LIFT Financial Inclusion Strategy

The enormous gap in access to financial services remains one of Myanmar's most pressing development challenges. Improving access to finance for unserved and underserved market segments is critical to expanding rural households' economic opportunities, while generating positive social and economic benefits for Myanmar[1].

Financial deepening indicators show that the financial market in Myanmar is extremely shallow. The estimated percentage/number of unbanked adults is 83 percent/33 million adults (FINSCOPE study funded by LIFT, 2014). Outstanding credit and deposits are equivalent to five percent and 13 percent of the gross domestic product, respectively (World Bank, 2013). This compares unfavorably to Cambodia (34 percent and 40 percent), and the Lao PDR (25 and 31 percent) who were surveyed at the same time.

The Myanmar government's response has been to make inclusive finance a priority. Over the past three years, the government has articulated its position in the *National Strategy for Poverty Alleviation and Rural Development* (2011), the *Strategic Framework for Rural Development* (2013) and *Microfinance Law 2011*. The Microfinance Law established the Myanmar Microfinance Supervisory Enterprise (MMSE)[2], under the Ministry of Finance, as the regulator and supervisor of the microfinance sector.

Since the Microfinance Law was passed, the number of licensed microfinance organizations and institutions (MFOs) has grown to 215. However, the large number of licensed MFOs does not imply a sufficiently large and well-established microfinance sector in Myanmar. While licensed MFO outreach is approximately 1.2 million clients with a total loan portfolio of USD 200 million, there is only one institutionally and financially sustainable MFO in Myanmar (PACT Global Microfinance (PGMF)). PGMF is the market leader and serves more than fifty percent total active clients. The remaining licensed MFOs face high operational costs, employ supply-driven lending technologies, and possess governance structures that will not lead to sustainability (they are licensed as an NGO, and remain affiliated with their parent NGO).

Building an Inclusive Rural Financial Market

LIFT's emphasis and investment in rural microfinance is guided by the view that its development supports a pathway out of poverty and rural economic growth. However, microfinance alone is not a panacea against poverty[3]. Microfinance development, though important, is not sufficient on its own to develop an efficient and functional rural financial market.

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[1] The theoretical importance of finance, showing its key role in resource allocation, is highlighted in the below two seminal books. The use of domestic capital markets to stimulate economic growth should take precedent over other development measures, e.g. encouragement of foreign capital investment. A repressed financial sector that discourages both saving and investment do not permit financial intermediaries from functioning at full capacity and fail to allocate saving into investment efficiently, thereby impeding economic development.
McKinnon, Ronald. *Money and Capital in Economic Development*. Brookings Institute. 1973.
Shaw, Edward. *Financial Deepening in Economic Development.* New York: Oxford Press. 1973.

[2] Renamed as the Financial Regulatory Department (FRD).

[3] There is no statistical analysis supporting the hypothesis that microfinance has a positive impact on poverty alleviation. At best, research has shown that the impact of access to microfinance on poverty alleviation is inconclusive. A more recent argument has been to conclude that there are positive benefits from microfinance for female empowerment, improving health,

This is critical because rural household heterogeneity is one of the drivers for the new LIFT Strategy; Hanging-In, Stepping-Up, and Stepping-Out. Rural Myanmar is not defined entirely by poverty. There is a broad range of economic classes of households and small businesses. It includes communities with farm and nonfarm households, small agri-business, input supply dealers, repair and service shops and retailers. These nonfarm businesses have forward and backward linkages with farm households. A financial inclusion strategy that does not recognize this rural household heterogeneity contributes to a rural financial market that is fragmented, and development that is stunted and slow.

Furthermore, the changing financial situation of rural households and small businesses, and their financial heterogeneity, requires a strategy that seeks to better align the supply of appropriate financial services with demand. For example, the percentage of rural households that have some of their members engaged in nonfarm businesses is substantial and growing, as well as the differences among smallholder farmers, give rise to opportunities for financial services that demand/require flexibility and diversity. This broader focus on rural finance also provides a more inclusive approach to growing the rural economy which encompasses but is not limited to microfinance, with the provision of other financial services to a wider clientele than small business and the poor alone. A robust, inclusive rural financial market can help people take advantage of economic opportunities, build assets, manage risks, and reduce vulnerabilities to external shocks.

