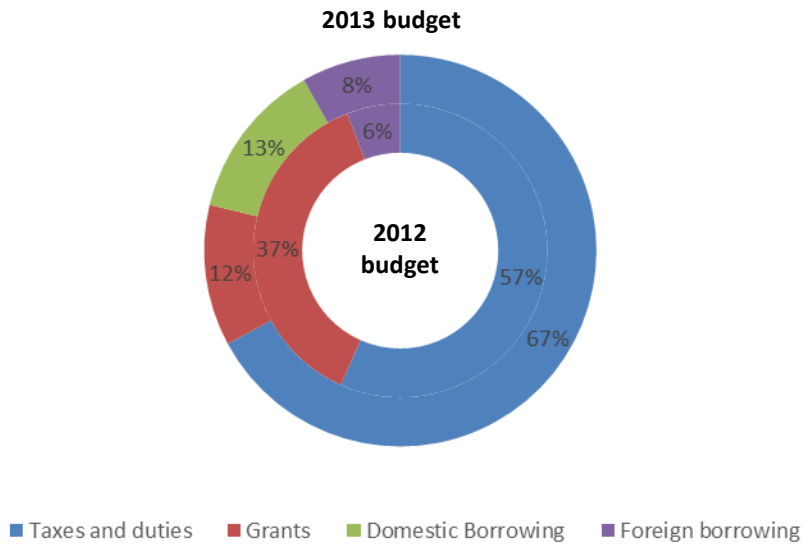


Figure 5: Composition of budget financing (2012 and 2013)

Source: Ministry of Finance, Economic Planning and Development, 2014

Box 4. Donor landscape in Malawi

Large and volatile aid flows to Malawi. Donor involvement in Malawi has increased substantially in the last few decades. Malawi's Ministry of Finance, Economic Planning and Development (2011) estimates that total donor aid flows to Malawi were more than 1 billion dollars in 2011. Figure 6 below illustrates the size of total official development assistance (ODA) flows to Malawi in US dollars from 1960 to 2012. It is clear that donor involvement increased significantly from the 1980s, with total aid rising up to 41% in 1994[15]. In 2012, total ODA aid flows into Malawi was estimated at 29% of GNI. The graph illustrates the volatility of aid flows to Malawi. This see-saw pattern holds true for the past decade and is very inhibiting for long term planning and stability.

[15] 1994 was the first time that Malawi held democratic elections

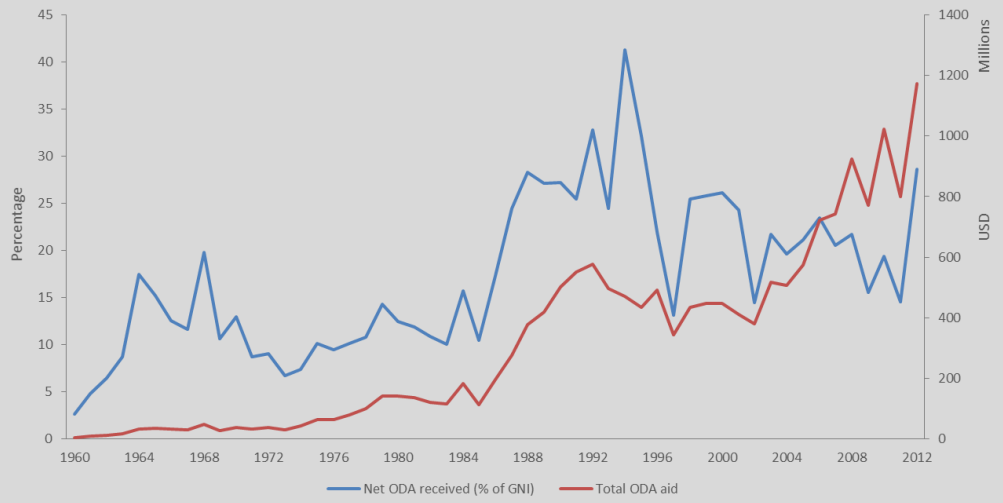


Figure 6: Official development assistance flows to Malawi

Source: World Bank, 2012

Donors are involved in all the economic sectors in Malawi with varying contributions.[16] The launch of the Millennium Development Goals (MDGs) in 2000 did much to enhance and coordinate donor aid, as well as prioritise certain sectors for intervention within Malawian society. Details of the 10 largest donors for the 2011 financial year are below in Table 4:

Donor	Number of projects	Aid disbursement in USD
USAID	13	124,503,992
World Bank	19	123,904,806
DfID	39	110,079,528
Global Fund	5	109,650,178
European Union	32	96,806,731
Norway	34	40,565,123
Japan	16	30,973,912
AfDB	11	29,197,764
CDC	11	24,668,969
GDC	17	22,556,557

Table 3: Sizing donor activity in Malawi (2011)

Source: Ministry of Finance, Economic Planning and Development, 2011

[16] Health care the biggest receiver of aid. The distribution of Aid is parallel with the focus areas of the MDGs. Approximately 25% (115 of 447) of all donor funded projects are health care related. This is understandable given the numerous health related challenges that Malawian society have experienced in recent history. Agriculture is the sector with the second largest donor presence, counting for 18% of all donor projects. This is mostly likely because of the pivotal role that agriculture plays in the combatting of poverty, especially in Malawi where 90% of the population is engaged in farming in some form or another.

Inflation is core to Malawi's macroeconomic struggles. High inflation has consistently plagued the economy since 2012. Figure 7 indicates inflation increased significantly from the beginning of 2012 and peaked at 40% in February 2013. Since then, it has trended steadily downwards to 20% in February 2015. The basket that makes up the Consumer Price Index (CPI) consists 50% of food and non-alcoholic beverages. The other major categories are housing, water and electricity (15%) and transportation (7%). The large share of food in the CPI basket implies that the inflation rate is very sensitive to adverse weather conditions which affect its production. The dramatic increase of inflation in 2012 was the combined result of the knock-on effects from the liberation of the exchange rate and a drought that significantly affected food supply during that period.

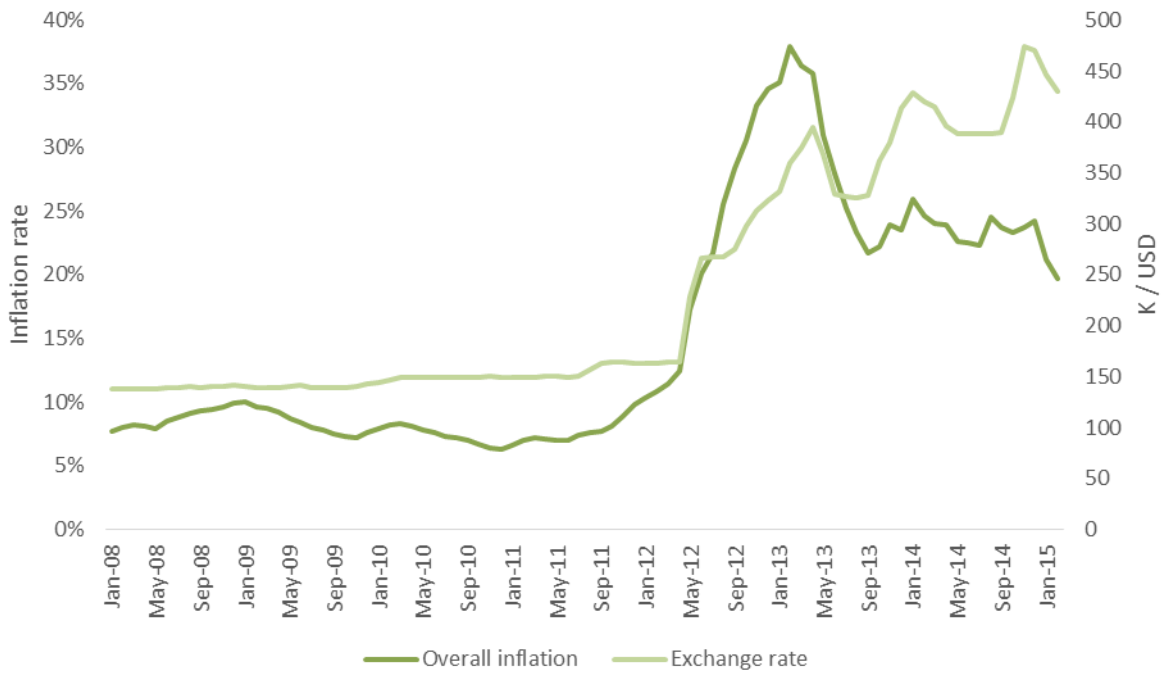


Figure 7: Inflation and exchange rate trends

Source: Reserve Bank of Malawi, 2015

Foreign exchange shortages hampers economic activity. The exchange rate was liberalised in 2012 through the adoption of a flexible exchange rate regime.[17] From Figure 7 one can clearly see a depreciation in the exchange rate in the subsequent time period. The Reserve Bank of Malawi argued that the depreciation in the currency will dampen demand for foreign goods due to the relative increases in prices and will increase the foreign exchange earnings from exports. However, Malawi has struggled to increase its foreign exchange reserves above the recommended import cover of 4 months, mainly because of variable tobacco crop yields and the withdrawal of donor funding.

Malawi ranks poorly in ease of doing business indicators. Private sector development is essential to achieve the government's vision of a productive and export economy. However, according to the World Bank (2014) the private sector is severely constrained. Malawi is ranked 164th out of 189 countries in the 2014 Ease of Doing Business Indicators. This is poor in comparison to the regional

[17] The time preceding the liberalization witnessed continued large spreads between the quoted exchange rate and the rate at which the currency traded on parallel market. There were also numerous episodes of significant foreign exchange shortages, which greatly restricted trade. These two factors were ultimately the IMF's motivation for pressuring Malawi to adopt a free floating exchange rate (IMF, 2012).

average.[18] Figure 8 below shows a breakdown of how Malawi is performing against the indicators that make up this figure.

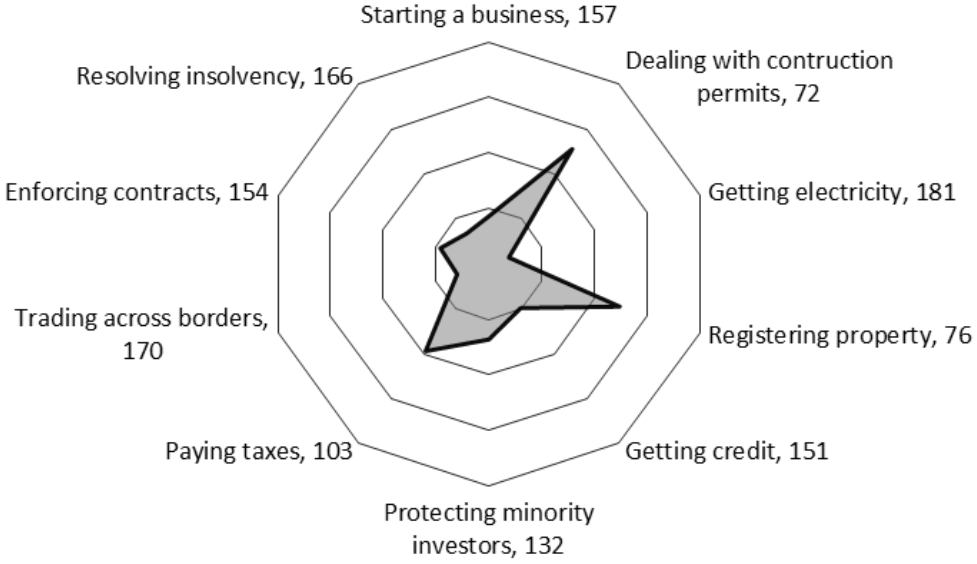


Figure 8: Ease of doing business indicators (world ranking)[19]

Source: World Bank, 2014

Macroeconomic environment constrains effective functioning of businesses, including financing service providers. High inflation, a volatile exchange rate, limited supply of FOREX, poor infrastructure and low economic growth all contribute to significant macroeconomic volatility and risk. The private sector in Malawi is faced with major risks relating to the environment in which they operate. This drives up costs and makes the economy less competitive. It also disincentivises innovation and promotes conservatism – especially in the financial sector in which institutions are sensitive to risks. Consequently, the macroeconomic volatility inhibits the formal financial sector's ability and appetite to expand business activities and move down market.

Box 5. MSME landscape

The development of Micro, Small and Medium (MSME) businesses falls under the mandate of the Ministry of Trade and Industry. The ministry defines MSMEs in Malawi as indicated in the table below:

[18] The average ranking for Sub Sahara Africa is 142/189.
[19] The number next to the indicator shows where Malawi is ranked compared to the other 189 participating countries.

MSME classification	Number of employees	Annual turnover (MK)
Micro	1 - 4	Up to 120,000
Small	5 – 20	120,001 to 4mil
Medium	21 – 100	Above 4mil to 10mil
Large	100 +	Above 10mil

Table 4: Official definition of MSMEs in Malawi

Source: Ministry of Trade and Industry, 2012 (draft)

Many MSMEs born out of necessity. According to FinScope's MSME survey (2012) 38% of MSME owners indicated that they established the business because they did not have any alternative to earn income. Therefore, a large proportion of MSMEs in the country are mainly reluctant entrepreneurs that operate survivalist businesses, which are unlikely to employ many people. Of the remaining MSMEs, more than half were established because their owner recognised a market opportunity[20]. Table 5 below indicates various descriptive characteristics of MSMEs in Malawi:

Malawi MSME profile	
Overview	Total number of MSMEs: 987,480 Total number of employees: 1,050,320
Size distribution	59% self-employed; 33% micro; 7% small; 1% medium.
Location	Northern district: 11%; Central district: 48%; Southern district: 41%
Area	Rural: 85%; urban: 15%
Gender distribution	Male 53%; female: 47%
Sectoral distribution	Agriculture: 63%; trade: 23%; services 7%; manufacturing: 7%
Registration	8% of MSMEs have business licences

Table 5: MSME profiles in Malawi

Source: FinScope MSME, 2012

MSMEs are mainly micro, rural, male run and unregistered. The majority (59%) of MSMEs are self-employed individuals with no employed staff. The remaining 41% employs more than a million individuals and consists mostly of micro enterprises. The geographic distribution is similar to that of the rest of the population. In contrast, the share of male owned MSMEs are higher than the population share of males. In aggregate, very few (8%) MSMEs are formally registered. However, Eighty two per cent of medium-sized MSMEs indicated that they are trading under a business licence.

High concentration of MSMEs in agricultural sector. Table 5 indicates that the majority (63%) of MSMEs are engaged in the agricultural sector. This further highlights the importance of the agricultural sector to the economy. Not only is it an invaluable part of society in terms of food security and productive outputs, but also because of the link to a vital growth area of the private sector.

Access to finance and low demand primary constraints to growth. Thirty four per cent of MSMEs regarded a lack of access to financing as the main obstacle to expanding their business operations. The second most popular response was a lack of demand for their products at 9%, followed by bad weather (6%) and transportation (5%). Malawi's high inflation and interest rate environment greatly increases the risk of

lending to MSMEs. The productivity of the respective MSME therefore has to be considerable to justify lending to its entrepreneur. Consequently, entrepreneurs in Malawi find it difficult to acquire the financing necessary to implement their ideas. Section 4.3.3.2 elaborates more on this topic.

2.2. Socio-economic and demographic context

Figure 9: Map of Malawi

Source: Ezilon.com, 2015

Landlocked, and geographically the smallest of all its neighbours. Malawi is located in South-Eastern Africa and borders Zambia on the West, Mozambique on the South and Tanzania on the North-East. There is no access to the ocean except through one of its eastern neighbours. The total land area of Malawi is 118,480 km^2, which includes 24,404 km^2 of water surface.

Densely populated country with a predominantly rural population. Malawi has a population of 16,362,567 people with a population density of 138 individuals per square kilometre. This makes Malawi one of the most densely populated countries in Sub-Saharan Africa (World Bank, 2013). Fifty five per cent of Malawians are adults. Figure 10 indicates that 57% of adults are female. The majority (85%) of the population live in rural areas.

[20] Other reasons for starting a business includes "interested in a particular product or service 6%), wanted to be own boss (5%), wanted to (5%)"

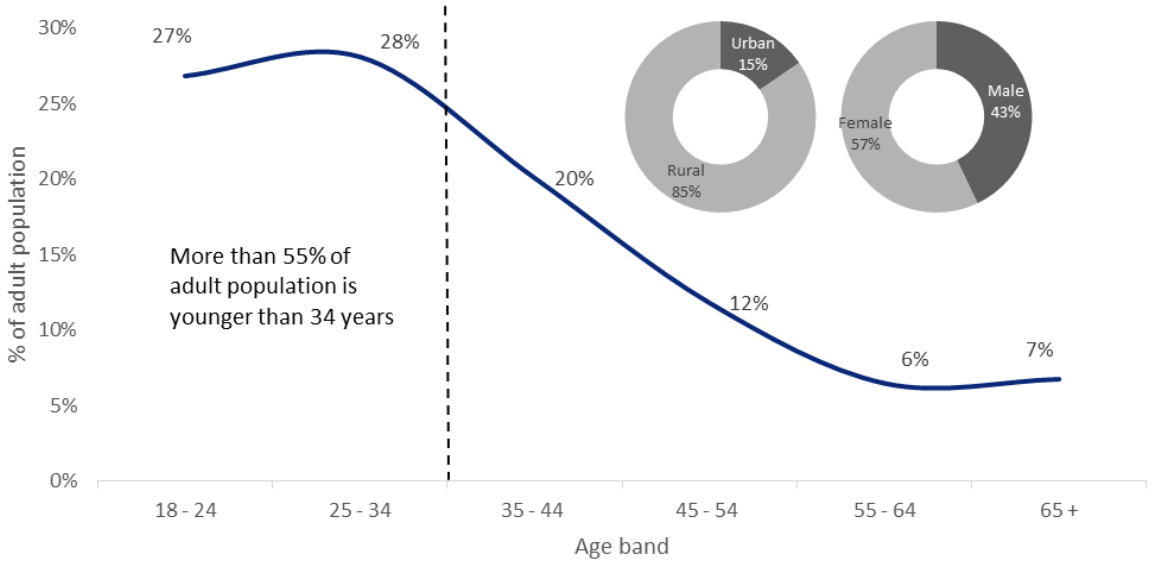


Figure 10: Adult population split across gender, rural-urban distribution and age

Source: FinScope, 2014

Increasing population growth rate has driven increases in urbanisation. Between 1987 and 1993 the population growth rate plummeted from 6% to 0% due to a very high disease burden and high infant mortality. This trend reversed in the subsequent years as better health outcomes were achieved. A direct consequence of the recovery in population growth rate was decreasing economic opportunities in rural areas due to smaller farm sizes. This phenomenon explains an increasing rate of urbanisation. In 2013 the urbanisation rate was 4%, which is 1% higher than the population growth rate (3%). Therefore, there will be increasing pressure on urban areas to support the population (Ministry of Lands and Housing, 2013).

SADC the primary destination for Malawian migrants. The United Nations reported there were 267,564 Malawians residing outside the country in 2013. The majority of them (90%) currently resides in different SADC countries. Other popular destinations for Malawian migrants are the United Kingdom and the United Arab Emirates (United Nations, 2013). It is likely that the total number of migrants is underestimated, because of the share of migration that occurs through informal channels into other SADC countries.

Land policy impedes development of private property. Approximately 90% of land in Malawi is customary land. As of yet, there are no defined laws that oversee the property rights of customary land. This serves as a significant barrier to long term investments because of the legal uncertainty that exists concerning the ownership of property. Under customary law, the right to own or distribute is not based on documentation that is guaranteed by a government statute, but on what is perceived as legitimate by the community and is normally not recorded in writing (Centre for Affordable Housing Finance, 2014).

The majority of the population live below the breadline. Poverty in Malawi remains high despite recording positive GDP growth in recent years. The World Bank (2013) estimates that 72% of Malawians live on less than USD 1.25 (PPP) a day. Figure 11 below depicts the income distribution of Malawi. The distribution is heavily skewed to the right, implying that the majority of Malawian adults

earn no or low levels of income. It shows that 55% of adults earn less than USD 12 a month, and 75% of adults earn less than USD 24 a month.

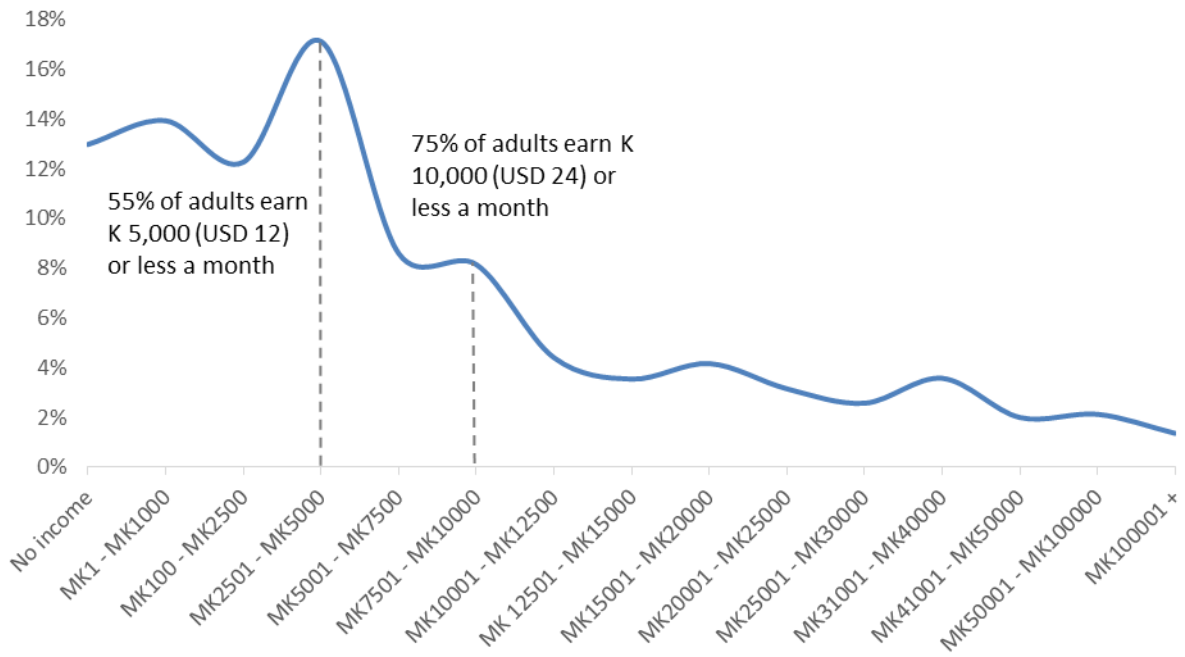


Figure 11: Monthly income distribution

Source: FinScope, 2014

Social protection programmes provide essential safety net to most vulnerable in society. The Ministry of Finance, Economic Planning and Development (2014) estimates that the government's social protection policies reach approximately 4 million people. There are four major categories of social protection programmes in Malawi; namely: the social cash transfer programme, the school meals programme, the public works programme and the farm input subsidy programme. The food and cash transfer policies have had limited success in reducing the absolute levels of poverty on a sustained basis, but it has provided a much needed supplement to the incomes of many destitute Malawians. In general, social protection programmes have been crisis orientated purely to act as a safety net in times of great need. To provide longer term solutions to poverty, the government has implemented the farm input subsidy programme. Agriculture data seems[21] to indicate that this programme has been quite successful in capacitating smallholder farmers to achieve crop yields necessary for food security.[22] However, there are concerns regarding the financial affordability of this programme as it has been expensive to implement (Charman, 2012).

Poverty and subsistence economy adversely affects education attainment. The World Bank (2013) estimates that the adult literacy rate in Malawi is 61%. Malawian males are significantly more literate (72%) than females (51%).[23] Primary education is free and compulsory for all Malawians. However, there are still many children do not get an opportunity to complete primary school (74% completion

[21] The political importance of agricultural data in Malawi has led academics to question the validity of data on numerous occasions, because there have been evidence of data tampering.
[22] In 2010 it was estimated that Malawi requires at least 2.5 million tons of maize to achieve food security. In 2010 Malawi produced almost 3.5 million tons of maize.
[23] According to a report by Ripple Africa (2015), 42% of girls drop out of education prematurely because of early marriage or pregnancy.

rate). Primary education usually starts when children are aged 6 years old and lasts 8 years, from standard 1 to standard 8. English is prioritised throughout children's' school years and all subject are taught in English from standard 5. Secondary education consists of 4 forms, each form lasting 1 year.[24] Secondary schools are not free and the yearly enrolment fees range between USD 30 and USD 1050. These fees exclude additional costs such as uniforms, text books, transportation costs, etc. The fees attached to secondary education, as well as the opportunity of forgone income when sending a child school, makes secondary education often unaffordable for households. Consequently, enrolment in secondary education is low and completion is significantly worse than primary education. Access to tertiary education is extremely limited and largely as a result of low secondary education completion rates (Ripple Africa, 2015). [25]

Life expectancy increasing as health care improves. As mentioned above, Malawi has historically been plagued by a high disease burden and infant mortality rate. In 1990, life expectancy was 47 years of age and 25% of infants aged under the age of 5 died per year. Since then, life expectancy has increased to 55 years and the under 5 mortality rate decreased to 7%. During this period of improvement total national health care expenditure increased from USD 12 per capita to USD 25 per capita. For this same period, donor funding of health care increased from USD 40 per capita to USD 85 per capita. The increased level of resources in health care contributed to the significantly improved health results. It also affected the cost of health care for individuals. Out-of-pocket expenditure on health care decreased from 26% to 9% of total expenses (World Health Organisation, 2014).

Box 6. Overview of the Malawian healthcare system

The Malawian health system consists of three different levels. Primary health care is mainly provided through community based programmes such as community health care centres and hospitals. At a secondary level, care is provided via district and CHAM[26] hospitals. Tertiary care is administered through central hospitals. Table 6 below indicates the health care provider landscape.

Ownership	Primary	Secondary	Tertiary	Others	Total
Government	493	53	5	24	575
CHAM	96	42	1	8	147
NGO	56	1	0	13	70
Private	243	4	0	0	247
Statutory organization	13	0	0	7	20
Total	901	100	6	52	1059

Table 6: Facilities by type and ownership

Source: World Health Organisation, 2009

[24] After the first two forms the pupil writes a junior certificate examination, which is a requirement to enrol in the last two years of secondary school. A senior certificate examination is written at the end of form 4. Only 14% of individuals that enrol in secondary education completes the junior certificate examination.
[25] Only 0.8% of the population enrolled in tertiary education in 2011 (World Bank, 2013).
[26] CHAM (Christian Health Association of Malawi) was established in 1966 to advise churches on health related concerns. The objectives of CHAM is to coordinate, facilitate, provide and develop health care across the entire country.

Shrinking disease burden[27]. HIV/AIDS is the biggest killer in Malawi. In 2012, 27.1% (40,800) of deaths was attributable to HIV/AIDS. The disability-adjusted life years lost (DALY) due to HIV/AIDS increased in the excess of 200% for the period between 1990 and 2010. However, this figure peaked in 2000 and is on a downward trend. Malaria is the second biggest cause of DALYs in Malawi and responsible for 6.3% of total deaths in 2012. Similar to HIV/AIDS, the health burden of malaria is slowly decreasing. Lower respiratory infections are the second biggest killer in Malawi, causing 8.6% of total deaths. The DALYs of lower respiratory infections increased slightly, but is on an upward trend. The mortality rates and DALYs of historically burdensome health issues, such as diarrhoeal diseases and protein-energy malnutrition, are trending downwards (Institute for Health Metrics and Evaluation, 2012; World Health Organisation, 2012).

Despite the marked improvement in health care outcomes, there is still considerable scope to do more. Malnutrition is very prevalent with approximately 47% of children aged under 5 years of age being stunted. There is also a significant shortage in health care personnel. In Malawi there is only 1 doctor per 50,000 people, compared to 13 per 50,000 people in the rest of Africa (World Health Organisation, 2012).

Crime and social disorder an increasing concern in Malawi. The crime and safety situation in Malawi is a growing concern, especially with a high urbanisation rate and limited economic opportunities. Criminal activity is higher in urban areas and the general lack of trust in the public police force has resulted in a number of community justice incidents (Overseas Security Advisory Council, 2014). The abuse of alcohol has been associated with many domestic crimes.[28] The continued negative effect of alcohol in Malawian society has prompted the government to establish a National Day on no harmful use of alcohol (Eide *et al.*, 2013). Public protest events have continued since 2011, as the public's discontent with the current economic situation increases. Even though most of these protests events have been peaceful, there were a few incidents when violence broke out. Most notable was the nationwide anti-government protest in 2011 which resulted in at least 20 civilian deaths (Overseas Security Advisory Council, 2014).

2.3. Infrastructure context

Limited infrastructure to facilitate domestic and international trade. The World Economic Forum (2014) ranked the overall quality of Malawi's infrastructure as 118 out of 144 countries. This ranking of "inadequate supply of infrastructure" is considered the third biggest constraint on business activity. The World Bank (2013) estimates that Malawi has road network of 15,451 kilometres, of which 45% is paved. The railway network in Malawi is limited. The network extends from the Zambian border in the west through Lilongwe, to Blantyre in the South into Mozambique. There it links with the Nacala corridor, which goes east to the deep-water port at Nacala. This link to the ocean is essential for international trade. The road and railway infrastructure is ranked 99th and 89th out of 144, respectively. Malawi has one international airport, which is located in its capital city, Lilongwe. The African Development Bank (AfDB) has agreed to fund a feasibility study for the development of an inland port at Nsanje, Malawi and the construction of the Zambezi Waterway. This project could potentially enhance the efficiency of trade for Malawi. However, very limited progress has been made since 2012. The Chinese government is also a key contributor to infrastructure development in Malawi.[29]

[27] Disease burden is measured as Disability-Adjusted Life Years (DALYs), which is the sum of *life lost due to premature mortality* and *years of health life lost due to disability*. This figure is calculated for the entire population to ultimately measure the aggregate cost of the disease in terms of healthy years lost.
[28] Alcohol was linked to 25% of murders, 40% of suicides, 27% of road traffic accidents and 45% of sexual and physical assault cases.
[29] China has proved a willing partner to the Malawian government to assist it in tackling the major infrastructural challenges in the country. China has also been involved in the construction of the 101 kilometre Karonga Chitipa road worth 55 million USD, a soccer stadium worth 65 million USD and the construction of a 5 star hotel worth 90 million USD (Thindwa, 2014).

Poor electrification with significant supply shortages. According to the World Bank (2013), only 8.7% of Malawians have access to electricity. There is significant differences in electrification between rural and urban areas. 37% of the urban population have access to electricity compared to only 3.5% of the rural population. The Electricity Supply Corporation of Malawi (ESCOM) is the sole provider of electricity in Malawi. Hydropower accounts for 94% of generated energy. The power utility has struggled to generate sufficient power to supply the meagre grid with enough and consistent electricity flows.[30] This is support by the FinScope (2014) survey, in which only 9.5% of urban adults and 0.5% of rural adults indicated that they use electricity for cooking.

Access to an improved water source[31] high, but limited access to sanitation. Most (85%) Malawians have access to piped water on their premises, with 95% of urban individuals and 83% of rural individuals. In contrast, only 10% of Malawians have access to sanitation facilities. More individuals living in urban areas access to sanitation (22%) compared to individuals living in rural areas (8%).

Underdeveloped irrigation network in Malawi. The World Bank (2013) estimates that Malawi's irrigation network reaches only 0.53% of all agricultural land. This figure is indicative of a significantly underdeveloped irrigation network, especially given the abundance in water resources that Malawi has access to. The Malawian government has implemented a variety of irrigation strategies[32] to expand the reach of the country's irrigation network. It estimates that these initiatives increased irrigation-fed agricultural land by 2,759 hectares to the benefit of 72,000 farmers (Ministry of Finance, Economic Planning and Development, 2014). However, this only represents a very small proportion of total arable land.

High mobile penetration, despite limited levels of electrification. Approximately 70% of Malawian adults access mobile telecommunications services with 50% of adults owning their own cell phone. This implies that a sizeable proportion (20%) of adults access mobile networks by borrowing a cellphone. (Groupe Speciale Mobile Association, 2012). The cost related to mobile phone usage in Malawi as a percentage of GDP was estimated at 56%. This was the highest in the world in 2013. Yet, despite the extremely high costs and unreliable access to electricity, the trend in mobile subscribers have been steadily upwards over the past few years (ITU, 2014). Supply-side interviews and qualitative research (2014) indicated that there are concerns regarding the mobile and broadband network in Malawi. The network often experiences down-time and significant periods sub-optimal performance. Therefore, even though the mobile penetration rate is high, mobile access is often restricted as a result of network failures.

2.4. Political context

A multi-party democratic system with a liberal democratic constitutional order. Malawi is a democratic republic with two spheres of government: national and local. The executive consists of a president, a first and second vice-president and a cabinet. The president is the head of state and can be elected for a maximum of two five-year terms. Cabinet members are appointed by the president and do not have to be members of parliament. The legislative branch of government consists of a unicameral National Assembly that has 193 members elected by popular vote. Malawi has an independent judiciary that comprises of a Constitutional Court, High Court, Supreme Court of appeal and lower

[30] To address the unstable electricity supply, the Malawian government has signed a USD 667 million deal with a Chinese energy company (Thindwa, 2014).

[31] Access to an improved water source refers to the percentage of the population using an improved drinking water source. The improved drinking water source includes piped water on premises (piped household water connection located inside the user's dwelling, plot or yard), and other improved drinking water sources (public taps or standpipes, tube wells or boreholes, protected dug wells, protected springs, and rainwater collection).

[32] These strategies include: The smallholder crop production and marketing project

level magistrates' courts (Commonwealth Local Government Forum, 2012). After independence from British rule in 1964, Malawi was under the rule of Dr Hastings Banda for 30 years. During that period, power was centralised in the presidency. In 1994 Malawi transitioned to a democratic political system. A more liberal constitution was deliberately designed to disperse power from the presidency to various public and private institutions. However, due to a lack of human resources and capacity, the presidency remains extremely influential in policy decisions (Chirwa & Chinsinga, 2013).

Poverty reduction through economic development a priority for government. Throughout the policies of the Malawian government, it is clear that the government has a strong focus on reducing the extent and depth of poverty in the country. Listed below are three of the most prominent policies relevant for financial inclusion in Malawi:

- *The Malawi Growth and Development Strategy II (MGDS II)*. MGDS II is Malawi's overarching medium term strategy designed to attain its long term growth and development aspirations.

- *Financial Sector Development Strategy (FSDS) 2010 - 2015.* The main goal of the financial sector development, as envisioned by government in MGDS, is to build a sector which supports financial services and stimulates sustainable economic growth.

- *National Strategy for Financial Inclusion (NSFI).* The NSFI focuses specifically on improving the delivery of quality and diverse financial services to those that are currently excluded from the financial sector.

High donor involvement, but volatile. As discussed in Box 4 aid flows to Malawi are highly volatile. Since the transition to a multiparty democracy in 1994, and the subsequent increase in donor funding, donors have not hesitated to withdraw funding when there were reports of governance concerns. For example, the IMF suspended their lending programme to Malawi in 2001 and 2011, because of economic mismanagement (Resnick, 2012). Global Financial Integrity (2013) estimates that overall illicit financial flows from Malawi totalled USD 1,046 billion in 2011 (26% of GDP) and USD 552 million in 2012 (13% of GDP). For a country so heavily dependent on foreign aid, the subsequent withdrawal of USD 150 million in budgetary support came at a great cost to the economy and society (Dionne, 2014).

3. Regulatory and policy framework

This section outlines the policy and regulatory framework applicable to financial services in Malawi and the key regulatory issues from a financial inclusion point of view. It starts by giving an overview of the policy framework and then provides context and describes the structure of the regulatory framework, before discussing key regulatory issues.

Key issues: regulatory framework

Previous financial inclusion policy expired in 2014.

Existing policies encourage inclusion through:

- Allowing a tiered approach to documentation for AML/CFT purposes.
- Enabling alternative distribution such as bank agency and mobile money.
- Allowing deposit taking by microfinance providers.
- Changing bank data collection strategies to promote inclusion.
- The introduction of financial literacy and consumer protection initiatives.
- Establishing a unit responsible for financial inclusion within the Ministry of Finance.
- Encouraging risk mitigation through considering microinsurance initiatives.
- Improving credit information through the establishment of credit reference bureaus.

A number of gaps and contradictions in the regulatory framework create uncertainty for both financial customers and providers and invariably contribute to the risk and cost for one or both. These include:

- No population register or National ID
- Self-risk assessment is required by financial services providers to meet AML/CFT requirements
- Lack of electronic transactions and communications legislation
- NPS bill delayed and lacks interoperability requirement
- No comprehensive credit regulation to clarify market conduct requirements
- Uncertainty over jurisdictional authority of different consumer protection regulatory bodies
- Exchange control and export control cause distortions in the market
- The Pension Act places onerous requirements on small businesses

- The definition of banking business is unclear
- The MSME policy remains in draft since 2012

Malawi's regulatory framework has suffered from frequent structural changes. Partly as a result of this the country's courts are both inefficient and ineffective, constituting a major risk and cost for financial service providers, particularly in the provision of credit.

3.1. Policy environment

Frequent policy reversals contribute to environmental uncertainty. Malawian financial sector policy has not been stable over the years and has been characterised by periods of beneficial policy development and growth interspersed with periods of policy reversal accompanied by financial sector stagnation or decline (World Bank, 2015). These frequent policy reversals not only undermine the generation of long term policies but also create an uncertain operating environment for financial providers which increases their operating risk and therefore cost.

Financial sector policy often driven by donor agenda. There is a very close correlation between development partner policy assistance frameworks, financial sector policy changes and financial sector development. Very limited financial sector development occurs that is not co-funded by development partners due to State budgetary constraints. Donor policy support instruments and strategies therefore shape the direction of financial sector development in Malawi.

Government strategy guided by MGDS II. Malawi currently operates under one consolidated national strategic framework which underpins and co-ordinates government activity. Thematic elements contained within the national policy are, in theory, then extracted and developed into subject specific policies such as financial sector policies, which are aligned to the national policy. The Malawi Growth and Development Strategy II 2011 to 2016 (MGDS II) is the second medium term national development strategy and is intended to be a single policy reference document. MGDS II is based on six thematic areas:

1. Sustainable Economic Growth;
2. Social Development;
3. Social Support and Disaster Risk Management;
4. Infrastructure Development;
5. Governance; and
6. Gender and Capacity Development

From the focus areas, nine key priority areas were identified:

1. Agriculture and Food Security;
2. Energy, Industrial Development, Mining and Tourism;
3. Transport Infrastructure and Nsanje World Inland Port;
4. Education Science and Technology;
5. Public Health, Sanitation, Malaria and HIV and AIDS Management;
6. Integrated Rural Development;
7. Green Belt Irrigation and Water Development;
8. Child Development, Youth Development and Empowerment; and

9. Climate Change, Natural Resources and Environmental Management.

There is no explicit focus on the development of financial service sector despite the crosscutting role that financial services would need to play in order to materially advance the nine key priority areas.

MGDS II places heavy reliance on MFIs to deliver on financial inclusion goals. Where goals involve focus actions and activities with a financial inclusion component, on most occasions there is a strong reliance upon micro-finance institutions and methodologies.

3.1.1. Financial sector policies

The Financial Sector Development Strategy 2010 to 2016 (FSDS) is Malawi's primary financial sector development policy. Developed in line with MGDS I (which was in force at the time) and therefore predating MGDS II, FSDS is not strictly in line with current national policy. The policy aims to align the financial system with growth sectors, creating a conducive business environment with an emphasis on financial inclusion, financial deepening and competitiveness. Many of the policy's intended outcomes still remain challenge, however there was significant movement on the legislative and regulatory fronts and some of the of the financial infrastructure requirements identified in the strategy have been effectively introduced..

3.1.1.1. Financial inclusion-specific policies

The Malawi National Strategy for Financial Inclusion (2010-2014), which has run its course, was Malawi's primary financial inclusion strategy. The strategy was intended to focus on the key financial inclusion-related aspects of the FSDS. These included greater market transparency, developing the financial infrastructure and promoting the MSME sector. The specific targets identified in the strategy are listed in box below.

Box 7. Targets of Malawi's National Strategy for Financial Inclusion (2010-2014)

i. Provide loans to 3.4 million Malawians by the end of 2014;
ii. Increase the loan portfolio of inclusive finance providers by K 88,714 million (USD 212,2 million) in 2014;
iii. Increase the volume of savings mobilized to a level of 676,910 million Kwacha (USD 1.44 billion) by the end of 2014;
iv. Support the existing inclusive finance providers to increase outreach and establish 10 new (two each year) inclusive finance providers;
v. Support savings mobilization and transform five credit-only MFIs into deposit-taking inclusive finance providers;
vi. Establish two cooperative banks;
vii. Increase the number of women clients in the sector to a level of 60 percent;
viii. Eliminate exclusion by improving access to inclusive financial services to the disadvantaged groups; and
ix. Provide financial literacy education to all.

A number of policies covering other sectors also have a direct or indirect impact on the development of the financial services sector, either by providing a facilitative environment for the provision of

financial services or financial inclusion can help achieve alternative policy goals. Some of these policies are discussed below.

Health Sector Strategic Plan aims to reduce out of pocket expenses. In the past, health care financing has been insufficient to meet basic health needs of the population despite financing support from development partners. The Health Sector Strategic Plan (HSSP) contains various plans to increase health care financing to a level which it considers adequate to ensure sufficient health care access for the entire population. It envisions a 5 year budget of USD 2.5 billion. A 50-50 financing burden is anticipated, with national government and donors sharing equal responsibility of funding the HSSP. The Malawian government is committed to increase the health sector's share of the national annual budget to 15%[33] from its current 8.4% to ensure that it meets the funding targets (Ministry of Health, 2011).

Private sector promoting telecommunication policy to increase access to communication services. The 1998 communication sector policy emphasises the critical role that the private sector has to play to achieve greater levels of telecommunication penetration in Malawi. The policy envisions that the competitive forces of the private sector will enhance access specifically for the rural population, where most Malawians live. Part of the liberalisation process will be to eventually sell the government's majority stake in Malawi Telecommunications Limited (MTL). The Malawi Communication Regulatory Authority (MACRA) was established under the policy to regulate all entities involved in communications in Malawi. MACRA is an independent institution and reports to the Ministry of Information. Its primary function will be to issue licences (Ministry of Information, 1998).

Creating an enabling trade and industry environment a key priority for government. Similar to the telecommunications policy, Malawi's trade and industry policies have a strong private sector focus. The National Export Strategy (NES) aims to increase exports to keep up with the economy's consumption and import levels. The strategy focuses on enhancing the productive capacity of specific export-orientated clusters. These clusters include oil seed products, sugar cane products and manufactures; specifically manufacturers engaged in agro-processing. Furthermore, existing export clusters will receive support to facilitate diversification of products and greater levels of value-addition (National Export Strategy, 2012). Another priority area for government is MSMEs. The core message of the MSME Policy Strategy of Malawi is that government should create "an enabling environment that combines minimum regulation with maximum openness and provides equal incentives for all enterprises." Access to finance, and specifically start-up financing, is identified as a key element to promoting MSMEs. It is proposed that the private sector should be incentivised to provide more innovative financial products to MSMEs. The policy also supports the institutionalisation of a national identification system, the lack of which is currently detrimental to MSMEs' ability to access finance.

3.2. Regulatory framework

Malawi's legal system historically in a state of flux. Malawi's legal structure has experienced a chequered and unstable history. Changes in the political leadership have instigated a number of fundamental changes to Malawi's court structures over the last 50 years. Many of these changes have reversed or backtracked on prior modifications. The key configurations of the country's legal system over this period include:

[33] In 2001 countries belonging to the African Union (AU) set the target for health care financing as a percentage of national budget at 15%. This declaration was dubbed the Abuja declaration.

- Prior to 1966, as a British colony, Malawi applied the English legal system in the enforcement of formal contracts. However, traditional legal systems were also recognised and applied in rural, customary areas.

- Following independence in 1966, the then Government formalised the traditional legal systems. This created a legal system that operated in parallel to the formal legal system with extensive lower regional and appeal powers over traditional communities. Furthermore, these traditional courts were subverted as instruments of executive power through the appointment of loyalist chiefs with little or no customary law training. The traditional court structures were therefore used to reinforce the centralised executive power and hence undermined the courts' efficacy.

- In 1993, following the change in the executive, the traditional legal structures were abolished and converted into Magistrates courts based mainly on received English legal principles. This change prompted major structural changes and upheaval, causing further turmoil and undermining performance.

- The traditional courts were then reinstated in 2011 with limited jurisdiction as a step to restore customary judicial structures and effective access to justice. This change once again caused disruptions and upheaval, particularly as most of those with experience of the traditional legal system had been lost in the intervening period.

The primary result of this fluctuating approach to Malawi's legal system is that it has been in an almost permanent state of disruption and upheaval as structural changes are implemented and core knowledge is learned or relearned. These disruptive changes have led to:

- A scarcity of experienced officers.

- A lack of trust in the court system.

- A lack of effective access to justice for the vast number of Malawians reliant on Traditional court processes.

- Backlogs and reduced efficacy of the formal legal system.

Inefficient courts frustrate the development of financial services. The inefficiency of Malawi's court processes, both traditional and formal, represents an inherent barrier to formal financial services providers realising collateral and enforcing debt. A number of industry participants highlighted the delays in civil processes, particularly the realisation of collateral, as a major barrier to the extension of financial services, especially credit. According to supply side interviews, most legal matters involving collateral take 2-3 years before the matter is heard by a court. The standard civil process averages 432 days (World Bank, 2014), but could be as long as 5 years (International Bar Association Human Rights Institute, 2012). In a high interest rate environment like Malawi, formal legal system processes to realise loan security have been rendered irrelevant for all but high value matters as the cost of legal proceedings often outweighs the value recouped by the credit provider and the potential realisable value is diminished either by inflation directly or by the impact on affordability of any judgement after any accumulated interest. The risk of contract enforcement for providers is then reflected in larger interest rate spreads, particularly for lower value loans, as the provider endeavours to price the risk into the cost of the loan.

Civil judgements often ineffective. The delays in civil processes, a lack of trained personnel, an ineffective collateral register system and perceived corruption of the justice system are all aspects that affect the credibility and effectiveness of the judicial system. Judgements are also often ineffective and difficult to enforce, particularly against Government and the executive. Non-compliance with court orders is as high as 60-70% in certain types of matters (International Bar Association Human Rights Institute, 2012). This erodes the rule of law. In many cases, default judgements[34] result simply because parties have lost interest or communication with the courts regarding their matter.

Sluggish legislative process delays development of financial services industry. Malawi's legislature only operates for brief periods during the year. The Malawi constitution requires parliament to sit for a minimum of 10 weeks per year in two sittings. However, even this low target has frequently not been achieved. For example, between 2004 and 2009 the Malawian parliament met only 8 times for a total period of about 30 weeks (Catholic commission for justice and peace 2004-2009 Parliamentary audit, 2009). This creates a lot of pressure for competing ministries to get important bills passed and means that if this short window is missed, the next opportunity to pass important legislation is six months later. The short sitting period is, at least partly, due to a lack of funding to house and feed legislators that must travel to Parliament in Lilongwe (Rotberg & Salahub, 2013). The result for the financial services sector is that important legislation can remain in bill form for long periods waiting to be passed by the legislature.

Legislative process can result in inappropriate changes and badly structured amendments to bills before enacting. Well drafted and structured financial bills are sometimes enacted with either vague additions, deletions or inappropriate changes to the structure. This is particularly problematic as bills that have been technically drafted to serve the requirements of the market regulator are changed through the parliamentary process by legislators with little or no technical expertise. This can have an unintended disruptive or restrictive effect on the financial services industry and it can also potentially limit the discretion of institutions and ministries to issue competing regulations in order to make the legislation more effective and meaningful.

3.3. Supervisory landscape

Table 43 in appendix 1, shows the supervisory landscape of the different types of financial institutions in Malawi as well as listing under which primary legislation their activities fall, their permissible activities and their basic prudential and operating requirements. The Reserve Bank of Malawi is the primary supervisor of all formal financial institutions in Malawi, with the different types of institutions supervised by relevant divisions within RBM. RBM is governed by an independent board of directors to which the Governor is answerable, whilst the principal objectives of RBM are defined within the Reserve Bank Act of 1989 and the Reserve Bank (Amendment) Act of 2011.

3.4. Regulatory issues for financial inclusion

Recent changes to financial legislative framework. Within the last 5-10 years a number of important financial services acts have been passed into law. These include amendments to the Umbrella Financial Services Act, the Agency Banking Regulations, the Financial Cooperatives Act, the Credit Reference Bureau Act, the Pension Fund Act and the Microfinance Act. However, there remains a

[34] Default judgments arise in circumstances whereby one party to a suit has failed to perform a court-ordered action, and subsequently that failure has not only prevented the issue from being presented before the court but also results in the court settling the legal dispute in favour of the compliant party.

number of gaps in the legislation as well as contradictions in the regulation, both of which increase uncertainty for market players and also creates challenges for regulators. Some of these key regulatory issues relating to the provision of financial services are discussed below.

No population register or National ID increases cost and risk for financial providers. The existing Malawi legislation includes no framework for the maintenance of a population register and database which would be required to underpin the issuance and maintenance of formal identification documents. Due to process deficits, fraud and counterfeiting, the voters registration card (the only widespread form of identity in Malawi) is no longer viewed as an effective form of identification by financial institutions. Instead financial service providers require passports or driving licenses as proof of identification from communities with very limited numbers of licensed drivers and fewer numbers of international travellers. The lack of a national ID makes it very difficult and expensive to meet KYC (Know Your Customer) requirements for new customers and to keep track of existing clients, particularly in the event of non-repayment of loans. This issue is so central to the operation of financial services providers that some institutions have expressed the willingness to assist in the issuance and verification of forms of identification, given a regulatory structure. Others have already initiated their own biometric analysis of new customers.

Self-risk assessment required by financial services providers. The Financial Intelligence Unit (FIU) of Malawi, established under the Money Laundering Act of 2006, requires financial service providers to develop their own AML/CFT risk based policy in providing exemptions to clients. This approach is not being substantively adopted by most providers due to the perceived risk of non-compliance with legislation. Most providers have therefore reverted to the last set of guidelines issued on a rule based threshold approach which has not kept track with inflation. These earlier guidelines are still in force according to the FIU despite the change to a risk based approach. Access to formal financial services is therefore restricted for consumers without appropriate identification. Given the lack of a National ID, appropriate identification is a passport or driving license which only a small proportion of adults have. Furthermore, the current AML/CFT legislation and regulation appears to be ineffective based upon reports of widespread corruption (Nawaz, 2012) and illicit flows of 13-26% of GDP in recent years (Kar & Spanjers, 2014) and possibly aimed too heavily and broadly at lower risk individuals transacting low value payments as opposed to more focused, within the limited resources, on higher risk, higher value flows necessary to achieve the ongoing illicit flows at the current reported levels. The net effect of the current AML/CFT regulatory configuration seems to unnecessarily burden the poor and deny access to financial services for the most vulnerable groups whilst not having any discernible impact on illicit flows and limited numbers of successful prosecutions. Low thresholds restrict access and generate high levels of reported suspicious transactions which further constrains limited supervisory capacity without hampering such illicit flows. Countries like Mozambique have adopted high thresholds for transactions for individual transactions and focussed supervisory attention on larger suspicious flows. AML/CFT regulation needs to have substantial threshold levels below which no Identity verification nor address verification is required in order to accommodate the average Malawian citizen, particularly the poor and excluded groups until a comprehensive National ID and population register is in place.

Lack of electronic transactions and communications legislation means digital communication and transactions not legally binding. There is no comprehensive legal framework for electronic documents, electronic commerce and no legal standing of documents transmitted electronically such as via email, faxes, electronic documents or mobile payments. Although there have been isolated, specific regulatory concessions, current legislation and the legal systems require formal paper documents and instruments for all transactions. This is a fundamental framework upon which efficient digital financial

services is based and the lack of a comprehensive and integral framework will stunt the development of more efficient and inclusive financial services.

NPS bill delayed and lacks interoperability requirement. The first version of the NPS (National Payments System) Bill was drafted in 2014, but has still not been enacted. The major weakness identified in the most recent version of the bill reviewed is it does not formulate any interoperability principle or requirement for NPS. One implication of this is that despite the time, effort and resources invested in the National Switch (Nat-Switch), banks are not required to make use of it or allow other banks' customers to use their physical payments infrastructure. There are also no sort at source concepts which could precipitate a grossly inefficient concentration of POS machines at high ticket value merchants and lower concentrations at higher turnover establishments frequented by the poor.

Comprehensive credit regulation would remove confusion and clarify market conduct in market. Currently, aspects of credit regulation appear piecemeal in various pieces of legislation, but there is no comprehensive framework nor regulator. This manifests in confusion and uncertainty over a number of different credit issues, including:

- *Confusion with regard to prescription of debts*. Consultations with both providers and regulators (2014) indicated that most believe that debts in Malawi do not prescribe. However, on further investigation, the Limitation Act of 1623 under English law was received, revised and promulgated in Malawi and in most financial transactions stipulated that enforcement of debts prescribes after 6 years if no legal proceedings had been instituted.

- *Questionable legal basis for payroll deductions*. The Employment Act (2000) states that employers may not deduct from an employee's wages any amount except for contributions to compulsory social security schemes, certain allowable deductions between employer and employee and deductions in accordance with law or a court order. However, there is no provision in the Employment Act granting an exception for either the state nor employer nor third party payroll lenders to deduct repayments directly from payroll where the employer is not the principle creditor. Currently, these deductions take place through a tripartite agreement between the employee, Government and the lenders. A comprehensive credit regulatory framework would support a more formalised and regulated application of payroll lending and repayment deductions.

- *Disputed submission of client data to credit reference bureaus.* There exist a number of issues with the drafted credit reference bureau legislation, such as not fully considering the existing regulation covering the treatment of consumer rights, institutional rights, lending enforceability, credit assessment criteria and over-indebtedness definitions. The delay in operationalising a credit reference bureau is in no small part due to the framing of enabling legislation outside of the context of an overarching credit framework that effectively defines the rights of parties to credit agreements.

A comprehensive credit legal framework enables a regulator to proactively and acutely regulate the activity of providing credit across the entire market, rather than simply a retrospective aggregate view at institutional prudential asset level of only those formally licensed and supervised institutions that provide credit. Hence, under a credit act, informal moneylenders would fall within the ambit of regulation and would need to comply, but only register over determinable thresholds. A credit act can provide the basis for market conduct regulation and prudential regulation which, given the high Malawian interest rates, is particularly important to protect against potential over-indebtedness,

miss-selling and other market misconduct. For example, a credit act could place the onus of proof on the provider that a consumer was not already over-indebted at the time when a loan was extended or that the extension of credit was reckless, causing a debtor to become over-indebted. Enforceability of debts against consumers where reckless or non-compliant lending practices have occurred can also help to lessen contamination of the existing credit exposures of prudentially regulated institutions.

Uncertainty over jurisdictional authority of different consumer protection regulatory bodies. The consumer protection legal framework in Malawi is currently defined by the Consumer Protection Act of 2003, which establishes a body known as the Consumer Protection Council (CPC) which does not in practice exist. Instead the Competition and Fair Trading Commission (CFTC) established under the Competition and Fair Trading Act of 1998 is currently fulfilling the role of the CPC as defined within the Consumer Protection Act. Consultations with the CFTC (2014) also indicated that the original intention was to name the CFTC as the body responsible for implementing the Consumer Protection Act, but the name of the responsible body was changed before the bill was enacted in the legislature, thereby creating the current existing uncertainty. Additionally, the Reserve Bank of Malawi (RBM) has a department devoted to consumer protection and education in the financial sector, falling under the Microfinance and Capital markets division. Whilst there is some level of cooperation between these two bodies on financial sector matters, the overlap of regularity bodies and lack of clarity in the legislation creates uncertainty on issues concerning financial conduct.

Exchange control and export control cause distortions in the market. Malawi restricts the flow and exchange of foreign exchange in that it can only be exchanged by authorised dealers and that Malawians cannot freely keep foreign currency denominated accounts (FCDAs), except under very limited and defined circumstances. For farmers and other businesses whose products are priced and sold in dollars, regulation forces them to convert the foreign currency proceeds immediately. Low income farmers are particularly affected as they are effectively forced to sell their produce immediately at harvest time (due to lack of excess income) and then convert those dollars into Kwacha. This means that farmers have no bargaining power in the exchange rate they receive due to the timing of mass dollar sales during harvest time and the locked-in fees and margins earned by institutions. Authorised dealer institutions are able to arbitrage significant benefit out of the forced dollar sales over very predictable agricultural demand and supply cycles. The result is indicated in high foreign exchange spreads and the high proportion that foreign exchange revenue contributes to banks' overall revenue. Export control similarly has a restrictive and distortionary effect on the market. Major producers, commodity dealers and risk, supply and storage specialists are unwilling to invest due to the restrictions which could paradoxically undermine food security. Additionally export control eliminates the incentive for major agricultural buyers to invest in the country. Major agricultural dealers purchase crop surpluses at times when there is an excess and then sell internationally to places where there are production deficits. This type of activity plays critical supply and price smoothing roles and is an important market maker for excess production as well as a key source when food security is threatened due to drought and supply failure. Export restrictions make local commodity businesses unfeasible.

The Pension Act places onerous requirements on small businesses. The Pension Act of 2011 makes it a mandatory requirement for all employers to contribute at least 10% of the value of the employee's salary to the National Pension Scheme and employees to contribute 5% of their salary, provided that the employees earn more than K 10,000 (USD 24) per month or the employer employs 5 or more employees. This represents a substantial cost for any business and for MSMEs as it effectively increase their wage bill 10%. The level set of K 10,000 is also very low as it falls below the current minimum wage of K 12,500 (USD 30) p.m.

Mobile money regulations. Mobile money providers currently operate under the guidelines for mobile payment systems of 2011. These guidelines do not permit providers, users or other beneficial owners of the float to earn interest on their own funds in suspense. Interest can improve the business case for mobile money providers and encourage mobile money users to save. Formal mobile money regulations are being planned. A major issue for all mobile payments is the absence of electronic communications and transactions regulations, which means that all digital transactions, agreements and documents without legislation or an original hard copy lack formal legal standing. It is also planned to introduce Regulation of Interception of Communications and Provision of Communication-Related Information Act (RICA), requiring all sim card owners to comply with KYC requirements.

Banking definition unclear. The Banking Act of 2010 defines banking business as requiring the intermediation of funds. This definition includes all agents, payment system operators, deposit-taking MFIs and MNOs, which is not the intent. The definition should be amended or exemptions included to clarify banking business.

A number of regulatory changes supporting financial services development have been introduced. A variety of regulatory changes in aid of financial sector development have been introduced in Malawi in recent years, but remain at varying levels of implementation. These include:

- *Enabling alternative distribution such as bank agency and mobile money.* Agent Banking Regulations were introduced in 2012 under the Financial Services Act of 2010, allowing banks to use agents as distribution channels for their services enabling them to cost effectively increase their distribution network. Mobile payments system guidelines were also introduced in 2011 allowing MNOs to offer mobile money products to subscribers.

- *Allowing deposit taking by microfinance providers.* The Microfinance Act of 2010 created a legal space for deposit taking institutions to operate. Supporting regulations have since been released and some providers have indicated they are considering operating under a deposit taking license.

- *Changing bank data collection strategies to promote inclusion.* The Reserve bank of Malawi is developing new reporting templates for providers that include more granular client information enabling a greater understanding if financial inclusion realities on an ongoing basis.

- *The introduction of financial literacy and consumer protection initiatives.* A variety of financial literacy and consumer protection initiatives have been introduced by both donors and state institutions. Amongst others, RBM runs an annual national literacy week and financial education has been included in the school curriculum from 2015.

- *Establishing a unit responsible for financial inclusion within the Ministry of Finance*. The Financial Sector Policy Section which falls under the Economic Affairs division within the Ministry of Finance is responsible for driving the financial inclusion agenda in Malawi. Making a specific unit responsible for financial inclusion helps to ensure that there is a central coordinating unit responsible for implementing relevant policies. Elevating this unit to a division level would provide it with more authority, particularly when coordinating the activities of providers, donors and other government departments.

- *Encouraging risk mitigation through microinsurance and health financing initiatives.* Microinsurance legislation is being considered to provide licenses with reduced regulatory requirements to providers that are providing low cost products.

- *Improving credit information through the establishment of credit reference bureaus.* Malawi currently has two credit reference bureaus. Although not currently operational due to concerns over client privacy by banks, an amendment to the Credit Reference Bureau Act is in the process of being implemented to resolve this issue.

4. Target Market

Putting the client at the core is a key component of the MAP methodology. This section unpacks the nature, needs and realities of the target market for financial services in Malawi based on quantitative information from the FinScope 2014 survey, as well as qualitative insights from 44 immersion interviews conducted as input to this study.

This section starts off by considering the financial context of the target market: their profile, how they make a living, their main expenses and their level of financial capability[35]. This is followed by an overview of usage of formal and informal financial services, as well as the various barriers to greater uptake of formal financial services. Lastly, the target market is segmented into distinct groups to allow a more granular understanding of financial services usage and needs as basis for the rest of the analysis.

Below we summarise the key target market features outlined in the rest of the section.

Key findings: target market

The key target market findings are:

- *An impoverished society with limited opportunities to earn monetary income.* Both the FinScope research and the qualitative research paints a picture of an adult population with very low income levels. Subsistence agriculture acts as an indispensable supplement to monetary income and is vital to survival. Despite this, Malawians generally have a positive attitude towards life with entrepreneurial ambitions.
- *Low levels of formal financial service usage.* More than half (52%) of Malawian adults do not use any financial services and 66% do not use formal financial services. The majority of adults still prefer to transact in cash. This is because most Malawians are located in rural areas far from the predominantly urban-based formal financial services and the costs of formal products are often unaffordable. Instead, many Malawians rely on informal financial services. The period between 2008 and 2014 saw the introduction of VSLAs, which are currently used by approximately 1 million Malawian adults to meet their savings and credit needs.
- *Stark contrast in usage between urban and rural populations.* The majority (85%) of Malawians live in rural areas. Adults living in rural communities have significantly lower usage of formal financial services than their counterparts in urban areas. 28% of adults living in rural areas use formal financial services compared to 63% of urban adults. The poor infrastructure in Malawi increases the indirect cost for rural adults to access formal financial services, which are primarily located in the urban areas.
- *A diverse set of characteristics and needs across target markets.* Segmenting the adult population by main source of income enables a more granular analysis of the different financial services usage and needs of specific target markets.
    - The largest income source in Malawi is farming. In monetary terms, farmers are less well off than most other target markets. They have very limited access to formal credit and savings, and satisfy their financial service needs mostly from informal providers.

[35] We apply the definition of financial capability adopted by the Financial Education Fund (www.financialeducationfund.com), namely that a financially capable person can be regarded as one who has the knowledge, skills and confidence to be aware of financial opportunities, to know where to go for help, to make informed choices, and to take effective action to improve his or her financial well-being. An enabling environment for financial capability building would promote the acquisition of those skills.

- The development of Malawian MSMEs is a critical component of the country's long term growth aspirations. Small business owners are the second wealthiest group. Usage of formal credit is very limited. The quantitative research[36] indicates that most small business owners source their capital from personal income or from family and friends. Appropriately targeted financial services have the potential to increase the growth and efficiency of these businesses.
- Adults that earn a salary are the best-served in Malawi. Their average income is considerably higher than the rest of the population and they are less reliant on additional sources of income. They are the most educated, most urban and least likely to still live in their home district.
- Dependents are reliant on someone else, either another household member or a remittance sender, for their primary income. The dependents are predominantly female and many access formal financial services primarily to receive remittances. The increasing trends in urbanisation and migration suggests that the dependents target market and their reliance on remittances will grow in the future.
- Those engaged in piece work, ganyu, have very limited interaction with the formal financial sector. Their income is usually very low, compounded by the fact that they often earn their wages in-kind. This means that there is very little justification for them to own a bank account.

4.1. Target market context

This section considers the general and financial context of Malawi adults based on insights from the qualitative demand-side research.

4.1.1. Societal context

Poverty necessitates short-term planning horizons. A large proportion of Malawians live from hand to mouth and rarely have excess income. The uncertainty regarding where their next meal is coming from, due to low and irregular incomes, means that individuals often struggle to plan beyond the acquisition of basic goods for their daily needs. Hence, the planning horizons of many Malawians are very short-term and based only on their immediate needs. The quotes below illustrate this dynamic:

> *"A lot of challenges for us. As long as we wake up in the morning and find something to eat."*
>
> Farmer, male, 60 years old

> *"The problems that I face are hunger problems only; only hunger"*
>
> Farmer, male, 43 years old

Communities and families provide support structures to help the destitute and the poor. Both the qualitative and the Finscope research suggest that Malawians act communally to meet certain key needs and risks. Individuals that cannot sustain themselves are often supported by family via extended household structures and, family and friends are the most common provider of credit in Malawi (16% of total credit provided). Community support is regularly called on in the event of a death to assist with funeral arrangements. The popularity of Village Savings and Loans Associations (VSLAs) have increased significantly since it was introduced by CARE in 2009. The qualitative research also suggests that Malawians assist those in their communities that live in hardship:

[36] FinScope consumer survey 2014; MSME survey 2012

"So am I right to say the community you live in does support each other?
Yes with food and clothes from those who can afford it."

Trader, male, 46 years old

"So how about your community, how do you live in your community?
In our village we live okay. There are no problems. Me and my family we live peacefully with the people in our village. We help each other in times of trouble or problems."

Farmer, male, 43 years old

Rural population growth rate placing increasing pressure on farm sizes. Traditionally, Malawian adults prefer to live close to the area where they were born. 80% of adults indicate that they still reside in their home district. For most Malawians this is in a rural area where their parents engaged in some farming to sustain the household. However, population growth, particularly in rural areas, places greater demand for land. Consequently, landholding sizes have declined. In 1970 the average arable land was 0.4 hectares per capita, since then it decreased to 0.23 hectares per capita. For a society that is mostly engaged in farming activities as a primary or secondary source of income, this trend will place increasing pressure on rural farms as more people are reliant on smaller pieces of land over time. The result will be either increased rural poverty or force migration. Increased migration will in turn increase the need for reliable long distance payments, because migrants must support their dependents left behind in rural areas. The adults that remain in rural areas will increasingly have to look for alternatives to farming to supplement their income.

Poor infrastructure is inhibiting access to financial services for rural population. The majority of adults (85%) live in rural areas and are dependent on public transport to gain access to financial touch points. Poor infrastructure (see section 2.3) decreases the efficiency of transport, which increases the costs to access these touch points, making accessing formal financial services costly. A number of respondents complained about poor infrastructure in the qualitative research:

"Generally in terms of living conditions and other matters, how have things changes recently?
…The roads are in a poor state. The Indians who live around have tried to fix but still I would not say there is any much improvement. But in comparison to other areas, we can reach the city with ease."

Salaried employee, male, 28 years old

"What can you tell me about the area you live in?
Well, there are a lot of things that need repairs… we don't even have good roads; there is inconsistency of water supply, we do not have electricity, the roads are not fixed…"

Trader, male, 46 years old

Self-built housing the main method to satisfy house ownership aspiration. FinScope (2014) indicates that 78% of houses in Malawi are privately owned. Only 10% of residential property is rented. Houses are mainly constructed of brick (88%) and some are built from mud, wattle or dung (10%). There is a

large shortage of housing finance in Malawi. As a consequence, most houses are individually built from accumulated savings (Centre for Affordable Housing Finance, 2014). In general, Malawians place high value on house ownership and it is a large aspiration for many individuals as illustrated by the quote below:

> *"My wish is to build my own house. Right now I have already personally moulded bricks. I want to have a permanent house and do farming for my family."*
>
> Salaried employee, male, 40 years old

An entrepreneurial society in which many individuals aspire to have their own business. A large number of Malawian adults are engaged in some form of self-employment, whether it is small-scale farming, intermediate trading or owning a small retail business. From the qualitative research many interviewees indicated that a primary aspiration is to own a business or to grow their current business:

> ***"What are some of your aspirations? Your strongest desire… what would make you happy?***
> *If I could have my own agro business, that's what I like doing."*
>
> Salaried employee, male, 28 years old

> ***"Now tell me, what is the vision for your life?"***
> *Hmmm the greatest challenge is money, but we wish we did business"*
>
> Farmer, male, 60 years old

> *"The greatest challenge in my life is money. … If I can get a bigger sum of money I can start a better business because the one I have now has a capital of K 10,000 (USD 24) but my wish is to do a bigger better business…"*
>
> Farmer, female, 50 years old

4.1.2. Budget realities

This sub-section considers the insights from the qualitative and FinScope research on the financial lives of ordinary Malawians: how they make a living, what their main expenditure needs are and how they deal with the budget deficits that more often than not arise.

A diverse set of economic activities necessary to sustain households. A large portion of households engage in various economic activities to generate enough income and food to survive. Households' main source of income is often insufficient. Household members are therefore frequently required to farm to supplement the household's income and ensure that there is enough food to eat. According to FinScope, 47% of adults have more than one source of income and it is likely that this is

underreported due to the design of the survey question[37]. The following quotation provides an illustration of how individuals amass income from multiple sources:

> ***How do you make a living? Can you tell me what your source of income is?***
>
> *Ok. For daily cash, I sell fritters. The business is small for it is ok for daily requirements for the children. I get about K 800 (USD 2) per day or K 20,000 (USD 48) per month. I farm only a portion, sometimes only one hectare; and I rent out 15 hectares at K 10,000 (USD 24) per half-a-hectare and I get around K 300,000 (USD 720) when people have to plant or once a year. I do not farm because I do not have the right implements. They are broken and I am still not able to replace them.*
>
> ***Your husband also assists in the farming that you do?***
>
> *No he runs a panel beating shop. Ya! He also brings in an income. In fact he brings in household items that we need. He is also saving to build a house, our own house.*
>
> Farmer, female, 35 years old

Individual budgets stretched each month. According to FinScope, 75% of adults run out of money before the end of each month. This is related to their low incomes and greatly reduces Malawians' ability to save money or absorb the cost of a risk event, such as a death in the family or a medical emergency. It also explains why more than 80% of adults find it difficult to keep financial commitments (FinScope, 2014).

Financial planning and budgeting often untenable. The extent of poverty and the irregularity of income of adults make explicit budgeting challenging. Although almost 50% of the population plan their expenses, only 36% are able to keep to that plan. The main reasons for not keeping to the budget is insufficient and unreliable income.

> ***"Your house budget, do you do before or you just buy?***
> *Ah sister, we work on daily cash; we can't afford a monthly budget, there are certain expenses that you incur for the whole year, but when its food and other things, it's daily."*
>
> Trader, male, 46 years old

Lion's share of income spent on basic needs. From the FinScope survey it is known that 95% of the adult population most frequently spend money on food and groceries. Clothing was indicated as the second most-frequent expense. Furthermore, food and non-alcoholic beverages account for 50% in the CPI basket, indicating that adults spend most of their income on items of necessity.

[37] For instance, 25% of the adult population indicated that they receive remittances, but only 4% indicated remittances as a source of income.

"On which things do you spend money, like food, travelling or soccer? Which one costs you much?

Mmmh... As for me, I don't like travelling. I was born different from other people. All money that I get is used for family expenses such as groceries and soap."

Trader, male, 65 years old

Illness and theft considered the highest risk to income. According to FinScope, the two biggest threats to income are illness within the household and theft. 27% of adults identified illness within the household as the major threat to their income, and 22% identified theft to be the main threat. An illness in the household is particularly costly, because of the opportunity cost that is incurred. Firstly, income is lost because the sick individual is unable to work and secondly, healthy individuals often have to forgo earning an income to take care of the sick individual. Given that the budget of many Malawian adults are already under strain, a risk event like theft or illness can have a severe impact on the household. Therefore, adults require risk mitigation mechanisms to help them absorb certain shocks. The quotes below speak to the major threats to income:

"…do you see any problem with people making cash payments?
Yes, there is a problem; the biggest problem is theft or someone pick pocketing you. For example, there was a time I went to town to buy some items with K 5,000 (USD 12) in my pocket, the money was stolen and I was stranded."

Salaried employee, male, 57 years old

"Most Malawian-run enterprises are operated by (single) individuals and they are on a small scale. After I had recovered from sickness (I had resigned my last job because I fell ill) I tried to work with some people through forming, but somehow it did not work as smoothly as one would have expected."

Dependent, female, 61 years old

4.1.3. Financial literacy

Financial and general literacy rates a barrier to the uptake of financial services. FinScope (2014) and Chirwa & Mvula (2014) found that financial literacy rates in Malawi are low. According to FinScope, approximately 50% of adults understand inflation, but only 20% of adults could calculate simple interest rates. Figure 12 below further shows that just 15% of the adult population have heard of either a credit or debit card, whilst approximately a third of individuals know what life insurance or a current account is.

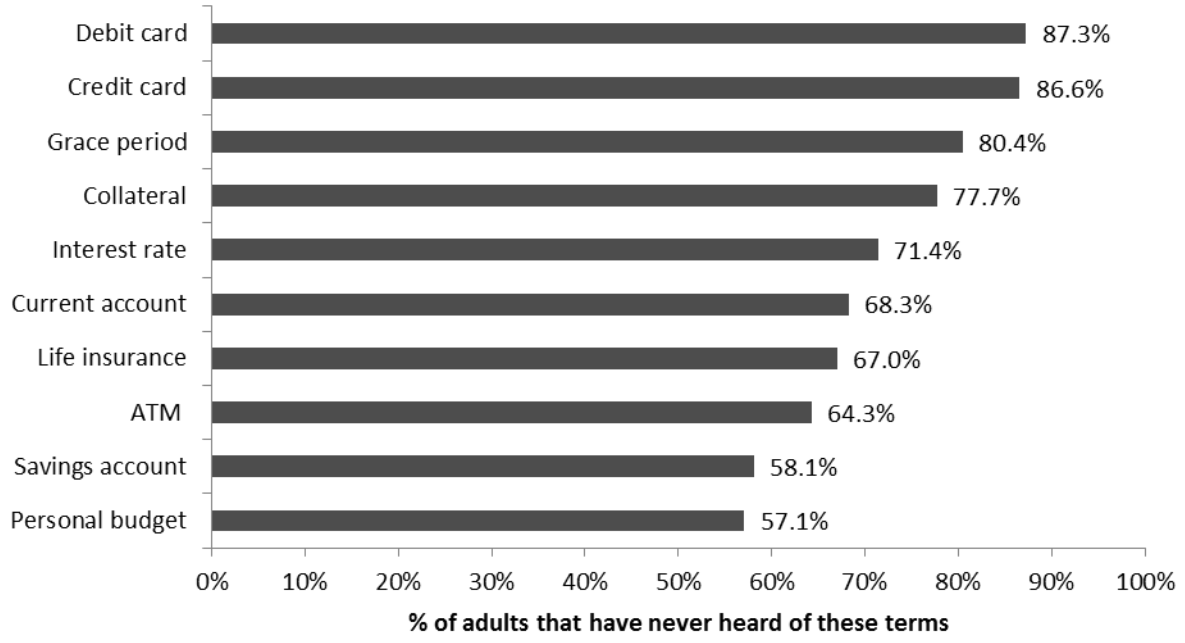


Figure 12: Awareness of financial terminology in Malawi

Source: FinScope, 2014

Financial literacy correlated with education and formal usage. The FinScope data displayed in Figure 12 made it possible to create a financial literacy index. Each adult was given a score out of 10 depending on how many of the terms in the graph they knew. 80% of adults scored 2 or less. Unsurprisingly, the index showed that there is a strong correlation between education attainment and financial literacy. Furthermore, there seems to be a strong correlation between formal financial usage and financial literacy. The adults with no access to financial services scored significantly lower than adults that uses formal financial services. This supports financial literacy as a usage barrier to financial services, but could also indicate the potential for learning-by-doing. However, there are some indications that the poor financial literacy findings might be exaggerated given certain indicators from Malawian society. The long value chains, the widespread aspiration to own businesses and the self-replication of VSLAs suggest a general level of basic financial literacy. Whilst many Malawians may not understand specific financial terminology, they may be familiar with financial concepts as illustrated by the quote below:

> ***"How do you go about if let's say I want to borrow a bag of maize how do I pay back?***
>
> *When it's a bag (mmm) then you pay back a bag plus a pail of maize as an addition to the bag."*
>
> Farmer, male, 39 years old

4.2. Take-up of financial services

A portfolio of financial services required. It is not only important to look at the usage of financial services in a linear, absolute way, but also in terms of the types of financial services used per person

served. Individuals require a portfolio of financial services to effectively address their needs For example, insurance may be the most appropriate instrument to mitigate high impact, low frequency risk events such as death, but savings may be more appropriate for low impact, high frequency risk events. Similarly, credit may be appropriate for productive uses, but not for risk mitigation.

Thus this section measures and discusses take-up of financial services across two dimension: breadth and depth of access. Breadth refers to the proportion of adults that have access to at least one type of financial product (as typically measured by the access strand), whilst depth considers the number of different products used by each adult.

Box 8. The Access Strand explained[38]

Breaking down the Access Strand. The Financial Access Strand is used to enable comparison of levels of financial inclusion across countries or market segments. In calculating the access strand, a hierarchical approach is used in order to depict:

- **Banked:** The percentage of adults that has bank products. This is not necessarily exclusive usage – these individuals could also be using financial products from other formal financial institutions or informal products.
- **Other formal:** The percentage of adults that has financial products from non-bank formal financial institutions such as microfinance institutions (MFI), SACCOs or insurance companies, *but do not have a bank account*. These individuals could also be using informal products.

The banked and other formal segments together form the formally included population.

- **Informal:** The percentage of adults that is not formally served, but use informal financial products or mechanisms. This is exclusive informal usage and does not include individuals who are within the banked or other formal categories of the access strand that also use informal services.

The banked, other formal and informal segments together form the financially included adult population.

- **Excluded:** The percentage of adults that does not use any financial products – formal or informal – to manage their financial lives.

The access strand does not show overlaps between the various categories. Consequently, the "other formal" or "informal only" segments do not indicate total usage of non-bank formal or informal financial services, only those individuals who have a non-bank financial service but not a bank account, or an informal financial service but no formal financial service. An individual with both a formal and an informal financial product would only appear under formal take-up.

The access strand applied to product markets. The access strand is furthermore used to illustrate take-up across particular product markets (i.e. credit, savings, insurance and payments). The product market access strands also indicate those reached only by "unintermediated" financial services. These are financial services extended between family and friends, without being intermediated through a third party institution or collective grouping. Thus, for example, saving at home, borrowing from friends and family or sending a remittance with another person would be regarded as unintermediated services.

Particular financial products, services, mechanisms and activities that have been included for each product market access strand are listed below:

[38] The access strand explanation has been adopted from the access strand definition used by FinScope.

Credit access strand

- ***Banked:*** Having a loan product or credit account with a bank. Some of them may also be accessing credit from an alternative formal provider, informal credit or borrow from family and friends.
- ***Other Formal***: Having a loan product or credit account with a payroll lender, MFI or SACCO, but not from a bank. Some of them may also be accessing informal credit or borrow from family and friends.
- ***Informal***: Those who do not have formal credit, but borrowed money from an employer, VSLA, other community group, informal money lender or katapila. Some of them may also be borrowing from family or friends.
- ***Family or friends only*****:** Those who do not have formal or informal credit as above, but borrowed money from family or friends.

Transaction strand

- ***Banked:*** The proportion of adults that have a bank account in their own name.
- ***Formal***: Those who report having a mobile money account, but that do not have a bank account.

Remittance strand[39]

- ***Banked:*** The proportion of adults that use banks, to send or receive remittances. Members of this segment may also be engaged in formal non-bank remittance activities, informal remittance activities or friends and family remittance activities. Largest contributor: using bank accounts for remittance purposes.
- ***Formal***: Those who have sent or received remittances in the last 12 months via formal payments providers, including the Post Office, MoneyGram or Western Union, but that do not use a bank account. Some of them may also be sending or receiving money through informal channels or family and friends.
- ***Informal***: Those how have not sent or received formal remittances, but have sent or received remittances in the last 12 months via a bus, taxi or hawala trader.
- ***Family & friends or self-delivery only***: Those who do not fit into either of the previous two categories, but have sent or received remittances in the last 12 months directly via friends or family, or who delivered the funds themselves.

Savings strand

- ***Banked:*** Those who save with or have a savings account with a bank
- ***Formal***: Those that have a savings product at a SACCO, Pension Fund or Unit Trust, but not a bank account. Some of them may also be saving in an informal institution or at home.
- ***Informal***: Those who do not have a formal savings product as defined above, but who save with a VSLA or other community savings group. Some of them may also be saving at home or through other unintermediated means.
- ***Saving at home/with household members*****:** Those who do not fall into either category above, but save in a secret place at home, in livestock or in kind, within the household or family, or who ask another person in the community to keep money safe for them.

Insurance strand

- ***Formal*****:** Those with any formal insurance product (like motor insurance) with an insurance company.

4.2.1. Breadth of usage

Half of the adult population is financially excluded. Figure 13 indicates the extent that Malawian adults access financial services. Most notable is the fact that the majority of adults do not use any financial services, formal or informal. 34% of the adult population access formal financial services and an additional 14% make use of only informal financial services. In total, a quarter of the adult population access informal financial services.

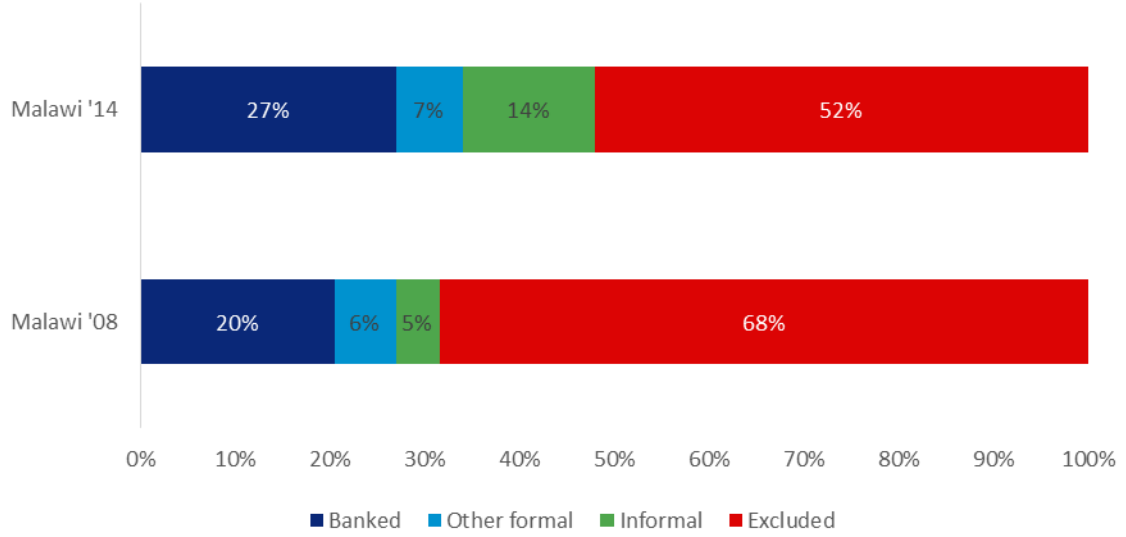


Figure 13: Financial services usage in Malawi

Source: Finscope, 2014, 2008

Overall financial usage increased since 2008, with the biggest increase in informal access. The usage of formal financial services increased 8% from 2008 to 2014 as illustrated by Figure 13. Uptake of formal and informal financial services together increased by 16 percentage points. The largest increase was in the number of adults accessing financial services through informal providers, which increased from 7% in 2008 to 26% in 2014.

Low inclusion compared to other African countries, but relatively highly banked. Figure 14 indicates that Malawi is the second least financially included country in SADC[40]. However, bank penetration is relatively high compared to neighbouring countries.

[39] Only a remittances access strand is shown within the payments section as the other component of payments is access to bank accounts which is measured as a dichotomous variable i.e. respondents either have a bank account or do not, and hence it is not meaningful to show this in an access strand.

[40] Although, it is expected that Zambia will be shown to also have a higher level of inclusion once FinScope Zambia's 2015 figures are released.

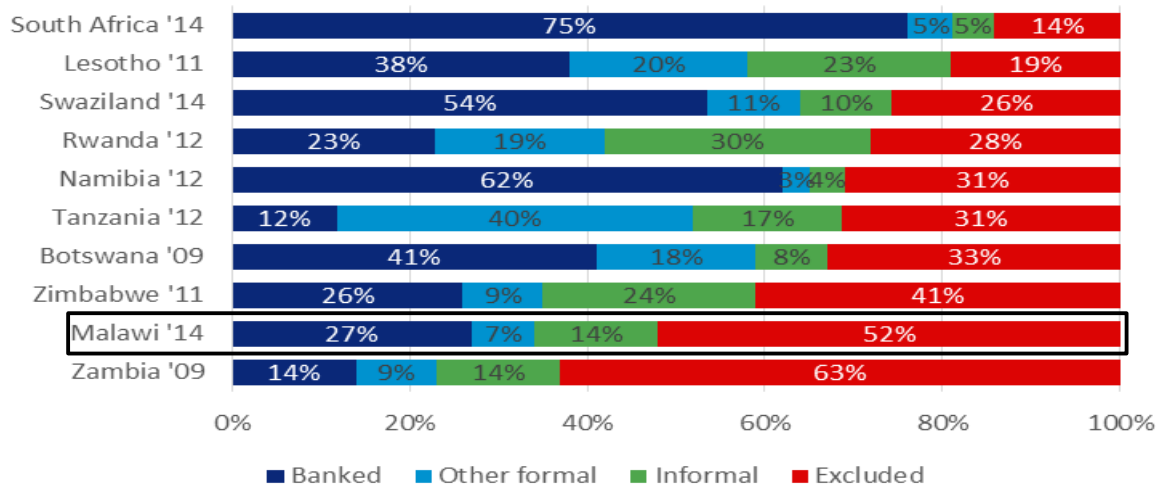


Figure 14: Cross-country access strand comparison

Source: FinScope, 2014

Urban population significantly better served than rural population. Figure 15 shows the urban rural split of the population and the access strand of each area. According to FinScope (2014), 63% of urban adults are financially included, whereas only 28% of rural adults are included. 35% of urban adults use formal savings products, but only 10% of rural adults save formally. The total usage of informal financial products (compared to the informal-only component shown on the access strand) is similar in both areas at 25% of the entire population. Poor financial infrastructure in rural areas and high transport costs act as barriers for rural adults to access formal financial services.

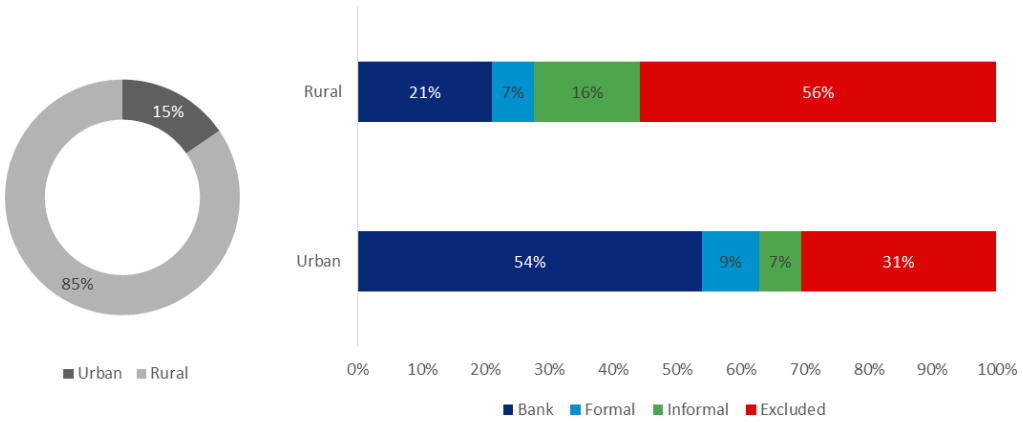


Figure 15: Area split and usage

Source: FinScope, 2014

Similar overall usage levels across genders. Figure 16 indicates that 30% of males access financial services via bank accounts compared to 22% of females. This discrepancy is partly driven by the fact that the majority of salaried employees are male, who receive their income by cheque or directly into a bank account. However, females make greater use of informal services than males. 26% of females access informal financial services, compared to 23% of males, which amounts to approximately 400 000 more females using informal financial services than males.

