

Chapter 1

Introduction

1.1 Background and Rationale

The experiences of any microfinance institutions have exemplified the fact that a strong repayment rate is a major aspect of financial success in the microfinance industry. It may be difficult that the target beneficiary clients are poor, low income, illiterate, with no infinite credit history and no potential for collateral. Yet, these are simply the challenges that microfinance institutions take on when providing loans to marginalized people in developing countries. These risks are closely related to high risk of loan return (Berglind, 2007).

Many of credit history have been trying to meet improvement in welfare of borrower and financially sustainable of offering the loan to poor. Especially in rural areas, it is hard to provide the loan widely due to the poor infrastructure and because of the difficulties there are to overcome with regards to the risk of loan default. In terms of repayment rate, the risk of loan offering is crucial to investigate. A key question is what situation leads the client to be a defaulter or delinquent member? By exploring this question, this study will offer possibilities for better policy's design in order to reduce the difficulties of borrowers so that credit provision can enhance the goal of financial suitability. The determinant of repayment rate of borrowers depends on a number of variables. Generally, the demographic characteristics affect

on group lending. Demographic characteristics can include age, sex, the level of education, the employment status of borrowers and their family, the assets of borrower, institutional mechanism, and group lending mechanisms. It is important to study what factors are affecting the repayment performance of the borrower so that both the microfinance institution and the target households will gain a benefit after the adjustment of regulations based on the findings on borrower's repayment performance.

1.1.1 The Union of Myanmar

The Union of Myanmar is the second largest country in South East Asia. It is bordered by five nations including Laos to the east, Thailand to the southeast, and Bangladesh to the west. It is sandwiched between India to the northwest and China to the northeast. The country is plagued by political instability and violent inter-ethnic conflict. Historically, Myanmar has been the target of expansionist of great powers in a variety of cases. For instance, in the 13th century, the region was attacked by the Mongols and later in the 19th century British colonialist held power. Finally in the 20th century, the country was ruled for a short period by the Japanese (Poon Kim Shee, 2002).

The political turmoil in Myanmar's past and present has had significant economic implications since independence on January, 4th 1948. After the independence (1950/51 to 1989/90), GDP growth rate was average 5.8 percent. Under the socialist government (1961/62 to 1989/90), the growth rate of GDP decreased from 3.5 to 1.9 percent (Myint, 2005). Due to the unsuccessful economy of the socialist government, in 1988, a pro-democracy demonstration occurred around the

hole nation. A military junta seized power after the crackdown of the socialist government. A market-based economy had been used under the military government since then the average GDP has gone up about 6.1 percent (Myint, 2005).

Table 1.1: Major Economic Indicators of Myanmar

Year	99/00	00/01	01/02	02/03	03/04	04/05	05/06
Govt expenditure(% of GDP)	5.8	13.6	10.5	8.6	9.5	6.0	12.1
Military expenditure(% of GDP)	7.6	3.5	2.58	2.42	3.76	3.91	1.40
Health expenditure (% of GDP)	0.13	0.07	0.06	0.55	0.49	0.61	0.17
Education expenditure(%of GDP)	0.45	0.24	0.22	1.32	1.52	2.22	0.46

Source: Burma Economic Review (2005-2006)

Table 1.1, shows that the percentage of GDP of social development expenditure is around 1%. It is relatively low compared to other neighboring countries but the military expenditure is significantly higher than other countries.

Myanmar has been endowed with arable land, forestry, minerals (including gas and oil), fresh water and marine resources. However, while abundant in natural resources, due to the dual exchange rate system and high public expenditure of state owned enterprise, the country's economy has underperformed. In the list of Human Development Index, Myanmar was ranked 135th out of 178 countries world wide (United Nation Development Programme, UNDP 2008) and (Asia Development Bank, ADB 2008).

Myanmar is a mainly agriculture-based country. The country's agricultural sector also includes fishery and forest production. More than 60% of the national labor force is employed in this sector. The agriculture sector is hampered by inadequate rural roads, lack of fertilizers and pesticides, lack of investment,

inadequate electricity and irrigation systems. Where there are irrigation systems in place many have filled with silt and become unusable. The Ayeyarwady delta region is an enormous, flat delta surrounded by hills and mountains. Myanmar is a country that experiences heavy rainfall.