LIFT is committed to promoting and developing a rural financial market that is inclusive of all economic strata. This allows the population, including the poor, women, landless and internally displaced, farmers and small businesses, sustainable access to a wide array of quality financial services that meets the diversity of their effective demand. In so doing, the rural population can take advantage of economic opportunities that diversifies their income base, helps manage risks, builds assets and reduces vulnerability and increases resilience to external shocks, i.e. income and food security smoothing.

Financial Inclusion Strategy

The primary lending technology of MFOs in Myanmar is predominantly characterized by loans to women in small groups who have access to land. LIFT's Financial Inclusion strategy seeks to expand access of the rural population to a diversity of financial services and financial intermediaries. The strategy gives priority to the development of efficient and sustainable financial intermediaries and demand-driven financial services that reflect a rural financial market systems approach. Ancillary to these investments, LIFT recognizes the importance of, and invests in advocacy for legislative and regulatory development.

Objectives

- Increase the supply of rural financial services (loans, savings, financial education, business services) customized to the demand and needs of rural households and businesses.
- Expand outreach.
- Develop institutional and financial sustainability of rural financial intermediaries, e.g. MFOs, MFIs, financial cooperatives and commercial banks.
- Increase the institutional diversity in the rural financial market, e.g. effecting an increase in local and international lenders access to rural financial market institutions, that in turn,

absorbing external shocks, increasing investments in home improvement and education, e.g. a "welfare-enhancing" effect. This hypothesis has also been found to be inconclusive.

increases market size that is currently constrained by both dependence on grant funding and legislation (CBM cap on foreign investment).[4]

- Advance the effectiveness and usefulness of rural financial market legislation and regulation.

Market development is the underlying purpose important to achieving the strategic objectives of LIFT's Financial Inclusion strategy. Market development is defined as providing institution-building support to MFOs and banks. This can be done through upscaling MFOs or downscaling banks with transfers of lending technology, organizational engineering, technical assistance services, training of staff, and other non-financial services[5].

Strategic Considerations

The general uniformity of supply-driven financial services of Myanmar MFOs in the same rural markets is a significant disadvantage in moving the frontier out towards a more inclusive rural financial market. LIFT's Financial Inclusion strategy requires special attention be given to the integration of gender, migration/remittances and internally displaced persons and the extreme poor in the rural financial market.

Gender

LIFT investment in microfinance has impacted largely on women, and increased their access to financial services (ie LIFT supported MFOs are supplying loans to approximately 675,000 women, or 95 percent of the total 717,000 clients). The predominant MFO supply-driven lending technology is financing women organized in small groups (collateralization through social capital) whose households "own" land. These services are effective at supporting household income smoothing and consumptive needs as well as access to small business investments.

While these microfinance services by MFOs are effective at empowering women in household decision making, LIFT also recognizes the need to increase access to a more diversified portfolio of quality financing products beyond the micro scale typical of MFO services. There is an unmet effective demand for more diversified financial products and services with sufficient scale to support both on farm smallholder, and off farm SME investments. LIFT will ensure that its financial inclusion programme provides equal access for women to the wider portfolio of loan products that will be supported under this strategy.

Migration and Remittances

LIFT recognizes the business opportunity and potential for MFO remittance services, i.e. money transfer services and the demand for these services by migrants. Remittance transfers by migrant workers and professionals are a significant flow of money for Myanmar that estimates put in the range of US$ 5-10 billion. MFO remittance services would provide benefits to both the MFO and client that include greater liquidity for financial intermediation, and reducing risk with financial collateral and more reliable and greater income flows.

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[4] This includes strengthening the banking sector in the areas of financial services research, design and delivery.