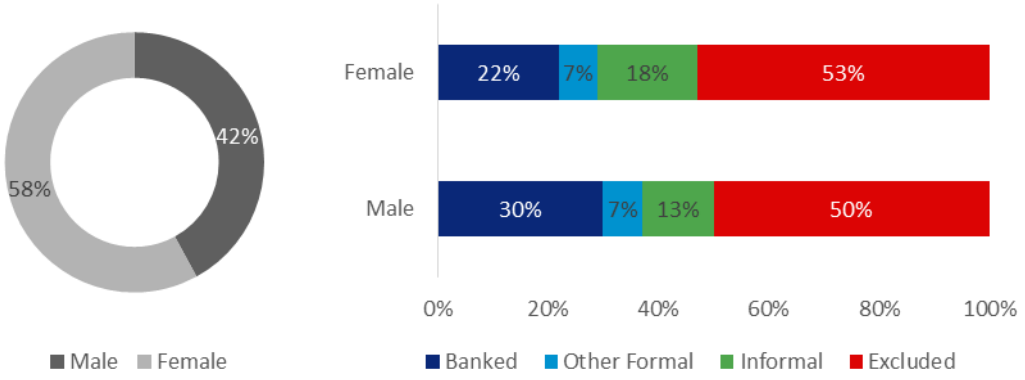


Figure 16: Gender split of financial access

Source: FinScope, 2014

Usage across product markets

Saving products are the most commonly used financial service. The savings access strand, as depicted in Figure 17, indicates that 43% of adults save, with the largest proportion saving at home (25%). 15% of adults save with formal institutions, of which 12% save with banks and 13% save through only informal channels. This makes savings the most commonly used financial service in Malawi. Total informal savings increased by 17 percentage points from 2008 to 2014 after VSLAs were introduced by CARE. The FinScope survey also showed that savings is the most common way that Malawian adults protect themselves against risks. However, keeping savings at a formal institution is problematic for most individuals that live in rural areas, far from financial access points such as an ATM or a bank branch. Even mobile bank branches, designed to improve accessibility, are still considered problematic. This is supported by the following quote:

> ***"What is your view on saving money in the bank?***
>
> *Well, I feel it's very inconvenient because just imagine if someone was sick and I want to go to the hospital where will I get the transport money or I want to buy seeds and there are mobile banks but imagine it comes here once a week and how can you access the money in case of emergency."*
>
> Farmer, female, 50 years old

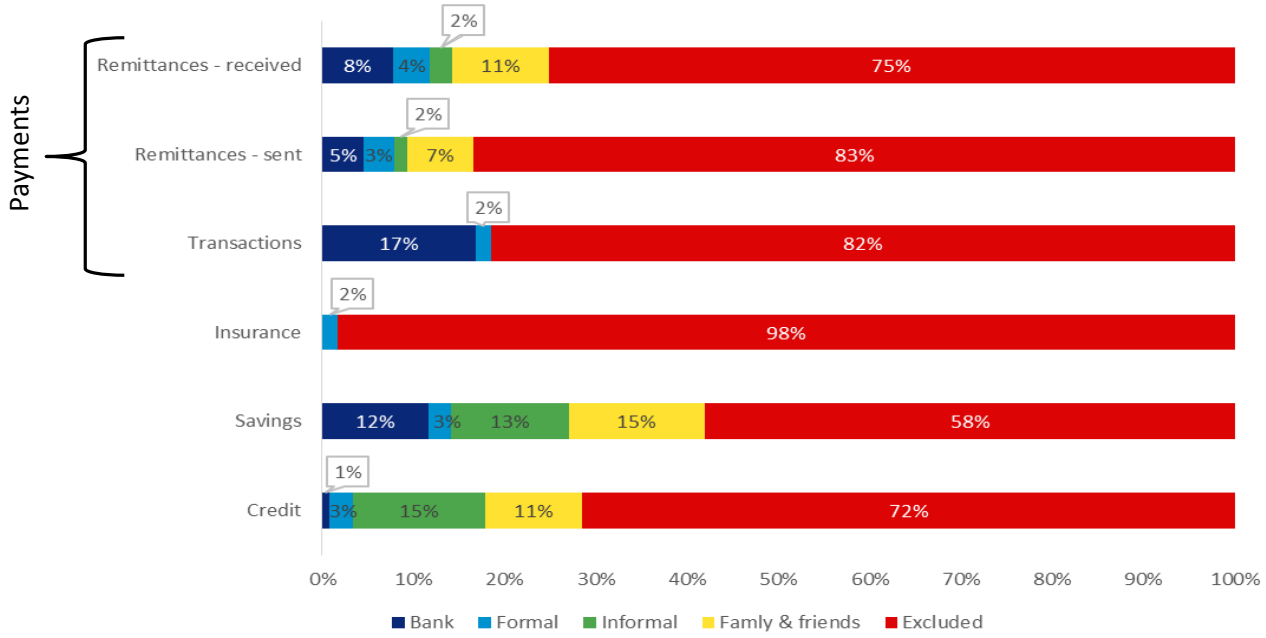


Figure 17: Financial service usage across product markets[41]

Source: FinScope, 2014

The majority of Malawians rely only on cash for transactions. 16% of adults have bank accounts that they can use for transactions. In 2014 only 2% used mobile money exclusively. However, uptake is expected to have increased since (see section 6.2.1). The fact that a large proportion of the population does not access transactional financial services is indicative of an economy that is still largely cash based. The preference for cash is supported by the qualitative research:

> ***"What mode of payment do you use and how many ways do you know?"***
>
> *"I think its 2 or 3 ways that I know, the first I would say is by carrying cash and that's the way I mostly use and there is another way that I know and this is through your phone, Airtel money and TNM Mpamba, but I prefer using cash"*
>
> Salaried employee, male, 41 years old

Insurance uptake is low. From Figure 17 it is apparent that a very small proportion of adults have formal insurance. In Malawi, formal insurance consists mainly of car insurance and medical insurance. It is worth noting that informal insurance (burial societies, cooperatives etc.) usage was not measured in the FinScope survey. Therefore, the overall insurance usage figure is likely to be a significant underestimation (see section 6.4). The quote below further supports the assertion that many individuals consider VSLAs as their insurance, because a contribution towards insurance is often mandatory.

[41] Payments was split up into three separate product categories: transactions, remittances received and remittances sent. The reasoning behind this is that different financial channels are used for each product category.

"I can't afford insurance, because I have little money. I think my insurance is the "village bank" to which my wife belongs."

Farmer, male, 58 years old

Family and community members the most common source of credit. 28% of adults indicated in FinScope (2014) that they have credit, of which 89% obtained it from family and friends. The qualitative research highlighted the fact that it is very expensive to borrow from formal institutions (see quote below). Therefore most adults rely primarily on family and community members when they require a loan.

"Was the loan fair and beneficial?

It brought problems to me because it was a small amount yet I pay bank a lot. I have realized that the longer the repayment period, the more you will end up paying in total."

Salaried employee, male, 39 years old

Family and friends the primary channel used to send remittances. 33% of adults use remittances services. The family and friends channel is the biggest for sending and receiving remittances. However, for overall usage, the usage of formal remittances channels is similar to that of informal and family and friends channels.

4.2.2. Depth of usage

Figure 18 below illustrates the overlaps of financial service usage by means of a Venn diagram. Each circle is proportional to the number of adults that use that category of financial service. The percentage in each segment indicates the percentage of the total population that falls into that category. For instance, the segment where bank and formal intersect consists of 7% of the adult population. Therefore, 7% of the population uses both a financial service provided by a bank and a financial service provided by another formal institution. The Venn diagram allows one to have a closer look at the usage of multiple financial service types.

Overlap of formal and informal financial usage limited. Figure 18 indicates Malawian adults tend to use either formal or informal financial services, not both. Adults that use only informal financial services make up the largest share of the population, followed by adults that only use bank financial services. Formal financial services, other than bank, are usually used in combination with either banked or informal financial services. In general, there is limited overlaps with only 10% of adults accessing both formal and informal financial services.

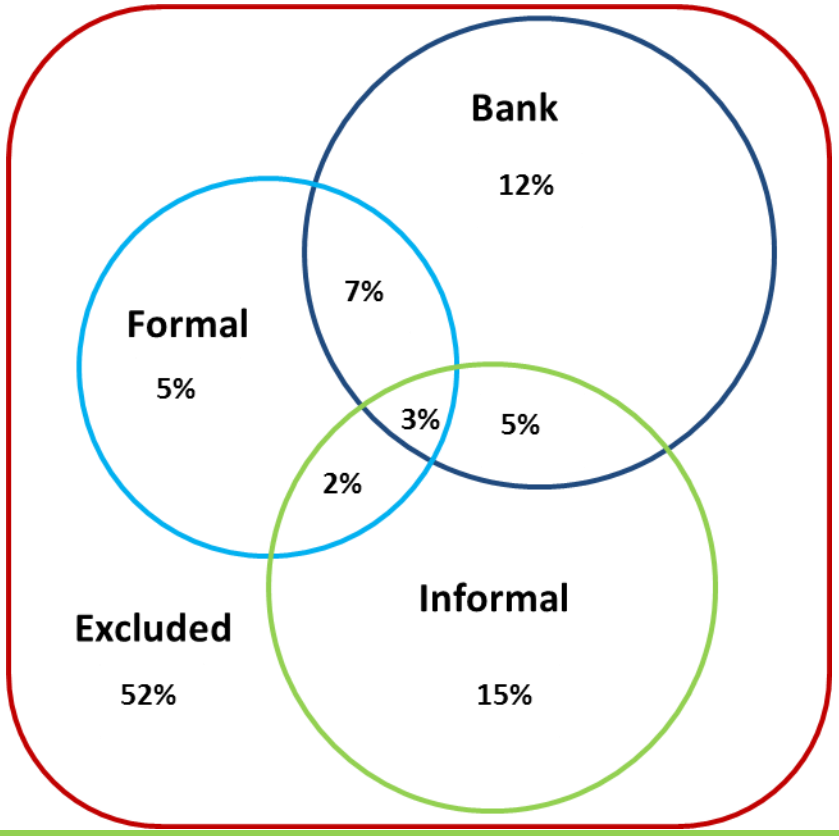


Figure 18: Overlaps between the product categories

Source: Finscope, 2014

Limited usage of more than one formal financial service. Figure 19 below indicates that 41% of formally included adults do not use more than one formal financial service. Of those that use more than one service category, the most popular combination is a transaction and a savings service. This is to be expected since a savings account at a bank offers both services and hence many of these adults likely have just one product, which can be used for multiple purposes. A negligible proportion (0.7%) use all four financial services.

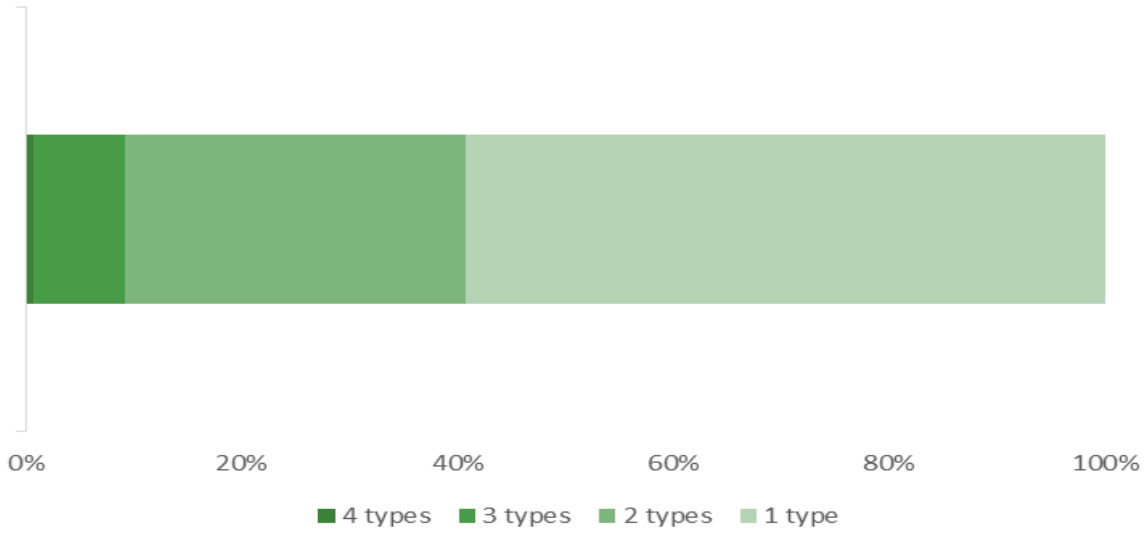


Figure 19: Multiple financial product usage by formally included population

Source: FinScope, 2014

4.3. Segmenting the target market

In order to better understand and unpack demand-side behaviour, assess the nature of uptake and identify key priority areas for future extension of financial services, it is useful to segment the adult population into distinct groups. Looking at an entire population as one homogenous target market conceals a multiplicity of different constraints and needs. To appropriately address the needs of groups of people as dissimilar as salaried employees and farmers it is critical to understand the needs and characteristics of each group. Such an understanding can then inform policies and interventions that effectively target the specific needs of each different segment of the population. These groups, called target market segments, were determined based on main individual income source as reported by FinScope, but also taking into account geographic, demographic and other parameters. Main income source is used as a proxy for the level and regularity of income, both of which are key predictors of whether a person would be a viable financial service client. Income-earning activity is also strongly aligned with earning potential, lifestyle and financial service needs. The intention is to create clusters of people who are sufficiently different from other groups and yet have enough shared characteristics to form a common target market for financial institutions and policymakers. FinScope 2014 survey data is used to profile each of the segments and assess their current interaction with financial services and potential needs.

In the rest of the study the target market segments will form the basis for assessing gaps and opportunities in the various product markets.

4.3.1. Introducing the segments

The segmentation exercise renders five distinct target market groups for Malawi as illustrated in Figure 20:

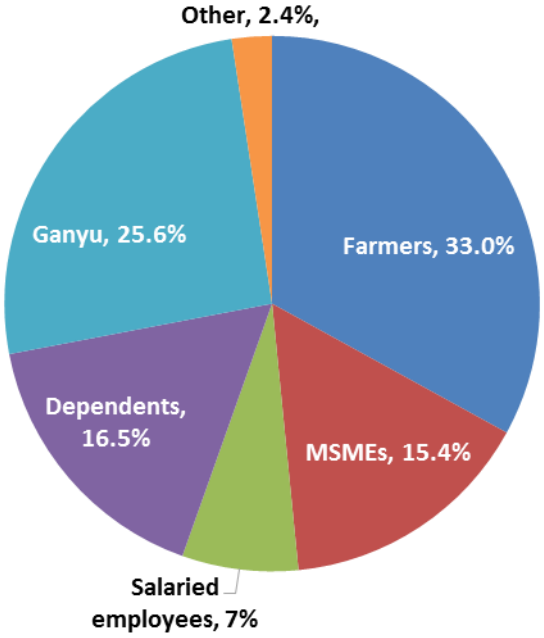


Figure 20: Size of target markets as a percentage of total population

Source: FinScope, 2014

- **Farmers** (2,647,633 individuals) – are adults that obtain their income from farming or fishing activities. It is the biggest target market and lives mostly in rural areas.

- **MSMEs** (1,237,819 individuals) – are adults that derive their main source of income from owning and running a business. They are the second wealthiest target market and comprise approximately one sixth of the adult population.

- **Salaried employees** (562,819 individuals) – are adults whose main source of income is salaries from a private or public institution. They are the wealthiest target market and live mostly in urban areas. This target market has the highest education levels, but is also the smallest in size.

- **Dependents** (1,327,005) – 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 to give them money. Also included in this target market are adults that receive money from friends or family outside of Malawi. This group typically include housewives, students and seniors.

- **Ganyu** (2,053,818) – are adults that engage in piecework for their main source of income. Similar to farmers, ganyu live mostly in rural areas.

"Others" excluded. There are a small number of adults that obtain their income in a different manner than those specified above. Most notably they include pensioners, rent receivers and adults that receive money or food from an aid agency. The number of adults that earn their income in this manner constitutes only 2.5% of the total population and is not a cohesive segment based on common parameters required to making assessments related to financial service provision. Therefore, they do not warrant analysis as a separate target market.

Non-resident Malawians not included. According to the World Bank[42], approximately 276,000 Malawians live outside the borders of their country. It is likely that most of these individuals are income generating adults that earn a higher average income than their counterparts in Malawi. Even though these adults are not a direct target market for financial inclusion in Malawi, they still act as key players in the financial inclusion sphere because many of them are senders of remittances. Therefore, they are important enablers for those that they support and must be considered when devising strategic imperatives for inclusion in Malawi.

Farmers and salaried employees decreasing over time, whilst dependents and Ganyu grow rapidly. Table 7 below displays the change in the size of each target market over time. The first data column shows the number of adults in the target market as recorded in FinScope 2008. The second data column shows the number of adults per target as recorded in the latest FinScope survey. The third data column indicates the change in the number of adults from 2008 to 2014 per target market and the fourth data column shows this change as a percentage.

Target Market	FinScope 2008	FinScope 2014	Change	% Change
Farmers	3,100,770	2,647,633	-453,137	-15%
MSMEs	823,523	1,237,819	414,296	50%
Salaried employees	847,809	562,924	-284,885	-34%
Dependents	236,573	1,327,005	1,090,432	461%
Ganyu	880,088	2,053,813	886,769	133%
Total Adult Population	6,050,715	8,023,571	1,972,856	33%

Table 7: Shifts in target market numbers between 2008 and 2014

Source: FinScope, 2014

Table 7 shows a clear trend. The number of adults in the ganyu and dependent target markets have increased significantly more than the total adult population. In contrast, farmers and salaried employees decreased as a share of total adult population. There are proportionally more MSMEs in 2014 than in 2008. The large increase in dependents indicates an increase in dependency as more people are reliant on others for income. Similarly, the increase in ganyu adults indicates that a larger proportion of the rural population is dependent on piece work as their main source of income. The table below summarises the key demographic indicators of each target market group:

[42] This figure is based on 2010 calculations

	Farmers	MSMEs	Salaried employees	Dependents	Ganyu	Total Adults
Number and % of Adults	2 647 633 (33%)	1 237 819 (15.4%)	562 924 (7%)	1 327 005 (16.5%)	2 053 818 (25.6%)	8 023 571 (100%)
% Female	55%	56%	41%	70%	56%	58%
% Rural	95%	68%	49%	65%	93%	81%
Avg. monthly income (MK)[43]	12 144 (US $29)	18 963 (US $46)	28 153 (US $68)	14 153 (US $34)	5 427 (US $13)	13 484 (US $33)
% with < $1.25 a day income	84.3%	73.8%	50%	82.3%	92.2%	81%
% with >1 income source	58%	45%	32%	46%	38%	47%
% younger than 30 years	39%	46%	41%	53%	44%	44%
Most common level of education	Primary: Std 1-5	Primary: Std 6-8	Secondary: 3-4	Primary: Std 6-8	Primary: Std 1-5	Primary: Std 1-5
% of population with primary education or less	84.2%	69.5%	42.2%	66%	86.2%	76%
% of adults with access to a mobile phone	67%	79%	88%	75%	57%	69%
% that owns a car	1%	4%	13%	5%	0%	3%
% that live in their home district	89%	72%	47%	67%	88%	80%

Table 8: Basic target market indicators

Source: FinScope, 2014

The poorer, more rural target markets make up the majority of the population. Farmers and ganyu are the two largest target markets in Malawi. Both are, on average, poorer and more rural than the overall population. They are also the target markets with the lowest level of education and with the most adults still living in their home districts. In contrast, salaried employees is the target market of which the least adults still live in their home districts. They are also the wealthiest group. However, even amongst this group, 50% of adults earn less than USD 1.25 a day.

Asset ownership according to income distribution. Higher income target markets, such as salaried employees and MSME owners, have greater access to assets than the poorer target markets. Almost all (88%) salaried employees have access to a mobile phone, compared to 67% of farmers and 57% of ganyu. Motor vehicle ownership is also concentrated among salaried employees. A higher proportion of farmers and MSMEs own bicycles compared to the other target markets.

[43] Average income was calculated based on the information provided from FinScope 2014. FinScope only captures in which income bracket an adult falls – no their actual income. Therefore , the average income was calculated based on the median of each income bracket and should be regarded as indicative only

4.3.2. Usage by segment

Usage of financial services is spread as follows across the segments:

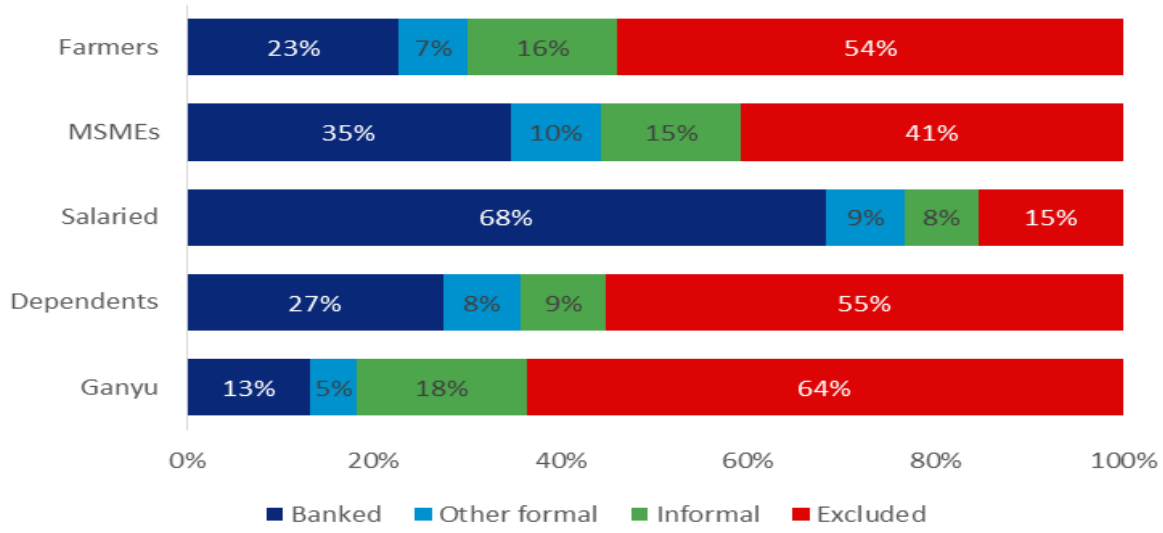


Figure 21: Usage of financial services per target market

Source: FinScope, 2014

Greater usage of financial services by wealthier, more urban target markets. From Figure 21 it is clear that the usage of financial services is positively correlated with income. Salaried employees are the best served, whereas ganyu are the least served. MSMEs are better served than farmers and dependents, but less so than salaried employees. The target markets that are predominately rural, farmers and ganyu, access informal financial services on a relatively greater scale. In contrast, salaried employees and dependents, which have a proportionally greater number of urban dwellers, make less use of informal financial services.

Breadth of access increased across all target markets from 2008 to 2014. Even though some target markets are still underserved, overall access to formal financial products increased for all target markets. It is also worth noting that the 2008 FinScope survey was conducted well before mobile money was introduced, whilst the 2014 survey was conducted fairly soon after mobile money was introduced and therefore substantially underrepresents the current level of mobile money usage[44]. The proportion of ganyu using bank services increased threefold from 4% to 13%, the proportion of salaried employees that access formal financial services increased by 13 percentage points and MSME uptake of formal products increased by 15 percentage points. Therefore, there is a clear trend toward greater use of formal financial services, even among those least well served. Usage of informal financial services also increased from 2008 to 2014, which was mainly driven by the spread of CARE inspired VSLAs. For target markets living in rural areas, mostly farmers and ganyu, informal financial services often present them with the only way to meet their financial needs. Usage of informal services by farmers increased from 5% to 16% and usage by ganyu increased from 5% to 18%. Informal financial service usage is not only isolated to farmers and ganyu, but is also popular among many salaried

[44] Reserve bank data (2014) indicates that there are 1.1 million mobile money subscribers. However, since initial rapid uptake many subscribers have become inactive.

employees. Although the increase has not been as significant as with the more rural target market, many salaried employees use informal financial services as a secondary or tertiary financial service.

Comparing depth and breadth of usage. Figure 22 below plots the depth against the breadth of financial service usage across the five target markets. The depth of financial inclusion, indicated on the y-axis, is stated as the average number of products used by each included adult (a value of between 1 and 4). This is mapped against the breadth of financial inclusion (measured as the percentage of the population using at least one product) on the x-axis. The figure shows the reach of the formal market (represented by the solid bubbles) as well as the combined total of the formal and informal market (represented by the shaded bubbles). The size of the bubble represents size of each target market.

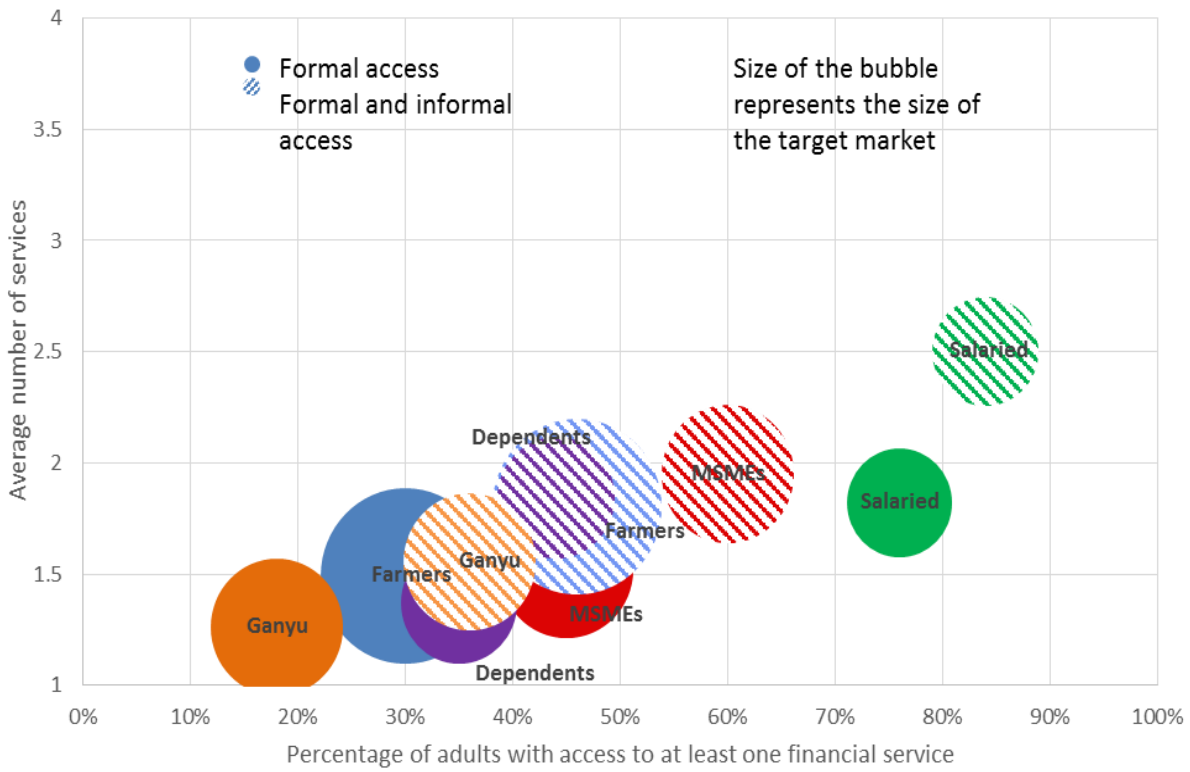


Figure 22: Depth of financial access per target market

Source: FinScope, 2014

Unequal distribution of depth to financial access. From Figure 22 it is clear that the higher income target markets have access to a greater portfolio of products. Salaried employees, the smallest target market consisting of only 7% of adults, is the target market with access to the greatest number of financial services. On average, salaried employees use 1.8 formal financial products. 46% of salaried employees access more than one formal financial service. In contrast, only 3.4% of ganyu (26% of adults) access more than one formal financial service. 10% of farmers, the largest target market, access more than one formal financial service. 17% of MSMEs and 11% of dependents access more than 1 formal financial service respectively. Therefore, salaried employees who are the smallest and the wealthiest target market have, on average, access to a larger portfolio of financial services than the other target markets.

Informal financial services increase both depth and breadth of access. Figure 22 shows that for all target markets, breadth and depth of financial services is increased when taking informal usage into account. Informal financial services increase the breadth of access to financial services disproportionally more for the poorer target markets than the wealthier target markets. Salaried employees' average number of products used increased more than the other target markets, indicating that even the richest target market derives considerable value from access to informal financial services. This illustrates that informal products play an important role in extending the level of financial inclusion of all groups throughout the income range. For the poorer segments, financial products comprises only of informal products, whilst for the wealthier segments, informal products complement their formal products to extend their depth of their access.

4.3.3. Target market profiles

Below we unpack the profile for each segment based on the summary indicators provided in the previous two sub-sections. This allows us to conclude on the primary financial service needs for each target market.

4.3.3.1. Farmers

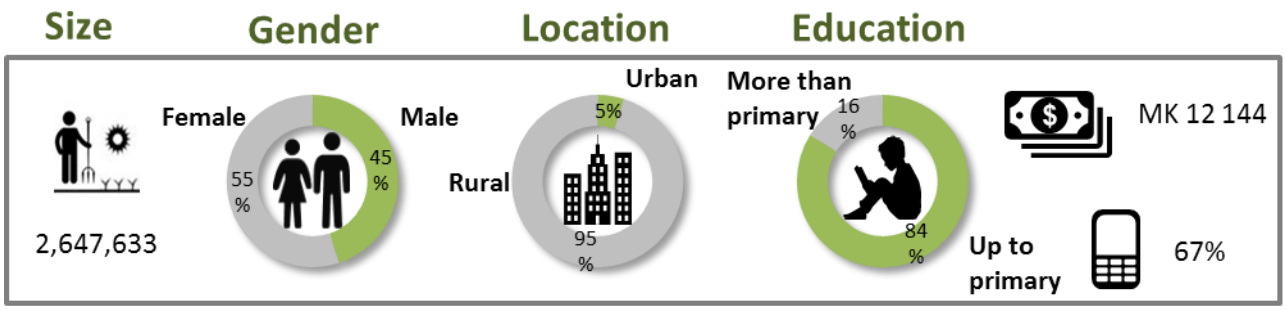


Figure 23: Famers key indicators

Source: FinScope, 2014

Low level of income, mostly survivalist. Farmers are the largest and second poorest target market. However, income might not be the most accurate measure of wealth for farmers since 91% of them consume rather than sell at least some of their produce, thereby augmenting their livelihoods. The seasonality of their economic activity presents them with great challenges, because they are often too poor and lack the requisite storage infrastructure to delay the sale of their produce until prices are more favourable. Consequently, they are unable to maximize their income and increase their productivity. It also forces farmers to diversify into other economic activities during the off season, as illustrated by the quotes below:

> *"I am a farmer. I farm maize, cassava and vegetables, when it's not time to grow these crops then I become a full time tailor as you can see. This helps me to pay for my day to day expenses. I get about K 400 (USD 1) to K 600 (USD 1.5) per day. The size of my farm is about 1-and-a-half acres. It takes me one month to prepare it because I use a hoe. Last season, I used about 2*

bags of fertilizer. I sell about 25 bags of cassava at K 6000 (USD 14) each. I can get up to 100 bags if I have enough fertilizer. 17 bags of maize are for food consumption only."

Farmer, male, 58 years old

Geographically static. Most (89.2%) of farmers are living in their home district. Land is passed on from generation to generation and most farmers are too poor and lack the opportunity to migrate to other areas. Education attainment is more often than not insufficient for the younger generation to access economic opportunities in the urban areas. Therefore, the majority of the farming population is static and engaged in subsistence farming for a living. As a result of this,family farms are further subdivided with each new generation, reducing the average farm size, and therefore productivity of these farms, and increasing the number of people reliant on the same amount of land for their livelihoods.

Limited rural footprint for financial service providers inhibits access for farmers. As expected, farmers live almost exclusively in rural areas. Given the financial landscape of Malawi, this greatly constrains their access to formal financial services. Formal financial service providers are mostly located in urban areas. Consequently, the transport and opportunity cost for farmers to access these services are significantly higher than for target markets, such as salaried employees, who live mostly in urban areas. This is illustrated in Figure 24 below by the relatively low uptake of most formal products and relatively high uptake of informal products by farmers. However, despite the low penetration of formal financial services, due to the size of the target market, farmers still account for the largest portion (30%) of formal financial services users.

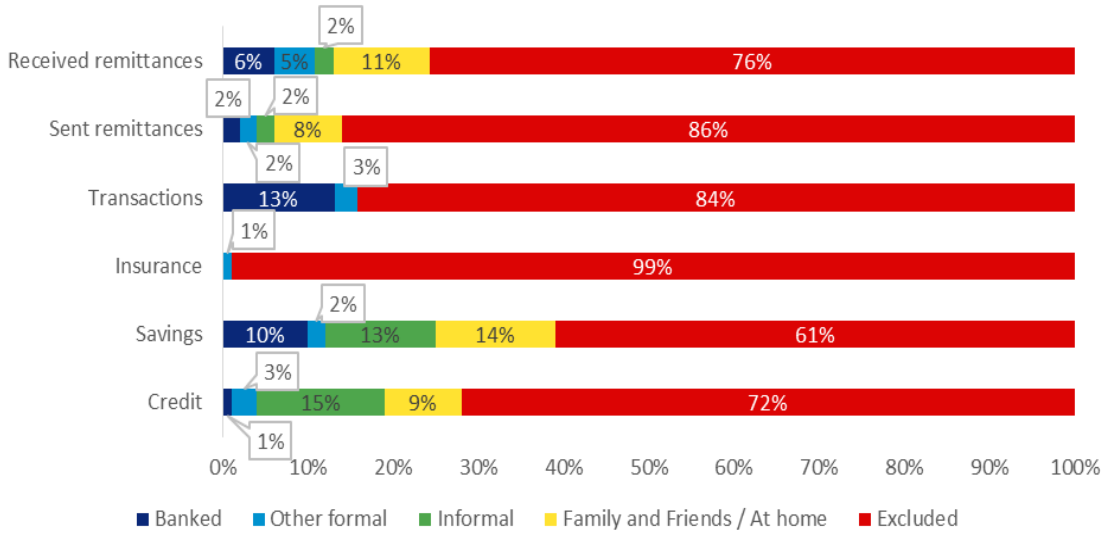


Figure 24: Farmers' usage across target markets

Source: FinScope, 2014

Highest usage of informal savings and credit services. Figure 24 indicates that the most commonly used formal financial service by farmers is transactions. This is expected because having a bank account automatically grants the user transactional capabilities. Savings and credit are the most overall used financial services. Farmers access these services mostly through informal channels. Even farmers that use formal financial services often still make use of informally provided services such as VSLAs. In fact, 25% of banked farmers use informal financial services. The importance of informal financial services is further underlined by the fact that 35% of total borrowing and saving by farmers

takes place at a community and family level, since those services are more accessible in terms of eligibility requirements or more conveniently located, as expressed by this farmer:

> ***"Are you a member of any other association of a village bank?***
>
> *We men usually say we do not belong to a village bank, but in fact we do. My wife does belong to a village bank so indirectly I also do. She belongs to a group called Africare. She contributes K 125 (0.3 USD) per week. That is where we sometimes take loans from. I also opened a bank account so I could access loans, but I do not use accounts as bank is 20 kms away."*

Farmer, male, 58 years old

Depth of formal access limited as farmers opt for informal savings and credit. Only 11% of farmers use more than one formal financial service. 66% of formally financially included farmers use the formal sector solely for transaction purposes. The most popular combination of formal products is transactions and savings. However, these two services are often accessed through one bank account. Formal insurance usage is extremely low, even for farmers that access the other three financial services.

Segmentation analysis of farmers

Farming is a way of life in Malawi. According to FinScope 2014, 88% of the adult population is involved in farming activities. Many of them use farming as a means to supplement their income earned from other economic activities. However, Table 8 indicates that the percentage of adults that farm for their main source of income is significantly lower at 33%. Farmers can be split into two groups: subsistence farmers and trading farmers. Subsistence farmers are farmers that consume, rather than sell, most of their produce and typically have access to limited resources and land. Trading farmers sell, rather than consume, most of their produce. They generally have access to more resources and farm for a business to maximize income (See Box 3 in section 2.1).

Trading farmers financially better off, but only marginally more included. About half (52%) of farmers indicated that they farm for the purpose of selling their produce. The remainder (48%) indicated that they either farm purely for consumption or that they consume most of their produce. The typical crops that subsistence farmers plant are maize, groundnuts and beans. These crops have relatively low export value, but have very high subsistence value. In contrast, the most popular crops for trading farmers are tobacco, sugarcane and cotton, which have significantly higher export value, but are also more strictly regulated. Trading farmers' monthly income of K 14,543 is higher than the monthly income of subsistence farmers, K 8,636. This is to be expected, since the majority of the yield of subsistence farming is non-monetised. Figure 25 below illustrates the level of financial access for the two categories.

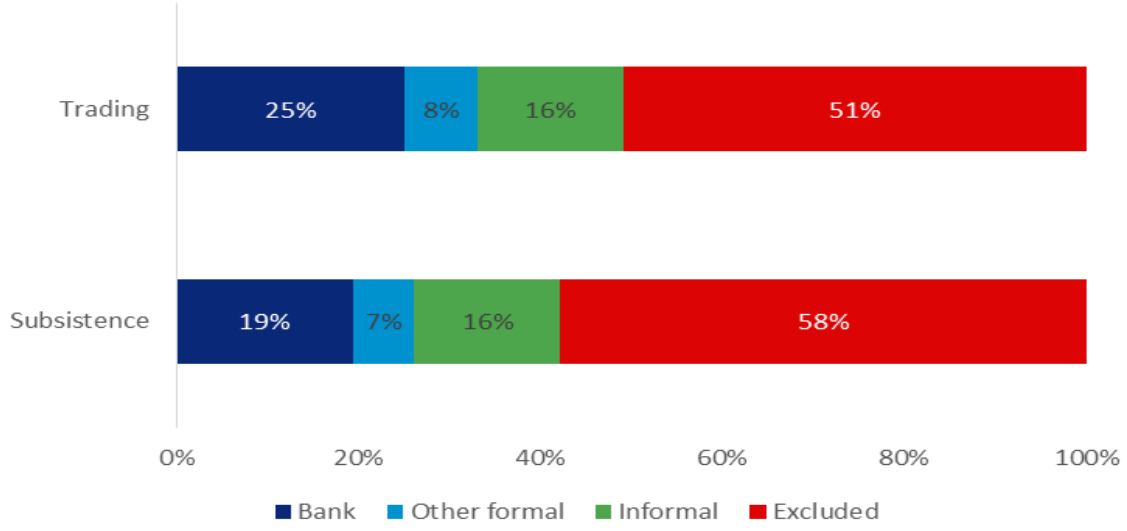


Figure 25: Financial access per farmer category

Source: FinScope, 2014

Despite trading farmers earning substantially higher monetised income, their level of financial usage is only marginally higher than that of subsistence farmers. The main difference between the two groups is the percentage that are banked; 25% of farmers have a bank account compared to 19% of subsistence farmers.

Given that trading farmers are actively trying to sell their produce, one would expect them to be more financially included. The fact that trading farmers earn monetised income make them more for suitable for input financing services and storage of value accounts than subsistence farmers. The low levels of access to financial products, particularly formal products, by this groups suggests an opportunity for providers to target this subset of farmers for customer growth. Additionally, as these farmers are selling their products they are necessarily linked into some form of value chain which may offer the potential for aggregation of farmers for providers to target as a group.

Income and formal financial service usage correlates with education level of farmers. Figure 26 below indicates that farmers that have obtained a higher level of education, specifically higher than primary, are more formally included. 49% of farmers with secondary education or more uses formal financial services compared to 28% of farmers with primary education or less. FinScope also indicates that higher educated farmers have higher annual incomes. On average, farmers that have obtained at least some secondary education earn K 25,278 (USD 60) compared to farmers with only primary or no education who earn K 10,149 (USD 24). This educational dividend emphasises the need for skills development. The poorly educated farmers constitutes 90% of all farmers and 30% of the adult population. Their relative size coupled with the large education dividend in farming makes them the ideal target group for skills interventions.

Figure 26 further indicates that both well-educated and poorly educated farmers make limited use of formal credit. 5% of well-educated farmers use formal credit compared to 4% of poorly educated farmers. Currently, informal institutions and family and friends are the major providers of credit to farmers.

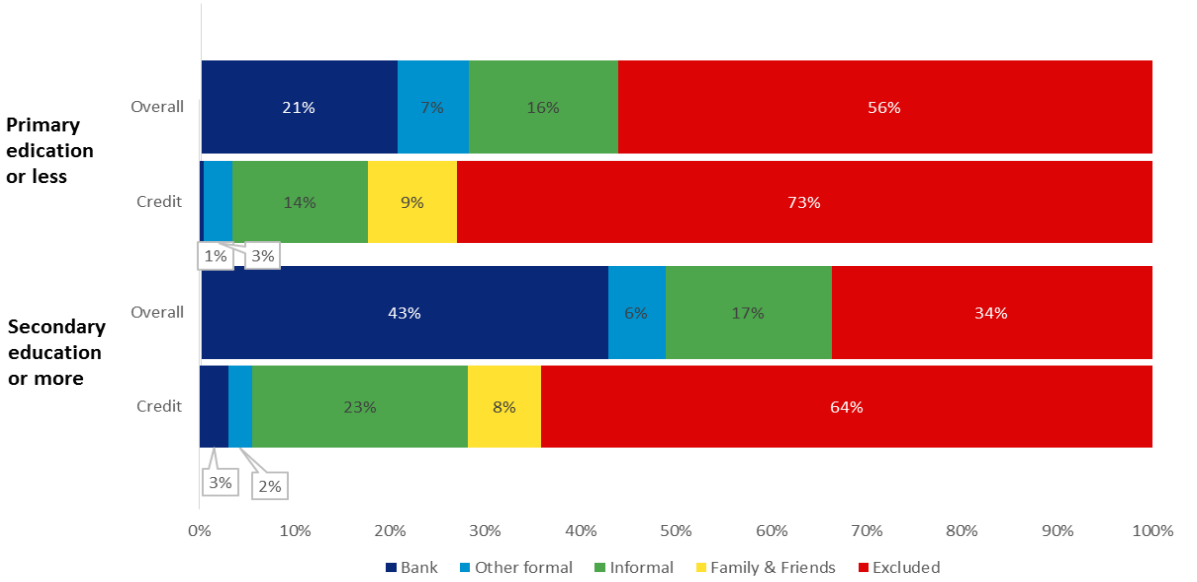


Figure 26: Financial usage per education attainment category

Source: FinScope, 2014

Farmers that are more educated are more effective at farming. This directly translates into higher annual income and greater usage of formal financial services. Formal credit usage does not display the same disparate usage levels as overall financial usage. Therefore, input credit should be better targeted towards the more educated farmers, who has the capacity to absorb the risk and increase their productivity.

Tobacco farmers have a greater level of financial usages than non-tobacco farmers. 29% of trading farmers indicated that they grow tobacco as the crop from which they earn their main source of income. The high value of the crop is a direct result of the international demand for it. Consequently, many subsistence farmers also have a small tobacco field to ensure at least some monetised income. Farmers that grow tobacco earn, on average, K 15,204 (USD 36) compared to K 11,251 (USD 27) earned by non-tobacco farmers. The difference in earnings is not as stark as between trading and subsistence farmers. However, the difference in financial service usage is marked as illustrated in Figure 27 below:

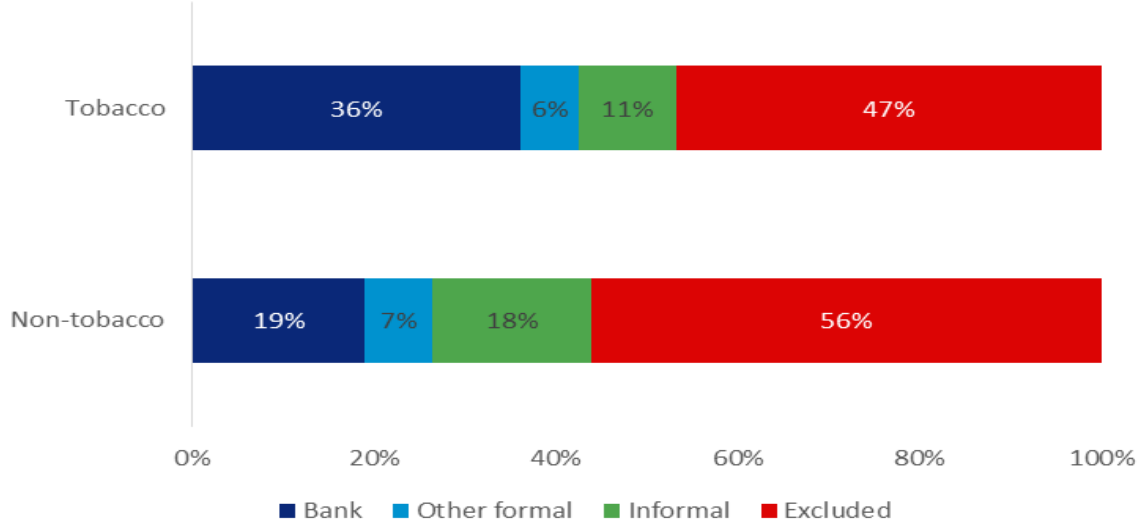


Figure 27: Financial access for non-tobacco and tobacco farmers

Source: FinScope, 2014

36% of tobacco farmers are banked compared to only 19% of non-tobacco farmers. Therefore, non-tobacco farmers are more reliant on informal financial service to meet their needs.

Main financial service needs:

Even though farmers are classified as a separate target market, it is important to keep in mind that the adults in other target markets often engage in farming activities to supplement their incomes. Therefore, targeted financial service interventions may benefit a larger share of adults than just those in the farmers target market.

Seasonality of farming income implies farmers could benefit from input credit products. The cash flow models of farmers are unique due to the seasonal aspect of their business activity. This should be taken into account when designing financial products for their needs. The seasonality of income also creates the need for *consumption smoothing vehicles*. Farmers could benefit from a financial product that they can use to save income over an extended period until they need to purchase inputs.

4.3.3.2. MSMEs[45]

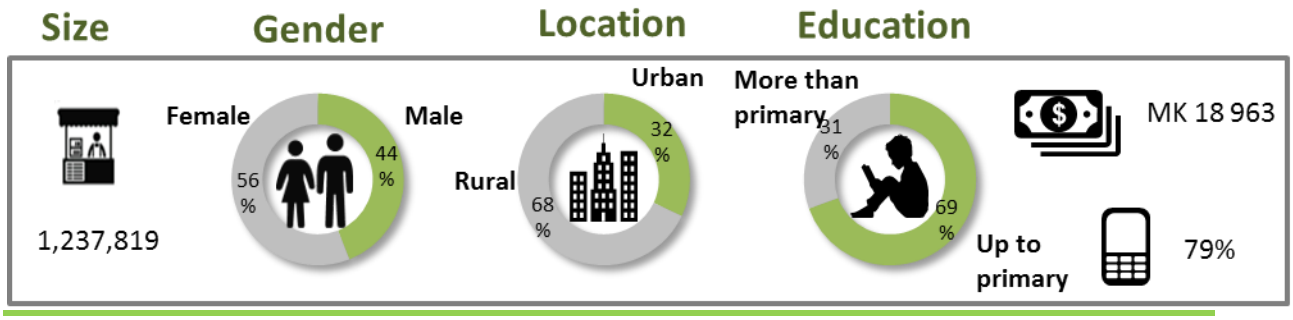


Figure 28: MSME key indicators

Source: FinScope, 2014

MSMEs critical to achieving broad economic goals. Microenterprises are key contributors to the economic development of any country. In developing economies, they are often the value adders to primary products and is the first step for entrepreneurs with the potential to establish larger corporations (Radas & Bozic, 2009). Especially in Malawi, MSMEs are of vital importance, because of the limited private sector development that has been achieved to date.

Business ownership a big aspiration for many Malawians. MSME owners have the second highest income levels of the target markets and are more urbanised than the population average. FinScope (2014) indicates that 38% of adults would start a new business if they received a large loan. From the qualitative research it is apparent that owning a business is a very high aspiration for many Malawians and seen as a way to improve their current living conditions:

> ***"Tell me about your dreams and aspirations?***
> *I want to be independent and do my own business and help myself in a way that I want."*
>
> Ganyu, male, 43 years old

[45] The MSME section draws both on data from the 2014 FinScope consumer survey and the 2012 FinScope MSME survey. The financial service usage data comes from the consumer survey, whereas the business related data comes from the MSME survey. Each time data from the MSME survey is used it is mentioned explicitly.

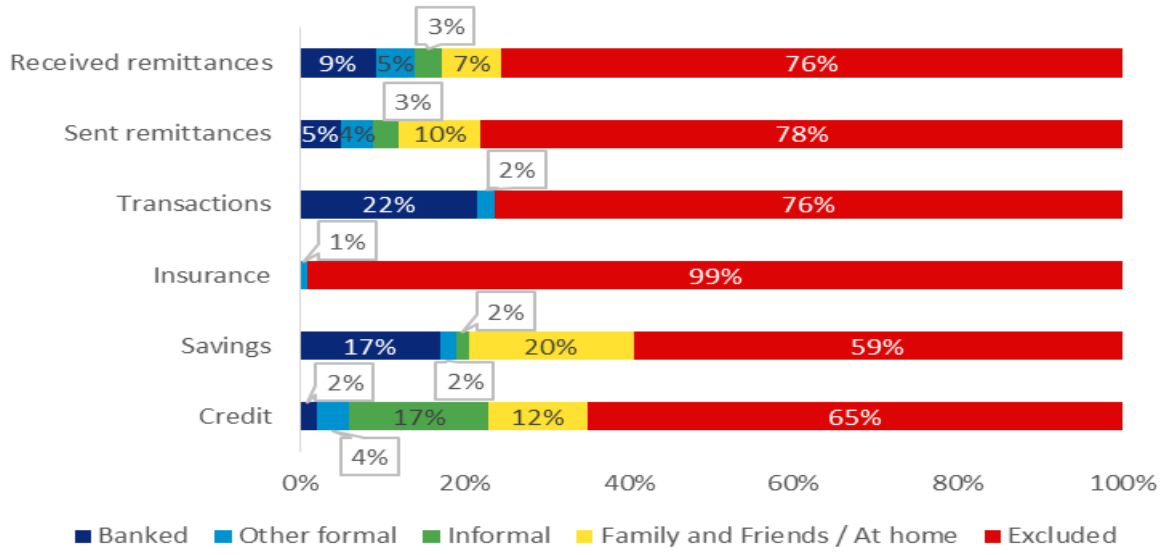


Figure 29: MSMEs usage across product markets

Source: FinScope, 2014

Limited usage of financial services by small business owners. Figure 29 indicates that the majority (76%) of MSMEs do not use formal financial services. Most notably, only 24% of MSMEs use formal transaction services implying that most business owners transact only in cash. 17% of MSMEs opt to save in banks, with a larger proportion (20%) currently saving at home. Formal credit extension to MSMEs is very limited. Only 6% of MSMEs indicated that they currently have credit from a formal institution. However, 29% of MSME acquired credit from non-formal sources, such as VSLAs or from family and friends.

Uptake of formal financial services increased by 15 percentage points from 2008 to 2014. Uptake of formal financial services by MSMEs increased from 35% in 2008 to 45% in 2014. This was mostly driven by an increase in the proportion of MSME owners that uses bank transaction services, particularly in the urban areas. As indicated by Figure 29, 24% of MSMEs use transactional services. The figure further indicates that informal usage is prominent for savings and credit. Approximately 28% more MSME owners use informal credit and savings than in 2008. Most of these MSMEs are located in rural areas. Therefore, there is clearly a demand for financial services, but the formal sector is less able to reach these MSME owners. This could be due to proximity and infrastructure challenges, but may also reflect a focus by providers on those easiest to reach.

Sourcing money, lack of demand identified as main challenges. In the MSME survey, 34% of MSMEs identified "access to finance" as the biggest obstacle to growing their business. This response is confirmed by the qualitative research as displayed below. FinScope indicated that only 6% of all MSMEs make use of formal financial institutions to access credit. Therefore, there would appear to be a mismatch between the supply and demand of credit to this target market. As a result the majority of MSMEs acquire finance for their business from savings and credit obtained from VSLAs or family members.

"I sell shoes in and around Limbe. From my side I want my business to go far like other business people, be able to… maybe…. Be a successful person. A Malawian that is able to do something. We are living a poor life, but I would like to see my business grow but due to lack of capital I can't improve. "

Trader, male, 46 years old

Depth of formal access fairly limited, but better than other target markets. 17% of all MSMEs use more than one formal financial product. The most common formal product combination to have is transactions and savings. 15% of MSMEs use both formal and informal financial services. Furthermore, 34% of MSMEs that use formal products also use informal products indicating that for many MSMEs informal financial services play an important role in augmenting their formal services.

MSME segmentation[46]

Given their role in the economy, it is important to further segment MSMEs in Malawi to get a better understanding of the different levels of capability that exists within the target market. The segmentation analysis provides an enhanced understanding of the key needs of different types of MSMEs and how financial services can be used to address them.

The FinScope MSME survey (2012) questions business owners in Malawi on a variety of issues. This includes their educational attainment, which shows the skills they have at their disposal, as well as their reason for being in the business, which gives an idea of their aspirations. When individuals are profiled according to these two parameters, four distinct sub-segment profiles emerge. These are introduced in the graphic below:

[46] The data used in the MSME segmentation is from the MSME FinScope survey that was conducted in 2012

	Primary education or less	Secondary education or more
Aspirational Entrepreneur	Struggling go-getters: *Ave income: K 157,457 (USD 378) p.a.* *43% of MSMEs* *16% Urban* *0.25 employees on average* This group of entrepreneurs is motivated to grow, but struggle to realise the potential of their business due to a lack of skills. Skills interventions such as training, may be the most effective intervention for these MSMEs.	Driven achievers: *Ave income: K 566,750 (USD 1359) p.a.* *16% of respondents* *34% Urban* *1.18 employees on average* This group of entrepreneurs has both the drive and the potential to succeed. They are prime candidates for greater access to financial services, particularly capital.
Entrepreneur out of necessity	Survivalists: *Ave revenue: K 133,433 (USD 320) p.a.* *33% of respondents* *9% Urban* *0.23 employees on average* Entrepreneurs that do not have the required skills or the drive to grow. Their main focus is day-to-day survival. These MSMEs are not likely to grow substantially.	Reluctant entrepreneurs: *Ave income: K 177,301 (USD 425) p.a.* *8% of respondents* *32% Urban* *0.4 employees on average* This group of entrepreneurs has the potential to grow, yet they have not exhibited the desire to be entrepreneurs. They still need to recognize their potential.

Table 9: MSME Segmentation

Source: FinScope MSME, 2012

Segmentation yields four distinct groups of MSMEs with differing characteristics and needs. The average revenue earned per segment corresponds with each segments' level of empowerment. Driven achievers earn significantly higher revenues than the other segments. The two largest segments, struggling go-getters and survivalists, constitutes 76% of total MSMEs and have the lowest average level of education attainment. The lack of skills is a significant constraint for the majority of MSMEs. Below follows a discussion of indicators that further describe the differences in economic profile:

- **Driven achievers** constitute 16% of MSMEs. MSMEs in this segment employ on average the most employees (1.18) and are the most likely to create employment opportunities because of their ability to generate profits. 34% of driven achievers operate in urban areas, more than any other segment. The average revenue of this segment is four times higher than the aggregated average of the other segments. The utilization rate[47] of driven achievers is the highest of the four segments. On average, driven achievers work 45 min more per day than the other segments. 50% of driven achievers indicated that they work more than 8 hours a

[47] The utilization rate is an indicative measure of resource usage. It measures the hours that the business is operating as a proportion of the available working hours. For example, a utilization rate of 50% indicates that a business is operating for half of the available time and can increase production without having to invest in additional capital goods.

day. Access to a mobile phone is also the highest in this segment with 72% of driven achievers indicating that they own a mobile phone.

- **Reluctant entrepreneurs** is the smallest segment with only 8% of MSMEs falling into this category. They employ 0.4 employees on average, considerably less than driven achievers. A third of the segment operates in urban areas. The average MSME owner in this segment works 6.5 hours per day, with 33% indicating that they work more than 8 hours per day. 70% of reluctant entrepreneurs have access to a mobile phone.

- **Struggling go-getters** is the largest group, consisting of 43% of MSMEs in Malawi, and employing 0.25 employees on average. 16% of struggling go-getters work in urban areas. Their utilization rate is very similar to that of reluctant entrepreneurs. 34% of entrepreneurs in this segment indicated that they work more than 8 hours per day. However, struggling go-getters have significantly lower access to mobile phones. 36% indicated that they have access to a mobile phone compared to 70% of reluctant entrepreneurs.

- **Survivalist** entrepreneurs comprises a third of MSMEs and operates almost exclusively in rural areas. As their name suggests, survivalist MSMEs struggle to operate at full capacity and are not focussed on creating employment for other people. On average, they employ 0.23 employees. 21% of survivalists indicate that they only operate between 1 and 4 hours per day. 34% of survivalists have access to a mobile phone.

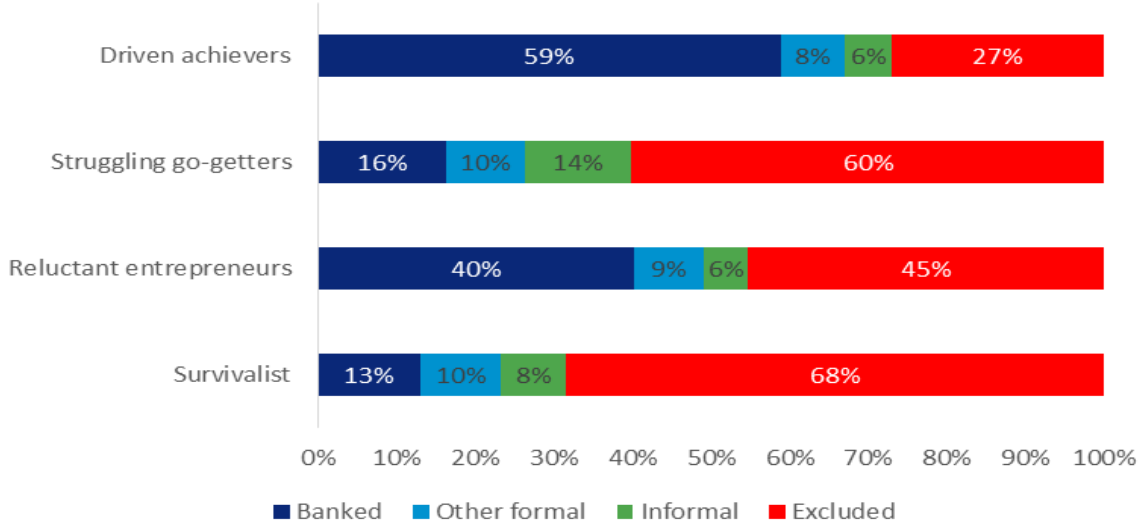


Figure 30: Usage per MSME segment

Source: FinScope MSME, 2012

Larger MSMEs more financially included. Figure 30 indicates that driven achievers and reluctant entrepreneurs are the largest users of financial services. 67% of driven achievers use formal financial services compared to only 23% of survivalists. It is worth keeping in mind that driven achievers and reluctant entrepreneurs are more prevalent in urban areas than the other two MSME segments, which makes banking services more easily accessible.

Access to credit very limited. 24% of MSMEs indicated that they have some form of credit. 18% said that they use this credit to grow their business. Ideally most of this credit should flow to MSMEs that would utilize it optimally. However, when comparing access to credit across segments, driven

achievers access credit only slightly more than the other segments. 18% of driven achievers access formal credit compared to 12% of struggling go-getters, 14% of reluctant entrepreneurs and 12% of survivalist (see section 6.1).

Main financial service needs:

The segmentation analysis emphasises the fact that different types of MSMEs require different types of interventions. From a financial services perspective, it is crucial that *credit* is channelled to those MSMEs with the capacity to absorb it and have the ability to translate the additional funds into outputs. Especially in the high interest rate environment of Malawi, extending credit to MSMEs not productive enough to afford the repayments will ruin their business and achieve the opposite of the intended outcome.

MSMEs will benefit from a *portfolio of financial services* to assist them to maximize the efficiency of their business. Credit is important for capital investment; transaction services will help them to receive customer payments, pay suppliers and salaries of employees more efficiently; insurance to mitigate risks that prevent them running their businesses; and savings to smooth consumption, mitigate risk and for capital investment. The popularity of savings at home, borrowing from friends and family and the large share of MSMEs that do not use transactional services indicate that there is potential for greater penetration of formal financial services.

4.3.3.3. Salaried employees

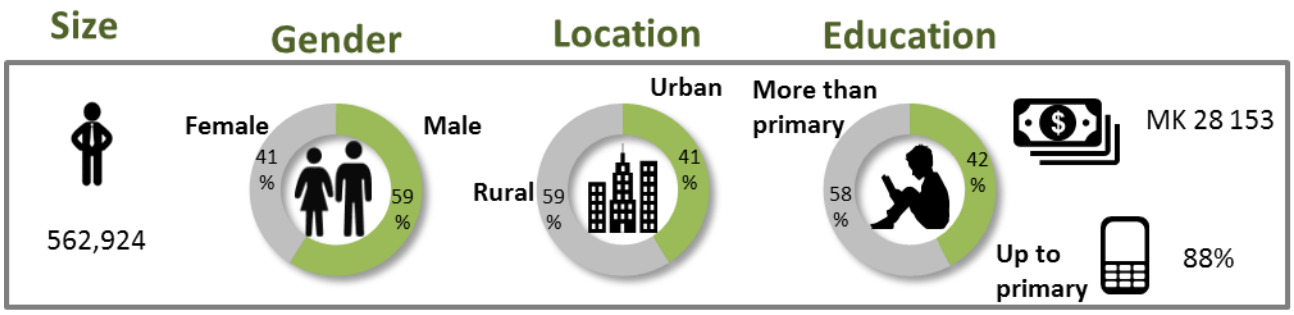


Figure 31: Salaried employees key indicators

Source: FinScope, 2014

Wealthiest, most urban and best educated target market. Salaried employees are in the best economic position of all target markets. They consist of government and formal private sector employees. Their average income is significantly higher than the rest of the segments, more than twice that of the second wealthiest target market. However, there is still a large proportion (50%) that earn incomes of less than USD 1.25 a day. It is the only target market of which the majority of the population are male and live in urban areas. This is in stark contrast to the rest of the population, who are mostly female and live in rural areas. Education attainment is also the highest of all the target markets. It is interesting to note that a relatively small proportion of salaried employees live in the district where they were born. This, coupled with the higher levels of education, is indicative of a group that was able to overcome the opportunity cost of education and access better economic opportunities.

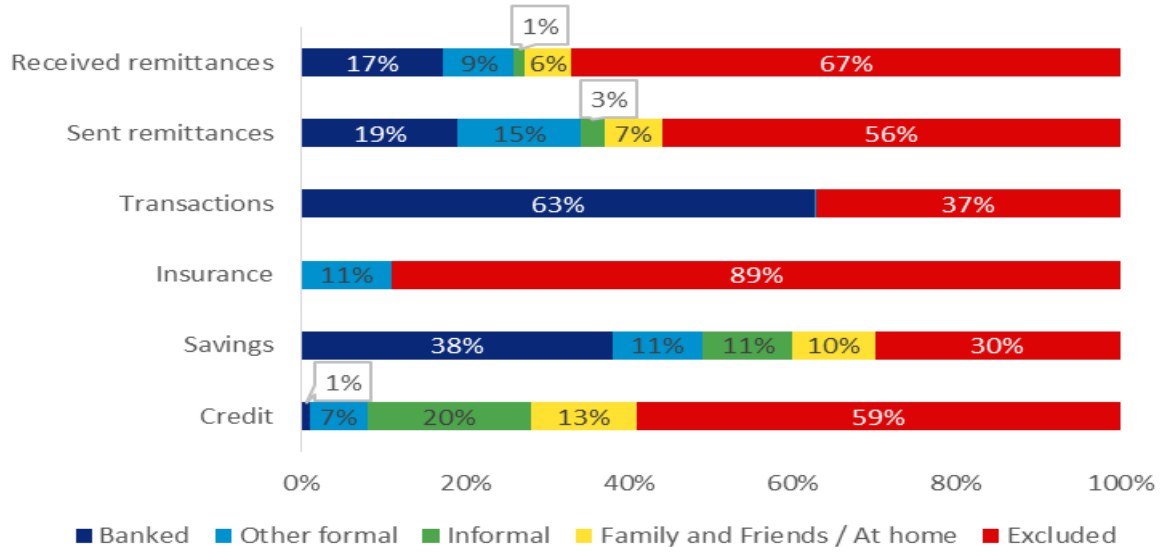


Figure 32: Salaried employees' usage across product markets

Source: FinScope, 2014

Best served. Their income levels and proximity to financial services places salaried employees in the position to be the most financially included target market. Their relatively high and regular incomes also means they are the target market primarily targeted by formal financial service providers. Figure 21 shows that only 15% of adults that earn a salary do not use any financial services. As with other target markets, a greater proportion of the target market use informal credit than formal credit. Insurance uptake by salaried employees is the highest of all target markets. This speaks to their ability to afford goods that would require insurance, like cars, or the fact that insurance is linked to their employment, like medical aid as well as the regularity of their incomes. This is illustrated by the following quotes:

> *"Medical insurance is being introduced by my employers so hopefully next time you come around I will be on MASM. I am aware of insurance types - medical, car, life insurance. I might get additional insurance 'when I decide to have children' or when I buy a car (for accident cover); I am not as about to die soon so I guess I do not need life insurance."*
>
> Salaried employee, male, 65 years old

> ***"How do you manage some impacts such as car accidents or thieves breaking in your shop?***
>
> *Yes because it's a law you can't drive without insurance."*
>
> Salaried employee, male, 27 years old

Primary senders of remittances. Being the highest earners and living in non-rural areas make it logical for salaried employees to be the largest senders of remittances. There is a strong preference for formal channels as 75% of all remittances are sent and received via formal channels. However, there is also a significant proportion (33%) of salaried employees that receive remittances. This further emphasises that being formally employed in Malawi is not necessarily indicative of financial independence.

Deepest served. Most salaried employees access at least 2 financial services, primarily transactions and savings as a combination. As indicated by the breadth analysis, credit and insurance usage is limited in comparison. Even though the majority of salaried employees use formal financial services, 24% of the formally included use informal financial services as well. Most of the 24% is made up out of salaried employees with bank accounts that save in VSLAs or other community-based savings groups. Informal financial services therefore usually deepen salaried employees' access to financial services, augmenting their existing formal products.

Main financial service needs

On average, salaried employees are well-served in that most salaried employees use at least one formal financial service. Consequently, the depth of financial access is a greater priority for this group. The wealthier adults in this target market will benefit from a variety of financial services to fulfil their needs. Salaried employees are also the main target market for insurance and long term savings, though significant inroads can still be made in this regard. Bank accounts, can be leveraged as a channel to distribute additional financial services and increase the depth of access.

4.3.3.4. Dependents

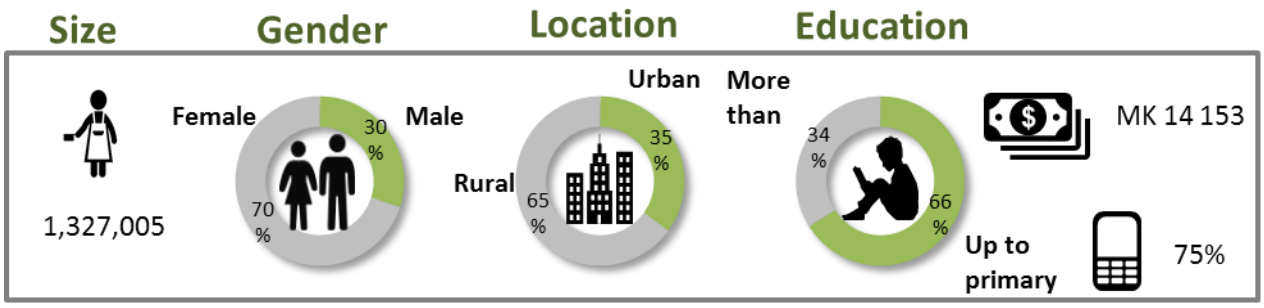


Figure 33: Dependents key indicators

Source: FinScope, 2014

Young and mostly female. The dependents target market are strongly skewed towards females, at 70%. Dependent adults have higher incomes than both the ganyu and farmers target markets, but have access to fewer financial resources than MSMEs and salaried employees. This is especially true for dependents living in urban areas. Typically, the urban proportion of the dependents group consists of wives of higher income earners and individuals that can afford to pursue tertiary education. Therefore, it is interesting to note that urban dependents have the second highest levels of education attainment, after salaried employees. In contrast, rural dependents have a similar education profile to farmers. They are also more likely to farm: 92% of rural dependents engaged in farming as a means to obtain a secondary source of income, whereas only 60% of urban dependents engage in farming.

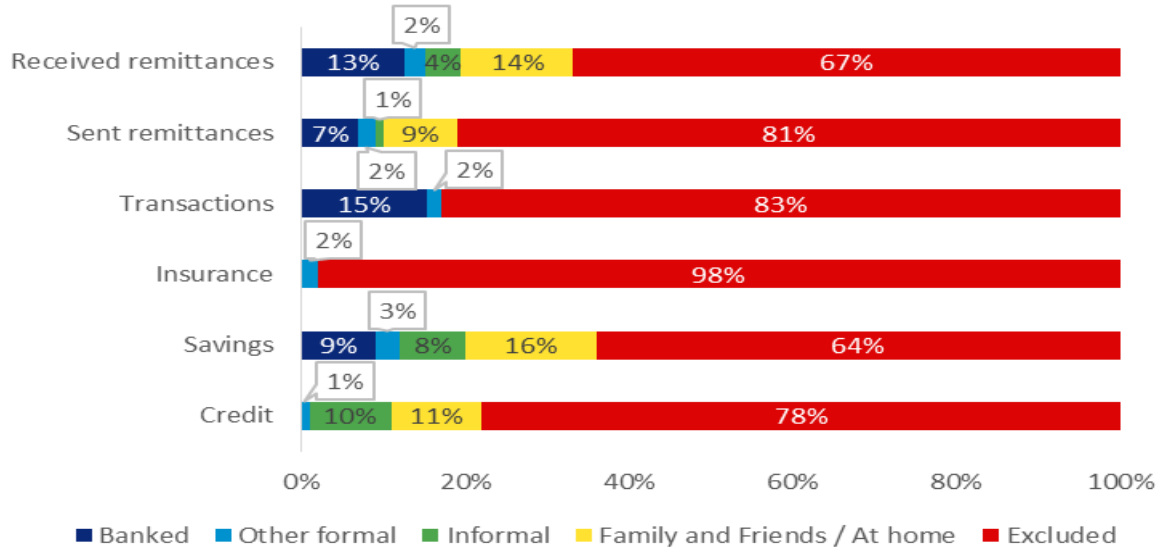


Figure 34: Dependents' usage across product markets

Source: FinScope, 2014

Usage of financial services mostly at an informal level. Dependents by definition do not have access to a regular, formal source of income. This restricts their potential access to financial services such as credit. However, transaction and saving products – to receive and store money – will provide them with better alternatives to meet their key needs and mitigate the risks to which they are exposed. Currently, only a quarter of dependents access formal transaction services and about 12% have formal saving accounts. The majority of dependents use informal mechanisms to receive and store remittances.

> ***"What do you think about banks?***
>
> *I know about banks but for me I keep my cash in the house because it is only for half a day then I use it. Sometimes money can get lost or a house can burn down. But I don't have any money to keep at the bank."*
>
> Dependent, female, 56 years old

Receiving formal remittances a driver of financial capability. Dependents that receive remittances as a source of income are confronted by the need to use a remittance service, be it formal or informal. As soon as a formal channel is used, this also confronts these adults with the need to acquire the financial capability to engage with the formal financial sector (Bester *et al*., forthcoming). In Malawi receivers of formal remittances scored 6.9 on the financial literacy index compared with an average score of 5.1 for the entire population. Through this initial engagement with the formal sector, remittance receivers may be empowered via the initial use of the remittance (and the associated financial capability) to expand their usage of financial services to other product types, as they are forced to engage with financial services.

Very limited depth of financial access. Typically, dependents benefit most from transactional products that allow them to receive remittances in an efficient manner. 55% of the financially included dependent adults use only transaction services. The percentage of dependents that use more than one financial service is limited (11%) and similar to that of farmers. There is almost no overlap of

formal and informal financial service usage by dependents. Only 6% of dependents use both formal and informal financial services.

Main financial service needs:

As the primary receivers of remittances, dependents would benefit from a cheap, reliable payments channel that they can use to receive their main source of income. This will not only help dependents, but all target markets since remittances receivers are prevalent across the board. However, it is of particular importance for dependents that are reliant on remittances for their primary income. The importance of affordable and reliable remittances are likely to increase in tandem with the increasing levels of urbanisation and migration. Furthermore, the strong female skew in this target market indicates that more women will be required to take on responsibilities as the head of the household if their husband or another household member moves away to find work. This has the potential to empower these women through their new role in the household but they will also require additional financial products, such as convenient store of value services, as they assume primary responsibility for the daily household expenses.

4.3.3.5. Ganyu

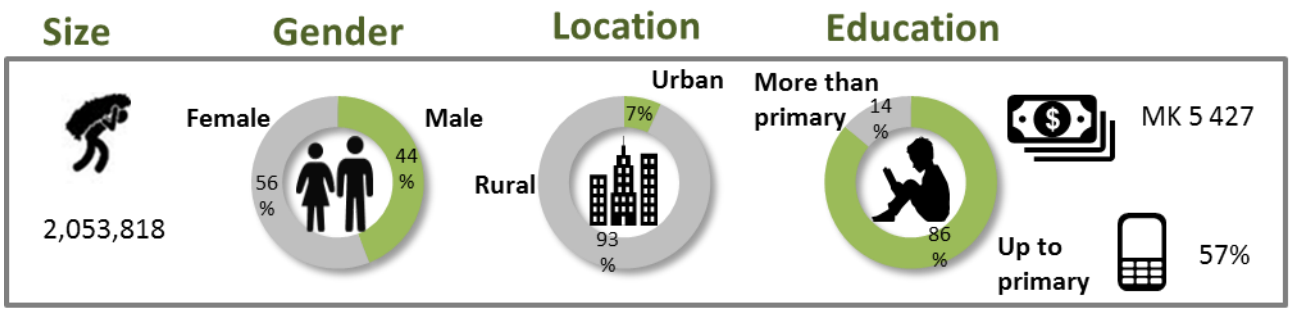


Figure 35: Ganyu key indicators

Source: FinScope, 2014

Extremely poor, live from hand to mouth. The average income of ganyu is K 5,427 (USD 13) per month, which is significantly lower than that of the other target markets, and is less than half of the national average. Ganyu earn their living by mostly doing piece work in rural areas. In general, their income is barely sufficient to sustain them on a daily basis. Living from hand to mouth makes ganyu highly vulnerable to any shocks that prohibits daily labour. Education attainment past primary education is very low, because ganyu find it impossible to afford the costs involved with sending their children to secondary school. The effect of poverty on education is emphasised by the quote below:

"May I ask…how old are you?

I am 31

How far did you go with your schooling?

I only did up to standard 8[48]*… because of poverty. Poverty is not a good thing."*

Ganyu, male, 31 years old

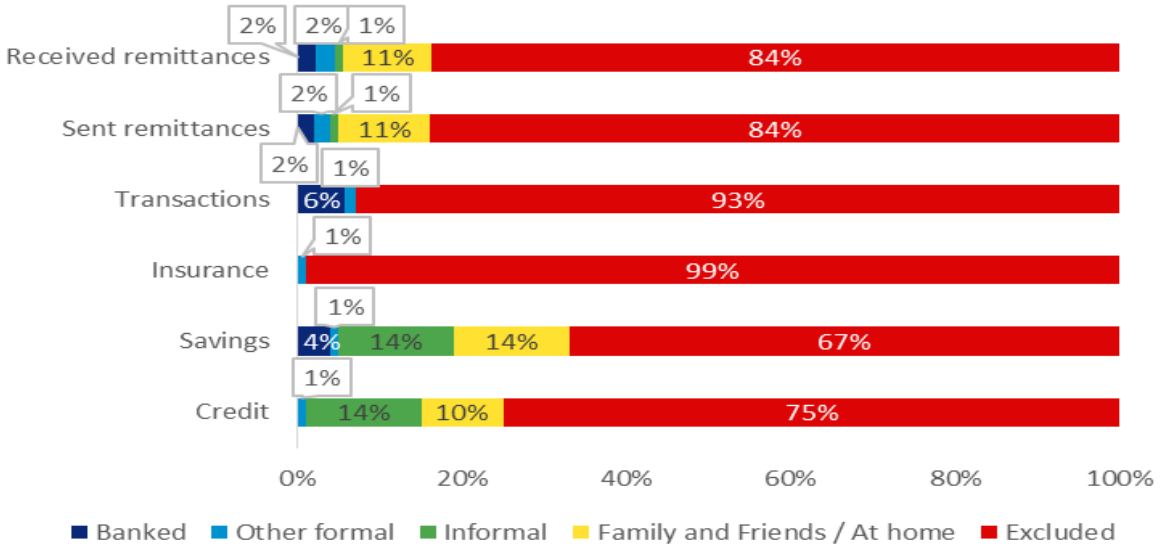


Figure 36: Ganyu's usage across target markets

Source: FinScope, 2014

Very low levels of formal financial access. Ganyu is the least financially included target market. The lack of monetary income is a primary reason for their exclusion. The little additional money that they have, they mostly save at home or at a community level as shown by Figure 36. FinScope indicates that credit is mostly used to pay for living expenses when income is insufficient. Consistent with other target markets, transactional services is the main formal financial product that ganyu use. However, very few ganyu go beyond that and use other formal financial services. Only 3% of ganyu use more than one formal financial service. In general, access to the current structure of financial services is not a priority for ganyu, as the following piece worker explains:

"Do you have a bank account?

No! I just think for the present. I make a decision on what I should do next or what I am going to eat this day or this morning.

Most of the time, when we are doing casual work we take the money as a pre-payment so we can buy maize meal and relish and eat for the day and it's gone. The following day you also

[48] Standard 8 is still primary school in Malawi (see section 2.2).

have to do the same thing. By the time you finish all the work, all you have managed to buy is soap, so that you can at least, look presentable. Then you start your search again."

Ganyu, male, 31 years old

Main financial service needs:

The very limited and irregular monetary income that ganyu earn restricts the impact that financial services can have for this target market. The main financial service need that Ganyu adults do need, is a product that can help them manage their irregular income by providing assistance with consumption smoothing challenges.

4.4. Conclusion

Non-monetised income key to supplement meagre sources of monetised income. Even though the section divided the adult population of Malawi into 5 distinct groups according to their source of income, most Malawians have multiple sources of income. Only 33% of adults are classified as farmers, however 88% of adults farm. The general lack of economic opportunities, and the consequent tight budget constraints, force individuals to supplement their income through farming. This is sustainable for individuals living in rural areas. However, the trend towards higher urbanisation means that a smaller proportion of the population have the ability to supplement their income through subsistence farming. The result is that urban adults are often dependent on their friends and family in rural areas for income. Therefore, remittances flow not only from urban to rural areas in Malawi, but also from rural to urban areas.

Access to formal financial services concentrated in richer and more urban target markets. Community and family support plays an invaluable role in society. Financial assistance from friends and family in times of need is common if the commitment horizon is determinable. The extent of poverty and the general lack of resources often makes it impossible for individuals to commit to helping each other if it is for the unforeseeable future. Informal community savings groups, specifically VSLAs, perform an indispensable function in society. For many rural adults, informal savings and/or credit through VSLAs are the only financial products they use. Additionally, 24% of adults with bank accounts also save in VSLAs, implying that even individuals that have access to alternatives still often prefer to save at a community level. Furthermore, the incidence of VSLA participation by urban adults is also significant. Therefore, it is apparent that the value proposition of VSLAs in Malawi is high. Formal financial service usage is disparate between target markets and area. Salaried employees are the biggest users of banking services in Malawi. They typically reside in urban areas and have a higher average income than the other target markets. Similarly, urban MSMEs' formal financial usage is higher than that of rural MSMEs. In contrast, farmers and ganyu have very low levels of formal financial usage, because they often live far away from formal financial institutions and it is not uncommon for a large proportion of their income to be unmonetised.

Disaggregation enables focus. The segmentation approach implemented by MAP disaggregates the adult population of Malawi into five discrete target markets based upon their primary source of income, each of which exhibits different behaviour and has different financial service needs. This disaggregation enables focus upon the key needs of each target market and allows interventions to be targeted at achieving these. The primary needs identified across the five target markets are:

- The seasonal aspect of **farmers**' income creates a need for financial services that enables them to smooth their consumption. Farmers will benefit from having easily accessible financial

services in which they can store their seasonal lump sum of income. Furthermore, appropriately channelled input credit can assist farmers to enhance their productive capacity and increase their income.

- **MSME**s will benefit from accessing a portfolio of financial services. Credit is important for capital investment; transaction services will help them to receive customer payments, pay suppliers and salaries of employees more efficiently; insurance to mitigate risks that prevent them running their businesses; and savings to smooth consumption, mitigate risk and for capital investment. This will enable them to maximize the efficiency of their business. Current usage levels of informal and family and friends financial services indicates that there is scope for the formal sector to play a bigger role. It is important to channel credit appropriately to MSMEs that have the capacity to generate sufficient returns, otherwise credit extension will be economically destructive.

- Depth of access to financial services is the main priority for **salaried employees**. They are, on average, the wealthiest target market and will benefit from a portfolio of financial services. Even though insurance uptake of salaried employees is the highest of all target markets, there is significant scope to improve their ability to mitigate risks through insurance products.

- The nature of the income sources for **dependents** makes remittance related products a priority for them. They would benefit most from cheap, reliable transaction services which they can use to receive income. In addition, secure savings products in which to store remittances will allow dependents to better smooth their income.

- **Ganyu** are unlikely to constitute a feasible target market for formal financial service providers, because of their low, irregular levels of income and their location. The financial service from which they will benefit the most is a secure store of value product that will assist them with consumption smoothing and help them to manage the irregularity of their income.

5. Provision of financial services

Financial inclusion can only be achieved in a sustainable manner if the needs of the target market are aligned with the incentives of providers to offer appropriate products that match these needs. This section provides an introduction to the main providers of financial services and available financial service infrastructure. In Malawi this infrastructure consists largely of the capital market, and the various distribution channels available for financial services.

Key issues: provision of financial services

Provider overview:

- Strong reliance on cash
- Banks the dominant players in terms of value of both credit and deposits
- Informal providers serve a high proportion of adults
- Mobile money is a growing payments provider

Financial service infrastructure: capital markets

- Illiquidity of stock exchange limits financial intermediation
- Small capital market offers investors with limited opportunities
- Graduation of MSMEs restricted by limited availability of capital financing

Financial service infrastructure: distribution channels

- Malawi relatively poorly served by basic bank infrastructure
- Banking agents an emerging channel
- The costs of running ATMs limit incentive for roll-out by banks and create imperative for interchange fee to be set at a level that provides incentive for bank investment
- Banks are almost exclusively situated in urban areas, forcing most Malawians to incur high travel costs to access
- Mobile money has a broad distributional reach
- Mobile money agent network faces challenges of illiquidity and limited business case
- Points of aggregation in agricultural value chains offer potential for financial services distribution
- Outgrower schemes provide access to credit for some farmers
- Commodity exchanges facilitate access to credit
- Malawi Post Corporation boasts a wide distribution network and is a major provider of domestic remittances
- Retailers also hold potential as alternative distribution points for financial services

5.1. Provider overview

This section provides an overview of the landscape of various types of financial institutions in the Malawi financial sector. Understanding this landscape will provide a basis for the exploration of product markets to follow in section 6.

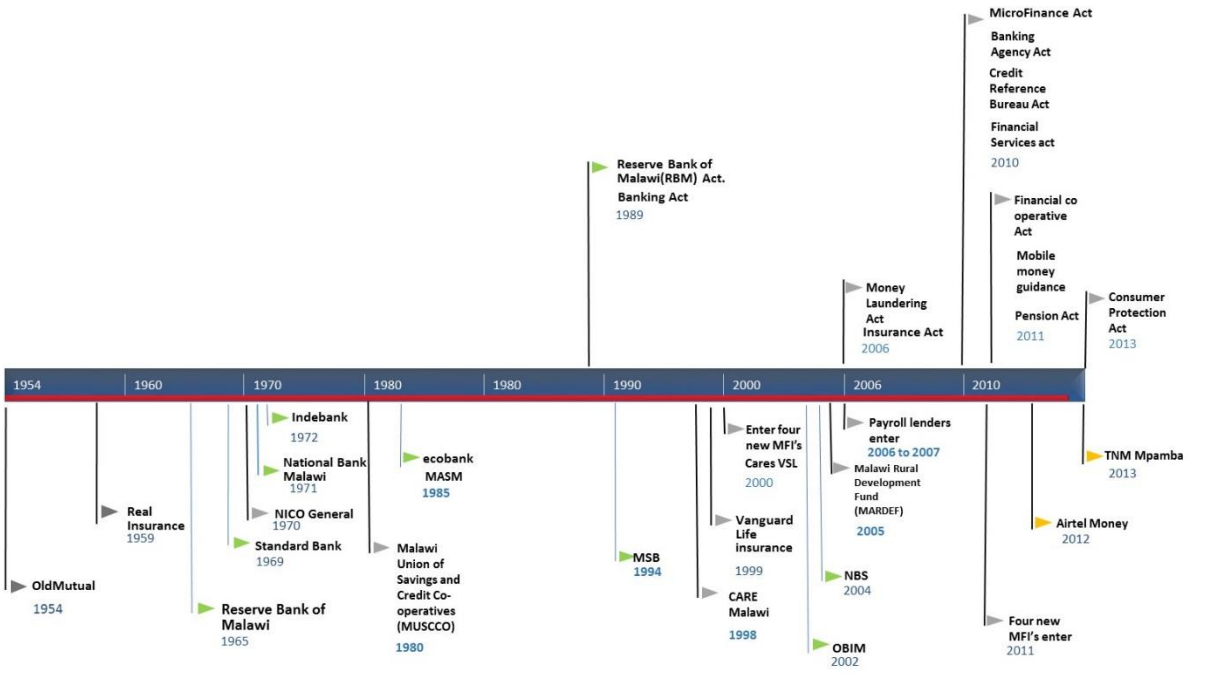


Figure 37: Timeline of entry of critical institutions and legislation

Source: Authors' own

Shifting provider environment. Figure 37 above shows that whilst the largest two banks and insurers have been in Malawi for many years, the last 10 years have seen the introduction of a number of new banks. Likewise, the MFI market space has historically been in a state of flux with providers entering and leaving the market with a high frequency over time. The payroll lenders are a relatively new entrant to the market and have been operating for the last 7-8 years.

Last 5 years has seen a wave of regulatory changes. Since 2010, a number of new financial acts have been passed into law. This includes an updated Financial Services Act, but has also enabled a number of new institution and distribution types. This includes the Banking Agency Act, the Credit Reference Bureau Act, Mobile Money Guidelines and the Microfinance Act which provides for reduced requirements for a number of non-bank institutions and creates a regulatory space for new categories of provider, including deposit taking MFIs.

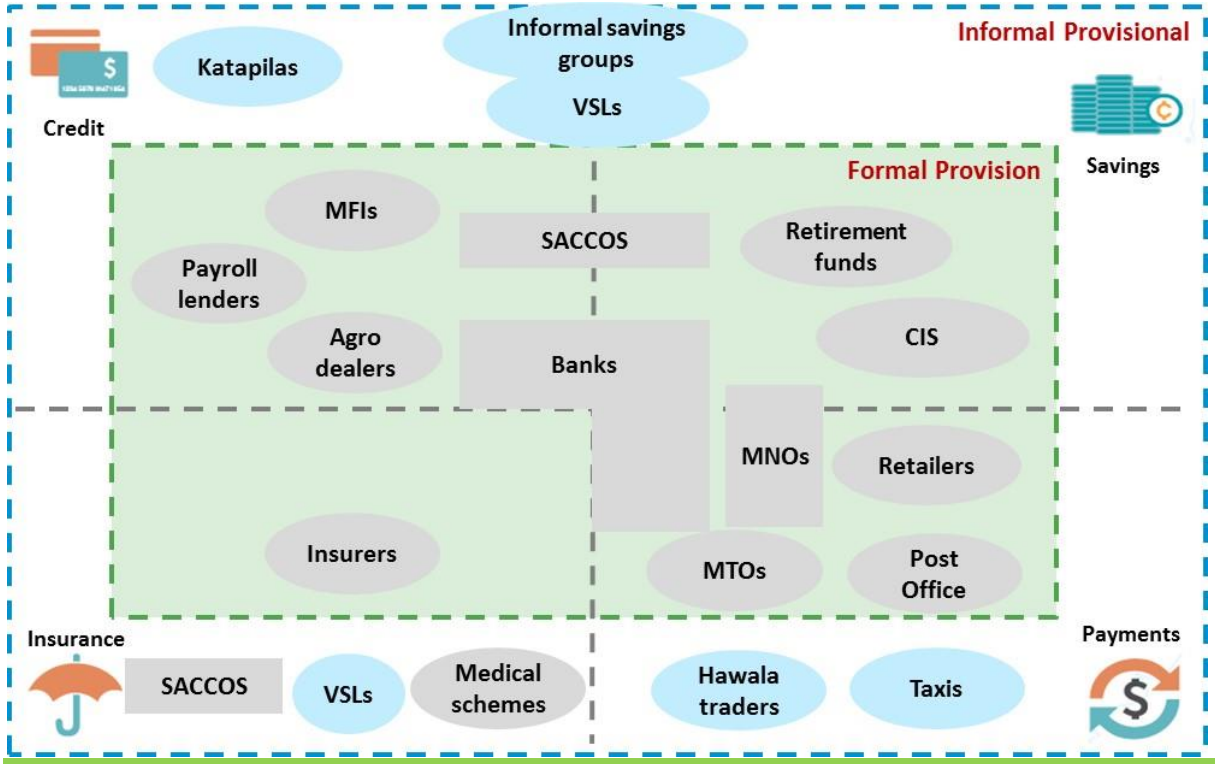


Figure 38: Overview of providers currently operating in Malawi

Source: Authors' own

Formal providers maintain limited reach. Figure 38 above illustrates the provider landscape of Malawi. The nature of provision is constrained by the limited size of a viable market for many formal providers. The majority of Malawian adults' financial service needs are met by informal providers. Much of this informal market is too expensive for formal providers to serve, particularly given the lack of infrastructure in non-urban areas, but is also due to the informal providers often better meeting the needs of Malawians.

Strong reliance on cash despite risks. Despite a widespread realisation by Malawians that transacting and saving in cash entails the risk of theft, 99.94% of all payments transactions are made in cash (BTCA, 2013) and 23% of adults indicate that they save in cash at home (FinScope, 2014). This high reliance on cash necessitates physical cash distributing infrastructure for formal financial providers to meet the needs of their consumers. This is expensive and the result is that formal provision is targeted primarily towards urban centres.

Banks the dominant players in terms of the value of loans and deposits. Between them, the banks account for 92% of the total credit extended in Malawi, despite only having 15% of the total clients. Similarly, banks account for 89% of deposits. This makes the banks the dominant players in both the credit and savings markets, although the focus of most of the banks is primarily on corporate clients, particularly in terms of credit extension.

Informal providers serve a large portion of adults. In total, 25% of adults indicate that they use informal mechanisms to meet their financial service's needs, and even this underestimates the true level of reliance on non-formal mechanisms. In the credit market, 15% of adults indicate having an informal loan and 16% a loan from family or friends. In contrast, 4% have a loan from a formal provider. Similarly, 17% of adults save through informal mechanisms and 23% at home, compared to 12% saving

with a bank and 4% with another formal provider. Whilst informal insurance is not captured in the FinScope survey, qualitative interviews indicated that a far greater proportion of adults are reliant on informal risk mitigation measures, such as community contributions to funerals and pools set aside for this purpose by SACCOs and VSLAs, than the 2% with formal insurance (FinScope, 2014).

Mobile money a growing payments provider. Mobile money was first introduced in Malawi by Airtel with their Airtel Money product in 2012, followed in 2013 by TNM Mpamba. Since its introduction, growth in mobile money has been rapid and it now has in excess of 1.1m total subscribers (14% of adults). Mobile money meets a previously unmet need amongst Malawians for low cost, low value, secure payments and also extends the reach of formal provision. However, growth in uptake slowed in 2014 and only 20-25% of subscribers are active users. This indicates that mobile money; limited by infrastructure constraints, agent liquidity issues and a struggling business case; is not yet fulfilling its potential to extend the reach of formal provision.

Insurance mainly limited to salaried employees. FinScope (2014) indicates that just 2% of Malawian adults are currently covered by formal insurance products. Whilst this may be an underestimation where insured adults are unaware of the policy, it nevertheless indicates very low penetration. The focus for formal insurers is therefore primarily on extending access to those adults easiest to reach. This is primarily the salaried employees who have the highest and regular incomes and live mostly in urban areas.

5.2. Financial service infrastructure

Financial institutions need access to capital as well as channels through which to distribute their products. These channels can be provided by the institutions themselves (considered traditional channels) or by other institutions (alternative channels). This section discusses these components in two sub-sections: the capital market and distribution channels.

5.2.1. Capital markets

Capital markets mobilise savings from those with a surplus and allocate them to investment opportunities in the form of debt or equity. An efficient capital market mobilises large volumes of savings and allocates them to the most productive opportunities at the lowest possible cost to both parties (Levine, 1997). At both ends of the intermediation value chain, this influences the extent to which savings is mobilised and credit is provided through the formal financial sector.