As a result, floods and landslides take place regularly during the mid-monsoon period (June to August) in the delta area which has a vast number of rivers and streams. The country is also highly vulnerable to cyclones and earthquakes. It was severely affected in early May 2008 when cyclone Nargis caused ripped through the Ayeyarwady Delta, taking the lives of 140,000 peoples and affecting the lives of approximately 2.4 million people (Microfinance Industry Report).

Figure 1.1: GDP growth rate

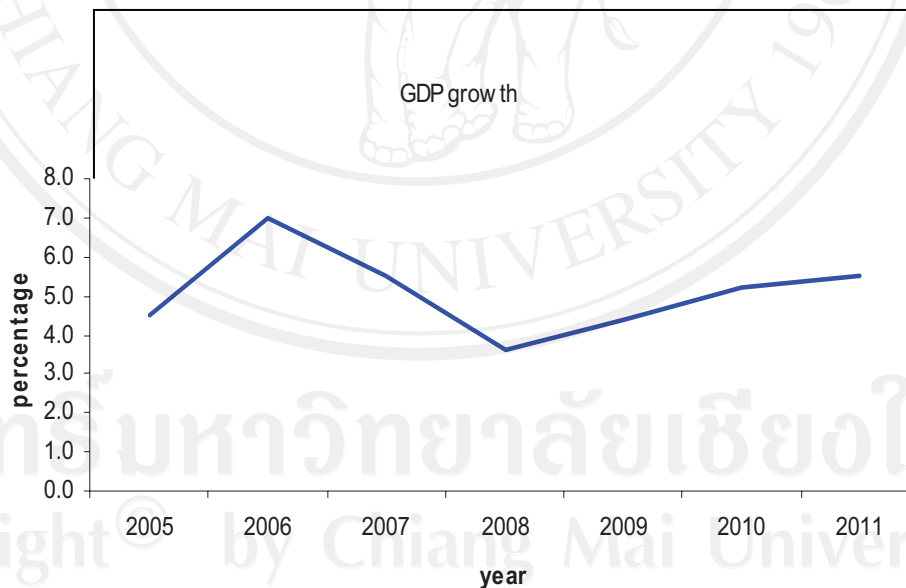


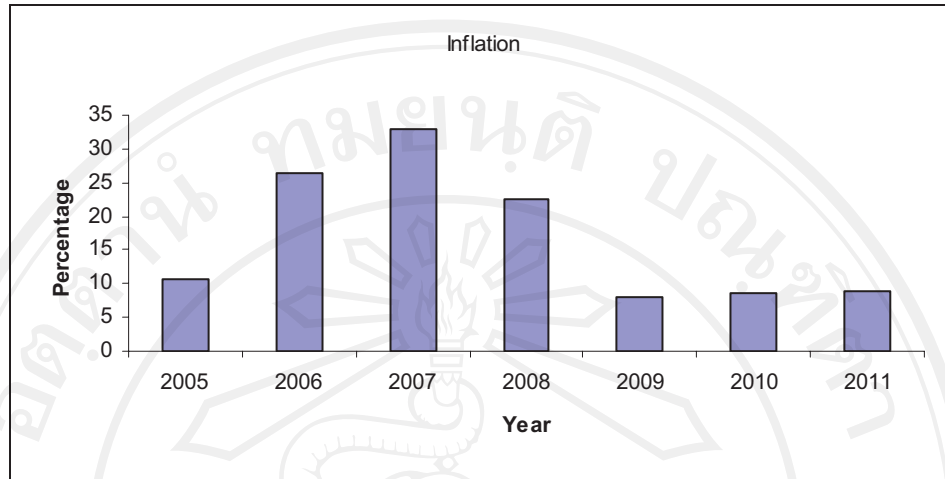
Figure 1.1 shows how Myanmar's GDP declined an estimated 4.4% in 2008 but rose up in 2009. This rise may be a result of the increase gas export to neighboring countries. Private consumption was sluggish because of the weakness of remittance

from Myanmar worker who are working abroad as the recession hit countries like Singapore, Thailand, and Malaysia (ADB, 2008). Teak and rice exports have been monopolized by the government since many years ago. Since 1998, sesame exports have also been restricted by government (Toshihiro, 2007, P-7). At present, the major commodity being exported is natural gas. Myanmar's major trade partners are China, India and Thailand.