[5] There is also a broad consensus that the delivery of institution building services is best targeted at those organizations that have actually been engaged in the development and implementation of lending technologies. Successful investments require that these institution building services are provided by a specialist provider willing to make a long term commitment as a quasi-owner to a one-on-one relationship with the MFO for the joint learning-by-doing of the microfinance business. These "providers" hold a significant comparative advantage in the delivery of institution building services.

Internally Displaced Persons and the Extreme Poor
LIFT supported MFOs ratio of grants to total assets is high. In other words, MFOs are not highly leveraged, and are dependent on donor funds that come with expectations to push the frontier out and provide financial services to this sub-class of the poor; internally displaced persons (IDPs) and the extreme poor. In order to do this, appropriate financial services are needed to meet this effective demand.

A challenge is that the majority of IDPs in Myanmar are isolated from economic growth activity in rural Myanmar. Most have not been integrated into the wider economy in their area resulting in uncertain and sporadic access to finance. They continue to live apart, in organized camps or in directed locations in villages. Providing loans in this "safety net" situation does impose a debt burden on IDPs, and a higher risk that potentially undermines financial performance of MFOs due to the uncertain income flows typical of the economic environment that IDPs live in. MFOs are further constrained by a rigid supply-side lending technology that is not appropriate to provide sustained financial services to IDPs and the extreme poor.

LIFT's FI strategy includes providing IDPs and the extreme poor with access to financial services that will enable them to take advantage of economic opportunities and generate livelihoods. MFOs are the means of providing this finance if "sustainable/profitable" livelihood programs are implemented. Finance provides the opportunity for IDPs to procure assets to pursue livelihood programming and opportunities.

Operationalizing Financial Inclusion Strategic Considerations
There is an effective demand for a broad range of financial services not being supplied, though in some environments and situations, the magnitudes may be small and not cost-effective to supply. At the same time, MFOs are not in a position to take advantage of these opportunities. This is due to legal limitations as financial services providers, limited institutional and operational development, limited research and development capacities, inadequate capital reserves and limited networks of branch offices. LIFT's Financial Inclusion strategy of "market development" is to "evolve" MFOs so that they can develop and supply a full range of sustainable demand-driven financial services, possibly including money transfers and hire-purchase.

Monitoring and Evaluation/Knowledge Management
The rapid growth in financial services that is accompanying economic growth in Myanmar is a clear indication that there is a demand for these services, and that people realize benefits from these financial services.

It is much more appropriate to view credit as a product of financial intermediation. Acceptance of this view results in not measuring the impact of loans on borrowers and more attention to the behavior of savers and financial intermediaries and to the overall performance of financial systems. It also directs more attention toward measurement of the costs of using and providing financial services and highlights the effects of policies and of technological change on financial markets.

Loan impact studies are misleading because the underlying assumption that a loan is an input, rather than part of the financial intermediation process, ignores the essential property of financial services, their fungibility. A loan provides additional liquidity or purchasing power for use in any of the borrower's production, investment, or consumption activities. Most rural households in Myanmar have several sources of income, engage in multiple occupations, and have a number of potential uses for additional liquidity. Measurement of the impact of a loan requires collection of costly information on all changes in these sources and uses of liquidity that are contemporary with loan receipt and then a comparison of the "with" and "without" loan situations. Because the "without" loan case can be specified only through assumption and conjecture, loan impact can never be determined with certainty.

Attention will be focused on explaining the behavior of rural financial institutions, an effort that would include the cost and returns associated with various financial services, such as mobilizing rural savings, lending to small businesses, and accommodating the seasonality of liquidity flows in agricultural areas. This emphasis will result in a better understanding of the elements required to build sustainable rural financial institutions. Furthermore, focus will be directed toward measuring the performance of the rural financial market and institutions, e.g. financial and institutional sustainability.

LIFT Financial Inclusion Programme

Rationale

LIFT is committed to promoting and developing a rural financial market that allows the population—including the poor—broad access to a wide array of financial services that meets the market's diverse effective demand for quality financial services at competitive prices. Currently microfinance targets the poor primarily engaged in subsistence agriculture.