Over USD 1 billion of capital mobilised by financial institutions in Malawi[49]. Financial institutions in Malawi mobilised USD 1.13 billion of capital in 2013 (approximately 26% of GDP). The biggest providers of capital in Malawi are the pensions funds, contributing 37% of total capital mobilised in the economy. Life insurance companies and banks are the second and third biggest contributors with 32% and 26% respectively. The remaining 5% of mobilised capital is from general insurance, private equity and various other institutions.

Illiquid stock exchange restricts financial intermediation. The first trade on the Malawi Stock Exchange (MSE) was registered at the end of November 1996. Currently, there are 14 listed companies listed on the exchange with no new listing since 2007. The market capitalisation of the MSE is USD 1.341 billion, which is approximately 31% of GDP. Even though the market capitalisation has increased in nominal terms over the past few years, it has shrunk in US dollar value because of the depreciation of the

[49] Capital in this instance refers specifically to financial capital.

Malawian Kwacha. The past 18 years have been characterised by very limited activity. 13 companies were traded in 1,673 transactions on the exchange in 2014, with no activity on one share. The transactions are typically high value trades (MSE annual report, 2014). This is indicative of a dormant secondary market, which forces investors to apply a buy-and-hold strategy resulting in increased risk associated with investing in equities in Malawi.

High cost associated with listing on the stock exchange. The MSE has only one board. As of yet, there are no functioning alternative boards on which smaller enterprises can list to obtain equity capital. To list on the main board, the applicant must have subscribed capital[50] of at least 250 million Kwacha (USD 600,000). Furthermore, the applicant must issue at least 30,000,000 shares in the rights offering and the entity must have a satisfactory audited profit history for the past three years. The cost of listing raises the barrier even higher. Of the last 14 rights offerings, the average cost was 13.2%[51] of the amount raised with the one entity paying almost 30%. To remain listed, companies on the exchange have to pay an annual sustaining fee[52] of 0.05% of market capitalisation.

Bond market a relatively cheap way for public sector to raise capital. The Reserve Bank of Malawi is the principal issuer of treasury bills and treasury bonds on behalf of the Malawian government. The majority (74%) of the government debt is held by the RBM. The remaining 26% is held by the public or other financial institutions. Treasury bills are offered in three maturities, 91 days, 182 days and 364 days. The average yields for these instruments are 24.18%, 24.24% and 25.17% respectively. This is about 5% higher than the latest inflation rate of 19.6%[53], but 13% lower than the credit interest rate. Therefore, treasury bills are comparative to other debt relatively cheap, but it comes with the disadvantage of being a short term instrument and inappropriate for large infrastructure investments. In December 2014, the government of Malawi listed three longer term instruments on the MSE. The coupon rate for these bonds were well below consensus inflation expectations, resulting in a very moderate response by investors. A shallow financial market with a narrow investor base and low levels of information significantly increases the risk attached to Malawian public debt instruments (SADC COMESA study, 2008).

The enactment of the 2011 pension act a potential driver of significant opportunities in the capital market. In 2011 the Malawian government wrote the new pension act into law. This act requires all employers to provide retirement and life insurance benefits to their employees. Under the new system, it is mandatory for employers to enrol employees earning more than K 10,000 (31 USD) per month and the total contribution has to be at least 15% of earnings. Subsequent to the Pension Act, the number of pension funds increased from 390 in 2010 to 1,777 in 2013 and membership increased from approximately 75,000 in 2010 to 191,256 in 2013. The introduction of the mandatory pension system has had a significant effect on the mobilisation of savings. The assets of the pension fund industry increased by 209% from 2011 to 2013, from K 74 billion to K 229 billion. 44% of assets are invested in listed equities and 21% are invested in government securities. The initial rapid increase of pension fund membership is subsiding as most employers have caught up to the change in law. However, the resulting increase in capital accumulation will continue to drive demand for investment opportunities.

A small capital market presenting investors with limited opportunities. There are very few shares listed on the stock exchange. T-bills remain oversubscribed. Activity in the real-estate sector is limited and less than 1% of total portfolio investment is invested outside of Malawi due to stringent capital

[50] Subscribed capital is the proportion of the issued capital, which has been subscribed by the public.
[51] Total listing cost have since been capped at 7.4%
[52] The annual sustaining fee is capped at 5 million Kwacha.
[53] The most recent inflation data in the write-up of this document indicated an inflation rate of 19.6% for February.

controls (FinMark, 2014). Subsequent to the enactment of the mandatory pension system, the market capitalisation of the stock exchange increased by more than 100%. All of the above indicates significant excess demand for investment opportunities. Currently, the capital market presents investors with insufficient supply of investment opportunities. The development of the Malawian capital market and creation of more diverse investment opportunities is pivotal for the large amount of available capital to have real economic benefits.

Graduation of MSMEs restricted by limited availability of financing. Similar to many developing economies, successful small and medium enterprises in Malawi struggle to increase the size of its operations. Various factors contributes to this phenomenon, but as seen in Box 5, access to finance is a major problem for MSMEs in Malawi. Many Malawians aspire to be entrepreneurs and grow their businesses. However, very few are able to graduate their businesses from small to medium or medium to large due to insufficient or inappropriate financing. This is especially pertinent in Malawi, where interest rates on credit are often in the excess of 35%. The implication is that the return on using credit has to be in the excess of 35%, otherwise it is economically destructive to borrow money. Therefore, entrepreneurs are hesitant to take on so much risk. An alternative to debt financing is equity financing. The current fee and compliance structure of the MSE is completely inappropriate for MSMEs, which restricts their ability to acquire equity financing. An alternative exchange would arguably be better suited for MSMEs to raise equity capital to bridge the financing gap.

Collateral provided by commodity exchanges key for farmer capital accumulation. Commodity exchanges[54] provide an aggregation point for produce ahead of sale that is a natural touch point with farmers for aspects relating directly to their produce and the payment that results from its sale. They often have warehousing services that sort, grade and store produce while it is active on the exchange. The storage facilities allow farmers to postpone selling produce when market prices are low due to excess supply at harvesting time. Malawian commodity exchanges do not yet provide a wide range of investment products, such as forward contracts. Once forward contracting is introduced, commodity exchanges will be invaluable to smoothing out the volatility that currently exist in agricultural commodity prices. However, they do provide a warehouse receipt when goods are received, which can act as collateral. The quality assurance of the collateral provided by the commodity exchange is an important factor in enabling farmers to better manage their financial lives. The seasonal nature of farming inhibits many famers to acquire capital during certain stages of the year. However, the collateral enables farmers to obtain important inputs, such as seeds and fertilizer, to enhance productive capacity even if they do not have the cash-flow to fund it.

5.2.2. Distribution channels

Distribution of financial services to low-income and rural populations is often challenging. Traditional provision through branches and agents with well-trained staff is expensive and can seldom be justified to viably serve low income clients. Further, transport costs and the inconvenience to access urban financial centres often places formal financial services outside the reach of many low income people. The formal institutional layout of banks and other formal institutions also provide door-step barriers where consumers feel intimidated or uncomfortable to transact in an environment so foreign to them. Alternative forms of distribution can reduce the cost of provision and improve use of financial services through improved access to the product in an environment that is familiar and trusted.

[54] Commodity exchanges are an institution that determines and enforces rules and procedures for the trading of commodities and related investments. They can also be the physical centre where trading takes place.

This section sets out the current traditional and alternative distribution channels used in Malawi and in doing so, identifies some further opportunities to extend distribution.

5.2.2.1. Traditional distribution

Malawi relatively poorly served by basic bank infrastructure. Figure 39 below illustrates that Malawi has significant limitations in terms of the network of banks' distribution networks. In terms of the distribution of ATMs across the country, Malawi is comparable to most SADC countries with approximately 2.5 ATMs per 100,000 people. The BIS (Bank of International Settlements) calculates that the average number of ATMs per 1 million adults in the G20 countries is 417. Malawi has 6% as many ATMs. Malawi bank branch infrastructure is equally limited with a total of 257 branches across the entire country – an average of 1.6 branches per 100,000 people, lower than all other SADC countries apart from Angola. Malawi's POS network is even more limited in scope with an estimated 4.8 POS devices per 100,000 people. The average number of card transactions made per POS (Point Of Sale) per month is just 336, illustrating that even the existing network of POS devices are not well used. Effective access is further reduced through lack of interoperability. The recent launch of the National Switch, enabling full interoperability between the banks, should increase the business case and demand for POS devices. A number of banks have indicated that they are preparing to roll out POS devices in 2015.

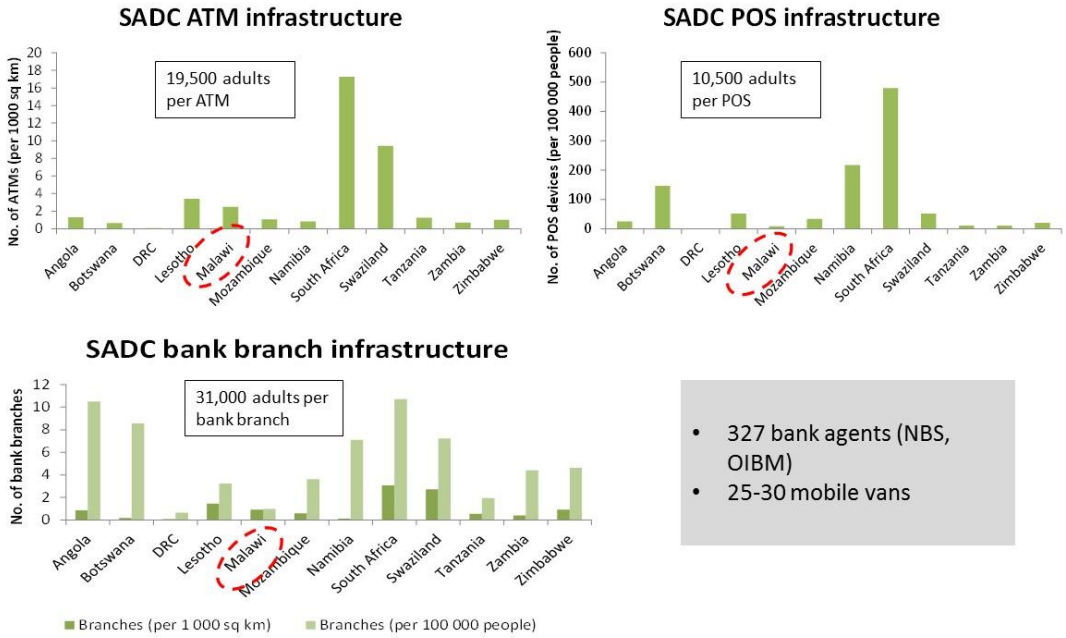


Figure 39: Malawi's bank infrastructure compared to the SADC region

Source: RBM, 2014; Red Flank, 2013

Banks use a variety of channels in order to try and improve distribution. The banks in Malawi use a number of different channels to distribute their services. Nearly all the banks have at least one mobile van, OIBM has the most with 13. The vans travel to areas unserved by permanent bank infrastructure to originate accounts and provide customer service to clients. Most also have ATMs built in, enabling the vans to cash in and cash out. Although considered valuable in expanding the reach of the banks, the vans are much too expensive to run sustainably and many plan to reduce them in the imminent future.

Banking agents an emerging bank distribution channel. Two of the banks: OIBM and NBS have also recently introduced bank agents as another alternative distribution channel. The two banks have followed contrasting strategies in their implementation of banking agents. Whilst OIBM have focused on increasing the number of bank agents over a short period of time, NBS have developed a smaller agent network which they hope will be more sustainable and allow them to slowly grow this network over time. OIBM requires its agents to be retailers that have been in business for a minimum of 18 months. Currently these agents are only able to cash out, but the intention is to expand these functions to include deposit taking and account origination. The agents earn a flat fee of K 100 (USD 0.24), out of a customer fee of K 150 (USD 0.36), per transaction. NBS recruits entrepreneurs as agents, provide them with training, and who must then meet internal capital requirements of K 50,000 (USD 120) for the lowest tier agents (this increases to K 250,000 (USD 600) for the highest tier agents) and must have a physical premises. These agents can both cash in and cash out. NBS' strategy is to locate these agents close to service centres to allow for easy rebalancing and overcoming liquidity constraints. However, this does not substantially increase the geographic reach of the bank.

Running expenses the primary cost of ATM rollout. The average running costs of an offsite ATM constitute a substantial cost for banks. From provider discussions, the monthly running costs of an ATM can cost in the region of K 450,000 (USD 1079) per month. The biggest costs are the annual ICT maintenance costs and the rental costs, although security and liquidity costs are also significant. The cost of purchasing an ATM machine costs about K 11 million (USD 26,379) with a further cost of K 5 million (USD 11,990) to deploy it. Many of the banks do not charge their customers anything for ATM cash withdrawals and hence financing an ATM must be cross-subsidised by earnings from other bank activities. This disincentives ATM rollout by these banks. Even those banks that do charge for ATM withdrawals, typically charge K 100-K 150 (USD 0.24 – USD 0.36) per withdrawal which means that an average of 3,000-5,000 withdrawals are required per ATM simply to break even on the running costs of the machine without covering any of the upfront investment cost. Currently there are 4,700 ATM transactions per ATM per month. This suggests that even with the existing limited and urban based ATM network, ATMs on average are only just covering their running costs (and that is for banks that charge a cash withdrawal fee). These ATMs are also already being used at close to capacity. Assuming that each user takes 5 minutes on average for a transaction, then all ATMs are being used constantly for 13 hours each day. ATMs in rural areas will likely have substantially lower usage than the existing ATMs in the main urban areas. Furthermore, up until the recent launch of the National Switch, most of the banks were not interoperable and hence those withdrawals could only be made by the bank's own clients.

The importance of an appropriate interchange fee. The costs of running ATMs, particularly in rural areas (most ATMs are currently situated in urban areas and so the cost of running rural ATMs will be significantly higher), make it unprofitable for the banks to engage in a countrywide rollout of ATMs. The new national switch will make all banks interoperable and thereby changes the equation for banks. Whereas previously banks needed enough of their own clients in an area to support the placement of an ATM, there now only needs to be enough potential ATM users from all banks to support the placement of an ATM, provided the interchange fee is set at a sufficiently high level for acquiring banks to allow them to recoup the running costs of the ATMs. On the other hand an excessively high interchange fee will reduce access to lower income users.

The cost of branches varies substantially depending on location and size. The costs of branches are naturally substantially higher all other bank channels and a branch may cost anywhere between K40m to in excess of K 200 million p.a., based on discussions with providers in 2014.

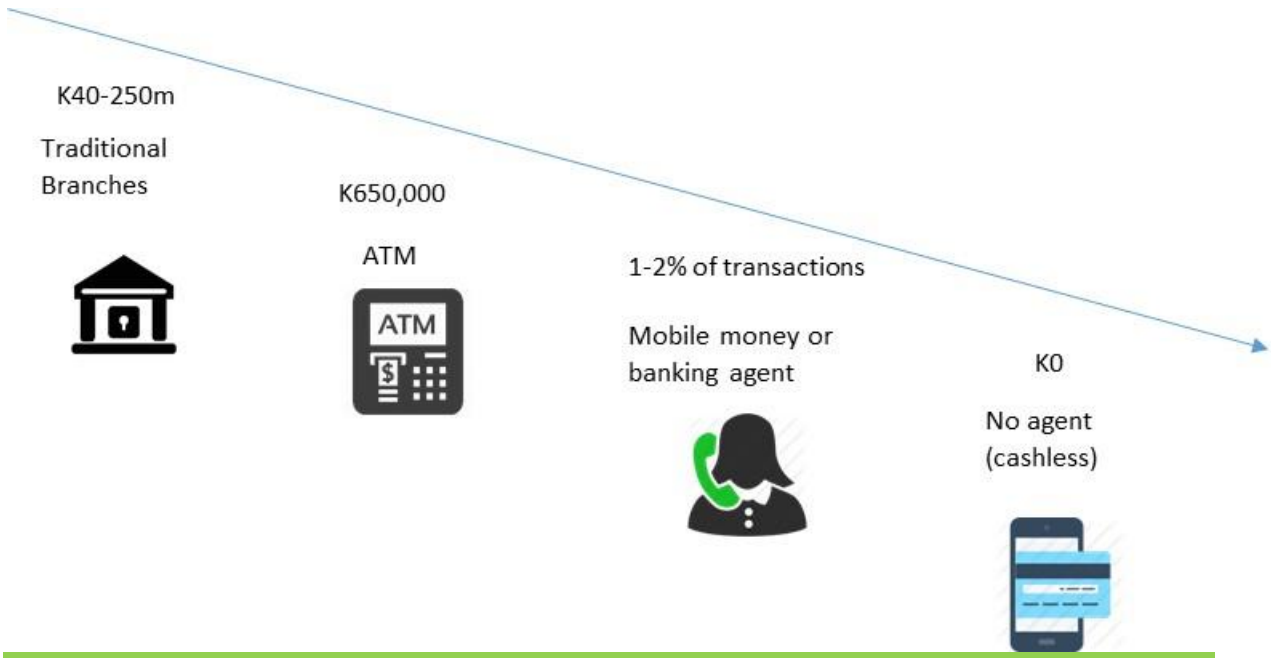


Figure 40: Digitization dramatically reduces costs for the provider

Source: Adapted from CGAP, 2012; In-country consultations, 2014

Costs decrease with digitisation. Figure 40 above illustrated the relative cost of different channels of provision for providers. The figure illustrates that the greater the level of digitization, the less direct contact the provider needs with the client and hence the cost of providing the service falls dramatically. For example, serving a customer through a bank branch includes the cost of renting the premises (or foregone rent if it is owned), the cost of salaries to staff to serve the customer face to face (banks' largest single cost), security costs, as well as all the other maintenance costs associated with maintaining a branch. In contrast, a card transaction at a POS device costs the bank nothing per transactions (there is some upfront cost associated with issuing the card to the client and engaging with the merchant). Hence, if greater digitization can reduce the cost of providing the product, then this can be passed on to the consumer through lower prices.

The MFIs have a total of 155 distribution points throughout the country. The total physical distribution network is smaller than banks', but is more widespread with branches situated in both urban and rural areas. This explains why the average travel time to reach a non-bank formal institution (MFI or SACCO) is shorter for rural adults than to reach a bank branch (as shown in Figure 41 below). This is primarily driven by the MFIs' mandate which, due to state or donor funding, is primarily focused on serving lower income and rural entrepreneurs. FINCA, for example, has 22 service outlets, with one in each district of the country, ensuring a broad reach for the provider. Additionally, the MFIs have a total of 487 loan officers who monitor the borrowers and usually also offer some training and/or mentoring to borrowers.

The SACCOs typically have just one office/ branch per cooperative. In total there are 56 branches across the country. These are member-owned and run organisations and hence most members are usually proximate to the SACCO's headquarters. The primary target market for SACCOs is salaried employees and hence many are situated in or close to urban areas. However, there are also a number of rural SACCOs serving local farmers.

Banks are almost exclusively situated in urban areas. Figure 39 above shows that the number of bank branches and ATMs is fairly limited in Malawi, but exacerbating the constraints on access for most Malawians is that these tend to be almost exclusively situated in urban areas. Figure 41 below shows a heat map of the bank branches and ATMs in Malawi. The maps clearly show that the three major cities of Blantyre, Lilongwe and Mzuzu have the greatest density of bank infrastructure and nearly all other bank infrastructure are situated in smaller urban areas, with substantial gaps in coverage between the towns.

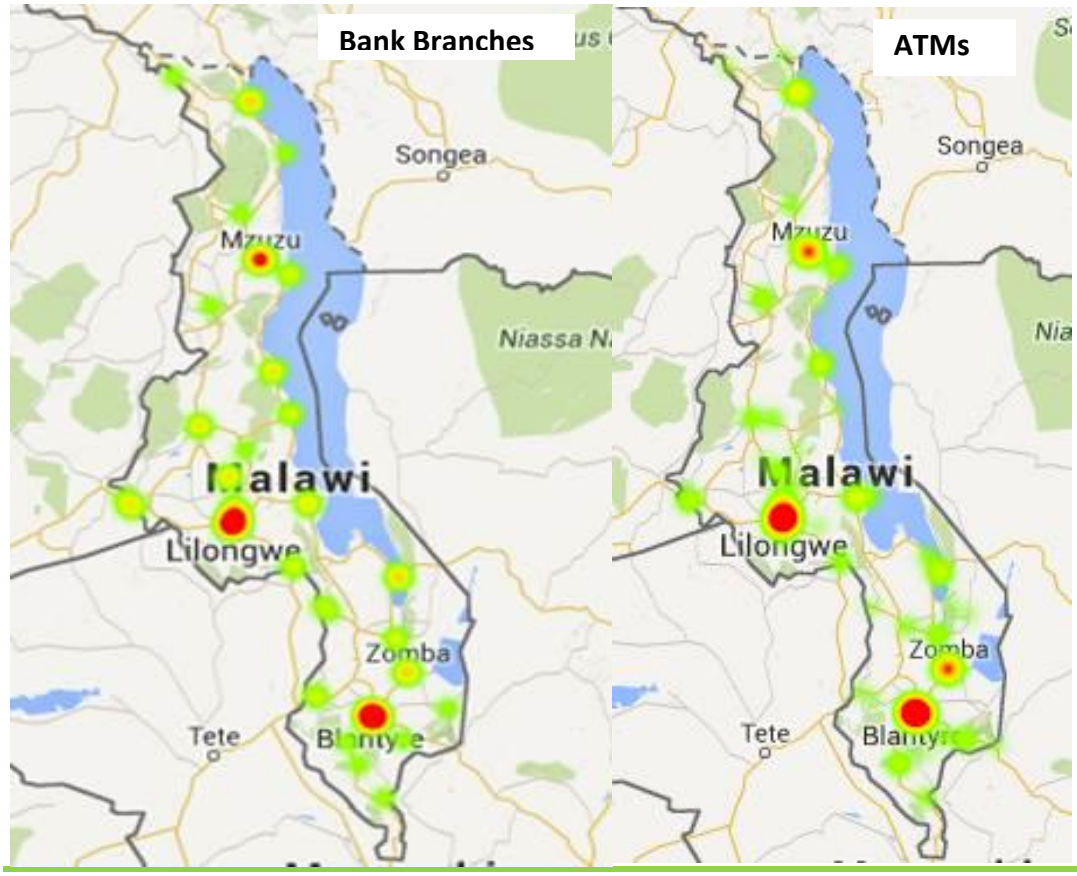


Figure 41: Heat maps of bank branches and ATMs in Malawi

Source: Author's own based on data collected from consultation with banks and websites of banks, 2014-15

Travel substantially contributes to the cost of accessing financial services. The figure above shows that the majority of bank infrastructure is situated in urban areas. This means that rural dwellers must travel long distances to access financial services provided by these institutions. Figure 42 below shows the average time taken to reach a bank branch and other financial institution, split between urban and rural. The figure shows that the time taken to reach formal financial services is substantially longer for rural dwellers than urban dwellers, unsurprisingly. But furthermore, it shows that on average an adults living in a rural area takes 87 minutes to travel to a bank branch, then spend time in the bank branch and a further 87 minutes to travel back home. In effect this means each transaction at a bank will take half a day for the average rural adult, a substantial opportunity cost for adults reliant on their own labour for income, such as MSMEs and farmers.

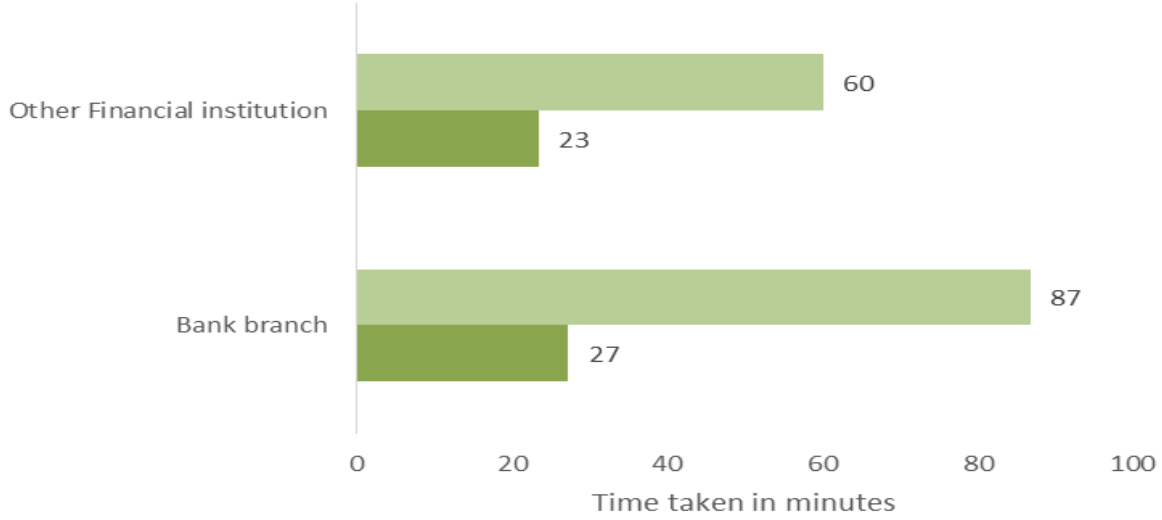


Figure 42: Average time taken to access distribution point

Source: FinScope, 2014

The longer travel time for rural adults not only means significant opportunity cost in terms of the time used to travel to access financial services, but also substantial direct travel cost. It costs in excess of K 1,000 (USD 2.40) for 43% of rural adults to travel to the closest bank branch using public transport. This equates to more than 10% of the average income of rural adults and for many this cost is even higher. However, perhaps most tellingly, 78% of rural adults do not ever travel to the closest bank branch or don't even know where it is as shown in table below.

Provider	***Never goes***	***Average time taken (minutes)***	***% within 30 minutes***	***Most common method of travel***	***Cost using public transport (K)***
Banks	*74%*	*65*	*33%*	*Public transport*	*801*
Other formal	*84%*	*49*	*53%*	*Walk*	
Post office	*73%*	*60*	*41%*	*Walk*	
Market	*5%*	*43*	*59%*	*Walk*	
Private money lender	*83%*	*37*	*71%*	*Walk*	

Table 10: Travel time, expense, difficulty and mode for adults to reach financial service touch points

Source: FinScope, 2014

Insurance primarily sold through traditional channels. Consultations with insurers indicate that the most insurance products are sold through brokers, agents, banks or direct from insurance companies.

Currently, there are 12 brokers, 27 agents, and 52 insurance branches operating in Malawi. There are also 5 "agents for brokers" which are banks licensed to distribute insurance. The traditional approach to distribution limits insurance companies' abilities to reach down-market as these channels typically are too expensive to allow for lower-cost premiums.

5.2.2.2. Alternative distribution

Distribution of financial services is labelled as alternative when it occurs in partnership with institutions that are not the primary financial services provider or channels commonly associated to that financial services provider.[55] These channels could be other financial service providers, such as insurance distribution through banks, or institutions that see value in aligning their primary service offering with financial services. Examples of such institutions include retailers, post offices and petrol stations.

Alternative distribution landscape. Table 11 below outlines the alternative distribution landscape in Malawi. Overall, mobile network operators, partnered with informal retailers, hold the widest reach of the distribution channels. The reach of the other channels are more limited. However, the nature of these institutions can complement a wider range of financial services and in combination with a broader distribution network, they could be valuable partners in successfully extending distribution. It is important to note that distribution is not only focused on ensuring a physical footprint for financial services provision, but that distribution touch points exist in areas that are functionally valuable for consumers. It is therefore possible to have multiple touch points in one physical location that provide different value offerings for consumers.

The predominant product currently provided is payment services. Potential exists to expand this to serve all product markets. The channels will be examined in further detail in the section that follows below.

[55]Consequently, alternative distribution channels could be considered traditional distribution once use of the channel is entrenched.

Distribution channel	No. of channel Institutions		No. of outlets:		Products			
			Current	*Potential*	*Payments*	*Credit*	*Savings*	*Insurance*
Agriculture value chains	N/A		N/A		✓	✓	✓	✓
Mobile network operators	2		~18,000	Unknown	✓	✓	✓	✓
Petrol stations	5	7	123	167	✓			
Pharmacies	Unknown		34	94	✓			✓
Post Office	1		180	180	✓	✓	✓	✓
Networked retailers (excl. agro)	Unknown		153	236	✓	✓	✓	✓
Agro retailers	1	2	65	169	✓	✓		✓
Unnetworked retailers	Unknown		10,596	434,491	✓			

Current provision
Potential provision

Table 11: Overview of alternative distribution channels in Malawi[56]

Source: In-country consultations, 2014; Redflank, 2013; 2012; RBM 2014; MERA, 2014; Carmona, 2013; FinScope MSME, 2012; Bench Marks Foundation, 2009; Akalchi, Chalmers & Revoredo-Giha, 2013)

Mobile network operators

Mobile phones a convenient low cost method to transact and save. Using mobile phones to access financial services is convenient and reduces transport costs needed to access most financial services. Storing and sending funds through mobile phone linked accounts is also safer than using most informal methods as it removes the easy access to the physical funds and is possible to do so privately.

Only half of Malawians own a mobile phone, but growing. Slightly more than half of Malawi's adult population owns a mobile phone (51%), which corresponds to just over 4 million Malawian adults. However, 69% of adults have access to a mobile phone, with the difference able to use a friend or family members' phone. Mobile phone ownership has more than doubled in terms of number of adults since 2008 (1.9 million to 4 million) with penetration rising from 32% in 2008. The proportion of adults with access to a mobile phone has similarly risen from 46% in 2008.

Two MNOs operating in Malawi. Two MNOs, TNM and Airtel, are currently operating in Malawi. Both operators offer mobile money products – TNM Mpamba and Airtel Money. Airtel was the first to introduce the product to the Malawian market in early 2012, whilst TNM followed just over a year later. There are 1.1 million registered subscribers, with 18% (200,000) active users within the last 30 days[57] across the two providers. Mobile money is an e-money payments mechanism that allows users to convert cash into mobile money at an agent and then use that mobile money to pay bills (e.g. electricity, airtime and insurance), pay for goods or pay someone else – who can then withdraw the money in cash from an agent. Bulk payment disbursals like salaries and social cash transfers are also possible through mobile money. A number of the banks have also partnered with the mobile money providers to offer a service which enables the transfer of customers' funds between their bank and mobile money accounts. This effectively extends the distributional reach of banks, because customers can effectively cash in and out of their bank account through a mobile money agent. It also extends the reach of mobile money providers as their customers can also cash out at ATMs. Additionally the e-money stored in mobile money accounts can be used as a store of value, i.e. a very basic savings

[56] A range of institutions provide agency services for MNOs and therefore there will be an overlap between the MNO category and the other distribution channels. It is important to note that the potential outlets show the total number of outlets available in this channel and do not necessarily speak to the ability of those outlets to provide financial services.
[57] Active is defined as a subscriber that has made at least one transaction within a defined period of time, in this case 30 days.

account. Users must register to send, but do not need to be registered to receive mobile money (although there is a cost difference for the sender).

Patchy network coverage. Network coverage varies substantially across different regions in Malawi, and hence many mobile money users may face limitations on rural areas where connectivity is patchy or non-existent.

Mobile money has a broad distributional reach. Between the two MNO's there are over 18,000 registered agents of which Airtel accounts for more than 80%. This correlates to 1 agent per 440 adults. In comparison, the ratio in Kenya is 1 agent per 321 adults, in Lesotho 1 per 508 adults and in Swaziland 1 per 870 adults. However, the relatively high rate of inactivity amongst Malawian mobile money agents suggests that this comparison may overstate the relative reach of mobile money in Malawi. These agents are spread throughout Malawi with the largest portion situated in the central region.

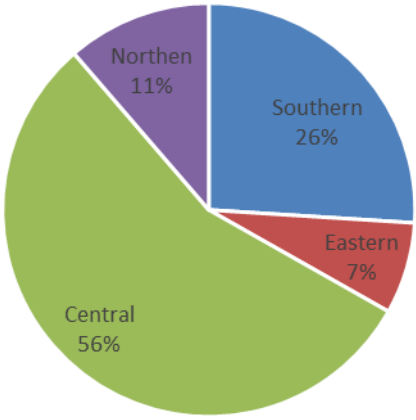


Figure 43: Distribution of mobile money agents by region

Source: RBM, 2014

Figure 44 below shows that the majority of mobile money agents are shops. However, 17% of mobile money agents are airtime agents suggesting that these are standalone agents for whom the commission from selling airtime and as a mobile money agent is their primary source of income.

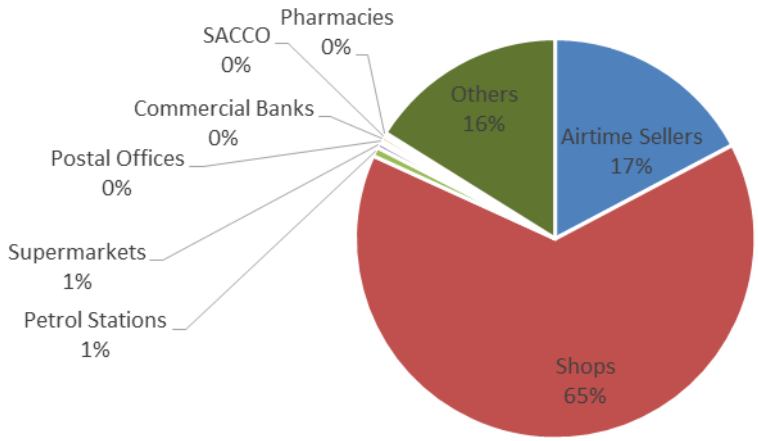


Figure 44: Types of mobile money agents

Source: RBM, 2014

Agents earn commissions on customer cash-in and cash out transactions. TNM has recently switched from a tiered agent commission structure to a flat commission of 2% of the value of the transaction for both cash-in and cash-out transactions. Airtel pays the same commission of 2% of the value of transactions.

The agent network faces a number of challenges:

Liquidity constraints. Liquidity management by agents is consistently cited as the greatest challenge faced by maintaining a broad agent network. The major competitive advantage of mobile money is their broad reaching distribution through the agent network and therefore to be considered useful by subscribers agents need to be situated throughout the country. However, this causes major challenges, particularly in rural areas where small retailers may have only limited cash reserves, when multiple users need to cash out, thereby draining the agents' cash reserves. Super or rebalancing agents are used in Malawi, but these are typically not roaming and many agents may be far from the closest super-agent. A comprehensive GIS mapping project undertaken by the MMAP is attempting to go beyond the basics of understanding where agent are currently situated but also endeavours to identify potentially viable agents in unserved areas and map the spending behaviour of residents in each area enabling better liquidity management for agents.

The business case. The business case for mobile money agents is limited. If agents earn average commissions of 2% of the value of deposits and 2% of the value of withdrawals, then agents will still only earn in the region of K7,500 (USD 18) per quarter. However, there is a potential opportunity for agents to increase their revenue earned from mobile money by encouraging customers to purchase goods using mobile money. If one considers the different payment methods available, from the merchant's perspective, their maximum possible monetary return is to sell their goods using mobile money as they earn the profit on the goods sold and by recording the transaction as a cash out, will also earn commission from the MNO. Additionally, the agent will have no cash handling costs. From a monetary return perspective accepting credit cards to pay for goods through a POS device is the worst option for merchants as they must pay a merchant discount to the acquiring bank, typically of between 2% and 5%, though it is typically higher for smaller merchants. However, credit card payments have the advantage of eliminating cash handling costs for the merchant and provide an additional option

for the customer. Furthermore, studies indicate that consumers will spend substantially more on average when a credit card as compared to cash (James & Jones, 2001). Cash is the simplest type of transaction and the merchant earns a one-to-one return on the sale price. However, cash handling costs can be substantial, particularly given the risk of theft. However, if the retailers are required to pay their suppliers in cash then it is likely they will prefer cash as tender as it limits the need to withdraw cash – a potentially major cost for rural agents.

Limited potential super agents. Super-agents or rebalancing agents help to ensure that mobile money agents maintain sufficient liquidity to meet their requirements at all time. Super-agents can be fixed – such as a large retailer or petrol station which nearby agents can use to rebalance when they have too little or excess liquidity. However, in more rural areas where there are limited options available for super agents, roaming super-agents are often a more effective means to rebalance agents. Roaming super-agents are usually service providers that already travel through rural areas frequently as part of their core business to deliver goods or services and can travel with cash as well to rebalance rural agents. In Malawi, there are limited established distribution networks along these lines that can act as super agents for rural agents.

Agriculture value chains

Agriculture production in Malawi is largely made up of smallholder farmers that focus on crops for both productive and food security purposes (see Box 3 and section 4.3.3.1 for further details). It is a dominant sector in Malawi that touches a high proportion of the population and therefore holds potential to be leveraged to distribute financial services at a broad scale.

Points of aggregation in the value chain offer potential for financial services distribution. Agriculture value chains provide an opportunity for financial services distribution at points of aggregation[58] where financial services are a naturally complementary activity (such as credit for input supplies). The actors in the value chain behind these aggregation points provide a unique partnership advantage for financial service providers, because of both their reach to and knowledge of the targeted farmers. For the value chain actors, complementing their core service offering with financial services provision can enhance their business and often the productivity of the overall value chain as a result. As such, two important factors to identify partners are those that have (i) the reach to, or touch point with, farmers and (ii) an incentive to be involved in financial services provision.

Overview of value chain actors per major Malawian crops. Table 12 below provides an overview of value chain actors per major Malawian crops for export and domestic consumption[59]. Key actors per crop are highlighted in bold. The section that follows unpacks the potential for financial services distribution that the value chain actors hold.

[58] Points of aggregation are where multiple farmers are likely to deal with one value chain actor on a predictable basis.
[59] The table shows the top export crops in 2013 in descending order of importance (FAO, 2013). The one exception is maize which is currently under an export ban, but holds high importance and prevalence amongst farmers for domestic food security purposes.

		Tobacco	Tea	Sugarcane	Cotton	Main oil seeds* and pulses	Maize
No. of farmers		1,109,715	15,956	46,290	355,878	1,961,584**	2,115,341
Financial services currently available in the value chain		Bank accounts Bank credit Outgrower scheme Insurance	Outgrower scheme	Outgrower scheme	Outgrower scheme	Warehouse receipt financing	Warehouse receipt financing
Input provider		Input suppliers; **tobacco companies** (OS)	Input suppliers; **tea estates** (OS)	Input suppliers; **processor/ buyer** & **producer association** (OS)	Input suppliers; **ginners** (OS); government	Input suppliers	Input suppliers; government
Producers	**Farmer**	Commercial; SHF	Commercial; SHF	Commercial; SHF	Commercial; SHF	Commercial; SHF	Commercial; SHF
	Producer association	Commercial; SHF	Commercial; SHF	SHF	Commercial; SHF	Commercial**, SHF**	**SHF**
Processing, storage and sale		Processors; **auction house**	**Tea estates** (OS); **auction house**	**Processor/ buyer & sugar estates** (mill on-site),	Traders, SHF associations; **ginners** (OS)	Producers; traders & local markets; **commodity exchanges**	Producers; traders & markets; **commodity exchanges**
Buyers		Domestic wholesalers & retailers; exporters	**Tea estates** (OS); domestic wholesalers & retailers; exporters	**Processor/ buyer & sugar estates** (OS)	**Ginners** (OS), exporters	Local traders; domestic processors, wholesalers & retailers; exporters	Local traders; domestic processors, wholesalers & retailers
Post purchase agro-processor		Agro-processors (domestic & international)	**Tea estates**, agro-processors (domestic & international)	**Processor/ buyer & sugar estates,** agro-processors (domestic & international)	Agro-processors (domestic & international)	Agro-processors (domestic & international)	Agro-processors (domestic)

Tight value chains
Loose value chains

Table 12[60]: Overview of value actors for key Malawi crops[61]

Source: FinScope, 2014; In-country consultations, 2014; NES, 2012; , Ministry of Agriculture and Food Security, 2011; Cuddeford, 2014; FinMark Trust, 2012; ITC, 2013; NKC, 2012; Prowse & Moyer-Lee, 2013; Illovo Sugar, 2015; Pound & Phiri, 2011; SOMO, 2008; Oliva & Agar, 2006; Grundling & Steynberg, 2008; Ministry of Agriculture and Food Security, 2006; Kumwenda & Madola, 2005; Monyo & Kananji, 2013; NASFAM & ACE, 2013.

Input provider

Distribution channel with high reach to producers. Input providers have a fairly regular touch point (relating to seasonal purchase of inputs) with farmers across the board. They tend to be based close to the farming community and therefore have a strong advantage of reach for financial services provision. The current status of financial service provision is unknown, with the exception of the agro-dealers covered under the retailers section that follows below. The incentive for input providers to offer financial services is to support their primary offering through drawing feet into their outlets and supporting the purchase of goods through facilitating access to credit[62], transactional or savings products. Potential for this channel is therefore as a distribution partner, rather than provider (with trade credit provision as an exception).

[60] At the time of publication an export ban was placed on maize.

[61] *Main oil seed exports excluding cotton (Soybeans, ground nuts, cotton seeds and sunflower seeds)*

***Number of farmers is understated as FinScope (2014) only provides information on pulses and groundnuts*

OS: Outgrower Scheme

SHF: Smallholder Farmer

[62] This can include both trade credit provided by the input provider or links to input purchases on credit provided by outgrower schemes.

Producer association

Limited number of associations. In Malawi producer associations have not been naturally self-forming and mainly exist where there have been third party interventions. There are varying levels of producer associations across local, regional and national levels and crop types. Two national bodies sit across these associations and in doing so, provide a central communication channel – Farmers Union of Malawi (FUM) and National Smallholder Farmers' Association of Malawi (NASFAM). Further details follow below:

- **FUM:** FUM is an umbrella body of farmer organisations that focuses on creating a conducive policy environment for farmers. It has a membership base consisting of smallholder associations (178 organisations) and individual, medium and large scale farmers (500), which amounts to more than 1,000,000 individual farmers members (NASFAM, 2015).

- **NASFAM:** NASFAM is the largest independent, smallholder-owned membership organization in Malawi with over 100,000 subsistence and commercial smallholders organised across 48 associations nationally (NASFAM, 2015). The role the association plays is outlined in Box 9.

Limited direct provision of financial services, greater role in facilitating access. Current provision of financial services through producer associations occurs on a limited scale through SACCOs (see section 6.1.3.4). The main role that associations currently play in financial services is leveraging the surety of a group structure to access financial services[63], acting as a voice for farmers needs and assisting initiatives that link financial service providers to their members.[64] Additionally, associations are involved in the purchase of produce to facilitate access to competitive pricing or value addition through agro-processing (such as NASFAM). This is not currently leveraged for financial services, but the receipt of sales proceeds at this point can be channelled into digital payments channels and targeted savings products.

Current activities hold high potential to be scaled. The current touch points with financial services are a natural complement to the associations' core function and hold high potential to be increased in scale. NASFAM is a notable champion in this regard due to their national representation of smallholder farmers and track record of driving related initiatives.

Box 9. NASFAM's role in Malawi

NASFAM is a member managed smallholder association that plays a number of roles across the agriculture sector from forming farmer groups, providing a central information and demonstration point to inform the farmer groups, enhancing production (facilitating access to inputs, buying, processing and on-selling produce), facilitating market access and providing a voice for smallholder issues. NASFAM's engagements are split between two organisations, NASFAM development and commercial. These organisations provide the following services:

[63] The ability to access finance through a group setting that the farmers are comfortable in is an important function in an environment where literacy levels are low and peer engagement can assist with understanding the services. The ability to access finance through a group setting that the farmers are comfortable in is an important function in an environment where literacy levels are low and peer engagement can assist with understanding the services.

[64] Examples of this are associations providing links to outgrower schemes (such as the Tobacco Association of Malawi and Dwangwa Sugarcane Growers Association) and the advocacy of NASFAM that has resulted in producer links to Village Savings and Loan Associations (VSLAs) and the creation of a commodity exchange.

NASFAM Development

The focus of the NGO is to deliver community development and capacity building services. Services are as follows:

- *Farm Services Unit*: Conservation agriculture services, natural resource management services and services aimed at building community resilience to climate change.
- *Monitoring, Evaluation and Communications Unit:* Performance reviews, baseline surveys and association assessments, NASFAM tracking system (member production data), NASFAM programme evaluations, impact assessments, radio programmes and publication services.
- *Training Unit*: Consultancy services and training programmes for association leadership, IPC boards, NASFAM boards and farm business.
- *Community Development Unit:* Programmes in gender integration, HIV and AIDS integration, food security and utilization and adult literacy.
- *Policy and Programmes Unit:* Policy advocacy services, policy dialogues, networking services, policy fora, communication programme (print and electronic) and white paper production.

NASFAM Commercial

The purpose of the company is to provide NASFAM farmers with commercial services that will enable the farmer to make a profit, through input and output marketing among other interventions. Services are as follows:

- *Tobacco Operations Unit:* Agronomic services, farmer representation at the floors, contract marketing, hessian program, tobacco transport and queries handling.
- *Crop Marketing Unit:* Crop procurement, crop marketing, value addition and products branding and bulk selling.
- *Agro-processing and Warehouse Management Unit:* Agro-processing, warehousing and mechanization of value addition.
- *Seed multiplication Unit:* Seed production and project management.
- *Input Marketing and Logistics Unit:* Fertilizer program, seed marketing and produce transportation.

Source: NASFAM, 2011; NASFAM,n.d.

Processing, storage, and sale actors

Suitable distribution channel for all product markets where they support or complement core business. There are a wide range of actors that provide processing, storage, sale and purchase activities across the range of produce categories (see Table 12). Depending on the value chain, different actors in this category will be a suitable partner for financial services distribution. As discussed above, these are actors where financial services either support or complement their core business. Providing access to credit and insurance will support the production process that generates business for these channels. Trade credit to input suppliers (discussed above), bank credit, credit on the back of warehouse receipts and outgrower schemes are current examples of this. The insurance provided is agriculture and credit-life on the back of bank credit and medical insurance for tobacco producers (channelled through the auction houses). For actors that link to the sale of produce, there is a natural connection to payments services that enhance access to transactional and savings products.

Aggregation points for payment provide opportunity for increasing digital access. Buyers, such as commercial estates and ginners, or the facilitators of purchase, such as auction houses and commodity exchanges, are actors that influence the flow of payment for produce. Some of these actors are providing links to digital payment channels for the receipt of funds (e.g. the tobacco auction houses

and commodity exchanges can pay proceeds into bank accounts), but this is an area where more active engagement can take place. Both through making the first step of moving from cash payments to digital, and allowing a range of options (such as banking and mobile money). This is particularly important as digital payments products can act as a gateway to the use of other financial services (e.g. channelling payments into savings accounts).

Actors that provide processing will be a growing channel for financial access. Crops that require processing before and after sale provide an opportunity for a touch point for financial services – both to support the processing activity (e.g. credit and insurance) and as a general financial services channel to link into digital payments for the receipt of funds, as discussed above. A large range of produce in Malawi fit this criteria; namely, main export produce such as tobacco, tea, sugarcane, pulses, cotton and groundnuts, as well as lower priority produce such as rice, dairy and coffee (Ministry of Industry and Trade, 2012). The level to which this financing is occurring beyond access to payments is unknown and requires further exploration. Agro-processing is stated as a priority area in the Malawi's Agriculture Sector Wide Approach (ASWAp) and therefore the potential for leveraging this value chain actor should grow over time (Ministry of Agriculture and Food Security, 2011).

Outgrower schemes provide access to productive credit. Contract farming[65] or outgrower schemes exist in Malawi for sugar, tea, cotton, coffee, tobacco and horticulture crops (Agar, J., *et al* , 2012). They are facilitated through a range of processors, storage and sale facilitators (as well as producer associations as discussed above). The schemes are often accompanied by support for production through trade credit for inputs provision and loans for working capital. Notably, the overall support provided to farmers can enhance their productivity and thereby their eventual income that will be channelled into financial services. Currently, the main use of contract farming is to provide a channel for stable supply of produce for export to international markets. Side-selling of produce, thereby breaking the outgrower agreement, is listed as a big risk factor for outgrower schemes (Kumwenda & Madola, 2005). While technically these schemes can be used for any crop, risk factors that impact the strength of contracts limit its application. This is one driver for the choice of the crops listed above as they exist in tight value chains that reduce the ability to deviate from contractual agreements. It has been highlighted that there is strong potential for contract farming to grow due to insufficient coverage of smallholders currently (Ministry of Agriculture and Food Security, 2011).

Commodity exchanges facilitates access to credit. Commodity exchanges provide a service that allows farmers to control when their produce is sold by providing storage and sale facilitation services for harvests. There are two commodity exchanges currently active in Malawi (see section 5.2.1 for further detail) that provide these services for a wide range of crops through a national network of warehouses. They are more likely to service the looser value chains that are lacking a central point of aggregation for sale. In terms of financial services, the exchanges are relatively new in the market and do not yet provide a wide range of investment products (such as forward contracts). Their financial services focus is facilitating access to credit attached to warehouse receipts that are generated when produce is securitised for sale on the exchange. Potential exists to further extend the use of warehouse receipting, and thereby provision of linked credit, as well as develop up investment and support financial products[66] linked to the exchange. Additionally, warehouses could act as a channel for

[65] "Contract farming can be defined as agricultural production carried out according to an agreement between a buyer and farmers, which establishes conditions for the production and marketing of a farm product or products. Typically, the farmer agrees to provide agreed quantities of a specific agricultural product. These should meet the quality standards of the purchaser and be supplied at the time determined by the purchaser. In turn, the buyer commits to purchase the product and, in some cases, to support production through, for example, the supply of farm inputs, land preparation and the provision of technical advice."

[66] An example of this is pre-export financing. Export payments are initially secured by a letter of credit from the purchaser, while the exchange has a responsibility to pay the depositor immediately. This provides a short-term cash flow gap that could be financed by credit with the letter of credit as collateral. (AHCX, 2015)

insurance linked to their services (for e.g. credit-life, credit-health and asset insurance) and general products that would benefit their consumers (for e.g. agriculture insurance).[67] One notable factor for the targeting of financial services is that a large proportion of the exchanges' client base are traders or farmers associations. Therefore, direct access to the producers is currently limited.

Box 10. Distribution potential per major crop

This box will outline financial services distribution potential that is unique to the major crops in Malawi. Across the crops, there is a need for increased insurance and digital payments provision in-line with discussions above. All the crops included in the discussion have been prioritised either for export or food security by the Malawian government and therefore hold growth potential that financial services can both leverage and support.

Tobacco

The tight tobacco value chain and high prevalence of smallholders provides opportunity for increasing financial access. Tobacco is Malawi's dominant cash crop for export, with just over 70% produced by 750,000 smallholder farmers (versus 30 commercial farmers) (see section 2.1). As illustrated in Table 12 above, tobacco production is a tight value chain with four major auction floors based in the major centres of Lilongwe, Limbe, Mzuzu and Chinkhoma, and a number of rural auction floors all under the control of Auction Holdings Limited (AHL) (NASFAM, 2015; AHL, 2015). The produce is sold to both international and local buyers. In addition to the aggregation provided by auction houses, there are outgrower schemes and producer associations (such as the Tobacco Association of Malawi (TAMA) and NASFAM).

High level of existing access to finance could be leveraged to increase depth of access. Tobacco producers have the highest access to financial services: banked (receipt of payment from auction houses via electronic means was a push for this)[68], access to credit through direct relationships with the banks or contract farming and insurance through the auction floors and on the back of bank credit (see section 4.3.3.1 for more details on access and income profiles).[69] Historically, 20-30% of tobacco has been sold through contract farming. There is a strong push from the market to increase this number[70]. It has been noted by Malawian stakeholders that finance has been successful with this group of farmers due to a tight value chain (reducing side-selling risk) and the high sustained demand for this product as an export commodity.

AHL and producers associations can facilitate access to finance. There are two particular actors that have a high involvement in the tobacco trade or a strong interest in the farmers involved which provides incentive to act as partner for facilitating financial access for tobacco farmers. AHL sits within a group of companies (AHL Group) that are involved in the tobacco value chain from providing inputs to processing. Producers associations, such as TAMA and NASFAM, have dedicated services for tobacco farmers including facilitating connections to contract farming and transport programmes that provide insurance (NASFAM, 2015).

[67] Producers will interact with the exchange on a fairly infrequent basis and therefore insurance distribution through this channel will need to take into account the nature of interaction with producers. Examples of this could be a bulk payment option to assist with infrequent and lumpy income flows or the use of the channel for insurance sales that are supported by other institutions subsequently (for e.g. a call centre).

[68] The provision of access to bank accounts for tobacco farmers is an example of financial services innovation for the agriculture value chain. The Tobacco Association of Malawi partnered with First Merchant Bank (FMB), the agro retailer group of Farmers World and AGORA to develop an account targeted at tobacco farmers; namely, the Makwacha Card. The proceeds from auction sales of tobacco are deposited into the farmer's FMB accounts and access via their Makwacha card at Farmers World and AGORA shops, which have a largely rural based footprint. The card holds a dual advantage of also acting as an Identity card. (In-country consultations, 2014)

[69] There are a number of financial products targeted particularly at tobacco farmers – both stand alone and as inputs into contract farming agreements (these are explored further in.

[70] The major buyers on the tobacco market are Limbe Leaf, Alliance One, Premium TAMA and Japanese Tobacco Limited (Prowse & Moyer-Lee, 2013).

Sugar

Single market for sugarcane reduces risk for credit financing and provides central points for access to finance. The highly perishable nature of sugarcane requires production and processing to have a close link, because it is not possible to store cut sugarcane.This drives a close connection between producers and processors in the value chain. Illovo Sugar (Malawi) Ltd is Malawi's only sugar estate producer and processor. There are two milling facilities based on Illovo owned estates in the South and Central regions of Malawi (Illovo, 2015). Sixty per cent of total sugar sales is sold to domestic consumer and industrial markets and the balance is exported. The involvement of farmers in the value chain stops at the point of sale of their produce (even transport to the mill is outsourced). This focuses the potential of financial services distribution to actors involved in inputs provision, outgrower schemes and sale transactions, and particularly on Illovo as the single market for sugarcane. There are outgrower schemes present between smallholder farmers and Illovo Sugar controlled estates that provide access to credit for inputs and working capital. These are facilitated by both the estates and producer associations. In addition to these schemes, the lowered risk from the tight value chain of sugar has facilitated credit extension by banks (Agar, J., *et al* , 2012).

Tea

Low numbers of smallholders engaging in production, but high potential for financial access through tight link to commercial buyers. Large commercial tea estates dominate production, with some interaction from smallholder farmers (SOMO, 2008). Similar to sugarcane, tea is a crop that requires processing close to the point of production and therefore facilitates a close link between the actors involved in this section of the value chain (Kumwenda & Madola, 2005). The main buyer for tea from smallholders are the tea estates, with some competition from the government initiated Smallholder Tea Company. The produce is then sold at auction by one of these buyers once it has undergone processing. Consequently, the main distribution of financial services for smallholders currently occurs through outgrower arrangements with the commercial tea estates. Similar to sugarcane, there is provision of bank credit to farmers, although it is unclear whether this is targeted at the smallholder or commercial level. The estates themselves are mainly self-financed and only access insurance and short-term credit when needed. Aside from interim production financing needs, there is a need for assistance to new sector entrants that require financing over the several seasons that it takes to produce a first crop of tea for sale (Oliva & Agar, 2006).

Cotton

Producer associations and ginners provide potential for financial aggregation. There is a high prevalence of smallholder farmers growing cotton. Cotton ginners are a central link in the value chain through acting as both a processor and the key buyer for cotton. Cotton can either be sold directly or indirectly to the ginners through traders and producer organisations (Ministry of Agriculture and Food Security, 2006). As such, there are two central links to finance in the value chain currently in place – access to outgrower agreements through producer organisations or directly with ginners. The government is exploring the use of levies on exports to finance input provision to the cotton industry (Grundling & Steynberg, 2008). This could have an impact on the viability of cotton outgrower agreements, because input access is often one draw point to the agreements for farmers. The ginners have been a strong advocate for the development of cotton in the past and therefore hold potential to act as both a channel and champion for financial services provision.

Pulses, ground nuts and maize

Producer associations and commodity exchanges offer finance potential in these loose value chains. As illustrated in Table 12 above, maize, pulses and the main oil seeds[71] all sit within loose value chains that have producers associations and commodity exchanges as a point of aggregation. The financial services of credit and payments access through commodity exchanges are particularly relevant as these produce categories are currently the main users of the warehousing system. However, the use of local markets to also sell these crops does provide a central meeting point that provides the opportunity for informal financial services touch points. Beyond these two points, targeted financial access is low due to the risk provided by the loose value chains (with the exception of cotton) and the high prevalence of smallholder farmers. Producer associations, such as NASFAM, are another channel that can facilitate access to financial services through direct means (such as linking to financial institutions) and indirect means through advocacy and building financial services appropriate financial services infrastructure. This is particularly developed for general promotion of groundnuts due to the fact that NASFAM buys up a portion of the groundnut crop for agro-processing and sale to international markets (Derlagen & Phiri, 2012).

The prioritisation of maize for food security purposes impacts the potential for financial services distribution. The importance placed on maize for food security distorts the progression of the crop as a cash crop for exports through export bans and government subsidised inputs (thereby crowding out incentive for private input provision through outgrower schemes).[72] This reduces the drive to commercialise production beyond sale in local markets and could have repercussions on the development of actors in the maize value chain and their subsequent ability to provide channels for financial services distribution. It does however make the government a key player in the maize value chain and one which could assist in the promotion of payments through the digitization of their subsidy provisions (see section 2.1).

Petrol stations

Limited potential for distribution in urban areas. There are a total of 167 petrol stations concentrated in urban and peri-urban areas (MERA, 2015). These stations have the smallest client base out of assessed alternative distribution channels. FinScope shows that only 3% of adults (234,775 adults) own a car, truck or other vehicle. The total vehicle usage in Malawi will be higher than this due to commercial use of vehicles, but this is not likely to escalate the figures to significant numbers. Although the value of payments for the services offered is generally high, the number of active car based customers does place a limit on the potential cash stocks on site.

Pre-paid cards for fuel purchases, electronic payments, ATMs and mobile money are currently provided. Total and Petroda offer a fleet management prepaid cards (PlusCard and PetroPlus Card) and Puma Energy allow for pre-payment at bank branches (Redflank, 2013). They used to offer e-fuel prepaid cards.Less than 10% of petrol stations provide a POS (or ATM) that could support this. Conversely, a high proportion of stations provide mobile money services. There were 123 registered mobile money agents in late 2014. This rose from 13 agents at the beginning of 2013, but following a peak of 166 agents in the first quarter of 2014 the number has been steadily declining (RBM, 2014). Some petrol stations have begun to use their mobile money agency to support their core offering. This is a notable factor for driving digital payments usage. For example, customers can pay for fuel and others services in all 55 Total service stations using Airtel Money.

[71] With the exception of cotton.
[72] Over 50 per cent of the current budget of the Ministry of Agriculture and Food Security is allocated to an input subsidy to support maize production (ASWAp, 2011).

Potential for growing mobile money and the payments infrastructure. A high proportion of petrol stations already offer mobile money services. Mobile money is still in its infancy in Malawi and the decline of petrol station agents highlights a broader need to identify means to support the sustainability of this channel (such as finding ways to drive usage). As mentioned above, this is particularly relevant given the potential that mobile money holds to further enhance access to broader financial services. A second area of potential is increasing the provision of ATMs and POS devices at petrol stations. This provides the infrastructure for digital payments and general banking services access, while supporting the core business of petrol stations by providing access to capital to pay for their services.

Pharmacies

Distribution potential for health insurance and payments provision. In 2013 there were 94 pharmacies in Malawi, the majority of which were located in urban areas in the South and Central regions (Carmona, 2013). Other health care providers, such as private clinics, also dispense medication and therefore create a substitution effect that reduces the potential growth of pharmacies. That said, there still exists great potential for expansion into underserved areas that is currently constrained by other issues such as insufficient stock, suitable labour and general business model issues. A third of pharmacies in 2014 were already acting as a distribution channel by providing mobile money agency services (RBM, 2014). There is no business model complementarity for financial services aside from extending access to digital payments and medical insurance to facilitate sales. Twenty two per cent of pharmacies currently accept medical insurance. The provision of medical insurance through this channel could therefore also have the benefit of increasing the use of the product in their outlets.

Post office

Wide distribution network of post offices with low levels of interaction with target markets. Malawi Posts Corporation (MPC) is the only postal services operator, with 180 branches spread across every municipality in Malawi. This footprint covers 76% of the population (Redflank, 2013). They provide postal services and operate telecentres out of 20 branches that provide business and ICT services. In relation to financial services distribution, Redflank (2013) lists the MPC as having the largest brick and mortar services network. Yet, despite this physical presence they are not widely used by the adult population currently. Seventy three per cent of adults (5,743,390 adults) say they never travel to a post office and/or don't know where it is (FinScope, 2014). Of those that know the location of a local post office, 13% (1,012,509 adults) can walk to it, while 6% and 8% will take their own vehicle or public transport, respectively.

MPC is a dominant player for remittances and money transfers, along with providing voucher sales, bill payment, mobile money services and agency banking. MPC provides a wide range of financial and payment services currently. Firstly, they offer vouchers and bill payments for the following providers: MNOs (airtime vouchers), Central Region Water Board (water bills and connection fee payment) and ESCOM (pre-paid vouchers and bill payments (currently available at two branches and will be expanded to all post offices)). They provide both mobile (41 branches) and banking agency services for the MNOs and NBS Bank (RBM, 2014). MPC is a dominant player for money transfers and remittances with an internal money transfer system (Fast Cash) and links to the international remittance providers – Western Union and MoneyGram. It uses a real-time tracking system to manage payments, but struggles with guaranteeing real time settlement due to liquidity issues (Redflank, 2013).

Potential to enhance current partnership offerings and introduce dedicated Post Bank. The range of financial services currently provided has high potential to be expanded through adding new providers to the agency and bill payments offerings. However, this will only be successful if this channel can resolve issues with liquidity and poor service (Redflank, 2013). Enhancing cash reticulation systems and adding service offerings that can assist with driving the correct liquidity balance are possible means of approaching this. For example, adding further bill payments and savings functions that encourage cash-in to balance cash-out from services such as money transfers. It is in discussion whether financial services provision should be enhanced further not only through partnership, but also via the creation of a Post Bank (In-country consultations, 2014). If the Post Bank is developed then this channel will become a primary financial service provider that can provide payments, savings, insurance and credit services.

Retailers

Wide footprint of unnetworked retailers. There are two different categories of retailers used in this study: networked and unnetworked retailers. Networked retailers function as one part of a chain of outlets that are owned and coordinated by a central company, whereas unnetworked retailers are independent entities. Unnetworked retailers far outnumber networked retailers in Malawi (Redflank, 2013). The FinScope MSME survey (2012) places the broad categories of retailers as 87% (859,108 businesses) of MSMEs, while a narrower category of those purely focused on retailer activities is 44% (434,491 businesses) of MSMEs.[73] This will include a wide range of retailers (from marketplace traders to established stores) that are not all suitable for distribution partnerships. Networked retailers on the other hand are more established stores mainly in the supermarket[74], clothing and agro-dealer business lines. Current estimates are 405 stores across Malawi (Bench Marks Foundation, 2009). The majority of unnetworked retailers are based in rural areas (92%), while networked retailers are mainly based in urban areas (with the exception of agro-dealers[75]). Given the large rural population of Malawi, this means that unnetworked retailers are located in close proximity to the majority of the population. This is further confirmed by the fact that 79% of adults say they are within in walking distance of a market – one location for these retailers (FinScope, 2014). That is not to say that the broader population do not access the networked retailers, but those outside of close proximity are more likely to do so on an infrequent basis when their local retailers are unable to meet their needs and they are able to travel to the retailers that can (for e.g. a monthly supermarket shop).

Leveraging existing infrastructure, increasing footfall and adding to profitability are motivators for partnership. Retailers provide liquidity and physical infrastructure that financial service providers can leverage for distribution purposes. The benefit for retailers is financial services enhancing profit through: (i) increasing footfall, (ii) driving more profitable customer behaviour (increasing basket size and value) and (iii) lowering costs through leveraging existing infrastructure for further product provision (Eighty20, 2013).

[73] Most unnetworked retailers fall within the range of businesses included in the MSME categorisation. This therefore is able to provide a good indication of the number of unnetworked retailers, although the possibility of small overlaps with the networked category and missing some unnetworked retailers does marginally reduce the accuracy of this estimate. The narrower definition of retailers is compiled by taking account of MSMEs that only focused on the sale of goods (those that sell products in the same form they were bought, animal by-products or items collected from nature).

[74] The supermarket space is dominated by the local providers of Peoples Trading Centre, Metro and Chipuku. International chains such as SPAR and Shoprite-Checkers also operate in the country (Redflank, 2013)

[75] Agro-dealers provide a retail offering focused on farmer's needs (mainly input and equipment supplies). These outlets have high reach due to the fact that their target market are a high proportion of adults (2,647,633 adults) and they are located in proximities that are accessible for their largely rural based (95%) customers (FinScope, 2014).

Payments are the only financial service currently offered. Money transfers, mobile payments and loan repayments are the only financial service currently distributed through retailers. The level of basic payments infrastructure of POS or in-store ATMs is low at networked retailers and basically non-existent for unnetworked retailers (RBM, 2014; Redflank, 2013). The one exception to this are the agro-dealers Farmers World and Kulima Gold that have partnered with FMB and OIBM, respectively, to provide in-store ATMs and POS devices (Dermish *et al.,* 2012*)*. Farmers World has used this network to allow for the acceptance of loan repayments for NGO partners. Further, Farmers World have a remote delivery system[76] that could be leveraged for money transfers. The People's Trading Centre have worked around the lack of payments infrastructure by allowing Zoona to leverage their retail footprint through housing Zoona kiosks that have their own payment devices. The kiosks currently provide domestic money transfer services. Both networked and unnetworked retailers are leveraging mobile phones to provide mobile money services. Although, unnetworked retailers are doing so at a much larger scale (10,596 shops versus 66 supermarkets)[77] (RBM, 2014).

Potential for increased financial services offering if infrastructure issues are resolved. There is potential to expand the financial services offering of networked retailers through enhancing current payment services and rolling out credit, insurance and savings products that complement their service offerings[78]. This potential will be limited for credit in the current constrained context (see section 6.1.5). It will be important for retailers to enhance their payments infrastructure to facilitate financial services provision and for the retailer landscape to grow to include more furniture and clothing retailers that provide opportunity for secured credit, saving stamps or vouchers and lay-bye offerings. While the supermarket market is dominated by local players, there is a developing presence of international retail chains that offer financial services through their stores in other markets (e.g. Shoprite and 7-Eleven). This experience could be leveraged for rolling out similar offerings in Malawi. Conversely, unnetworked retailers have limited potential to expand into financial service offerings beyond payments. This is due to the lack of a central aggregation points for partnership coordination and the unsuitable nature of some businesses due to informality, short life spans and limited cash stocks. However, there does exist potential to both expand and strengthen the mobile money agency offering to suitable retailers[79] in this channel.

[76] The system allows customers to pay for goods at one Farmers World outlet and collect from a different outlet nationwide.

[77] The majority of networked retailers in Malawi are supermarkets and agro-dealers. It therefore a fair assumption that the RBM's category of "shops" is largely made up of unnetworked retailers, while "supermarkets" are networked retailers. Notably, agency by supermarkets dramatically decreased in 2014 from 141 supermarkets in the first quarter to 66 in the third quarter.

[78] These are products such as credit accounts, secured and unsecured loans, lay-byes, savings bonds or stamps, credit-life and other microinsurance products that are attractive to the retailer's customers. These examples often occur in the retailer environment because they both support their core business of merchandise sales and add to the revenue of the retailer (by reducing the relative cost of infrastructure and adding revenue line items) (Eighty20, 2013)

[79] A business can only become any agent if it is a registered entity and can provide evidence of commercial activity carried out for 18 months (Redflank, 2013).

6. Product markets

6.1. Market for credit

Why focus on credit? The effective allocation of capital for productive purposes is a fundamental goal of the financial system. Credit is a product of this intermediation process and can contribute to productivity through spurring economic growth, employment and improved welfare if used for purposes such as building businesses, funding education, funding larger assets and preventing people from falling into poverty after a shock. However, it can also trap people in a cycle of debt that causes severe hardship. Getting the balance right between improved access to credit and protection against over-indebtedness is difficult and requires a comprehensive view of the market from the consumer and provider's perspective.

To help achieve this balance in Malawi, the following section explores the market for credit to consider the challenges, gaps and opportunities in further expanding provision to the identified target groups. This includes providing an overview of current take-up, the providers of credit and the products available.

Key issues: market for credit

The key issues from this section are the following:

- Low and declining access to formal credit
- The cost of credit makes it unaffordable for most Malawians
- VSLAs are the largest providers of loans and have seen rapid growth in recent years
- Macro-economic conditions, lack of information on consumers and difficulty in realising collateral constrains credit provision

6.1.1. Current usage

Formal credit usage low and declining. Figure 45 below shows that just 4% of Malawian adults currently use credit from a formal provider, only half the number that used formal credit in 2008. Figure 46 below, also shows that Malawi has the lowest formal credit usage amongst comparator countries in the SADC region. Formal credit usage has declined from 480,000 adults with credit to 270,000 in 2014, while the use of informal credit has increased significantly between 2008 and 2014 from 340,000 to 1.2 million. Figure 49 below illustrates that this trend of declining formal credit usage but increasing use of credit overall (formal + informal) is consistent across the five target markets, indicating that the change in usage patterns overall is pervasive across the market.

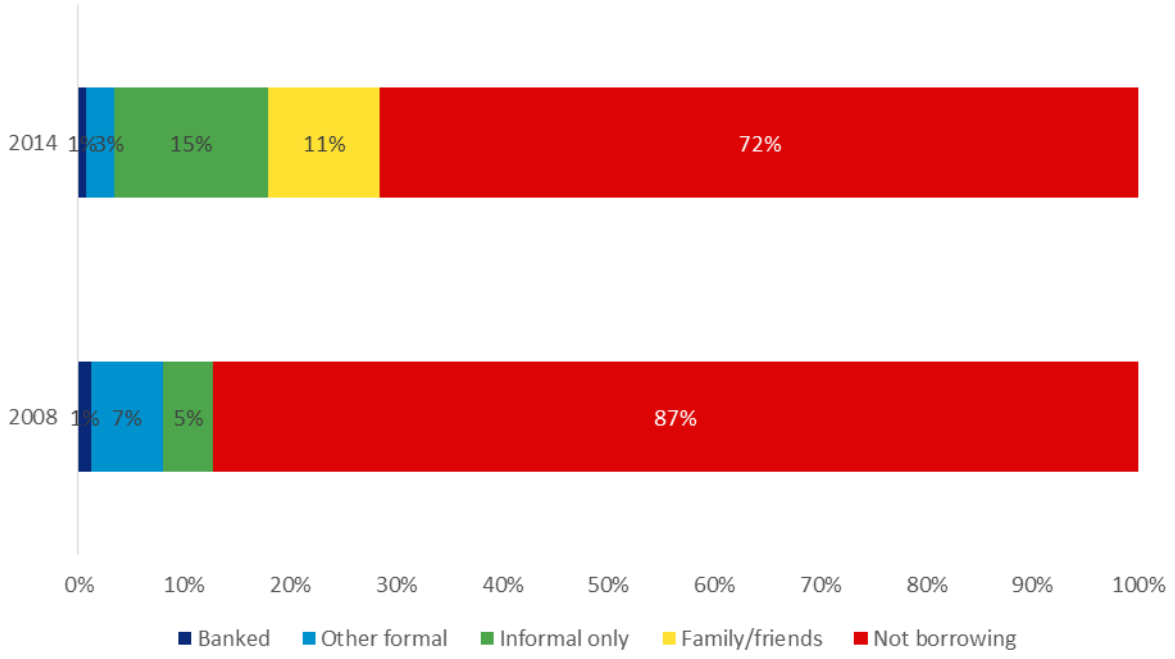


Figure 45: Comparative credit access strand between 2008 and 2014

Source: FinScope, 2008, 2014

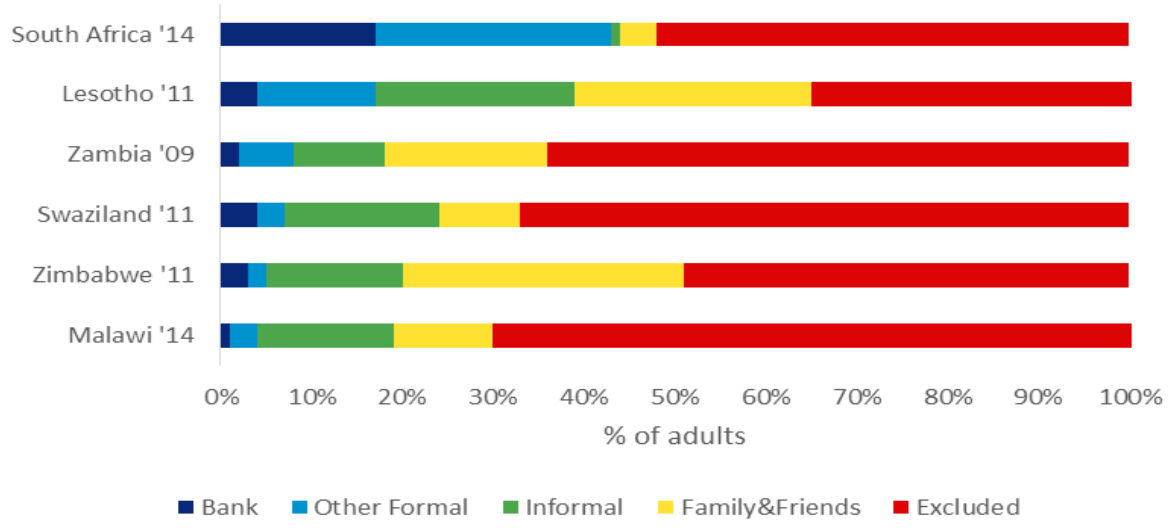


Figure 46: Comparative credit access strands across SADC countries

Source: FinScope, 2009-2014

High interest rates pushing consumers away from formal credit. The substantial increase in inflation between 2008 and 2014 from 7.7% in January 2008 to 23.3% in Oct 2014 and peaking at 37.9% in February 2013 (RBM, 2014), as discussed in section 2.1, has had a significant impact on the cost of credit in Malawi as the Reserve Bank has increased the bank rate in an effort to curb inflation. Figure 47 below, shows that the lending rate has nearly doubled between 2008 (25%) and 2013 (46%). This makes formal credit less affordable for Malawians, hence reducing their formal credit usage.

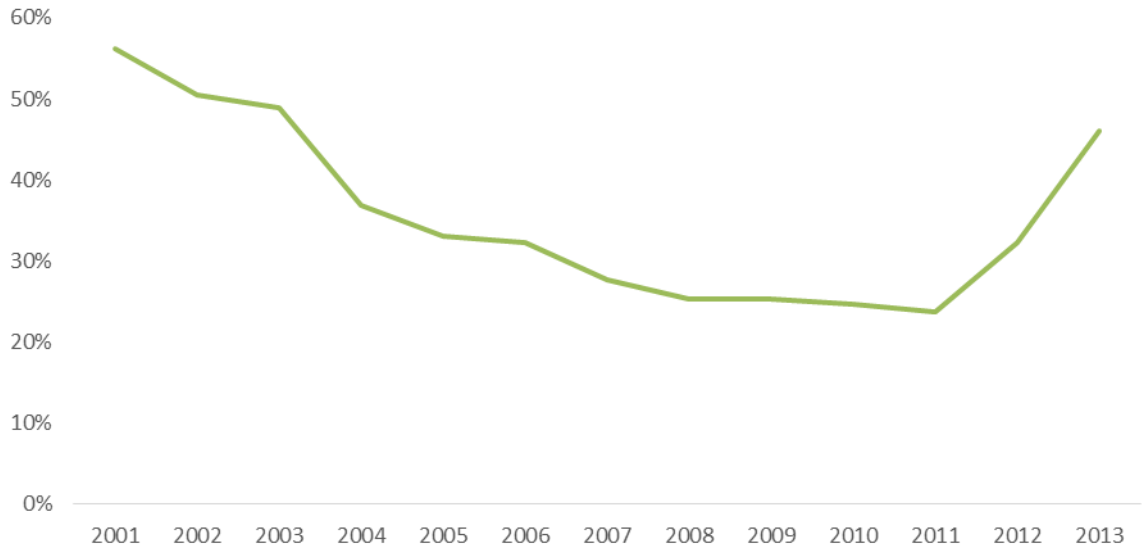


Figure 47: Lending interest rate

Source: World Bank, 2013.

Rise of VSLAs shifting use to informal credit. Whilst cost escalation may partially account for the declining use of formal credit, other factors have contributed. A major driver of the shift from formal to informal credit is the rise of the VSLAs. The methodology of these groups is explained in greater detail in section 6.1.3, but Figure 48 below shows the dramatic increase in the use of such community groups for credit. Whilst most of the categories of informal credit usage have increased a little between 2008 and 2014 (apart from Church groups), the proportion of lenders from community groups has increased substantially since 2008. The proportion of lenders from these groups in the population has increased by 7.1 percentage points or by an astonishing 2,836%. Whereas, community groups accounted for 6% of total informal borrowers in 2008, they accounted for 60% in 2014.

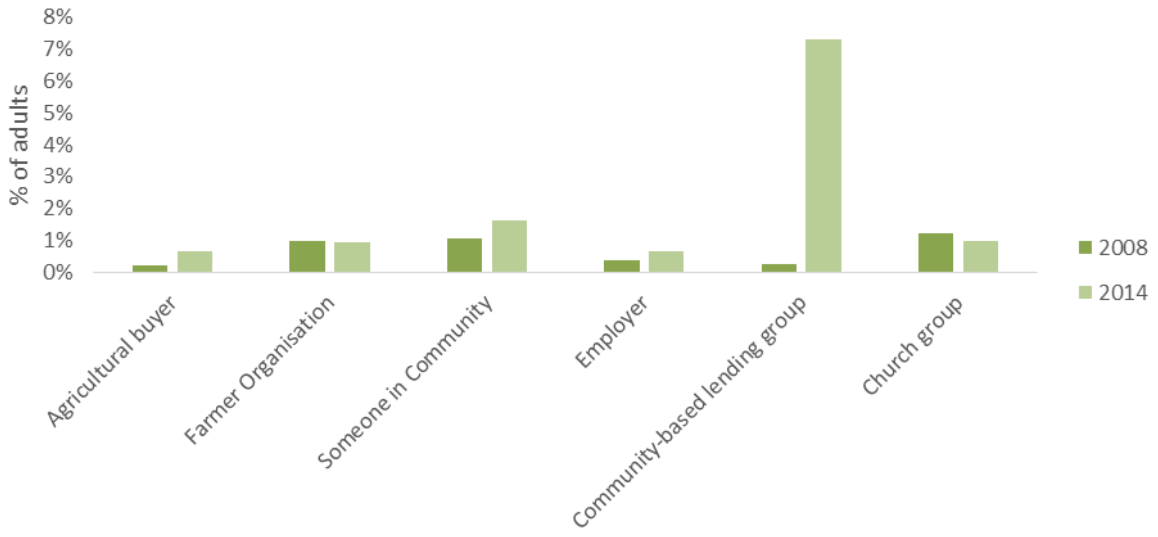


Figure 48: Comparative informal credit usage between 2008 and 2014

Source: FinScope, 2008, 2014

Stricter bank requirements reducing availability of loans. A third reason that contributed to the shift in credit usage is changing bank behaviour. Difficulty in realising collateral due to inefficient judicial systems and preparations to comply with Basel II requirements have both contributed to this change. [80]. Furthermore many of the banks have experienced increased NPLs as consumers struggle to repay loans due to interest rates and inflation, putting pressure on bank liquidity (discussed in section 6.1.3).

[80] Padgett (2012) found a negative relationship between the implementation of Basel requirements (II and III) and the availability of credit to small businesses due to the difficulties for banks to raise the additional amounts of capital necessary to offset the risk of lending to small businesses. This is particularly relevant in a market without strong credit agencies, making it harder for banks to make a detailed and accurate analysis of the risk of their clients (Cardone- Ripotella et al., 2011*)*

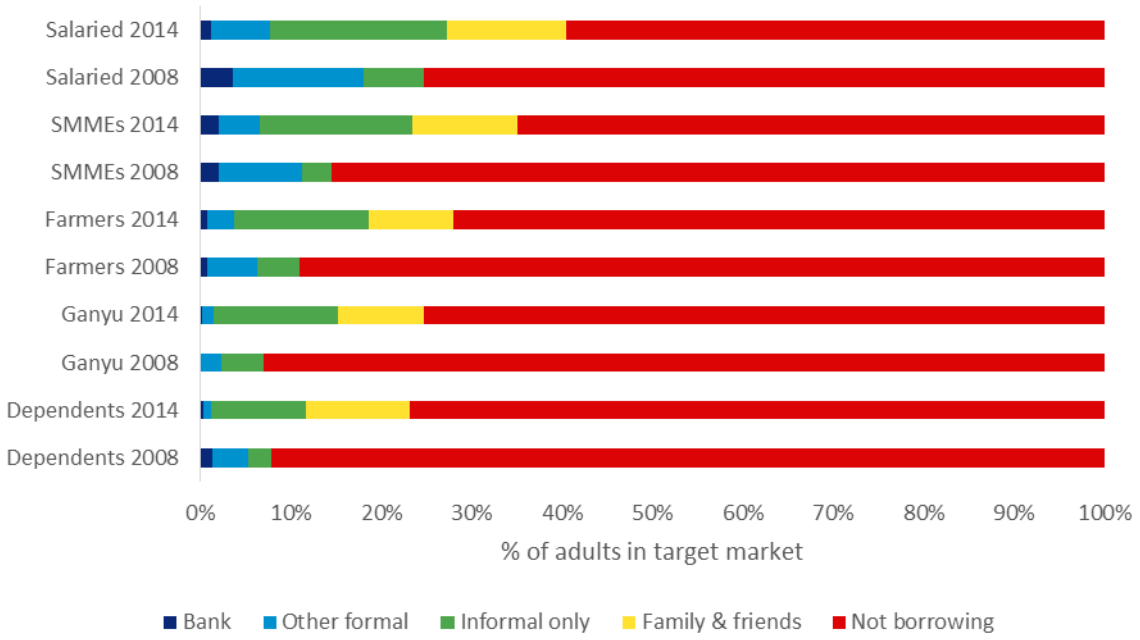


Figure 49: Comparative credit access strands between 2008 and 2014 per target market

Source: FinScope, 2014, 2008

Salaried employees and MSMEs highest users of credit. Both Figure 49 above and Table 13 below, which shows the total usage of each type of credit rather than the access strand, illustrate that salaried employees and MSMEs are the greatest users of credit. This has remained consistent between 2008 and 2014. The salaried employees tend to have the greatest access to credit as they are the most able to meet the eligibility requirements. All payroll loans from payroll lenders and banks and most other personal loans from banks and SACCOs are only extended to applicants with a payslip and hence are salaried employees. A limited number of MSMEs may qualify for bank loans, but the majority are able to access loans from MFIs. These two groups are also the largest users of informal credit. As relatively wealthier groups they are more able to access a loan from informal lenders than other groups due to their relative ability to repay.

	Bank	Other, non-bank formal	Informal	Family and friends	Not borrowing
Farmers	1%	3%	15%	14%	72%
MSMEs	2%	5%	18%	18%	65%
Salaried	1%	7%	21%	24%	59%
Dependents	0%	1%	11%	15%	77%
Ganyu	0%	1%	14%	15%	75%
Total	***1%***	***3%***	***15%***	***16%***	***72%***

Table 13: Total access to credit per provider category

Source: FinScope, 2014

Farmers and MSMEs account for greatest number of loans. Despite salaried employees having the highest credit penetration amongst the target markets, due to the relatively small number of adults within the salaried employees target market, salaried employees only account for 16% of total formal

credit users. Comparatively, farmers and MSMEs account for 36% and 32% of total formal credit users, respectively.

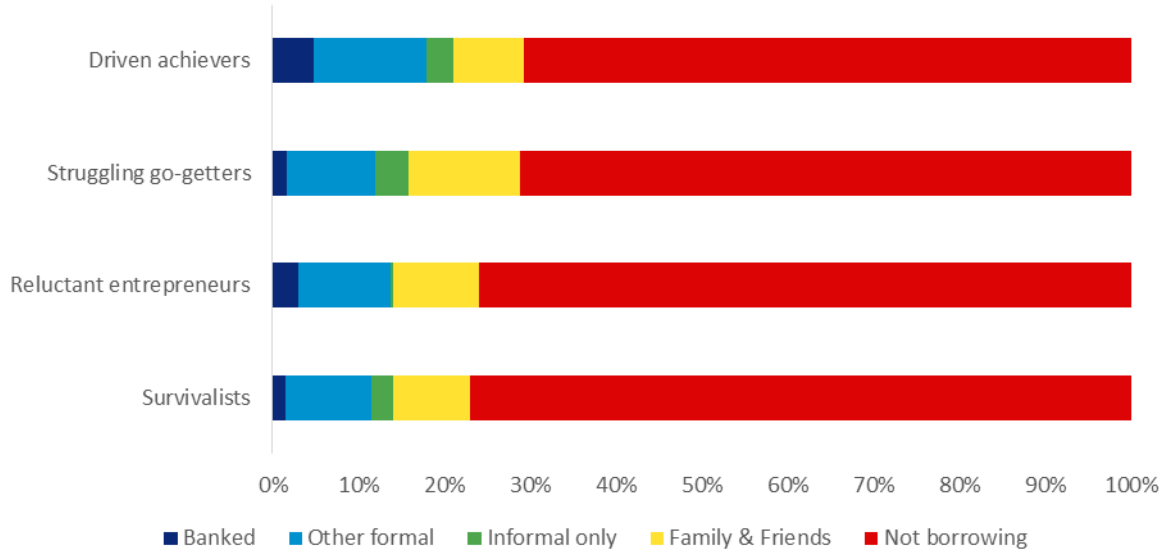


Figure 50: Comparative credit access strands across different types of MSMEs

Source: FinScope MSME, 2012

Different types of MSMEs display similar credit usage despite varying capacity to absorb credit. Figure 50 above shows credit usage for the different types of MSMEs. The Driven Achievers are the highest users of credit, particularly formal credit, whilst the Survivalists have the least. However, the differences between the different types of MSMEs is small and even amongst the driven achievers, 71% do not use any kind of credit. Whilst credit may not be appropriate or required for all businesses, this suggests that the credit that is available in the market, particularly the formal credit could be better directed towards those businesses with both the ability and motivation to grow i.e. the Driven Achievers. This subset of MSMEs will be better able to absorb and repay the credit through ongoing growth and will also be more likely to have a beneficial impact on the broader economy through greater contribution to GDP and employment generation. For example, if all of the loans provided by banks and other formal institutions were directed towards the driven achievers, those MSMEs, with the greatest chance of growing, 82% of them could have access to formal loans.

Proximity not a major determinant of credit uptake. Figure 51 below shows that credit uptake for adults who live in rural and urban areas is very similar. Although bank credit penetration is higher in urban areas than rural areas, the number of rural bank credit clients is higher (36,000) than in urban areas (24,000). This similarity in access reflects a willingness to travel to access loans and the extremely low levels of overall access, targeted largely at those with relatively higher incomes. Issues of proximity may therefore become more substantive if formal credit provision increases and the value of loans is small. Informal credit is provided by both community groups and moneylenders situated in both urban and rural areas and hence proximity should be less of an issue to access informal credit.

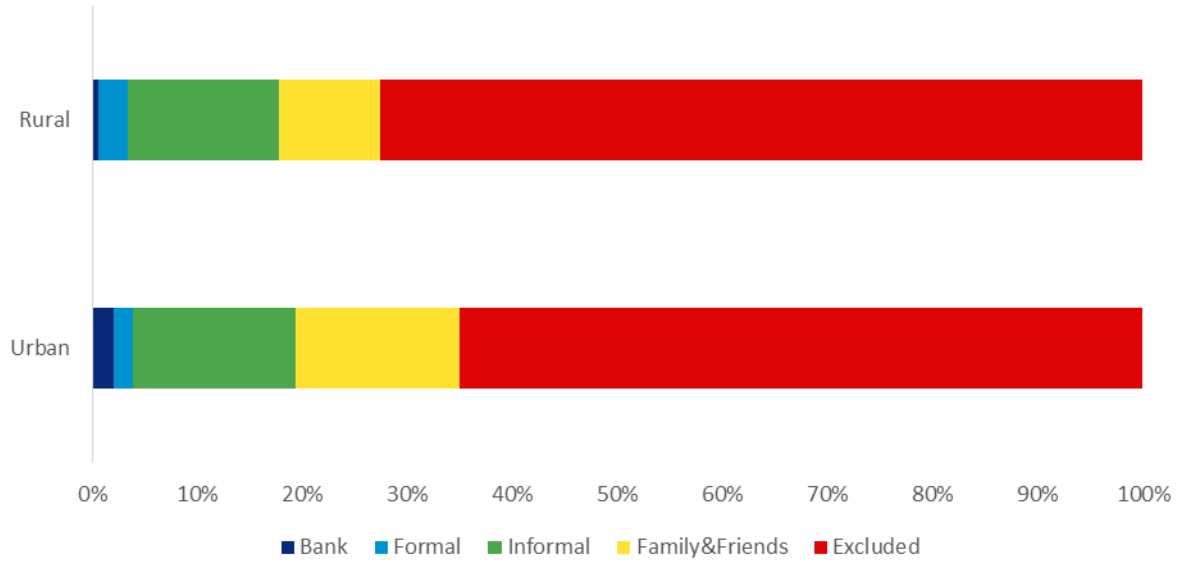


Figure 51: Credit access strand for rural versus urban dwellers

Source: FinScope, 2014

Low credit penetration for farmers, beyond rural nature. The farmers constitute a substantial portion of credit users by virtue of the relative size of the group. However, they report significantly lower usage of credit products, both formal and informal, than both salaried employees and MSMEs. This is despite the fact the farmers typically have a great need for credit to purchase inputs in planting season which they can only pay back with a delay when paid for their produce. Limited eligibility due to low and irregular incomes may account for the relatively lower credit penetration amongst farmers.