Economic difficulties were also presence in October 2005 when the price of fuel rose up eightfold. Consequently, the basic commodity price also increased. In addition, in the black market the exchange rate is 1 US \$ equal to 1260 Kyat but the official exchange rate is only 1 US \$ equal to 5.78 Kyat (EIU, 2007). It is grossly overvalued.

Possession and use of US dollars are forbidden without a special license by the government which has issued the Foreign Exchange Certificates (FEC) for legal use. Foreign business, companies or organizations are allowed to deposit in a state owned bank, but withdraws can only be made in FECs. The Myanmar Foreign Trade Bank (MFTB), the Myanmar Investment Bank (MIB), Commercial Bank (MICB) and the Myanmar Economic Bank (MEB) are legally allowed to deal in foreign exchange transactions (Financial Standard Foundation, 2010).

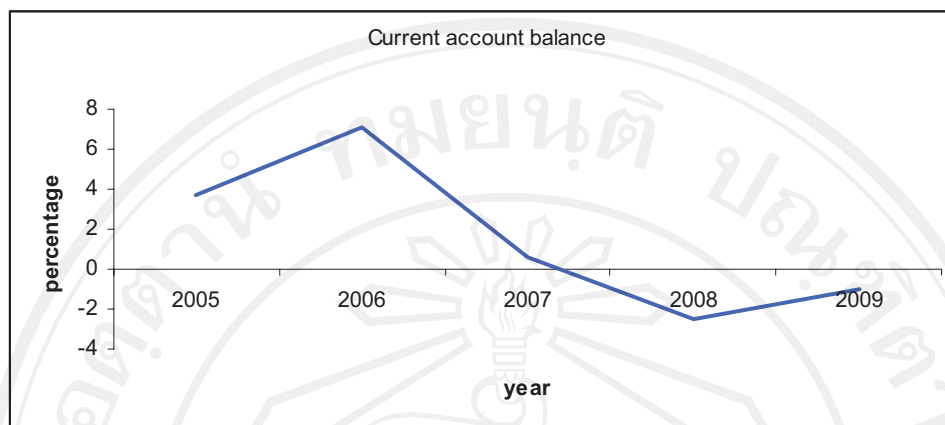
Figure 1.2: Inflation



Source: ADB, 2010 report

In Figure 1.2, indicates that the inflation was at the highest point as an estimated 34% in 2007, which affected the double increase of fuel price. Due to the high drop in food and fuel prices, decline in domestic economic activity and fiscal deficit, the inflation was pulled back to 22.5% in 2008 and went down to 7.9% in 2009. In 2010, the inflation moved to 8.5% due to the higher global commodity prices (ADB, 2010).

