

In Malawi 65 percent of the population lives below the national poverty line and the majority of these are women. Malawi's economy is predominantly agricultural and highly dependent on erratic rainfall. Agriculture accounts for 90 percent of foreign exchange earnings, 40 percent of GDP, and employs 80 percent of the workforce (2005). Only two thirds of the population can read and sectors which would add value to agricultural produce are relatively small.

Malawi has an underdeveloped finance sector—particularly in terms of serving the poor. Of the economically active poor in Malawi, it is estimated that only three percent have access to savings and one percent have access to credit. Institutions and management skills in the sector are weak. Almost all microfinance institutions (MFIs) operate with limited outreach and loan availability. Access to and availability of financial services in the rural areas is particularly limited.

Microfinance expands choices for people. The ability to save and borrow reduces vulnerability in a fundamental way—health and education expenses can be covered in the short-run. In this way it supports social welfare objectives by offering a means for the vulnerable to protect themselves. It also provides a route for the economically active to start or expand small businesses. Availability of financial services can empower the poor to move themselves out of poverty.

Microfinance is an unusual sector in development because it is designed to pay for itself. Donors may front money, but this is used and reused by the project or institution in the form of low interest loans. Experience with micro-credit schemes in developing countries during the 1980s and 1990s demonstrated that poor people, particularly women, repay

loans—in the better programmes, repayment rates were higher than in the formal financial sector of those countries—and women are willing to pay interest rates that allow Microfinance Institutions (MFIs) to cover their costs.

UNDP in partnership with United Nations Capital Development Fund (UNCDF) is supporting the Ministry of Finance to implement the project, Financial Inclusion in Malawi (FIMA). The project will set up a Microfinance unit in the Ministry of Finance, as it currently has no designated unit to monitor this area. It will focus on developing and implementing a national strategy for building an inclusive financial sector in Malawi.

### An inclusive financial sector

The needs of the poor are diverse. The Consultative Group to Assist the Poor (CGAP), a consortium of 33 public and private development institutions supported by the World Bank, has a vision of what the world's microfinance sector should look like, which is what FIMA is based on. The vision is that the poor will have access to the same basic range of services as other members of society. This includes not only credit, but financial services in savings, payments and insurance. Also, the microfinance sector should be competitive. Financial services should be provided by diverse institutions—not just projects or NGOs, but also banks and specialized institutions.

Financial services need to be provided on a sustainable basis. One-off project

support is ultimately not that useful. There should be permanent institutions in this sector, working according to principles of sustainability, i.e. they should cover their costs through appropriate interest rates.

In order for these things to be possible, countries need to have appropriate legal and regulatory instruments in place.

The FIMA project will focus on three areas of microfinance to support innovation, increased outreach and sustainability of operations. The first is supporting the government to develop its policy framework—both legal and regulatory. UNDP has established a microfinance forum for all stakeholders to encourage policy dialogue. The second is supporting innovation through provision of grants for research and development into new products able to reach and meet the needs of a larger number of the rural poor. The third is providing grants in support of capacity building of key institutions and players at the policy, market infrastructure and microfinance institutional level. This includes the Reserve Bank of Malawi, the Malawi Microfinance Network, financial and technical service providers, and relevant Government institutions. The project will provide loans directly to MFIs planning to increase micro-loan availability. It will also support a credit granting scheme, placing funds in the commercial banks to risk share with the bank when it loans to MFIs.

## Investment Fund

The US\$4 million put in by UNDP and UNCDF will only go so far. The project will set up an investment fund, which aligns with the principles of microfinance and can provide a sustainable source of funds. Investors can put money into the fund, and this money would be lent to MFIs or put into the credit granting scheme to enable financial service providers to access commercial funding to grow their own capital. Cordaid, a Dutch foundation, has already pledged to contribute US\$1 million to the fund.

All potential investors with some knowledge of the microfinance sector are invited to become members of the fund's investment committee. This committee will provide oversight on where to invest and will serve as a coordination mechanism for donors interested in microfinance. The investment committee will interact with the project steering committee but maintain independence and operate according to its own guidelines.

The project began in July 2007 and will continue through 2011 subject to extension. The planning phase is complete and the project is now recruiting four staff for the Microfinance unit at MoF.

## Contact:

Bill Chanza  
Programme Officer  
UNDP Malawi

**Office:** + 265 (0) 1 773 500, Ext. 210  
**Email:** bill.chanza@undp.org

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USD\$ 2,000,000

## Implementing Partners:

United Nations Capital Development Fund, Ministry of Finance, Malawi Microfinance Network (MAMN), Ministry of Industry, Trade and Private Sector Development and the Reserve Bank of Malawi

## Development Partners:

Cordaid