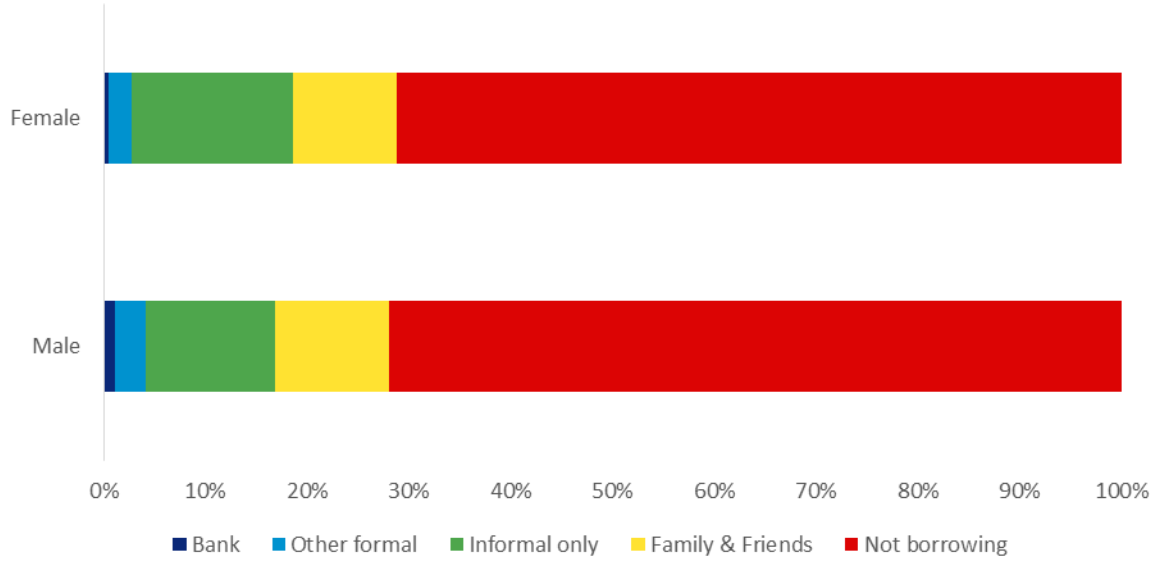


Figure 52: Comparative credit access strands between males and females

Source: FinScope, 2014

Similar level of overall access to credit between genders. Figure 52 above shows that both females and males have similarly low access to formal credit and the largest portion of credit users from both genders use informal credit. A significant portion also use credit from family and friends.

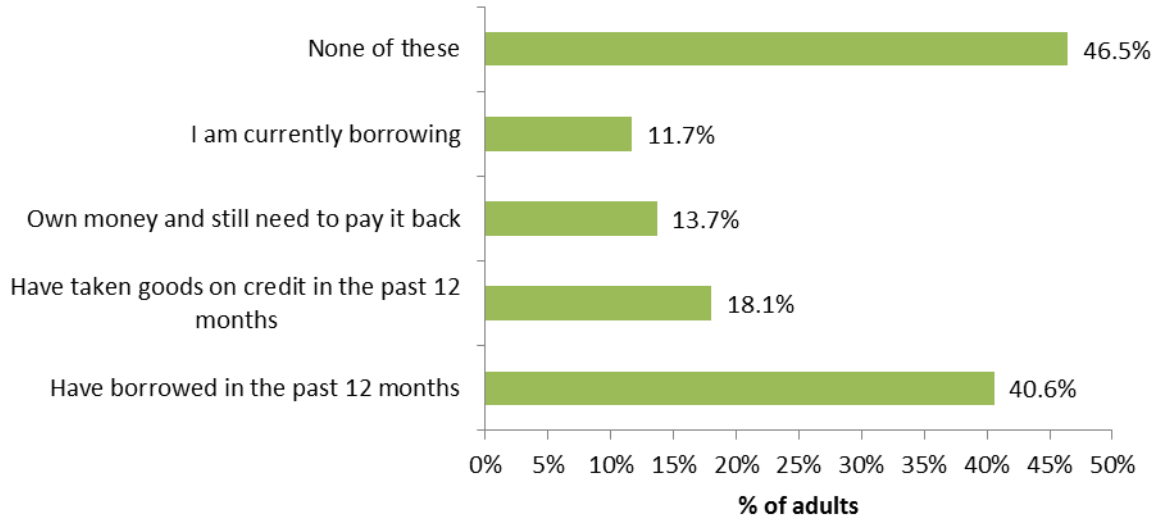


Figure 53: Borrowing in the last 12 months

Source: FinScope, 2014

Most Malawi adults have borrowed within last 12 months. Despite current low levels of access, a large portion of adults have indicated that they have borrowed recently, but do not currently have credit (as illustrated by the access strand). More than half of Malawi adults indicated that they have borrowed either money or taken goods on credit within the last 12 months. The likelihood is that most of the additional responses have used informal credit, because of the relatively shorter terms of informal loans compared to formal loans. This suggests that credit is fairly prevalent in Malawi, primarily from informal providers.

No evidence of over-indebtedness in Malawi, although data limited. Limited information is available on debt levels, however only 0.3% of adults indicated that they used credit to pay off another loan – usually an indication of over-indebtedness. Payment Solutions data (the government payroll payment system and only data on debt repayment across a range of consumers) indicates that there is also no evidence of over-indebtedness when looking at formal credit provided to government employees. However, without an operational credit reference bureau or even a National ID it is not currently possible to ascertain the level of indebtedness in society. Furthermore, as illustrated above, the majority of borrowers obtain loans from informal providers. The qualitative interviews conducted also did not find over-indebtedness to be a widespread problem in Malawi.

6.1.2. Use cases

This section outlines the use cases for credit by Malawi adults, as identified through the qualitative and quantitative demand-side research. At the end of the credit market analysis, we will return to the use cases as the basis for the identification of gaps in current provision and opportunities to extend access.

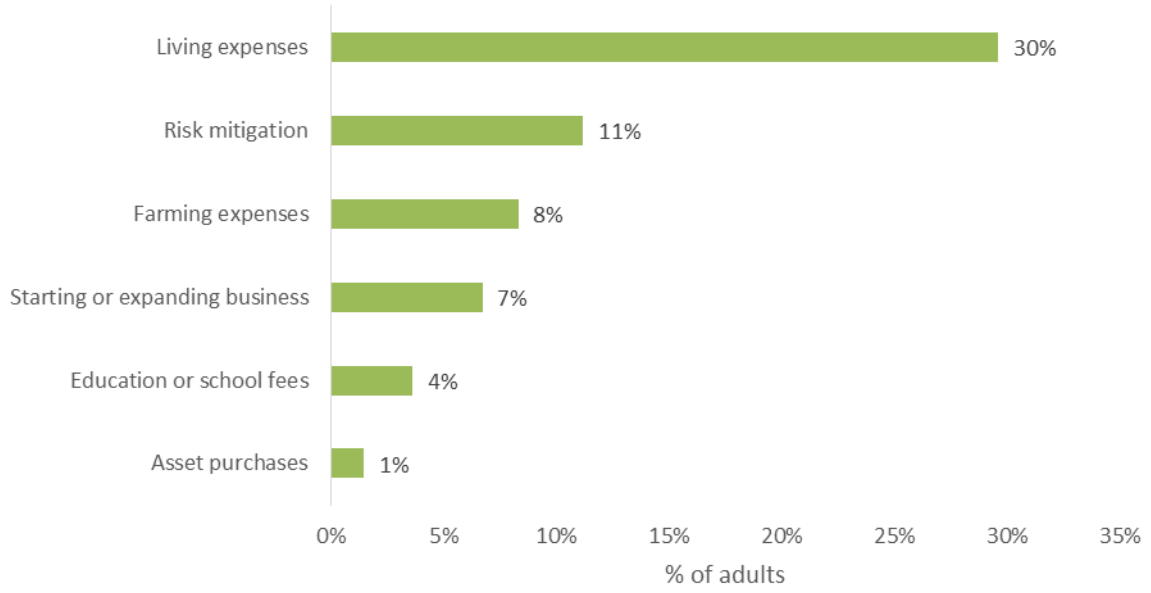


Figure 54: Reasons for borrowing

Source: FinScope, 2014

Consumption smoothing the primary reason for using credit in Malawi. Figure 54 above shows that 30% of adults indicated that they use credit to pay for living expenses. All five of the target markets indicated that consumption smoothing is the primary reason why they borrow; ganyu (34%) and farmers (30%) are the most prevalent users of credit for consumption smoothing. These groups have the most variable income.

Risk mitigation an important use case. Borrowing to deal with risks, including medical and non-medical emergencies and funeral expenses, is the second most common reason to use credit in Malawi, with 11% of adults indicating that they borrow to address at least one of these risks. MSMEs are the greatest users of credit to mitigate risks. For example, as MSMEs are completely reliant upon themselves for their income, a day spent sick equates to day's lost income. Therefore, in the absence of insurance 15% of MSMEs resort to credit to deal with risks. 14% of salaried employees also use credit for risk mitigation. Dependents (8%) are the lowest users of credit for risk mitigation, likely due to the fact that they can rely on their household to support them through many risks events.

Farming expenses a key use case for either input financing or asset investment. As discussed in section 4.3.3.1, 88% of Malawian adults are involved in farming. Whilst for many this is primarily subsistence farming, for 33% farming is their primary source of income. The irregular nature of farming incomes and the high capital investment required up front for seeds, fertiliser, livestock or farming equipment means that many farmers require credit in advance to fund this initial capital investment. As Figure 54 shows, 8% borrow for farming expenses for either input financing or asset investment. Unsurprisingly, farmers are the target market with the greatest likelihood of borrowing for farming expenses. 14% of farmers borrow for farming expenses. Between 4% and 7% of the other target markets borrow for farming reasons.

"Since farming is not an easy process, honestly speaking as I said at the beginning there are a lot of things that are needed to sustain farming…for the materials and the equipment I might need close to half a million (MK 500 000) since we are small farmers."

Farmer, male, 43 years old

Credit for business investment. Seven per cent of adults in Malawi indicated that they borrow to start or expand their business. Unsurprisingly the main users of credit for businesses are the MSMEs, 15% of whom borrow for their business. 5-6% of the other target markets borrow for businesses.

"I have ever taken a loan. I took a loan this year, last month. They call it Vision Fund that's where I took it… I wanted to start a business, to buy flour and make some flitters to be selling when I have free time."

Farmer, female, 60 years old

Different types of MSMEs require different types of credit. Driven Achiever MSMEs can absorb more substantial and longer term credit than other MSMEs, as they are more willing and able to pursue and achieve growth. Other MSMEs, despite indicating a need for credit, are much less likely to be able to effectively absorb large loans and use the credit productively enough to be able to maintain repayments over an extended period. Therefore, non-driven achiever MSMEs may benefit from short-term trade financing to manage cash flow on an interim basis, but other products, particularly savings, may frequently be a more optimal source of funding for such MSMEs.

Credit also used by a minority of borrowers to fund education. Figure 54 shows that 4% of Malawian adults borrow to pay for education. The greatest users of credit for education are the salaried employees – 7% of them indicated they use credit for education. This is relatively lower than in other MAP countries; in Swaziland for example, education was the top use case for credit and the second highest in Lesotho. This may reflect the lower education dividend in Malawi than in those countries. In Swaziland, for example, the salaried employees are substantially more educated than the general population and earn an average salary 3 times the average. In contrast, the difference in education levels between Malawi's salaried employees and the rest of the population is far smaller and the average income is twice the population average.

Housing finance. Use of credit to finance housing is very low. However, from qualitative interviews housing is a substantial aspiration for most Malawians. Personal loans and savings are used to finance housing at present due to the limited mortgage market. However, longer-term debt is needed to fund significant housing expenses given the cost.

6.1.3. Providers

This section provides an overview of the Malawi providers involved in credit provision. Both the willingness and ability of these providers to serve lower income people is discussed.

	Bank	Other formal	Informal	Excluded
Farmers	601 816	191 477	424 080	1 430 260
MSMEs	428 580	119 662	184 534	505 043
Salaried	384 316	47 848	43 703	87 057
Dependents	364 186	108 507	122 586	731 726
Ganyu	272 187	100 402	373 140	1 308 084
Total	***2 051 085***	***567 896***	***1 148 043***	***4 062 170***

Table 14: Number of clients by type of provider and by target market

Source: FinScope, 2014

Banks the largest financial service provider. Table 14 above shows the segmentation of the different financial service providers' customer groups by target market. The table shows that whilst farmers are amongst the least banked target market (as discussed in section 4.3.3.1), due to the number of farmers they do still constitute the largest portion of bank clients, accounting for 29% of total bank clients. Similarly, farmers constitute the largest portion of formal providers' clients and the largest number of users of informal financial services. Farmers also account for the largest number of adults without access to any financial services (35%). This reflects proximity challenges for farmers in accessing formal financial services. It is also indicative of the fact that farmers are the biggest target market.

Domestic credit to GDP slowly increasing. World Bank data (2015) shows that the amount of domestic credit provided by the financial sector as a percentage of GDP is increasing over time. Malawi's overall domestic credit provision as a proportion of GDP is currently very similar to its three neighbours at 31%.

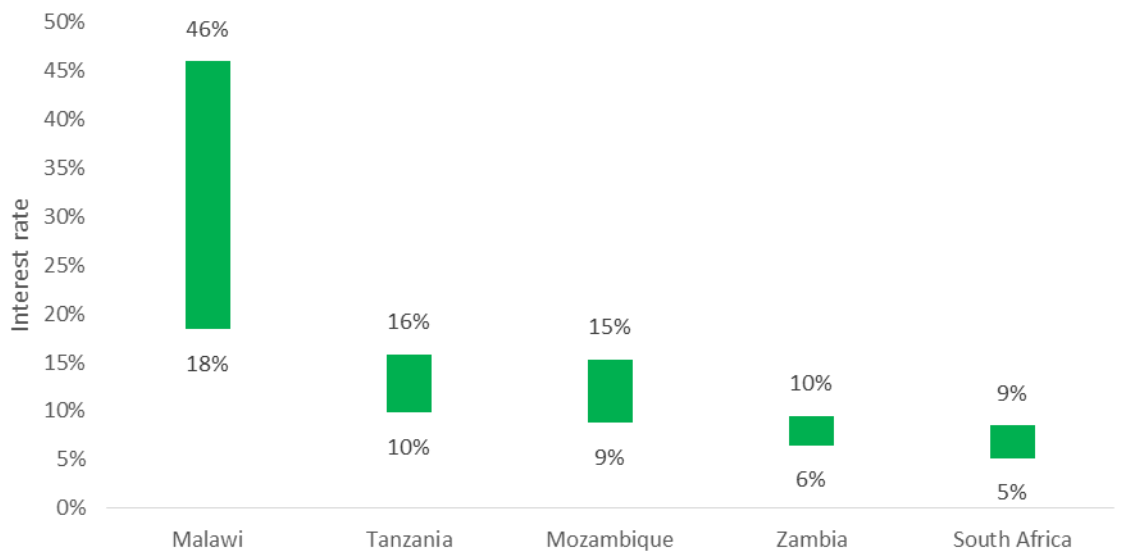


Figure 55: Comparative interest rate spreads across selected countries for 2013

Source: World Bank, 2013

Interest rate spread highest in region and increasing. Figure 55 above shows the relative interest rate spread between Malawi and its neighbours. The figure clearly illustrates that Malawi has a substantially larger interest rate spread than its neighbours. World Bank data also shows that these high interest rate spreads have been in place for a number of years and have increased since 2013. One of the primary implications of the high interest spreads is the effect it has on the cost of capital in the economy. Figure 55 above shows that lending rates in Malawi were 46% in 2013, which equates to the second highest lending rates for any country in the world, for which data is available, after Madagascar (World Bank, 2015).

Box 11. Drivers of the high interest rate spread

The high interest rate spread in Malawi, as shown in Figure 55, is a historical fact with the interest rate spread having remained at broadly similar levels for the last 15 years, although there was a noticeable rise in 2011 and 2012. Chirwa and Mlachila (2002) found that the high interest rate spreads were a factor of high monopoly power (although this has decreased somewhat over time with new entrants. the discrete clusters each targeting specific target markets discussed below, suggests that this may remain an issue), a high central bank discount rate, high reserve requirements (implicit tax) and high inflation rates in Malawi. The reasons for the upward trend in the spreads are the upward movements in the nonfinancial costs, provision for doubtful debts, the exchange rate uncertainty, the rising bank discount rate, and continuing high and variable inflation.

Additionally, the high return on treasury bills may crowd out retailer credit and limited development of the domestic derivative market means an inability to for providers to hedge against FOREX and inflationary fluctuations.

Categories of credit providers. Table 15 below summarises the categories of providers of credit, showing the number of providers within each category, the number of clients, the loan book, average loan size and the interest rate charged by each category of credit provider.

Type of provider	Number of institutions	Number of Clients	Loan book (K million)	Average loan size (K)	Interest rate (p.a.)
Banks	11	300,000	234,000	780,000	35-50%
Payroll Lenders	5	60,000	4,939	82,317	70-110%
MFIs	7	98,314	5,947	60,490	35-70%
SACCOs	48	83,000[81]	2,943	26,757	36%
Agro-dealers[82]		52,000			
VSLAs	~65,000[83]	585,000	5,000	8,250	240%
Informal moneylenders[84]		130,000			600%
Informal retailers[85]		410,000			

Table 15: Summary of credit providers in Malawi

Source: Authors' own based on In-country consultations, 2014; Standard Bank Limited, 2013; National Bank of Malawi, 2013; First Merchant Bank, 2013; NBS Bank, 2013; Malawi Savings Bank, 2013; FDH Bank, 2013; Nedbank, 2013; Indebank, 2013; Ecobank Malawi, 2013; FinScope, 2014

Banks provide largest amount of credit, informal highest number of loans. Figure 56 below illustrates the market share of the credit market by both clients and value. The figure shows that in terms of clients, the overall credit market is dominated by informal provision. More than 50% of credit clients receive credit from informal providers. The banks have the greatest proportion of formal clients with 17% of total credit clients; MFIs and SACCOs each account for 6% of total credit clients. In contrast, the banks completely dominate the total loan book, accounting for 91% of total credit, although this includes credit extended to corporates as well as individuals and MSMEs. Therefore, banks play a central role in the credit market in Malawi as the largest providers by value, but only play a peripheral role in the provision of credit to individuals and MSMEs. The payroll lenders, MFIs and SACCOs, each account for 1-3% of the total credit market whilst informal providers, despite dominating by volume, account for only 2% of the value of total loans extended.

[81] Estimated based on average proportion of members that take loans (MUSCCO, 2015).
[82] Data unavailable
[83] Estimated based on total respondents that indicated membership to an informal savings group divided by CARE's estimated average membership of 18 for VSLAs.
[84] Data unavailable
[85] Data unavailable

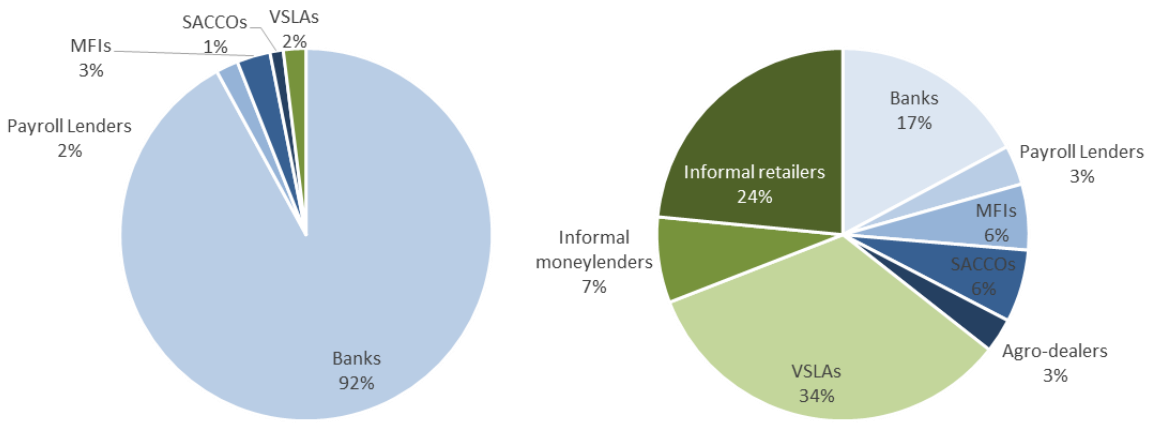


Figure 56: Industry breakdown of credit provision by number of clients and by loan book

Source: Authors' own based on In-country consultations, 2014; Standard Bank Limited, 2013; National Bank of Malawi, 2013; First Merchant Bank, 2013; NBS Bank, 2013; Malawi Savings Bank, 2013; FDH Bank, 2013; Nedbank, 2013; Indebank, 2013; Ecobank Malawi, 2013; FinScope, 2014

Most adults can only access informal credit at high rates, MFIs the exception. Figure 57 below plots the different types of credit provider by average interest rate charged and average income of their customers. The figure shows the difference in market targeted by the different types of providers. The formal providers serve a much higher income market than the informal providers, whilst the informal providers charge substantially higher interest rates than the formal providers. The MFIs are the one group of formal providers that target the lower income market, primarily in the form of MSMEs. This is partially made possible as they are subsidised by either donors or government. Evidence from qualitative interviews suggests that informal retailers may provide customers with goods on credit at no or very low interest rates on an *ad hoc* basis. However, this credit is typically very low in value in the form of the goods purchased. It is extended in order to earn goodwill and loyalty from customers and is expected to be repaid within a very short time frame (a few days). Figure 57 shows that the different types of formal providers target different types of consumers. Whilst banks only provide credit to corporates and high net worth individuals (as shown in the figure), the payroll lenders and SACCOs exclusively target the salaried employee target market. Even though these institutions effectively only provide credit to the wealthiest 5% of the population, the figure shows that these institutions still serve a relatively lower income market than banks on average. The MFIs, however, target substantially lower income customers, primarily in the form of MSMEs.

Short term loans provided by informal institutions. The informal providers typically offer loans of shorter term than the formal providers. The term of these loans is 1-2 months and the interest rate is usually charged per month or simply on the sum borrowed. The interest rate charged by VSLAs isless than informal moneylenders and these two institutions tend to target slightly different credit needs. The informal moneylenders are typically used in the event of an emergency when customers need cash immediately whereas VSLAs usually distribute cash once a month. Therefore, credit from VSLAs is more often used for less immediate needs such as investment in micro businesses or farming inputs.

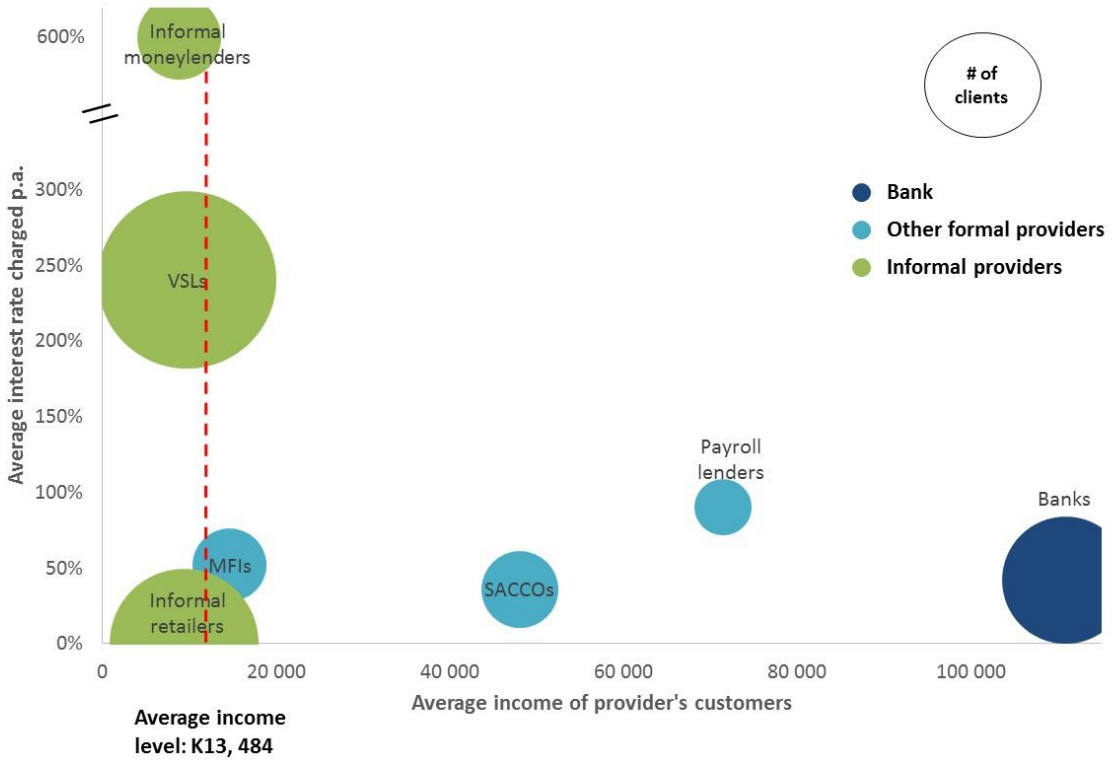


Figure 57: Credit providers by average interest rate charged, average income of clients and number of clients served

Source: Authors' own based on In-country consultations, 2014; Standard Bank Limited, 2013; National Bank of Malawi, 2013; First Merchant Bank, 2013; NBS Bank, 2013; Malawi Savings Bank, 2013; FDH Bank, 2013; Nedbank, 2013; Indebank, 2013; Ecobank Malawi, 2013; FinScope, 2014

Non-performing loans vary between and within providers. Figure 58 (NPL figure) below shows the relative NPLs of different types of formal providers. The NPLs reported by the banks are substantially higher than those reported by the other types of formal institutions, although they vary significantly between banks. This is likely due to a combination of product design and reporting.

Product design drivers of NPLs:

- The vast majority of bank credit is targeted towards larger corporate entities. The macroeconomic issues of the last 2-3 years have constrained the growth of the private sector, reducing their ability to repay bank loans. Furthermore, many of the banks' loan books are dominated by only a handful of major clients and hence, if just a few of these are unable to repay, as has been the case for many in recent years, the NPL ratio is substantially affected.

- The payroll lenders are guaranteed repayment of their loans for as long as their client continues to be employed, because repayments are automatically deducted from their salary payments. Hence, the NPLs of payroll lenders would be expected to be very low, as the only time their loans would be unpaid is when a client loses their job or in the event of the government not making payment.

- The MFIs rely heavily on group loans, with these constituting the majority of loans distributed. The NPLs of these type of loans are consistently lower than for individual loans in Malawi, with

the theory being that the peer pressure of other group members force full repayment. However, even if some members do not repay, the group as a whole stands liability for the loan and hence the provider can often achieve repayment for the non-paying individuals' portion from the remainder of the group.

- SACCOs require substantial collateral in the form of savings for all loans. This serves as security against non-repayment, but also limits the size of the loan ensuring the members are more likely to be able to repay the loan. Loanees, as members and shareholders of the SACCO, also have more of an incentive to repay the loans as they benefit from any profit earned by the SACCO.

- Many SACCOs struggle with a shortage of appropriate skills amongst members who can properly run and manage the SACCO (Genesis, 2013). This may lead to an underestimation of the true value of loans in arrears as the processes are not efficiently managed. Indeed, many SACCOs remain paper-based.

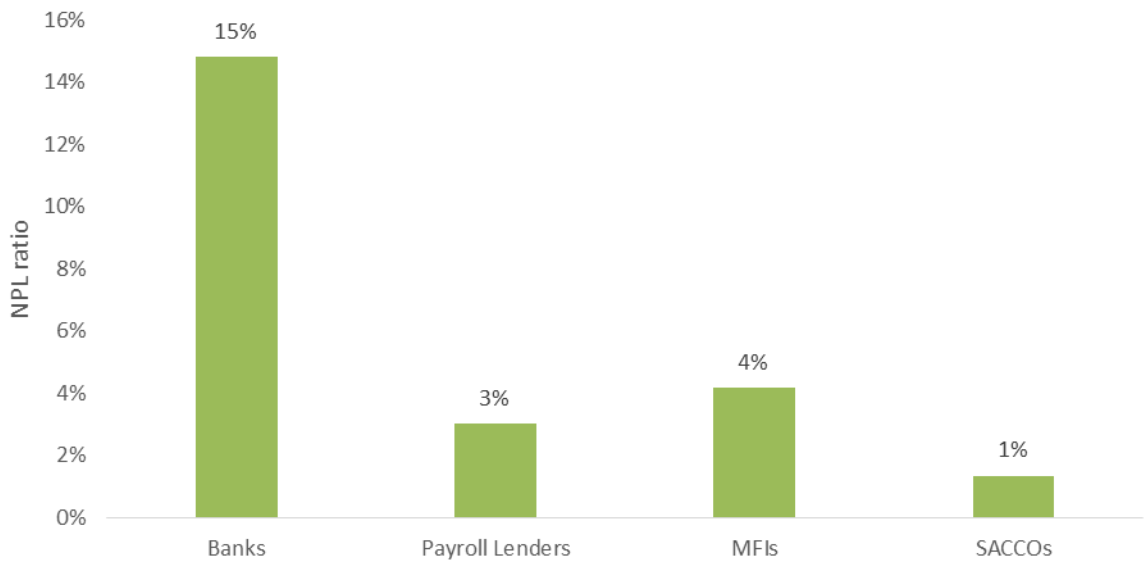


Figure 58: Average NPL ratios of formal credit providers

Source: Authors' own based on In-country consultations, 2014; Standard Bank Limited, 2013; National Bank of Malawi, 2013; First Merchant Bank, 2013; NBS Bank, 2013; Malawi Savings Bank, 2013; FDH Bank, 2013; Nedbank, 2013; Indebank, 2013; Ecobank Malawi, 2013.

6.1.3.1. Banks

Banking business in Malawi is defined in the Banking Act of 2009 as:

"the business of receiving deposits or deposit substitutes from the public that are –

(a) Payable, with or without, interest, on demand, or after the expiration of a stated period; and

(b) *Transferable by cheque or other means."*

This is a strict definition of banking business as it includes all deposit taking institutions rather than restricting banking business to only institutions that intermediate deposits. MNOs offering mobile money products and deposit taking MFIs will both fall under this definition of banking business and have to be explicitly exempted in legislation pertaining directly to them.

Many banks but market dominated by big 2 in terms of assets. There are a large number of banks in the Malawi market, although, as shown in figure below, the largest two (National bank and Standard Bank) account for 45% of the value of the total loan book. Conversely, the smallest 5 banks only constitute 15% of the market.

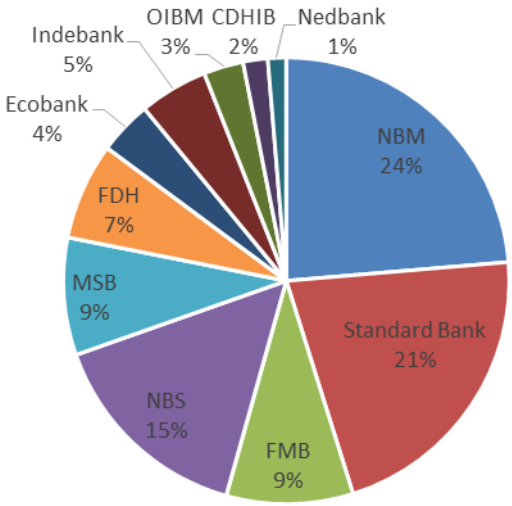


Figure 59: Market share of individual banks by value of loan book

Source: RBM, 2014

OIBM dominates by client numbers. Whereas National Bank and Standard Bank are substantially larger than the other banks in terms of both loan book and assets, the rank as only the 5th and 6th largest banks, respectively, in terms of clients. OIBM accounts for the largest proportion of customers followed by Malawi Savings Bank. Both of these follow a strategy to extend access to banking services to the unbanked and hence have the most clients but relatively lower average loan sizes and deposit values. In contrast, National Bank and Standard Bank both have a larger focus on serving corporates and high net worth individuals and therefore the average value of their loans and deposits are substantially higher.

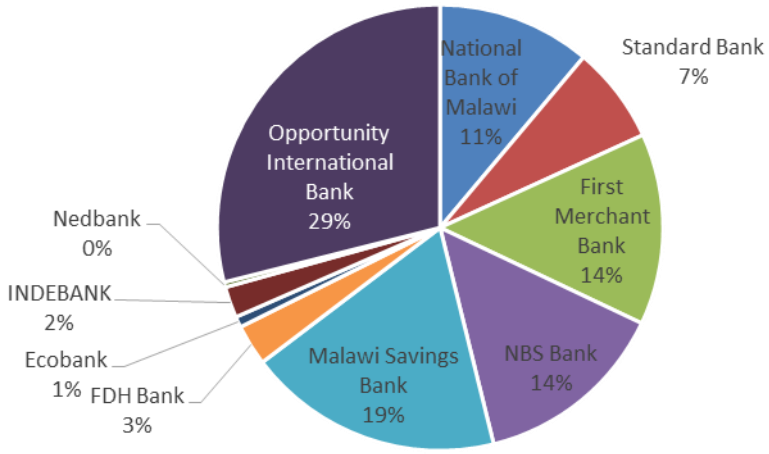


Figure 60: Market share of banks by number of customers

Source: In-country consultations, 2014.

Profitability differs widely. The profitability recorded by the banks ranges from National Bank, Standard Bank and FMB which recorded profitability ratios of 32%, 31% and 31% respectively to MSB and Nedbank which recorded a profitability ratio of 4% and a loss of 1% respectively. The larger banks are highly profitable but the remainder of the banks are struggling. This is indicated by the loss recorded by Nedbank in 2013 whilst International Commercial bank was acquired by FMB in 2013 after it was unable to meet the minimum regulatory capital and other liquidity requirements (CFTC, 2013). At two other banks have also struggled to meet minimum regulatory capital and liquidity requirements.

Operating efficiency varies significantly between banks. NBM and Standard Bank have the highest average staff cost, but also the highest revenue per staff. This indicates that in a market of constrained skills they have captured the majority of those skills by offering relatively higher wages than the other banks, and as a result have employees that are more efficient and productive. Ecobank is likely able to be more efficient than other small banks, because it is able to leverage off the skills and technology of its parent company.

Funding expensive for banks. The high cost of raising capital domestically, the high interest rates charged on interbank loans and the variability of exchange rates means that raising deposits is the only affordable channel of raising capital for banks. This competition for deposits has led to a reduction in bank charges (i.e. monthly service fees and cash deposit and withdrawal fees) of basic bank accounts although the interest paid on these accounts is often very low and encouraged some banks to target lower income consumers to garner their deposits. However, it also increases competition for the deposits of large depositors, particularly corporates with the implication that the level of interest paid to corporate account holders is typically significantly higher than to individuals.

NPLs high for banks. The average NPL ratio for the banks is 14.8%, which is relatively high. The average is driven up by a couple of banks with exceedingly high NPLs. The weighted average across the sector is 15%, meaning that 15% of the total value of loans extended by banks are not performing. Three banks have NPLs exceeding 20%, with the highest nearly 50%. Five banks have NPLs below 10%.

Credit led revenue model. Figure 61 shows that interest revenue contributes 51% to the banking sector's total revenue. In contrast, fees and commissions contribute only 5% of total revenue.

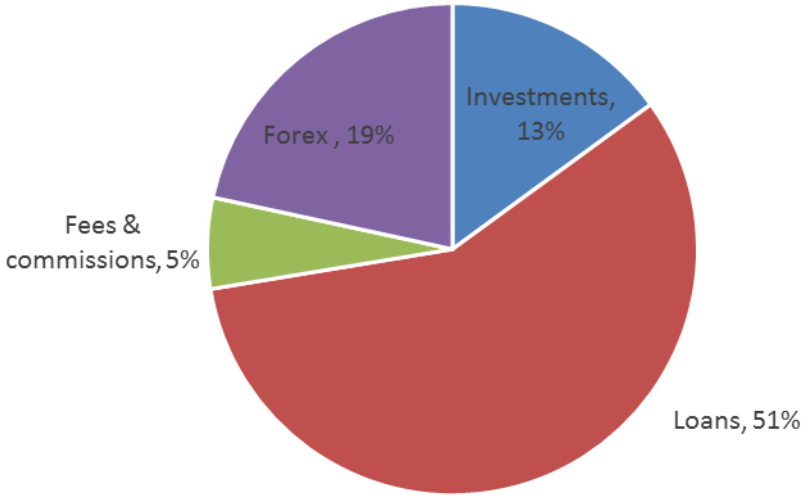


Figure 61: Breakdown of banking sector revenue

Source: RBM, 2014

FOREX revenue constitutes an unusually high proportion of banks' revenue. Figure 61 also shows that the banks earn an unusually large proportion of their revenue from foreign exchange – 19% of revenue across the sector. This opportunity arises due to the frequent and major fluctuations in the exchange rate which allows them to trade the currency at a profit. The foreign exchange shortages within Malawi also increases the foreign exchange spread and enable the banks to earn greater income on exchanging currency.

Mix of foreign and locally owned banks. Of the 11 operating banks in Malawi, 7 have majority domestic ownership whilst the other 4 are majority foreign owned. The ownership structure has an important bearing on the incentives and actions of the banks. Some foreign banks have an explicit mandate to serve foreign customers' interests. Foreign owned banks are also answerable to the group's oversight and externally set KPIs (Key Performance Indicators[86]). Foreign banks are also frequently able to leverage the group's infrastructure, enabling economies of scale and requiring reduced investment locally thereby operating more efficiently.

Figure 62 below shows the relative cost and productivity of staff across the different banks. The figure shows that the biggest banks have the highest average costs per staff member, but also the highest productivity per staff member. This suggests that in an environment of limited skills, the largest banks secure these skills by paying higher salaries, but are more productive as a result.

[86] KPIs are a set of measures that a company uses to gauge or compare performance in terms of meeting their strategic and operational goals

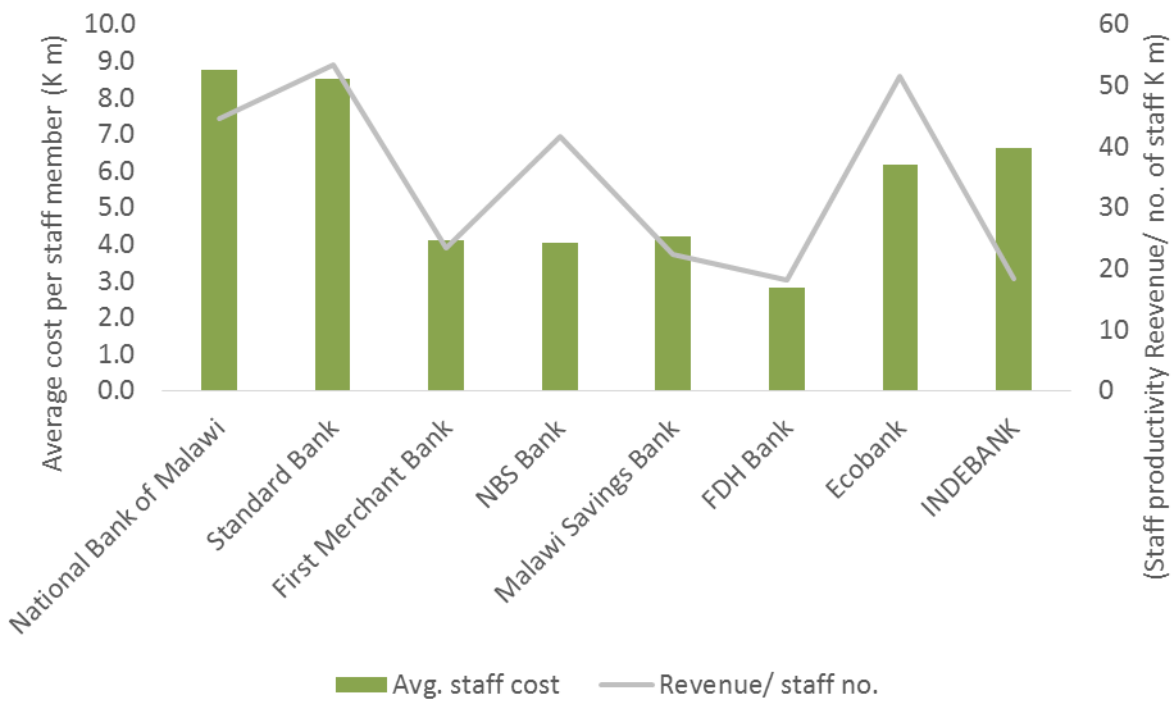


Figure 62: Average staff cost and staff productivity across Malawi banks

Source: In-country consultations, 2014; Standard Bank Limited, 2013; National Bank of Malawi, 2013; First Merchant Bank, 2013; NBS Bank, 2013; Malawi Savings Bank, 2013; FDH Bank, 2013; Nedbank, 2013; Indebank, 2013; Ecobank Malawi, 2013.

Bank credit clients male, wealthy, relatively urban and well-educated. The bank credit clients are relatively more urban than the overall population: An adult living in an urban area is 2.1 times as likely as an adult living in a rural area to have credit from a bank. Adults with credit from a bank are also more likely to be male (62%) and their average income is K 110,000 – 8 times higher than the average. Bank credit clients are also relatively better educated than the overall population with bank clients 13 times more likely to have tertiary education than the general population.

MSMEs and farmers the primary beneficiaries of bank credit. MSMEs is the target market that accounts for the largest portion of bank credit clients (41%), with farmers second (32%). The high proportion of farmers that make up total bank credit clients is due to the size of the target market despite relative low penetration, as shown in section 6.1.1.

Distribution points primarily limited to urban areas. Bank loans are primarily distributed through bank branches. In Malawi, there are a total of 257 bank branches and, as discussed in section 5.2.2.1, these are almost entirely situated in the major urban areas. The majority of adults that live in rural areas would therefore be required to travel long distances to access a bank branch.

Bank strategies differ. The result of this skewed market is that although there are a large number of banks in the market, this does not necessarily mean that they are all competing with each other. It is possible to place the different banks into four separate clusters based on size and incentives:

Cluster 1 consists of the big 2 banks: NBM and Standard Bank. These two banks dominate the market and primarily compete with each other. Although some of the mid to smaller banks may attempt to

compete for customers, these two banks appear to have secured the majority of the major corporate and high net worth clients between them. These two banks are highly profitable.

Cluster 2 consists of the 2nd tier banks, including FMB, NBS, FDH, Indebank and CDHIB. This is the most diverse of the clusters. 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. With the exception of FMB (which has a very specific business model), these banks are not very profitable compared with the big 2.

Cluster 3 consists of those banks with more of a developmental focus: MSB and OIBM. MSB as a wholly 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. As a result, between them these two banks service the largest number of individual loans provided by banks, despite accounting for only a small portion of the loan book.

Cluster 4 consists of those banks which are wholly owned subsidiaries of foreign banks including Ecobank and Nedbank. Although Nedbank has recently begun to adapt its strategy to service a wider audience, these banks' primary focus is on servicing the needs of their foreign clients with business interests inside Malawi.

Banks in cluster 1 therefore have the greatest ability to serve the lower end of the market: boasting the most extensive distribution infrastructure, the most efficient systems and a greater capacity to cross-subsidise less profitable clients. However, given how profitable and comfortable their current position is, there is limited incentive, at least in the immediate term, for these banks to move substantially downmarket. Conversely, cluster 3 has the greatest willingness to serve the lower income market, and are the banks doing this to the greatest extent, but their relatively small size, inefficiencies and lack of higher income and corporate customers means they struggle to remain profitable over time and are vulnerable to macroeconomic shocks.

Partnerships provide potential for banks to serve more customers. Partnerships with aggregators allows banks to more cost-effectively serve additional groups of clients they may otherwise be unable to reach. A number of the banks have partnered with the mobile money provided to allow the transfer of funds between mobile money and bank accounts (discussed in section 6.2). Allowing loan repayments through mobile money makes it easier for consumers not residing close to the bank to repay. OIBM, for example, also partnered with CARE to provide loans to VSLAs which then disbursed the funds through the existing structures. Whilst these loans had a number of issues concerning provision, the repayment rate of 94% suggests that this may be a viable model for credit provision. Thailand's Village Funds present an existing example of the effect of funnelling credit through local community savings groups (see Box 12 below). Although in the Thailand case the funding is provided by the State, the high repayment rates suggest that commercial providers may also viably serve customers through this channel.

Box 12. The typical operating model of Village Saving Banks in Thailand

The National Village and Urban Community Fund was established in Thailand in 2001. The initiative provided one million Baht to each of Thailand's approximately 80,000 villages. The National Village and Urban Community Fund Committee was established to oversee the Fund and reports directly to the Prime Minister's

office, providing guidelines on how to set up Village Funds. The Village Funds are managed by the village committee and are often staffed by leading members of other community based financing initiatives such as Sajjas[87]. Each Village Fund must open an account with BAAC, GSB or KTB to access seed money and further financing and each Village Fund member has to open an account with the same institutions. As of August 2012, there were 79,255 Village and Urban Community Funds with THB 162 billion (in outstanding loans) and nearly 13 million members. 32% of the population that are currently borrowing are borrowing principally from the Village Fund.

Within the guidelines set up by National Village and Urban Community Fund, the individual village committees can set interest rates, maximum loan amounts and the terms of the loans. Interest rates for loans are subject to the general 15% interest rate cap, but are usually set around 6% per annum. Borrowers must have an income-generating project in order to borrow up to the normal limit of THB 20,000, but can get higher amounts if they meet a more rigorous standard of creditworthiness. Emergency loans of THB 10,000 can be obtained without having a project. NSO's socio-economic survey data reports that over 90% of loans taken out from Village Funds are paid back in full. This is consistent with reported figures by the Village and Urban Community Fund Office and with previous studies.

Source: MAP Thailand, forthcoming

6.1.3.2. Payroll lenders

Payroll lenders provide low risk personal loans based on future salaries, largely to government employees. The largest provider of payroll loans is Blue, whilst Select and Get Bucks are also major providers. A number of much smaller providers also offer the service. Select indicated that 90% of their loans are housing finance loans.

Primarily regional businesses. The three largest payroll lenders, which account for in excess of 95% of the market, are all regional firms which provide payroll loans across a number of countries in SADC. Hence, they all follow a similar model, typically offering standard products and repayment terms. They are also substantially funded by their parent company either through loans or equity, usually via South Africa.

[87] *Sajja savings groups are community-run savings groups aimed at encouraging people to save.*

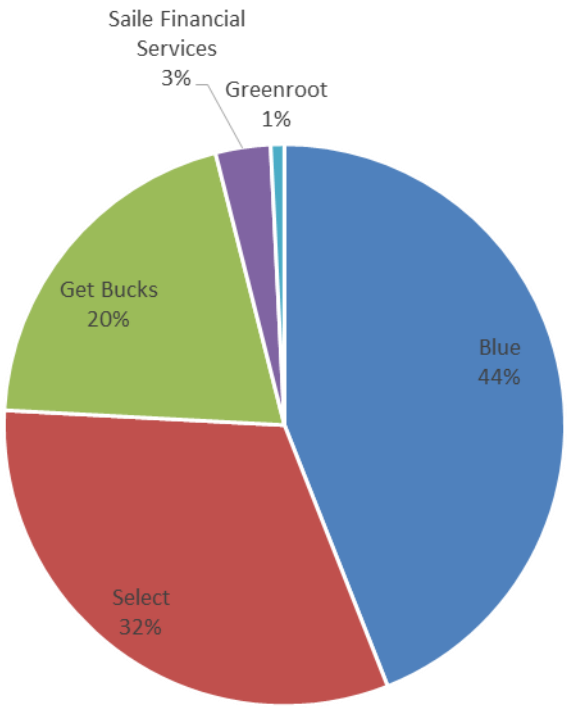


Figure 63: Market share of payroll lenders by value of loan book

Source: MAMN, 2014

Heavily reliant on government as primary payer. Whilst Government is not the direct client of the payroll lenders, they are responsible for paying the payroll lenders once the deductions have been made from the government employees' salaries. Government is frequently late on its payments to the payroll lenders. This constitutes the greatest risk to these institutions.

Payment Solutions acts as intermediary to deduct repayments. Payment Solutions acts as the technical intermediary between the Government and the payroll lenders. It tracks all loans provided by the payroll lenders to government employees, as this information is submitted by the lenders. Payment Solutions then automatically deducts the repayment from the loanee's salary. However, Payment Solutions tracks the deductions and calculates the net payment due to each lender. The Government then pays this amount directly to the lender. The Payment Solutions system also doubles as a rudimentary credit bureau. Lenders are unable to extend loans through the system to government employees for whom the repayments of that loan would result in more than 50% of their salary being deducted, as per the Employment Act.

Size of potential market capped by strategy and lack of large employers. The payroll lenders' limited focus on government employees means that their potential market is limited by the number of civil servants, currently 170,000. The number of clients from which credit repayments are deducted (i.e. the payroll lenders, SACCOs and one bank) initially increased, but have remained fairly constant over the last two years at 50,000 deductions per month. Savings contributions for SACCOs and insurance premiums, which can also be deducted through the Payment Solutions system, are increasing in number.

NPLs low for these institutions. The NPL ratios of these institutions are very low, comfortably below 5%. There is very low risk of non-repayment by customers due to the automatic payroll deductions.

The only real risk arises when a customer loses their job. A far bigger risk is the late payment of funds owing to them by Government.

Given the prevalence of starting your own business as an aspiration for Malawians, discussed in 4.1.1, it is likely that some payroll loans are used to finance small businesses. It is not clear how prevalent this is, but salaried employees that require a second source of income or that are about to retire and require an alternative source of income may use payroll loans to finance small businesses. An illustration of this is that MARDEF, the State owned MFI, developed a MSME development loan product targeted at salaried employees.

6.1.3.3. MFIs

Both payroll lenders and MFIs operate under the Malawi Microfinance Act. However, the scope and focus of the operations of these two groups means they operate with entirely different business models and targeting completely different markets. Where the payroll lenders offer personal loans to individual government employees, the MFIs offer loans to MSMEs.

Finca is the largest operating MFI. Figure 64 below illustrates the market share by customers of each the different MFIs. Finca accounts for 45% of MFI customers and 64% of the loan value. Microloan Foundation and Vision Fund are the other large operating MFIs. The State-owned MFI – MARDEF, reportedly had as many as 250,000 clients, more than 5 times as many as Finca currently has, however they are not currently extending loans and have not done so for more than a year (In-country consultations, 2014).

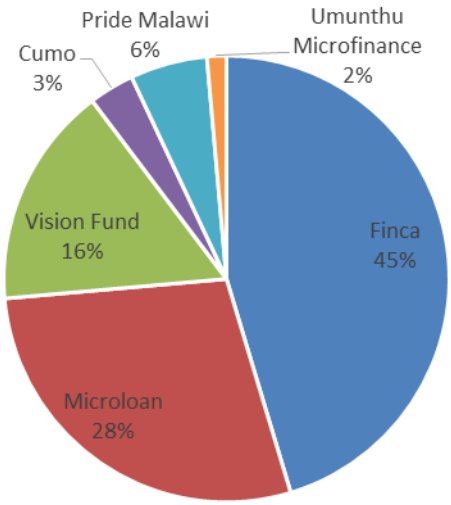


Figure 64: MFI market share by customers

Source: MAMN, 2014

Some MFIs require and provide training upon receipt of MSME loan. All MARDEF loans were provided with 2 days of business training, although due to funding constraints these training courses fell behind schedule. CUMO offers Entrepreneurship training in partnership with MEDI (Malawi Enterprises Development Institute) and Microloan foundation also provides training and mentoring to clients. In many cases the loan officers of the MFIs also provide ongoing training and mentoring to their loan clients. SMEDI, a recent amalgamation of the Small Enterprise Development Organisation (SEDOM),

the Development of Malawian Enterprises Trust (DEMAT) and the Medium Enterprise Development Institute (MEDI), is now mandated with acting as the apex MSME training body and will be responsible for licensing trainings.

MFIs main providers of MSME credit. The MFIs are funded by either donor organisations or government enabling them to offer loans to MSMEs at subsidised rates. The interest rates charged by the MFIs are generally comparable to the banks – 35-70% per annum but target substantially more risky loan clients. The MFIs are the largest providers of credit to MSMEs in Malawi with 98,314 clients. The average loan extended by MFIs is K 60,490 (USD 145). The result is that the cost of administering their loan book is relatively expensive compared to the revenues earned from the loans and that most of the MFIs are not sustainable by themselves, but require ongoing additional capital investment.

Constrained by cost of capital. The MFIs are constrained in their potential for growth due to the cost of accessing capital from the open market. These institutions remain operational as their funders provide capital in the form of grants or zero interest loans. Currently the cost of raising capital through either bank loans or through the capital market would not be sustainable for these institutions. The Microfinance Act includes a provision for deposit-taking MFIs and a number of MFIs are considering evolving into deposit takers. This would give them access to a cheaper source of capital and expand their product offering to their customers. However, administering deposits will also increase operating costs.

Rural focus. The MFIs primarily target MSMEs situated in rural areas, often driven by the mandate of their donor funding. Over 80% of all MFI clients are situated in rural areas (FinScope, 2014). There is also a slight skew towards females in the provision of loans by the MFIs, with 56% of MFI clients being female. This is largely due to some individual MFIs whose mandate is explicitly on women. The education levels of the MFI clients is consistent with the overall population education levels.

The MFIs are able to serve a primarily rural client base through a fairly large network of branches, many of which are situated in rural areas. In total, MFIs have a branch network of 155 branches. This is smaller than the banks, but this network is more widespread and is spread between urban and rural areas. FINCA, for example, has 22 service outlets, with one in each district of the country, ensuring a broad reach for the provider. The MFIs also make use of 487 roaming loan officers to monitor the loans that have been extended. Some of these loan officers are also responsible for finding new clients (although they cannot originate loans) and for collecting repayments. Innovative solutions have been tried at various MFIs to more effectively and efficiently service their loans. For example, motorcycles, which can travel off road, have been provided to loan officers to overcome the lack of infrastructure. Partnerships with MNOs to enable repayments of loans through mobile money have also been launched. The use of new technology, such as iPads, on which loan officers can update the status of loans electronically, can pinpoint the GPS coordinates of clients and which automatically update to a central server when online have also been explored.

Low NPLs. The average reported NPL ratio of the MFIs, excluding MARDEF, is low at about 4%,with the portfolio at risk after 30 days also low at 7.5%. This either suggest that loan repayments to these institutions are very good or that non-performing loans are frequently rolled over to keep the NPL ratio low.

6.1.3.4. SACCOs

SACCOs provide 10-15% of formal loans. Compared to the other formal providers of credit, there are a fairly large number of SACCOs, with 48 registered with MUSCCO. In total SACCOs in Malawi have a membership of 110,000, with an average of 2,290 members per SACCO. SACCO membership is primarily restricted to salaried employees. SACCOs are situated in both urban and rural areas and are often formed based on employment as a common bond, such as the teachers SACCO. There are also some farming SACCOs made up of low income subsistence farmers such as in the villages surrounding the towns of Salima and Mangochi (Genesis, 2013).

Cooperative structure determines behaviour. As the SACCOs are owned by their members they do not have a profit motive, which allows for smaller interest spreads. This also creates a greater incentive for members to repay their loans as all members benefit from any profits made by the SACCO. The cooperative structure also entails societal benefits as members value belonging to a community organisation from which they can get advice and support.

Automatic deductions used. Many of the SACCOs, like the payroll lenders, make use of the Payment Solutions system to make automatic deductions for loan repayments, savings contributions and membership fees of government employees. For other members, these payments may be made by bank EFT, cheque or cash.

Governance a challenge for SACCOs. Poor governance has been identified as a significant challenge due to the lack of appropriate skills and systems. There is a skills shortage nationally and those people with suitable qualifications are not willing to relocate to remote rural areas where SACCOs are situated. Further, SACCOs are also often not able to afford appropriately skilled staff. Training is provided to elected board members on the management of financial co-operatives. However, board members can only be elected for a maximum of two consecutive terms of 3 years each. This means that once they have gained the experience required to work within the SACCO environment, they are obliged to step down, reducing the SACCO's ability to capitalise on this knowledge gain (Genesis, 2013). The lack of skilled management also contributes to SACCOs' very high operating expenditure, calculated at 82% (MUSCCO, 2015).

Manual systems a constraint. One of the problems impeding the progress of SACCOs in Malawi is the manual systems that are still being used by many of the organisations. In an attempt to computerise the day-to-day running of SACCOs, MUSCCO bought a new system with 39 software licenses in 2009. However, the cost of activation has been too high and many SACCOs have not yet implemented these systems.

MUSCCO the apex organisation for SACCOs. SACCOs become members of MUSCCO by contributing share capital to the organisation. Member SACCOs are divided into 3 chapters representing each of the three regions of Malawi (Northern, Central and Southern regions). Each of these regional chapters elects representatives to participate in the MUSCCO General Assembly Meeting and the board members of MUSCCO, which is made up of 5 directors and 3 external technical members.

Four main services are offered by MUSCCO, including:

- **Finance** - MUSCCO provides finance through its Central Financial Facility (CFF), which extends liquidity management services and short-term financing to SACCOs in times of trouble. The CFF also operates as a financial institution for SACCOs where they are able to invest and borrow at

favourable rates. All member SACCOs are obligated to invest 10% and 15% of their share capital and deposits respectively in the CFF.

- **Operations** - MUSCCO plays the role of technical assistant to member SACCOs, providing them with services that help in enhancing the day-to-day operations of the organisations. These technical services include: auditing, business planning and budgeting, training of staff and board members, community relations, design of programmes and member education.

- **ICT support services and technology transfer** - the apex provides ICT specific services to assist SACCOs with the transition from manual to computerised systems.

- **Auditing and supervision** - the introduction of the Co-operative Societies Act of 1998, saw the Registrar of Co-operatives delegating its responsibility of auditing and inspecting of all SACCOs to MUSCCO. Moreover, since the supervision and inspection of SACCOs has migrated to the Central Bank under the Financial Co-operative Act of 2011, MUSCCO was given a mandate to supervise all small SACCOs with less than MK 75 million[88] (USD 18,000).

6.1.3.5. Agricultural dealers and retailers

Input financing beneficial for both farmers and agricultural buyers. Input financing is typically provided to farmers by the end buyer of the produce through contract farming agreements. In cases where it can be assured that farmers will sell to a given buyer –most often in tight value chains (see section 5.2.2.2) – the end buyer can, either directly or in partnership with a financial service provider, effectively provide the farmer with credit to purchase inputs.[89] This is a fairly low risk loan provided the farmer can be relied on to sell to the lender, because the repayment can be automatically deducted from the produce returns. Furthermore, it benefits both parties by helping the farmer to increase productivity, as well as have the certainty of their future income flow. In Malawi, widespread side selling of agricultural products in loose value chains increases the risk of entering into a contract farming arrangements and disrupts the opportunity to make use of the credit access opportunities that come with it. This means that if the final buyer in these value chains were to extend input credit to those individuals from whom they buy, it would mostly be to the intermediate traders and not directly to the farmers who most require cost effective options.

Malawian loose value chains victims of side selling. Due to the poor infrastructure in Malawi, a value chain arrangement of multiple, intermediate traders has emerged for some crops that, while seeming to add unnecessary cost, it may actually be efficient. Reason being that the challenges in transporting the produce from the rural farms to the mostly urban buyers are undertaken by traders specialising in the transport of these goods and who have the appropriate capital (i.e. access to trucks or similar). Furthermore, these traders play an intermediate aggregation role. The small size of many Malawian farms means that even an entire season's produce may be too small for a major agricultural buyer to efficiently process. This intermediation role has its own bridging financing needs for those that buy up produce to sell through the commodity exchanges that the exchanges are providing for in the form of warehouse receipt financing (see section 5.2.1). However, these long value chains make it unfeasible to cut out the middlemen and extend credit through contract farming agreements to farmers.

[88] Genesis. 2013. Understanding financial co-operatives: South Africa, Malawi and Swaziland

[89] In some arrangements the buyer will take on the credit and directly provide the farmer with inputs in order to ensure the funding is used for its intended purpose.

Outgrowers the largest providers of agricultural loans in Malawi. FinScope (2014) indicates that 52,000 Malawian adults currently have credit through outgrower schemes, although this will vary according to season. This means that outgrowers constitute the largest providers of loans (by number) to farmers, even though it is a relatively small proportion of total farmers.

Tobacco the primary recipient of credit. Outgrower schemes exist in Malawi for sugar, tea, cotton, coffee, tobacco and horticulture crops. These are considered 'tight' value chains in Malawi making them conducive for credit to be provided to the respective farmers. The largest of these crops is tobacco. Tobacco farmers do receive input credit from a variety of providers, including the banks. The tobacco farmers are lucrative clients due to the value of the crop and the fact that their earnings are priced in dollars, creating an additional opportunity for buyers to earn revenue from the currency conversion. In Malawi there are only four buyers of tobacco[90]. These buyers also provide farmers with input financing through contract farming agreements as illustrated in the quotation below:

> ***"In farming, there are a lot of things that are needed like tobacco needs fertiliser. How do you buy your fertiliser? Do you save your money for it?***
>
> *I buy some and some I get it from the club*
>
> ***What club?***
>
> *Alliance*
>
> ***Okay, what else do they give you?***
>
> *They give us a plastic for shading, on fertiliser they give us two bags for maize too and they also give some money (respondent talking to another person) for the workers and that you can also use it for food. They also give us fertiliser, pesticides and everything needed for the nursery."*
>
> Farmer, female, 60 years of age

Cotton a potential area for input finance growth. Cotton is farmed by more than 350,000 farmers (FinScope, 2014) in Malawi and operates in a tight value chain, with cotton ginners both processing and buying all cotton produced. As discussed in section 5.2.2, financing can therefore potentially be provided through outgrower agreements with producer associations or directly with ginners.

6.1.3.6. Informal credit providers

Informal provision largest source of credit after family and friends. The largest portion of credit users in Malawi receive credit from informal providers, as discussed in section 6.1.1 and highlighted below in Figure 65. The greatest source of informal credit is from VSLAs or similar informal savings and credit groups. Informal moneylenders, or *Katapilas,* also provide informal credit, whilst informal retailers and businesses may provide goods or services on credit albeit usually on an *ad hoc* basis.

[90] The largest buyer is Limbe Leaf Tobacco Company Limited taking over 50 percent of the tobacco on the Auction Floors. Alliance One buys between 30 and 40 percent of the Tobacco. Africa Leaf buys about eight percent and RWJ Wallace buys less than one percent (IDE-JETRO, 2015).

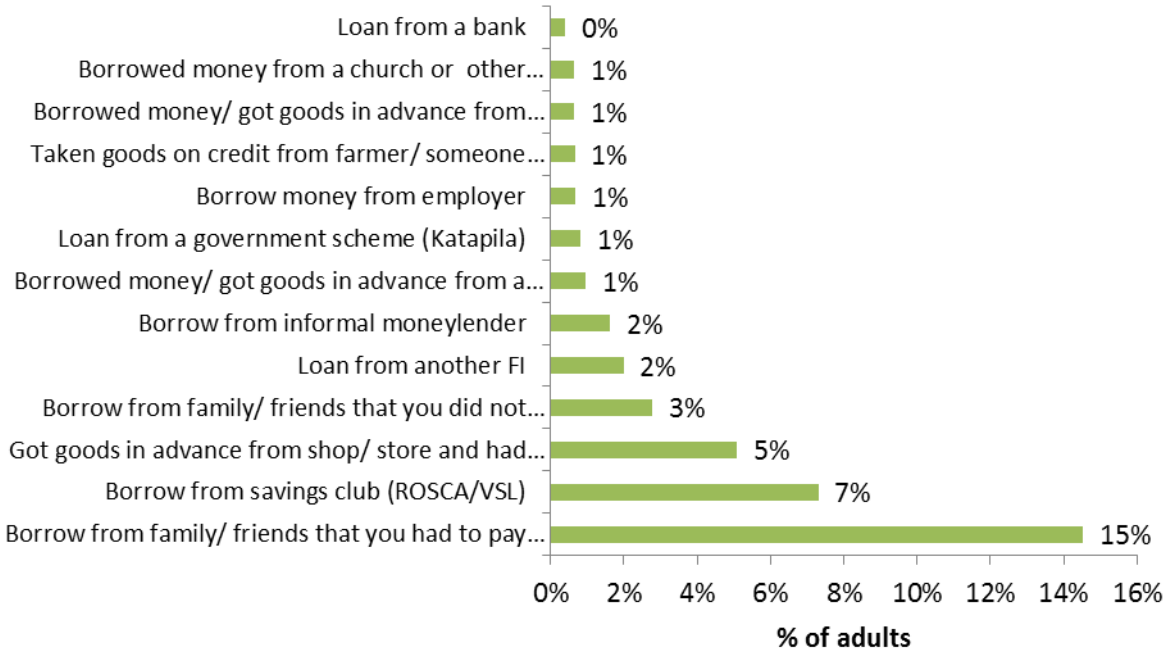


Figure 65: Source of loans by Malawi adults

Source: FinScope, 2014

Informal loans small in value. The total value of informal loans is relatively small compared to the major formal providers. The total loan book of VSLAs and other savings and loan groups is estimated at about K5 billion, approximately 2% of the banks' total loan book, with an average loan size of about K 8,000.

VSLA's play key role in credit. Figure 48 illustrates that community based groups like VSLAs are the largest source of informal credit for Malawians. The figure also shows the dramatic increase in the use of these groups between 2008 and 2014. This increase can be primarily attributed to the work of donor organisations such as CARE, which have established these VSLAs in Malawian communities.

CARE calculates that they have established 9,161 number of VSLAs with 164,758 members. A number of other organisations have also aided the establishment of similar groups to a lesser degree. However, there is also evidence that these groups have been self-replicating with communities copying the methodology and creating similar groups themselves. Per FinScope (2014) over 1 million Malawians belong to or have accessed credit from VSLAs.

The VSLAs' operations are discussed in box below:

Box 13. How VSLAs operate

VSLAs are typically made up of 15-30 members, who meet on a regular basis, most commonly weekly. Members make savings contributions at each meeting. The average weekly contribution amount ranges from K 200-1000, with a K 50 contribution to an emergency fund. The joining fee is generally K 1000. This savings pool is then lent out members who must repay with interest (20% on average). This is encouraged on a monthly rotational basis. It is possible to on-lend to persons outside of the group. The qualitative research indicates that this is encouraged if the group members don't have a productive need for the loan. The interest

paid on these loans is fed back into the overall funds pool. At the end of each 10-12 month cycle the total fund is shared out between the members. The share-out is done proportionately on the basis of value of member savings contributions and the interest paid by each member.

Sources: Karlan, et al., 2012; CARE, 2013

Katapilas play limited role, speed main benefit. Perceptions of informal moneylenders are mixed with some users considering them abusive whilst others think they provide a valuable service. The greatest advantages of informal moneylenders for borrowers is the immediacy of the loan and the lack of eligibility requirements. The quotes below illustrate these different perceptions of informal moneylenders in Malawi:

> *"People prefer to come to me because they might want the money to be used for whatever soonest like today or tomorrow. But the banks' regulations may say you wait for three months before they process the loan. Then they would just say, let me go to that friend of mine to borrow money so that I solve this problem. They want instant help."*
>
> Farmer, female, 39 years old

> *"Other people who sell profitable businesses just take money from these katapilas. These borrowers are not afraid because they know that tomorrow, they will earn more money, but for someone like me, I can't take money from katapila. I feel like they are stealing my dreams to progress*."
>
> *Farmer, male, 31 years old*

> "*From my own experience money lending helps, especially in the villages where certain people have no means to overcome different obstacles, but money lender should also view what the person will use the money for. As in my case for example, I took money from a money lender for a good cause that I was very specific about. Whereas some people would take a loan for four bags of fertiliser and only buy two, and eventually fails to pay back the loan.*"
>
> Salaried employee, male, 42 years old

Informal retailer credit widely available. The MSME FinScope (2012) indicates that the majority of MSMEs offer goods and services on credit to their clients, although these are primarily provided on an *ad hoc* basis rather than as a standard arrangement. Figure 66 below shows that 55% of MSMEs provide goods and services on credit, but only 6% of them do so as standard service.

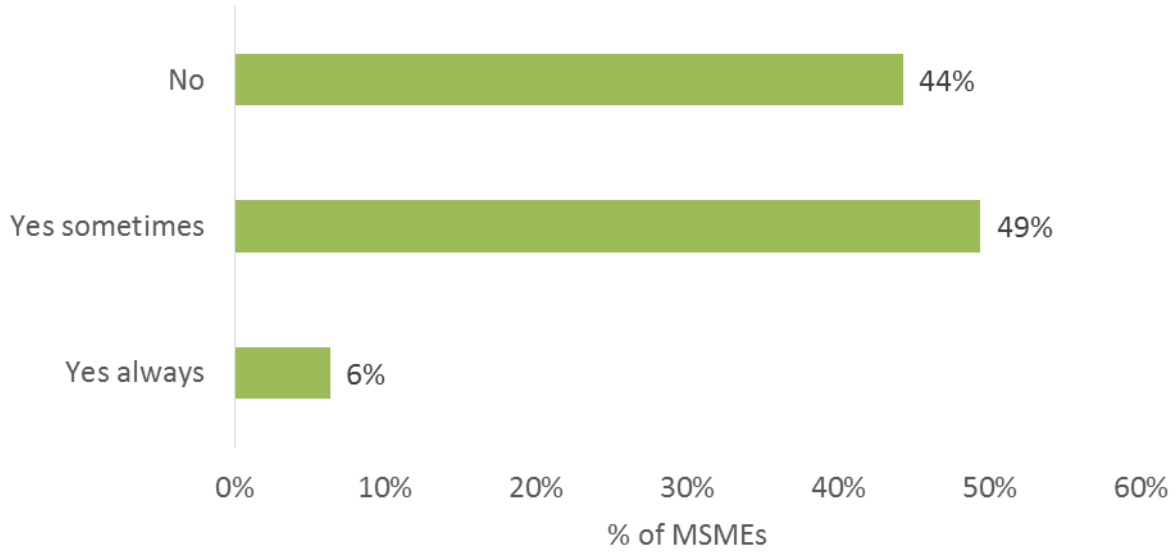


Figure 66: MSMEs that offer goods or services on credit

Source: FinScope MSME, 2012

6.1.4. Products

Linking providers with products. Table 16 below shows which products are provided by which providers. The table shows that the majority of providers offer personal loans, but that there are limited options for more specifically structured loans. Both farmers and MSMEs also use personal loans from the various providers to fund their operations However, these products are not specifically designed for these purposes and hence is sub-optimal. This is particularly the case for asset purchases. Asset backed loans are structured so that the asset purchased acts as collateral against the loan, thereby reducing the risk for the provider and the cost for the borrower. The lack of options for these type of loans means that MSMEs and farmers that require asset investment frequently have to pay personal loan interest rates to fund assets.

				Products			
				Personal	***Agriculture***	***MSME***	***Asset backed***
				All target markets for consumption smoothing and risk mitigation	*Primarily farmers*	*Primarily MSMEs*	*MSMEs, farmers and salaried workers*
Providers	***Banks***		*Salaried workers, tobacco farmers*	✓ 91,000 35-50% p.a.	✓ Limited to tobacco 35% - 50% p.a.	✓ 12,000 loans 35-50%	✓ 35-50% p.a.
	Payroll Lenders		*Salaried workers*	✓ 60,000 70-110% p.a.			
	MFIs		*MSMEs, limited farmers*		✓ 13,000 35-70% p.a.	✓ 82,000 35-70% p.a.	✓ Limited 35-70% p.a.
	SACCOs		*Salaried workers, some farmer SACCOs*	✓ 120, 000 members 36%			
	Agricultural dealers & retailers				✓		
	Informal	*VSLs*	*All target markets*	✓ 585,000 240% p.a.	*Loans used for farming and MSME purposes* →		
		Moneylenders	*All target markets*	✓ 130,000 600% p.a.			
		Informal retailers	*All target markets*	✓ 410,000 Goods and services			

Table 16: Providers and the products they offer, including the number of clients served and average interest rates

Source: Authors' own based on In-country consultations, 2014; Standard Bank Limited, 2013; National Bank of Malawi, 2013; First Merchant Bank, 2013; NBS Bank, 2013; Malawi Savings Bank, 2013; FDH Bank, 2013; Nedbank, 2013; Indebank, 2013; Ecobank Malawi, 2013; FinScope, 2014

Most loans are short term. Figure 67 below illustrates the proportion of different loan uses by their term. The figure clearly shows that the majority of loans are very short in terms. 55% of all loans have a term of only one month, with a further 25% a 2-3 months term. Only 4% of all loans have a term of more than a year. This is true even for loans that are typically very long term in structure. Mortgages, for example, are usually repaid over a period of more than 15 years due to the size of the sum. In Malawi only 4% of credit used to buy or build a dwelling has a term longer than 12 months. The short term of loans in Malawi is partly due to the pervasiveness of the informal sector as a provider of loans. However, even the formal providers typically only offer short-term loans due to the high interest rates which make multi-year loans unaffordable for most people.

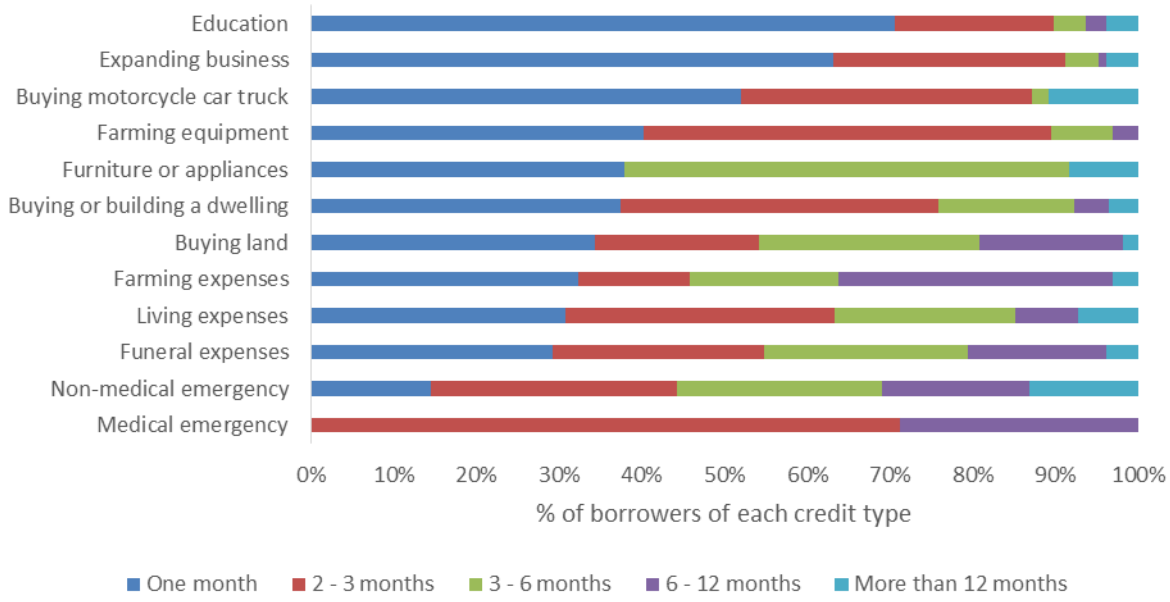


Figure 67: Length of loan term for different types of credit products

Source: FinScope, 2014

6.1.4.1. Personal loans

Personal loans are the most commonly accessed loan product across target markets. Personal loans are loans extended to individuals for no specific predetermined purpose, i.e. the individual accessing the loan can use the funds for any purpose for which they deem fit. Therefore, personal loans may be used for a variety of reasons, most commonly for consumption smoothing, but may also be used for business or farming credit, to mitigate risk, housing finance or to fund education. Personal loans are used by all target markets.

Banks, payroll lenders and SACCOs are the primary suppliers of formal personal loans. Figure 68 below shows that the total volume of personal loans is relatively equitably split between the three primary formal providers. However, banks account for the overwhelming majority of the value of personal loans to individuals in the formal sector. This illustrates the relatively higher average loan size of personal loans provided by the banks (K 420,000 (USD 1,005) compared to K 82,000 (USD 200) for payroll lenders and K 32,000 (USD 77) for the SACCOs).

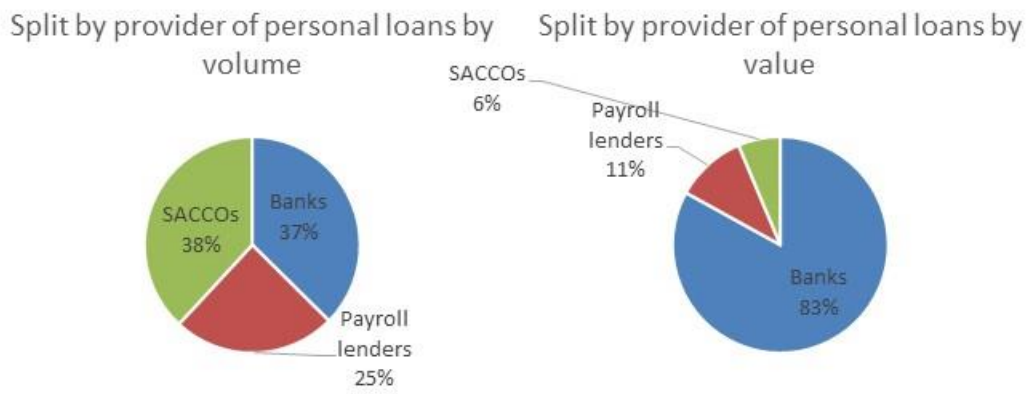


Figure 68: Proportion of personal loans provided by different formal provider types by number and by value of loans

Source: In-country consultations, 2014; Standard Bank Limited, 2013; National Bank of Malawi, 2013; First Merchant Bank, 2013; NBS Bank, 2013; Malawi Savings Bank, 2013; FDH Bank, 2013; Nedbank, 2013; Indebank, 2013; Ecobank Malawi, 2013; MAMN, 2014; RBM, 2014

Personal loans not core to bank business. Although banks are the greatest providers of individual personal credit, this is not generally their core focus and constitutes just 24% of their total loan book (RBM, 2014). The interest rates charged by banks is determined by the prevailing lending rate set by the RBM and currently ranges between 7 to 10% over base lending rates on personal loans. Although most of the banks do have payroll loans, only OIBM uses Payment Solutions for automatic deductions. The other banks require the client to have their salary paid into an account with that bank from which an internal debit order is conducted.

Payroll lenders specialise in personal loans. They offer unsecured short-term loans up to 24 months in term with values up to K 1,000,000 (USD 2,400) (Izwe, 2014). The effective interest charged on these loans ranges between 70-100% per annum on average. These charges are usually structured with a lower quoted interest rate, but a large administration fee. RBM has, however, instructed providers to clearly indicate the total effective interest rate as customers are frequently unaware of the large administration costs added to the advertised interest rate when initiating a loan.

SACCOs' loans are secured against the members' savings. The maximum loan size is typically 2-3 times the value of a members' shares and savings in the SACCO. SACCOs charge around 36% p.a. interest. Loans usually have a term of up to 24 months.

Salary deductions limited to 50%. Individuals are limited to a maximum monthly deductions of 50% of their salary. Payroll lenders and SACCOs are therefore restricted from lending to customers for whom the repayments of that loan will exceed the 50% threshold.

Very low credit card penetration. FinScope indicates that just 0.2% of Malawi adults currently have credit cards. In the past, the use of all cards was severely constrained due to the lack of a central switch and limited interoperability between banks (this is discussed in more detail in section 6.2). Hence only Visa branded credit cards were able to be used to any extent. Nat-switch (the new national switch) facilitates the potential for a greater use of card payments, however the accompanying ecosystem of POS devices will first need to be developed and extended to create a consumer use case for credit cards. Increasing access to credit cards could provide a low cost and convenient alternative to other forms of consumption smoothing for those that qualify: primarily the formally employed.

Informal loans dwarf formal loans. FinScope indicates that 586,000 adults have a loan from a savings club (VSLA or similar), 409,000 through an informal retailer (purchasing goods or services on credit) and 129,000 from an informal moneylender. IPA (2012) estimate that the median size of loans from VSLAs in Malawi may range between USD 13 (K 6,500) and USD 20 (K 10,000). Qualitative research indicates that loan size may differ substantially across groups. However, given the average savings contribution and frequency of loans, this estimate seems broadly average across all savings groups. Qualitative research conducted indicates that the average size of loans from informal moneylenders is typically lower than from savings groups. Figure 69 below illustrates the relative size of informal personal loans to formal in terms of value and volume. The number of Malawians using informal loans is substantially higher than formal loans, but by value banks still account for 75% of the personal credit extended to individuals in Malawi.

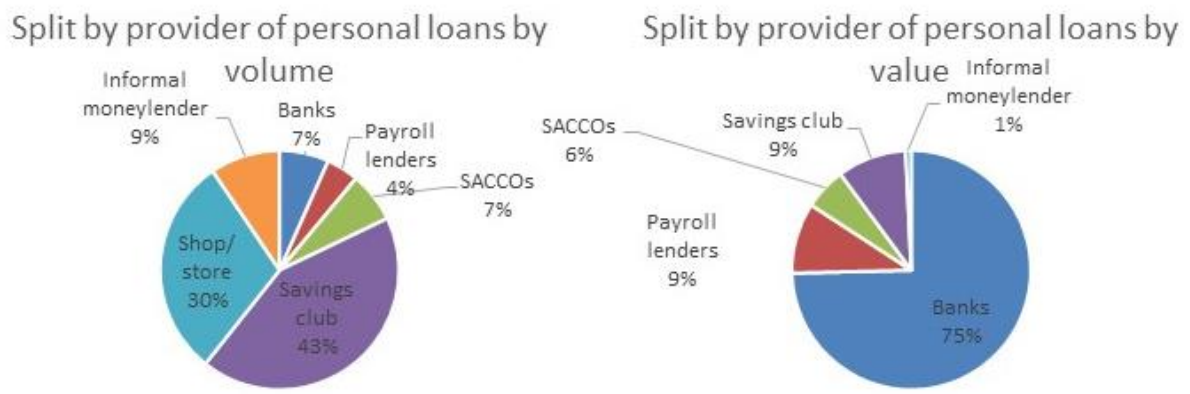


Figure 69: Proportion of personal loans provided by different formal and informal provider types by number and by value of loans

Source: : In-country consultations, 2014; Standard Bank Limited, 2013; National Bank of Malawi, 2013; First Merchant Bank, 2013; NBS Bank, 2013; Malawi Savings Bank, 2013; FDH Bank, 2013; Nedbank, 2013; Indebank, 2013; Ecobank Malawi, 2013; MAMN, 2014; RBM, 2014; FinScope, 2014

Short term, high cost of informal loans, with flexible repayment. The term of loans extended by savings groups and moneylenders is typically very short: 1-3 months with high interest rates. Qualitative research indicates that the average interest rate charged by the groups is 20% on the sum and because the term is typically 1 month, the annual interest rate is 240%. The annual interest rate charged by informal moneylenders is 600% p.a. on average, but can be as high as 1200% p.a. The quote below is an explanation of how the VSLAs operate by a VSLA member:

> *"On our group we agreed that, on every K 1,000 (USD 2.4) one is required to pay K 200 (USD 0.48), an interest of 20%. When one lends more than K 50,000 (USD 120) or K 100,000 (USD 240) he or she is allowed to pay back in two months since the amount is too huge. If it's less than that one is required to pay back within a month for instance today is 12, next month on the same date, one is supposed to pay the money back .and if one finds problems with paying the whole amount she is supposed to pay an interest but the other month you are required to pay back the whole amount."*

Salaried employee, male, 33 years old

6.1.4.2. Agricultural loans

Limited access to formal credit for most Malawian farmers. Only 1% (or 20,000) farmers have access to credit from a bank and only 4% (or 100,000) farmers use formal credit (FinScope, 2014). Credit, therefore seems to be primarily directed towards a small proportion of large commercial farming operations.

RBM reports that 21.5% of credit from banks is directed to the agriculture, forestry, fishing and hunting sector. These are almost exclusively directed towards the larger commercial enterprises, particularly to the tobacco sector. FinScope (2014) reports that, although only a small proportion of farmers have access to formal credit, due to the number of farmers in Malawi, they still account for 36% of Malawi adults with formal credit. Nevertheless, it is likely that a proportion of these are not agricultural-specific loans but rather personal or asset backed loans which may be used to fund farming activities or for something else.

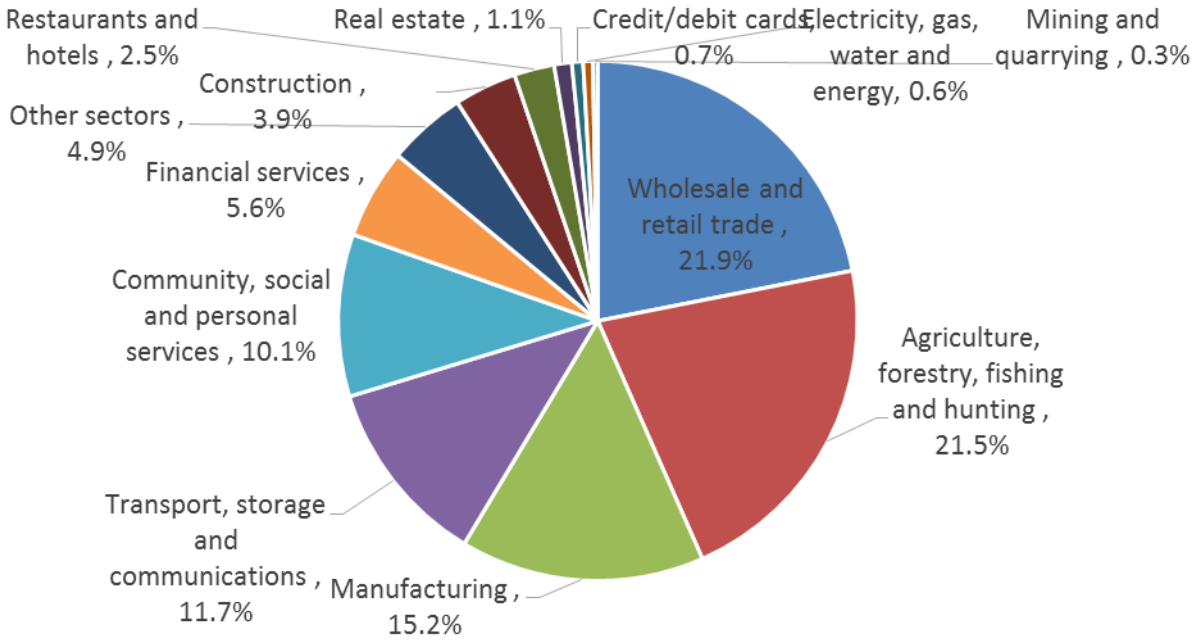


Figure 70: Bank credit by value split by receiving sectors

Source: RBM, 2014

Tobacco farmers the primary beneficiaries of formal credit. Tobacco farmers as major earners of foreign exchange in the economy and with the most developed value chain are the primary beneficiaries of formal credit in Malawi. Anecdotal evidence suggests that some banks explicitly target tobacco farmers as clients in order to gain access to the foreign exchange earned and supplement their foreign exchange revenue stream.

Box 14: Example of a tobacco loan from National Bank

- Seasonal facility made available to the agriculture sector, mainly tobacco growers to assist with the growing and marketing of the crop.

- Other commercial enterprises eligible under this facility include seed maize, tea, coffee, sugar cane and livestock producers.

- Borrowers are allowed to overdraw their current accounts against agreed cash flow projections up to an agreed seasonal limit.

- Qualified Agricultural Officers visit customers, to give advice where necessary.

- The Bank monitors proceeds of sales received from Auction Floors and other established markets. The Bank registers a Tobacco Stop Order with Auction Holdings Ltd or enters into irrevocable arrangements with produce buyers to pay sales proceeds through growers' accounts with the bank.

- Customers are usually required to put up a contribution of up to 40% of the total financing requirement from their own funds.

- Smallholder farmers with not less than 3 years experience in growing tobacco.

- Sole proprietors, mostly Malawians in the rural areas, who farm on their own land or leased land.

Source: National Bank of Malawi, 2014

Some of the MFIs provide small value loans to a minority of farmers. Certain MFIs, including MARDEF, Vision Fund and the Microloan Foundation, do offer agricultural loans. Although these constitute a very small portion of their total loans. Many of the MFIs indicated in discussion that whilst they would theoretically like to increase credit to farmers, practically, due to infrastructure constraints and the riskiness of the activity, this is not an immediate focus for them.

Commodities exchanges improve collateral. Two agricultural commodities exchanges (ACE and ACHX) have begun operating in Malawi within the last few years. Apart from providing their core service as a sales platform, bring buyers and sellers together, both also offer warehouse receipting services to farmers. Warehouse receipting entails the farmers storing their produce in an exchange owned warehouse for a fee. The farmers then receive a receipt recognising that they have have deposited produce in the warehouse. A number of banks in Malawi now recognise these receipts as collateral and will provide loans up to the value of 70% of the deposited produce backed by the receipt. The loan is then repaid when the produce in the warehouse is sold. In practice, due to minimum sizes imposed on depositors to the warehouse, this service is only available to larger farmers or more frequently traders who aggregate produce from multiple farmers and transport it to a warehouse. However, sellers that have elected to make use of this service to date have made a net loss on average with the increase in sale price during the period of storage not fully accounting for the costs of storage and the interest payments on the loan (ACE, 2015), as discussed in section 5.2.2.

Limited offtake agreements and outgrower schemes partly due to the high incidence of side-selling. Only a limited number of small-scale offtake-type arrangements appear to be in place in Malawi currently. A major barrier to setting up large scale arrangements of this type is the absence of truly closed value chains. The high incidence of traders mean that farmers will frequently sell produce to

traders at a local market rather than to one central aggregation point. This means that there is no guarantee for funders of recouping credit provided up front (as discussed in section 6.1.3.5).

6.1.4.3. MSME loans

MFIs the primary providers of MSME loans. MFIs account for more than 90% of the MSME specific loans provided in Malawi. Banks service the rest. However, the banks provide more credit by value to MSMEs with far larger average loans sizes. The primary focus for most of the banks is on the larger MSMEs, those that are classified as small and medium, rather than micro enterprises which constitute the vast bulk of MSMEs in Malawi.

Loan size and interest rates. For many banks, MSMEs' minimum loan size is K 1,000,000 (USD 2,400) or even higher. In contrast the average loan size for many MFIs is in the region of K 35,000 (USD 85) – K 40,000 (USD 96); the maximum loan size is K 1,000,000 – K 2,000,000 (USD 2,400 – USD 4,800)) for most MFIs. The interest rates charged on MSME loans vary by institution. It is partially based on the funding model, and by loan type. However, interest rates generally range from 35% - 70% per month with loan terms of usually less than 12 months. This makes loans from these institutions generally more expensive than banks (which range are usually between 35-50% p.a.), but offer a far greater number of loans of much lower value.

Group lending is highly prevalent by MFIs to MSMEs. All the MFIs offer group loan products, which constitute the vast majority of their clients (although not of their loan book as group loans are invariably lower value than individual loans). Figure 71 below indicates 45% of all MSMEs with all types of credit (i.e. including personal loans and asset-backed loans) have group loans. The NPL ratios reported by MFIs on group loans are also invariably lower than on individual loans. Only a small portion of loans extended by MFIs and banks are to start-ups, with most institutions unwilling to give credit to businesses that do not have a track record.

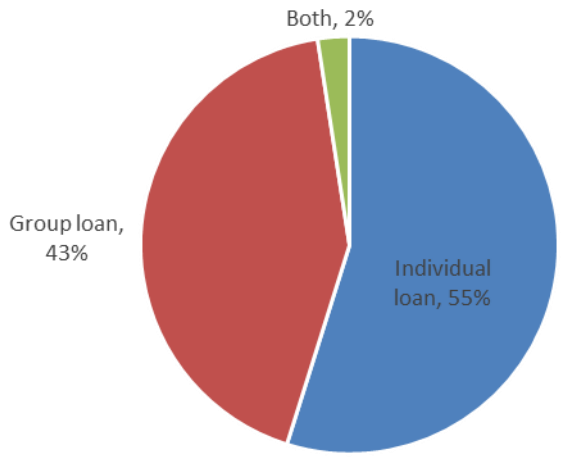


Figure 71: MSME loans split between individual and group loans

Source: FinScope MSME, 2012

Access to finance a barrier for MSME growth. Figure 72 below shows that MSMEs cite access to finance as their greatest barrier to growing their business. There may well be an inclination amongst MSMEs to consider credit a panacea to their existing challenges, whilst this is not the case, it seems clear that access to finance is a constraint to the growth of some MSMEs in Malawi. Finance can come in many

forms: equity, savings and credit and for many micro businesses savings may be the most appropriate source of finance. However, for those MSMEs with the capacity to successfully absorb credit it can be vital to stimulate growth, allowing the MSME to invest in assets and inputs it may otherwise be unable to afford.