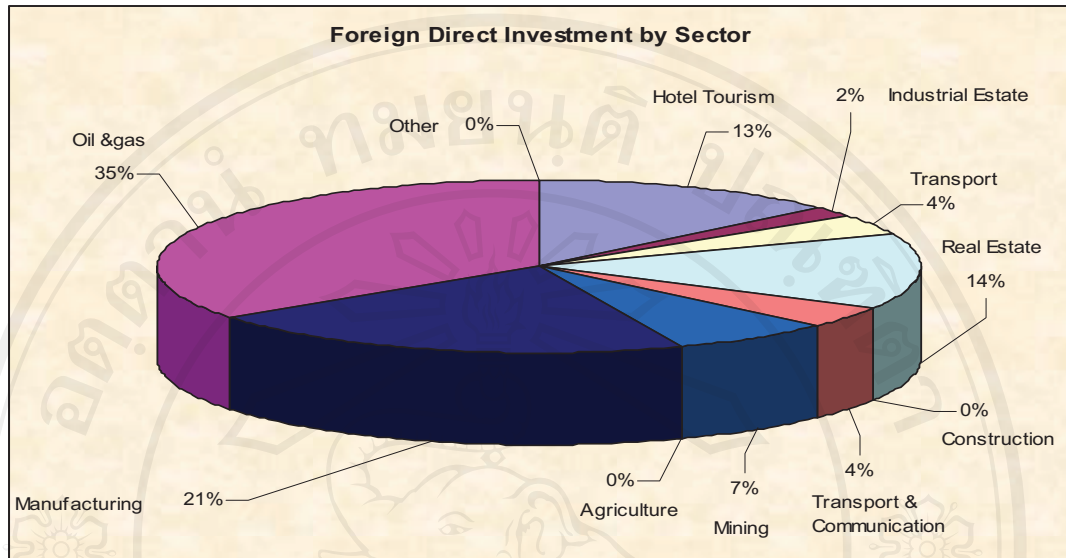
Figure 1.3: Current Account Balance



Source: ADB, 2010 report

In Fiscal Year 2008, the external current account balance showed a deficit and fell down to 2.5% due to higher expenditure used for repairing the cyclone-damaged area and repaying higher interest rates on domestic debt. The country population is 58.85 million and the annual growth rate of the population was 1.2 percent from 2007 to 2009. The urban population was 31.6% of the total population in 2008 (ADB, 2010 report). According to the household living condition assessment, the incidence of poverty was 32% in rural areas and 22% in urban areas, in 2007. (A Joint United Nation Development Programme (UNDP, 2007).

Figure 1.4: Distribution of employment by sector



Source: Burmese Economic Review (2005-2006)

In 2005, Burmese Economic Review showed that Singapore, Thailand, Malaysia, Indonesia and the Philippines invested about US \$ 3962.87 million in 170 projects. Figure 1.4 shows that the percentage of foreign investment in oil and gas (35%) is the higher than any other sector. However, all those profits go directly to the government budget, which as described earlier does not trickle-down to benefit the people in education or health services. The people of Myanmar have not shared in this prosperity. Commercial banks are forbidden to offer credit to the agriculture sector. A particular problem is the lack of credit to farmers. Only the state bank, Myanmar Agricultural Development Bank can extend credit to farmers. Disbursements of average loans are inadequate to meet the needs of farmers. Many farmers, therefore, either do without credit or must rely on moneylenders who charged very high interest rates (Microfinance Industry Report, 2010). In 2003, the bank crisis was very severe and country's 20 private banks were closed down. Until now, Myanmar does not have a proper banking system. In December 2005, the largest private banks functioned

under tight restrictions limiting the private sector's access to formal credit bank. Since then, the private banking system collapsed. At present, there were only a few private banks which rely mostly on money transfer, and do not conduct significant business in deposits and loan transactions. Officially, foreign trade data are not reliable, because the estimation of black market size and unofficial border trades are larger than the official economy. (Burmese Economic Review, 2005-2006).

1.1.2 Credit Policy in Myanmar

Current microfinance activities in Myanmar are organized under the authorization of government. They are allowed to operate by signing a Memorandum of Understanding (MoU) which establishes the relationship between the microfinance organizations co-operating with government ministry. Therefore, in Myanmar, microfinance is not yet regulated as financial institution, but it is somewhat authorized by case-to-case permission by the government. There is no specific microfinance law in Myanmar. In the late 1990s, microfinance law was drafted but no enforcement has been seen as of yet and it is not likely to change even after the end of election 2010. In 1990, the Financial Institution Law was regulated by the Central Bank. Thus, the financial institution needs the permission of Central Bank to get into operation (Micro-industry Report, 2010).

According to the Financial Institution Law of Myanmar, all credit needs the collateral with real estate or fixed deposit account. Therefore, millions of small and micro-entrepreneurs has been relying on informal money lenders or pawnshops for credit with interest rates of around 20% (Microfinance Industry Report, 2010). In Myanmar, the financial market consists of formal and non-formal financial sectors

including state-owned banks, private commercial banks, saving and credit cooperatives, public pawnshops and public licensed pawnshops. The state-owned banks are the Myanmar Agricultural Development Bank, the Myanmar Economic Bank and Central Co-operative Bank. The Myanmar Agricultural Development Bank (MADB) has been promoting agriculture loans, agricultural techniques, storage distribution and marketing in relation to agriculture and livestock-based industry. The MADB is a second largest formal financial institution in Myanmar. It targets the rural development sector and was established by the law of 1990, since 1953. In the 2004-2005 fiscal year, 27.4 billion kyat (24 million dollars) was provided for the rural development sector (Tomoko Kiano, 2005)