LIFT's strategy requires its Financial Inclusion Programme to continue to grow and expand the scope of microfinance services in order to help develop a more robust, inclusive rural financial market that is essential for a growing and equitable rural economy. What is required is a rural finance approach that includes, but is not limited to, microfinance, and as such cuts across all economic strata in a community. A robust, inclusive rural financial market can help all people take advantage of economic opportunities, build assets, generate employment, manage risks and reduce the poor's vulnerabilities to external shocks.

The Financial Inclusion Programme will target support to existing microfinance institutions (MFIs) in the central dry zone and Ayeyarwady Delta, and new and existing MFIs in the upland regions[6], to achieve sustainability, and increase their supply of a broad array of demand-driven financial services that serve diversified market segments, e.g. deposit services, lines-of-credit, leasing, term-finance, financing for seasonal crops (beans/pulses, oilseeds), debt consolidation loans and investments in agricultural cooperative businesses.

Existing Situation in Myanmar

UNCDF's Making Access Possible (MAP) reported in its FinScope Myanmar 2013 that 18 percent of total adults have access to credit that includes 13 percent through banks (State Banks and Private Banks) and 5 percent through non-banks (registered coops, registered pawn shops and microfinance institutions). Nearly 30 percent of adults have access to informal finance. Approximately 40 percent of adults have no access to financial services.

There are 15 private commercial banks with 485 branches countrywide. However, the penetration rate of commercial banks' financial services is only one client per 100,000.

Myanmar Agricultural Development Bank (MADB) is the largest financial institution providing agricultural loans—in 2013, 2.6 million farmers throughout Myanmar. In 2013, MADB increased the loan size per acre *for paddy* from Kyat 40,000 to Kyat 100,000, and reduced the annual interest rate from 8.5 to 5 percent annually. However, for other crops such as beans and pulses, the loan size remained unchanged at Kyat 20,000 per acre and the interest rate remained at 8.5 percent. The MADB maximum size loan is based on a financing a maximum of 10 acres (or Kyat one million). A recent JICA study (2012) showed that 90 percent of MADB's loan disbursement in 2012 went for paddy.

The Department of Cooperatives has started disbursement of agricultural loans to the village cooperative societies sourced from a USD 100 million loan from China. Loans are for six months,

[6] Refer to the LIFT website and its annual reports for more information about these agro-ecological zones.

maximum loan size is set at USD 500 and at an interest rate of 1.3 percent monthly. There is a compulsory savings of USD five that is deducted upfront, and additional 0.7 percent charged to be invested in village development activities.

By November 2014, the Ministry of Finance had issued microfinance license to 215 microfinance institutions (MFI) which include 7 international NGOs, 21 local NGOs, 77 cooperatives, 14 foreign microfinance companies, 95 local microfinance companies, and 1 joint venture company. The majority of MFIs, with the exception of the microfinance NGOs, target urban markets. To promote more microfinance services in rural areas, the Ministry of Finance drafted a new microfinance policy that allowed MFIs to borrow from other financial institutions in order to support an increase in the loan size from Kyat 500,000 (~ US$ 500) to Kyat 5 million (~ US$ 5,000), and for MFIs' loan portfolios to be 50 percent rural based. LIFT has been providing capital and institutional support to 16 MFIs including 9 local MFIs since 2010. They have reached 158,642 households in 5,505 villages by June 2014 (70 percent are in the dry zone, 23 percent in the Delta and seven percent in the uplands). All of them target poor households. The loan size is ranging from Kyat 100,000 to Kyat 400,000, with a mean loan size under Kyat 200,000 (US$200).

In summary, the main limitations of the current financial services available and that need to be considered in designing investments to deepen Myanmar's rural financial market, include the following (the list is not exhaustive):

1) There is limited access to formal financial services;
2) Current MFIs provide access to financial services to poor households of less than six months, and with an average loan size of $200;
3) MADB and MFI loans are together smaller than the effective demand for this financial service, especially for crops other than rice;
4) Financing for non-paddy agricultural production by MADB is one-tenth of what is provided to lower return, lower value paddy (many smallholders are engaged in production of higher-return, higher-value crops);
5) The release and repayment dates of MADB financing are bureaucratically established, and often do not meet the planting and harvesting schedules for smallholder farmers;
6) There are extremely few deposit-led financial institutions;
7) Term financing, either from formal or informal sources, is negligible, meaning that financing for small-scale agricultural technologies and equipment is negligible;
8) Financing for small businesses from formal sources, excluding smallholder farmers, does not exist;
9) LIFT surveys indicate that the overall amount of household debt is increasing.