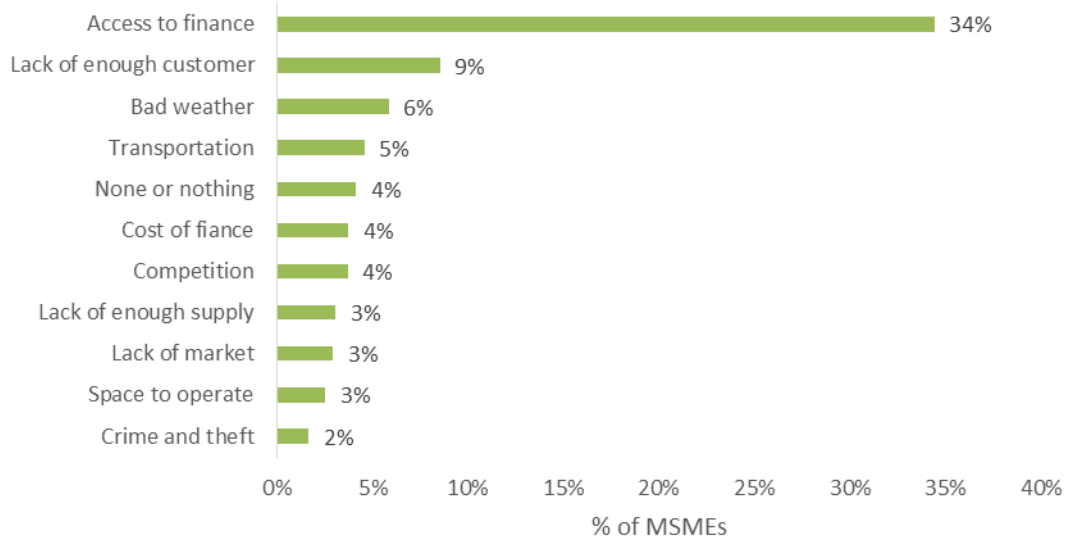


Figure 72: Constraints to growth identified by MSMEs

Source: FinScope MSME, 2012

MARDEF also offered MSME loans to government employees. This is partially motivated by the idea that civil servants may require an additional source of income to their pension following retirement. However, as the most highly educated target market, they may also represent significant opportunity to develop growing MSMEs; 8.8% of salaried employees have a secondary source of income from running a MSME.

Business registration a challenge for many MSMEs. Many MSMEs face significant challenges to formally register their businesses. Registration is done in decentralised offices in each region, although proximity to these office for rural MSMEs may remain a challenge. Only 3% of MSMEs are formally registered in Malawi (FinScope MSME, 2012). This poses a problem to accessing credit from many providers that require their loan clients to be formally registered, including the banks and many MFIs. This issue has been recognised by the Government of Malawi, which partnered with the World Bank in 2007 on a project called the 'Business Environment Strengthening Technical Assistance Project (BESTAP)' aimed at, among other objectives, streamlining the process of formalising a business in Malawi. However, the programme closed in 2012 and MSME registration remains an issue in the country.

Personal loans used for business. As discussed in section 6.1.4.1 above, personal loans may also frequently be used to fund businesses, particularly when specific MSME loans cannot be accessed. This is particularly true of informal loans, such as those from savings groups. IPA (2012) found that about 40% of loans from VSLAs are used for investment in businesses. Similarly, credit obtained from informal moneylenders may frequently be used for business purposes.

Inappropriately directed loans can cause iatrogenic harm. Loans provided to MSMEs without the necessary skills to use the funding productively may end up far worse off than if they had never

received the loan. The widespread low education levels and lack of skills in Malawi highlight the need for a greater focus on skills development for most MSMEs with loans targeted at only those MSMEs with the ability to absorb the high cost financing. One of the individuals interviewed within the qualitative research presents a good example of this: he has some secondary schooling and would be classified as a struggling go-getter, was able to benefit from a small value loan to run a simple firewood business but did not have the necessary skills to successfully absorb a larger loan and successfully run a more advanced business and ended up worse off than before the loan.

> *"I decided to take a loan at pride Africa to boost my business. I started firewood business I was transporting firewood on my bicycle the firewood to the markets and I would sell K 10.00 a bundle I bought a machine and goats' decided to take another loan again at (Finca Malawi) due to failure of paying back the loan I sold my machine and goats to repay and I went down to zero*."

MSME owner, male, 35 years old

6.1.4.4. Asset-backed finance

NBS dominates the mortgage market. Before 1989, only the New Building Society (since converted to NBS Bank) could offer mortgage finance. Since then the mortgage market has been broadened to include other banks. However, NBS still holds a 70% market share. Strict eligibility criteria, including a minimum 10% cash deposit, a minimum of six months history with a bank and 3 months of payslips, restrict access to mortgage finance. NBS has a maximum term of 15 years. The interest rate charged on mortgages is the base lending rate, which is currently 36%. Due to the strict eligibility requirements and the very high interest rates charged, the mortgage market in Malawi is very small. Less than 1% of Malawians even qualify for a mortgage (CAHF, 2014).

Select micro housing loans. Housing loans are offered by Select Africa, the second largest payroll lender in Malawi. The loans are structured in the same way as all other payroll loans with repayments automatically deducted from the salaries of recipients. This restricts access to micro housing loans to government employees and a limited number of private employees from whom repayments can be easily deducted.

The micro housing loans are low value, targeted towards incremental building costs or home improvement. The loans, which range from K 20,000 (USD 60) – K 1,000,000 (USD 2,400), are disbursed in the same way as personal loans provided by payroll lenders. The term of the loans can range from 3 to 48 months. Select's funders require that 75% of their loans must go to housing. However, one of the biggest challenges is to keep people from diverting the funds (Select Africa, 2014).

The provision of these housing loans is accompanied by housing support services (HSS) provided by Habitat Malawi. The HSS includes:

- Technical information: Information kits, brochures, lists of builders or other non-customized information available to housing microfinance clients.

- Professional services: Design advice or services; information regarding permits, secure tenure and land issues, technical advice, etc. This is customized advice provided without a site visit (Standard Bank, 2015).

Banks provide motor vehicle finance for the small minority of Malawians that qualify. Just 3% of FinScope (2014) respondents report owning a car, truck or motor vehicle. National Bank, for example, offers personal vehicle finance only to salaried employees. The term of the loan is up to 48 months and is charged at an interest rate of base + 4%. Standard Bank only offers vehicle finance to businesses.

MFIs offer limited amount of asset finance. A number of MFIs offer asset finance products for MSMEs specifically. MARDDEF, for example, offered equipment loans up to a value of K 30,000,000 (USD 71,950) backed by the underlying asset.

A number of providers offer invoice discounting products though limited provision of hire and lease. Leasing & Finance Company of Malawi Ltd. (LFC), a part of FMB Malawi, offers asset finance as its core business. Among other products, LFC offers 'Factoring' (also known as Invoice Discounting). LFC is able to advance cash against the security of customers' debtors books, thereby allowing the customers to free up cash that is tied up in the debtors to more productive sectors of their business. A number of other banks including Indebank, FDH and NBS also offer invoice discounting products.

No evidence of retailer asset-backed credit. There are no major retailers that offer large assets such as household furniture on credit currently in Malawi.

Difficulties in realising collateral a major constraint to asset-backed lending. The inefficiencies in the court system, as discussed in section 3, makes it too time consuming and expensive for providers of loans to realise collateral. Industry consultations indicated that it frequently costs a provider more to realise collateral than to write off the loan. This represents a disincentive for providers to provide loans backed by assets.

6.1.5. Barriers

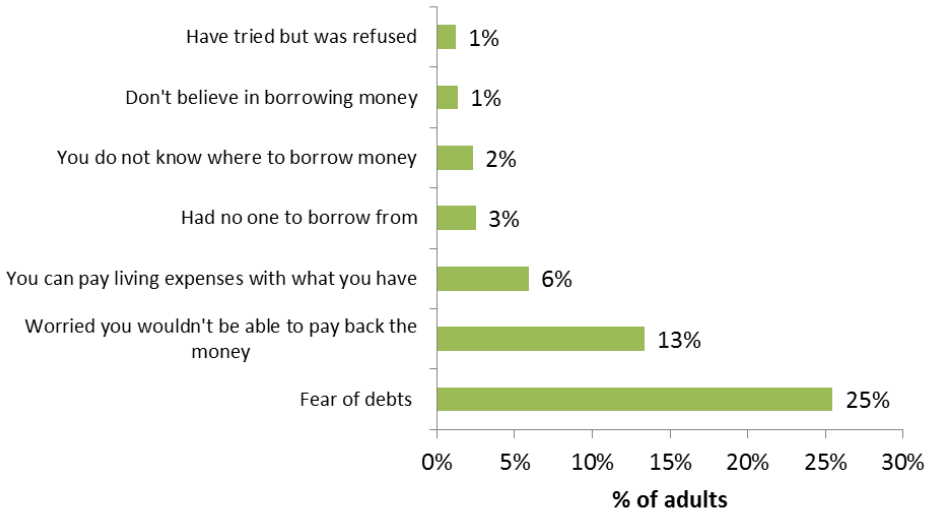


Figure 73: Reasons for not borrowing

Source: FinScope, 2014

Affordability. The very high interest rates throughout the Malawian market make credit unaffordable for many adults whilst any loans longer than a year become very difficult to repay unless the borrower's income raises rapidly. Even at the lowest interest rates offered in the markets, the sum repayable doubles every two years. Hence the majority of loans in Malawi have a term of less than 3 months. Figure 73 above also indicates that worries about the ability to repay the loan is the second most cited reason for not taking credit by Malawian adults.

Eligibility. The majority of Malawians are not eligible for credit. For individuals, formal credit is only available to the salaried employees, which constitute only 7% of the total adult population, through either the payroll lenders or the banks, with the banks being highly selective about whom they grant loans to. Most loans require property or cash as collateral, as the quote below illustrates.

> *"Banks give loans to their customers and they only give you when they are sure that you will be able to pay back or if the customer has security in terms of property but they don't take security of vehicles*."
>
> Salaried employee, male, 41 years old

> *"You need to have a collateral (Mmm) for you to get a loan like Limbe Leaf (Mmm) if you want to take a loan of half a hector you pay K 17,000 (collateral for half hector) and if it is one hector you pay K 34,000."*
>
> Farmer, female, 39 years old

MSMEs may also be eligible for specific MSME loans from MFIs and, although not all MFIs require a business plan, most MSMEs do require a track record as very few loans are extended to start-ups.

Fear of credit. Figure 73 above shows that fear of debts is the foremost reason cited why adults in Malawi do not borrow. This fear of debts is also linked to the affordability barrier as the higher the

interest, the more likely the borrower will be left with a large, unpayable debt. The quotes below illustrate that many Malawians feel stressed and pressured when owing money.

> *"I honestly don't feel better it* [credit] *gives me a lot of pressure I end losing my peace my appetite and I live in fear until i pay back the money. And about the village bank I left because honestly I had no peace."*
>
> Farmer, female, 50 years old

> *"I am scared of getting into debts because I don't want to be caught up failing to pay back the loans."*
>
> Farmer, male, 67 years old

> *"I don't feel comfortable being in debt and I feel as a person you can never be happy being in debt."*
>
> Salaried employee, male, 41 years old

> *"Honestly my friend, it's a great burden and I am feeling the pressure. I will finish repaying this coming February. The original amount was 80000; they refused to give me 100000 because of my salary. But when I finish repaying I want to get another one. But if you ask how I feel about this loan, I would honestly tell you it's painful but I do it because I have no choice*."

> Salaried employee, male, 57 years old *"Debt can be stressful especially because sometimes business goes down. If that happens, you can even lose your house."*
>
> Salaried employee, male, 28 years old

Physical proximity may be a barrier to access. Although there is similar levels of formal access to credit between urban and rural areas, rural areas are primarily served by the MFIs which target rural enterprises. Hence proximity may be an issue for individuals wishing to access a loan from either a bank or a payroll lender.

Lack of financial literacy a barrier to accessing formal products. Both the FinScope and the RBM Capabilities Survey (2014) found that Malawian adults have low levels of financial literacy. For example, FinScope found that 71% of adults have never heard of the term 'interest'. The pervasive success of VSLAs suggests that these findings may underrepresent the true level of understanding of the concepts. However, even if the concept is understood, if the term is not familiar itis a major barrier to entering into a credit contract with a formal provider.

6.1.6. Regulatory issues to consider

Inefficiency of court system makes it difficult to realise security of collateral. The inefficiency of the court system in Malawi means that realising security on loans is both time consuming and costly for the banks. As discussed in section 3, most legal matters involving collateral take 2-3 years before the matter is heard by a court, but can take as long as five years (International Bar Association, 2012).

Limited information on borrowers. There is currently no functional credit referencing process as banks currently refuse to supply consumer data to the licensed Credit Reference Bureaus. This means that providers have very little information on potential clients and makes lending to individuals very risky for providers.

No population register or national ID. The lack of a National ID makes it difficult for credit providers to confidently ascertain the identity of loan applicants or the extent to which they are indebted, particularly if a voter's registration card is used, as it is reportedly easy to forge. This makes it easy for applicants to 'disappear' if they are unable to repay the loan, because without a national identity it can frequently be impossible to track them down.

Uncertainty around MFI exclusion from banking. MFIs are not explicitly exempted from the banking act in the Microfinance Act and therefore under the current legislation deposit taking MFIs would fall under the definition of banking business in the Banking Act of 2010.

MSME policy implementation delayed. MSMEs require broader support to benefit from credit. The MSME policy has been in draft since 2012, which limits the potential of finance to achieve development goals.

Comprehensive credit regulation would remove confusion and clarify market conduct in market. Currently, aspects of credit regulation appear across various pieces of legislation but there is no comprehensive framework nor regulator, as discussed in section 3. This has led to confusion and uncertainty amongst both providers and customers over a number of different credit issues, including:

- Confusion with regard to prescription of debts.
- Questionable legal basis for payroll deductions.
- Non-functioning credit reference bureaus

6.1.7. Gaps & opportunities

Use cases	Target Markets	Potential impact and opportunity
Consumption smoothing	All	May be important for individuals, but probably lowest priority due to lack of externalities and high costs. Also savings likely more appropriate and informal credit serves this need better. ***Reduce unnecessary barriers***
Risk mitigation	All	Also may be important for individuals, but credit is usually a suboptimal response to risk in terms of cost, does have flexibility benefit. ***Reduce unnecessary barriers***
Farming inputs	Farmers	Important to increase access to improve productivity. Credit is appropriate for farming inputs as there is a delay between the investment up front and receiving the return ***Significant area of opportunity***
Capital investment	MSMEs and Farmers	Important needs to be directed to MSMEs and Farmers with capacity to absorb, repay and benefit from the credit. Focus on "driven achievers". Constraints include limitations of funding and expensive interest rates. Some also have poor repayment partly due to the lack of an operational credit bureau. Issue that these loans may often be too small but especially too short term. Difficult and expensive to reach and monitor. Need points of aggregation and easy automatic deductions of repayments. ***Significant area of opportunity***
Short-term trade credit	MSMEs	May be important for smaller MSMEs, but business case for formal provision limited. Will only likely ever be provided primarily by informal providers and this is already taking place. Not a focus area.
Asset purchases	MSMEs	Very important and backed by assets should reduce costs and risks theoretically. Banks risk averse, difficult to realise security, high interest makes it unaffordable ***Significant area of opportunity***
	Salaried employees	Can be important to assist wealth accumulation. No major consumer retailers seem to offer goods on credit

Education	All	Education is important for long term growth in Malawi and the provision of targeted financial services can aid individuals to pay to enhance their human capital. Given the low income dividend from education in Malawi, the demand for education seems relatively low. Savings also likely more appropriate until tertiary.

Table 17: Market for credit: opportunities summary across use cases

Source: Authors' own

Credit for farming a core, largely unmet need. Farmers are the largest target market in Malawi and farming is an activity particularly suited to credit given the high up-front costs of farming inputs and the delay between investment and return. Credit is therefore critical for many farmers to be able to afford necessary farming inputs in planting season. For example, many farmers are unable to afford sufficient fertiliser to fertilise their entire farming plot or even sufficient seed, thereby reducing their produce and harvest return. Just 4% of farmers have formal credit and this is almost entirely directed towards tobacco farmers. Whilst a larger proportion are able to access informal loans, these are not typically appropriate for farming needs as most informal loans are very short term, most commonly one month. Yet the lag between planting and realising the investment when the harvest is sold may be 3-6 months depending upon the crop. This, therefore, represents a gap in provision.

Side selling limits opportunity for input financing. Due to the widespread side selling of most value chains, traditional off-take agreements are unfeasible for most value chains. Aggregation through farming associations which, by increasing the overall value of produce transported could possibly invest in transport themselves or make it worthwhile for a buyer to collect the produce may present the most likely avenue for the provision of formal input credit to farmers from most value chains.

Improving access to credit for Driven Achiever MSMEs is an opportunity to enhance growth outcomes and employment within the economy. This may not necessarily entail increasing the overall credit available to MSMEs, but targeting the credit more effectively towards those businesses with the ability and incentive to grow may lead to improved outcomes. In contrast credit, particularly larger value loans, is frequently detrimental to MSMEs unable to absorb it. Smaller value loans may benefit other MSMEs with short term trade credit. However, for struggling go-getter MSMEs the greater opportunity is skills enhancement through training, allowing them to graduate to the driven achievers category.

Broader support services required to realise MSME credit potential, MSME policy required. MSMEs often do not have the skills or the market to grow their business to the extent that they can repay and benefit from larger loans. Mentoring, incubators, apex bodies and similar initiatives are required to develop MSME potential beyond credit.

Wholesale credit potential for MFIs. The cluster 1 banks have the greatest ability to move into this market, but the lowest incentive. Whilst these banks may consider entering this market as too risky and beyond their core focus, there may be an opportunity for these banks to provide wholesale lending to MFIs who then have the expertise and infrastructure to administer small value loans.

The cluster 3 banks and the MFIs are already targeting this MSME market and to a lesser extent the farmers. However, there may be an opportunity for some of the cluster 2 banks to extend their reach into these markets. These markets are currently struggling to compete for a small market with a

number of competitors. One avenue for growth therefore may be to start extending credit further downmarket than they currently do through new partnerships.

Leveraging VSLAs as conduits of formal loans. Whilst the OIBM pilot with CARE to distribute loans directly to VSLAs had a number of issues, largely related to the product design and accessibility for the VSLA customers, the high repayment rate through this pilot, as well as through similar organisations in Thailand, suggests that disbursing loans to VSLAs for them to on-lend to members through their existing structures may be a cost effective method to distribute loans. The major advantage of local community groups distributing loans is that the asymmetric information between provider and recipient is substantially reduced as the VSLAs have a good understanding of each members' ability to repay the loan and can also effectively monitor them over time. This benefit is exaggerated in Malawi as, due to the lack of credit bureau or even National ID, formal providers frequently have very little information on borrowers. The formal providers, through this collaboration, could also encourage the VSLAs to offer recipients slightly longer term loans or structure them specifically for MSMEs or farmers, thereby overcoming some of the existing disadvantages for consumers of VSLA loans.

Alternative products required for consumption smoothing and risk mitigation. A large portion of borrowers use credit for either consumption smoothing or risk mitigation, as illustrated in section 6.1.2. However, in many cases credit may be a sub-optimal response mechanism, because credit entails the additional cost of interest and as most of this credit comes from informal providers, this interest cost is particularly high. Developing appropriate savings for consumption smoothing and low cost, high frequency risk events and insurance products for high cost, low frequency risk events is likely to better meet the needs of individuals in many cases.

Cost of capital a major issue to the further extension of credit. The high cost associated with institutions raising capital for lending through the various channels available constrains extension of credit. The development of the capital market as an additional, viable alternative to raise wholesale funding will improve availability of longer term capital and reduce cost of capital to the provider and consumer.

Non-functioning credit reference bureau increases risk and cost of lending. The lack of a functioning credit reference bureau in Malawi raises the cost of lending as credit providers have limited prior information on clients' ability to repay. This, combined with the lack of a national ID, means that it is also very difficult to track down defaulters as they can easily 'change identity' and disappear. The result is that many lenders are more conservative in their lending, hence reducing the amount of available credit.

Overarching regulatory framework to reduce market uncertainty. Introducing comprehensive credit regulation enables the supervisor to proactively and acutely regulate the activity of providing credit across the entire market, rather than simply a retrospective aggregate view at institutional prudential asset level of only those formally licensed and supervised institutions that provide credit. Furthermore, there are a number of areas of uncertainty and confusion within the credit market which could all be clarified in a comprehensive credit regulation, thereby reducing the uncertainty and risk for both providers and consumers.

6.2. Market for payments

Why focus on payments? Effective payments mechanisms are a requirement for the efficient provision of all other financial services and form a vital backbone for the provision of goods and services in the broader economy. Payments allows for the transfer of value between individuals and businesses.

Given the frequency with which every member of society makes payments, optimising the efficiency and affordability of payments mechanisms is directly welfare improving.

This section unpacks the key drivers for the market for payments with a view to exploring the gaps and opportunities for improving payments in Malawi. This will include exploring providers and product areas, such as transaction banking, E-money (including Mobile Money) and money transfers.

Key issues: market for payments

The key issues from this section are the following:

- High level of cash dependence
- Some evidence of in-kind payments, maize or foodstuffs
- Many high value payments made in cheques
- Banks primary provider of formal payments
- Very few third party providers to provide efficiencies of scale
- Payment infrastructure is very limited
- Current bank and national switch cost structure does not support further roll out of ATMs or POS devices
- National switch provides improved interoperability
- Bank agency growing
- Mobile payments increasing, but at slow pace
- Business case and illiquidity constraining agent network
- Security a driver of formal payment/ store of value use
- Remittances used across society and growing

6.2.1. Current usage

Cash the predominant form of payment. 95% of adults indicate that they use cash to purchase food and clothing, whilst 40% use cash to purchase large household items (FinScope, 2014). BTCA (2013) estimates that just 0.3% of payments in Malawi are through electronic channels and 75% of the total value of payments made in Malawi is through cash.

Majority of income is received in cash. Figure 74 below shows that 79% of adults receive their income in cash and only 5% through the bank. The heavy reliance and low use of bank accounts to pay incomes applies across target markets. The salaried employees account for the largest portion of adults paid through a bank, but even for this target market, only 23% receive their income through a bank. MSMEs are the highest recipients of cash, with 90% of MSMEs receiving their income in cash. However, more than 70% of all the target markets receive their income in cash.

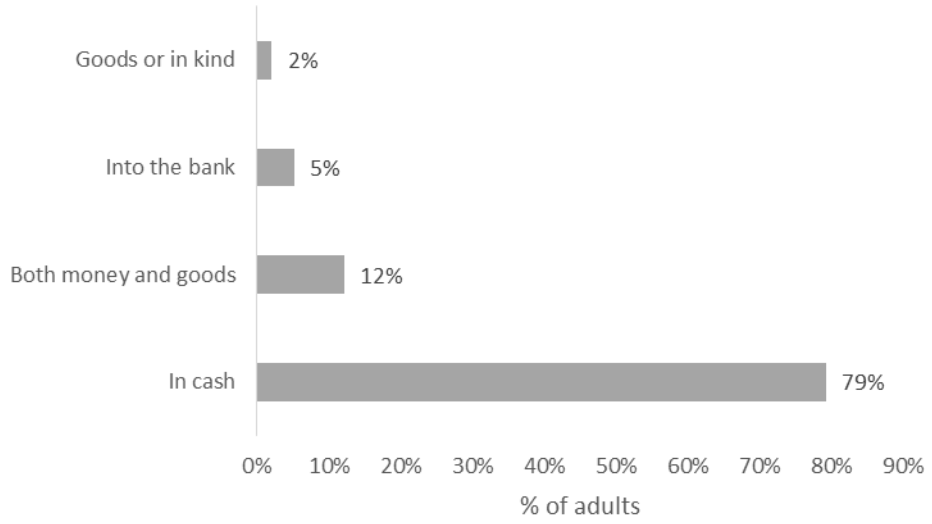


Figure 74: How adults receive their income

Source: FinScope, 2014

Cash used despite risks, due to limited alternatives. Both FinScope and qualitative interviews indicate that most adults in Malawi prefer to transact in cash even though they recognise the risk of keeping and carrying cash. Despite the pervasive use of cash, 73% of adults agree that it is not safe to keep cash (FinScope, 2014). 53% of Malawian adults prefer to carry cash than use a bank card, whilst 65% preferred to be paid in cash than through a bank (FinScope, 2014). The quotes below further illustrate the strong preference for cash as a payments mechanism amongst Malawians:

> *"When I sell my produce, I prefer getting my money in cash*."
>
> Farmer, female, 60 years old

> *"Well I believe with cash it's convenient because imagine if I want to buy something to eat I can just buy there and then with no problems at all."*
>
> Farmer, female, 50 years old

> *"I won't lie to you, if I was taught to use them I would use them but right the only way I use and find easy is cash."*
>
> Farmer, male, 67 years old

> *"I love to use cash but then things are changing. I now believe that these modern ways are more suitable than walking around with a lot of cash in your pocket."*
>
> Salaried employee, male, 41 years old

> *"The good thing about cash, here in the village because we have small shops that wouldn't accept cheques or other payments so it's better we use cash*."
>
> Salaried employee, male, 41 years old

Some income in kind. Figure 74 also shows that 14% of adults receive at least a portion of their income in-kind, although only 2% only receive in-kind payment. Ganyu account for the majority of adults that receive payment in kind. 22% of ganyu receive a portion of their income in goods, often maize or foodstuffs. The quotations below, provide examples of Malawians that are paid, at least partly, in kind:

> *"Mostly we pay them in cash but it also depends on the agreement if the person says I have no food then we give them the foodstuff equivalent to the money I could have given him."*
>
> Farmer, male, 39 years old

> *"Yes, but it really hurts because you do a whole hector only to be given 2 tins of maize, sometimes this maize is even mixed with husks. Life is hard."*
>
> Farmer, male, 31 years old

> *"Yes the best profit for your lending is to be paid in tobacco*."
>
> Farmer, male 43 years old

> *"Yes, especially during harvesting time – when harvesting the maize, we hire people to help us and when they are done we give them a bag of maize*."
>
> Salaried employee, male, 57 years old

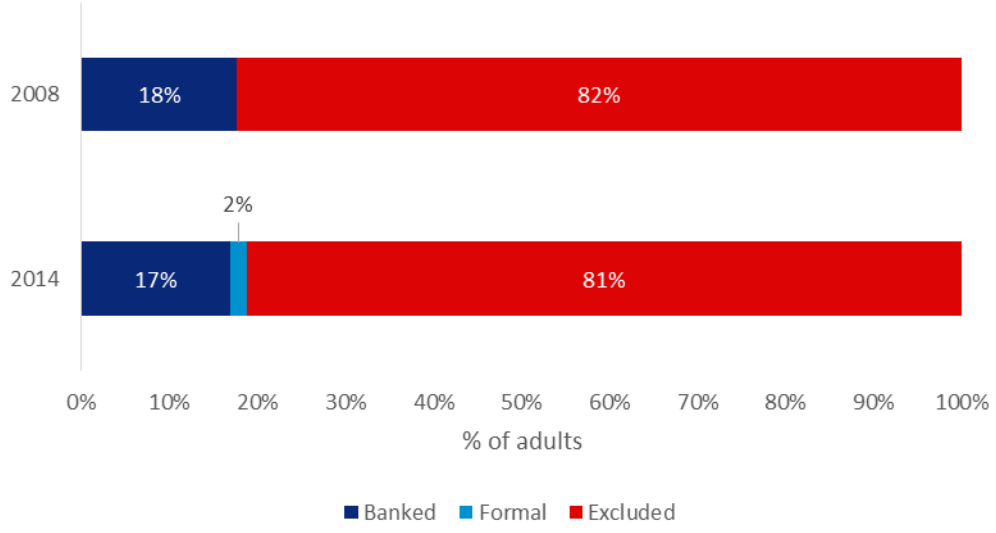


Figure 75: Comparative transaction account usage between 2008 and 2014

Source: FinScope, 2014, 2008

Bank transaction account penetration unchanged over past 5 years. Figure 75 above shows that bank account penetration has remained fairly constant between 2008 and 2014. However, the total number of bank accounts have risen by about 280,000 due to the increasing population size. The introduction of mobile money by the MNOs have also provided an additional, non-bank transactional account product to the market in the interim since 2008. Given the growth in uptake of these electronic money products and the time since the FinScope survey was in field (early 2014), the proportion of adults using these transaction accounts is now higher than illustrated in the figure.

Bank account usage low compared to region. Figure 76 below illustrates comparative FinScope figures of transaction account usage across comparative countries in the SADC region. The bottom four countries all have similar bank access with Malawi slightly higher than Tanzania and Zambia (although in Tanzania and Zambia this may well have changed since their previous FinScope survey). These countries all have significantly lower bank usage than Zimbabwe, Lesotho, Swaziland and South Africa.

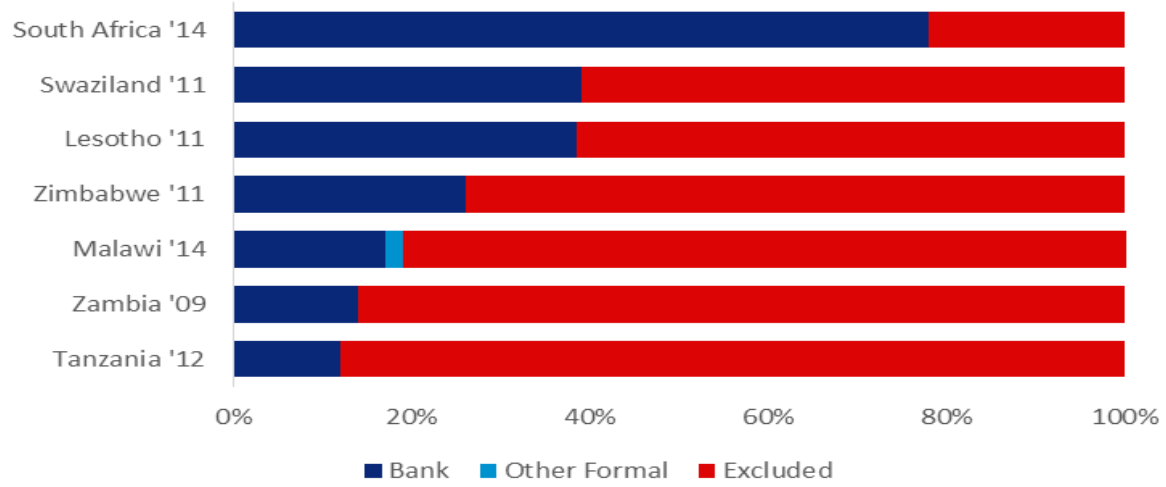


Figure 76: Cross country comparison of transaction account usage

Source: FinScope, 2011; 2014

Salaried employees proportionately the greatest users of transaction accounts. Figure 77 below shows that salaried employees have the highest uptake of formal transaction products and have experienced the largest increase since 2008. The higher bank account penetration for this target market reflects the need of many to receive their salaries into bank accounts. All of the other target markets have maintained relatively similar bank account penetration since 2008.

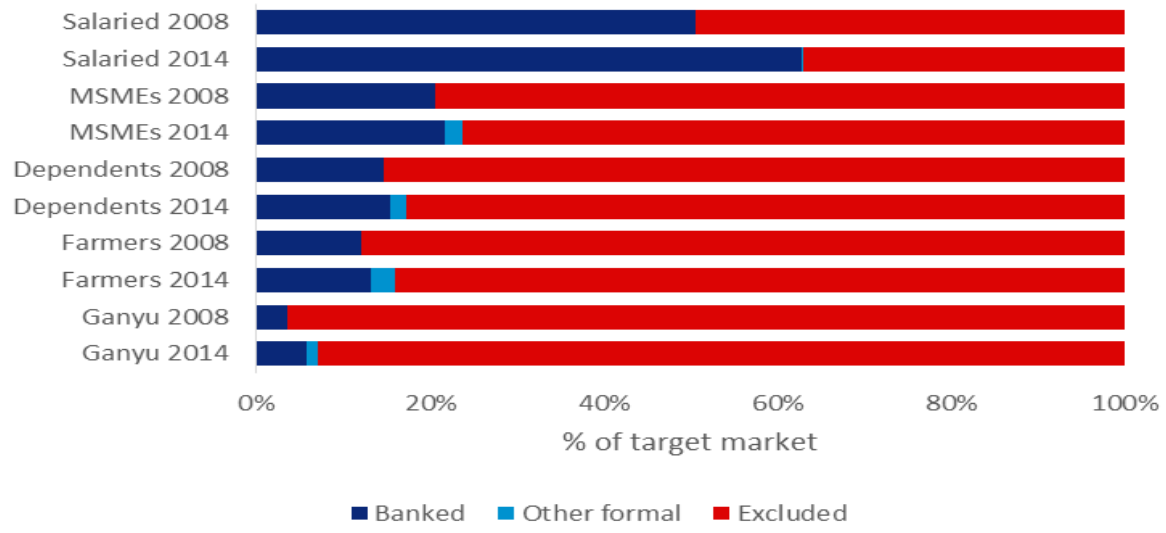


Figure 77: Comparative transaction account usage between 2008 and 2014 across target markets

Source: FinScope, 2008, 2014

Despite low penetration, farmers account for large number of bank accounts. Although farmers have the second lowest level of bank penetration amongst the target markets, as the largest target market, farmers still account for a similar number of bank accounts to the salaried employees (each of these target markets accounts for 26% of the country's bank accounts).

	Banked	Total other formal	Excluded
Farmers	13%	3%	84%
MSMEs	22%	3%	76%
Salaried	63%	7%	37%
Dependents	15%	3%	83%
Ganyu	6%	2%	93%
Total	17%	3%	81%

Table 18: Total usage of transaction services per target market

Source: FinScope, 2014

Highest penetration of mobile money amongst salaried employees. Table 18 shows the total use of other formal transaction accounts. In this case this category refers only to the use of mobile money products. Due to the intervening time period between when this survey was conducted and this report, these numbers may be considered out of date for a product experiencing such rapid growth. The table does show that salaried employees are the target market with the greatest use of mobile money. However, farmers do account for the largest portion of mobile money users, constituting 36% of users.

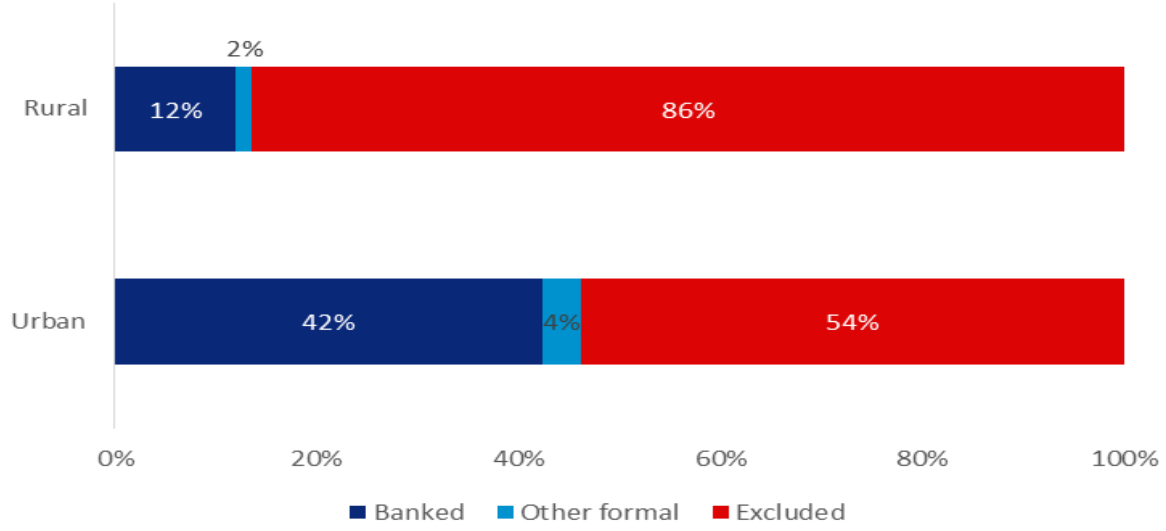


Figure 78: Comparative transaction account usage between rural and urban dwellers

Source: FinScope, 2014

Urban access to bank accounts substantially higher than rural access. Figure 78 shows that, whilst 42% of urban dwellers have a bank account, just 12% of rural dwellers do. This discrepancy may be partially explained by the greater proportion of salaried employees that reside in urban areas, but may also suggest that proximity is a significant barrier to accessing bank products for those living in rural areas. However, as the majority of Malawians do reside in rural areas, there are a greater number of rural bank account holders (780,000) than urban bank account holders (505,000).

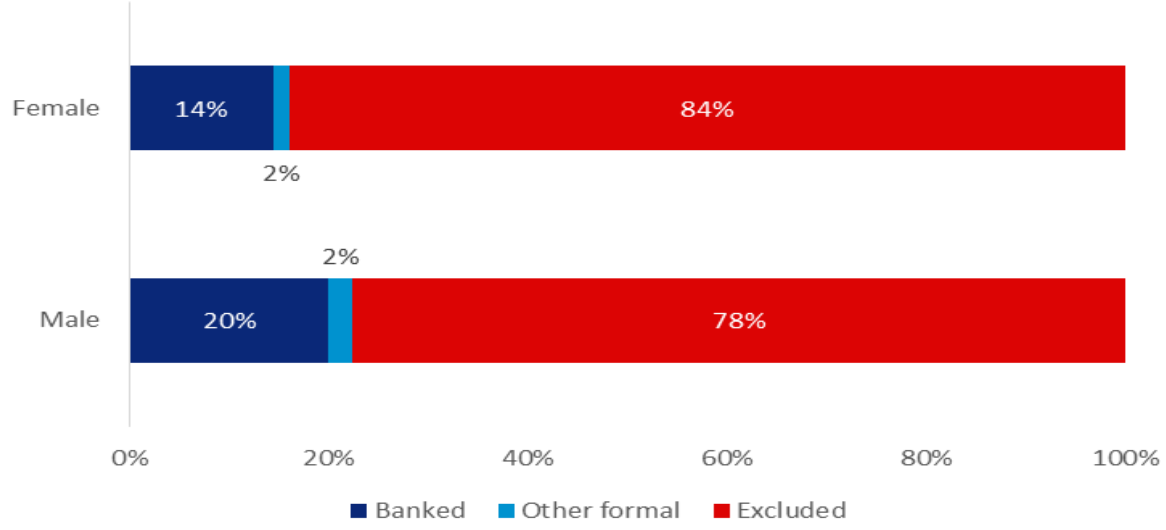


Figure 79: Comparative access strands across genders

Source: FinScope, 2014

Gender difference in access. Figure 79 shows that a greater proportion of men have access to bank accounts than women in Malawi. However, as there are more females than males in the country, in terms of absolute numbers, a similar number of females (660,000) and males (690,000) have bank accounts. The relative usage of other formal products (mobile money) is similar between genders.

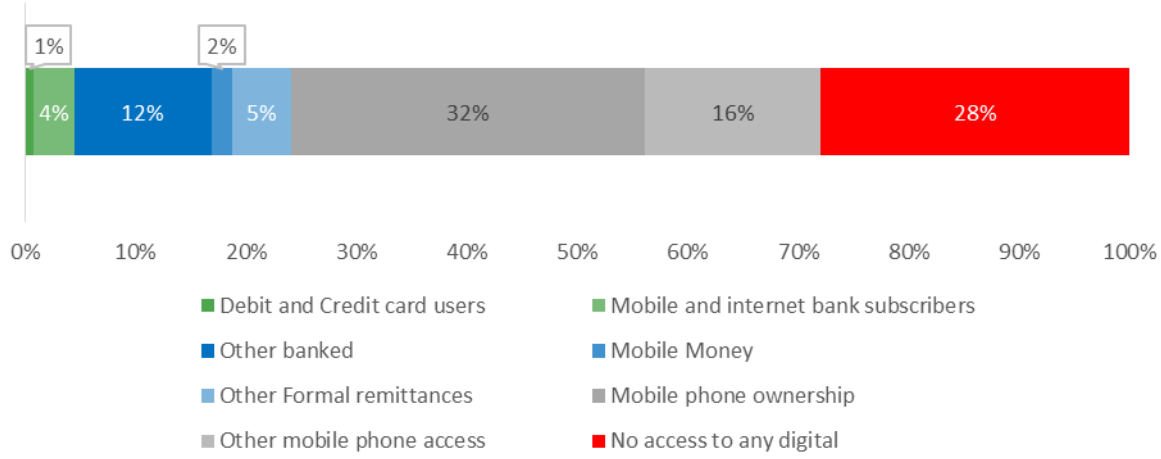


Figure 80[91]: Digital access strand

Source: FinScope, 2014; RBM, 2014

Relatively limited usage of digital financial services but greater potential. Figure 80 above illustrates the number of adults that use different types of digital financial services and those that potentially could. This strand is structured in a similar way to a product access strand, therefore accounting for overlaps by taking a hierarchical approach (see Box 8). The figure shows that, whilst 24% of adults use some form of formal transactions, most of these still involve some cash e.g. ATM and mobile money agent cash withdrawals. Only transactions conducted by card (1%) and through mobile or internet

[91] The four groups of colours each indicate the following: green – already cashless; blue – other cash based formal financial services; grey – potential users of digital financial services; red – no access to digital services.

banking (4%) are completely cashless. However, the large portion of adults that own mobile phones but don't use formal transaction channels (32%) are a potential opportunity for providers of mobile money and mobile banking as they already have a touch point. Additionally, a further 16% of adults have access, but don't own a mobile phone.

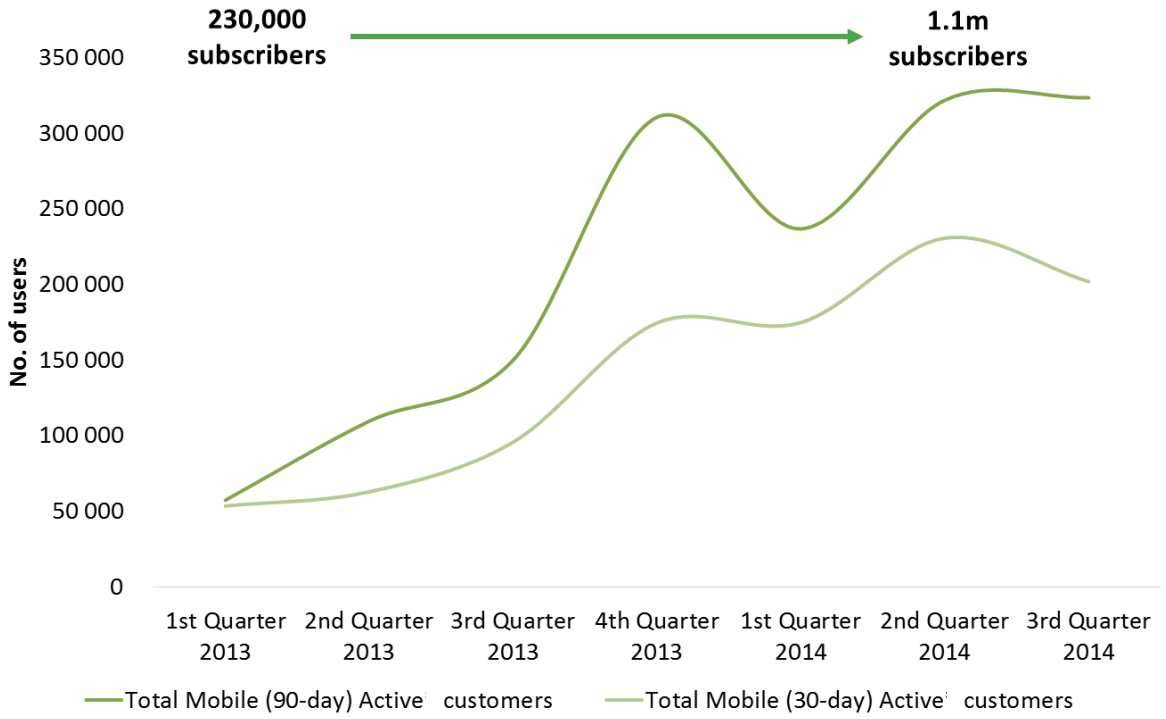


Figure 81: Growth in number mobile money users over time

Source: RBM, 2014

Rapid initial uptake of mobile money but has since slowed. Figure 81 above shows the rapid increase in the number of mobile money consumers over time. In total, as of 3rd quarter 2014, there are over 1.1 million mobile money subscribers, constituting 14% of Malawian adults (RBM, 2014). However, the proportion of active accounts has been low at 25% - 30% for 90 day active and 15 - 20% for 30 day active[92]. This means that only 3% of Malawian adults have used mobile money within the preceding 30 days. Although usage remains low, Figure 81 above does illustrate the rapid growth in uptake over the last two years since the product was first introduced into the market in February 2012 by Airtel. The total number of transactions grew 150% in 2013 from 3.4 billion in the first quarter to 8.6 billion in the fourth quarter.

[92] Accounts are considered active if at least one transaction, either incoming or outgoing, has been conducted in the account during the last 30 days or 90 days, depending on the definition.

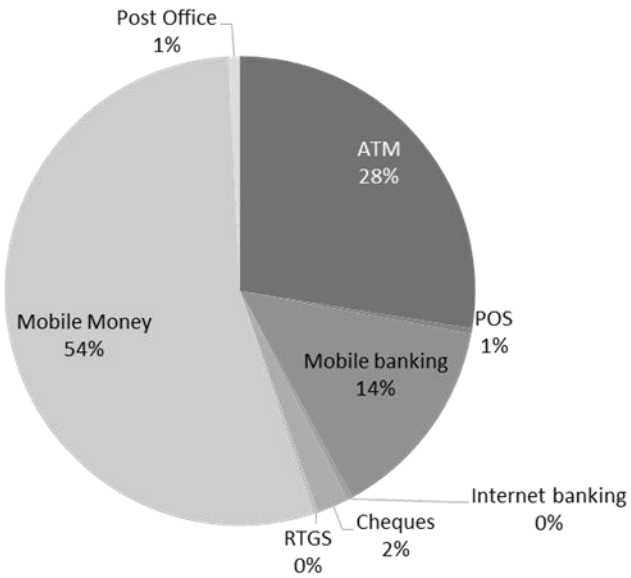


Figure 82: Comparative use of different payments channels by volume of transactions

Source: RBM, 2014

Mobile money makes up over half of non-cash transactions. Figure 82 above, shows that mobile money transactions account for 54% of all non-cash transactions in Malawi (3.8 million transactions per month). ATM withdrawals accounts for the second highest number with 28% (1.9 million withdrawals and transfer payments per month) with mobile banking third, constituting 14% (1 million transactions per month) of all non-cash transactions. Cheques and RTGS account for only a tiny portion of the volume of transactions, but the majority of the total value of transactions. The post office is the most frequently used formal provider to send and receive remittances, although still constitutes only a small portion of total payments. The use of POS card transactions is highly limited and usage of internet banking is limited to just 30,000 subscribers.

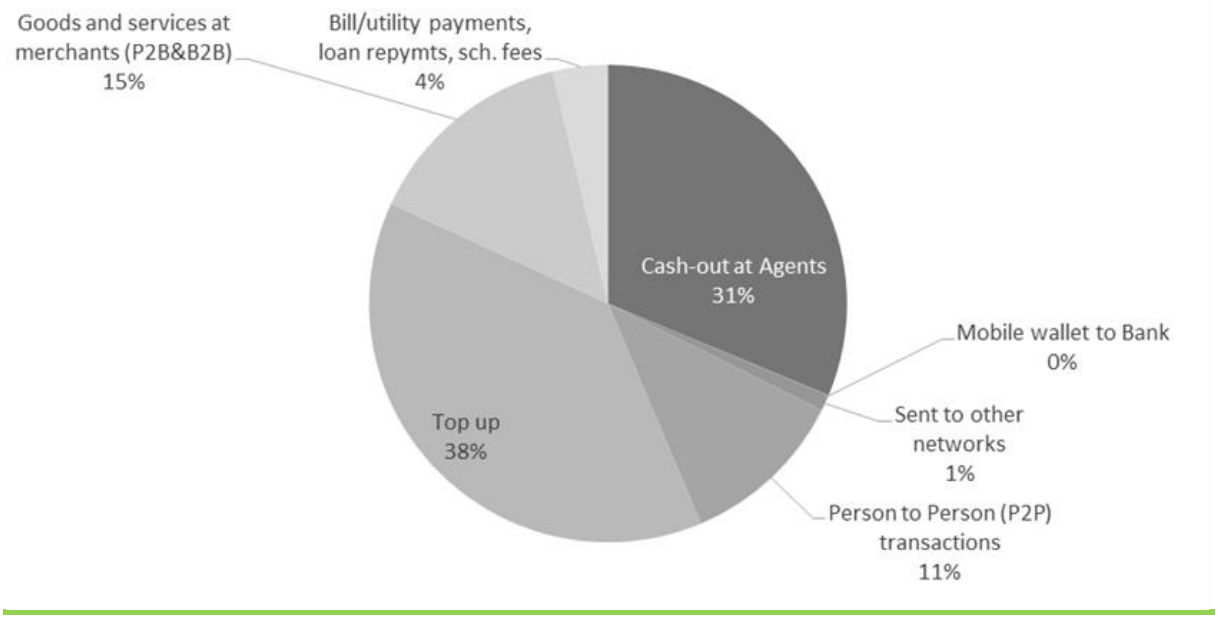


Figure 83: Uses of mobile money by value

Source: RBM, 2014

Most transactions for airtime. Figure 83 above shows the breakdown of mobile money transactions by value. Cashing in and out at agents constitutes the largest proportion of the value of mobile money transactions, whilst airtime top-ups account for 39% of the value of total transactions. Person to person transfers account for only 11% of the value.

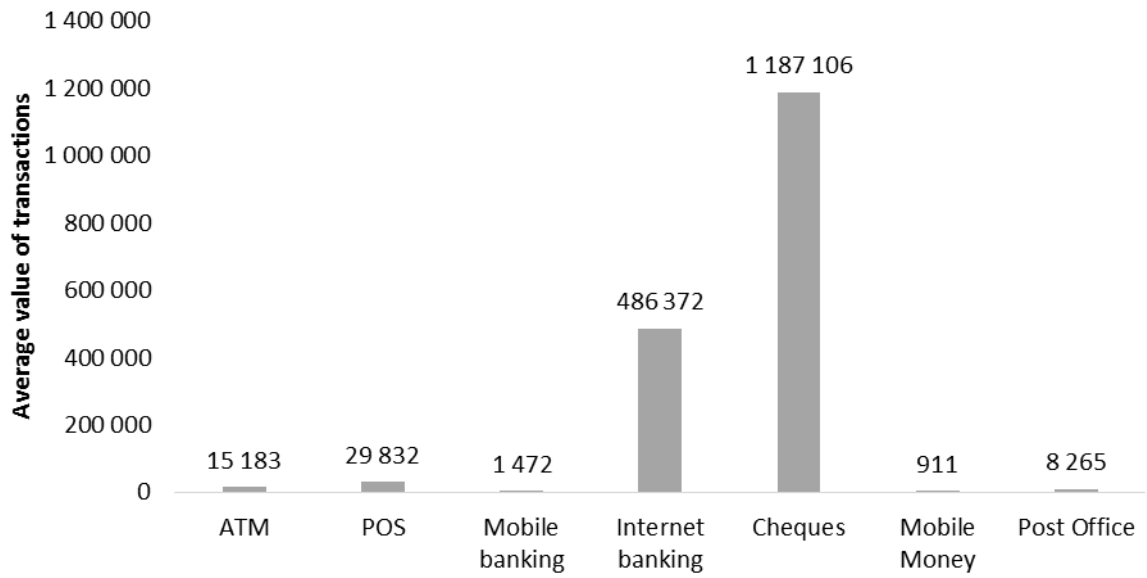


Figure 84: Average value of transaction per channel

Source: RBM, 2014

Mobile money enables lowest value transactions. Figure 84 above shows the average value of transactions made through various payments channels. The average value of transactions made through mobile money and mobile banking channels is substantially lower than alternative channels, indicating that they are filling a niche for low cost, low value payments previously only met by cash.

Bank accounts primarily used only for basic deposits and withdrawals. Figure 85 below shows the different uses that have been made of bank accounts by banked adults in Malawi. The figure shows that the primary uses are simply cash withdrawals and deposits. What could be considered more complex payment mechanisms are far less used with 1% of banked adults using a stop order and less than 0.5% a debit order. The quotation below illustrates that bank accounts are often seen as merely a vehicle to receive and potentially store income.

> ***"In your explanation should I assume that your bank account is just for receiving your salary?***
>
> *Yes, just for my salary."*
>
> Salaried employee, male, 57 years old

The high portion of banked adults that have deposited into a bank account in the last 12 months does however suggest that the accounts may be used as a store of value and not simply as a mailbox to receive salaries.

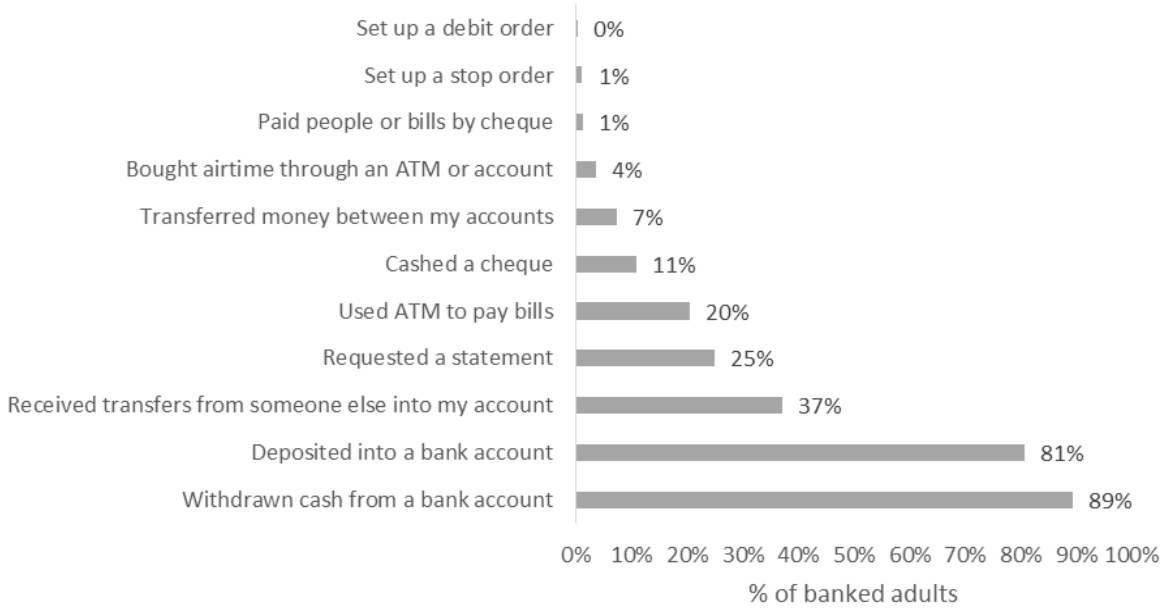


Figure 85: Bank uses in last 12 months

Source: FinScope, 2014

Cheques remain a major channel for retail payments. Figure 86 below illustrates that cheques account for 79% of the value of retail transactions (RTGS transactions are excluded). The continued prevalence of cheques as a payments mechanisms is partly driven by the government's historic reliance on cheques as a primary payments channel, including to pay salaries. However, this was set to change in 2015. Government will now pay salaries directly through the new RTGS system and will endeavour to digitise all its payments. This will have knock on effects as recipients of government payments will be forced to receive these payments through bank accounts. ATM withdrawals account for 13% of the value of non-cash transactions whilst internet banking accounts for 5% of the value, indicating that payments through this channel have a high average value and are primarily used by corporates and a limited number of high net worth individuals.

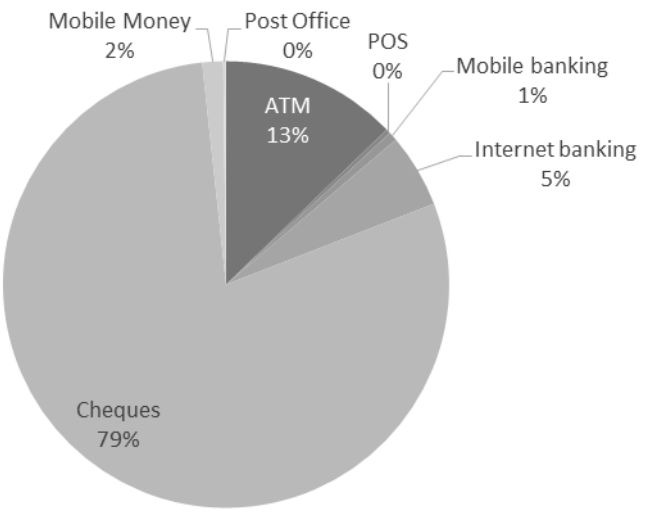


Figure 86: proportionate use of retail transaction channels by value

Source: RBM, 2014

Very low use of cards. FinScope indicates that 11% of adults in Malawi have bank cards, with the majority of these used exclusively for ATM withdrawals from their current or savings accounts. This constitutes 65% of adults with transactional bank accounts. Just 0.8% of Malawi adults use debit cards, whilst only 0.2% have credit cards. A preference for cash and lack of interoperability coupled with high costs of card transactions have driven this behaviour. Lack of interoperability has meant that very few POS devices are in use as clients cards would only work in POS devices supplied by their own bank. In practice, only Visa branded credit and debit cards can be used to any significant extent in the country before now as four of the banks are licensed as Visa acquiring.

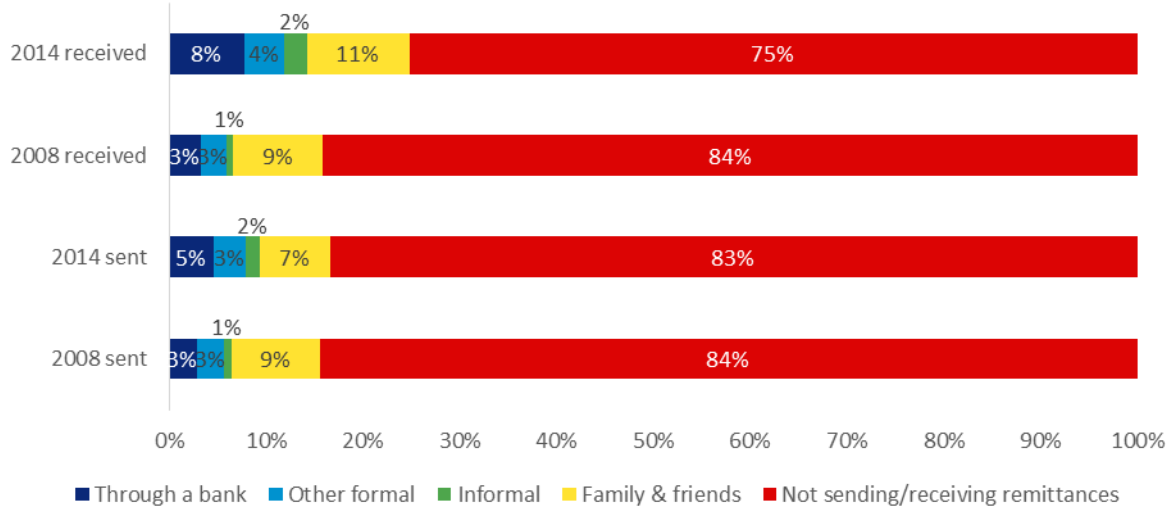


Figure 87: Comparative use of remittances between 2008 and 2014

Source: FinScope, 2008, 2014

Remittances the second most widely used financial service. More Malawian adults either send or receive remittances than use any other single financial service apart from savings. In total 1.4 million Malawian adults either send or receive remittances through formal or informal channels compared to

2.2 million adults that save through formal or informal channels and 1.1 million adults with transaction accounts.

Formal remittances received doubled from 2008, however still relatively low at 12%. Figure 87 above shows the access strands for sending and receiving remittances in 2008 and 2014. The figure indicates that whilst the proportion of senders has remained relatively constant (the absolute number of senders rose from 930,000 to 1.3 million adults), the proportion of receivers has increased (the number of receivers rose from 960,000 to 1.9 million adults). The dependency ratio (proportion of remittance receivers that each sender is responsible for) has therefore increased substantially from 1 to 1.5, which indicates that each sender is responsible for more dependents on average. Figure 88 below shows an equivalent increase in the proportion of remittances received from within Malawi and from outside.

	Sent		*Received*	
Bank	*5%*	*366,970*	*8%*	*623,504*
Other formal	*3%*	*269,704*	*4%*	*335,542*
Informal	*2%*	*128,141*	*3%*	*217,215*
Family & Friends	*8%*	*610,282*	*11%*	*888,507*

Table 19: Total use of remittances by different channel for senders and receivers

Source: FinScope, 2014

Remittances largely through family and friends. Table 19 above shows that the largest portion of remittances are sent via family and friends or self-delivered. This may be the cheapest option provided that the deliverer is travelling in any case. The remittance can be delivered directly to the recipient. However, the major disadvantage is that the sending of the remittances is reliant on someone making the journey and hence are likely to be relatively irregular and are not appropriate to address risk events which require an immediate response. The quotes below present examples of Malawians that use this channel for remittances and highlights some of the advantages and disadvantages.

"If I need to send anything to my grandmother, I deliver in person or I send the children."

Farmer, female, 35 years old

"What were the disadvantages and advantages of sending through a friend?

The advantage was that this person was staying in our neighbouring village so there was no problem for him to deliver the money.

In a situation where you want to send money and there is no one to send, what do you do?

I would have to postpone sending."

MSME, male, 29 years old

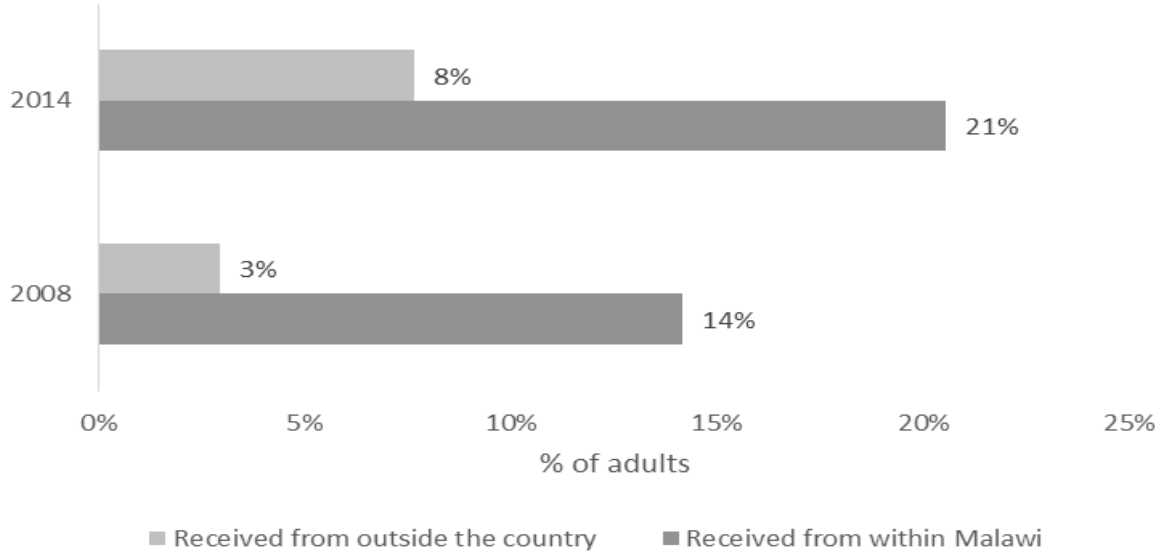


Figure 88: Comparative proportion of cross border and domestic remittances sent and received

Source: FinScope, 2008; 2014

Remittances largely domestic, foreign remittances increasing. Figure 88 above shows that the majority of remittances are received from within Malawi. This is consistent with data collected by the World Bank indicating only a small portion of Malawian emigrants, as discussed in section 2. The value of remittances received in Malawi is also fairly low. The World Bank (2014) estimates that total remittance inflows constitute only 0.8% of GDP. This information underrepresents informal activity, but still indicates low levels of cross border remittances.

Senders and Receivers	Total sent		Total received	
	2008	2014	2008	2014
Total population	*16%*	*17%*	*16%*	*25%*
Farmers	10%	14%	13%	24%
MSMEs	19%	22%	17%	24%
Salaried	43%	44%	24%	33%
Dependents	16%	19%	45%	33%
Ganyu	5%	8%	8%	16%

Table 20: Comparative proportion of senders and receivers between target markets and years

Source: FinScope, 2008; 2014

All target markets both send and receive remittances. Table 20 shows that the proportion of remittance senders across all target markets have increased slightly between 2008 and 2014, whilst the proportion of remittance receivers have increased more substantially across all target markets, apart from the dependents. The increasing levels of remittances may indicate increasing levels of movement by Malawians in search of work, whilst the greater increase in receivers may also indicate that a greater proportion of Malawians are vulnerable and struggling following the worsening macroeconomic environment between 2008 and 2014. Salaried employees are the primary senders of remittances, as the highest earning target market with regular income, this is consistently found across countries (e.g. Thom et al. 2014; Jefferis & Manje, 2014). The dependents are proportionally the greatest recipients of remittances, however the proportion of dependents receiving remittances has fallen significantly between 2008 and 2014. Due to the relative size of the target market, the farmers constitute the largest number of remittance receivers. This highlights the importance of developing rural infrastructure allowing these adults to easily access their remittances.

6.2.2. Use cases

In this section we outline some of the main use cases for potential uptake by Malawians of efficient and cost-effective payments mechanisms. At the end of the payments market analysis, we will return to the use cases as the basis for the identification of gaps in current provision and opportunities for growth. Table 21 below shows the main payment categories in Malawi:

	PAYER				
		Government (G)	***Donor (D)***	***Business (B)***	***Person (P)***
PAYEE	***Government (G)***		Grants, Tax (D2G)	Tax (B2G)	Tax (P2G)
	Business (B)	Procurement (G2B)	Business funding/ loans, Bill payments, Grants (D2B)	Bill payments, Spot payments (B2B)	Bill payments, Spot payments (P2B)
	Person (P)	Social transfers, Salaries (G2P)	Social transfers, Salaries (D2P)	Salaries, Loan disbursements (B2P)	Remittances, Wages (P2P)

Table 21: Payment Grid-Categories of payments in Malawi

Source: Authors' own adapted from BTCA, 2013

Remittances (P2P), largely domestic. 1.9 million Malawian adults indicate that they receive remittances according to FinScope (2014). Whilst very few indicate that this is a primary source of income, it is nevertheless likely that this constitutes a vital additional source of income for many Malawians. Remittances are defined in Bester *et al*. (2010) as "non-reciprocal transfers from one person to another across a distance" and therefore constitute a person to person money transfer. Remittances are used by all the target markets, but are of particular importance to civil servants and company employees, which are proportionately the major senders of remittances, and the private dependents which are proportionately the largest receivers of remittances. However, farmers account for the largest number of senders and receivers. Remittances are largely used to support dependents. Although of high importance to remitters, remittances only constitute a very small proportion of the total payments made by individuals. BTCA (2013) estimates that remittances constitute only 0.05% of the total volume of payments made by individuals, although they account for 3.5% of the value of payments made by individuals. BTCA (2013) also estimates that the average value of remittances received domestically is K 7,000 (USD 17) compared to remittances received from abroad which have an average value of K 27,000 (USD 65).

Bill payments (P2P, P2B, B2B). Bill payments refer to the settlement of documentary accounts once presented for acceptance. A key element of a bill payment transaction is that it can be discounted to an intermediary and still charged in full to the client. For example, bill payments include payments for water, electricity, airtime, loan repayments, insurance premiums, school fees. Bill payments are relevant for all the target markets, because all individuals have to pay bills of some form.

Spot payments (P2B). Spot payments constitute the payment by a person to a business in return for a good or service. Spot payments are payments that are made at the point at which delivery is taken of the good or service. The distinction between bill and spot payments hinges upon the immediacy of

the transaction and fulfilment, coupled with the handover of possession or control of goods and therefore whether the transaction is better described as *ad hoc*, on the spot for possession of goods versus the settlement of documented accounts of future or past services or in respect of delivery of goods. For example, spot payments include payments for groceries, clothes and appliances. BTCA (2013) estimates that P2B payments account for 99.7% of all personal payments, the vast majority being for purchases such as groceries, clothes and appliances. Indeed, P2B payments are estimated to account for 97% of all payments made in Malawi. P2B payments also account for 85% of the total value of personal payments. It is estimated that 99.8% of P2B payments are made in cash.

Salary payments (B2P, G2P, D2P, P2P). Salary payments constitute the payment of individual employees by their employer, either a business, individual, donor or government. From the individual receiver's perspective it is imperative that they receive salaries on a consistent, timely and reliable basis. The salaried employees and MSMEs (who employ others) are the target markets primarily affected by this use case. Salary payments constitute 21% of the total volume of payments made by businesses in Malawi. For MSMEs, these payments are made almost exclusively in cash. Salary payments also constitute 45% of the total number of payments made by Government. All of these payments are made by cheque, although with the introduction of the new RTGS system, it is intended to migrate these payments to electronic channels (BTCA, 2013).

Social welfare transfers (G2P, D2P). Social welfare payments constitute the payment of grants to grant recipients by government or transfers to needy recipients by donors. As with salary payments, grants also constitute a bulk payment disbursal by the state or donors, but the recipients have considerably different profiles that will affect the payments mechanisms used. Social transfers and pension payments constitute 11% of government's payments, none of which are made through electronic channels. Social welfare payments account for 92% of donor organisation's payments. It is estimated that 79% of these payments are made through electronic channels (BTCA, 2013).

Tax payments (B2G, P2G). Tax payments would largely affect the salaried employees that are required to pay income tax and the MSMEs who are required to pay VAT on goods and services sold. Improved tax collection is fundamental to boost Malawi's government revenues (see section 2.1). Efficient, simple payments mechanisms provide a significant contribution to effective tax collection.

6.2.3. Providers

This section considers the supply of payments services in Malawi in terms of providers and products, including the payments infrastructure underlying each of the providers' operations.

	Banks	Mobile money	Other formal remitters (MPC, Western Union, MoneyGram)	Informal remittances	Remittances sent with family & friends	Population
% urban	39%	34%	26%	16%	17%	15%
% female	49%	45%	43%	49%	53%	57%
% primary education or less	51%	51%	49%	62%	72%	76%
% tertiary education	9%	14%	6%	2%	2%	3%
Average income (K)	34 857	30 907	27 151	17 208	12 820	13 484
% farmers	27%	35%	33%	36%	35%	33%
% MSMEs	21%	15%	18%	20%	16%	15%
% salaried employees	27%	16%	21%	9%	5%	7%
% dependents	16%	15%	12%	23%	23%	17%
% ganyu	9%	19%	16%	12%	21%	26%

Table 22: Comparative demographics of clients of different payments providers

Clients of formal providers male, urban wealthier and better educated than average. Table above shows the demographic profiles of the adults that use ach type of payments provider. It shows that bank and mobile money users are relatively better educated and earn higher incomes than the population average. Users of formal payments providers are also relatively more male and substantially more urban than the population average. Farmers and salaried users account for the largest portions of bank accounts, whilst farmers constitute the largest portion of mobile money and other formal remittance provider clients.

6.2.3.1. Banks

Banks the primary provider of non-cash transaction services. The banks have historically been the primary providers of non-cash transaction channels for consumers. They offer the ability to transfer cash directly into an account, conduct EFTs (Electronic Fund Transfers) between accounts and to a limited extent offer debit and credit cards (as opposed to an ATM card) that allow consumers to pay

for goods and services through a POS device, thus reducing the need to access cash. Some of the banks also offer internet and/or mobile phone banking, adding avenues for customers to make payments and transfers without any physical interaction with the bank. Additionally, two of the banks offer non-account money transfers.

Banks are trusted. Banks in Malawi are generally trusted places to store value. Just 0.7% of unbanked adults in Malawi indicated the reason for being unbanked was that they did not trust banks. The relatively high crime levels and prevalence of theft also provide an incentive for adults to store their money in secure institutions rather than simply keep cash at home. Qualitative interviews, as illustrated below, indicate that people recognise the value of banks as places to keep your money safe from the risk of theft.

> *"(laughs) Chief, these ways that are used now are better than those used in the past, because giving you the money by hand was risky and you might get attacked by thugs and even armed robbers would storm the … office to rob teacher's and pensioners salaries and pensions. People would end up 2 to 3 months without getting paid but now with these bank accounts that we use, you know your money is safe."*
>
> Farmer, male, 67 years old

> *"Cash is fast, easy and convenient if you are physically present; however, it can be stolen; bank is safe, but inefficient – long queues; mobile is convenient, provided that the network is working."*
>
> Salaried employee, female, 23 years old

Limited distribution footprint makes banks inaccessible for many Malawians. Across Malawi there are 257 bank branches, 411 ATMs and just 771 POS devices. This corresponds to 1 bank branch per 31,000 adults, 1 ATM per 20,000 adults and 1 POS per 10,000 adults. However, even these overstate the true level of access as the bank infrastructure is largely concentrated in urban areas. Additionally, due to the limited interoperability between banks, consumers have only have been able to use their own banks' infrastructure. Therefore at best, customers of MSB (the bank with the largest branch network in the country) have access to 48 branches and NBS customers (the bank with the most ATMs) can use 82 ATMs nationally.

Banking agents have the potential to increase the reach of banks at a relatively lower cost. Recent regulation enabling bank agents has led to the roll out of bank agents by two banks: OIBM and NBS. The bank agents are substantially cheaper than establishing new physical infrastructure and offer a more sustainable option to increase the banks' distribution network. Additionally, some of the banks have linked with mobile money providers to enable customers to transfer funds between their bank and mobile money accounts, thereby enabling the mobile money agents to effectively act as agents for the bank. However, as with mobile money agents, the banking agents face a number of core challenges including liquidity management and developing a sustainable business case. Currently most of the bank agents remain in areas around the major urban centres and hence do not yet substantially increase the banks' distribution footprint.

Box 15: Malawi payments system infrastructure

Name of payment system component	Location	Function
Automated Transfer System (ATS)	RBM	SWIFT based real time gross settlement system (RTGS). Core systemic settlement system.
Central Securities Depository (CSD)	RBM	Holds securities so that ownership can be systematically transferred through electronic transactions rather than the transfer of physical certificates.
Malawi Inter-Bank Transfer and Settlement System (MITASS)	RTGS	SWIFT based real time gross settlement system (RTGS).
Electronic Check Clearing House (ECCH)	Malawi	An interbank payment system for cheque transactions between Malawi based bank accounts.
Malawi Automated Electronic Clearing House	Malawi	An interbank payment system for low value electronic credit and debit order transactions between Malawi based bank accounts only.
Malawi switch centre (Malswitch)	Malawi	A NPS operator that switches payments for 4 of Malawi's banks.
Malawi National Net Settlement System (MNNSS)	Malawi	A NPS operator that switches card based payments and clears locally between of the four banks licensed for VISA issuing and acquiring.
Nat-Switch	Malawi	NPS operator that switches payments and clearing instructions between member banks. Nat-Switch enables interoperability between 11 banks.
The Southern African Development Community Integrated Regional Settlement System (SIRESS)	Regional (currently located in South Africa and operated by the South African Reserve Bank (SARB) for the SADC Banking Association)	SADC's SWIFT based real time settlement system. It is a high value regional payment and settlement RTGS system for participating banks and central banks within SADC to expand to include low value transactions. It is intended to become the settlement system for regional low value Automated Clearing House (ACH) systems.
Regional Payment and Settlement System (REPSS)	Regional (COMESA)	COMESA's SWIFT based real time settlement system.
Society for Worldwide Interbank Financial Telecommunication (SWIFT)	Belgium	An international co-operative organisation that provides a secure transactional network and sets standards of interoperability for international financial transactions.

Table 23: Payment system components

Source: Author's own

Figure 89 below presents an illustration of Malawi's current National Payments System. The figure shows that there are currently a number of different operators connecting different groups of banks. With the introduction of Nat-Switch to connect all 11 banks centrally it is expected that following a period of transition these alternative operators will fall away.

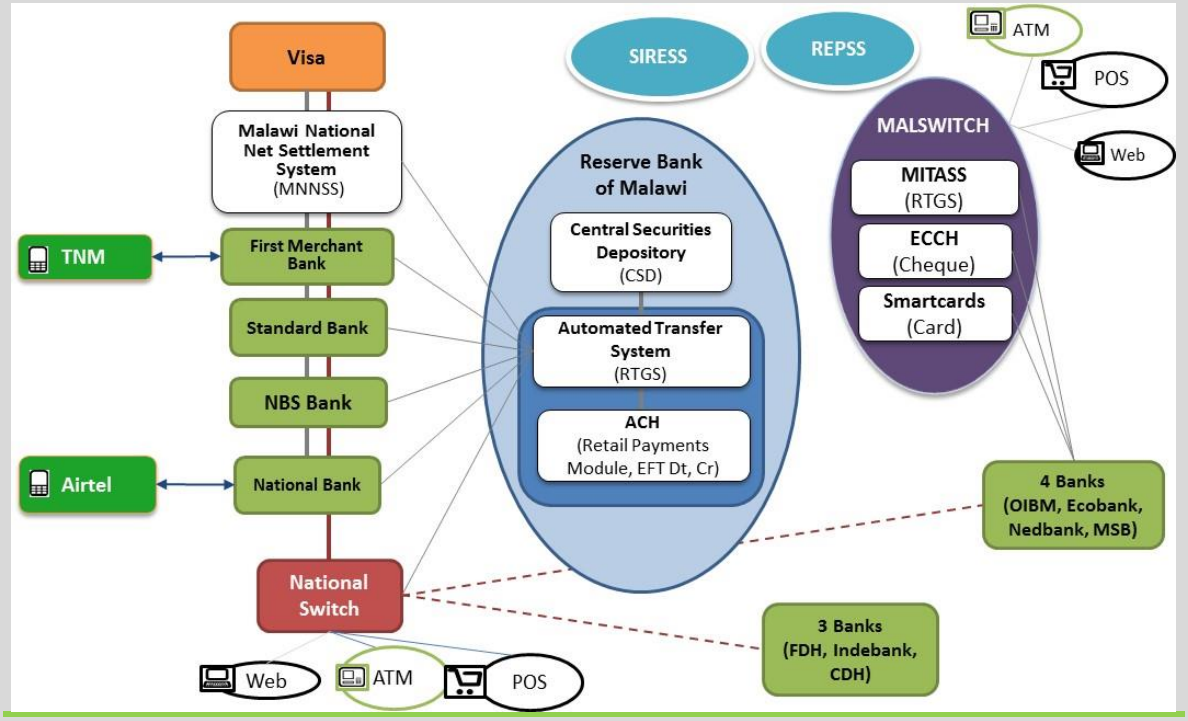


Figure 89: Illustration of Malawi's current NPS

Source: Authors' own

Nat-switch focused on card interoperability. The National Switch (Nat-switch) began operating in early 2015. The primary objective of Nat-switch is to enable the interoperability of card-based products. Initially, Nat-switch will enable interoperability between the 11 banks[93] . This means that card holders will be able to use any ATM to withdraw cash from their accounts and will also be able to use any bank's POS device to make card-based transactions.

Nat-switch to expand offering and participants in subsequent phases. The second phase for Nat-switch, currently planned for January 2016, is to create an international gateway for card switching by linking to Visa (VIP) and Mastercard's (MIP) global switch. Currently, four of the banks are licensed as Visa issuing and acquiring. Therefore, Nat-switch will initially need to build in safeguards preventing non licensed banks from accessing the Visa and Mastercard networks until they are individually licensed. Finally, in the third phase, Nat-switch intends to give MNOs and third-party aggregators access to the switch to enable the incorporation of mobile money and other closed loop systems into the core national payments system.

Nat-Switch operating model. Nat-switch will operate purely as a payment system operator and will not operate any of its own payments delivery infrastructure, such as ATMs or POS devices. Revenue will be earned from transaction fees. The initial capital investment for the establishment of Nat-switch came in the form of a loan from the World Bank together with capital contributions from each of the banks. The 11 banks are the

[93] As of 15 April 2015, 6 banks were connected to the switch

owners of Nat-switch, but all initial returns from fees, including from the interchange fee, will initially be put towards the repayment of the original World bank loan.

Interchange fee not earned by banks. The interchange fee charged to banks whose customers use another bank's ATM will not be earned by the bank that owns the ATM, but will rather be put towards paying off the World Bank loan that was used to establish Nat-switch. This eliminates the incentive for banks to roll out ATMs in rural areas where they have insufficient customers to support it. Effectively there is no incentive for any bank to increase their existing level of ATM infrastructure. Consultations with banks further indicated that the majority of banks plan to increase their POS network, but not their ATM network.

New regional switch recently operational. The SADC Committee of Central Bank Governors (CCBG) agreed to the development of SADC regional payments structure in 2009 in the interest of more effective financial integration in the SADC region. The Integrated Regional Settlement System (SIRESS) was developed under auspices of SADC and the CCBG. The regional payment system accommodates Continuous Processing Line (CPL) and Real Time Line (RTL) processing of high value irrevocable settlements directly between regional banks, as illustrated below in Figure 90. As of December 2014, all but one of Malawi's banks were already using SIRESS for regional payments. Banks in non-CMA countries have already started testing, first clearing in ZAR and later in regional currency ZAR equivalents, although there is no long term finality as to the choice of the main switching currency. SIRESS is the core settlement system, which will underpin regional payment clearing houses, initially for batched low value EFT Credits and Debits and later for other payment instruments such as card based payments.

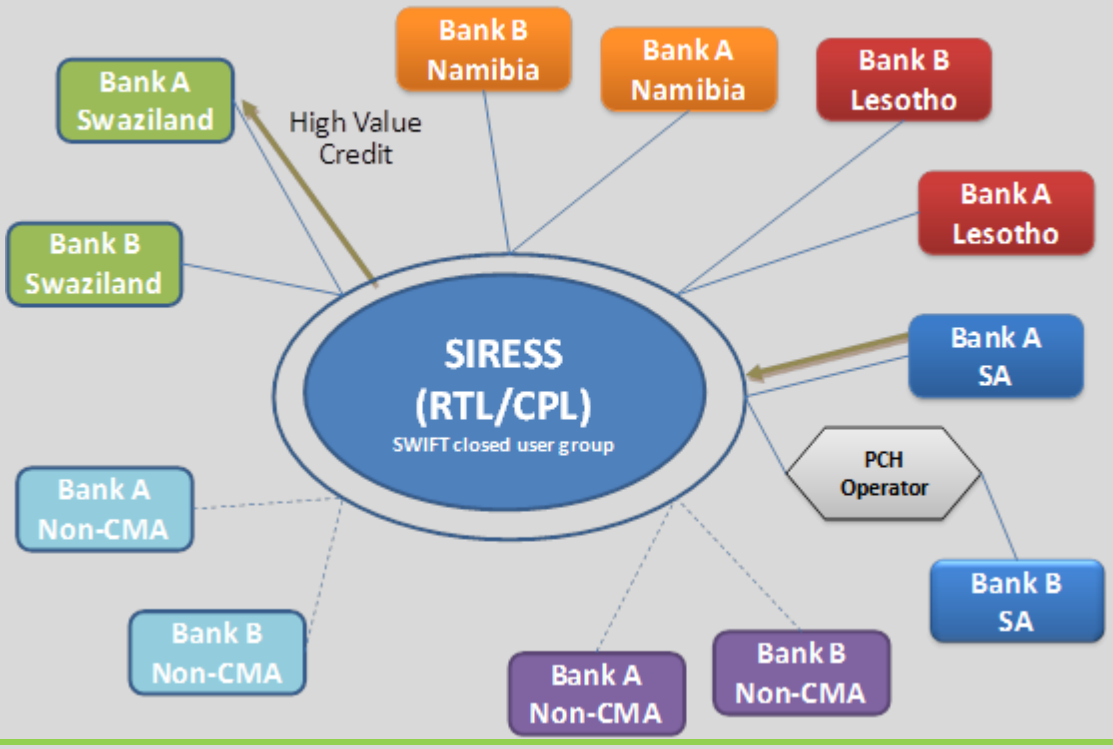


Figure 90: The SADC regional payments system – SIRESS

Source: Authors' own

SIRESS can reduce risk and create substantial economies of scale, reducing costs on cross border transfers. SIRESS makes it possible to send wholesale payments directly from one regional bank to another in real time and at minimal cost and disruption, bypassing costly and slow correspondent banking systems. Regional

clearing agreements and facilities hold much potential for Malawi as these arrangements are designed to operate at vast scale and at a marginal cost that would be near impossible for any single country to match. Consultations with banks indicated that even at this early stage and with low volumes being processed through SIRESS, they are finding transactions through this switch as a cheaper alternative.

Interoperability improving. Prior to the launch of the new National switch, the only form of real interoperability in the Malawian market was limited to banks able to issue VISA cards. The largest four banks are all able to issue Visa accounts and up until the National switch, these were the only debit and credit cards that could be used on the POS devices distributed through the country. In practice, these POS devices were primarily targeted towards the tourist market with the majority situated in hotels, tourist resorts or other tourist-targeted services. The Visa cards can also be used to withdraw cash from the ATMs of these four banks. The new National Switch will ensure full interoperability between all of Malawi's banks, but these debit and credit cards will not be able to operate outside of the country. Malawians can obtain a Visa branded card from one of the four Visa banks which can be used externally. However, this is considered a 'premium' account and the costs are higher.

6.2.3.2. MNOs

Mobile money a new product that meets a previously unmet need. Mobile money was first introduced in Malawi by Airtel in 2012 and TNM introduced Mpamba in May 2013. The uptake and usage of mobile money has been rapid since then with over 1.1 million subscribers as of the third quarter of 2014. The rapid uptake, combined with the lower average value of transactions through the channel, indicate that this product is meeting a previously unmet need.

Mobile money holds potential to meet needs of rural communities. The overwhelmingly rural population and poor infrastructure of Malawi, means mobile money has clear potential to serve a previously unserved population. The relatively high costs of travel to access bank infrastructure creates a significant potential gap in the current provision of formal payments products and therefore potential for products with greater distributional reach. As indicated in table above, FinScope (2014)[94] indicates that there is relatively higher penetration of mobile money in urban areas than rural areas (34% of mobile money users are urban dwellers, compared to 15% of the total population), but the majority of users are still based in rural areas. Additionally, as the product gains familiarity and the agent network is expanded and service issues resolved, the uptake in rural areas may grow substantially. The quotation below illustrates the proximity benefit of mobile money for users.

> *"Yes I have heard about that [mobile money] and these are the most used services here since the banks are much far away from us. Most of the people here use these services."*
>
> Farmer, male, 43 years old

Growth in mobile money slowed in 2014. Although initial usage of mobile money was rapid, growth in 2014 slowed. This may be due to a variety of contributing factors:

[94] As the FinScope 2014 consumer survey was conducted in 2013 and mobile money was only introduced in 2012 and has experienced substantial growth, the FinScope mobile money user figures are outdated. Relative statistics such as the demographics of mobile money users are discussed here as indicative but may well have changed in the interim.

- *Early adopters now served.* The early adopters are those individuals most receptive to such a product as it fills a specific need, such as to send or receive remittances and demand from this 'easy to reach' group may be saturated.

- *Marketing approach.* Initial promotional offers by the MNOs drove initial uptake but do not necessarily indicate an underlying demand for the product and were not sufficiently targeted at consumer needs. For example, in 2012, its launch year, Airtel distributed K 25 million (USD 60,000) in prizes as part of a promotion[95] and also awarded 415 scholarships[96]. Since then, promotions have tended to be less substantial and have focused on loyalty more than initial sign-up. Marketing also initially incentivised mobile money as tool to make bill payments, especially airtime, rather than as a secure store of value – the more significant use case for most Malawians.

- *Negative market discovery.* Liquidity and connectivity issues relating to the completion of payments may have given users a negative experience both discouraging them to continue using it, as the quote below illustrates, but also discouraging their friends and family to start using it.

  "Why did you stop [using mobile money]?

  It once happened that I had sent K 4,000 but the person did not deliver it."

  MSME, male, 29 years old

- *Awareness.* Awareness and education in using the product is a barrier to further growth as the quotation below alludes to. Many adults indicate they are aware of mobile money, but require more training and support to use it. This requires agents to be incentivised to create the market for mobile money.

  "Chief I won't lie to you, I am too old to understand some of these new things."

  Farmer, male, 67 years old

- *Agent issues.* Providers reported a high dormancy rate of agents with as many as two-thirds of agents dormant. Additionally many of those operating agents suffer from liquidity issues. Both of these factors, exacerbated by limited agent support from the providers, hampers the delivery and quality of the product to consumers.

The incentive for MNOs to invest in and develop mobile money is primarily focused on airtime sales. Mobile money constitutes only a small proportion of MNOs' revenue stream and stand-alone profitability is low. The majority of revenues earned from cash out at agents, which constitutes a substantial portion of direct mobile money revenues, are paid out to their agents as commission. The incentive to make significant investment in agent networks, systems and infrastructure is therefore limited and at best a long term business strategy. The primary reason for mobile money investment is indeed indirect benefits, because it is intended to reduce churn of voice customers and more significantly, lower the cost of distributing airtime, as Box 16 below illustrates. However, as many of the mobile money agents were originally, and still are, airtime agents as well, this business model effectively relies on their agents cannibalising their own business. As mobile money can be used for more than just airtime purchases, mobile money agents earn commissions on a larger variety of

[95] See: http://malawivoice.com/2012/10/20/machinga-cdss-teacher-wins-mk5-million-airtel-yabooka-sms-promotion-73351/
[96] See: http://www.nyasatimes.com/2012/11/20/airtel-malawi-launches-timaitha-fiesta-promotion/

transactions, but would be strongly incentivised to continue to sell customers airtime via the vouchers, rather than mobile money due to the higher commissions.

Box 16: TNM case study: An illustrative example of the airtime business case

TNM in Malawi accounts for about 45% of market share. The direct cost of selling airtime (including agent commissions and discounts, cost of recharge vouchers and the direct marketing development costs) accounts for 28% of operational costs and constitutes 37% of net profit for the 2013 financial year. Hence, if airtime agents are paid an average of 5% commission[97] (or can buy airtime at a 5% discount), then by shifting all airtime sales to mobile money (agents are paid 2% commissions for cash-in), TNM could theoretically reduce operational costs by 25% and increase net profit by 30%.