The first micro lending program was founded in 1995 by the Group de Recherche et d'Echanges Technologique (GRET) in Chin State. Then, several of microfinance projects were subsequently established: In 1997 the Private Agencies Collaborating Together (PACT) which is one of United Nation Development Project (UNDP) in Mandalay, Sagaing, Shan, Delta, and Megway and in 1997, the Yadanasubu was founded in Tanintharyi State. In 1998, the World Vision in Yangon, Mandalay, Ayeyawaddy, Shan, Kayin and Mon State. Subsequently, in 2002, the Association of Medical Doctors of Asia (AMDA) in Mandalay State, in 2002, the Save the Children (Dawn Micro-finance Program) in Yangon Division and in 2005 the Private Agencies Collaborating Together (PACT), which is not collaborating with UNDP in Magway.

Currently, in 2009, 6 microfinance institutions (PACT (Non- UNDP), GRET, Save the Children, AMDA, PACT (UNDP), Total (Ya Da Na Su Bu) and World Vision are operating specific MoUs with authorities. The microfinance sectors

are servicing more than 385, 000 clients in Myanmar. The target beneficiaries 90 % are women (Microfinance Industry report, 2010). Apart from this other microfinance programs are in collaboration with religious organization, local NGOs and other development organization. These programs provide very few beneficiaries compared to the population of the country who are living in poverty. However, microfinance institutions are one of the significant poverty alleviation tools in Myanmar and group lending technology has attracted much attention from development groups. Since many micro-credit organizations have experienced success in reducing transaction costs and obtaining favorable repayment rates with no collateral, this is preferred by poor people. The moderate formal sector is made up of local NGO- MFIs and INGOs which are not under the control of state-owned bank. Yet, these semiformal banks are not without restriction. Nevertheless, all of these projects need to inform the assigned ministry in detail regarding the project activities. Many times they face barriers to implementation, such as long period of waiting time for government permission for extension new area. Some MFIs in Yangon-based organizations submitted proposals for expansion to another area years ago and are still waiting to get permission by the government. Adding to the difficulties, MFIs in Myanmar still do not have a legal MFI approval for their operations.

1.1.3 Credit Policy in YWCA and YWDP

In Yangon, the YWCA and YWDP aim to assist and enrich women and their families in terms of physical, mental, emotional and spiritual capacity in order to improve the household's quality of life. Hence, they have implemented a number of capacity development training programs, and activities for Myanmar women over the

decades. YWDP is one of sub-branch of YWCA and existed for satellite area of Yangon. YWCA, credit provision is for village level and some of township in Yangon.

One of the existing development assistances being provided by YWCA (Yangon) to Myanmar women is through a project known as the YWCA Holistic Development Project. It provides a number of services, such as micro-loan, health and education services to disadvantaged women, their families, and poor people suffering from health issues. With the primary goal of empowering the women through provision of income opportunities and capacity development, a saving and credit service was initiated and piloted in 1996 for the women in Hlaing Thar Yar township, a satellite township of Yangon Division, with the support of EZE¹ (The Protestant Association for Co-operation in Development) from Germany.

MFI-YWDP is the main focal project to undergo analysis of the repayment performance of borrowers in this study. YWDP exists under the umbrella of YWCA and it is Christian-based religious organization but this organization runs a holistic development project which is helping all members of the community without restriction the religion. This organization first uses the savings method before lending the loan. In every loan cycle, the borrower must have 1/3 of savings depending on the loan amount. At present, the organization's total number of clients is 2196 persons and the project was started in 1996, with 30 women participating in the pilot test. That was the precursor of YWDP, starting with 30 women in the North Okkalapa

¹ EZE, one of the church based development organization from Germany, has been supporting the churches and churches related organizations, NGOs, community based organization, women group and intermediary organizations (www.globenet.org).

township. The required group size is minimum 10 to maximum 30 members. Group meeting for repayment is held bi-weekly or monthly.

1.1.4 Loan Product of YWDP

There are five kinds of loans, i.e. normal loan, special loan, development loan, festival loan and micro-enterprise loan. Loan amount can be borrowed depending on the borrower's savings amount, their business and repayment history.