1. LIFT's Financial Inclusion Programme—Scope and Scale

The Financial Inclusion Programme will support the rural population across a spectrum of financing investments and activities through MFIs and commercial banks:

a. *Expansion of existing pro-poor financial services*
b. *Investment financing for agricultural and off-farm small businesses*
c. *Mobilization of savings*

d. *Market development assistance for institutional sustainability of MFIs and downscaling financial services of commercial banks*
e. *Partial Risk Guarantee Fund (PRGF)*

Expansion of existing pro-poor financial services

The Financial Inclusion Programme will invest capital in existing MFIs in order to increase access to financial services among poor households. These investment funds will support the expansion of the basic credit technology—group lending, to primarily women, with the group's social capital underwriting the credit risk.

Investment funds for new financial services for seasonal crops that are demand-driven, not supply driven by existing credit technology will be supported.

In addition, the Financial Inclusion Programme will invest in the introduction of a new pro-poor financial service, a debt consolidation loan that combines one or more high interest informal loans into a single, new loan at lower interest.

Investment financing for agricultural and off-farm small businesses

Small businesses are job creators. Improving access to finance for small businesses is a key element of LIFT's Financial Inclusion Program. Currently, MFIs are not supporting small business development because their credit technology is not targeted towards financing small businesses. As a first step, for those MFIs interested in expanding their client base, the building of appropriate credit technology and infrastructure is required (see market development section below). A key demand-driven financial service for small businesses is expected to be a line of credit—a financial service that establishes a maximum loan balance (credit limit) that the small business can borrow against where there is no interest charged on the unused part of the credit limit.

The supply of demand-driven agriculture-related term financing for small businesses is absent, and is critical in supporting rural economic growth. Potential entrepreneurs face capital constraints (capital thresholds) that require medium- to long-term financing. Therefore, LIFT will increase access to financial services that allow for investments in small scale appropriate technologies (e.g., small scale mechanization hire/purchase of equipment and tools with instalment payments at affordable cost; small scale irrigation; greenhouses). The Financial Inclusion Programme will involve financial services that allow for investments in small-scale agricultural technologies (SSATs) and small business, including:

- *Small scale mechanization*: LIFT will invest in financial service providers to allow farmers to purchase agricultural equipment and tools with instalment payments at affordable cost. This can be done through partnerships financial service providers and agribusiness input suppliers.
- *Agriculture infrastructure development in association with private sector business, e.g. contract farming*. This will provide investment in the private sector for development of agricultural infrastructure, e.g. small scale irrigation to promote production of higher value and marketable products that are required in contract markets.
- *Greenhouse agriculture*: This will support development of greenhouse agriculture through entrepreneurship loans, especially for next generation of farmers.

- *Agri-business and agro processing*: This will support small-scale processing and agri-business support services for agricultural commodities with value adding potential. It could also support leasing for other livelihoods equipment (e.g., baking equipment, tooling machinery, brick making, etc.).

There is a great opportunity for accelerated SSAT adoption in Myanmar smallholder agriculture. LIFT sees three main factors driving opportunities to invest in SSATs in the targeted townships: 1) high demand and prices for maize and beans/pulses; 2) land ownership patterns in Myanmar put most arable, and currently cultivated, land in the hands of smallholder farmers; 3) growing scarcity of farm labour; and 4) the increased availability of new SSAT technologies supplied by the private sector.

SSATs are crucial in sustainable crop intensification and improved rural livelihoods as they provide smallholder farmers the opportunity to lower their costs, increase production, and increase their incomes. SSATs are broadly absent across Myanmar. One of the key factors driving LIFT's investment in SSATs is the development of more diversified smallholder farming systems that can sustainably produce two to three crops a year (intensification) on the same land.