Source: TNM, 2014

Rudimentary interoperability between the two mobile money providers. The new National Switch does have the capacity to allow MNOs to connect in the second phase, thereby allowing full interoperability between the two providers and the banks. Whether agreements can be reached with the banks to allow a non-bank direct access to the switch remains to be seen, although they may gain indirect access through a sponsored arrangement with a bank. In the interim, as agents are not permitted to be exclusive by regulation, interoperability between MNOs is achieved at a rudimentary level through the agents. Although subscribers cannot send electronic money from an Airtel Money account to a TNM Mpamba account, or vice versa, a subscriber can send e-money to a non-subscriber albeit at a slightly higher cost. The recipient is forced to cash out completely on receipt of the funds. Alternatively, a sender can cash in, at an agent, directly to the recipient's account (similar to a cash deposit into a bank account). This is illustrated in Figure 91 below. This also circumvents the cost charged for sending money. A final option employed by users is to effectively sort at source. Subscribers may have sim cards for both providers, enabling them to use whichever network the recipient is using. If this practice is widespread it directly undermines the MNOs' endeavour to reduce churn by offering mobile money.

[97] This is a conservative assumption as, particularly for lower values, commissions may well be substantially higher.

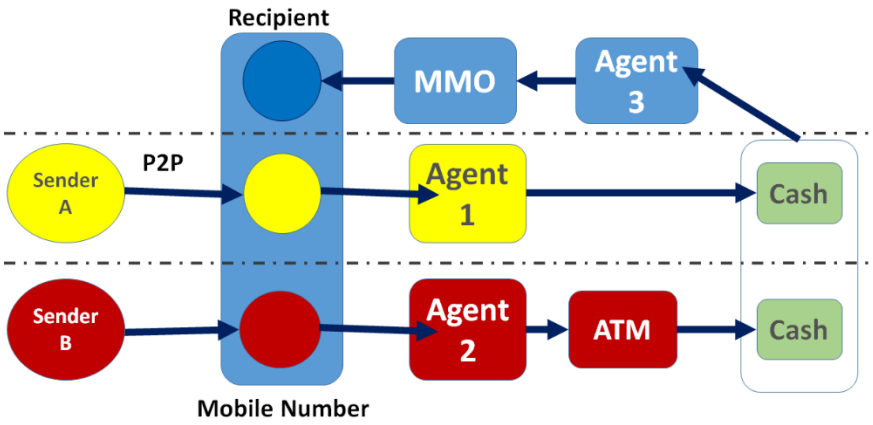


Figure 91: Models of quasi-interoperability

Source: Authors' own

Selected interoperability between mobile money providers and banks. Some of the banks have partnered with one or both of the MNOs to provide a bank account linked mobile money product. The product enables customers to transfer funds between their mobile money and bank accounts. This enables interoperability between the specific bank and MNO with some level of indirect interoperability to other banks. It allows mobile money funds to be transferred into a subscriber's bank account and then transferred to an account at another bank. However, this does require subscribers to have a bank account at a partnered bank and requires a number of steps. This is illustrated in Figure 92 below. A number of additional banks have indicated that they are in discussion with one or both MNOs to also provide this product. Table 24 below illustrates which banks and MNOs are partnered to provide this product.

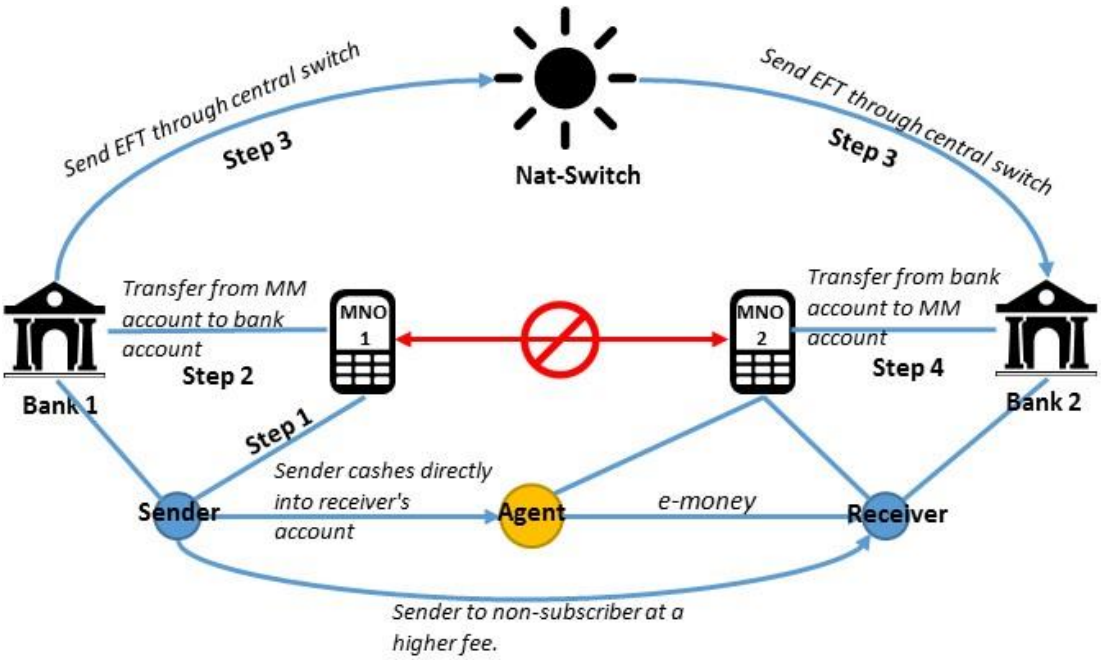


Figure 92: Transfer through bank

Source: Authors' own

Mobile money provider	Partnered with
Airtel	National Bank, OIBM
TNM	FMB

Table 24: Banks and MNOs partnered to provide account to account transfers

Source: Provider consultations, 2014-15

Agents earn commissions on customer cash-in and cash out transactions. TNM has recently switched from a tiered agent commission structure to a flat commission of 2% of the value of the transaction for both cash-in and cash-out transactions. Airtel pays the same commission of 2% of the value of transactions.

Agents unaware of commission levels. Interviews with mobile money agents indicated that very few know or understand the commissions which they are paid. Hence, simplifying the commission structure may improve this situation. TNM pays agents their commissions following each transaction, thereby directly linking the commission paid to the customer transaction, and making it simpler for agents to understand how commissions are calculated. In contrast, Airtel pays commissions at the end of each month and hence, their agents have little idea how these are calculated, making the link between transactions and commission revenue weaker. Agents receive a bonus fee of K 300 (USD 0.7) for signing up new subscribers for both providers.

Substantial agent networks. As discussed in section 5.2.2, the mobile money agent network across the two providers is substantial with in excess of 18,000 agents. A broad network of agents is critical to the success of the product, because the easy accessibility to the product is its key competitive advantage. It allows people to keep their money safer than in cash, but still have relatively easy access to it. The quotations below illustrate that users appreciate the convenience of mobile money compared to a bank combined with the relative security compared to cash.

> *"I can say they [TNM Mpamba and Airtel Money] are good and very important services because you always walk with your money in the phone meaning every time you need the money you get it, so it like you are walking with a bank in your hands."*
>
> Farmer, male, 43 years old

> *"Using cash requires you to use carry money in your pockets so in this way you might use money unnecessarily but when you use Airtel money it's more like the money is your bank account so you wouldn't miss use it and when moving around you wouldn't have problems because when you carry money you don't feel free*."
>
> Salaried employee, male, 41 years old

Agent support and related business case limited. The need for a widespread network of agents needs to be balanced by the need to develop the business case for individual agents. The average cash-in and cash-out per agent has increased over time. However, if they earn commissions of 2% of the value of deposits and withdrawals, then agents only earn in the region of K 2,589 (USD 6.21 per month, or 19% of average monthly income). This is certainly insufficient for stand-alone mobile money agents to exist and even small businesses may not consider it worth the effort.

Technology used impacts security of product. Airtel money is administered through the SIM toolkit[98], whilst TNM runs Mpamba through a USSD[99] network. The SIM toolkit is generally considered more secure than USSD for financial transactions, because the USSD communication is not encrypted and if someone were able to break the GSM encryption, they would have access to the data. SIM toolkit is considered the most secure method of mobile banking. It allows the provider to load its own encryption keys onto the SIM card. Thus the consumer's data can be stored on the SIM card and the consumer can be authenticated on the handset prior to having to carry any data across the mobile network. The data is also encrypted prior to leaving the handset and only decrypted using the provider's encryption keys (Krugel, 2007). This means that TNM Mpamba may be more restricted in terms of their ability to increase transaction limits than Airtel money due to the greater security risk of the system. Switching to the SIM toolkit is a challenge as it needs to be loaded on each subscriber's individual SIM.

Mobile money guidelines restrict the accrual of interest. The 2011 Mobile Payments System Guidelines stipulate that "interest earned or otherwise accrued to balances in the trust account shall not be to the benefit of or otherwise paid to the Mobile Payment Service Provider". Instead the mobile money providers have used any interest accrued on corporate social responsibility projects. The guidelines also stipulate that the mobile money float should be kept in a trust account with a bank "whose usage shall be restricted to facilitating mobile payment transactions."

Box 17: Mobile money infrastructure

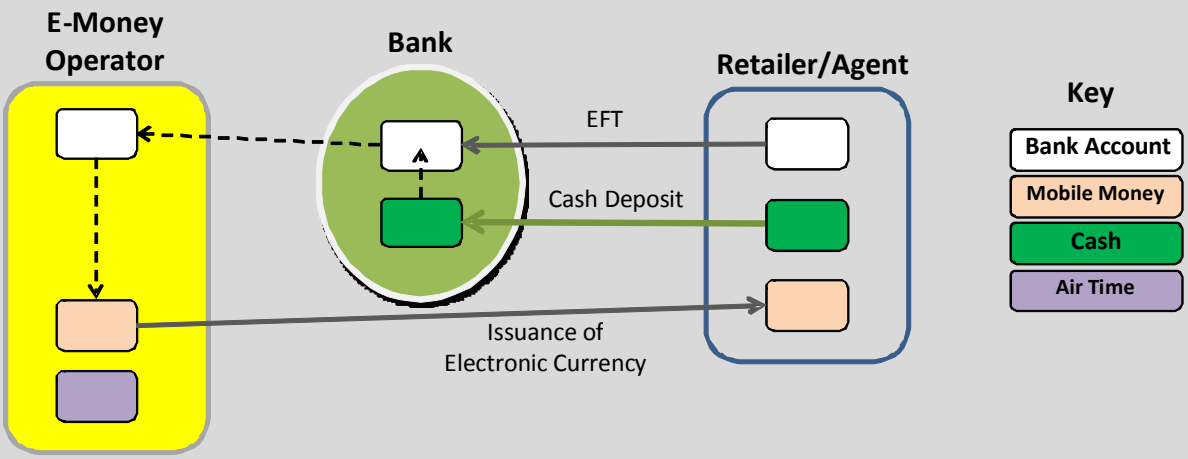


Figure 93: Flow of funds between agent, bank and E-money operator

Source: Author's own

E-money agents can benefit from a reduction in bulk cash handling charges. Figure 93 illustrates how e-Money agents interact with e-Money operators. Agents purchase electronic currency from the e-Money operator who then originates and issues the electronic funds into a system account in the name of the agent, which is then reflected on the agent's mobile electronic view of the system. The purchase transaction is effected by either a cash deposit directly into the bank or an EFT into the float account, which is then electronically traced

[98] The SIM Application Toolkit consists of a set of commands programmed into the SIM card which define how the SIM should interact directly with the outside world and initiates commands independently of the handset and the network. This enables the SIM to build up an interactive exchange between a network application and the end user, and access or control access to the network. The SIM also gives commands to the handset, such as 'display menu' and 'ask for user input' (Krugel, G 2007).

[99] USSD is a data bearer channel in the GSM network. Like SMS, it transports small messages of up to 160 characters between the mobile handset and the network. Unlike SMS, which is 'store and forward', USSD is session based and can provide an interactive dialog between the user and a certain set of applications. In other words, both sides of the dialogue happen during a session whereas an SMS based interaction is broken into each segment of communication between the client and the service (Krugel, 2007).

and uploaded to the e-Money system. As the agent has purchased the electronic currency, the agent's own electronic funds are being traded. Redemption of e-Money occurs the opposite way around whereby the agent redeems currency back to the operator who in turn initiates an EFT from the float account to the merchant's bank account. The added benefit to an agent is that if the electronic currency was accumulated through encashment using retail cash receipts, the subsequent electronic deposit on redemption is not subject to bulk cash handling charges normally charged to cash based merchants.

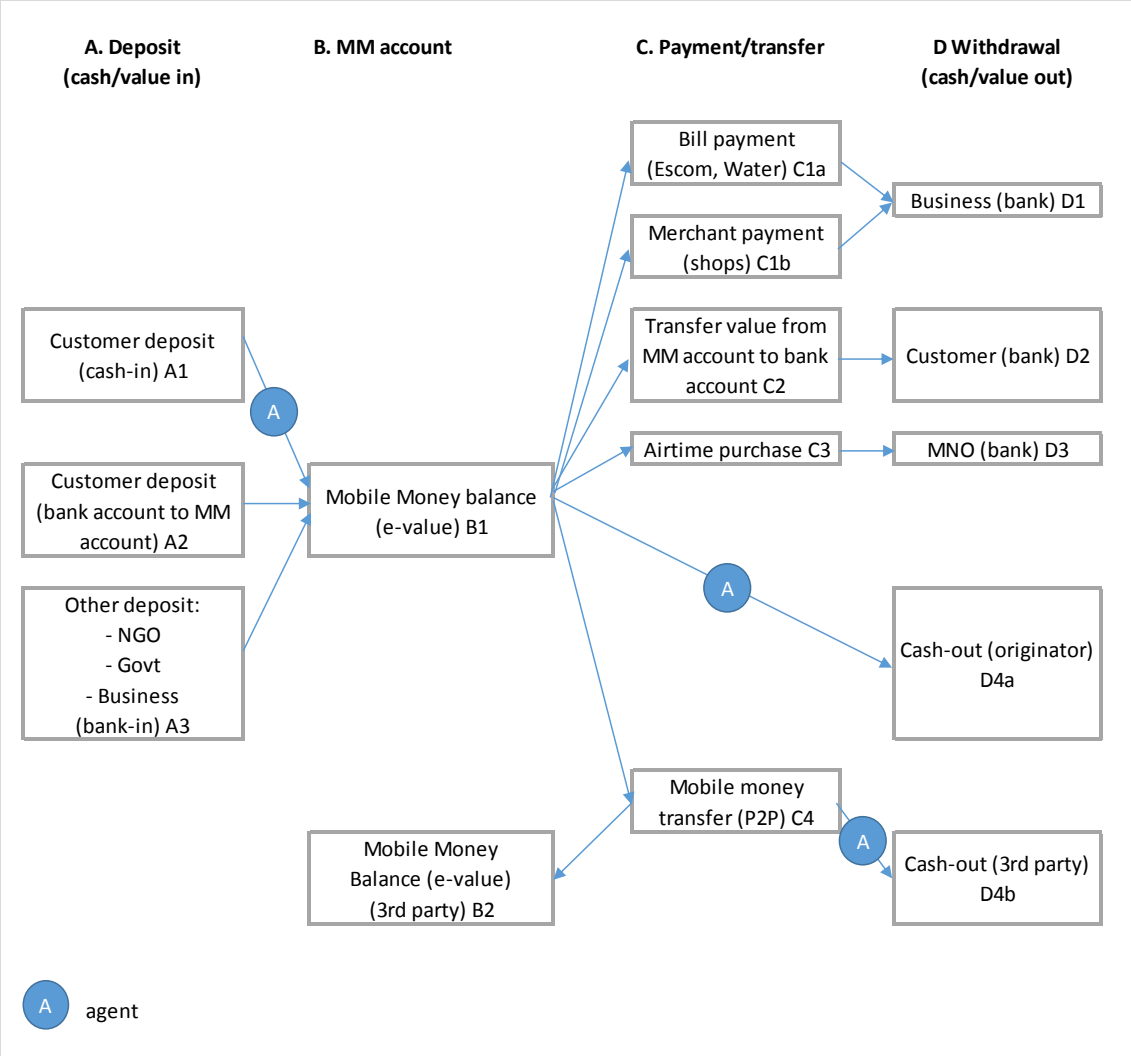


Figure 94: Mobile money transaction flows

Source: Authors' own

Figure 94 above shows the structure and flow of transactions through the mobile money ecosystem. The flow of funds can be classified under deposits (A), payments/transfers (C), and withdrawals (D). The funds held in mobile money accounts are shown under (B), and represent the total value of mobile money in issue at any time. Over any given time period, mobile money balances will increase (or decrease) by the differences between deposits (A) and withdrawals (D). The total value of mobile money balances at any point in time represents the value of funds "in transit" plus any "savings" held on the system.

6.2.3.3. Post Office

The Post Office is the major provider of formal domestic remittances. Malawi Posts Corporation (MPC) has the largest physical infrastructure of any payments provider in the country with 180 post offices and an additional 154 postal agencies (which fall under the jurisdiction of District Assemblies) as set out in section 5.2.2.2. Fast Cash is the most widely used money transfer product available in Malawi. In 2014, an average of 60,000 remittances per month were made through Fast Cash. In contrast, an average of 220 remittances were received through Western Union and 315 through Moneygram in Post Office branches[100] (MPC, 2014).

Other services include cross border remittances, bill payments and bank agency. Six post offices currently act as banking agents for NBS bank, whilst a number of other banks are interested in also leveraging Post Office infrastructure. Both Western Union and MoneyGram payments can also be received through the Post Office, although not sent.

Ambitions to expand financial service role. MPC future strategy includes expanding their provision of financial services to become a fully-fledged Post Bank. Lack of electricity, liquidity, network connectivity or computers, in many branches are critical limitations at present. Core skills and systems required for banking would also need to be acquired.

6.2.3.4. Retailers

Financial services offerings by retailers are limited, however selected retailers offer money transfer products.

Peoples Trading Centre and Zoona offer closed loop money transfer services. Senders can deposit money with a teller in their local store, which can be accessed with a unique pin by receivers in any other Peoples store. The cost of this service is tiered according to the value sent, between 5-10% of the value sent, up to a maximum of K 200,000 (USD 480). The service is offered in 87 Peoples retailers. Both the sender and receiver are required to present proof of identification, potentially representing a challenge for many Malawians.

Farmers World also offer a quasi-money transfer service to customers. Customers can purchase goods in one store but take possession of the goods in a different store, thereby effectively enabling in-kind remittances to be sent between stores. The retailer also offers a money transfer service between branches on an *ad hoc* basis.

6.2.3.5. Money Transfer Agents

MoneyGram, Western Union, Mukuru operate in Malawi. Money Transfer Agents (MTAs) make non-account money transfers between individuals, focused on cross border transfers. Mukuru operates through 65 bank branches across Malawi. MoneyGram and Western Union both operate through bank branches and transfers can also be received in post office branches. All the MTAs require proof of identification for all senders and receivers. Mukuru and Western Union only accepts driver's license and passports, although Mukuru agents can accept a voter's registration card as ID. MoneyGram also accepts voters' registration cards as ID. All of the providers will only receive cross border payments and not send. The operational Manual for Cross Border Foreign Exchange Transactions Issued to ADBs

[100] These products can also be accessed through other distribution points, most notably bank branches, and hence this underrepresents the total number of remittances sent through this channel throughout Malawi

(2015) stipulate that ADBs (Authorised Dealer Banks) may approve applications for travel allowances for USD 5,000 per day up to a maximum of USD 10,000. In order to send remittances to dependents, an affidavit in English stating the need for assistance must be provided. Otherwise, apart from where it can be proved that the remittances are for school fees or alimony, residents are limited to remitting amounts up to USD 1,000 per calendar year.

6.2.3.6. Informal

Significant use of informal channels. 10% of remittance senders use informal channels, whilst 11% of remittance receivers receive remittances through informal channels, as the quote below illustrates. Research in the SADC region indicates that sending remittances with taxis, buses or trucks is a popular channel through which to transport informal remittances. Truen & Chisadza (2012) found that 40-50% of immigrants in South Africa (from the other SADC countries) preferred sending remittances via bus or taxi.

> ***"How do you send money to your mum?***
>
> *Well I just send someone to give her or I send with some minibus drivers."*
>
> MSME, male, 29 years old

Lack of documentation, lack of alternatives and convenience drives informality. The major advantage of this channel is that no paperwork or bank accounts are required, enabling access by undocumented migrants, and that it is highly convenient as the cash can often be sent door-to-door, which is major advantage if the recipient resides in a rural area. Below is an excerpt from an interview conducted with a provider of this service as part of the qualitative interviews:

> *"Then even before we got the trucks, people would ask, "please help I need to give money to my mother or relative, she is sick" or something so that is how we help people. We had to do it to help those who were saying we have "starving wives and relatives" that needed to receive money that side of Malawi. I don't lend out money. I only give to a person their own money. The difference is that it is handed over by someone else to another person and it is a different person that receives it; receiving from me. You receive in Malawi, some money that was handed (by your relative) to my brother in Gauteng. On handing the money you give a name upfront of the collecting relative. If he/she is collecting for the 1st time, then you must give your relative a hint word which he/she will have to mention on collection. He just use the cell to tell me whose relative has given. The majority of my customers have relatives outside of the country- Gauteng to be specific. Sometimes 20 people receive or up to 50 clients per month. Mostly a lot of people are not able to find money on their own.*"
>
> Dependent, male, 46 years old

In kind remittances sent at times. There is also evidence that many remittances are made in kind. Cash is particularly easy to steal, so for many migrants it makes sense to save by buying goods, which are then remitted at a later point (Truen & Chisadza, 2012).

Informal remittances can be sent via Hawala traders. Hawala traders operate similar to any formal closed loop money transfer system. Senders deposit money with a Hawala trader. The Hawala trader's counterpart is then notified to make a payment to the receiver. The Hawala traders then settle between each other, often through the transfer of goods. The Hawala traders have a great advantage over existing formal remittance channels as they reside in the community and are informal. They can therefore overcome problems of proximity and documentation.

Formal alternatives needed, due to slow speed, losses and unreliability of some informal options. The major disadvantage of informal channels is the expense (10-30%) and there are little or no safeguards against theft and the loss of the money. The delivery of the money is also uncertain and may take a long time, with customers having limited recourse (Truen & Chisadza, 2012). These issues with informal methods are illustrated in the quotation below:

> *"There are also problems with informal methods of remitting money. I have relatives who are dependent on their children who work in SA. They receive remittances through individual business people – amounts that range between ZAR 1000 (USD 82.50) and ZAR 2000 (USD 165). A few cases have been observed where this money was never delivered to them. It is common that the business men do not always deliver. Such cases have been reported to the police. The senders are forced to change business people."*

Salaried employee, male, 26 years old

6.2.4. Products

			Number of customers	Products				
				Account based products		*Non-account based products*		
				Bank accounts	*e-money accounts*	*Domestic money transfers*	*International money transfers*	*Other payments*
Providers	***Banks***		1.3 million	✓		✓		✓
	MNOs		1.1 million		✓			✓
	Post Office		60,000 transactions p.m.			✓	✓	✓
	Retailers					✓		Not widely available
	MTOs					✓	✓	
	Informal	*Hawala traders*					✓	
		Busses & taxis	200,000			✓	✓	
		Friends, family or self	1.3 million			✓		

Table 25: Matrix of providers and the products they provide

The table above shows which providers provide which products. The banks and MNOs between them account for the account based products. There are about 1.3 million adults with bank accounts, although the total number of bank accounts exceeds 2 million. Additionally there are 1.1 million mobile money subscribers, although most of these are not active. There is also a substantial overlap between the users of these products with a large portion of mobile money users also having a bank account.

There are a far greater variety of non-account based payment product providers. Two of the banks: MSB and OIBM offer domestic money transfer products for non-accountholders, whilst the Post Office accounts for the majority of formal non-account payments through its Fast Cash product. However the primary channels for non-account based money transfers are informal – either through Hawala traders, busses and taxis or with friends, family or physically transported by the sender themselves.

6.2.4.1. Account based products

Bank accounts

Savings accounts frequently used as transaction accounts. Basic savings accounts in Malawi offer the majority of transactional capability to cheque or current accounts. However, as illustrated in Table 25 above, the cost to the consumer of savings accounts is typically lower, with lower monthly service fees. Savings accounts may also pay minimal interest on deposits. As a result, basic savings accounts are often used as transaction accounts by Malawians.

Basic cost profile estimated. Table 26 below lists all relevant bank transaction costs for entry level current and savings accounts, and mobile money accounts in Malawi and compares these to the costs of entry level accounts in Swaziland, South Africa and Lesotho. A basic transaction profile is assumed for a low income bank account holder that is using the account to a limited extent, although more frequently than simply as a 'mailbox'. This provides a basic estimate of the monthly cost for a bank account holder and when applied across countries provides a comparison of basic monthly costs.

USD	Assumed transaction profile[101]	Malawi current account	Malawi savings account	Swaziland	South Africa	Lesotho	Malawi Mobile money
Monthly service fee		2.47	0.41	1.11	0.26	0.73	0.00
Debit orders	1	2.60	2.84	1.63	0.32	1.25	n/a
Debit order bounce		55.70	55.70	27.01	0.89	n/a	n/a
ATM withdrawals--on us (w/d: $10 each)	3.1	0.12	0.12	0.40	0.43	0.42	0.48
Statements requested – ATM	1.2	0.02	0.02	0.36	0.32	0.24	0.05
Statements requested – Counter	0.11	4.13	3.68	0.96	0.96	1.73	0.05
Deposit ($50) – counter	0.31	-	-	1.83	1.08	1.18	0.00
Estimated monthly cost[102]	**-**	**5.90**	**4.03**	**5.09**	**2.72**	**4.10**	**N/A**
Value in local currency		K 2,457.35	K 1,679.32	E 59.14	R 31.67	LSL 47.73	N/A
As a proportion of average income		18%	12%	6%	1%	5%	
Monthly cost (excl. debit orders)		3.30	1.19	3.46	2.41	2.86	1.55

Table 26: Estimated transaction cost per account compared across SADC countries

Source: Author's own calculations

Cost profile high compared to region, but driven by specific components. Table 26 above shows that the cost of a basic transaction profile in Malawi is relatively expensive compared to other countries in the region. In terms of absolute cost, the monthly cost of Malawi's current accounts are higher than in the comparison countries. Savings accounts in Malawi, although cheaper are still relatively expensive compared to the other countries. When the costs are considered relative to the income levels of each country, however, it is clear that these accounts are completely unaffordable for most Malawians. The monthly cost of a basic transactions account in Malawi constitutes 17.5% of Malawians' average monthly income. Savings accounts are less expensive, but still constitute 12.8% of Malawians' average income, more than twice as high as in the other countries.

[101] This banking profile is based on the postulated Southern African profile for low income bank customers (Genesis, 2005). The profile estimates the usage of a low income user that is using the account to a limited extent, although more frequently than simply as a 'mailbox'
[102] Estimate is based on the weighted average according to the market share of the banks operating in each country.

Debit order costs and statement costs high. The relatively high cost of Malawi bank accounts are primarily driven by the high cost of debit orders and statements. The cost of debit orders is substantially higher than in the comparison countries, and the cost of debit orders bouncing is very high and. Although not a direct cost, because costs add to the indirect costs of debit orders as the risk of one bouncing can be very severe given that the cost of one debit order bounce is equivalent to nearly 2 months income for the average Malawian adult. Hence, FinScope (2014) indicates that only 0.1% of adults have used a debit order within the last 12 months. The cost of statements is also very high. This is an important barrier to new users. Zollman (2014), for example, finds that low income individuals and first time bank users frequently do not trust that their money will be available when they need it, or that the bank will steal their money. Easy and cheap mechanisms with which to check on their money are therefore critical to build trust in the provider and product.

ATM and monthly service fees low. In contrast, the costs related to withdrawing and depositing money and the monthly service fee on savings accounts is very low in Malawi. A number of the banks offer at least one of these services free of charge for entry level accounts. This means that the most basic cost of bank accounts is low in Malawi, but the available transactional capability is limited due to cost.

Cost of accessing bank infrastructure the largest contributor to overall cost. Whilst the basic cost of bank accounts may be low in Malawi, the overall cost of use is high. If a basic bank account holder is assumed to have a savings account and makes two withdrawals a month and one deposit, this amounts to K 267 p.m. (USD 0.65) constituting just 2% of average income and is therefore affordable for most. However, as discussed in section 5.2.2, most Malawians live in rural areas far from bank infrastructure and the average transportation cost to reach the closest bank is K 801 (USD 1.92) a trip. Two ATM withdrawals would require two trips. Additionally, the time spent travelling to and from the branch as well as the time spent in long queues adds up to nearly half a day on average each trip, a substantial opportunity cost for adults reliant on their own labour for their income and equivalent to a day's lost income each month. When these additional transport costs are added, the total cost of using a bank is substantially higher, as illustrated in Figure 95 below. This further points to the fact that if providers increase the cost of access (such as ATM withdrawal fees), thereby enabling a greater rollout of ATMs and other bank infrastructure, counterintuitively the actual cost to access bank accounts will fall for most Malawians.

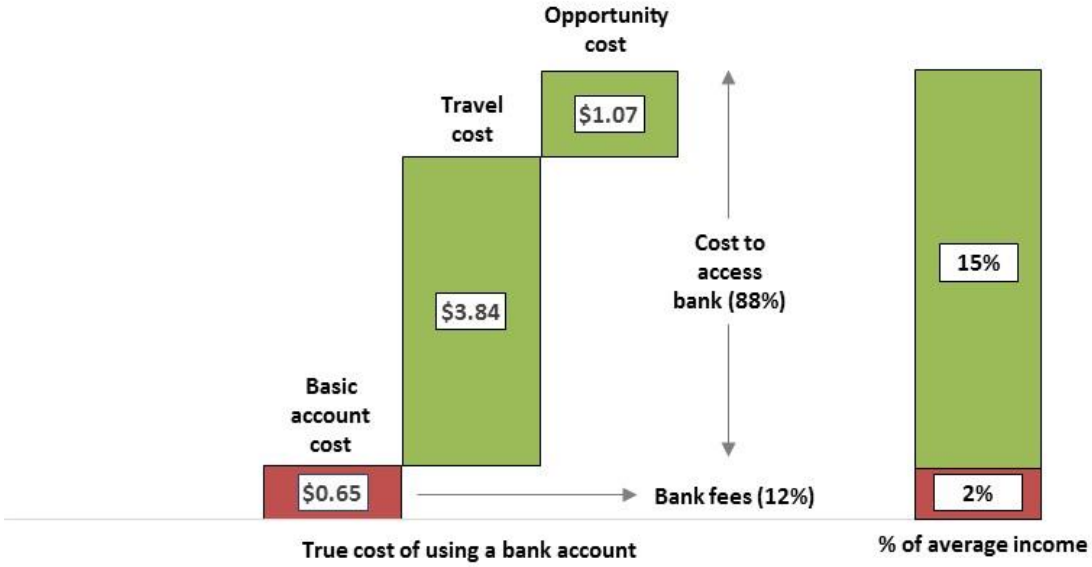


Figure 95: True cost of accessing a bank account in Malawi taking into account travel

Source: FinScope, 2014

Foreign denominated bank accounts. Most of the banks do offer personal bank accounts denominated in foreign currency. These are targeted primarily towards employees of international organisations, such as donors, who earn income in foreign currency and wish to guard against the risk of currency fluctuations.

Mobile banking and internet banking. In total six of the banks offer mobile banking and four internet banking. These provide account holders alternative channels through which to interact with their account. Banki M'Manji, OIBM's mobile banking product is the most widely used of these and has 140,000 registered users. The product allows users to make balance enquiries, purchase airtime, request a mini-statement, pay utility bills and transfer money to another OIBM account.

E-money

Mobile money primarily used for airtime purchases, some remittances and bill payments. Both mobile money products in Malawi allow subscribers to transfer money to other subscribers and non-subscribers. Bill payments for electricity, water, airtime, insurance premium payments to certain insurers and loan repayments from some MFIs are also available with mobile money. Some mobile money agents may also accept electronic money for goods and services provided; for example a retailer that is also a mobile money agent may accept electronic money to pay for goods. The quotation below highlights some of the key advantages of using mobile money to send remittances.

> *"Mobile banking is good because we can send money to our relatives that are very far away from us and our relatives can also send money to us easier than using banks, because banks have long processes and they require you to have proper documentation."*

Salaried employee, male, 41 years old

Bulk payment disbursals can also be made through mobile money. Bulk payments enable salary and wage payments into mobile money accounts. This may be particularly useful for employees without bank accounts that reside a long distance from the nearest bank infrastructure. Furthermore, social transfers from both government and donor organisations can be distributed directly into recipients' mobile money accounts. This has substantial advantages over alternative mechanisms. It is cheaper than distributing cash and also potentially safer for recipients. Many recipients of social transfers reside in very rural areas and therefore distributing the grants into bank accounts, even low cost accounts, is not really practical due to the difficulty the recipient has in accessing the bank. However, low literacy levels and lack of access to mobile phones amongst welfare recipients may be significant barriers to using this channel to distribute social transfers. A number of pilot projects to distribute social transfers through mobile money have already been launched in Malawi.

Box 18: Pilots to distribute social welfare transfers through mobile money

The disbursal of social welfare payments through mobile money has been recognised across countries as a major potential use case for mobile money. Distributing welfare payments in cash to predominantly rural beneficiaries can be cripplingly expensive, for example in Lesotho welfare grants were distributed using helicopters to the most remote recipients. In Malawi, the limited infrastructure and high cost of transporting cash makes the distribution of welfare payments similarly expensive.

Mobile money theoretically provides an ideal mechanism to distribute these payments at low cost to both the provider and the recipient, who does not have to travel to receive the payment. Additionally, distributing social welfare payments through mobile money increases the volume of electronic money in the system and nudging recipients to use e-money rather than cash for bill and spot payments where available. In so doing providing a powerful demonstration effect for other community members on the benefits of the product. However, the success of these initiatives is dependent on creating a positive demonstration effect for users of the product to ensure continuing trust and usage. This includes:

- Ensuring agents have sufficient liquidity to allow clients to receive the cash payments timeously.
- Developing an ecosystem of businesses that accept e-money for goods and service purchases to encourage use of digital tender to move beyond cash.
- Ensuring that issues and faults with the system are minimised as just one experience of a bill payment not being reflected can erode all trust in the system for users.

Two of Malawi's most prominent social cash transfer programs, the Social Cash Transfer Program (STCP) run by the Ministry of Gender, Children and Community Development and the Donor led Integrated Annual Emergency Response have both started experimenting with shifting from cash to electronic delivery via bank accounts or mobile money.

- The SCTP aims to support the poorest 10% of Malawians through regular cash transfers, intended to reduce malnutrition and boost school enrolment. A pilot was launched in 2014 in 3 of the districts to distribute these payments electronically. In two of these districts the program has partnered with FMB and transfers the funds into recipients' bank accounts (opened for them as part of the pilot). They are then able to withdraw the cash from the bank's ATMs.

In the other district, the program has partnered with Airtel to disburse the transfers into recipients' mobile money accounts. However, the recipients are still required to physically show their pass book to the agent to receive their payment and hence there is no real difference for the recipient who still has to travel to the distribution point except that they now, in addition, must remember to take their phone with. Also, they do not immediately receive cash, but must go through the additional step of converting their e-money to cash.

The MMAP[103], meanwhile, is also planning to run a pilot for the same program in which the transfers will also be distributed through mobile money. This pilot intends to take a more systematic approach and has first undertaken detailed GIS mapping to establish whether there are sufficient agents to meet recipients' needs, analysis of liquidity requirements based on current spending patterns and have worked to build an ecosystem of retailers and service providers that accept e-money as tender. This pilot will not require any physical interaction with the recipient (pass books will be discarded) and hence the benefits from distributing via mobile money can be experienced by recipients.

- The Emergency Response aims to save lives, reduce suffering and build resiliency among food-insecure households during Malawi's drought season. These payments were first piloted through Airtel money in 2012, although issues with the service led to one NGO abandoning the service and reverting to cash. However, the World Food Programme and the INGO consortium have decided to use Airtel Money exclusively for the 2013-2014 response.

Mobile money costs. Mobile money subscribers are charged to send money to another account, purchase goods, pay bills, request bank statements and to cash out at an agent. Cash in at agents and airtime purchases are free. The cash out costs are tiered based on the amount that is withdrawn. The cost of P2P transfers on the same network and bill payments are K 50 (USD 0.12) for both providers. Balance checks are free on Airtel money, but K 10 (USD 0.02) on TNM Mpamba.

Reduced documentation required for mobile money. Application for a mobile money account requires the applicant to show the agent proof of identity in the form of passport, driving license, voter's registration card or other photo ID, although this ID is not verified and no copy is made. No proof of address is required. This makes the documentation requirements to access mobile money substantially less onerous than most other formal payments providers.

Mobile money accounts' value capped. However, the reduced documentation requirements mean that the value in accounts are capped. Airtel allows a maximum transaction amount of K 100,000 (USD 240 or 7.4 times the average monthly income) and a maximum current balance of K 300,000 (USD 720). TNM tiers transaction limits depending on the level of KYC requirements complied with:

- The lowest tier caps transactions and the wallet balance at K 50,000 (USD 120) and is available if the proof of income presented is in the form of a letter from their chief or district commissioner.

[103] The Mobile Money Accelerator Programme is a body administrated by FHI360 and including regulators, providers and donors which endeavours to support and advance the growth of mobile money in Malawi through a series of coordinated interventions.

- The second tier is available to subscribers presenting a voter's registration card as their proof of identity and caps transactions and the wallet balance at K 200,000 (USD 480).

- Finally in the third tier, transactions and the wallet balance are capped at K 300,000 (USD 720) and are available to subscribers that present their passport or driving license as proof of identity. For most Malawians, these caps are likely high enough not to be a major barrier to use currently.

6.2.4.2. Non-account based products

Domestic money transfers

The Post Office's Fast Cash product is the most widely used remittance product in Malawi. As illustrated in Figure 96 below, an average of 60,000 payments were sent in 2014. The value of money remitted through this channel rose 45% between January 2013 and January 2014, and in the busiest months in excess of K 500 million (USD 1.2 million) was sent per month through this channel. The average value of transaction sent through this channel throughout 2014 was K 7,800 (USD 18.7). Fast Cash is a closed loop domestic money transfer product between Post Offices, using the Post Office's internal online network. The product is available in all 180 post offices, giving the product a substantial distribution reach and the money transfer is done in real time. When making a deposit, the sender receives a unique ID. The sender then sends this ID to the recipient who uses it to receive the money from another Post Office branch.

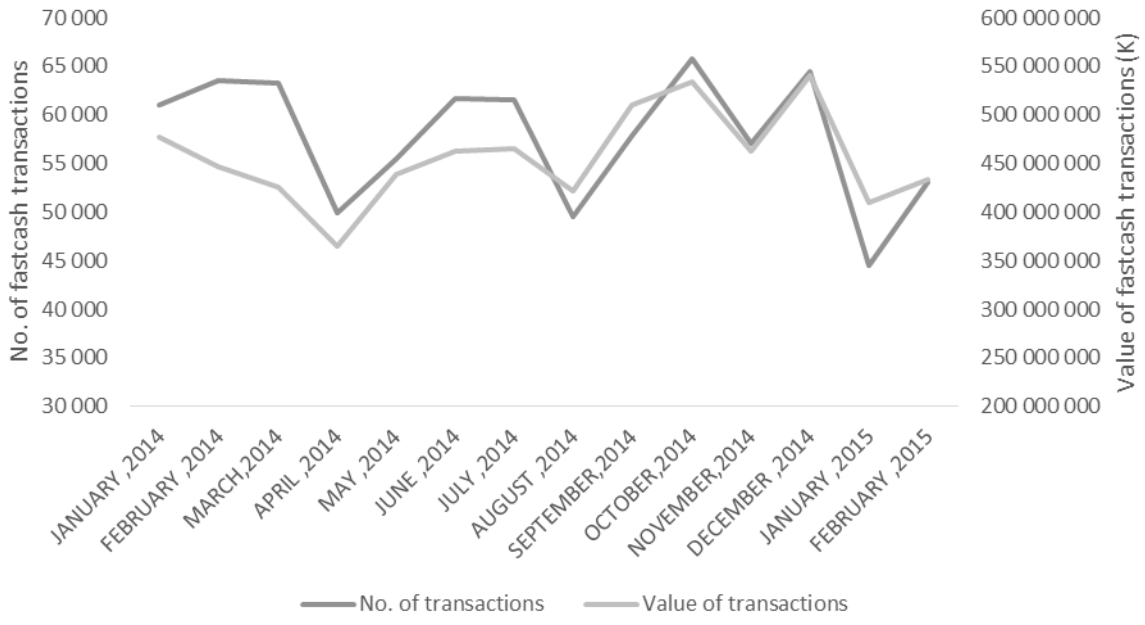


Figure 96: Fast Cash transactions since January 2014

Source: MPC, 2014

No documentation barriers to Fast Cash. A major advantage of Fast Cash is that no documentation is required to complete the transfer. If the receiver does not have proof of ID the sender of the money is asked to write a test question and provide an answer. The same information is communicated to

the recipient who goes to the post office and provides an answer to the test question. The cost of the service is 10% of the value sent.

Rural network and liquidity challenges with Fast Cash. Some of the major challenges with the Fast Cash product involves sending money to some of the more remote locations, where Post Offices may not have electricity, network connectivity or even computers. In this case the information regarding Fast Cash transfers can be accessed by Post Office employees via mobile phone, although this still relies on connection to the mobile network and this may delay transfers and reduces reliability. Liquidity constraints in smaller and more remote Post Offices can also be a challenge and moving money is the largest cost to the Post Office in providing this service.

Two banks offer non-account based money transfers. OIBM offers a money transfer service to non-customers, whereby money that is sent can be withdrawn by recipients from OIBM ATMs using a pin created during the sending process. MSB offers their Zafika product at a cost of 5% of the value and is similarly available to non-account holders and can be withdrawn from MSB ATMs or branches. The product is not very widely used with just over 600 transfers made per month on average.

Certain retailers offer closed loop money transfers between branches. Peoples Store in partnership with Zoona offer money transfers between their 87 stores. Transfers are done by the tellers. Both the sender and receiver are required to show proof of identity in the form of a driving license, passport or voters registration card. The sender creates a secret pin which they then send to the receiver. Confirmation of the transfer is SMS'd to both sender and receiver at which point the receiver can collect the cash from any Zoona agent at a local Peoples Store, if they have proof of identity, the secret pin and the confirmation SMS. The cost of this service is tiered according to the value sent, between 5-10% of the value sent, up to a maximum of K 200,000 (USD 480). Farmers World also offers in-kind remittance services. However, there may be potential to expand the offering of money transfers through retailers.

Remittances most commonly sent via non-formal channels. Domestic money transfers are generally not made through formal channels. FinScope (2014) indicates that 200,000 adults send domestic remittances through informal channels such as busses and taxis, whilst more than a million adults send remittances through family and friends. The costs may vary considerably for informal channels, although most typically the cost is 10-20% of the value sent. The cost of sending money with family and friends is nominally zero.

Relative cost of channels inversely proportional to proximity of distribution points. The most expensive channels are also those that have distribution points closest to the receivers. Informal taxis or busses are the most expensive channel but access cost for recipients are lowest as these are taken directly to the recipient's community. Fast Cash, through the Post Office, is the most expensive formal channel, but as with informal providers, the relatively larger distribution network of the Post Office reduces the average cost to access the money transfer for recipients. In contrast, sending remittances through banks are the cheapest channel – Zafika costs just 5% and the cost for transferring funds between bank account holders (this naturally requires both sender and receiver to be banked) is even lower. However, due to the limited bank infrastructure, the access costs are substantially higher and as a result, the net cost may actually be higher than informal channels, particularly for small values. As the value of the remittance increases, travel costs remain standard, it becomes relatively cheaper to use formal channels. Table 27 below illustrates the relative costs of domestic money transfer channels, taking into account estimated travel costs. Family and friends do not cost anything and will deliver the remittance directly to the recipient and hence is the overwhelmingly preferred channel by Malawians.

However, this does mean that the timing of remittances is reliant on when someone is making the trip and therefore may not be sent regularly.

To send K 2,000 (USD 4.8)	Basic cost	Travel cost	Opportunity cost	Total cost
Informal (busses & taxis)	K 400 (USD 0.96)	-	-	K 400 (USD 0.95)
Post Office[104]	K 200 (USD 0.48)	-	K 224 (USD 0.54)	K 444 (USD 1.02)
Retailers (Zoona & Peoples)[105]	K 150 (USD 0.36)	K 801 (USD 1.92)	K 224 (USD 0.54)	K 1,175 (USD 2.82)
Non-account bank transfers (Zafika)	K 100 (USD 0.24)	K 801 (USD 1.92)	K 224 (USD 0.54)	K 1,125 (USD 2.70)
Bank account transfers[106]	K 219 (USD 0.53)	K 801 (USD 1.92)	K 224 (USD 0.54)	K 1,244 (USD 2.99)
To send K 4,000 (USD 9.6)				
Informal (busses & taxis)	K 800 (USD 1.92)	-	-	K 800 (USD 1.92)
Post Office	K 400 (USD 0.96)	-	K 224 (USD 0.54)	K 644 (USD 1.50)
Retailers (Zoona & Peoples)	K 300 (USD 0.72)	K 801 (USD 1.92)	K 224 (USD 0.54)	K 1,325 (USD 3.18)
Non-account bank transfers (Zafika)	K 200 (USD 0.48)	K 801 (USD 1.92)	K 224 (USD 0.54)	K 1,225 (USD 2.94)
Bank account transfers	K 219 (USD 0.53)	K 801 (USD 1.92)	K 224 (USD 0.54)	K 1,244 (USD 2.99)
To send K 8,000 (USD 19.18)				
Informal (busses & taxis)	K 1,600 (USD 3.84)	-	-	K 1,600 (USD 3.84)
Post Office	K 800 (USD 1.92)	-	K 224 (USD 0.54)	K 1,044 (USD 2.46)
Retailers (Zoona & Peoples)	K 600 (USD 1.44)	K 801 (USD 1.92)	K 224 (USD 0.54)	K 1,625 (USD 3.90)
Non-account bank transfers (Zafika)	K 400 (USD 0.96)	K 801 (USD 1.92)	K224 (USD 0.54)	K 1,425 (USD 3.48)
Bank account transfers	K 219 (USD 0.53)	K 801 (USD 1.92)	K 224 (USD 0.54)	K 1,244 (USD 2.99)

Table 27: Comparative costs of domestic money transfer through different channels for different values

Source: FinScope, 2014; In-country consultations, 2014; World Bank, 2015

Cross border money transfers

The Post Office also administers cross border transfers. The Post Office acts as agents of MoneyGram and Western Union (receipts only) and directly provides cross border Postal Orders. Figure 97 below illustrates that usage of these channels is very limited. There has been significant growth in 2014, though this is from a very low base. In September 2014, just K 44 million (USD 105,500) was received

[104] FinScope (2014) indicates that although it does take a substantial amount of time to reach Post Office branches, the largest portion of users are able to walk.
[105] These retailers are distributed primarily in urban areas and hence it is assumed that the travel costs are similar to a bank.
[106] To send using a bank account, the basic cost was calculated as the monthly service fee of an account plus the cost of a cash deposit + the cost of a cash withdrawal

through MoneyGram and Western Union in the post office with a combined total of 821 payments. The average value of each transaction was K 54,210 (USD 130).

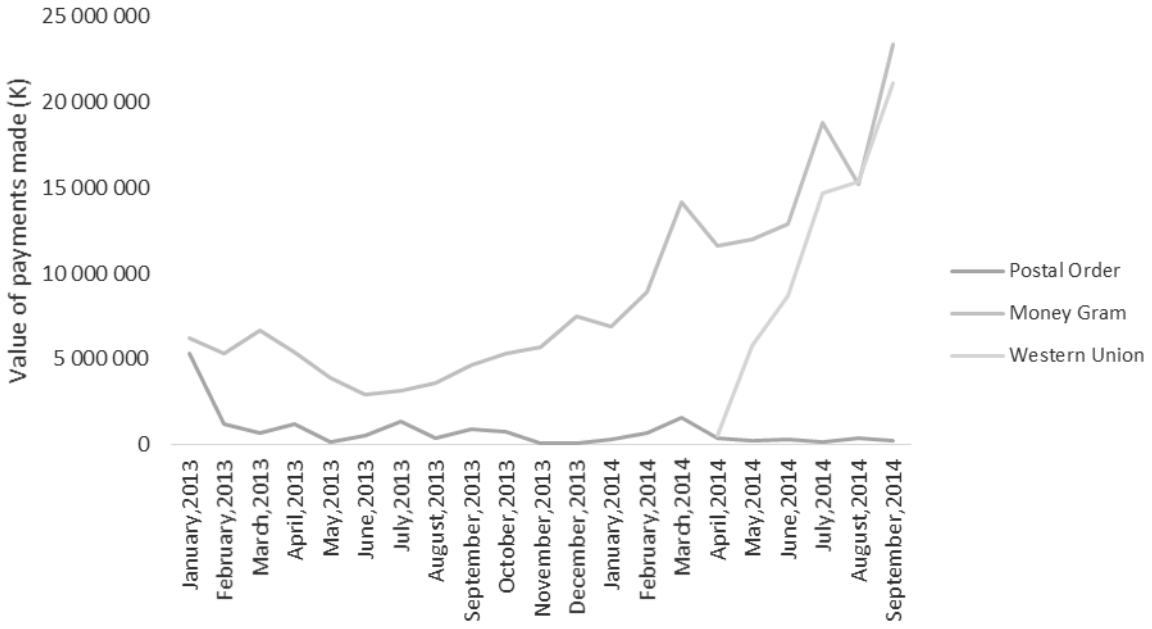


Figure 97: Value of cross border payments through Malawi Post Office

Source: MPC, 2014

Cost of remittances from South Africa. Figure 98 below, compares the cost and time taken to send remittances from South Africa to Malawi (the only Malawian remittance corridor tracked by the World Bank), through different channels as well as illustrates the number of adults that either send or receive remittances through each channel. South Africa is one of the major remittance sending countries to Malawi: World Bank (2012) estimates that only Zimbabwe and the United Kingdom send more remittances to Malawi. The Post Office, whilst the cheapest option also takes the longest time to transfer. The costs for the other formal providers are very high and likely beyond the reach of most low income migrants. As with domestic transfers, family and friends is the most widely used channel.

	Percentage cost: SA to Malawi (USD)	Time taken	No. of clients
Post Office	3.2%	>6 days	
Moneygram	13.0%	1 hour	111 481
Western Union	15.92%	1 hour	
Mukuru	15.76%	Same day	
Banks	26.5%	3-5 days	190 279
Informal	~10-20%		111 643
Family & friends	–		376 780

Figure 98: Comparison of cross border money transfer products

Source: World Bank, 2012; FinScope, 2014

Other non-account based payments

Limited evidence of bill payments through retailers. Bill payments such as electricity and water bills are not widely available through retailers. The Post Office does allow customers to pay electricity, water and DSTV bills in branch.

Potential for pre-paid cards. Pre-paid cards are not widely used in Malawi. With the improved interoperability anticipated through the National Switch, such cards will become more useful, particularly for salary payments or loan distributions to individuals without bank accounts. Prepaid cards have found significant success in Mozambique as a tool to pay salaries more efficiently and safely than cash to employees without bank accounts.

Box 19: Pre-paid cards

Pre-paid cards are usually card association debit card product that can be linked to a separate account linked to the account holder such as pre-paid travel cards or cash passports, but can also be issued on behalf of corporate clients linked to a sub-account on the corporate's main bank account. The sub-account has a drawing limit which corresponds to the amount due to the supplier or employee.

If the card is issued to a corporate against the corporate's account and the corporate issues the card to an employee or supplier, then both the card and the deposit remain the property of the corporate until it is withdrawn or spent by the employee or supplier. In this way the card operates on the same basis as a cheque or promissory note, but has the additional advantage that the amount can be either withdrawn or spend in smaller amounts as suits the intended recipient. Cards

can also be issued to employees for corporate procurement purposes. As the owner of the account and card, only the corporate is subject to KYC.

In Mozambique, pre-paid cards are used to pay the salaries of employees by some large employers. In particular this has been implemented by large agricultural producers that pay farmworkers through pre-paid cards rather than cash or cheque (Chamberlain, *et al,* forthcoming).

6.2.5. Barriers

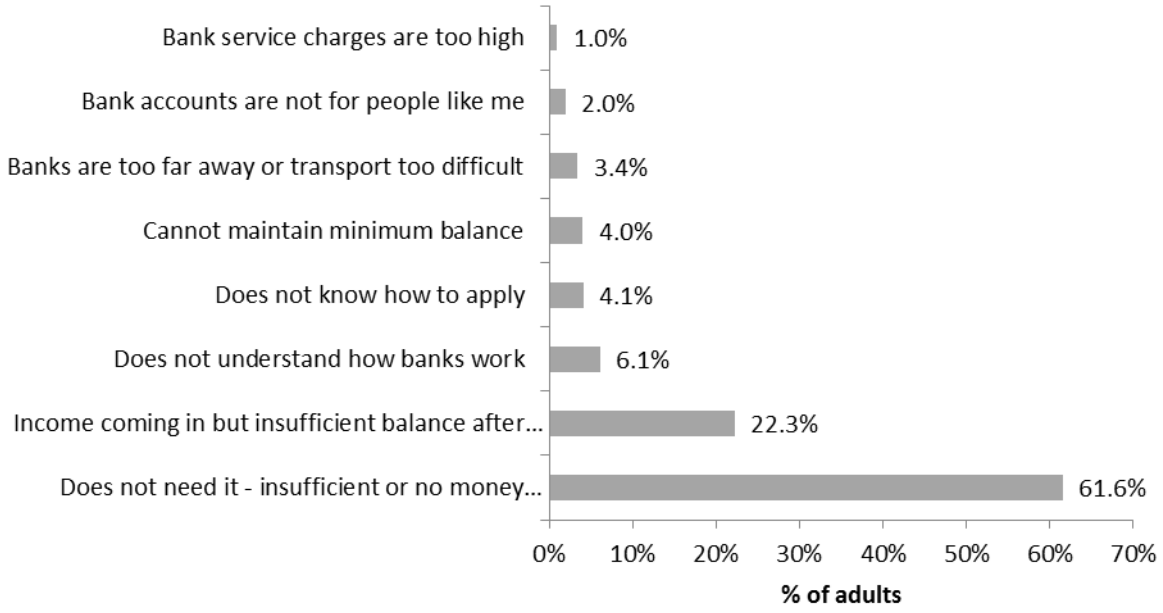


Figure 99: Reasons for not using a bank account

Source: FinScope, 2014

Affordability of access. Even low cost accounts constitute significant expense for low income earners and for non-urban dwellers, the cost of travel to access most formal providers is very high. Figure 99 above shows that although only a small portion of adults indicate that bank service charges are too high, 62% respond that they have insufficient or no income and a further 22% that they have insufficient income after expenses. Hence, whilst the bank costs may not be excessive, they are still too high for the majority of low income Malawians to see the value in having an account, particularly when travel costs are included. The minimum balance may also be a barrier for lower income Malawians, as the quote below discusses, because the low income levels preclude sufficient funds to meet the initial minimum balance required to open an account. Only two of the banks offer any accounts with no minimum balance required. Other banks require minimum balances ranging between K 200 (USD 0.48) and K 5,000 (USD 12) for savings accounts, but as high as K 20,000 (USD 48) for current accounts.

"Well they are right receiving money from the bank is expensive because to open some accounts, you need K 10,000 (USD 24), others K 5,000 (USD 12)."

Salaried employee, male, 57 years old

Proximity - limited distribution footprint. The limited bank distribution network in Malawi and the need for customers to travel long distances at significant expense is a barrier for many Malawians, particularly in rural areas. The quotation below illustrates this barrier. Mobile money, with a substantially larger distribution network, has the potential to mitigate this barrier to access.

"It's better because when we receive we don't need to travel to the bank."

Farmer, male, 60 years old

Eligibility. The lack of a national ID excludes many Malawians from using formal payments products. Whilst banks and mobile money operators do allow customers to open accounts with a voter's registration card, the value of these accounts is capped. Furthermore, as the quotation below shows, not all Malawians even have access to voter's registration documents. Letters from the chief are sometimes accepted, but this leaves applicants vulnerable to exploitation with chiefs often requiring some form of remuneration.

"No I just heard about it [electronic money transfer] but I have never used it. However there was a time that my father was sick in the village then I decided to send money through Mpamba but when I went to open an account with the service provider, I was told to produce a voting registration card so with the belief system of my denomination, Jehovah's Witness, we don't vote so they told me to produce a passport or driver's license to register but I don't have any of those. The only ID I have is from my work place so I failed to use Mpamba. Then I reverted to the only way I use to send money where I send through a bus. I get the money and gave it to the bus conductor of a bus going to our village and we give them the phone number of the recipient of the money, however we pay K 2,000 (USD 4.80) for this service."

Salaried employee, male, 57 years old

Cross border providers, however, require either a passport or a driving license as proof of ID for both senders and receivers. This excludes the majority of Malawians from using formal cross border channels as the quotation from a Malawian informal money transfer operator (Hawala trader) indicates:

"What makes your customers keep using your services?

It is too complicated to send through bank. Perhaps no ID." "

MSME, male, 45 years old

Perception that bank is 'not for me'. Many lower income Malawians feel that banks are the exclusive preserve of the wealthy and may be intimidated to even enter a bank branch. The quotation below illustrates this perception.

*"**Do you have a bank account?***

Hmmm we don't have … (laughing)

Why are you laughing?

We don't have an account… just look at the way we are… do you think we can have an account?"

Farmer, male, 60 years old

Financial literacy and lack of basic education. Low levels of financial literacy and education levels make it challenging for many Malawians to deal with formal financial providers. The quotation below explains some of the practical problems experienced by the illiterate when trying to use mobile money, for example.

"Because there are some things that need schooling, they need someone who went to school. Let's say they have sent you money through phone, if any problem rise, it gets hard because it needs someone who understand English to make the whole thing straight just for you to get your money. So, because I am not much literate, I always have problems with them."

Farmer, female, 60 years old

This lack of education also has a detrimental impact on Malawians ability to use new forms of technology. The result is that whilst mobile money may have the potential to act as a distribution point for financial services, the target market may be uncomfortable transacting using a mobile phone as the quotation below alludes to.

"If someone came explained to you, would you be keen to use mobile money?

No I don't have time; even on my phone right now there are lot of things that I don't even know. I don't have time."

Salaried employee, male, 77 years old

Hassle factor. The limited distribution network means that each bank branch serves a large number of customers. This leads to long queues, as discussed in the quotations below, and long waits for account holders. Not only is this inconvenient, but for customers that are reliant on their own labour for their income, such as MSMEs, it has a direct adverse effect on their welfare.

"The biggest problem that I see is that of congestion in these banks and because of these congestion we end up being mixed with people that want to deposit millions, when you are just there to withdrawal a thousand kwacha and also this encourages robbery in banks and areas around the bank."

Salaried employee, male, 57 years old

"The advantage of the bank is safety of the money. However, the advantage of Airtel and TNM is that there are so convenient because of the way the banks are crowded these days. Overcrowding is a major disadvantage with these bank nowadays."

Salaried employee, 25 years old

Similarly when network connectivity is down or agents have liquidity constraints, it increases the hassle factor for mobile money users who must either wait until the problem is resolved or return at a later date as the quotation below mentions.

"Well, sometimes the time you want money is the exact time their network is down or sometimes you go to an agent and they tell you there is no money."

Salaried employee, male, 27 years old

6.2.6. Regulatory issues to consider

Institutions required to conduct own risk assessment for KYC requirements. Malawi allows for reduced KYC requirements for low value accounts, however, this value is not regulated but rather each institution is required to conduct their own risk assessment. In practice this means that the banks take the most conservative approach available, sticking to basic exemption approach for accounts below the value indicated in old guidelines as they do not want to take the risk of being liable due to their risk assessment not being deemed appropriate. It is particularly challenging for Malawi's providers to conduct a self-risk assessment as they have not been given access the National Risk Assessment (NRA). Furthermore, for smaller institutions, such as MFIs, implementing an entire self-risk assessment is particularly onerous and expensive. It has also been mooted by MACRA to require all mobile phone users to officially register. If this comes to fruition it could potentially be leveraged by financial institutions as they could use this information rather than requiring customers to resubmit their KYC documentation. Onerous AML/CFT requirements may increase the risk of money laundering and terrorist financing as the larger the excluded market is, the more developed are informal payments channels thus making it easier to send laundered money or terrorism financing payments through informal mechanisms.

Lack of electronic transactions and communications legislation. Malawi does not currently have any electronic transactions and communications (ETC) legislation in place. There is no comprehensive legal framework for electronic documents, electronic commerce and no legal standing of documents transmitted electronically such as via email, faxes, electronic documents or mobile payments. MNOs require subscribers to sign an agreement recognising electronic communication when they are subscribed, but strictly this has no legal standing. This is a fundamental framework upon which efficient digital financial services is based and the lack of a comprehensive and integral framework will stunt the development of more efficient and inclusive financial services.

Foreign exchange restricted. Malawi restricts the flow and exchange of foreign exchange in that it can only be exchanged by authorised dealers and that Malawians cannot freely keep foreign currency denominated accounts (FCDAs), except under very limited and defined circumstances.

NPS bill yet to be finalised. The National Payment Systems Bill is yet to be passed into legislation, despite already being drafted in 2002. The lack of overarching legislation creates a regulatory vacuum. Additionally, the draft bill does not formulate any interoperability principle or requirement for NPS.

One implication of this is that despite the time, effort and resources invested in the National Switch (Nat-Switch), banks are not required to make use of it or allow other banks' customers to use their physical payments infrastructure. There are also no sort-at-source concepts, which could precipitate a grossly inefficient concentration of POS machines at high ticket value merchants and lower concentrations at higher turnover establishments frequented by the poor.

Unlevel playing field between mobile money and bank agents. The agent banking regulations (2012) stipulate the requirements for bank agents. These include that banking agents require a physical premises and all agents must be approved by the registrar. In contrast, there is no direct oversight of mobile money agents.

6.2.7. Gaps & opportunities

Use cases	Target markets	Impact and opportunity
Remittances	All as receivers, Salaried employees as senders	Vital source of income for non-household dependents. **Domestics remittances:** Potential opportunity through improved efficiency of Post Office provision to speed up transactions, increase availability of alternative cash out points for remittances to provide lower cost options, e.g. cash out infrastructure expansion including bank agency, mobile money and retailer money transfers. **Cross border remittances:** Identification a major constraint for both migrant senders as many are undocumented workers and receivers who must have either a passport or driving license to receive formal money transfers through most operators. ***Significant area of opportunity***
Bill and spot payments	All	Reduced cost of transactions and improves access to goods and services. Priority because it affects large number of people. Need more places where digital options can be used and need to reduce costs of basic transactions, such as statement queries. ***Significant area of opportunity***
Salary payments	Salaried employees, MSMEs	Employee receipt shift from cash to electronic payments can improve digital use to improve security, efficiencies and enable wider payments eco-system. Government salary payments shifting away from cheques towards electronic payments would substantially increase throughput improving efficiency and reducing costs of electronic payments as well as introducing employees to electronic payments. Could also reduce cost for employees who do not have to visit a branch to deposit the cheque. Should take place with new switch.
Donor receipts	MSMEs, farmers, dependents, ganyu	Increasing use of mobile and agency channels to distribute donor grants will help overcome proximity issues and related travel costs for recipients. Already implemented by some donors, development of distribution network is required to effectively address this use case.
Tax	Salaried employees, MSMEs	Efficient payment mechanism may reduce cost and difficulty of paying tax. Given low government revenue and budget deficit improving tax collection is critical to broader economy

No value proposition of formal payments given limited reach. The high risk of theft when transacting predominantly in cash is widely acknowledged by consumers, but a lack of viable alternatives means that the Malawian economy remains overwhelmingly cash-based. Access to physical bank infrastructure is both expensive and time-consuming for customers and even those with bank accounts make most payments in cash due to a lack of alternative consumer payment mechanisms with POS devices being virtually non-existent.

Mobile money has potential for shift away from cash, but constrained. The introduction of mobile money to Malawi has the potential to shift at least some consumer transactions away from cash to e-

money. The relatively lower average value of mobile money transactions and the fact that it already accounts for more than half of all non-cash transactions indicates that it is already addressing a previously unmet need for low cost, low value, secure payments.

Development of mobile money ecosystem a long-term objective. The initial rapid growth rates experienced by the mobile money providers has slowed in 2014 as future growth is reliant on the product more effectively meeting client needs than alternative payment methods, primarily cash. In order to be a truly viable alternative to cash, mobile money would need to be broadly accepted by retailers and service providers as tender. It is therefore critical to create a mobile money ecosystem through which users can transact primarily in mobile money without requiring cash. In reality, this is a long-term goal and the first step is to build a large and effective agent network. The key issues of agent liquidity and ensuring a sustainable business case need to be addressed.

Expanding ATM networks can enable other payments players, including agents. Expanding the ATM network not only reduces the time and cost to access banking for clients, but can also play a critical role in expanding the reach of mobile money. A core challenge to the expansion of effective mobile money agents in rural areas is liquidity constraints; ATMs provide a reliable and stable point for effective liquidity rebalancing by agents. The lack of infrastructure, in terms of both network connectivity as well as road infrastructure substantially increases the cost of running ATMs, particularly in rural areas.

Interoperability changes the equation for distribution infrastructure and adoption of digital instruments. The recent launch of Nat-switch and the concomitant interoperability between the banks can potentially change the incentive structure for banks in the roll-out of ATMs. Where banks previously required a sufficient number of their own clients in a given area to make a new ATM viable, there now just needs to be a sufficient number of all bank customers in an area to make an ATM viable, provided the owner of the ATM is appropriately remunerated for each transaction by another bank's customer. This is termed the interchange fee and is critical to incentivise the roll-out of ATMs as it provides a clear business case for banks or third party providers to build and maintain ATMs. However, the current low ATM charges in Malawi make it unfeasible for banks to expand their ATM network into rural areas and the interchange fee will not be paid to the ATM owner, but will rather be put towards the repayment of the World Bank loan for Nat-switch. Therefore, whilst interoperability theoretically creates a significant opportunity for greater ATM roll-out, in practice the current fee structure completely disincentives it and may lead to a reduction in the already limited ATM network.

Box 20: Potential for ATMs appropriately incentivised

ATMs can potentially provide services beyond simply customer cash withdrawal and the running of them can be structured to improve efficiency.

Establishing cash-accepting ATMs, as are prevalent in most countries, would mean that users are able to both deposit as well as withdraw funds from their accounts, helping to facilitate greater payments capability, particularly for regular, small value savings contributions.

Self-stocked ATMs are situated within retailers or other businesses that deal with substantial cash. These businesses are able to deposit their excess cash directly into the ATM, thereby reducing liquidity management costs for the ATM and cash handling costs for the merchant.

Third party service providers could potentially play an important role in the roll-out of ATMs if appropriately incentivised. These providers can roll-out non-branded ATMs, which can be used by all bank clients. The

provider would benefit from specialisation and economies of scale. Indeed, third party providers can go further and provide additional back-end services to multiple banks, thereby reducing bank's operational costs as they benefit from economies of scale.

Need to reduce use of inefficient cheques. The use of cheques is declining, but still accounts for a large portion of the total value of payments made in Malawi. As a very high cost payments mechanism, further reductions in the use of cheques should be encouraged and a reduction in the maximum amount permitted to be transacted by cheque can further reduce usage.

Need to reduce costs of statements to ease transition for first time banked. For first time users of banks, trusting that their money will be safe can be a major leap of faith. They therefore want to frequently check to ensure that it is still there. The high cost of statements at banks makes this unfeasible and can act as a significant barrier to consumers initially using bank accounts, or customers being disillusioned as a large fee is deducted each time they check their account.

Potential for social welfare transfers through non-cash channels to encourage use of digital. Both donors and the government disburse social welfare payments to low income Malawians. Distributing these payments through digital channels, such as mobile money, will be substantially less costly than distributing through cash. Additionally, distributing these transfers in mobile money can potentially provide a powerful demonstration effect as non-recipients observe recipients using and transacting in mobile money. A number of pilots have already been launched and more are planned. It is critical that they are properly implemented with sufficient agents and an ecosystem of goods and services that can be purchased with mobile money in order to provide a positive demonstration effect.

The lack of a national ID creates eligibility barrier. No national ID in Malawi means that in order to meet full KYC requirements, customers require a passport or driving license, which only a small portion of adults have. Adults without this documentation are restricted to low value accounts that are exempt from full KYC requirements. Access to cross border money transfers are also limited to only people with a passport or driving license by most providers.

E-wallet type products not available. There may also be potential for the banks to develop electronic money products such as the FNB's (First National Bank) eWallet in South Africa and other countries in which FNB operate. An eWallet can be opened by an FNB customer who can transfer funds into their eWallet from their bank account. These funds can then be used to pay bills and to send money to both FNB and non-FNB customers. A major advantage of such a product is that the money can be withdrawn from any bank outlets such as ATMs, although money can only be sent by the bank's clients.

Box 21. The FNB e-Wallet

The e-Wallet enables consumers to send money or make payments to anyone with a valid mobile phone number. The recipient does not require a bank account or bank card to withdraw the money.

Any FNB account holder can create an e-Wallet for themselves, by sending money from one of their FNB accounts to their mobile phone number. Money can be sent from an FNB ATM, Cellphone Banking or Online Banking. Similarly, any FNB account holder can send money to anyone else's mobile phone using these channels.

The person receiving the money can withdraw the money from an FNB ATM without requiring a bank card. They can also buy prepaid airtime with the money in the e-Wallet or send the money on to someone else's mobile phone.

Source: Thom et al., 2014

Post Office partnership potential. The Malawi Post Corporation (MPC), with the largest formal distribution network, is already the primary provider of formal domestic remittances in Malawi and it holds significant potential as a distribution point for other financial services. The post office already have 6 branches operating as banking agents for NBS and similar future partnerships with other financial services providers could significantly improve distribution although infrastructural constraints at rural branches will restrict the use of all branches for similar roles. There is also potential for the Post Office to expand its offering of accepted bill payments beyond the current portfolio of DSTV, electricity and two water boards.

Engage with key countries to enable undocumented migrants to send small value remittances formally. Although cross border remittances account for a relatively small proportion of total remittances, it remains a critical source of income for recipients. Furthermore, as a large proportion of migrants are undocumented, it is likely that the stock of Malawi migrants is underestimated and with the continually rising population emigration is expected to continue to rise. Remittances sent by migrants will therefore continue to increase and become an even more important source of income. However, restricted access to formal channels by undocumented migrants restricts their ability to send remittances by increasing the cost and difficulty as they are forced to use informal channels of family and friends. Engaging with the governments of countries with the largest informal migrant stocks, such as South Africa and Zimbabwe, is therefore a major opportunity to improve access to formal remittance channels.

6.3. Market for savings

Why focus on savings? Mobilisation of savings to provide capital for growth and development is one of the key roles the financial sector plays (Levine, 1997). Small amounts of savings are pooled to fund investment in larger, more productive projects. Saving requires forgoing current consumption for future consumption in the hope that these small amounts can build up to fund an asset, send a child to school, cope with emergencies or protect against an income shock.

Initiatives to promote savings in developing countries have traditionally been limited. The focus has been on microcredit under the assumption that low-income households cannot save and rather need credit to improve their livelihoods (Ledgerwood, 2013). However, this assumption has been changing. Evidence has revealed that savings might be more important for low-income households where small fluctuations in cash flows can have a significant impact (Collins *et al*. 2009). Low income people want to save and can save. Formal savings, and to an extent informal savings, offers the benefit of security from crime, wealth accumulation and hedging against inflation, if returns are possible. Most significant might be the built-in self-control mechanism. Funds at home are easier to spend; removing that temptation is a significant first step to building up assets (Banerjee & Duflo, 2011). Finding appropriate instruments to accommodate small value, irregular savings should be the policy focus to allow people to better manage their own futures.

In order to enhance these emerging benefits, this section will explore the current usage and use cases for savings in Malawi, as well as provide an overview of the formal and informal institutional and product landscape (including barriers for access and usage). From this it will conclude with identifying the gaps and opportunities for savings in Malawi.

Key issues: market for savings

The key issues from this section are the following:

- Saving decreased from 2011 to 2014. The value of savings deposits is low in comparison to the region.
- Inflation significantly erodes savings -both value and the ability to save.
- High demand for savings (prioritised above credit and insurance) despite low recorded value of savings.
- Main use cases are consumption smoothing, investment and risk mitigation.
- Main institutional providers of savings are banks, VSLAs and MNOs:
    - Banks are the dominant provider of formal savings by deposit values, whereas MNOs hold the highest number of clients.
    - Informal savings landscape is dominated by VSLAs. Growth of the development and use of VSLAs has experienced rapid growth in recent years (1.1 million members in 2014).
    - Saving at home is prevalent.
    - Non-monetary saving is significant
- Low value short-term savings products favoured by the market.
- Mandatory pensions driving growth in long-term savings landscape that will continue to increase as compliance occurs.
- Limited tailored savings products for lower income groups.
- Proximity to formal institutions and financial capability are the main barriers to saving.

6.3.1. Current usage

Low levels of saving. Gross savings of 7.9% of GDP are low in comparison to the region where average savings are double Malawi's current rate (World Bank, 2012). However, as per Figure 100 below, while access to savings in Malawi is also low, it is higher than most of its neighbours. Over half the adult population do not save (58%), with only 27% of adults saving in institutions.

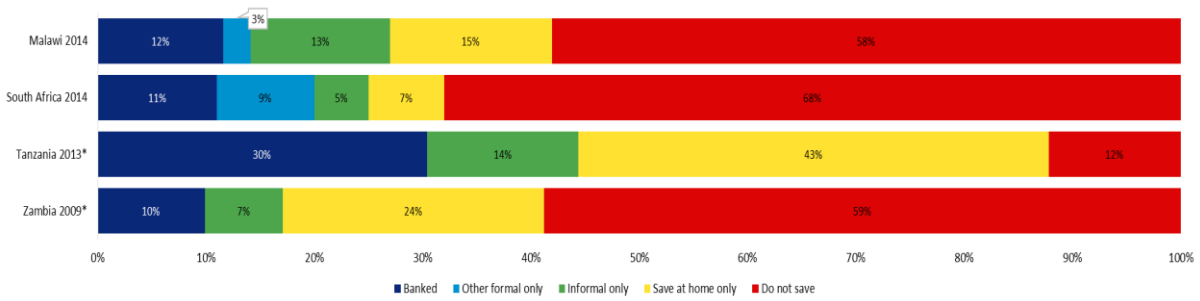


Figure 100: Savings access strands for Malawi, South Africa, Tanzania and Zambia

Source: Malawi FinScope, 2014; South Africa FinScope, 2014; Tanzania FinScope, 2013; and Zambia FinScope, 2009

Savings penetration decreasing in formal and overall terms. As shown in Figure 101 there was a reduction in the savings penetration by 21%. This corresponds to a decrease in the number of adults saving between 2008 (3.8 million adults) and 2014 (3.4 million adults) by 11%. This is supported by a decline in the value of savings with gross savings decreasing by more than half from 2008 to 2012. Inflation tripled in the same period (World Bank, 2012). Usage of formal savings had a net decline of 2%, despite a nominal increase in other formal usage. Informal savings is the only usage category that increased with a sharp upwards trend of 12% to 1 million adults.

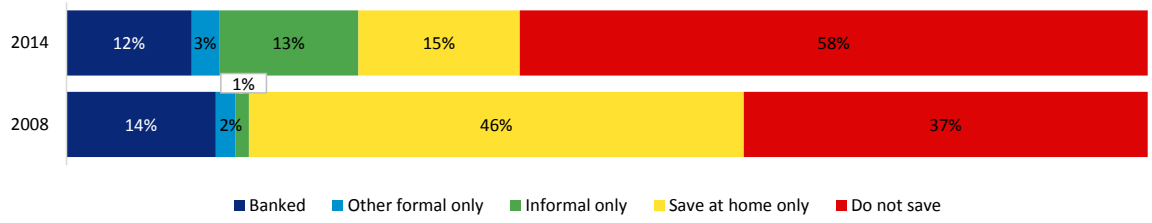


Figure 101: Savings access strand comparison (2008 and 2014)

Source: FinScope, 2014; FinScope, 2008

Total institutional savings increased. There was an increase in total number of adults saving between 2008 and 2014 in all categories except save at home (FinScope, 2014). The reason this does not strongly reflect in the savings usage numbers is because of population growth over the period.

Increasing trend to access savings products from a range of sources. The proportion of adults using savings products from multiple providers increase from 2008 to 2014. Individuals are therefore choosing to use a portfolio of savings products to fulfil their needs, which indicates that there is potential unmet demand within the different access categories. Only 22% of those that save informally are also saving with other institutions (FinScope, 2014). There is a fairly equal split in the respective overlaps to accessing formal institutions and saving at home.

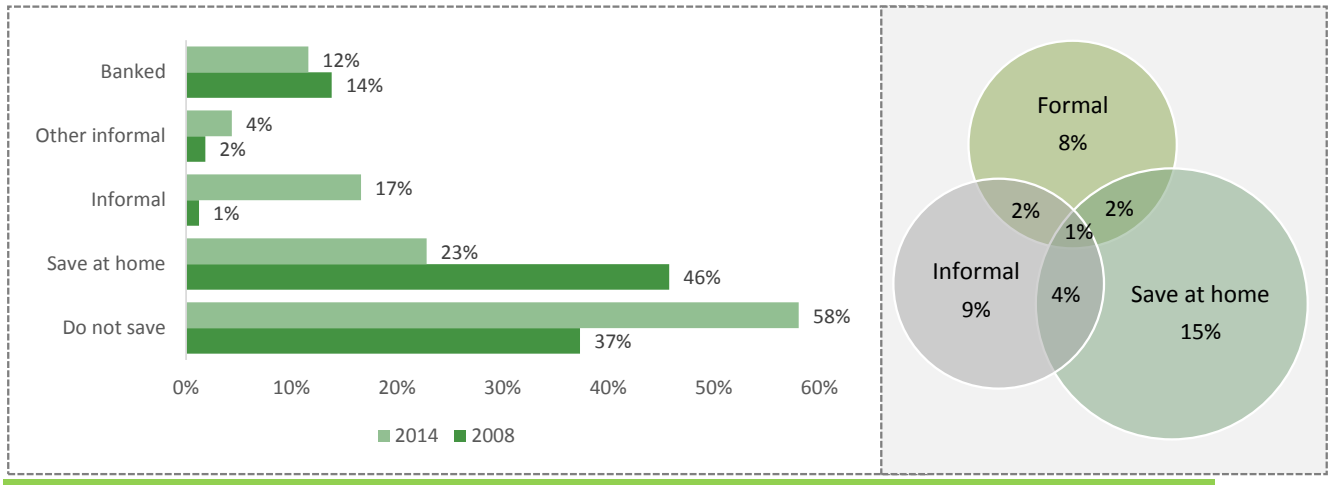


Figure 102: Total savings access (2008 and 2014)

Source: FinScope, 2014; FinScope, 2008

Unintermediated savings sources popular. Savings at home was the most used category of saving in 2014. Furthermore, 26% of adults save through investment in assets. This form of saving provides the dual benefit of building wealth and the ability to use the asset in some cases. Moreover, it is beneficial as an inflationary resistant option for saving that is preferable over formal access due to the close proximity of access, despite a higher hassle factor in liquidation. Overall 24% of adults (1,912,789 adults) noted that investing in assets is a safe form of saving. Interestingly, after investing in shares, investments in the fixed assets of property and land were seen as the least safe investments due the risk of losing the asset (by 39% and 34% of adults, respectively). This was corroborated by the qualitative research, with the risks of theft or damage to value from disease (affecting assets such as livestock and farm produce) noted as the reason that some respondents preferred monetary savings. Both FinScope (2014)[107] and the qualitative research provided evidence that popular assets for saving are in livestock, land (including farmland) and business assets. Saving in produce, such as maize, was a common theme in the qualitative research, but less prominent from the FinScope survey (2% of adults indicated utilising this form of saving).

> ***"In what way do you keep your profits? Do you have a bank account? Or you have other ways of keeping money?***
> *No I don't have any bank account nor use any local ways but I keep my money in my materials or product, which is banana stock."*
>
> MSME, male, 32 years old

Salaried employees have highest usage level of saving. As shown by Figure 103, salaried employees save the most (70%), while farmers (39%), dependents (37%) and ganyu (33%) save the least. Salaried employees save the most in formal institutions. Savings in informal institutions are similar across salaried employees; MSMEs, ganyu and farmers. Saving at home provides the main access to savings for all target markets except salaried employees.

Most savers are farmers. There are 1 million farmers saving, compared to a range of 400,000-700,000 adults in each of the other target markets. Farmers and ganyu are the primary users of informal savings.

[107] Ten per cent of adults save in livestock (750,000 adults), 7% of adults in land and farmland (570,000 adults) and 6% of adults in business (510,000 adults).

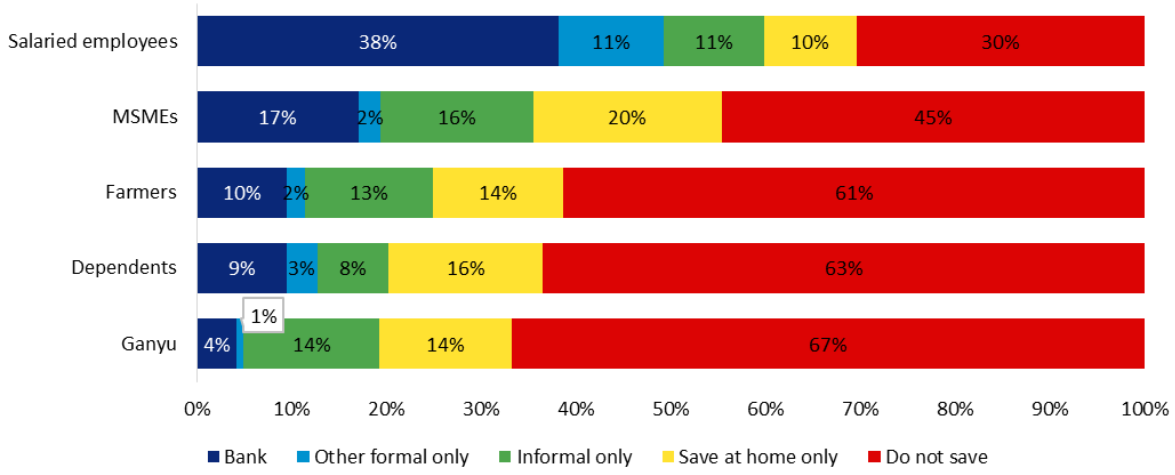


Figure 103: Target markets' savings access strands (2014)

Source: FinScope, 2014

Salaried employees and MSMEs use a range of savings products. Table 28 below shows that salaried employees are the greatest users if both formal and informal savings products. MSMEs are the target market with the greatest proclivity to save at home.

	Bank		Other Formal		Informal		Save at home		Do not save	
Salaried employees	38%	215 138	25%	139 079	22%	124 243	20%	114 861	30%	171 364
MSMEs	17%	211 626	4%	50 206	22%	270 197	34%	425 149	45%	551 947
Farmers	10%	252 170	3%	72 695	17%	449 654	21%	549 030	61%	1 623 861
Dependents	9%	125 972	4%	52 312	10%	133 596	23%	305 156	63%	842 603
Ganyu	4%	86 495	1%	29 333	15%	317 746	19%	392 339	67%	1 372 066

Table 28: Target markets' total access to savings by proportion of target market and number of adults (2014)

Source: FinScope, 2014

Better overall usage of saving in urban areas despite large rural population. 700,000 of urban adults save compared to and 2.6 million rural adults. Yet, proportionately there are more urban adults saving than rural adults (18% more adults in urban versus rural). Savings has moved from saving at home to informal for both urban and rural savers. The trends are less pronounced for urban usage in all areas, except for formal provision. Despite a lower increase in uptake of informal savings, the growth in usage of 9% of urban adults (110,000) is significant.

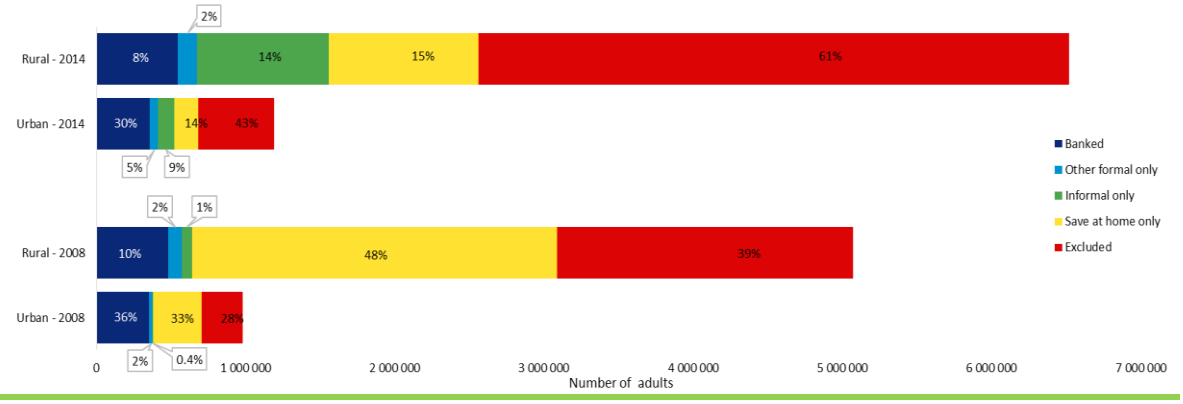


Figure 104: Rural/ urban savings access strands (2008 and 2014)

Source: Malawi FinScope, 2014; Malawi FinScope, 2008

Males dominate formal savings usage, while females are main informal only savers. As illustrated in Figure 104 above, there were more male adults using formal savings and more female adults using informal savings. This is supported by absolute numbers of saver. 670,000 male adults used formal only savings, while 464,000 female adults saved in this manner; 690,000 female adults used informal only savings, compared to 344,000 male adults. A greater number of male adults used formal savings when looking at total savings (increases by 2% more than female adults), while informal saving increased proportionately for both genders. Overall levels of saving were on par in 2008, but female adults experienced a greater decrease in saving usage in 2014 (62% excluded).

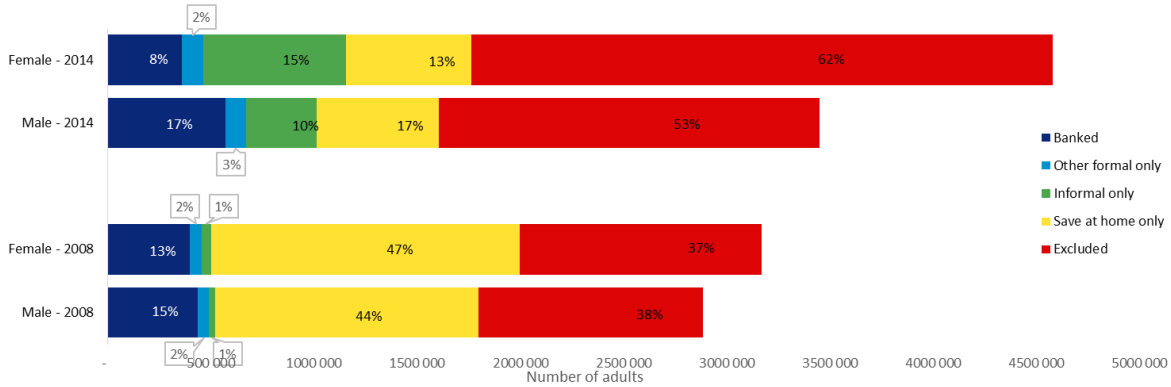


Figure 105: Male/ female savings access strands (2008 and 2014)

Source: FinScope, 2014; FinScope, 2008

Savings a priority financial service. Monetary and non-monetary savings are the primary resource used to finance large planned expenses. This prioritisation is backed up by the fact that savings is the second most used formal product after payments and is the most used informal product (FinScope, 2014). It is significant that savings is prioritised over credit and insurance, because these products often have overlapping drivers for use.

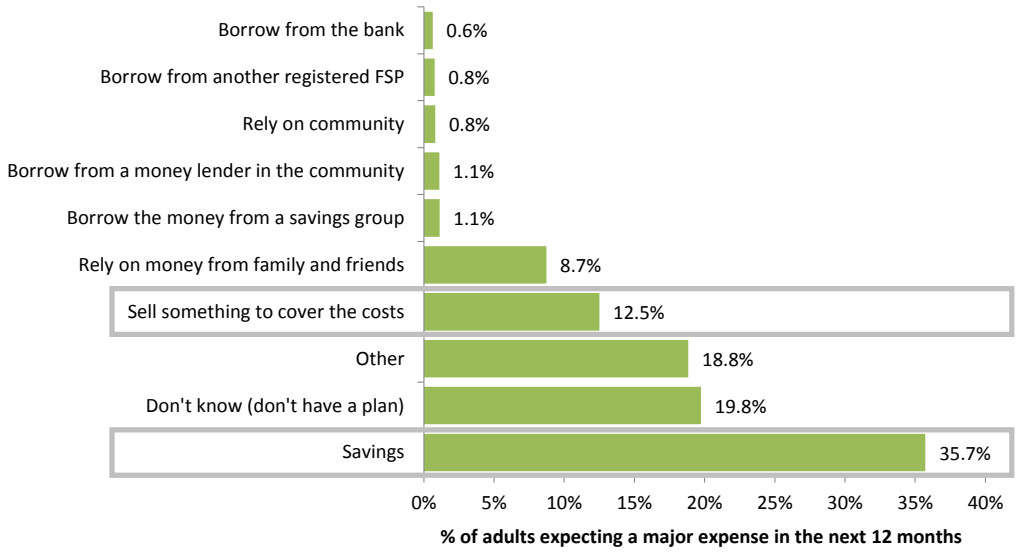


Figure 106: Approach to handling a major expense for Malawian adults

Source: FinScope, 2014

6.3.2. Use cases

This section outlines the use cases for savings as identified through the qualitative and quantitative demand-side research. It looks at why people currently save, what their saving needs are and where the potential drivers for savings lie. At the end of the savings market analysis, we will return to the use cases as the basis for the identification of gaps in current provision and opportunities for growth.

As shown by Figure 107 below, the top three use case areas are: (i) consumption smoothing, (ii) investment and (ii) risk mitigation (including saving for a safety cushion, emergencies and health issues).