Figure 1.5: Loan Product of YWCA

Name	Normal loan	Special loan	Development loan	Festival loan	Micro Enterprise loan
Loan size (Ks.)	10000-45000	50000-300000	1000000	10000-30000	500000
US\$	10-45	50-300	1000	10-30	500
No of borrower	1948	160	Individual Area	Depend on the festival	3
US\$=kyat	1USD=Ks.1000				

Source: Young Women Development Project (YWDP)

Normal loan can borrow between the arrange of 10000 to 45000 kyat. Maximum repayment duration is within 5 months. Borrower can submit the loan application after 2 and 1/2 months of being a member. They will need a recommendation of group members and the respective loan officer. Borrowers should

repay the loan within 2 month or 3 months. If borrower repays the loan in less than 2 months, she will have to wait until 2 months to get the next loan. This normal loan can be used for non-business affair.

Micro-enterprise loan amounts can range from 300,000 to 500000 kyat and are only available to borrowers who have borrowed three times in the past. Borrowers must have good regular repayment and savings without defaults in their credit history. The rate of repayment amount may be bi-weekly or monthly and meeting attendance must be 80% of the previous loan. The loan repayment term is a maximum of 12 months. The micro enterprise loan is allowed for use only in business. The borrower must explain the detail of their business and must have owned land and owned a house. They must have the permission of the family household-head, the assigned loan officer and respective ward leader, by signature. Loan officers must check on the borrower business within two weeks. So, borrower must wait two weeks to get this loan. The criteria of the special loan are the same with the micro-enterprise loan and the amount of loan is 300,000 kyat.

Development loans can be borrowed if the group experience is at least two years and the group meeting place must have at least three groups. It is required that there is an agreement of the households which are in the respective ward.

Development loans can be borrowed without charging any interest and the groups need to get the permission of the ward authority. That loan is not to be used for the borrower's business but for the development of their ward or township. Festival

loans can be borrowed only in water festival. The amount of loan is 30,000 kyat. Borrowers have to repay all the amount of loan after finishing the festival. This loan can be spent for the business during the festival time with no interest rate.

1.2 Significance of the Study

Many studies have investigated the impact and sustainability of micro-finance institutions, yet it is still difficult to conclude. While outreach is surprisingly impressive, financial sustainability remains a major problem. Since micro-finance can not rely on donor funds in the long run, they should be viable and sustainable by maximizing the full loan repayment. If MFI is financially sustainable, it can offer the loan continuously and it can extend the outreach, so that the well being of community development will be enhanced. There has been no empirical study done by YWDP. As repayment performance is a crucial indicator for the success of microfinance in Myanmar, therefore, the factors influencing repayment performance will be the significant part of our study.

1.3 Objective of the study

Client delinquency is considered to be highly correlated with MFI loan default (Rosenberg, 1999). Therefore, this study aims to investigate the intervention of repayment performance which can manipulate the sustainability of the microfinance institution. Moreover, this study will discuss what regulatory framework of micro-finance scheme or methodology should be promoted in the future. It will also explore what kinds of methodology are currently being used to improve not only credit institutions but also household welfare. According to these investigations the objectives are as follows;

- To investigate factors affecting the borrower's repayment performance.
- To provide policy recommendations which will promote the repayment performance of borrowers and sustainability of credit institution.

1.4 Scope of the Study

This study attempts to analyze the repayment performance of borrowers from sub-urban area of Yangon, Myanmar. It focuses on the characteristics of the borrowers and their families and the factors influencing the repayment behavior of both good borrowers and bad borrowers. Specifically, it aims to provide the picture of borrowers and their family characteristics and to analyze the influence factors on repayment performance. The sample size of the study is 400 respondents interviewed by using the survey questionnaire.

By analyzing the factors affecting the repayment performance of borrowers, this study will discuss the probability of being a good borrower and bad borrower according to the results of the marginal effect of logit model.

1.5 Outline of the Chapters

The thesis is organized in 5 Chapters. The general introduction explained in Chapter 1 and Chapter 2 reviews the theoretical background and related literature. The methodology explained in Chapter 3. Chapter 4 includes the empirical results discussion and the policy recommendation and conclusion are expressed at Chapter 5 respectively.