The multi-functionality and seasonality of SSATs have significant multiplier effects on economic growth. SSATs require correct/proper use and an accompanying service infrastructure for maintenance and repair. This builds new markets, significant off-farm employment and small business opportunities. For example, households without land could access SSATs to set up their own small businesses that sell services in land preparation, irrigation and transportation. Additionally, greenhouse production and small scale agro processing could also be a source of employment and small business ownership for youth and the landless.

Financial services, and in particular the supply of demand-driven agriculture-related term financing, is a critical constraint for potential SSAT entrepreneurs who face capital constraints (capital thresholds). They require medium to long-term financing. LIFT recognizes that financing SSATs for rural households and small businesses (both existing and new) can be risky, especially for MFIs and commercial banks moving into new regions and new portfolios. LIFT plans to underwrite these types of investments through direct financial investment and a mobile partial credit guarantee fund.

LIFT will invest in associated agricultural business/technical advisory and coordination projects in a follow-on RFP. There is an important role for business licensed cooperatives, government and commercial private sector input suppliers, and NGOs to facilitate the development of sustainable SSATs. These potential implementing partners will be engaged in activities supporting operational arrangements for the use of SSATs, to training, maintenance and related commercial supply infrastructure for sales and after sales services of SSATs. The inclusion of each is important in the research, development and supply of SSAT financing.

Mobilization of savings

As an investment towards increasing MFI sustainability and vibrancy, and promoting a means for social protection among MFI clients, the LIFT Financial Inclusion Programme will provide technical and financial assistance in the form of matching deposits with cash transfers--Individual Development Accounts. Individual Development Accounts (IDAs) are special savings accounts that match the deposits of the poorest clients. Other types of IDAs could include those targeting education and small business development, ie IEDAs and IBDAs. For every kyat saved in an IDA, savers receive a corresponding match, usually one to four times the size of each deposit the client makes, that serves as both a reward and an incentive to further the saving habit, and build assets that strengthen the clients' resilience to shocks. Each IDA programme may differ slightly and may have their own guidelines for how the savings can be used. In most cases, IDAs are used for specific purposes, e.g. starting a small business.

Market development assistance for institutional sustainability of MFIs and banks

LIFT market development programming has targeted and will continue to target investments that improve the sustainability of promising but still unsustainable MFIs, and down-scaling or up-scaling (down-marketing or up-marketing) financial services to commercial banks and MFIs respectively[7]. Examples of market development projects include the following: legal and regulatory framework, down-scaling or up-scaling of services through transfers of technology (small business financing), technical assistance services, training of the staff of MFIs and commercial banks, other non-financial services (sustainable business development services) and establishing business units whose focus is small business lending.

Partial Risk Guarantee Fund

LIFT will invest in a Partial Risk Guarantee Fund (*PRGF*) to provide risk capital that encourages MFIs and commercial banks to expand financing, through leasing (hire-purchase) to rural small businesses they currently do not serve. The PRGF promotes private sector investment (there is "significant" private capital available that is currently not being invested) through risk sharing with MFIs and commercial banks by guaranteeing a percent of the net loss on principal for leases covered by the PRGF. The expectation is that the MFIs and commercial banks will learn to provide financing in the future when there is no PRGF, and therefore bring about a sustainable increase in access to financing (credit and/or leasing) to rural small businesses.

The PRGF's operational structure is restricted by Myanmar Central Bank regulations and environment. An MFI or commercial bank will be given a lease portfolio guarantee (versus both a loan and lease portfolio guarantee) for leasing to rural small businesses equal to a proportion of the principal (it will be up to the applicants to propose the proportion).

The PRGF will be coupled with market development technical assistance to strengthen the MFIs and commercial banks business units engaged in leasing.

[7] Commercial bank down-scaling (or down marketing), and MFI up-scaling (or up-marketing) of financial services means developing and expanding lending to small businesses by adding to the bank's and MFI's financial services line, and just as importantly, creating a separate business unit that will be responsible for the introduction and development of the new credit technology.