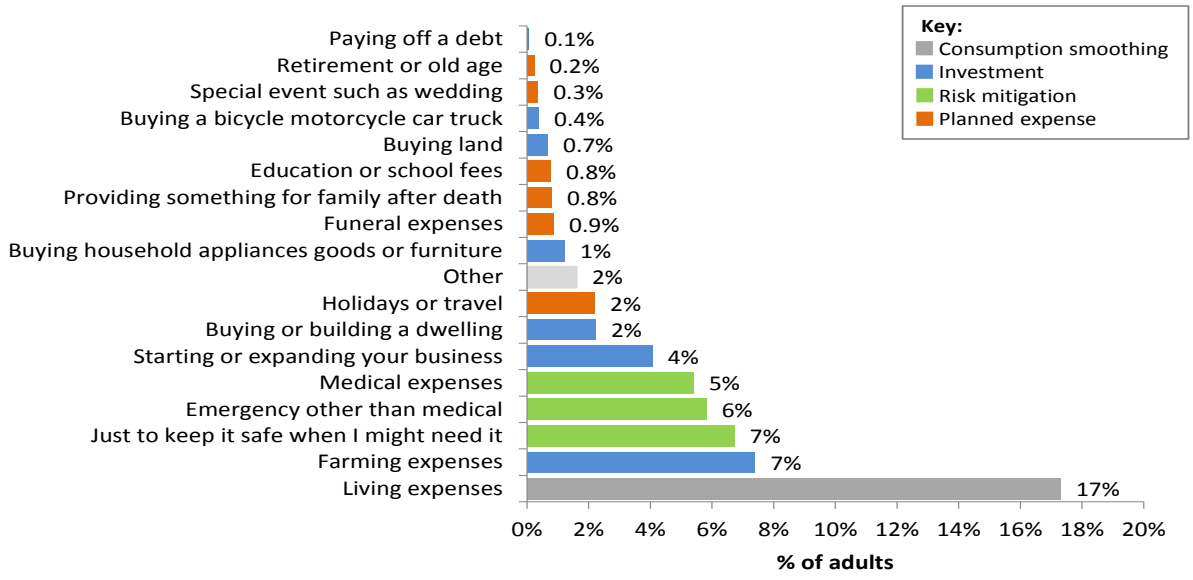


Figure 107: Uses for savings

Source: FinScope, 2014

Use of savings for consumption smoothing. Saving for consumption smoothing is to meet living expenses and manage irregular cash flows. This can be money put aside to cover expenses that occur during the month, as well as those that occur at longer time intervals. As shown by Figure 107 above, saving for consumption smoothing is a strong priority with 17% of adults saving for this purpose. It is the highest priority consistently across all target markets. Farmers (436,870 adults), ganyu (340,150 adults) and MSMEs (248,759 adults) are the main savers for this reason. These target markets have uneven income flows and therefore saving to smooth the ability to consume is a natural use case.

Use of savings for investment. Saving for use in a business, farming or asset purchase is considered saving for investment purposes due to the income generation or value appreciation potential. The number of adults saving for these needs are low, given the high number of farmers and MSMEs in Malawi (see section 4.3.1) and the dual benefit of usage of the investment while it provides a store of value. Only 11% of farmers (298,165 adults) are saving for farming expenses and 9% of MSMEs (107,805 adults) are saving for business investment. Low income levels and a lack of a housing market could explain the low investment in assets, including housing. Most saving for housing investment is for construction and not for purchase of a dwelling. This allows for incremental inputs as various building phases are achieved and does not drive a need for building up a large lump sum to purchase a dwelling.

Use of savings for risk mitigation. Savings for risk mitigation requires the accumulation of funds to absorb losses during risk events. The two high risk mitigation categories are to provide a general safety net, as well as one for non-medical emergencies. This shows a need to build up protection against unexpected events. It is interesting that this is preferred over saving for health emergencies, as these are costly life events for a large portion of the population and the greatest risk to income faced (FinScope, 2014). The next two main risks are theft (22% of adults) and drought (13% of adults). Given the high proportion of the population involved in rain fed agriculture, a savings safety net is a necessity to protect against droughts. Farmers, salaried employees and MSMEs are the main savers for this use case.

Use of savings for health needs. Saving for health needs falls under the category of risk mitigation. It has been separated to allow for discussion of aspects relating to this very specific type of risk. As

mentioned above, health issues are the top stated risk for Malawians (27% of adults). It is also listed as the most expensive life event (69% of adults). Public healthcare is free in Malawi, but often requires co-payments either due to lack of resources or additional out-of-pocket expenses, such as transport, food costs during hospitalisation and medicine. Private services require payment. An additional cost of health risks is the lost income during the time of illness. Farmers, ganyu and MSMEs are impacted by this because their income sources are dependent on an individual's labour each day.

> *"Well it is important to save money because there are times you might get sick while working and you can use the money to put casual labourers in your field that season."*

Farmer, male, 40 years old

Some community support is available in the case of health emergencies to limit financial cost. However, the high probability of health events and the unknown level of expense that these will bring, drive adults to set money aside to cover for this risk event.

Use of savings for funerals. Saving for funerals is not listed as a priority need in Figure 107 above. Yet, similar to health it is listed as one of the two most expensive life events by 72% of adults. There is evidence from the qualitative research of communities working together to support the funeral costs, reducing the need to save. Prioritisation of savings needs is important to take into account when assessing use cases, especially in an environment where disposable income to save is low.

> *"Here people are well connected. When one is sick they make sure they visit in the hospital and in an event of death people work together to help on the funeral arrangements and all the costs of the funeral are covered by the villagers and this is for every person."*

Farmer, male, 60 years old

Use of savings for education. Only 0.8% of adults are currently saving for education. Primary school education is free and secondary school education requires a level of co-payment (see Section 2.2). The levels of educational attainment are low (76% of adults have primary school or less), but obtaining a full education for future generations is a significant aspiration. Similar to health, education does have out-of-pocket expenses attached (e.g. school supplies, transport and food) and the opportunity cost of losing support to income generating activities. There is therefore a need to save to help finance direct and indirect expenses, and ensure that there are funds to cover for the opportunity cost of time spent learning.

> ***"Regarding your six children and looking at demands associated with school necessities, like books, school shoes and other items that children demand, how do you coping with these demands?***
>
> *That's my greatest problem and that's what has caused my two elder children to fail to continue with their school. Because I lacked money to send them to school, for example I have a child who walks to Ndirande from here in Chichiri. And being a girl child it's not easy; we can't even afford to give her money for lunch."*

Government employee, male, 57 years old

Use of savings for retirement. Only 0.2% of adults save for retirement per FinScope (2014). Community and family support can provide a substitute for support from retirement savings. Low incomes mean that survival in the immediate future is more important than in the long-term. This provides a further disincentive to save for retirement. The actual number of savers is understated when taking account of the 191,256 clients (2.4% of adults) of retirement funds in 2013 (RBM, 2013). The Pensions Fund Act (2010) mandates retirement fund contributions from employees that earn more than K 10,000 (USD 24) and are in a company with more than 5 employees. Demand for retirement savings will rise as full compliance with this requirement is achieved and as urbanisation continues.

6.3.3. Providers

Providers of savings products are banks, MNOs, retirement funds, SACCOs, VSLAs and informal savings groups. Figure 108 provides an overview of the provider landscape in Malawi. It gives an indication of the market share, targeted client base (average income) and value provided to clients (rate of return on savings) of the providers.

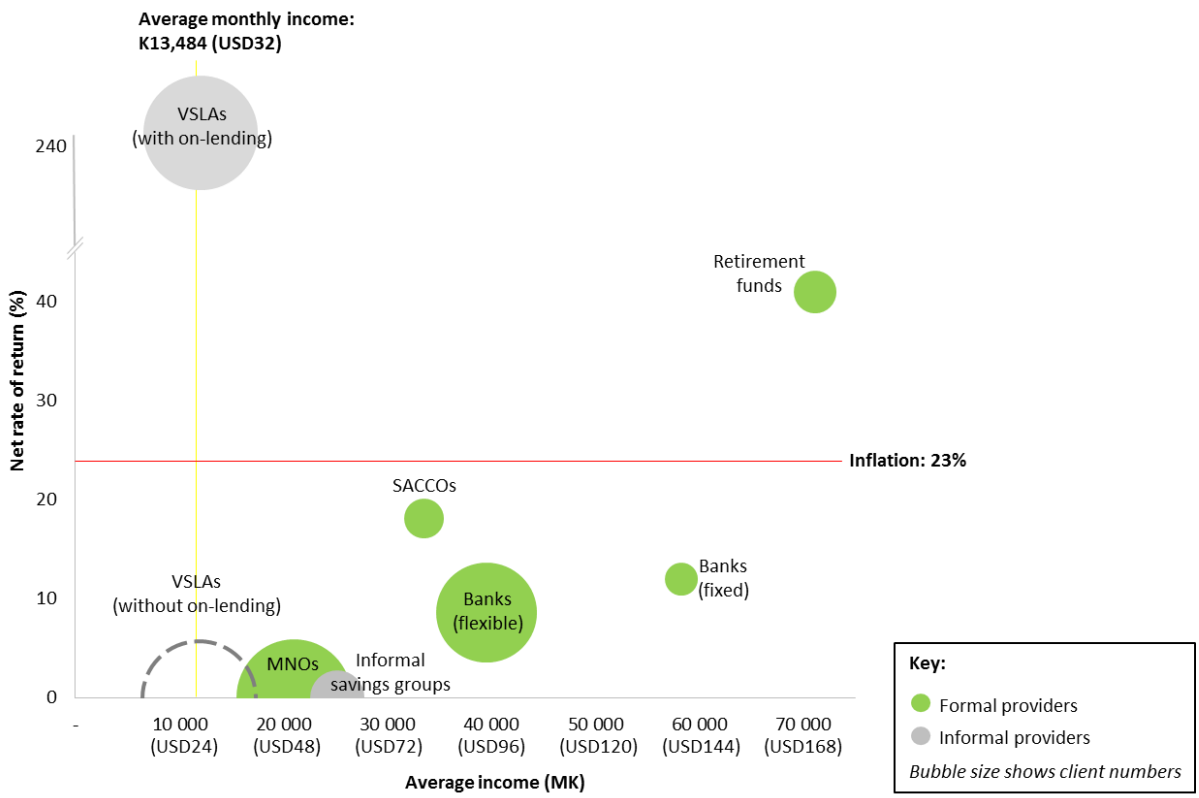


Figure 108: Overview of savings providers.[108]

Source: Authors' own based on In-country consultations, 2014; Standard Bank Limited, 2013; National Bank of Malawi, 2013; First Merchant Bank, 2013; NBS Bank, 2013; Malawi Savings Bank, 2013; FDH Bank, 2013; Nedbank, 2013; Indebank, 2013; Ecobank Malawi, 2013; FinScope, 2014

[108] The reason for including both VSLAs with on-lending and without on-lending relates to what the members of the VSLA do with the funds at their disposal. The source of return for saving in VSLAs is the interest from on-lending of deposits during the lending cycle of the group. If the members of the VSLA do not lend the money to non-members, then the interest paid is technically an additional savings contribution.

Banks and VSLAs are main providers. The two main providers of savings, by client numbers, are VSLAs and banks. Both of these providers are focused on the short-term product space. VSLAs (and MNOS) provide low value savings products while banks can service a range of values. VSLAs provide for a lower income range while banks serve higher incomes on average. Only VSLAs currently serve clients at or below Malawi's average income. Alternative informal savings group options serve a range of incomes (averaging from K 8,403 (USD 20) to K 32,836 (USD 79)). In terms of market share by deposits, banks far outstrip all other providers at K 190.3 billion (USD 456.5 million) (RBM, 2013). The two other long term providers are the next big players at K 17.6 billion (USD 42.3 million) for retirement funds and K 3.7 billion[109] (USD 8.8 million) for SACCOs (RBM, 2013; RBM, 2014)

Long-term savings providers are the only source of real returns. The only provider currently delivering real returns are retirement funds and VSLAs when gross returns are taken into account. SACCOs are mainly a long-term savings instrument and hold the potential to provide real returns in the long-term due to inflation fluctuations around their rate of return (RoR).

[109] This number covers the 45 SACCOs supervised by RBM.

	Banks	MNOs	Retirement funds	SACCOs	VSLAs
Average income	K 43,973 (USD 105)	K 24,688 (USD 59)	K 78,691 (USD 189)	K 38,317 (USD 92)	K 11,805 (USD 28)
% of adults	7%	3%	2%	2%	14%
% urban	38%	40%	47%	27%	12%
% female	39%	40%	37%	52%	64%
% primary education or less	61%	64%	35%	61%	87%
% salaried employees	25%	22%	65%	34%	8%
% MSMEs	24%	21%	8%	17%	20%
% dependents	13%	10%	5%	14%	11%
% farmers	28%	33%	13%	29%	36%
% ganyu	10%	14%	10%	5%	25%

Table 29: Overview of savings provider usage by target market

Source: FinScope, 2014

Potential for all providers to increase their market penetration. Savings uptake across providers and target markets is low. Potential therefore exists to increase market penetration across providers. However, this will be constrained by the fact that the capacity to save is low for Malawian adults and the cost to serve them is high. 89% of adults (7.2 million adults) indicated that there are times in a month when they have no money whatsoever. This correlates with the fact that 88% of the population lives under USD 2 a day. The focus by savings providers on higher income groups, that are a small percentage of the population, further supports this.

Theft and risk of damage to assets motivates the use of institutional savings. 74% of adults indicated that it is not safe to keep cash in their dwelling (FinScope, 2014). As referenced above, the qualitative research provided further evidence that despite the value of easy access (proximity) that saving in cash or assets provides, it does come with the risk of theft or damage to the asset.

> *"I would save in the bank because I know it's safer and it is unlikely that it would be misused. The other methods are risky, maize might get attacked by weavers or if kept for too long, it might rot because of the moisture."*

Farmer, male, 67 years old

Higher income groups are the main target market, with the exception of dominant providers. Banks and VSLAS serve most income ranges, although banks have a great focus on salaried employees and MSMEs. Other informal savings groups and MNOs have low levels of uptake, although MNO clients are growing. Long-term savings providers (retirement funds and SACCOs) have the lowest levels of uptake, with the exception of salaried employees.

6.3.3.1. Banks

Largest formal provider of savings value and volume. According to FinScope (2014), banks serve the second widest base of customers for saving (895,996 adults). As mentioned above, they hold the highest value of deposits by a large margin.

Customers saving through banks are mainly rural, educated, male and from a high income bracket. Customers saving at banks are largely rural (59% of adults customers) and male (61% of adults customers). This highlights the need to extend distribution of banking services to the rural areas where the majority of customers reside and review the potential value in increasing uptake by females. Salaried employees (215,000 adults) and MSMEs (212,000 adults) have the highest number of savers in their target markets at 55% and 31%, respectively. Farmers hold the highest number of savers by absolute numbers at 252,000 adults. The average income of bank customers is K 33,747 (USD 81), more than double the population average, and their education level is high at 59% of customers with secondary education or higher (FinScope, 2014). Both FinScope (2014) and the qualitative research showed that the consumer market trust banks as an institution. This is despite negative returns and bad experiences, such as transaction fees unexpectedly eroding the value of savings.

Many market players, but dominance held by a handful of banks. There are 11 banks in the Malawian market that provide a range of short to long term savings products. Standard Bank and National Bank of Malawi (NBM) are the main market players for savings with 28% and 26% of deposits respectively. In comparison, the share of deposits held by the next four major market players ranges between 7-10%. Section 6.1.3.1 highlights the difference in market share when looking at customer numbers of the banks. Opportunity International Bank of Malawi (OIBM) (29% of bank customers), Malawi Savings Bank (MSB) (19% of bank customers), NBS Bank (14% of bank customers) and First Merchant Bank (14% of bank customers) hold the highest market share in the respect. The difference between these market share splits reflects the different outreach strategies of the banks. Standard Bank and NBM are focused on corporate and high net worth clients, while banks such as OIBM and MSB pursue banking the mass market.

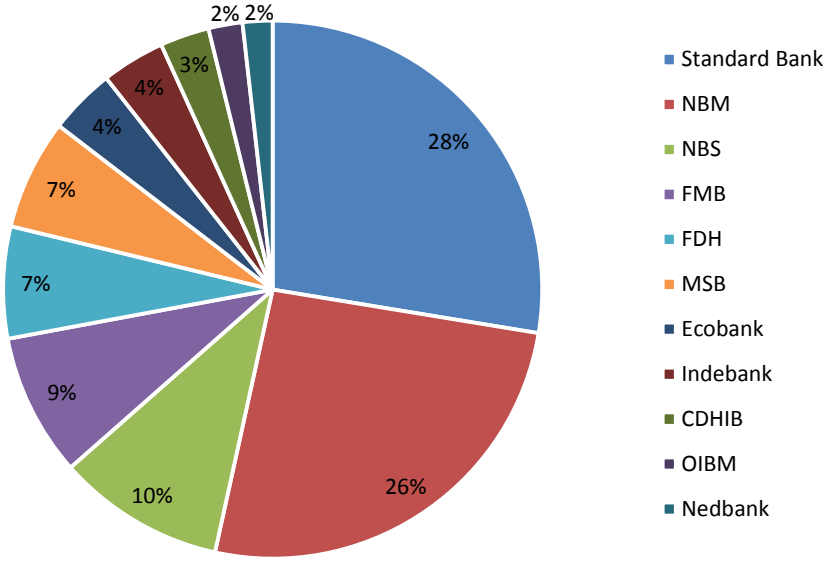


Figure 109: Split of deposits held by banks

Source: RBM, 2013

Increasing deposits is attractive for banks, but their current business model limits the ability to implement. In general, alternative sources of capital in Malawi are expensive (Section 6.1.3.1) and therefore attracting deposits is necessary for banks to source capital. This has led to a low transaction fee model to encourage deposits, where it is possible to have an entry level savings account that costs less than K 400 (USD 0.96) per month and requires a minimum balance of K 200 (USD 0.48)- K 1,000 (USD 2.4). There is one exception that requires K 5,000 (USD 12). Although the cost is still substantial for the average Malawian salary (3% of monthly income). Yet, despite motivating uptake with transaction fees, deposit rates on savings accounts are low in comparison to the lending rate and inflation. As discussed in section 6.1.3.1, interest revenue and therefore interest rate spread, provides over half of the banks' total revenue. This means that while there is an incentive to remove barriers to encourage deposits, the regulatory burden and unstable macroeconomic conditions renders banks unable to provide attractive deposit rates and remain sustainable. It is important to note that the drive for increasing deposits will be linked to the need for additional capital for on-lending or investment, both of which are constrained in the current environment.

Evidence of innovation in business model to reduce cost and increase appropriate outreach. There are examples of innovation by banks to increase access through business model adjustments. In regards to distribution, as discussed in section 5.2.2.1, banks are extending their reach through mobile vans (FMB, Indebank, MSB, NBS, OIBM and Standard Bank) and bank agents (NBS and OIBM). Banks are also linking with MNOs for payments. As discussed in section 6.2 and section 5.2.2 it is key to extend the reach of banking channels in order to reduce the real cost of banking for rural populations. Most banks have targeted accounts that provide features designed for a unique target market and consequently are often more affordable and suitable for that target market. The Pafupi savings account from NBS that targets women in rural areas is one example (NBS Bank, 2015), along with the range of student and farmer specific accounts at a number of the banks. OIBM in particular has been an innovation leader in piloting new products and channels. An example of this was an OIBM pilot run in 2009-2010 that tested different commitment options for farmers' savings account to see whether product design could increase savings values (Tantia & Comings, 2015).

6.3.3.2. MNOs

No explicit products or motivation to extend savings access. MNOs do not explicitly provide a savings product at present, although they have the potential to reach into underserved areas, as discussed in section 6.2.3.2. Their mobile wallet is a store of value where clients can hold savings, but it does not provide the benefit of earning interest on this store of value due to regulatory restrictions (see section 3.1.1). MNOs make the majority of their income from cash-out at agents and cannot utilise deposits to on-lend or invest. Therefore, while potential exists for transaction fee income and cross-selling benefits, there is no high incentive for MNOs to promote savings. It is, however possible to transfer funds from a mobile wallet to linked banks (low number currently) and consequently provides de facto access to formal savings products.

6.3.3.3. Retirement funds

Retirement funds provide long-term savings to the greatest number of adults. In 2013, retirement funds served 191,256 members (RBM, 2013). They are the dominant long-term saving market player by client numbers, but their level of overall market penetration is low at 2% of adults. As mentioned above, retirement funds are second to banks in terms of overall deposit value (this holds true for both banks' timed deposits and overall savings deposits).

Retirement fund customers are wealthy, male, urban and hold high education levels. There is an equal split in location for retirement funds' customers between urban and rural areas (47%), indicating an urban bias given population figures. Their customers are more educated (82% have secondary school or higher education) and more male (63%). The average monthly income for retirement funds' customers at K 71,149 (USD 171) is high compared to average income (USD 34), and high even compared to the monthly income of salaried employees (USD 68), which constitutes 65% of retirement fund customers (FinScope, 2014)

Growing industry. The retirement funds industry is made up of pension funds and umbrella funds for definitions of these entities). In 2013 there were 1,777 pension funds, 7 pension fund administrators, 2 umbrella funds and 7 portfolio managers/investment advisors (RBM, 2013). Pension funds, and consequently the retirement fund sector, have been doubling in size each year since the promulgation of the Pension Act in 2011. The regulator has stated its intention to release regulation that will reduce the number of pension funds by placing a licensing cap based on asset size (see section 6.3.6). As shown by Figure 110, the three largest pension fund administrators by funds under administration are NICO Life (663 funds), Old Mutual Life (518 funds) and INDEtrust (122 funds) respectively. The industry's rate of return for 2013 was 45% and operating ratio was 5%. Retirement funds were therefore providing real returns to members in relation to the average inflation rate of 28% in the same year (see section 2.1).

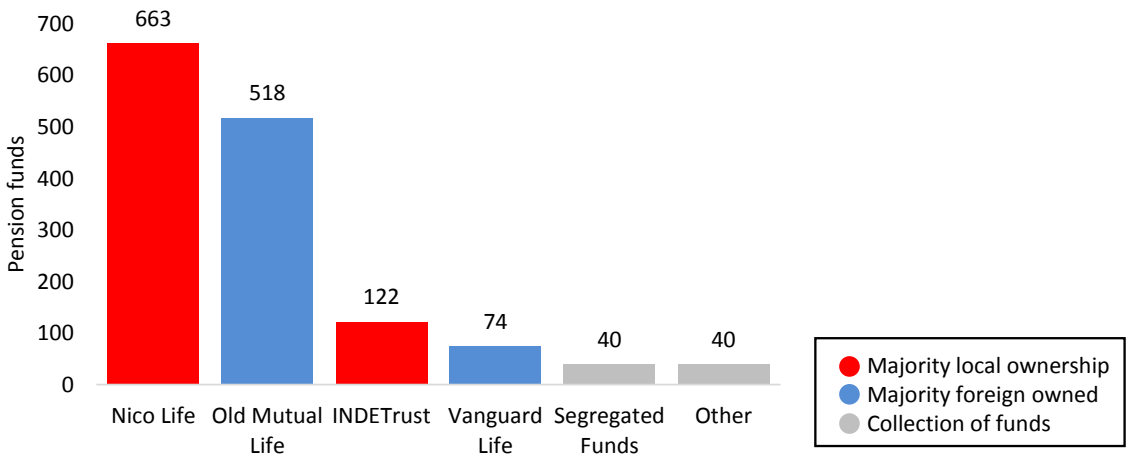


Figure 110: Market share of pension fund administrators (no. of funds administered)[110]

Source: RBM, 2012

The value of assets held has been steadily increasing (RBM, 2014; RBM, 2013). The total value was K 174.8 billion (USD 419.2 million) at the end of 2013. As at September 2014, this had increased to K 229.1 billion (USD 549.4 million). Figure 111 below outlines the split between different asset classes. Listed equities and government securities are the main asset class at over 60% of the split. Following these assets, retirement funds are investing in fixed deposits, unlisted equity, property and other assets, respectively.

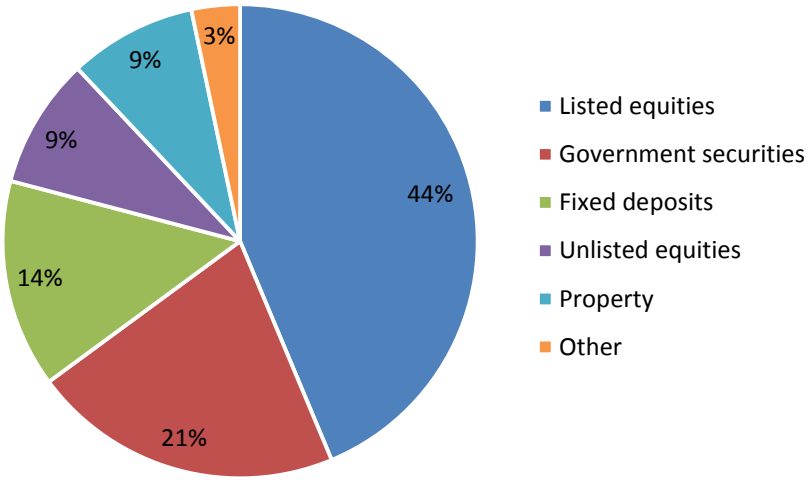


Figure 111: Asset split of the retirement fund industry

Source: RBM, 2013

Potential exists for retirement fund uptake to double. As mentioned above, the mandated retirement fund provision for employees earning above K 10,000, and not otherwise excluded, will drive an increase in access to savings for retirement. 65% (367,502 adults) of salaried employees earn over K

[110] Excludes the Civil Service Pension Scheme

10,000[111]. This means that, without factoring in exceptions, the potential for retirement fund provision covers 65% of salaried employees (367,502 adults) or double the current number of pension fund members. Beyond the mandatory categories, it is possible that there is further demand for retirement funds. Retirement savings were not highlighted as a strong use case in section 6.3.2 and so this group is not likely to be large. Consequently, just taking into account growth driven by mandated pensions, there is potential for market penetration to double.

Old Mutual life to become dominant market player. There is therefore a value proposition for growth in the market that creates an attractive business case for retirement fund actors to enter the market. This is evidenced by the mix of foreign and local ownership of pension fund administrators, a natural aggregator in the industry. The local company NICO Life was the main provider in 2013. However, this is likely to change as Old Mutual Life have won the tender to administer the National Pension Scheme, which handles government employees' retirement funds. Government has an exception from complying with the Act until June 2015. When full compliance occurs Old Mutual expects their current number of members to double (In-country consultations, 2014).

Pension fund consolidation and increase in umbrella funds on the horizon. The increased demand to-date has created a surge in the number of pension funds. This should reduce with the intended licensing cap.

6.3.3.4. SACCOs

Small number of SACCOs providing access for lower value and mainly long term deposits. As outlined by section 6.1.3.4, SACCOs are a mutual institutional structure where all members own the institution through purchasing shares. These shares are a long-term fixed savings instrument that is cashed out when membership is terminated. Over and above this, SACCOs provide access to short-term flexible savings products, fixed deposits, credit and insurances. There are 58 institutions which covered 98,871 members in 2013 (RBM, 2013). As highlighted in 6.3.3 above, SACCOs hold the third largest level of deposits. Average deposit levels per client is half that of banks (K 88,998 (USD 213)) and a third of retirement funds (K 112,293 (USD 269)) at K 44,376 (USD 106).

Customers of SACCOs are mainly female, rural, educated and double the average income. SACCO customers are majority female (52%) and rural (70%).[112] They hold a similar income profile to banks at double the population average (K 33,559 (USD 81)). SACCO customers have much lower education profile than other formal providers, even though they are more educated than most Malawians (46% hold a Secondary education or above). Salaried employees (44,986 adults) and farmers (38,008 adults) are the main members of SACCOs. Salaried employees show a clear dominance in uptake via percentage of their target market (11%) (FinScope, 2014). Most SACCOs are related to employment groups or to a limited extent farming.

Growth potential for SACCOs despite governance and cost concerns. Section 6.1.3.4 outlines that poor governance structures are hindering the growth of SACCOs. This is further highlighted by an expense ratio of 82% and net returns of 3% for the supervised industry players. The total number of registered SACCOs has decreased in recent years from 70 in 2006 to 48 in 2014 (MUSSCO, 2014). Conversely, membership numbers and the average savings value per member have been steadily rising. Further,

[111] This is an underestimation as for any company with 5 or more employees the salary exception does not apply and therefore all employees are mandated to take part in retirement funds.
[112] SACCOS fall with the "other formal savings institutions" category within the FinScope (2014) survey. It is therefore possible that information relating to their category could contain other institutions, but from additional research it appears SACCOs are the dominant player.

recent deposit levels have started to grow following a dip in 2011 and 2012 (RBM, 2013). SACCOs hold various advantages that can drive growth. These include farmers gaining access to a group that assists their primary business (e.g. with input sourcing and marketing) and financial needs, the ability to access finance in an environment where peer engagement can help overcome access barriers of financial literacy (a significant constraint in Malawi), and the potential access to credit in a credit constrained environment.

6.3.3.5. Village Savings and Loan Associations (VSLAs)

Dominant savings institution that provides access to low-value savings. VSLAs had a membership base of 1.1 million across 65,000 groups (see section 6.1.3.6). The members of these self-selected groups accumulate capital over a 10-12 month cycle through weekly or monthly savings contributions and monthly on-lending of funds via short-term loans. Overall deposits from low value contributions are estimated at K 1.07 billion (USD 2.6 million)[113]. Outstanding loans are estimated at K 718.4 million (USD 1.7 million) and therefore liquid assets retained by the groups are approximately K 350 million (USD 840,000). Contributions can also be used for informal insurance for emergency events that face group members (see section 6.4.3).

Members of VSLAs are poor, mainly female, rural based and hold low education levels. VSLAs members represent the population in terms of education levels, geographic location and average income (72% of members have primary school or less education, 82% situated in rural areas and an average income of K 11,896 (USD 29)). This income level sits below the minimum wage and the international poverty line of USD 1.25 a day. One deviation from the population average is that the groups hold a higher number of female members (64% compared to overall 58%). Farmers (410,000 adults), ganyu (280,000 adults) and MSMEs (227,000 adults) primarily constitute the VSLA membership (FinScope, 2014).

VSLAs provide local access points to saving that have financial literacy benefits. VSLAs operate on a community based model where members meet regularly in their local area. This provides the benefit of an institution in close proximity with access times that are convenient to the group and a setting where members are trained in the savings model by donors or are able to learn from their peers. This is an important benefit as access to savings through VSLAs is a lead product for 78% of informal savers (see 6.3.1) and therefore the teachable moments provided by VSLAs will be the first exposure to financial services use for many members. The exposure is not restricted to savings, but includes credit and insurance. It was referenced in the qualitative research that community issues of theft create a push for the groups to distribute out the cash on hand via loans whenever possible. Further, these loans provide the potential to grow the capital pool through interest repayments and are listed by the qualitative respondents as a key benefit of belonging to a VSLA.

> ***"There are other groups that believe that the money should not be kept, but all the money that has been raised should be distributed to the members. Was this the case with your group?***
>
> *Yes, in the first place, it was like that however we reached a point where we had no choice but to keep them in a safe with the treasurer and have the secretary keep the records."*
>
> Farmer, female, 50 years of age

[113] Estimated assuming similar profiles across the population as those of CARE groups' 2013 (CARE, 2013). The estimate of outstanding loans is calculated utilising a similar means.

Commitment savings model can increase savings achievable. Saving under the mattress is difficult as significant self-control is required to save and not to spend the saving. The VSLA model creates social pressure to keep to a regular savings commitment, addressing this barrier.

VSLA membership increased from zero to 16% of the population from 2008 to 2014. There has been a dramatic increase in informal savings from 2008 to 2014, as discussed in section 6.3.1. This was in large part caused by the introduction of VSLAs (In-country consultations, 2014; FinMark, 2013). VSLAs in Malawi were initially driven by donors, largely CARE, but their success has caused peers to replicate the structure. Only half the current VSLA members belong to donor initiated groups (620,000 members of the 1.1 million members per FinScope (2014)). CARE now builds in support for replication of VSLAs into their model by training self-sustaining community based agents ("village agents") that will both drive and manage the replication (CARE, 2013). Donor initiatives and peer replication of VSLAs are therefore expected to continue to drive growth.

6.3.3.6. Informal savings groups

A range of informal savings groups with low market penetration. Informal savings groups are a combination of Rotating Savings and Credit Associations (ROSCAs), savings only groups and informal membership organisations (such as informal savings and credit groups). In total these groups hold 248,000 members. Savings only groups (155,500 adults) have the highest uptake, followed by membership organisations (62,000 adults) and ROSCAs (31,000 adults) respectively.

Informal savings groups are predominantly rural, female, and hold medium to low levels of education.[114] Most groups are located in rural areas. ROSCAs have almost no urban presence (90% rural). Education levels in ROSCAs and membership groups are very low (90% and 84% with primary or less respectively), while informal savings only groups hold a higher level at 58% of members with primary or less. The first two groups also have a high female membership (76% and 80% respectively). Informal savings clubs are also predominantly female, but closer to the population average at 58%. Overall, salaried employees (57,052 adults), ganyu (52,086 adults) and dependents (48,431 adults) are driving the uptake via these groups (FinScope, 2014).

Groups are based in local communities and save towards a set goal. Groups are commonly formed out of their local community and so provide a convenient access point for saving. All groups are based on regular contributions for a purpose, or are time based commitments. ROSCAs (or Chipereganyu) allocate the full monthly pot of savings to different individuals each month, while other groups will collect funds to allocate once a goal has been achieved. Their informal nature reduces the transaction costs of saving in comparison to more formal alternatives. Two examples of informal savings groups identified by FinMark Trust (2013) are as follows:

- COMSIP, which was spun out of the Malawi Social Action Fund (MASAF) in 2008, uses a group model for those that receive payments under the Public Works Programme (PWP). The recipients are assisted to make savings for three months and then receive a COMSIP loan as group capital. It had approximately 90,000 members in 2013, but is not growing, as its membership is linked to the PWP activity.
- MUSCCO has experimented with a Group Savings and Loan Association (GSLA) approach in partnership with the Malawi Lake Basin Programme. So far it has over 6,600 members that are

[114] Note that the analysis that follows is open to correction as the membership numbers are too small to be accurately representative in the FinScope (2014) survey.

mainly female. These groups are formed on a similar methodology to VSLAs with the intention of graduating into SACCOs (MUSCCO, 2013).

6.3.4. Products

Usage of savings on a frequent basis for low value amounts. As shown by Figure 112 below, 46% of adults save some of their income. The majority of savings are contributed on a frequent basis, with 76% of Malawians saving either on weekly or monthly.

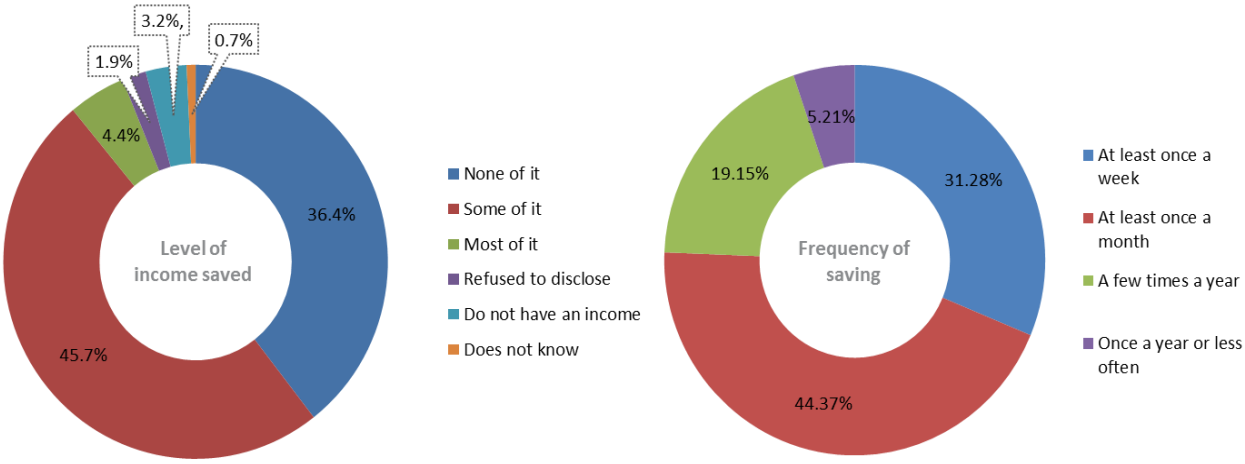
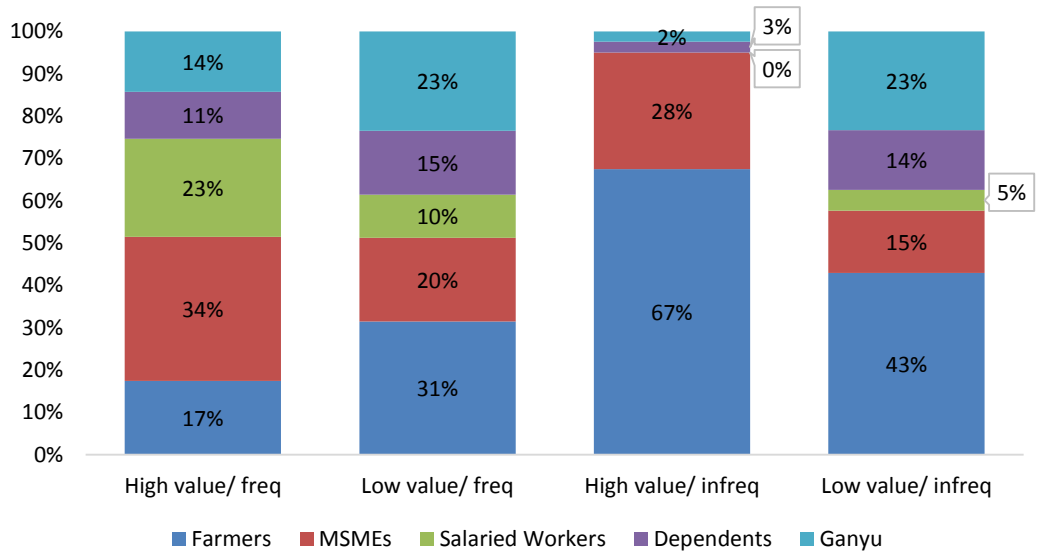


Figure 112: Savings behaviour - amount and frequency of saving

Source: FinScope, 2014

Frequent low value savings most common form of saving. 2.6 million adults save small amounts frequently, as per Figure 113 below. There is a clear income split between the high and low value demand for savings. Those that can save a portion of their income sit at the population average income, while those that save high proportions of their salary are either wealthier or extremely poor. Wealthier MSMEs and salaried employees are the main savers of most of their income on a frequent basis. This makes more sense for MSMEs as they typically have lumpy income flows and need to save for consumption smoothing purposes. Figures for the high value and infrequent category were too small to provide a representative explanation of the population.[115]

[115] If one examines the figures as they stand, the dominance by Farmers and MSMEs for high value, but infrequent, savings can also be explained by the uneven income flows and expenses that these target markets experience. The fact that most of their income is being saved at infrequent intervals either speaks to the fact that their income flows are uneven and consumption smoothing is required, or that the points in time when saving for expenses is needed the requires users of this category to set aside most of their extremely low incomes to cover the expenses.



	High value/ freq	Low value/ freq	High value/ infreq	Low value/ infreq
No. of adults	261 867	2 569 537	63 576	841 741
Average income (MK)	41 185	12 763	2 720	12 829

Figure 113: Savings value and frequency needs by target market, no. of adults and average income

Source: FinScope, 2014[116]

Most returns negative. As noted in section 6.3.3, most products provide a negative real return. The exceptions are two of the long-term savings providers – SACCOs (potential exception) and retirement funds.

6.3.4.1. Flexible and short term products

This section discusses flexible and/or short term savings products. Flexible products are product offerings that provide customers liquid access to their savings capital. Short term products are products that lock in savings for a period of a year or less. These two descriptions are often complementary, but there are some products which might be short term, but not flexible, and vice versa. There are 5 providers of flexible and short-term products, namely, banks, MNOs, informal savings groups SACCOs and VSLAs.

All formal products provide negative returns. Table 30: Real return calculation for main flexible and short-term product providers after inflation and transaction costs below provides a model to assess the potential for real returns from the main providers of short term and flexible products. It calculates the returns on small scale savings over the period of a year and assuming basic transactional behaviour of one deposit each month and one withdrawal at the end of the period. The purpose is to provide an indicative measure of the real value that these accounts provide when taking inflation into account.

[116] Value of savings is the percentage of income that is saved. High value is when a person saves most of their income and low value is when some of it is saved. Frequency is split between high (weekly to monthly) and low (a few times a year to less than once a year).

	Bank		Mobile Money		VSLAs	
	$5pm saved	$10pm saved	$5pm saved	$10pm saved	$5pm saved	$10pm saved
Base deposit over year	60.00	120.00	60.00	120.00	60.00	120.00
Less deposit fee each month	-	-	-	-	-	-
Annual interest	5.37	10.74	-	-	12.00	24.00
Monthly service fee (x12)	3.51	3.51	-	-	-	-
Sub-total	61.86	127.23	60.00	120.00	72.00	144.00
Less withdrawal fee	0.15	0.15	0.24	0.47	-	-
Less statement request (x1)	0.02	0.02	0.09	0.09	-	-
Nominal value of savings	61.70	127.07	59.67	119.44	72.00	144.00
Real value of savings	50.16	103.31	48.51	97.10	58.54	117.07
Percentage change between nominal and real	-16.40%	-13.91%	-19.15%	-19.08%	-2.44%	-2.44%

Table 30: Real return calculation for main flexible and short-term product providers after inflation and transaction costs [117]

Source: Authors' own

Banks provide the highest relative returns. Despite low transaction costs, mobile money delivers the greatest erosion to the real value of savings due to the lack of interest. VSLAs are close to this value, but offer a better real return due to no transaction costs[118]. Banks have minimal transaction fees, but balance these out with the provision of interest and so the inclusion of the fees only increases their relative erosion of savings by 16% and 14% respectively. It is important to note that taking account of the total cost of access and product features will have an impact on the assessment of savings products. Banks may provide the best real return, but they also commit customers to a monthly payment when regular income streams might not be guaranteed and due to proximity issues will have a higher direct cost to access the product. VSLAs and MNOs on the other hand have lower direct costs to access. The VSLA product structure also incentivises greater savings contributions than an individual might have set aside on their own.

Banks are one of the main providers of short-term and flexible products. Banks held the highest value of deposits for this product class at K 75.3 billion (USD 180.5 million) in 2013 (RBM, 2013)[119]. They provide a range of savings products of varying terms. As discussed in 6.3.3.1, most banks require a minimum balance of savings to be held and minimal monthly transaction fee. These charges appear low, but they are considerable when assessing the average Malawian monthly salary (3% of monthly income). To open an account a customer has to provide basic documentation such as identification documents (this ranges from voters cards to passports and drivers licenses) and proof of address (e.g. utility bill or letter from their chief). In some cases proof of income, recommendations from referees, and photos at registration or taking a loan is required.

Limited cash in and out options make flexible and low value savings through banks less attractive. There are a range of distribution touch points to access saving accounts from banks (see section 6.3.3.1), but in reality they are few in number and largely based in the urban areas – far from many of the banks' customers.

[117] Calculated at an exchange rate of MWK1:USD417 and the average inflation rate for 2014 (23%). Transaction costs are the average cost across providers in each institutional category.

[118] It is assumed that VSLAs are operating on a traditional cash based model and have not yet linked to formal financial services to store their deposits. VSLAs have zero real interest until funds are on-lent to persons outside of the group. For this model, it is assumed that on-lending has taken place at a monthly basis for the full amount.

[119] As an approximate measure this means that the deposits per customer is K 88,994 (USD 213). This is double the average monthly income of these customers.

MNOs provide a flexible short-term store of value product. The lower eligibility criteria and wider geographic reach of this provider could be driving the uptake of accounts outlined in section 6.3.3.2. MNOs offer small scale accounts with less KYC requirements (see section 6.2.3.2). These caps, should not provide a significant barrier for short term savings as they range from triple the average Malawian's salary upwards. In some cases MNOs also provide a link to bank savings products. However, MNOs do not provide an explicit savings product to encourage savings. As highlighted in Table 30 above, mobile money accounts offer relatively low transaction fees, but negative real returns due to the lack of interest provided.

SACCOs provide limited short term savings products. SACCOs are primarily a provider of long-term savings. However, they do also offer limited short term savings products (demand deposits). The value of deposits in 2014 was K 414.5 million (USD 994,000) (RBM, 2014). The interest rate provided is 1% per month, which is higher than the average provided by banks. The main eligibility criteria for the product is membership of the cooperative. Cash in and out occurs at the branch office. SACCOs have a mandatory monthly contribution towards store purchases.

VSLAs provide a short-term, but inflexible product with commitment benefits. Savings are locked into the group's pool for the duration of the savings cycle. This assists members to build up a pool of savings can be reinvested elsewhere. Members have the choice per meeting to contribute from 1-5 shares (Karlan *et al.,* 2012). The value of shares is determined by the group at the start of the savings cycle. As discussed in Section 6.3.3.5, liquidity during the savings cycle is provided via access to credit financed by the collective savings pot. Interest is earned through this lending activity and is thereby effectively an additional savings contributions (unless lent outside of the group). There are no explicit transaction fees for this product. Eligibility for accessing the group, and therefore products, is based on the group's assessment of suitability[120].

Informal savings groups offer simple short term savings products. Products of informal savings groups vary significantly and are usually contributed via regular in-person meetings and will be locked into the group until a particular goal has been achieved or when it is a member's turn to receive the rotating savings pot (in the case of ROSCAs). These products are therefore not flexible in nature, but often are locked in for a cycle of a year or less. The format of the groups does not create the ability to earn interest[121]. Similar to VSLAs, eligibility to access the product is determined by eligibility to access the group.

6.3.4.2. Fixed long term products

Banks have the lowest number of long-term savings customers, but the highest value of deposits. Deposits for long-term savings equalled K 115.1 billion (USD 1.3 million) in 2013, while their customer base totalled 89,102 adults at the beginning of 2014 (RBM, 2013; FinScope, 2014). They offer a range of long term products, the most common of which are fixed and notice deposits. These long-term products are savings accounts that have an agreed time period in which funds will be held in the account or notice of deposit will be provided. Interest rates are attached to the respective time period options and are generally higher than their short-term counterparts. The average rate provided in Malawi is 12% (various banks, 2015)[122]. At this interest rate level, long-term savings products do not

[120] Social capital is a prerequisite for membership, but also a benefit of that membership through the community support that comes from the group.
[121] The one exception is ROSCAs, but in the classic model these hold a similar interest profile to VSLAs where interest is in effect an additional savings contribution.
[122] The banks have varied strategies for whether interest rates increase or decrease with longer time periods. Rates can be negotiated for longer time periods.

provide positive real returns. Eligibility requirements and distribution touch points for these products are similar to those of short-term products provided by the banks (see 6.3.4.1 above).

Retirement funds are a steadily growing product that provides real returns. Retirement funds are, by their nature, a long term savings product. The funds account for the largest portion of long-term savings by customers and are steadily growing in membership numbers. Membership eligibility is based on income or mandatory provisions (see 6.3.3.3). Registration requires similar documentation to that of banks in addition to a regular income stream to make the pension payments. The funds can be either defined benefit, defined contribution or a hybrid of the two[123]. The value of contributions will differ according to the nature of the fund and the value of the member's pensionable salary. As per section 3, if the member is contributing to an employment based fund, the minimum contribution is 5% from the employee and 10% from their employer[124]. Contributions are most commonly paid by a member's employer directly from their payroll. Members can opt to join their own retirement fund, in which case payment will be remitted by both the employer and member directly to the retirement fund. Basic administration costs are paid by the employer. The time period of membership is dependent on either reaching retirement age or reaching 20 years of contributions.[125] Benefits can be paid out on a number of triggers: achievement of retirement age (50 years of age) or 20 years of contributions, permanent inability to work for medical reasons, immigration from Malawi, death and unemployment for longer than 6 months directly following termination of employment.[126] The payment can occur via lump sum (ranging between 40-100% depending on a legislative cap) or annuity.

SACCOs provide both general long-term products and savings via membership shares. All members of SACCOs access long-term savings through purchasing shares in the cooperative. These shares are only paid out on exit from the SACCO. Similar to their short-term savings, SACCOs also provide additional long-term savings products in an effort to encourage continuity of and provide value to their members. The uptake of fixed deposits products (K 9.6 million (USD 22,982)) is low in comparison to SACCO's shares of K 3.5billion (USD 8.3 million) (RBM, 2014). Their product features are similar to fixed deposits provided by banks. Overall eligibility for accessing savings products is linked to acceptance of membership to the cooperative (see 6.3.3.4). Shares can be held for as long as the SACCO is in existence. Returns from shares are higher than other long-term products offered by SACCOs, because they are based on investment returns. Payments for savings products from SACCOs can be made via the branch, bank deposit or directly from employee's payrolls. This could be a barrier for members without easy access to these touch points.

6.3.5. Barriers

Table 31 below provides a summary of the existence and severity of barriers that will be discussed in this section.

[123] A **defined benefit** pension fund is a type of pension plan in which an employer commits to a specified monthly benefit on retirement that is predetermined by a formula based on the employee's earnings history, tenure of service and age, rather than depending directly on individual investment returns. A **defined contribution** pension fund is a pension plan in which the employer, employee or both make specified contributions on a regular basis. The benefit at retirement is determined by the returns on investment the fund has achieved.
[124] Pension funds are mandated to provide life insurance alongside this product offering (see section 6.4.4).
[125] It is possible to switch retirement funds or be paid out benefits under other specific circumstances.
[126] The pay-out is limited to employee's contributions and applicable investment returns.

Access barriers		
	Proximity	• Formal institutions are located far away from the majority of the population.
	Affordability	• Low income levels in Malawi make saving unaffordable for some • Mandated retirement fund contributions could be unaffordable for some members
	Appropriateness	• Informal savings the only commitment device
	Eligibility	• Lack of national ID • Requirement to fit a profile for some institutions (e.g. SACCOs have explicit member profiles and VSLAs have an implicit bias towards female members)
Usage barriers		
	Financial capability	• Low financial literacy levels restricting capability to engage with products • Limited awareness of products
	Doorstop barrier	• Perception that formal institutions are "not for me"
	Hassle factor	• Crowded branches of formal institutions • Time consuming process of filling in forms and sanding in queues
	Value	• No real returns aside from retirement funds

Major barrier
Minor barrier

Table 31: Overview of access and usage barriers for savings

Source: Authors' own

6.3.5.1. Access barriers

Proximity

Proximity is a major barrier for formal access. Proximity to formal institutions, and particularly banks, has been highlighted in both FinScope (2014) and the qualitative research as a major barrier to savings access. Formal institutions and their distribution channels are mainly based in urban areas, while the majority of their customer base is located in rural areas. This means that their customers will have to incur travel and opportunity costs to access their savings.

> ***"Do you have a bank account?***
>
> *I just opened it a year ago at ABC Bank with an amount of K 500 (USD 1.20) but I do not use it either for depositing or withdrawing any amount from it, because of the distance from here to where the banks are, so I cannot waste some money traveling to the bank just to keep the money at the bank for while I have a house where I can keep the money."*
>
> Farmer, male, 43 years of age

This is particularly an issue when taking account of the fact that the highest demand for savings is for low value and frequent deposits, and therefore a profile that is likely to be sensitive to the cost trade-off of travelling to cash in and out of their savings.

Affordability

Low income levels make saving unaffordable for some. The majority of the population have low disposable income to set aside for savings. While this often means that savings are still possible, it increases the opportunity cost of setting funds aside (Banerjee & Duflo, 2012). FinScope (2014) shows

that for 89% of the adult population (7.2 million adults) there are times in a month where they have no money. Moreover, 45% of adults (3.6 million adults) that do not save, indicated the reason is because they have no money left over after expenses. 8% indicated they have no income at all and 4% place their money directly into the collective household savings.

> ***"What do you think about banks?***
>
> *I know about banks but for me I keep my cash in the house because it is only for half a day then I use it. Sometimes money can get lost or a house can burn down. But I don't have any money to keep at the bank."*

Dependent, female, 51 years of age

Mandated retirement funds sit below the minimum wage. The exception to comply with the mandatory retirement fund membership sits below minimum wage (K 15,000 (USD 36)) and does not apply when a company has five or more employees. Therefore, it is possible for persons earning less than K 10,000 (USD 24) to be forced to comply. The format of the mandatory provision places two thirds of the payments burden on employers (along with the requirement to handle administrative costs), but will still require a 5% contribution from the member's pensionable salary. An additional affordability issue is whether this new burden on the wage bill of companies is feasible. Total mandatory contributions by employers in 2013 were K 17.6 billion (USD 42.1 million) and total administration costs K 838 million (USD 2 million) (RBM, 2013; RBM, 2014). This totals to an K 18.4 billion (USD 44.1 million) cost burden to the employers of the 191,256 members in 2013. The burden of compliance will either (i) be borne by the balance sheet of employers or (ii) be passed onto employees through reduced income increases to compensate for their increased cost to company.

Appropriateness

Long-term savings and informal savings are the only commitment devices. It has been shown in literature that commitment devices in savings products assist with increasing uptake as it provides assistance with following through on time or goal based intentions for saving. Long-term savings products and saving through informal savings groups (VSLAs and other) are the only products that provide a commitment element. Given the low level of incomes in Malawi and the prioritization of saving to smooth consumption, products with commitment devices would provide high value due to assistance in increasing saving.

Eligibility

Compliance with AML/CFT increases eligibility requirements. AML/CFT regulation requires that identification is provided to facilitate access to financial products (see section 3.1.1.1). Lack of documentation is particularly problematic in Malawi due to the lack of a national ID and widespread identification system for physical addresses. There are substitute identification means on the market, such as passports, drivers' licenses, MEC IDs, but no universally accessible document is currently provided. Given the low prevalence of cars and general low income levels these are not commonly held documents and need to be sourced purely for identification purposes. In practice this is a fairly limited barrier to basic accounts, as customers have been able use voters' registration cards and letters from the chief.

Requirement to fit a profile by some institutions. Some providers only provide services to a particular profile of customer. For formal providers this is in the form of targeted products and membership to

SACCOs limited to matching particular profiles. For informal providers, there is an implicit eligibility barrier created by an association that membership of groups is for females.

6.3.5.2. Usage barriers

Financial capability

Low financial literacy levels restricting capability to engage with products. The ability to engage with information on financial services is an important precursor to effective usage of those services. Literacy levels, and importantly financial literacy levels, are low in Malawi. This means that the general population has reduced ability to engage with financial services that can restrict their depth of access.

Incorrect formal product usage erodes saving value. Savings are a unique product from general transactional products and as such, will have different product features. Incorrect product usage for savings can erode the potential value due to higher transaction fees or the lack of interest. Additionally, this experience can create a negative perception of the cost of savings that is incorrect and yet reduces the likelihood the product will be used. This is illustrated by the quote that follows below where the respondent saved funds in a transaction account:

" ***So what's the disadvantage of keeping money in the bank?***

Uhm banks are far they require you to travel long distances. They also charge high interest rates, for example one time I was banking with standard I left K 5000 (USD 12) and I stayed for about four months without going to the bank. When I went there, I found that all my money was gone and I owed them K 1050 (USD 2.5), I just left and never used that account again."

Farmer, male, 67 years of age

Doorstop barrier

Impression that customers will not be considered suitable by formal providers reducing their access. Doorstop barriers (or fear of officialdom) for formal institutions was evident in the qualitative research. The impression that these institutions are "not for me" provides a barrier to potential customers engaging with the provider to assess whether their products are in fact suitable. This impression can be generated by feeling that they will not fit the customer profile or that their income is too low to be a savings customer.

Hassle factor

Time cost to accessing financial services. Most savings providers require customers to either attend groups or travel to touch points to access their products. This means both time and cost trade-offs to access financial services, and the hassle of procedures required at these touch points. Examples of these are dealing with crowded branches of banks or sitting through a meeting of an informal savings group. Saving in assets even has a level of hassle factor to liquidate as it requires the effort of selling the asset in order to access funds.

" ***There other ways people keep money like the way you keep your money in the form of keeping maize, how important are these ways?***

These are excellent and cost effective, like I earlier said that when I buy sugar and keep it in the house; when I need to use sugar, I don't spend money going to get it somewhere and I am not charged on any transaction."

Salaried employee, male, 57 years of age

Value

Negative real returns aside from retirement funds. Section 6.3.4 shows the fact that no products, aside from retirement funds, currently offer positive real returns on savings. The implication of this is that savings held in institutions will erode in value. Additional benefits of saving in institutions might offset this erosion, but in large part this will form a value barrier to usage of these products.

6.3.6. Regulatory issues to consider

MFI deposit taking institutions enabled. The recent directive by the Reserve Bank of Malawi to enable deposit-taking MFIs will introduce a new savings institution to the market. MFIs have rural reach, but will face operational cost challenges to serve lower income clients, similar to the challenges of other providers.

Legal identity will assist VSLAs linking to formal institutions. Potential exists for VSLAs to link to formal institutions' financial services offerings as a group. In order to facilitate this, formal institutions can either deal with a group of individuals or with the VSLA as an independent legal entity. Formal registrations of VSLAs would make the latter possible. This could hold a further benefit of ensuring VSLAs are explicitly included from provisions for larger entities (e.g. SACCOs). Therefore, this would be an option for VSLAs that would like to connect to formal institutions and not a requirement for VSLAs in general. It must be noted that this suggestion is provided with the warning that registration of VSLAs is a new concept and should be developed with caution in order to ensure that it does not end up as a barrier to formation of VSLAs. A further benefit is to provide consumer protection for group members via the ability for recourse against a registered entity if there are abuses within the group. This could provide a level of consumer protection control without moving to the next step of attempting to regulate these groups.

Mobile money accounts are not promoted as savings products. Mobile money accounts are currently treated primarily as payments products rather than savings products. The regulatory restriction on earning interest on the mobile money float by mobile money providers limits the institution's incentive to promote and incentivise savings activity through mobile money (see section 6.3.3.2). The main reason for this is allowing clients to build up deposit balances in mobile money provides no benefit to the provider and, in fact, it could reduce revenues by disincentivising transactions on these balances.

Ability to fulfil KYC provisions without the infrastructure of a national ID. Access to appropriate savings is reduced if customers do not have access to suitable identification substitutes, because they will prohibit the opening of accounts at formal institutions (namely banks and SACCOs) and restrict the value of deposits in mobile money.

Feasibility of the mandatory pension provision in its current form. The current mandatory limit to comply with the Pension Fund Act (2011) is below minimum wage, i.e. below the minimum stated

necessary income level (see 6.3.5.1). It has been stated by regulators that there is an intention to revise this limit as it is unreasonable to assume excess income will exist for saving purposes.

Restrictions on providing financial assistance from retirement funds. The restriction on providing financial assistance utilising retirement fund contributions as collateral places a restriction on the potential for secured lending in a credit constrained environment. The potential for retirement funding to act as loans or collateral for housing should be considered.

High number of SACCOs in the market complicates supervision. There are currently a large number of SACCOs. The number of SACCOs has been steadily decreasing in recent years. RBM has dealt with the capacity burden that supervising a high number of entities creates by delegating regulatory authority to the industry body for SACCOs, MUSCCO. RBM issued directives to regulate SACCOs prudentially (capital adequacy and licensing requirements) and ensure good market practice (such as reporting requirements, liquidity requirement and asset classification) to assist with supervision and sustainability of these entities.

6.3.7. Gaps & opportunities

Use cases	Target markets	Impact and opportunity
Consumption smoothing	All	• Saving to smooth uneven income flows can assist with varied/ seasonal income and allow for predictable access to capital for household needs. • Affordable and accessible flexible savings products allows more effective and affordable smoothing of consumption than credit. ***This is a significant area given the number of people affected.***
Risk mitigation	All	Health and agricultural risks drive the need for appropriate savings. Limited savings products exist to specifically encourage saving for emergencies. Both insurance and credit represent alternative tools to mitigate risk. Credit is very expensive in this market and insurance only provides a viable alternative if appropriate and affordable products are developed. Medical schemes are increasing, but will likely remain accessible only to wealthier Malawians. ***This is a significant area given the number of people affected.***
Investment	Farmers & MSMEs	• Affordable fixed products that allow for the building of savings for investment into business assets. A commitment device and/ or incentive would be a helpful tool to enhance the usage of the product. • Saving in commodities (e.g. inventory) allows for the saving to hold an alternative productive use, while removing the temptation of easy liquidity. Credit is an alternative for this use case. The investment of credit into this productive use could be a worthwhile alternative if savings values do not cover the investment need. Existing saving products deliver returns that are below inflation and insufficient to grow funds for investment.
Funerals	Farmers, MSMEs, dependents & ganyu	Funeral expenses require a product that is affordable and possible to liquidate with short notice periods. Similar to health products, a built in commitment device could assist with building up savings and it is possible to substitute with insurance.
Education	All	Education is an aspiration for most Malawians. Limited saving products exist to encourage annual or long term saving for education.
Retirement	Salaried employees & MSMEs	Mandated retirement fund membership creates opportunity for increased access. This is particularly targeted at higher income employed target groups.

Table 32: Overview of gaps and opportunities per use case

Source: Authors' own

Savings an imperative for risk mitigation. Malawians face extensive income, health and weather risks. Savings is the main product used to address these risks given the unaffordable cost of credit and the limited availability of insurance products (combined with limited awareness of such products).

Limited proximity and appropriate products. The two main barriers to saving are proximity issues and inability to save because of low income levels and lack of appropriate products. Distribution should be improved through partnership and revisiting existing cost structures (see sections 5.2.2 and 6.2). Products that enable low value frequent saving while driving longer term commitment are required.

Macroeconomic uncertainty limits extension of savings. Macroeconomic uncertainty, inflation and an underdeveloped capital market impacts the business model of savings providers and reduces the real returns on savings products. Addressing these areas can encourage further roll out and enable higher consumer returns. This is particularly important for long-term savings that will counteract their purpose by reducing in value over time if their value does not exceed inflation.

High demand for flexible and low value savings products. It has been identified that the greatest product need is for flexible and low value savings. Addressing this opportunity will require resolving proximity issues discussed above, but also extending the awareness and ability to engage with current products through communication and financial literacy initiatives. It has been highlighted that both education and financial literacy levels are low in Malawi. This creates the need for clear and simple communication and initiatives to increase long-term literacy levels.

Seasonality of income in some target groups driving a high need for suitable saving products. Ganyu, farmers, dependents and MSMEs, to a certain degree, are groups that have lumpy income flows and as such require financial products that allow for consumption smoothing and setting aside funds for investment and risk mitigation. These target markets tend to be in the rural areas and have a low income base. Therefore, appropriate products should be accessible in the rural areas and caters for flexible short term access.[127]

Saving for education and investment. It has been highlighted in the demand-side research and FinScope (2014) that there is a use case for saving for education needs and investment in assets, particularly housing. Educational savings will require long-term products for the purpose of fee payment and co-payment areas such as school uniforms and textbooks. Facilitating savings for education, by providing the tools required to invest in education for individuals can contribute to greater human capital development across society. Housing is not often bought or sold, but rather constructed in increments as and when households can afford construction costs. Targeted savings products could assist with this process.

Unmet savings need highlighted by saving at home and saving in assets. The high level of saving at home and in assets shows there is unmet demand for institutional saving. The main reasons for saving at home are in order to have cash at hand for short-term needs and due to the hassle factor of accessing other savings touch points. It is an indication of proximity issues and inappropriate products, and the lack of electronic payments infrastructure that drives the need to keep cash to pay for day-to-day expenses. Saving in assets is inflation combatting and therefore highly valuable in the current macroeconomic context. It is unlikely that the need to combat high inflation will reduce in the short-

[127] Actors in the agriculture value chains discussion in section 5.2.2.2 provide a particular opportunity for outreach to both farmers and in some cases, the general rural population through agro-dealers that are open to the public.

term and therefore saving in assets will continue to be a valuable channel for ensuring positive real returns.

Potential for VSLAs to increase savings uptake. There has been a notable increase in informal savings in recent years that was largely driven by VSLAs. This institutional structure therefore appears to be accurately meeting a savings need in society. The implication is that VSLAs should be an important institution to develop in order to increase access to financial services. This is both for the initial savings held in VSLAs, as well as the savings deposits that members generate over savings cycles which can be invested elsewhere. CARE has run pilots in a range of countries to test potential links to financial services that range across the product markets (savings, credit, payments and insurance) including one with OIBM in Malawi (CARE, 2013). Lastly, the VSLA structure itself can be leveraged to graduate groups to formal product usage by evolving into a different institutional structure in the formal space, such as a SACCO. Some organisations are explicitly targeting the development of VSLAs as a basis for SACCO origination (e.g. MUSSCO).

Widespread mobile phone access across the target markets provides the infrastructure for mobile money take up. The widespread penetration of mobile phones in Malawi provides infrastructure that mobile money providers could leverage to increase savings access through, for example, e-wallets and similar products. This penetration ranges from 57% for ganyu to 88% for salaried employees (see section 4.3.2).

Potential for long-term savings to increase. Mandatory retirement fund membership could triple in the coming years. Given the low levels of social security provision in Malawi and increasing urbanisation levels moving people away from their community safety net, this could have a positive impact if implemented correctly. Consolidation of funds is needed to increase efficiency in the market. SACCOs provide potential for credit and short-term savings access while investing in long-term savings. Their mutual structure reduces profit based incentives to keep deposit rates low and therefore can provide products that achieve higher real returns than other formal providers. Further, the institution can balance between on-lending funds and investments to maximise returns that support this. SACCOs will need to improve business sustainability concerns. Capital market development and the ability to invest abroad will assist in enhancing this product area. This is a key product area to enhance given the long-term safety cushion and positive real returns it provides.

Appropriateness of mandated retirement fund contribution. It has been highlighted in a number of sections that the current mandatory retirement fund requirement could be unaffordable. This affordability relates to both the ability of the individual member to contribute and the sustainability impact it could have on employers of retirement fund members. These provisions should be investigated in order to ensure that required contribution is sustainable for those it applies to.

Retirement funds can be leveraged for housing and capital market development. There are currently regulatory constraints on utilising retirement funds as collateral for financial assistance and investing internationally (see section 6.3.6). Further, mandated retirement fund membership is increasing the asset base of this provider (some of which will be soaking up previously untapped deposits). Therefore, there is high potential for increased investment by retirement funds in the capital market, which could be leveraged to develop it. Conversely, the restrictions on financial assistance from retirement funds are hindering the potential for a secured credit resource in Malawi.

6.4. Market for insurance

Why focus on insurance? Both qualitative and quantitative research indicate that individuals in Malawi face a number of costly risk events. Many of these individuals (36% according to FinScope 2014) rely on savings to cover unforeseen expenses, while another 20% have no plan for how to pay for risk events. Savings, especially in an environment with high inflation and low deposit interest paid, is not always the most appropriate way to prepare financially to face risk events. Furthermore, in Malawi, many people save in assets—both livestock and crop—rather than holding money at a financial institution. These assets are often more illiquid, making them less efficient and feasible to cover emergency expenses. From a demand-side perspective, insurance therefore has an intrinsic value proposition a risk management instrument.

Insurance is also relevant from a supply-side perspective. Recent insurance legislation is changing the landscape and potentially increasing the client base of insurance companies through mandated life insurance contributions for formally employed individuals. The investment pool of insurers has also been growing in recent years, making these companies a valuable source of capital for growth in many sectors of the economy. Finally, conversations with some insurers indicate an insurance market outlook with increased innovation—from mobile-linked products to a greater focus on low-income targeted microinsurance products.

It is therefore important to unpack the key drivers of the insurance market in Malawi in order to highlight gaps and opportunities for extending the reach of the market.

Key issues: market for insurance

- Penetration of formal insurance is low.
- Informal risk mitigation common through VSLAs and SACCOs.
- Current users of insurance is largely employed, male, urban and educated.
- Illness and deaths within the family are the most pronounced insurance needs, theft also ranks highly.
- The two largest barriers to insurance uptake are awareness and affordability.
- Lack of a health finance framework inhibits health insurance provision.

6.4.1. Current usage

Low formal uptake[128]*.* The 2014 FinScope survey revealed that only 1.7% of adults in Malawi have formal insurance coverage—which equates to just over 136,000 individuals. This is a decline in coverage from the 3% of the population (or 193,000 adults) who were reported to have coverage in the 2008 FinScope survey. The 2014 figure is low relative to neighbouring countries, which range from

[128] Very few people take up insurance, which impacts the representativeness of FinScope (2014) data. However FinScope does provide an indicative measure that life, medical and motor insurance are the most popular insurance products.

3% formal coverage in Zambia, to 13% in Tanzania and up to 38% in South Africa, as shown in Figure 114.

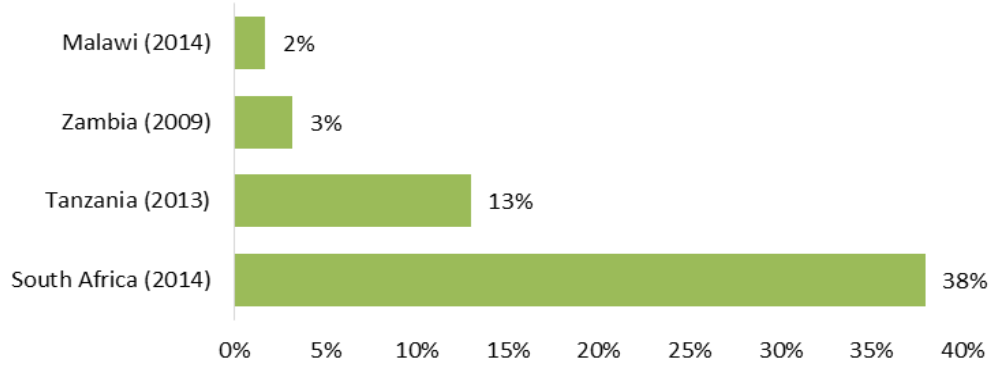


Figure 114: Percentage of adults with formal insurance cover: regional comparison

Source: Malawi FinScope, 2014; Tanzania FinScope, 2013; South Africa FinScope, 2014; Zambia FinScope, 2009; Mozambique FinScope, 2013

Formal uptake may be underestimated. Supply-side interviews indicate that the number of policy holders and covered lives may be higher than the figures quoted above. The Medical Aid Society of Malawi (MASM), alone, reports over 120,000 covered lives; while TNM's Moyo Life product reports over 200,000; and over 40,000 clients are receiving savings-life insurance[129] through OIBM and NICO Life. Simply from these few examples one can see that formal insurance coverage likely extends well beyond the FinScope figures. As FinScope captures self-reported coverage among adults, it may be indicative of a lack of awareness of cover for many (e.g. if they are covered via a family member or an employer).

Informal insurance further increases uptake figures. Although FinScope does not capture informal insurance uptake, research shows that many Malawians are receiving some form of risk cover outside of formal insurance. Most notably, VSLAs and SACCOs have built-in insurance-like components, which provide benefits upon death to their members. For the over 165,000 members in CARE-linked VSLAs, members make regular contributions to a pool of funds to help cover funeral expenses. This is the predominant VSLA model in Malawi and therefore could extend to the 1.1 million VSLA members in Malawi. For the approximately 98,000 SACCO members who fall under the oversight of MUSCCO, members pay a percentage of their loans for credit-life and savings-life coverage.

Desired insurance products are largely consistent with current uptake. When respondents were asked what insurance they would like to have in future, the general population showed a prioritisation of medical, life (both life and funeral) and crop insurance that matches with current uptake (see Figure 115). This is notable, because while the question speaks to what the respondent would prefer and not necessarily what they will do, it does provide a more representative picture of the population at large than the current low insurance penetration figures can indicate. Motor vehicle insurance on the other hand was the least favoured, although this is likely driven by low vehicle penetration rates. New areas of interest included personal accident, asset, legal and weather index insurance.[130]

[129] Savings-life insurance is a term used to denote simple life insurance products with benefits linked to the amount of savings held within an institution. For example, a savings-life product may be offered by a bank, and instead of a fixed pay out upon death of an insured account holder, beneficiaries would receive 3x (or another multiple) of the value of the insured's savings account upon death.
[130] It is notable that there is desire for two different forms of agriculture insurance; namely, crop and weather index insurance.

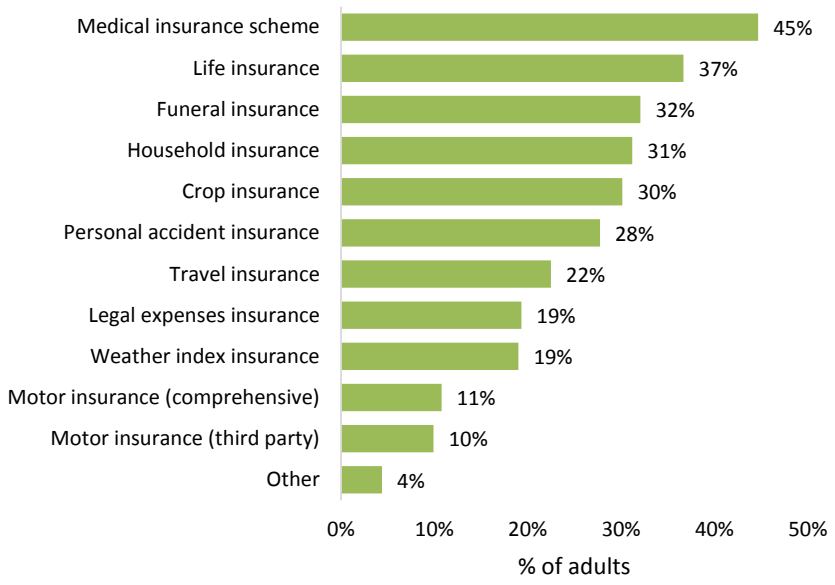


Figure 115: Desired insurance products

Source: FinScope, 2014

Community support provides coping mechanism for major risks. Qualitative research and supply-side interviews conducted in 2014 provided evidence of community support during life shocks when members were unable to carry the cost of the event. The evidence applied to assistance with funerals, transport to healthcare and care of children of family members when their primary care givers are unable to do so. While this will not provide an effective coping mechanism for all risks faced, it does act as cover for two of the most costly risks faced by Malawian households (see section 6.4.2). The quote that follows provides an illustration of this support following a death in the family.

> ***"How do you help one another during times such as these [unforeseen death] here?***
> *We contribute any amount to buy all things needed. Sometimes we get things on loan and pay later after the burial ceremony.*
>
> ***So how do you pay the loan?***
> *Everyone in the village contributes something towards the bill.*
>
> ***Where do you keep the money while waiting for other contributions?***
> *We collect the money and pay back the loan the same day."*
>
> Ganyu, female, 62 years of age

Formally insured are more male, urban, and educated. When compared to the overall demographics in Malawi, as shown in Figure 116, those who have insurance coverage deviate from the average. Current uptake is majority male (58% of the insured compared to 43% of the population), urban (61% of the insured compared to 15% of the population) and educated (71% of the insured have secondary or higher compared to 24% of the population). As many people receive coverage through employers, uptake of insurance products is strongly correlated with the salaried employees target market. Thus it would be expected that the demographics of the insured would largely mirror those of salaried employees—more male, more urban, and more educated.

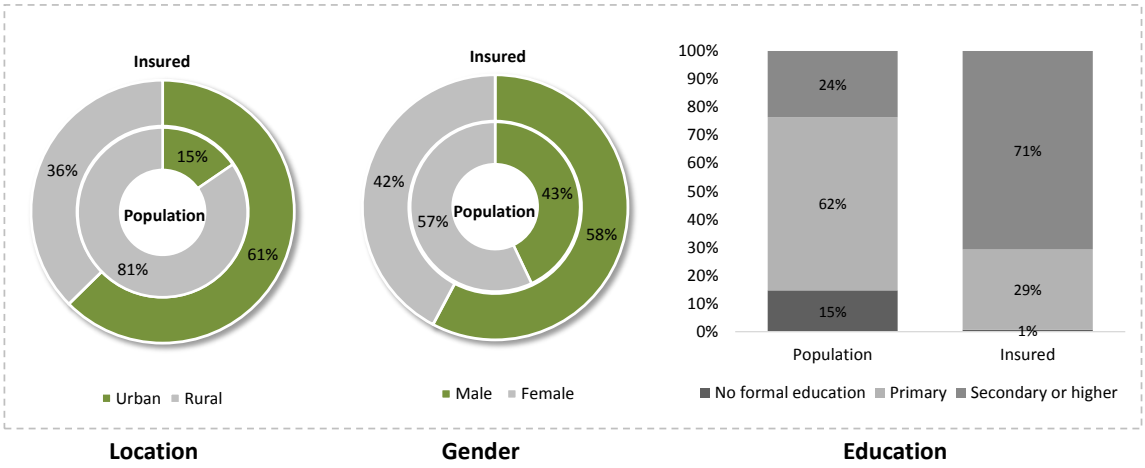


Figure 116: Comparing demographics of the insured versus Malawian adult population

Source: FinScope, 2014

Low penetration in target markets besides salaried employees. While 11% of salaried employees report insurance coverage in the 2014 FinScope, the numbers decline sharply to 1.8% for dependents and 1.4% for MSMEs. These figures appear even lower for farmers and ganyu at 0.8% and 0.6%, respectively. The figures for these four other target markets are so low that the difference between them is statistically insignificant.

Informal risk mitigation extends cover into rural groups and females. Although SACCO membership is largely drawn from salaried employees with the demographic profile highlighted above, 35% of their client base is currently women or rural populations (FinScope, 2014). Even more so, VSLAs tend to skew more heavily towards a rural and female client base. Sixty four per cent of VSLA members are female and 82% are based in rural areas. Qualitative research further supports the claim that women, specifically rural women, are the predominant members of these savings groups (see section 6.3.3.5). Therefore, this indicates that VSLAs and SACCOs are not only playing a role in increasing risk cover, but they are doing so to groups underrepresented in formal insurance schemes.

6.4.2. Use cases

This section outlines the use cases for insurance as identified through qualitative and quantitative demand-side research. While these use cases reflect need in the market, these should not necessarily be construed as feasible market opportunities in all cases. At the end of the insurance market analysis, these use cases will be revisited to form the basis for the identification of gaps in current provision and opportunities for growth.

To cover expenses linked to illness. As shown in Figure 117 and Figure 118, illness within the household represents both the largest threat to income and the most costly life event. It is the second most popular insurance product (39% of insured adults). Furthermore, the survey shows that medical expenses are also a main reason for savings (13%) and borrowing (12%) and therefore a significant use case for financial services exists. When asked what insurance products individuals would like to have in the future, medical insurance came out on top with 45% of respondents (3.6 million adults) signalling a desire to have coverage for illness.

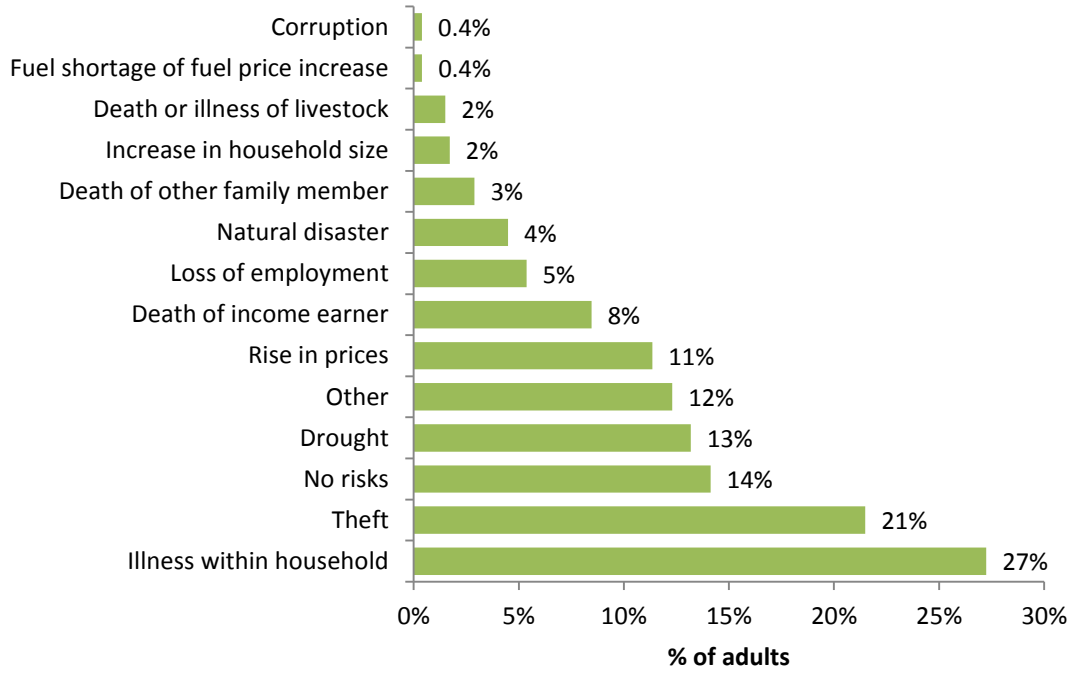


Figure 117: Biggest threats to income in Malawi

Source: FinScope, 2014

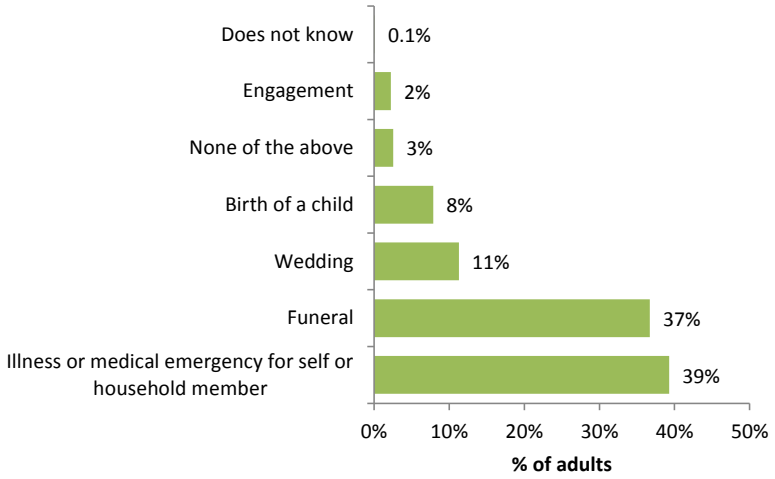


Figure 118: Most costly life events in Malawi

Source: FinScope, 2014

To cover funeral expenses. Twenty per cent of adults, or 1.6 million adults, come from a household that has experienced one or more deaths in the past year (FinScope, 2014). Furthermore, 37% of adults indicated that funerals are the most costly life event. Beyond just need, FinScope (2014) also captured the desirability of insurance to cover the costs of death, with 32% saying the same for funeral insurance.

To cover income lost from death or disability. As indicated in Figure 117 above, death of an income earner or other family members are seen as a risk to income for only 8% and 3% of adults, respectively. However, the loss of an income earner can have a significant and lasting impact on a household's

ability to support itself and therefore there is a strong use case for mitigating this risk for those that do face it. Despite its lower relative recognition as a risk, life insurance is the product with the highest uptake amongst insured adults (41%).[131] Although, when assessing the desirability of insurance, 37% of adults indicated that they would like to have life insurance in future.

To provide mandatory credit-life coverage. Many banks and MFIs require credit-life insurance coverage in order to receive a loan. Thus, over and above the use case for life insurance, this product category becomes a default important insurance use case, especially for MSMEs and farmers who might rely on credit to establish and grow their businesses (see section 6.1).

To cover the loss following natural disasters. With farming as a key source of livelihood for many Malawians, it becomes important to protect farmers, a group which bears a substantial amount of risk in their assets. As mentioned in section 2.1, 99% of agriculture land is used for rain-fed cultivation and therefore farmers are highly vulnerable to weather based events. FinScope (2014) shows that 13% of adults (1.1 million adults) recognise drought and 4% natural disasters (360,000 adults) as key risks to income. This became all the more evident with the recent floods of early 2015 that wiped out about 64,000 hectares of productive agriculture land and affected 120,000 farmers. For farmers, the loss of their crops—throughout the farming cycle—presents a significant threat to their incomes and livelihoods. This will require insurance that covers the farmers assets in the event of loss due to natural disaster.[132] Following harvest, farmers could benefit from goods-in-transit insurance or from asset insurance as crops are stored in warehouses threatened by flood and fire, as well the ever present threat of theft (as shown by Figure 117 above).

To cover the assets of MSMEs. Conversations with small business owners indicate that these entrepreneurs often face significant threats to their inventory and places of business (In-country consultations, 2014). Twenty one per cent of adults cited theft as a key threat (FinScope, 2014) and although this is a widespread issue, the target market over and above farmers that is likely to prioritise the cost of asset insurance are MSMEs, because their income depends on their business assets.

6.4.3. Providers

As shown in Table 33 below, there are seven general insurance companies and four life insurance companies currently active in Malawi. These are backed by one local reinsurer. Foreign reinsurance is allowable in the market, but only once support from local reinsurance has been exhausted (In-country consultations, 2014).

[131] The bundling of life insurance to mandated retirement fund provision for employees will likely drive even further use of this product as compliance increases (see section 6.3 for more details).
[132] Weather insurance could therefore in principle play an important role in protecting the loss of seeds and production from planting to harvesting stages. However, this product has proved challenging in the past, especially when targeting smallholder farmers.

Life insurers	General insurers	Reinsurance companies
NICO Life Old Mutual Life Assurance Smile Life Vanguard Life	Charter Insurance General Alliance NICO General Prime Insurance Real Insurance Reunion Insurance United General	Malawi Reinsurance

Table 33: Licensed insurance companies in Malawi[133]

Source: RBM, 2014

Life market dominated by two players. Together Old Mutual and NICO Life account for over 81% of the life insurance market share by premiums and 95% of market share by assets (pensions excluded) (RBM, 2013). This dominance is mainly focused on the saturated wealthier target markets and both companies have expressed intention to place greater strategic focus on the mass market over the coming years. This will become more relevant with the expected entrance of CIC Cooperative Insurance in 2015 through a partnership between MUSSCO and CIC Kenya. With approximately 98,000 members currently within MUSCCO-linked SACCOs, the expected entrant could reshape the provider landscape.

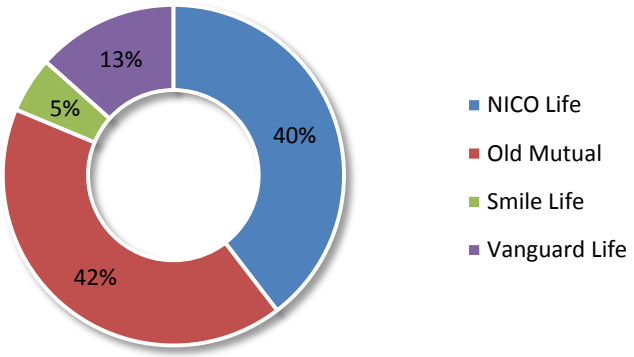


Figure 119: Market share by premium, life insurers

Source: RBM, 2013

General market is more competitive across a greater number of insurers. As shown by Figure 120, unlike the life market, the general insurance provider landscape is dispersed across a number of the market players. Over the past two years, the top four slots in terms of market share have remained unchanged with NICO General holding the largest market share by premium, followed by United General, General Alliance, and Real Insurance. The general insurance market focuses product provision on fairly standard corporate and upmarket offerings.

[133] In 2003, composite insurance licences were disallowed. Although the Insurance Act containing this mandate was not enacted until 2010, market players were advised in advance and complied with the Registrar's licensing guidelines, which required separate licences for life and general insurance businesses. NICO was the only composite insurer and company for which this change resulted in a split into two separate companies.

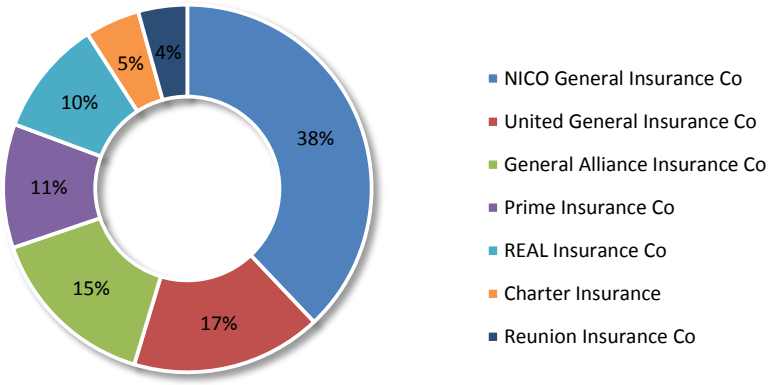


Figure 120: Market share by premiums, general insurers

Source: RBM, 2013

Both the general and life markets are improving performance and poised for continued growth. Both general and life insurance sectors have seen strong growth in premiums over the last four years (RBM, 2013). This upward trend indicates that neither market has fully matured and that there is likely still potential for further growth. However, it must be noted that high inflation during the period was one driving factor in the increase in premiums collected.[134]

Relatively stable formal provider landscape. Both the life and general insurance provider landscape have remained relatively unchanged in recent years, with the majority of the insurers in existence since before the turn of the millennium. The most recent entrant into the life insurance market was Smile Life (established in 2009). The general insurance market has not seen new entrants since 2000 when General Alliance was formed. One general insurer exited the market in 2011 due to regulatory compliance issues. As discussed above, a new market entrant is expected in 2015 based on a partnership formed in 2014 between MUSCCO and CIC Kenya (Mambulasa, 2014). CIC Cooperative Insurance has applied for both life and general licences, making it one of only two insurance players that will operate in both areas (In-country consultations, 2014).[135] This entrance to the market indicates that there is still confidence by outside insurance groups in potential growth for the Malawian insurance market, but serving a specific target group into which they already have an entry point.

Growing and profitable life insurance industry. As shown by Figure 121, the life insurance industry's profitability steadily increased from 2011-2013 to very high levels, while the management expense ratio has increased marginally and claims ratios have steadily been decreasing. Current profitability levels are driven by growth in premiums and investment income (RBM, 2013). It must be noted that pensions and annuities business lines are included in the profit and loss accounts of the two leading industry players and therefore profits cannot be attributed to life insurance alone. Furthermore, while the return on revenues ratios show a substantial income, a large portion of this is allocated to long-term business reserves, which is to provide for future claims. The size of this reserve and low claims is indicative of a young industry that has a stronger balance of new policies to those maturing. However, claims levels should be closely monitored to ensure low client value is not another factor. The decrease in the claims ratio provides a relative picture that is underpinned by a strong growth trend in

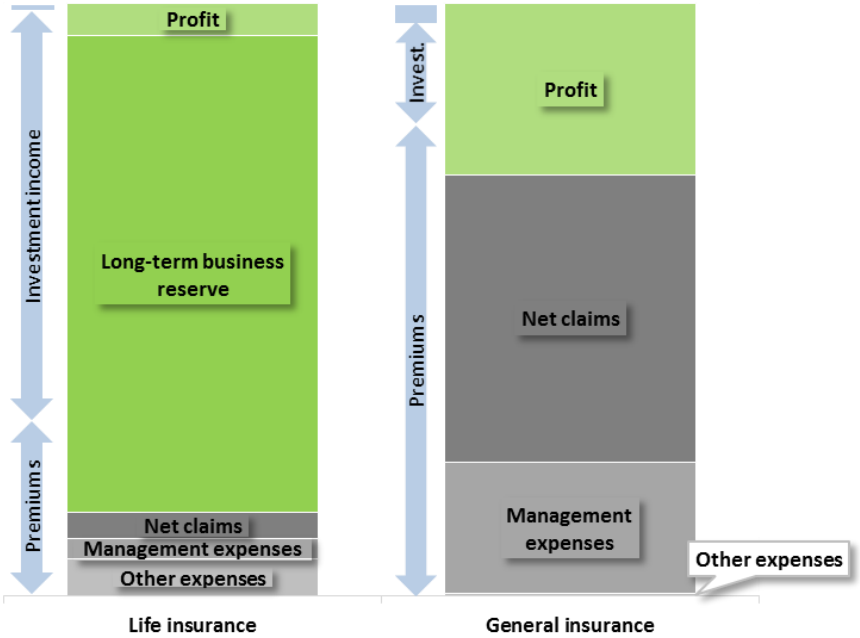
[134] RBM has adjusted their reporting templates to have the ability to track the causes of premium growth delineated between new business growth and market factors (for e.g. inflation) going forward.
[135] The new company plans to offer credit-life, savings-life, and eventually medical cover—specifically targeting clients of SACCOs.

premiums[136] which was not matched by claims, despite a steady increase over the period. The management expense ratio indicates an efficient industry with premium growth far outstripping the relative rise in expenses.

Following a challenging year in 2011, the performance of general insurers has been improving. The general insurance industry on the other hand has rebounded from low profitability levels during the 2011-2013 period and has healthy claims and expense ratios (see Figure)[137]. In addition to a general poor performance in the economy (see section 2.1), 2011 saw the write off of roughly K 1.5 billion (USD 3.6 million) of non-performing premium debts for general insurers under enforcement of Premium Payment and Capital Directives from the Reserve Bank of Malawi (RBM). At the same time, premiums declined and claims rose leading to poor net profits, solvency, and return on equity. However, since then the solvency has been improving to nearly double the minimum regulatory requirement. Management expense ratios have declined as fewer intermediaries have been used and premium collection has improved. Claims ratios for the industry hover around 60%, indicating a good balance of client value and business sustainability. Overall profitability increased 73% to K 2.6 billion (USD 6.2 million) from 2012 to 2013 (RBM, 2013).

[136] The industry registered growth of 48% in gross premiums written (RBM, 2013).

[137] Similar to the life industry, both claims and management expenses increased between 2012 and 2013. The effect of these increases was offset by the increase in premiums (RBM, 2013). Further decline in the claims ratio should be monitored to ensure consumer value is maintained, while continuation of the decrease in the management expenses ratio should be encouraged as it indicates improving efficiency in the business models.



Providers	Return on revenues ratio			Solvency ratio			Claims ratio			Management expense ratio		
	2011	*2012*	*2013*	*2011*	*2012*	*2013*	*2011*	*2012*	*2013*	*2011*	*2012*	*2013*
Life	55%	90%	93%	-	-	-	25%	20%	15%	9%	13%	12%
General	8%	40%	50%	15%	24%	33%	64%	62%	62%	34%	33%	25%

Figure 121: Insurance industry monetary flows breakdown and industry ratios[138][139]

Source: RBM, 2013; RBM, 2014

Disaggregation of life and pension business anticipated for 2015. RBM has indicated to life insurers that also provide retirement products that they will be required to completely separate their life insurance business from their pensions business. There is no clarity as yet on exact timelines of the required split. Stakeholder interviews conducted in 2014 indicate that the industry is actively taking steps in preparation for this split, with some trepidation about the sustainability of life insurance companies without pensions.

Dedicated medical schemes are currently unsupervised, but play an important role. Medical insurance falls under the purview of RBM as the insurance regulator, but in practice dedicated medical schemes are currently unsupervised. MASM, the country's largest medical scheme, along with other health schemes such as Liberty, Metropolitan, and Horizon have recently registered under RBM, although they are still waiting on guidance on what dedicated regulation will come and what the required reporting requirements will be. Approximately 120,000 individuals currently have coverage under MASM. Nearly a quarter of this client base purchase the low-premium *Econoplan*, making MASM a substantial contributor to the insured population in the country and one of the few players operating in the low-income space. CIC Cooperative Insurance has expressed interest in health insurance, although the current indication is that it will be offered as part of their portfolio of products and not under a stand-alone scheme. Consultations with other insurers indicate they are taking a wait-and-

[138] The life industry return on revenues ratio is calculated on the basis of consolidated financial statements that include business lines from pensions and annuities.
[139] The solvency regime for life insurance requires the maintenance of a solvency margin equal to or above K 75 million (USD 180,000) in adjusted net assets. Consequently, the Reserve Bank of Malawi does not publish the solvency ratio for this market category.

see approach on how health insurance will expand in Malawi, with only Smile Life pursuing a hospital cash back product[140] currently.

Informal coverage increasing in importance for risk mitigation. Little evidence was found of the existence of standalone burial societies in Malawi. However, as mentioned in Section 6.4.1, VSLAs and SACCOs are rising in prominence in informal risk mitigation:

- VSLAs have been growing in membership over the past five years. Although initially introduced by CARE, this model is now being employed in various modalities by a number of non-profits and other groups across the country. Due to an increase in actors and self-management by group members, one cannot assume that all use the CARE model of contributing towards a central pot to cover funeral expenses should they arise for a group member. However, the supply-side interviews and qualitative research indicate that many do.

- SACCOs have been informally covering savers and borrowers through a risk mitigation fund. This fund is grown through 1.5-2.5% contribution on members' loans. With over 98,000 members under MUSCCO-linked SACCOs, the RBM has become concerned in recent years that this pooling was acting too much like an insurance scheme. Consequently, MUSCCO initiated conversations with CIC about forming a new cooperative insurance company.

Limited state intervention. Unlike many of its peers across Africa, Malawi has seen relatively limited State involvement in the insurance market. All insurers are privately owned and operated and there is no previously State-owned monopoly, as is the case in for example Zambia and Tanzania. The Government does play some limited role in provision of funeral assistance[141].

6.4.4. Products

Life, medical, and motor vehicle insurance most popular products. As per Figure 122 below, life and medical insurance have the highest coverage rates, with 41% and 39% of the insured population taking up these products, respectively. Motor vehicle insurance, which dominates the general insurance industry, is held by 35% of those adults who have insurance coverage. At the same time, none of these products reaches more than 0.7% of the adult population. This is especially notable given the fact that third party motor insurance and life insurance attached to pension fund membership is mandated by government, as well as the fact that credit-life products are often required by credit providers. There are therefore factors beyond insurance that should be driving take-up, but have been limited in their application to date.

[140] Hospital cash back products provide a lump sum cash benefit upon hospitalisation that meets the requirements of the policy (e.g. hospitalisation lasting longer than 24 hours).
[141] This assistance is in the form of direct support for components of the funeral cost. For example, supply-side interviews conducted in 2014 indicated a practice of directly providing the coffin and transport. The costs are either covered by the government office or repaid by the employee.

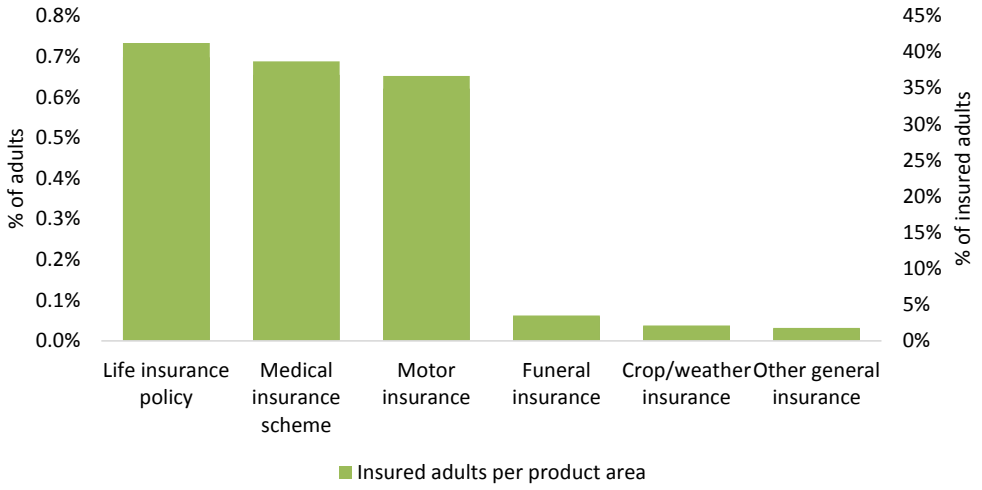


Figure 122: Uptake of insurance products

Source: FinScope, 2014

Current product target markets are group, corporate and motor vehicle owners. Life insurance revenues are overwhelmingly drawn from group life insurance schemes. Interviews with three of the four life insurance companies indicate that between 70-95% of premiums are drawn from group schemes, mostly through employer networks. Conversations with a number of general insurers indicate that the short-term industry in Malawi is also largely targeted to corporates. The product range provided is a fairly standard general insurance offering[142], with low levels of innovation (In-country consultations, 2014). This correlates with the strong prevalence of the salaried employee target market in insurance uptake (see 6.4.1). Motor vehicle insurance is one of the few general insurance products that reach into the retail/individual market.

Product servicing through traditional means. As outlined in section 5.2.2.1, both product lines favour traditional distribution channels. Premium payments can occur via cash or cheque through these channels or bank transfer/debit order. The preference per channel will naturally differ between individuals and corporates; and allow for some individuals connected to corporates to pay for premiums via payroll deduction. A number of insurers require annual or bi-annual payments of premiums (In-country consultations, 2014). The reason for this is that more regular payments, especially when leveraging traditional distribution approaches, are simply too costly. As discussed below, there are also embedded products in the market where payment will be linked to the use of or payment for another product. Some insurers will pay out claims via similar means as premiums (cash, bank transfer, etc.), but a number still only offer cheque payments.

Limited number of entry-level insurance products does exist across many product categories. There is a suite of products on the market that target low and middle-income customers. Table 34 summarises the key features of a number of such products, but is not necessarily exhaustive of all products on the market:

[142] These categories usually either relate to particular assets, such as motor vehicle insurance, or insurable events, such as fire and personal accident insurance products.

Product Type	Product	Provider	Minimum premium and benefits	Distribution channel
Funeral	TNM Moyo Cover	NICO Life	Free with K 1,000 (USD 2.4) airtime spend. Coverage starts at K 50,000 (USD 120) and increases with airtime spend	Mobile
	Funeral Cover	Smile Life	K 500 (USD 1.2) premium for K 30,000 (USD 72) cover	Direct sales in branch
Health	MASM Econoplan	MASM	K 1,800 (USD 4.32) premium for up to K 750,000 (USD 1800) annual health expenses. Has an attached funeral benefit.	Mix of direct sales, banks, auction houses
	Hospital Cash	Smile Life	Varying premium. Benefits of K 15,000 – 20,000 (USD 36 – 48) per day in hospital	Direct sales in branch
Agriculture	Mtetezi Tobacco Cover	NICO General	5% of insured crop	Sold to groups through banks
	Weather Index Insurance	IAM & Malawi Re	Varying premium and cover	Via banks which provide agri, loans
Asset	SME Asset Cover	NICO General	2.5% of SME loan	Banks
Credit-Life	Group Cover	Multiple insurers/ MFIs	Varying premium and cover	MFIs / Banks
	SACCO Credit-Life	MUSCCO[143]	1.5-2.5% of loan to cover loan value	SACCOs
Savings-Life	EduSave	NICO Life	Free to OIBM savers. Pays 5x savings balance upon death/ disability	OIBM
	SACCO Savings-Life	MUSCCO	1.5-2.5% premium. Pays 2x savings balance.	SACCOs

Table 34: Sample of entry-level products

Source: In-country consultations, 2014.

Many entry-level products are embedded. A number of the products shown in the above table are embedded products.[144] For example, TNM provides free life cover based on airtime usage (underwritten by NICO Life) and a number of MFIs and SACCOs embed credit-life and savings-life cover. Leveraging this channel for insurance provision reflects the difficulty and cost of individual direct sales. This is especially an issue due to low insurance awareness and prioritization of use (discussed further in 6.4.6 below). While embedded products have the ability to significantly increase insurance penetration, their role as a secondary offering has risks resulting from removed customer engagement. Additional communication must occur to ensure clients are aware of the products,

[143] MUSCCO-linked risk mitigation products are included in this table because they have a defined cost and benefit to cover a risk event for the compensation of premium payments. Although they are not regulated as formal insurance products currently, the offering is expected to transition to be offered by the new CIC Cooperative Insurance Company. It is expected to receive an insurance license in 2015 (In-country consultations, 2014)

[144] These are insurance offerings whose coverage is automatically triggered through the use of linked products and therefore the decision for uptake is not primarily linked to the insurance itself.

understand the benefits and can claim when eligible. One example of these risks is embedded weather insurance linked to agriculture lending, which has struggled to achieve sustainability in part as a result of client communication, in addition to a number of other factors as highlighted in Box 22.

Box 22. Index-based weather insurance in Malawi

Index-Based Weather Insurance (IBWI) has a relatively long history in the country. With the World Bank driving the initiative and supporting pilot costs and premium subsidies, IBWI grew from a pilot covering less than 1,000 groundnut farmers in 2005 to a broader program covering a mix of maize and tobacco farmers. A wide range of partners were involved in the initial years of the program including agriculture aggregators (e.g. NASFAM), insurance companies (through the Insurance Association of Malawi (IAM)), lending institutions (e.g. OIBM and the Microloan Foundation), and other providing product development support (like MicroEnsure and Columbia's International Research Institute for Climate and Society). Despite being heavily touted for its potential to protect smallholder farmers, as in many other countries, a number of challenges faced IBWI in Malawi including issues of basis risk, insufficient weather stations, unaffordable premiums, and a lack of education for farmers around the product. In 2010, the World Bank financial support came to an end with expectations that local players would carry the product forward.

Today, relatively little remains of the IBWI initiative. MicroEnsure has taken the lead role in facilitating product uptake through agriculture lenders. NICO General holds some of the risk, with other member institutions of Insurance Association of Malawi sharing the remaining portion. Roughly 6,500 smallholder farmers are covered, but the momentum seems to be waning rather than growing, as challenges in distribution and a lack of premium subsidies make the product unaffordable for many. (In-country consultations, 2014)

Growth in formal life insurance will occur by both individual and group policies. All three companies indicated an intention to grow their individual retail life insurance products over the coming years. This, in combination with the life insurance provision attached to mandatory pension cover provides an indication that growth will occur in this product area. Recent evidence of new policies shows that this might already be occurring. The number of individual policies underwritten just short of doubled between 2012 and 2013, while maintaining the same premium value per policy (RBM, 2013). Despite the growth push for individual on-boarding, group insurance is still a valuable focus. Group insurance is typically cheaper to distribute, and thus could offer the best potential to reach low- and middle-income individuals more effectively. In this case, group aggregators like MFIs, SACCOs, and perhaps even VSLAs could be leveraged. The number of new group policies underwritten slowed in 2013 (242 policies as compared to 490 in 2012), although the premium value per policy has increased tenfold. This is evidence that either larger or more high-end groups are being targeted (or some combination of the two).

General insurers likely to maintain high to middle income product focus. Whereas the life insurance companies indicated an intentional shift towards targeting more low-income individuals, general insurers appear much more sceptical. Insurance is seen as a luxury product that is not feasible for the population at large that have low funds left over after paying for food, transport and daily necessities (In-country consultations, 2014). Thus, few general insurance products are designed for the mass market, and it appears there is little momentum for growth in such markets in the near-term future.

Informal funeral insurance is low in value, but growing in prominence and establishes link to community support. In the model encountered in qualitative research for this study, VSLA members make an additional contribution to a pot for funeral expenses—usually around K 50 (USD 0.12)—each

time they deposit their savings with the group. The funds will be used in the event of death of a member or their family. At the end of a year, unused risk funds are often used towards a celebration for group members, and savings begin anew. There was notably a lack of clarity around how exactly these funds could be used and how far eligibility extends into one's family. However, it is clear that this pooling of funds is prevalent across VSLAs and that it can provide risk cover and potentially first-time exposure to low-income, rural populations who otherwise might be unfamiliar with insurance. Furthermore, the group provision for funeral risk could establish a support base that will expand beyond the funds collected.

6.4.5. Distribution

Majority of distribution occurring through traditional channels. Consultations with insurers indicate that the most insurance products are sold through brokers, agents (including banks) or directly from insurance companies. Currently, there are 12 brokers, 27 agents, and 52 insurance branches operating in Malawi (RBM, 2014). There are also 5 "agents for brokers", which are banks licensed to distribute insurance. The traditional approach to distribution limits insurance companies' abilities to reach down-market as these channels typically are too expensive to allow for lower-cost premiums.

Third-party insurance administrators have played a role in market deepening through alternative distribution. The use of alternative distribution channels for insurance remains fairly limited. While it does not appear that insurers or channels such as MFIs, and mobile network operators are leading the initiative to expand coverage through alternative distribution, third-party insurance administrators have stepped in to play an important role in this regard. Companies like MicroEnsure have been a driving force in forging partnerships between insurers and distribution channels, while also providing the impetus for new, innovative products to reach the market. MicroEnsure, specifically, has helped lead the roll-out of TNM's Moyo Cover, EduSave with OIBM, and index-based weather insurance for smallholder farmers; all products targeting broad bases of Malawians (see section 6.4.4 for further detail).

6.4.6. Barriers

Notwithstanding a stable provider landscape and products on offer which can cater to the needs of a wide range of Malawians, a number of barriers can inhibit access to, or usage of insurance at scale. Table 35 provides an overview of the barriers and indicates the severity of their impact. The section that follows will explore the reasons behind these barriers in further detail.

Access barriers		
	Affordability	• Insurance is unaffordable for the majority of the population
	Appropriateness	• Lack of product adaption to be appropriate for the mass market (product and channel design) • Bulk premium payments mismatch with income flows of target market
	Proximity	• Insurance distribution is mainly urban and targeted at corporates, therefore out of reach of most of the population
	Eligibility	• No eligibility issues for current target market, but KYC could become an issue as insurers move downmarket
Usage barriers		
	Familiarity	• Large proportion of the population do not know what insurance is or how it works
	Cultural	• Gradually decreasing perception that purchasing funeral insurance is wishing death upon beneficiary
	Financial capability	• Low literacy levels reducing the ability to engage with financial services
	Trust	• Negative experiences for those currently insured create trust barriers. This is however a small percentage of the population.
	Value	• Low awareness of embedded and employer provided products.

Major barrier
Minor barrier
No barrier

Table 35: Overview of access and usage barriers for insurance

Source: Authors' own

6.4.6.1. Access barriers

Affordability

Affordability an issue for most. Twenty two per cent of adults have indicated that they cannot afford the premiums (FinScope, 2014). This figure can be expected to be relatively conservative when taking into account the 44% of that adults have never heard of insurance. Many Malawians are living in abject poverty and insurance is not on their radar as a priority expense. A further corroborating factor is that the current uptake of insurance is mainly limited to the wealthiest target market.

The qualitative research (2014) also indicated affordability as an issue for insurance uptake. The following quotes provide an illustration of these concerns:

> ***"Are you insured?***
>
> *I can't manage [insurance] because I have little money. I think my insurance is the village bank to which my wife belongs."*
>
> Farmer, male, 58 years of age
>
> *"I am not insured yet. I need to consider, but I cannot just go for insurance when financially I am not ready."*
>
> Private sector employee, male, 28 years old

Box 23 Unpacking the affordability barrier

To illustrate the affordability barrier, one can use the two cheapest funeral insurance products on the market: one with a monthly premium of K 500 (USD 1.2) and the other an embedded mobile-insurance product that becomes active after spending K 1000 (USD 2.4) of airtime.

Assuming a maximum contribution of 10% of a customer's monthly salary (perhaps an unrealistic expectation), only 44% of adults could afford a premium of K 500 (USD 1.2). Assuming that one spends no more than 5% of one's monthly salary on insurance, an even fewer 27% of adults would be able to afford the cheapest insurance product. Such a premium provides only limited benefits, leaving the bulk of a person's risk needs uncovered, and yet is unaffordable to at least three in every four Malawian adults.

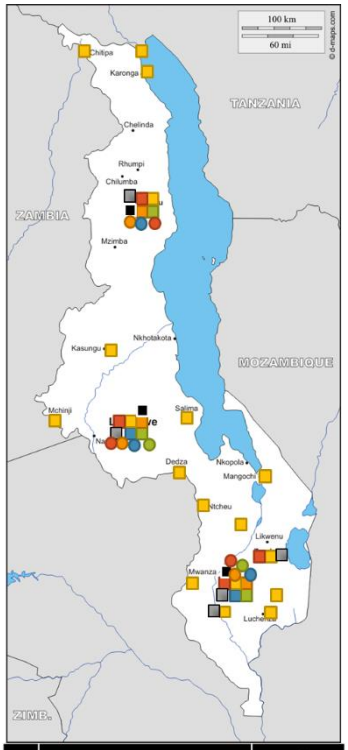
Appropriateness

Lack of proportionality. The majority of the products on the market are standard insurance offerings targeted at high income earners. While some entry-level products do exist and have innovative product and channel design to reach their market, this is not the norm. In order to reach the mass market, insurers will need to examine whether their products and distribution channels are appropriate for the mass market's needs.

Bulk premium payments can be burdensome. As mentioned in 6.4.4, a number of insurers require annual or bi-annual payments of premiums. These bulk payments, however, are difficult for many Malawians to cover due to the requirement to ensure funds are set aside despite many competing needs and the irregular nature of income of most target markets. To assist with this a number of banks have begun to offer insurance premium financing. As discussed in the section 6.1, current interest rates are high and so financing for premiums would make premiums even more unaffordable for most potential clients.

Proximity

Limited reach outside urban centres. As illustrated in Figure 123, the majority of both life and general insurers' branches are located in the three main cities of the country - Blantyre, Lilongwe, and Mzuzu. Only Prime Insurance, a smaller general insurance company, has a broader network of 18 branches spread throughout the country. The limited proximity of branches to large portions of the population makes sales and policy administration challenging for many people. Further, most insurance companies make use of traditional channels that are largely urban, along with targeting a corporate clientele that is primarily based in these areas. As insurers increase their alternative distribution channels, as both insurers and RBM have indicated is happening, the need for proximity to a fixed branch may be of less importance.



	Company	Branches
	Charter Insurance	2
	General Alliance Insurance	3
	Nico General	3
	Prime Insurance	18
	Real Insurance	5
	Reunion Insurance	7
	United General	3
	Nico Life	3
	Old Mutual Life	3
	Smile Life	2
	Vanguard Life	3

Figure 123: Insurance branches

Source: Author's own based on In-country consultations, 2014

Eligibility

KYC is not cited as a major barrier by insurers, but could become an issue with greater down-market focus. Conversations with insurers did not indicate KYC to be a major barrier. However, this may be due in part to the limited reach of insurers beyond the upper-end of the market. This could be due to the fact that the majority of current customers are employed and banked, indicating these clients already have some means through which to identify themselves. As insurers move down-market, such as with the TNM Moyo product, KYC may become more of an issue both for registration and claims processing, as people lack identification documents.

6.4.6.1. Usage barriers

Awareness

Lack of awareness of insurance. FinScope (2014) highlights a lack of familiarity with insurance as the main reason why Malawians do not have coverage. As mentioned above, 44% indicated they had never heard of insurance, with another 15% saying they do not know how insurance works and 7% saying they do not know where to get it, as shown in Figure 123. These figures were corroborated through conversations during the qualitative and supply-side research. One interviewee aptly noted: "people don't understand they are buying a promise."

The current slant towards a high-end target market of insurance and lack of exposure by the population at large, is likely to create a doorstep barrier for new clients from the mass market. This will be compounded by the fact that insurance is distributed through traditional channels that currently run operations targeted at high end clients and consequently have facilities suited to this market that might be daunting for others.

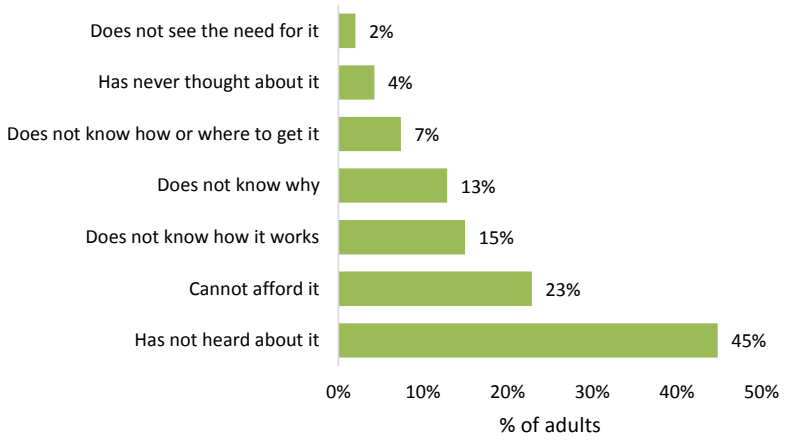


Figure 124: Reasons why Malawians don't have insurance

Source: FinScope, 2014

Cultural

Shifting cultural views on insurance. The qualitative research indicated that purchasing funeral insurance is akin to wishing death upon the beneficiaries. A number of respondents indicated this cultural perception is beginning to shift, particularly due to more people recognising the importance of insurance. A second cultural shift highlighted by one respondent was: "people no longer want to depend on others like they used to." This indicates a potential shift away from community support for risk mitigation to mechanisms within an individual or household's control.

Financial capability

Low financial capability in potential markets for growth. As discussed above, there is a low level of exposure to insurance products. Consequently, the extension of access to insurance will likely be to new customers that will be required to engage with foreign concepts for the first time. At the low literacy levels in Malawi, this is likely to be a challenge unless communication is simple and clear. This barrier is further compounded by the fact that general exposure to other financial services and financial literacy rates are low and therefore this will be a new skillset for many (see section 4).

Trust

Negative perceptions created from failure to pay claims. Qualitative research conducted in 2014 revealed that a number of people had negative experiences with insurance in the past. "Insurers don't pay", lamented one interviewee who had previously purchased motor vehicle insurance. A previous employee of an insurer cited the process of claiming on her husband's life insurance policy as taking over one year and only being resolved after she took the insurance company to court. She concluded, "Insurance is good, but very, very tricky. When they must pay, that's when they will start looking for a clause that allows them not to pay. I only managed to get paid not because I was clever, but mainly because I knew the system." In another example, a shop owner noted, "Of course we watch on TV adverts, so that's how we know [insurance]. However their conditions are not good in terms of them paying you in an event of damage. For example, when your property is damaged today, it will take some time—up to two years—without being repaid."

The negative feedback mainly came from higher-income, salaried employees or small business owners who fall within the limited segment of the population that has purchased insurance in the past.

Value

Limited awareness of embedded and employer provided insurance. The discrepancy between demand-side and supply-side data is explained by the large number of individuals that are unaware of having insurance products. Consequently, insurance products provide much lower value to beneficiaries than it should.

6.4.7. Regulatory issues to consider

Public sector driving uptake through mandated product provision. As discussed in 6.4.4, both third party motor vehicle and life insurance for employees that fall under the Pension Act (2011) is mandatory in Malawi. Action by the public sector is therefore directly assisting growth in sections of the insurance market.

Anticipated regulatory mandated split between life and pensions business. It is anticipated by the market that there is an upcoming regulatory requirement for life and pension businesses to split. This brings into question whether the life business will be able to function as a stand-alone unit given its current design in a group structure. The growth potential of the industry should assist in this regard. The interlinkage between mandated pensions and life insurance will also be a helpful factor in building a sustainable book.

Increased investment opportunities for long-term funds needed. Currently, insurance companies are restricted to investing domestically, where investment opportunities are limited (see section 5.2.1). This is a concern given the growth trend of both insurance industries and particularly the expected growth in the life insurance industry as compliance with mandated uptake increases. It is expected that RBM will issue a directive to allow for a small amount of funds to be invested offshore (In-country consultations, 2014). While this would certainly benefit insurers looking for returns on their funds, the general sentiment expressed in the consultations is that further offshore allowances are needed.

Microinsurance-specific regulation under consideration. Research is underway to assess the microinsurance market and how to regulate and supervise it. Microinsurance often calls for innovation to reach low-income markets and as such, is a unique insurance product offering that requires proportionate regulation (IAIS, 2012).

Need for appropriate health finance framework. Medical schemes are currently regulated under the Insurance Act (2010) and Financial Services Act (2010). They are, however, important players in the insurance industry that, up to this point, have been unsupervised entities. The Registrar has begun to take steps to bringing medical schemes into a regulatory framework by issuing guidelines for licensing. It has been stated that there is potential to build on this by issuing specific regulation for these entities (In-country consultations, 2014). Although the schemes appear to be operating as normal, uncertainty around forthcoming regulation can be damaging to an institution's willingness to offer new products

or move in certain directions. Likewise, overly prescriptive medical scheme regulation can impact on the ability to provide affordable products.[145]

Increasing use of technology for distribution pushes the need for regulation on electronic contracting. Many insurers, if not already doing so, are considering the use of technology like mobile phones and tablets to distribute insurance. Along with this comes the need for improved clarity from RBM on rules regarding electronic contracts and signatures.

Potential for insurance companies to front. Currently, if an insurance product is not offered in Malawi, brokers are allowed to front, or sell on behalf, of foreign insurers. However, insurance companies are not permitted to do so and consequently are limited from one means of expanding their product portfolio.

6.4.8. Gaps & opportunities

Use cases	Target markets	Potential impact and opportunity
Health cover	All	This is a key, costly and high risk area, but one which is currently covered in part by free public healthcare and substitute products such as savings. As such, it is a priority for wealthier target markets that can pay extra to seek better quality healthcare, but will be more appropriately served by substitutes and entry-level products for the mass market. These products include hospital cash plans.
Funeral cover	All	With a similar risk profile to health, funeral costs are currently covered by savings and community support. The latter is beginning to decline in importance, while informal insurance mechanisms provide coverage in a community setting. There is a clear need for expansion in informal and formal insurance products for this use case, an area that has been a successful mass market insurance product in other SADC countries. ***Significant area of opportunity***
Death or disability cover	Salaried employees and MSMEs	The impact that loss of an income can have on the vulnerable population of Malawi is crippling. Coverage for this is therefore an imperative need, but will be unaffordable for most target markets. Lowering cost through innovative and targeted products could extend coverage past current expectations. Mandatory life insurance will drive growth and market awareness in this product area. Savings can provide a lower value alternative. ***Remove unnecessary barriers***
Credit-life cover	Salaried employees and MSMEs	Opportunity is linked to growth in credit products, which is currently constrained. It holds the opportunity to support the sustainability of institutions lending to higher risk candidates and thus can assist in supporting this growth. The product is appropriate for wealthier target markets that are likely to take up insurance.
Natural disaster cover	Farmers	The Malawian population is highly vulnerable to natural disaster risk; particularly due to their widespread dependence on rain-fed agriculture and

[145] In South Africa, for example, prescribed minimum benefits and community risk rating imply that no medical scheme can offer a product that is accessible to the low-income market. Hence, medical scheme membership has plateaued at around 18% of the population with limited further growth expected.

		the prevalence of risk events. Agriculture insurance products have struggled in the past due to design issues, unaffordable premiums and lack of product understanding by farmers. The opportunity therefore lies in refining appropriate products, but possibly also shifting focus to also covering institutions providing financial services to mitigate sector wide risk impacts. ***Potential area of opportunity***
Assets cover – theft and fires	Salaried employees	Theft is highlighted as a key concern in Malawi. Salaried employees are the target market group that is most likely to accumulate assets and have the necessary income to insure them.
	MSMEs	Threats to inventory and their place of business are significant for MSMEs, but comprehensive insurance to cover these risks is out of the reach for most of this target market due to affordability. As with the above categories, savings can provide a safety cushion in these emergencies, albeit depending on the value of the loss. ***Remove unnecessary barriers***

Table 36: Market for insurance: opportunities summary across use cases

Source: Authors' own

Despite evidence on the ground that insurance penetration is moving beyond the limited figures indicated in the 2014 FinScope survey, it still remains evident that the market is underdeveloped and millions of lives are uncovered for the risks they face. Those who are uninsured often rely on savings or credit when such risks are realised, or they simply have no coping mechanism and find themselves set back financially. Factors such as awareness and affordability pose substantive barriers to insurance take-up in Malawi. At the same time, however, a number of opportunities exist for extending valuable coverage. These are covered in the section that follows.

Lowest hanging fruit is to further reach salaried employees. Despite higher and more stable incomes than the other target markets, only 11% of salaried employees currently have formal insurance (FinScope, 2014). This indicates a substantial portion that remains untouched, but could feasibly be reached. These employees tend to be wealthier (can afford premiums), more educated (capability to engage with insurance), and more urban (more easily accessed). Furthermore, due to the potential to aggregate salaried employees through group-based products and collect premiums through existing bank accounts, insurance companies could more quickly, affordably and efficiently launch products for salaried employees vis-à-vis other target markets.

Opportunities still exist to grow low- and middle-income targeted products. The outlook for microinsurance products is promising. The two largest life insurers have indicated a growing focus on this segment of the market, and the forthcoming entrance of CIC Cooperative Insurance further indicated there is optimism in lower-value risk cover. Furthermore, individuals' contributions to informal risk pools like VSLAs shows there is also some willingness and ability of low-income populations to contribute to risk protection mechanisms. Nevertheless, significant distribution and affordability challenges do exist. The majority of entry-level products currently making inroads into the market are doing so largely through group-based or embedded products. The challenge and high cost of individual retail distribution creates an imperative for some sort of aggregator to reach low- and middle-income client, as evidenced by CIC's willingness to enter the market by tapping directly with existing SACCO clients.

Funeral and medical insurance the most viable product growth areas. Quantitative research indicates medical and funeral expenses are high-risk, costly life events facing many Malawians (see Section 6.4.2). Insurers are picking up on this potential, as a number of relatively affordable products are starting to enter the market. In regards to medical cover, approximately 30,000 individuals are already covered under a plan costing K 1,200 (USD 2.9) per month. In regards to funeral, TNM and NICO Life have 127,000 active policies with twice as many covered lives. These examples are just two that highlight pioneer products in this space, with the potential for other players to further expand this sector.[146]

Potential fee changes to public healthcare could reshape demand for medical insurance. Currently, the majority of Malawians access healthcare through government facilities at no cost. While service quality is not outstanding, this free provision has limited the need of many for an insurance product to cover the direct costs of care. However, conversations with various stakeholders indicate that the government may shift policy in the coming months—introducing fees for certain treatments and providing tiers of service, whereby one might be able to pay for preferred care. Should this come to fruition, an increased opportunity for the provision of medical schemes or medical insurance might present itself.

Mandatory products drive uptake and awareness of insurance – positive demonstration effect key. It has been highlighted in this chapter that both third party and particularly life insurance products are mandated by government. This is a natural driver of uptake and exposure to insurance, which is a touch point that should be managed to have a positive demonstration effect in order to leverage the opportunity for expanded provision that they offer.

Credit-life will remain a key product. As discussed, many MFIs, banks, and SACCOs require credit-life insurance on loans. The use case for this type of insurance will thus remain as long as clients are borrowing to finance businesses and livelihoods. Although current macroeconomic factors have restricted the ability of many to access credit in the short-term, it is expected that credit use will rise as the economy improves and interest rates decline.

Natural disaster risk cover potential. Cover for natural disasters, and particularly in a highly agrarian economy as discussed in Table 37, is a key area of opportunity. Past experiences with agriculture insurance have not reached sustainable scale, but opportunity exists to learn from these experiences for future market interventions. The income level of the majority of farmers makes insurance for these risks largely unaffordable without premium subsidies. This could be an area of opportunity for government or interested parties to support farmer development. Further, the systematic risk natural disasters pose to financial service providers lending to farmers provides an opportunity for insurance cover at the institutional level to at least cover repayments of debt when a risk event occurs; thereby supporting the sustainability of the institution and their willingness to lend to farmers in future, along with protecting farmers from the income impact of bad debts compounding the direct income impact the disaster will have had.

Other use cases undermined by affordability issues for most groups. Asset insurance—for households, small businesses and farmers—can provide valuable cover to increase the resiliency of Malawians. However, these products often come at a cost beyond what these groups can afford to pay. Likewise,

[146] Despite the seemingly positive demand for medical insurance, data shows there are still significant barriers to overcome; with roughly 76% of those surveyed not having medical insurance, because of a lack of knowledge about the product. Even amongst those who do currently have medical insurance coverage, 53% do not know exactly who within their family it covers and 28% do not know who pays for it. This data speaks to the "automatic" nature of medical insurance and indicates insurers have some way to go to ensure that product awareness reaches both current and potential customers.

education-linked life products, income replacement products, and long-term disability products also have a role to play, but will tend to be viable mainly for wealthier salaried employees.

Potential for extended outreach through alternative distribution. As highlighted in section 5.2.2.2, retailers, pharmacies and the post office have the potential to be leveraged for distribution of financial services like insurance. These partners provide a footprint that assists with overcoming proximity and their functional overlap with other aspects of consumers lives remove doorstep barriers, as well as provide potential for an active sales partner where insurance is complementary to their core offering. Mobile money, while not yet as pervasive in Malawi as in some of its neighbours like Tanzania and Kenya, is another potential tool to be leveraged by insurers, whether for loyalty products directly for mobile users like that offered by TNM, or more loosely structured partnerships whereby premiums can be paid for more traditional insurance products via mobile wallets. While mobile money is not a panacea for increased reach and improved premium collection, it nevertheless is an option to be reckoned with, should mobile payments and usage continue to grow.

Different imperatives for different types of consumers. Consumers have varying needs and as such, will often require unique solutions. Table 37 highlights touch points and opportunities for insurance on the basis of consumers' engagements with the market.

Scenario	Who is affected?	Opportunities for insurers
Currently have formal insurance	Salaried employees, business owners, others	Improved product experience; broadened portfolio of insurance
Previously had formal insurance	Salaried employees, business owners, others	Rebuild trust in insurance; highlight value of products
Currently have informal risk mitigation	VSLA and SACCO members	Potential touch point for group distribution; opportunity to formalise existing risk pooling
Never had insurance	Salaried employees	Create awareness
	Everyone else	Create awareness, but recognise affordability constraints

Table 37: Opportunities for insurers, by insurance experience of individuals

Source: Authors' own

For those who have formal insurance, opportunities lie in improving product experience and growing the types and number of products purchased.

- *To improve experience, insurers should largely concentrate on premiums.* Premium payment mechanisms, which both lower the cost and the increase the frequency of premium payments, would be beneficial to current clients. In addition to improved ease of payment, more frequent premium instalments would reduce the need for premium financing.

- *To deepen penetration amongst current clients, insurers should look to bundling and cross-selling opportunities.* Through brokers, banks, and other distribution strategies, insurance companies should look how to grow the product portfolios of those who currently have insurance.

For those who previously had insurance but no longer do, insurance companies must focus on rebuilding trust and showing value.

- *To rebuild trust and show value, insurers should embark on marketing campaigns.* Clients need to believe that insurance is working and worth the value of the premiums they might pay.

For those currently participating in informal risk pooling, the awareness in regards to the benefits of risk mitigation products may already exist. Insurers can thus potentially tap into these groups for new distribution linkages—albeit with additional education around formal insurance.

For those who have never had insurance, one can further divide this group into salaried employees and all other target markets. For salaried employees, awareness is the key issue, as individuals need to better understand how insurance works and how it can be of benefit to them. For others without insurance, not only will awareness be an issue, but affordability as well. This portion of the population might be considered the "hard to reach", with multiple barriers inhibiting uptake.

- *To increase awareness, embedded products can often play an important role*. While there is an awareness of the need to increase financial literacy and has attempted to do this through nationwide, government-Low-cost, low-touch embedded products often form the foundation on which insurance appreciation can grow, and are already in evidence in Malawi's market. This comes with the caveat that effective communication is required to ensure the consumer is aware of the insurance and understands how to engage with it.

- *To combat affordability issues, subsidised embedded products, or loyalty-linked products, could play a role.* While the cost of insurance might be out of reach for the majority of Malawians, there are a number of third-parties who could also benefit from insurance products and might be willing to subsidise the cost of insurance premiums. Malawi is already seeing this from TNM which subsidises premiums for airtime loyalty, OIBM which subsidises EduSave premiums for those clients who have minimum balances in their savings accounts and from AHL that offers subsidised medical insurance for farmers that sell through their auction floor.[147][148]

[147] Potential examples include agro-financiers (who might have incentive to cover crop insurance premiums) and banks and MFIs (who might have incentive to fund portions of credit-life premiums).
[148] Further consideration should be given to other possibilities whereby a third-party might be incentivised to cover premium costs or tap into risk mitigation cover directly to support the sustainability of other financial service offerings.

7. Towards a financial inclusion roadmap in Malawi

This section synthesises the findings across the context, regulatory, target market and supply-side analyses 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.

7.1. Drivers of financial inclusion

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 to then isolate those unmet needs which can feasibly be addressed with the Malawian environment, in other words the key potential opportunities for increasing access to finance.

7.1.1. 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 market. Needs and circumstances differ across the five segments identified in section 4, and summarised in figure below, based on their income realities and demographic profiles. 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.

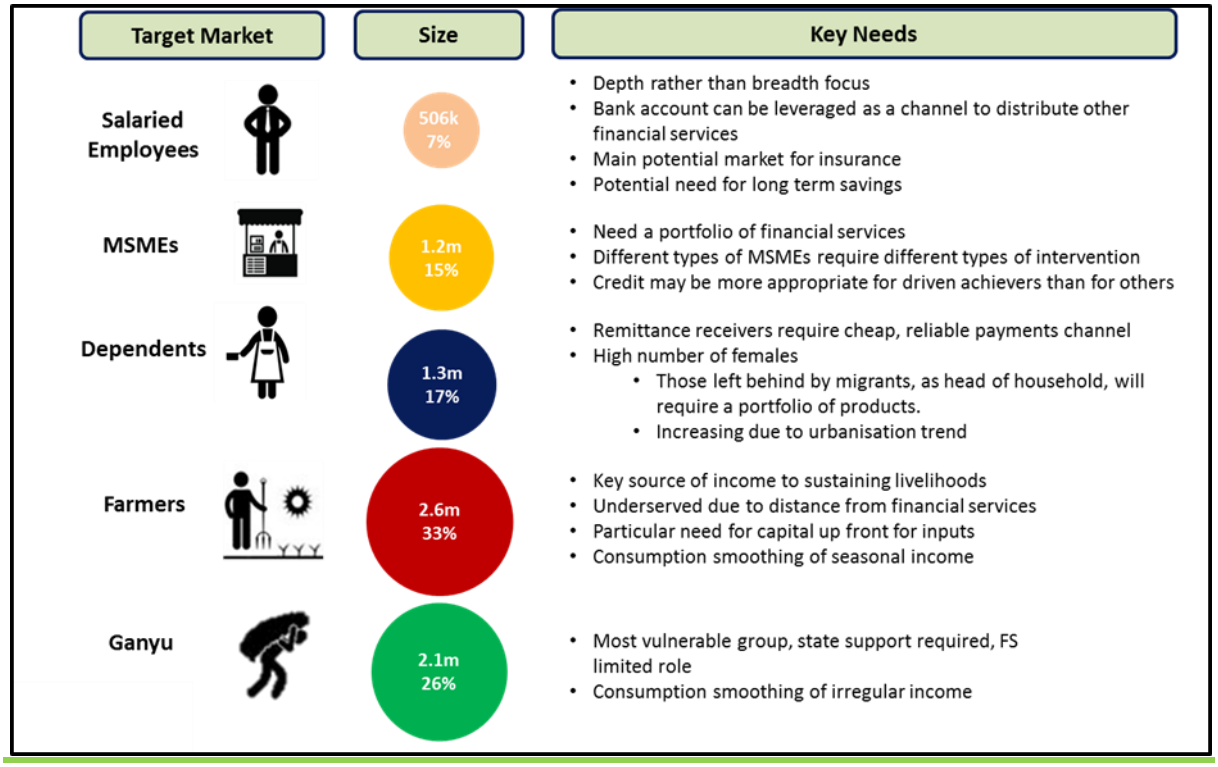


Figure 125: Key target market needs

Source: Authors' own

Different target markets have differing key needs. Figure 125 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.

7.1.2. 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 wholly 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 major 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.

7.1.3. 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. Frequent corruption scandals, particularly related to donor funding contributed to greater macroeconomic uncertainty. The donor response after each scandal 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 (Annual Economic Report, 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 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. 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.

7.2. 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[149])
2. Leveraging VSLAs to enable savings (~5.8m adults[150])
3. Targeted finance for MSMEs and farmers (~100,000 MSMEs[151]; ~130,000 farmers[152])

[149] Estimated number of farmers, MSMEs and salaried employees residing in rural areas and forced to travel to access formal payments
[150] Estimated number of adults not currently saving with formal or informal providers
[151] Driven achiever MSMEs with both motivation and ability to grow
[152] Proportion of farmers with both education and that farm to sell their produce

4. Niche insurance opportunities to reduce vulnerability (~60,000 adults[153])

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.

7.2.1. 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.

Box 24. 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.

[153] Salaried employees unserved by formal insurance.

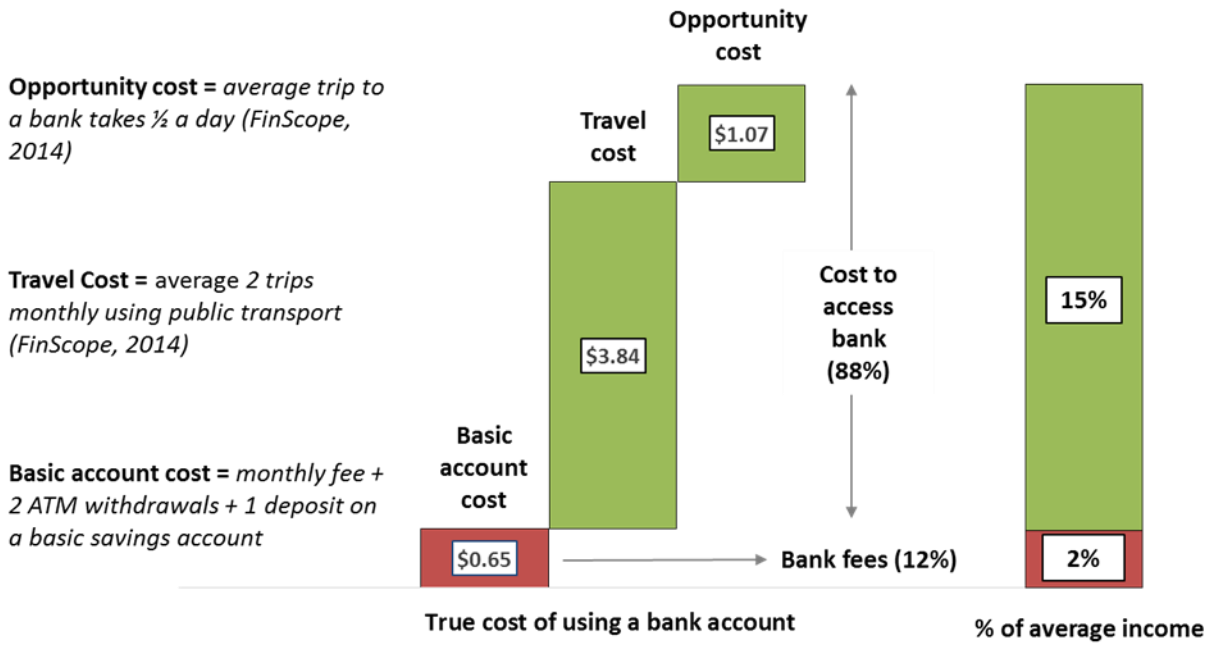


Figure 126: The true cost of using a bank account in Malawi

Source: FinScope, 2014; In-country consultations, 2014

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 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. As discussed in section 7.1.2, 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, as discussed in 7.1.3, 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 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 38 below 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[154] • Finalise NPS bill and include interoperability requirement • Evaluate bank premises regulation to create equal playing field for bank and MNO agents • 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 38: Potential actions to expand the reach of payments per stakeholder

Source: Authors' own

[154] See section 6.2.6

7.2.2. 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 127 below illustrates.

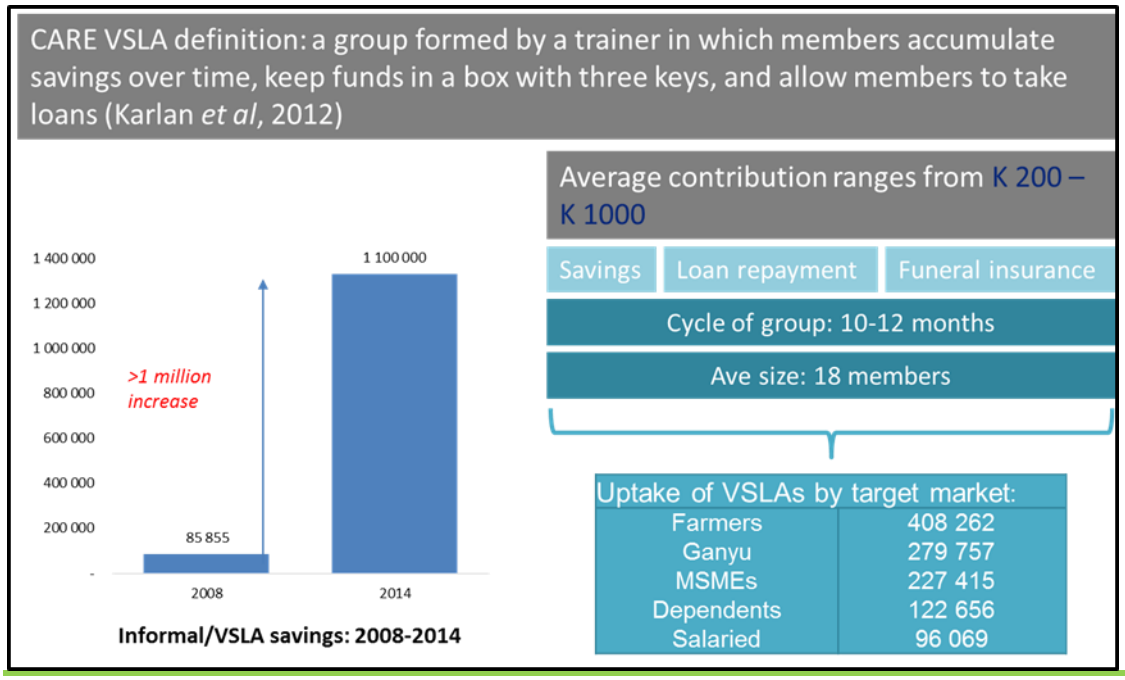


Figure 127: Summary of VSLAs in Malawi

Source: FinScope, 2014; Karlan, et al., 2012; In-country consultations, 2014

Opportunity. The growth in VSLAs suggests that important gains can be made by improving the design of formal savings products, 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.

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 39: Potential actions to leverage VSLAs to enable savings by stakeholder

Source: Authors' own

7.2.3. 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 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 40 below details the specific potential actions per stakeholder.

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

Table 40: Potential actions to maximise positive effect of credit to targeted MSMEs and farmers per stakeholder

Source: Authors' own

7.2.4. 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 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 41: Potential actions to achieve greater insurance value and penetration by stakeholders

Source: Authors' own

7.2.5. 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 capability will also 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[155]. 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 42 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 42: Potential actions to improve financial empowerment and education per stakeholder

Source: Authors' own

[155] 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.

7.2.6. 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

7.2.7. Donor Imperatives

The contribution of donors to Malawi is illustrated by the size and importance of donor financing development. Appendix 2 shows the broad variety of donor driven initiatives related to financial inclusion objectives. The high level of donor funding from a plethora of different donor organisations creates challenges for the government to implement and prioritise all of the, often contradictory, actions recommended or required by donor projects. At the very least, constant attention required by donors may hinder government officials to effectively implement initiatives.

The implication is that 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.

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.

7.2.8. 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 below.

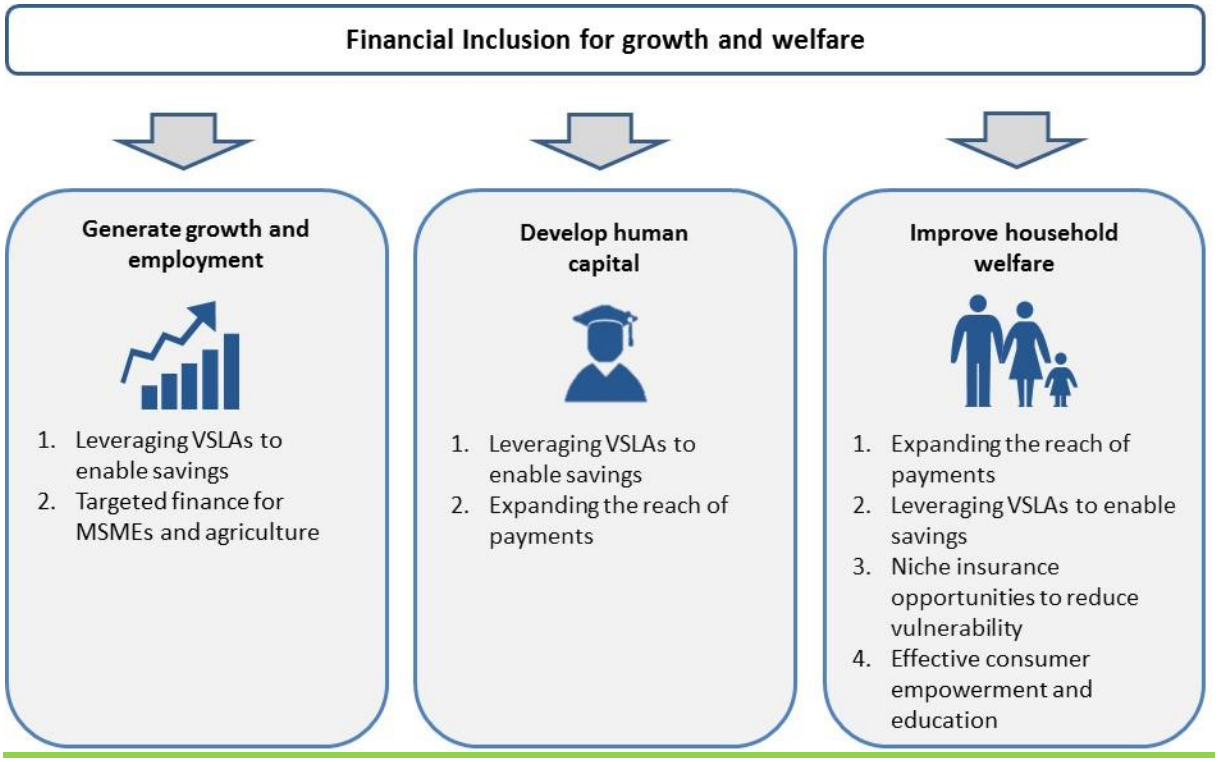


Figure 128: The role of the identified priorities in achieving Malawi's overarching policy goals

Source: Adapted from Bester et al., forthcoming

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.

7.3. 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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Appendix 1: Table of Supervisors of Regulations

Regulatory/ Supervisory Authority		Degree of Supervision	Financial Institutions	Main Legislation	Permissible Activity						Minimum Capital Requirement	Capital Adequacy	Liquidity Requirement	Mandatory Investment Requirements
					Deposit Taking		Credit provision	Payment Services	Insurance	Other Listed Activities				
	Supervisory Division/ Agent		Institutional Type		From the public	Intermediate Deposits	To the public				USD $		USD $	
Reserve Bank of Malawi		*Subject to Prudential Supervision*	Commercial Banks	Banking Act, 2010; Companies Act, 1984; Financial Services Act, 2010; Capital Market Development Act, 1990	Yes	Yes	Yes	Yes		Yes	Minimum of 5 Million USD to obtain/maintain banking license	Moving to Basel II 6% core capital; 10% total capital.	Required liquidity resreves 15.5% and 30% overall liquidity requirement (Liquid assets to Deposits and short term liabilities)	The Financial Services (large exposures and credit concentration limits for banks) Directive, 2012 provides limitations and regulation on capital concentration and other risks.
			Finance leasing companies		Yes, Approval Required	Yes, Approval Required	Yes			Yes, Approval required	1.5 million USD		30% of non-collateraized deposits.	
			Factoring companies		Yes, Approval Required	Yes, Approval Required	Yes			Yes, Approval required				
			Investment companies		Yes, Approval Required	Yes, Approval Required	No		No	Yes, Approval required				
			Electronic currency institutions		Yes, Approval Required	Yes, Approval Required	No			No				
			Other firms		No	No	Yes			No				
			Issuers or Management Companies Credit Card		No	No	Yes			No				
			Venture Capital companies		Yes	Yes, Approval Required	No			Yes, Approval required				
			Retirement funds		Yes	Yes	No		Yes	Yes	USD 600,000 (K 250 million);			
			Money Exchange		Yes	No	No			No				
			Malawi Stock Exchange		No	Yes	No		Yes, securities trading					
			Collective Investment Schemes		Yes, but limited	Yes	No		No	Yes				
			Insurers											
			Short Term	Insurance Act, 2010.					Yes		(Fifty Million Kwacha) USD 120,000			
			Long Term						Yes					
			Micro						Yes					

Regulatory/ Supervisory Authority		Degree of Supervision	Financial Institutions		Main Legislation	Permissible Activity						Minimum Capital Requirement	Capital Adequacy	Liquidity Requirement	Mandatory Investment Requirements
						Deposit Taking		Credit provision	Payment Services	Insurance	Other Listed Activities				
	Supervisory Division/ Agent		Institutional Type			From the public	Intermediate Deposits	To the public				USD $		USD $	
Reserve Bank of Malawi			Payments Service Providers												
	Reserve Bank of Malawi via the National Payment Systems Department		International Payment Associations		Payment Systems Bill, 2014; Guidelines for mobile system payments, 2011.	Yes			Yes						
			NPS Payment Operators			Yes			Yes						
			Mobile Network Operators			Yes			Yes						
			Mobile Money Operators			Yes			Yes						
			Cross Border Remitters			Yes			Yes						
			Payment Aggregators			Yes			Yes						
			Beareau Services			Yes									
			Remittance Service Providers			Yes			Yes						
		Subject to Monitoring	Other Service Providers	Credit information Beareau	Credit Reference Bureau (Licensing, Supervisory and Operational Requirements) Regulations, 2011.	No	No	No	No	No	Credit Reference Information Services	USD 50,000			

Regulatory/ Supervisory Authority		Degree of Supervision	Financial Institutions		Main Legislation	Permissible Activity						Minimum Capital Requirement	Capital Adequacy	Liquidity Requirement	Mandatory Investment Requirements
						Deposit Taking		Credit provision	Payment Services	Insurance	Other Listed Activities				
	Supervisory Division/ Agent		Institutional Type			From the public	Intermediate Deposits	To the public				USD $		USD $	
Reserve Bank of Malawi	**Microfinance Operators**														
	The Registrar of financial institutions	*Subject to Prudential Supervision*	Microfinance Institutions	Savings and Credit Bank	Microfinance Act 2010; Microfinance-Deposit taking institutions directives (2014)	Yes	Yes	Yes	Yes	Yes, Approval required	Yes, Approval required	USD 600,000 (K 250 million);		20% of all deposits liabilities	
				Postal Savings Bank		Yes	Yes	No			Yes, Approval required				
	Registrar of Cooperatives	*Subject to Prudential Supervision*	Financial Cooperatives (SACCOs)		Financial Services Act of 2010; Financial Cooperatives Act of 2011; Co-operative Societies Act	Members only	Yes	Members Only	Yes	Members Only	Yes, approval required	USD 4,800 (K 2 million), not less than 10% of total assets		Maintain at least 10% of total deposits and redeemable share capital in liquid assets	Max 5% assets to be invested in non-financial assets.
	Other Institutions														
	Need only register with the Reserve Bank	*Subject to Monitoring*	Microcredit Operators		Microfinance Act, 2010; Non deposit taking microfinance institutions directive, 2012; Financial services (capital adequacy requirements for deposit taking microfinance institutions) Directive , 2014.	No		Yes				USD 180,000 (K 75 000 000)			
	Need to be licensed and registered with the Reserve Bank		Deposit Taking Intermediaries			Yes						USD 600,000 (K 250 million);		20% of all deposits liabilities.	

Table 43: Regulatory authority, permissible activities and basic prudential and operating requirements per institutional type

Source: Authors' own

Appendix 2: List of Donor Projects

	Key projects/Initiatives Title	Donor	Scope (FI Product)	Project description, objectives & Outputs	Aid Modality	Type Of Assistance	Status	Currency	Budget	Project Timelines		Implementing Partner/Sector
										Date of Agreement Effective	Date of Planned Completion	
1	Women's Empowerment: Improving Resilience, Income and Food Security (WE-RISE)	Australia	Credit	The Project targets chronically food insecure smallholder women farmers. It is part of a multi-country program with Tanzania and Ethiopia under the Australia Africa Community Engagement Scheme (AACES) whose expected outcomes are; Food security (Agriculture sector), and economic development (through VSLA).	Direct Project Support	Grant	On going	AUD	2 203 034	Jul-11	Jun-16	CARE
2	Malawi Micro Finance (ANCP)	Australia	Credit	Households of VSLA members are the man targets. The project works with VSLA groups formed by other projects. The main outcome is economic development through Women Economic Empowerment (VSLA)	Direct Project Support	Grant	On going	AUD	1 292 573	Jul-13	Jun-17	CARE
3	Pathways to Secure Livelihoods : Women in Agriculture	Bill and Melinda Gates Foundation	Credit	Poor and food insecure women from both female and male headed households. Project is being implemented in Dowa and Lilongwe. Project targets food security (Agriculture), Economic Development (VSLA), and Governance.	Direct Project Support	Grant	On going	USD	1 500 000	Nov-12	Nov-15	CARE
4	Nutrition Foundation for Mothers and Children (MAZIKO)	Canada	Credit	Pregnant and Lactating Women and underfive children. Project is being implemented in Kasungu and Dowa. Project targets food and nutrition security (Agriculture), WASH, Economic Development (VSLA), Governance and Health sectors.	Direct Project Support	Grant	On going	CAD	5 602 139	Jan-12	Jun-15	CARE
5	Enhancing Community Resilience Programme (ECRP)	DFID, Norwagian Embassay & Irish Aid	Risk mitigation (Insurance)	Vulnerable communities to climate change related disasters. Project is being implemented in 7 districts (Mwanza, Nsanje, Chikwawa, Machinga, Mulanje, Thyolo & Kasungu). The project aims are resilience, agriculture, economic development (VSLA). Christian Aid VSLA interventions aims at strengthening and diversifying the household livelihood base. It enables them to manage their household cash flow more efficiently and in a flexible way, to invest in income-generating activities that secure and stabilise cash income and to access loans in time of need in remote rural settings where access to loans are very limited - budget is £ 354,298	Direct Project Support	Grant	On going	GBP	3 459 051	Sep-11	Jun-16	CARE, Christian Aid and Action Aid
6	Innovative approaches to delivery of Social Cash Transfer in Malawi project (SCTP e-payment project)	EU	Payment	The EU commissioned a project to identify alternatives to cash payments. The project in itself is only providing the platform for piloting and evaluating the e-payment of social cash transfers in Mchinji and Machinga. The actual transfers are provided by German-KfW. Save the children the implementing agency has brought in add-ons on Village savings and Loans as well as nutrition.	Direct Project Support	Grant	Ongoing	EUR	3 399 260	Dec-11	Mar-16	German-KfW. Save the children, Vulnerability, Disaster and Risk Management, EP&D, UNICEF (in partnership with WFP/FAO/ILO)
7	Post Harvest Loss reduction and Small Scale Irrigation Enhancement project (PHASE)	General Mills Inc	Credit	Poor and marginalised women and households affected by HIV/AIDS. Project Phased out in Dec 2014 and was implemented in Lilongwe and Salima. Project aims at achieving food security (Agriculture), and Economic Development (VSLA).	Direct Project Support	Grant	Closed	USD	700 000	Jan-13	Dec-15	CARE
8	Join My Village (JMV)	General Mills Inc	Credit	Rural adolescent girls aged between 10 and 18 in primary and secondary schools. The project was/is being implemented in Kasungu, Funding is provided yearly. Project targets education, Governance, Economic Development (VSLA) sectors.	Direct Project Support	Grant	On going	USD	700 000	Jan-14	Dec-15	CARE

	Key projects/Initiatives Title	Donor	Scope (FI Product)	Project description, objectives & Outputs	Aid Modality	Type Of Assistance	Status	Currency	Budget	Project Timelines		Implementing Partner/Sector
										Date of Agreement Effective	Date of Planned Completion	
9	National Social Protection Programme	GIZ	Capacity building	The GIZ Social Protection Programme aims to support the harmonization of the National Social Support Programme (NSSP). Two instruments within the NSSP are microfinance and VSLA. Being a new GIZ programme, they have just started to look at these instruments and are currently in the process of defining our approach.	Direct Project Support	Grant	Planned					To be confirmed
10	Women in Agriculture-Enhancing Food and Economic Food Security through Soybean and Groundnut Farming	Jeff Perls Foundation	Risk mitigation (Insurance)	Chronically food insecure smallholder women farmers. The project complimented the work of WE-RISE (Targeting food security (Agriculture), economic development (VSLA))	Direct Project Support	Grant	Closed	USD	100 000	Dec-13	Nov-14	CARE
11	Support for HIV Vulnerable Women in Rural Malawi	Johnson and Johnson Foundation	Risk mitigation (Insurance)	Untra Poor Women in Lilongwe. Project Phased out in Dec 2014 and was implemented in Lilongwe. Target Economic Development, Food Security (Agriculture)	Direct Project Support	Grant	Closed	USD	749 128	Dec-13	Dec-14	CARE
12		Margret A Cargill	Risk mitigation (Insurance)	Poor and food insecure women from both female and male headed households. Project is being implemented in Dowa and Lilongwe. Project targets food security (Agriculture), Economic Development (VSLA), Governance	Direct Project Support	Grant	On going	USD	652 000	Dec-14	Nov-16	CARE
13	Drought Mitigation through Irrigation Promotion and Conservation Agriculture Extension I (DICE II)	OFDA-USAID	Risk mitigation (Insurance)	Targeting the most vulnerable and food insecure households, the project implemented in three districts (Ntcheu, Salima & Dowa) and aims at achieving food security, disaster risk reduction, and economic empowerment (through VSLA).	Direct Project Support	Grant	Closed	USD	1 849 369	Sep-12	Mar-15	CARE
14	Home School Feeding Programmes	WFP/FAO	Payment	The programme is a school feeding programme implementing a cash payment system from sales of produce to schools. Other payments pertain to inputs procurement. The programme promotes collective marketing to primary schools, diversified income and investment, and warehouse receipting system.	Direct Project Support	Grant	Ongoing	MWK		Jan-14	Dec-16	Swedish Cooperative Centre
15	SCC-Malawi's Lake Basin Programme Phase II	NORWAY	Savings	Largely a climate change programme with focus on Food and Nutrition Security, Business and Marketing, Policy Advocacy, Women, Youth empowerment and Local NGO support. The main activities are vilage banks, SACCO and SMEs development.	Direct Project Support	Grant	Ongoing	MWK	900 000 000	Jan-14	Dec-18	Swedish Cooperative Centre
16	Right to Access Savings and Loans (RASO) Project – Phase II	SWEDISH	Risk mitigation (Insurance)	Economic empowerment project which targets marginalised women in T/A Makata- Blantyre rural are economically empowered and have increased their socio-economic status by 2017. Main activities areVillage Savings and Loans, Business development, and Loan revolving fund.	Direct Project Support	Grant	Ongoing	SEK	2 053 200	Jan-15	Dec-17	Swedish Organisation for Individual Relief
17	Promoting Women Economic and Social Empowerment (PROWESE) Project – Phase II	SWEDISH	Risk mitigation (Insurance)	Economic empowerment aimed at marginalised women in Balaka and Salima are economically empowered and have increased their socio-economic status by 2017. The project provides support in Village Savings and Loans development, Business Development and Loan revolving fund.	Direct Project Support	Grant	Ongoing	SEK	2 296 800	Jan-15	Dec-17	Swedish Organisation for Individual Relief
18	Youth Economic and Social Action (YESA) Project	SWEDISH	Risk mitigation (Insurance)	Economic empowerment aimed at marginalised youths in Chikhwawa in order to economically empower youth and have increased their socio-economic status by 2017. The project provides support in Village Savings and Loans development, Business Development and Loan revolving fund.	Direct Project Support	Grant	Ongoing	SEK	1 409 400	Jan-15	Dec-17	Swedish Organisation for Individual Relief
19	Mobile Money for the Poor	UNCDF	Payment	Ecosystem approach to scale-up digital financial services that meet the needs of rural and low income households. Collaborates with BTCA initiative. Currently providing TA to TNM, Airtel, OIBM, MSB, RBM and exploring partnership with Zoona, NBM.	Direct Project Support	Grant	Ongoing	USD	1 500 000			TNM AIRTEL RBM
20	Youth Start Programme Financial services for the youth)	UNCDF	Savings	Promoting delivery of financial services to Youths; basic savings product for youths.	Direct Project Support	Grant	Ongoing	USD	800 000			OIBM

	Key projects/Initiatives Title	Donor	Scope (FI Product)	Project description, objectives & Outputs	Aid Modality	Type Of Assistance	Status	Currency	Budget	Project Timelines		Implementing Partner/Sector
										Date of Agreement Effective	Date of Planned Completion	
21	Better than cash alliance - BTCA Help govet transition from cash to digital	UNCDF	Payment	Help government transition from cash to digital. Collaborates with MM4P and is championed by MoF.	Direct Project Support	Grant	Ongoing		0			MoF
22	Micro-lead Expansion Programme (encourage delivery of deposit products for rural communities)	UNCDF	Savings	Supports the expansion of FSPs which pursue a savings-led approach in the belief that savings, not credit, will allow low income populations to better take financial control of their complex financial lives.	Direct Project Support	Grant	Ongoing	USD	1 700 000			NBS Bank
23	Development Credit Authority Malawi (DCA)	USAID	Risk mitigation (Insurance)	Increase lending to underserved sectors by sharing risk with financial institutions	Direct Project Support	Grant	Closed		700 000	Jul-07	Sep-14	OIBM
24	Mobile Money in Malawi	USAID	Payment	.GIZ mapping; web application capturing data incl. MNOs (TNM, Airtel agents, commercial agents etc), MFIs, Banks and ATMs, volumes of transactions and general education/literacy service.	Direct Project Support	Grant	Ongoing		3 000 000		Sep-14	FHI 360
25	Livelihoods and Food Security Technical Assistance II Project (LIFT)	USAID	Risk mitigation (Insurance)	HIV infected and Malnutritioned individuals in the impact areas. The project is working with other CARE existing projects in Lilongwe and Kasungu. The project targets health, economic development (VSLA), and Governance.	Direct Project Support	Grant	On going	USD	150 000	Jun-14	Sep-15	CARE
26	United in Building and Advancing Life Expectations (UBALE)	USAID	Risk mitigation (Insurance)	The project is being implemented in three districts of Nsanje, Blantyre and Chikwawa with CARE Malawi being responsible for Nsanje targeting food insecure households. The project aims at achieving food and nutrition security within the health, nutrition, WASH, Governance, Economic Development (VSLA), and resilience sectors.	Direct Project Support	Grant	Just started	USD	11 100 000	Sep-14	Aug-19	CARE
27	Fingerprinting to Reduce Risky Borrowing (under Access to Credit and the Scale Up of Biometric Technology in Malawi)	USAID	Risk mitigation (Insurance)	It is a scale-up of a previous successful study conducted by IPA in 2008 in which research found that the introduction of better borrower identification (through fingerprinting) increased loan repayment for the riskiest subset of borrowers. The current study seeks to exam the effects of fingerprinting overtime, location (operating in 27 districts in Malawi), across multiple institutions, with the inclusion of information-sharing credit bureau, as well as direct effects on household welfare.	Direct Project Support	Grant	On going	USD	997 393	Jun-13	Dec-16	IPA
28	World Bank (FSAP and the Financial Sector Technical Assistance Project -FSTAP)	World Bank	Capacity building	The project aims at increase the number of bankable people who are banked. It key objectives are; Financial infrastructure (payment system – make it inter operable through the national switch); Financial hub - one infrastructure for all MFIs that links to the national payment system; Financial literacy – Consumer Awareness and Education Program (RBM) targeting school curricula among others; Financial Sector Policy – working with MoF on a number of policies including the financial strategy.	Direct Project Support	Loan	Ongoing	USD	25 000 000	Jan-14	Dec-19	MoF/RBM
29	Financial Sector Deepening Trust	World Bank/DfID	Capacity building	Enabling regulatory environment; reforms, capacity building. Currently put on hold. Need for MoF to move quickly and set up an independent trust to spearhead financial inclusion legislation.	Direct Project Support	Grant	Paused	USD				Ministry of Finance
30	Direct Deposits and Commitments to Save	World Bank	Risk mitigation (Insurance)	The goal of this projects is to reduce barriers to savings through multiple interventions including: labeled savings accounts, financial literacy classes aimed at increasing aspirations, and direct deposits. The study operates out the Chitakale Trading Center in Mulanje District.	Direct Project Support	Grant	On going	USD	282 875	Sep-12	Jun-15	NBS

Table 44: Donor Financial Inclusion Projects Matrix

Source: Imani Consultants, 2015

Appendix 3: List of In-Country Consultations

Date	Institution Name	Institution Representatives	Position
2014/10/27	RBM Exchange Control	Bartwell Chingoli	Manager, Exchange Control Operation
		Dalitso Bonongwe	Principal Inspector, Authorised Foreign Exchange Dealers
		Ken Khoswe	Principal Analyst, Capital Account Operations
		Francis Gama	Principal Analyst, Exports Monitoring
	Financial Intelligence Unit	Atuweni Phiri	Director
		Merium Chithila	Team Leader Operational Analysis
		Anita Mankhambo	Compliance and Prevention Officer
	Ministry of Youth	Justin Saidi	Principal Secretary
		Symon Maliko	Deputy Principal Secretary
	MARDEF	Josep Mononga	Chief Executive Officer
	MAMN	Chimwemwe Kaphagawani	Assessor
	Ministry of Finance, Economic Planning and Development	Harry Mwamlima	Director
		Ralph Tseka	Director of Economic Affairs
	World Bank	Efrem Chilima	Senior Private Sector Development Specialist
2014/10/28	RBM National Payment System	Fraser Mdwazika	Director
		Mushane Mwangonde	Manager, Oversight & Compliance Division
		Paxon Kaude	
	BLUE Financial Services	Steve Mgwadira	Chief Executive Officer
	Ministry of Gender, Children and Community Development	Gideon Kachingwe	
	OIBM	Wilson Moleni	Chief Operating Officer
		Victoria Munthali	Marketing Manager
	World Food Programme	Owen Maganga	Programme Officer
	MUSSCO	Fumbani Nyangulu	Managing Director
	MCTU	Grace Nyirenda	Deputy Secretary General
	Ministry of Finance – Pensions division	Ambrose Mzoma	Director Of Pensions
2014/10/29	UNCDF	Fletcher Chilumpha	Programme Manager
	Vision fund	Masutano Mulaga	Chief Executive Officer
		Samson Phiri	Chief Finance Officer

Date	Institution Name	Institution Representatives	Position
		Francis Saka	Marketing and Integration Manager
	DFID	Nick Amin	Team Leader - Growth
	Standard Bank	Charity Mughogo	Personal Banking
		Effie Malange	Channels
	NASFAM	Kingsley Makiyoni	Business and Institutional Development Manager
2014/10/30	FHI360	Henry Makwelero	Deputy Chief of Party
	Payment Solutions	Owen Phiri	Director
	Microloan Foundation	Peter Matumbo	Chief Executive Officer
	RBM Financial Markets	Henry Mathanga	Director, Financial Markets
		Rhodrick Wiyo	Manager, Market Development
	Ministry of Agriculture and Food Security	Melania Kanyama	Chief Economist
	CARE	Clement Bisai	Senior Technical Advisor
	Farmers World	Christos Giannakis	Farmers World
	Ministry of Health	Dalitso Kabambe	Director Of Planning and Policy Development
2014/10/31	Competition and Fair Trading Commission	Richard Chiputula	Director for Mergers & Acquisitions
		Lewis Kulisewa	Director for Consumer Welfare and Education
2014/11/03	MACRA	Jonathan Pinofolo	Data management
		Gondwane	
	MSB	Ian Bonongwe	Chief Executive Officer
		Kayisi Sadala	Deputy Chief Executive Officer
		Samuel Phiri	Head of ICT
		Felizarda Mbewe	Card and E-Banking Manager
	RBM Microfinance and Capital Markets	Tosh Mwafulirwa	Principal Examiner, Microfinance & Capital Markets Supervision
	FDH Bank	Thompson Mpinganjira	Chief Executive Officer
		Phillip Madinga	Managing Director FDH Bank
		William Mpinganjira	Chief Risk Officer
		Mike Chiwalo	Managing Director First Discount House
		Violet Skeva	HNI Manager
	Credit Data CRB	Patricia Mwane	Chief Executive Officer
	Malswitch	Austin Mzumara	
		Bisika	
	NBM	George Partidge	Chief Executive Officer
	Old Mutual	Edith Jiya	General Manager
	RBM Bank Supervision	Eldin Mlelemba	
		Sopani Gondwe	

Date	Institution Name	Institution Representatives	Position
	Insurance Association of Malawi	Dorothy Chapeyama	Acting President (CEO of Reunion Insurance)
	RBM Pension and Insurance	Noel Mkulichi	Director
		Paul Nyirenda	
		Kaluso Chihana	
		Limbikani Nundwe	
		Peter Kambalame	
2014/11/04	NBS Bank	Bernadette Mandoloma	Chief Executive Officer
		Mercus Chigoga	
	Bankers Association	Lyness Nkungula	
	TNM	Webster Mbekeani	Head of Division - Mobile Money
	PRIDE Malawi	Cornelius Majawa	General Manager
	FMB	Dheeraj Dikshit	Managing Director
		Ewen Hiwa	Head - Retail Banking
	MASM	Andrew Ngomwa	Managing Director
	Izwe Loans Limited	Ishmael Mtalimania	Acting Chief Executive Officer
	Smile Life insurance	Stain Singo	Chief Executive Officer
	NICO General Insurance	Donbell Mandala	Assistant General Manager Operations
2014/11/05	Malawi Post Office	John Katunga	Director - Operations
	CRB Africa	Daniel Puthenveetil	Chief Executive Officer
	Real Insurance	Grant Mwenechanya	Chief Executive Officer
	Malawi Stock Exchange	Symon Msefula	Chief Executive Officer
		John Kamanga	Chief Operating Officer
2014/11/06	Mudi SACCO	Triza Tsiga Magreta	General Manager
		Mercy Kalepa	Members Service Manager
		Duncan Mlanjira	Director
	Imani Development International	John McGrath	Director
	AHCX	Kennedy Marichi	Regional Manager - South
2014/11/18	DFID	Nick Amin	Team Leader - Growth
		Kerry Johnstone	Private Sector Development Advisor
	Ministry of Finance	Ralph Tseka	Director of Economic Affairs
		Golden Nyasulu	
		Saadat Siddiqi	Advisor, Financial Sector Policy
2014/11/19	Airtel	Francis Matseketsa	Head, Airtel Money
		Bigboy Makoloma	Operations and Project Manager
	World Food Programme	Daniel Longhurst	R4 Rural Resilience Programme
		Valeria Morua	Purchase 4 Progress Programme
		Joy Hara	Chief Economist

Date	Institution Name	Institution Representatives	Position
	Ministry of Industry and Trade		
		Esther Lwasa	Chief Economist
		Edson Mphande	Director of Planning
2014/11/20	FDH Bank & Western Union	Violet Skeva	HNI Manager
2014/11/21	Deloitte	Louise Meny-Gilbert	Consultant for SMEDI project
2014/11/28	SMEDI	Sarah Mwale	
2014/12/14	ACE	Kristian Moller	Chief Executive Officer
2015/02/03	FINCA	Alexon Mwakhula	Deputy Chief Operating Officer
		Vincent Phiri	Communication Associate
2015/02/04	Indebank	Maxwell Ng'ambi	Marketing Manager
2015/02/05	Nedbank	Paul Guta	Managing Director
2015/02/13	MicroSave	Venkata Atluri	Senior Manager – Country Development
2015/03/10	FDH Stockbrokers	Nelson Mkwende	Manager
2015/04/02	Nat-Switch	Gertrude Katumbo	

Appendix 4: List of Actions by Timeline

Expnading the reach of payments	
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
	• Evaluate bank premises regulation to create equal playing field for bank and MNO agents
	• 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

Targeted finance for MSMEs and farmers	
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 required
	○ 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)
	• 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

Niche insurance opportunities to reduce vulnerability	
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 mobile and rather than annually
MFIs	• Wholesale insurance for natural disasters to improve sustainability
Regulators and policy makers	• 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
Effective consumer empowerment and education	
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, appropriately designed required to achieve desired impact

Appendix 5: Insurance performance analysis

The following data speaks to the health of the insurance industry over the past four years. Note that 2014 annual data was not yet available at the time of publication. Life insurance data also is only reported back until 2011, while general insurance data includes 2010.

Solvency Ratio

Solvency ratios are measured, according to RBM, as adjusted net assets divided by net premiums written.[156] RBM requires a minimum ratio of 20% for general insurers. As evident in Figure 129, solvency ratios for general insurers have been increasing over time, indicating a more sound financial position. Part of this increase is due to an injection of capital that came in 2011 to a number of market players.

Unfortunately, RBM does not currently capture solvency ratios for the life insurance industry, but instead simply requires that insurers maintain adjusted net assets in excess of K 75 million (USD 179,856), which all insurers are currently complying with. RBM anticipates the development of more robust supervisory tools for the life insurance industry moving forward, including a new solvency regime.

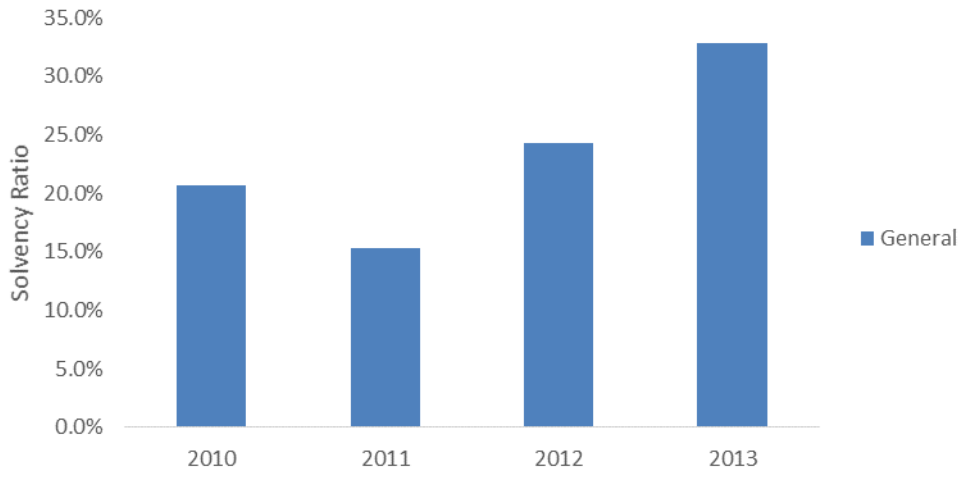

Figure 129: Solvency ratios

Source: RBM, 2014

Return on equity

Shown in **Figure 130**, return on equity (ROE) has been increasing over time for both general and life insurers. Measured as net profits over average shareholder equity, ROE illustrates the value the insurers are providing those supplying equity investment in the company. For general insurers, one can see a negative return on equity in 2011, before improving in performance in 2012 and 2013. Similarly poor performance was recorded for other indicators in 2011, which is further discussed at

[156] Other MAP exercises have measured solvency ratios as assets over expected liabilities; however, this report has decided to use the RBM method in order to maintain consistency with regulatory reporting figures.

the end of this appendix. For life insurers, ROE has grown significantly in the past three years, likely due to increased premiums and profitability from increased group life business.

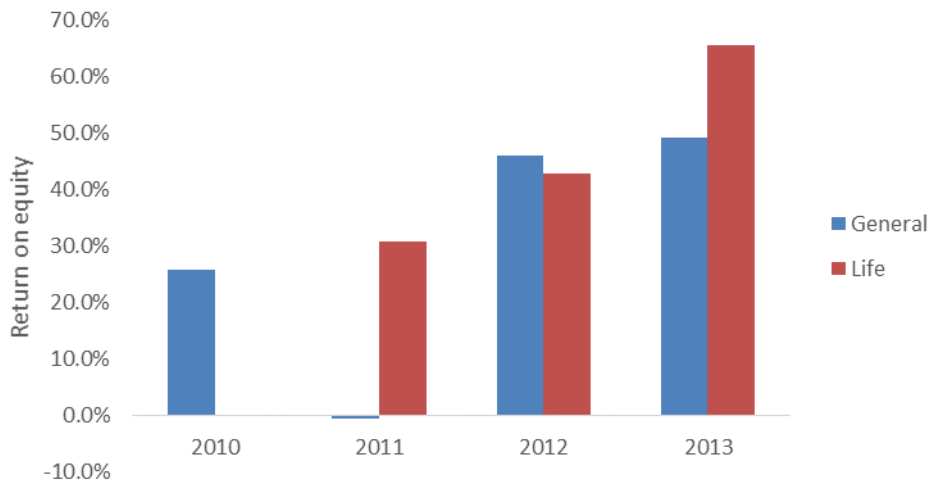

Figure 130: Return on equity

Source: RBM, 2014

Claims ratio

Claims ratios indicate the percentage of earned premiums that are paid back to clients through claims. The ratios indicate the value of the product to policyholders—anything too low indicates clients are not getting great value for the premiums they pay. At the same time, claims ratios also reflect the viability of the product. If claims plus expenses (as discussed in the section on expense ratios) are more than the premiums collected, then insurers must turn to making profits off investment returns or face threats to their sustainability.

In Malawi, general insurers have healthy claims ratios (between 50-70%), which show a nice balance between client value and business viability. Life insurers, on the other hand, have seen declining claims ratios over the past three years, starting from a relatively low base in 2011. Relative international benchmarks, these very low claims ratios are indicative of very low client value.

Figure 131: Claims ratios

Source: RBM, 2014

Expense ratio

Expense ratios consider the percentage of premiums that non-claim expenses comprise. Data from general insurers shows expense ratios have been relatively steady over the past 4 years, although declining in 2013. Further conversations with RBM indicate this may be the result of a decline in business transacted through intermediaries, resulting in reduced commission expenses. Premium collection has also improved following the issuance of the Premium Payment Directive, which could further decrease expense ratios through the reduction of premium bad debts and provisions. On the life side, expense ratios in 2012 and 2013 took a sharp dive from 2011. These low levels for 2012 and 2013 are puzzling.

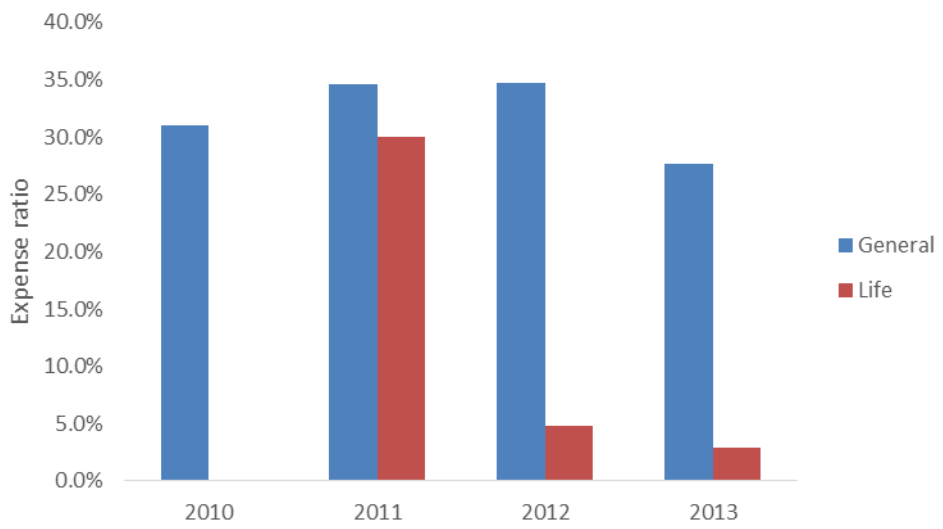

Figure 132: Expense ratios

Source: RBM, 2014

Net profit ratio

Net profit ratios, calculated as net profits over revenue, have been fairly consistent for general insurers, while life insurance companies saw a jump in 2012 and 2013. 2011 is again an anomaly as discussed below:

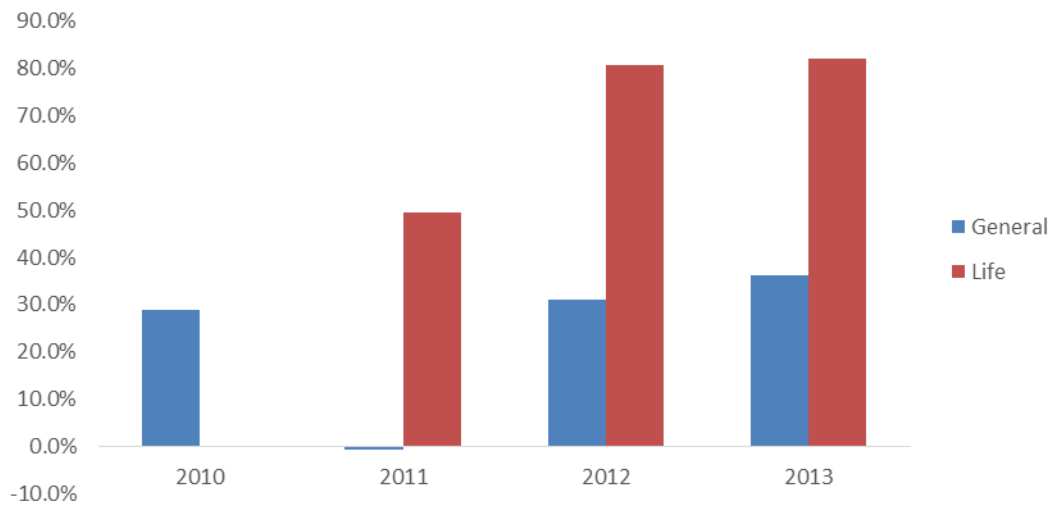

Figure 133: Net profit ratios

Source: RBM, 2014

2011 was an anomaly, with indications of negative performance across a number of indicators. As evidenced from low net profit ratios, solvency ratios, and return on equity, 2011 stands out for its poor performance. According to RBM, the driving force behind this poor performance was the writing off of non-performing premium debts. The Registrar of Financial Institutions strictly enforced the requirements of the Premium payment and Capital Directives. About K 1.5 billion (USD 3.6 million) of

uncollected premiums were written off in 2011. In addition, 2011 recorded the highest claims experience, likely due to a combination of a decrease in premium income as a result of a slowdown in the economy and an actual increase in claims incurred. These challenges were further compounded by a number of macroeconomic shocks in 2011, including fuel and electricity shortages, foreign currency shortages, and struggling construction, manufacturing, and trade industries.

It is not yet clear what impact inflation has had on the insurance sector. Inflation is a significant economic factor in Malawi. However, according to the RBM it is currently difficult to quantify its impact on the growth seen in insurance premiums over the past four years. The RBM is taking an intentional approach to better monitoring inflation as a distorter of industry performance moving forward.