MAKING ACCESS POSSIBLE

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Myanmar

DEMAND, SUPPLY, POLICY AND REGULATION

Synthesis Note

2014

ABOUT MAP MYANMAR

This MAP Study Synthesis Note serves to summarize a series of documents produced as part of the Making Access Possible (MAP) Myanmar initiative. Preparation for MAP Myanmar was approved by the President of the Union of Myanmar in January 2013. The programme has been developed by United Nations Capital Development Fund (UNCDF) in close cooperation with the United Nations Development Programme (UNDP) office in Myanmar and is embedded in the UNDP Country Programme and Action Plan (CPAP), which has subsequently been approved by the Government of Myanmar. MAP Myanmar is funded by the United Nations Capital Development Fund (UNCDF) and Livelihoods and Food Securities Trust Fund (LIFT). The project is governed by a Steering Committee chaired by U Htein Linn, Manager Director of the Myanmar Microfinance Supervisory Enterprise (MSE) and consisting of 10 members representing government and project sponsors.

This Synthesis Note presents the main findings of a comprehensive demand-side, supply-side and regulatory analyses (''Making Access Possible: Myanmar Country Diagnostic Report'', 2014). The supply-side analysis covers payments, savings, credit and insurance, and therefore provides an understanding of microfinance in a broad context. The demand-side component includes an analysis of access, usage, perceptions and attitudes of financial services by target groups. The demand-side analysis draws from quantitative data provided by the Myanmar FinScope Survey 2013 and qualitative research in the form of Focus Group Discussions (FGDs), Home Visits (HV) and Key Informant Interviews (KII). For more information on the research methodologies and scope of the quantitative and qualitative research conducted, please refer to ''Making Access Possible: Myanmar Country Diagnostic Report'', 2014.

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.

Note on the use of FinScope Survey 2013. Within this document (unless otherwise referenced) demographic, income and financial usage data is obtained from the 2013 FinScope Survey. It should be noted that the last official census in Myanmar was conducted on 31 March 1983. The sampling framework and weighting for FinScope is based on the latest (2012/2013) demographic estimates provided by the Central Statistics Office (CSO). The CSO estimated a total adult population of 39 777 041 at the time of the 2013 FinScope Survey.

A summary report and presentation of FinScope Myanmar is available as a separate deliverable and the FinScope dataset is available on request for future research.

THIS REPORT WAS PRODUCED BY THE CENTRE FOR FINANCIAL REGULATION AND INCLUSION (CENFRI) WITH SUPPORT FROM BANKABLE FRONTIER ASSOCIATES (BFA).

AUTHORS

Doubell Chamberlain, Hennie Bester, Herman Smit, Christiaan Loots, Shirley Mburu, Ahmed Dermish (Bankable Frontier Associates), Lara Gidvani (Bankable Frontier Associates) and David Saunders.

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A special mention and further gratitude is required for our local guide, U Thein Myint, and to the various translators who provided us with a unique window of insight into the Myanmar people. Lastly, we would like to thank the 178 individuals from government, donor agencies, financial services providers, industry bodies, technology providers, telecommunications operators and academia for your inputs into this research process and your efforts to extend financial services to the excluded.

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 recom-mended 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 enti-ties impacting on financial inclusion, using the evidence gathered at the country level.

At country level, the core MAP partners, collaborate with Government, other key stakeholders and donors to ensure an inclusive, holistic process. MAP Myanmar represents a partnership between UNCDF, UNDP, LIFT, Cenfri and FinMark Trust for the Development of a Strategic Framework for Financial Inclusion in Myanmar. This report was produced by Cenfri as part of the larger diagnostic work.

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Abbreviations and Acronyms

ASEAN	Association of Southeast Asian Nations
ATM	Automatic Teller Machine
CBM	Central Bank of Myanmar
CCS	Central Co-operative Society
Cenfri	Centre for Financial Regulation and Inclusion
CPAP	Country Programme and Action Plan
FGDs	Focus Group Discussions
FinScope	Myanmar FinScope Survey 2013
FMT	FinMark Trust
GDP	Gross Domestic Product
HV	Home visits
INGO	International Non-governmental Organization
KIIs	Key Informant Interviews
LIFT	Livelihoods and Food Securities Trust Fund
MADB	Myanmar Agricultural Development Bank
MAP	Making Access to Financial Services Possible
MEB	Myanmar Economic Bank
MFI	Microfinance Institution
MIC	Myanmar Insurance Company
MIS	Management Information Systems
MPU	Myanmar Payments Union
MSE	Microfinance Supervisory Enterprise
MSMEs	Micro, Small and Medium Enterprises
NGO	Non-governmental Organization
PACT	Private Agencies Collaborating Together
POS	Point of Sale
RTGS	Real Time Gross Settlement
SFI	State Financial Institution
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
SMIDB	Small and Medium Industrial Development Bank

USD/Kyat Exchange Rate

Foreign exchange. The local currency in Myanmar is the Myanmar Kyat (K). The United Stated Dollar (USD) equivalent shown throughout this document was calculated using a six month average exchange rate (between 1 April to 30 September 2013) of Kyat 946 /USD.

Glossary

The **glossary** with terms and definitions used in this report can be found in **Appendix A: Glossary.**

The government objective is to reduce poverty from 26% to 16% by 2015

Key facts

Myanmar is the poorest country in Southeast Asia

Myanmar's population is the 24th largest in the world

$3.50 per day average income

60.9 million people, 39.8 million adults

7% of adults have higher education

7 out of 10 adults are rural

400 000 new jobs will be needed in the financial sector by 2030

Urban average income twice that of rural

Government Policy Objectives to improve financial access in Myanmar

TASK 1: TO INCREASE AGRICULTURAL OUTPUT

19 million adults in Myanmar reported to be involved in farming

TASK 2: TO INCREASE RURAL PRODUCTIVITY AND ESTABLISH COTTAGE INDUSTRIES

7.2 million adults in Myanmar reported to be self-employed, 65% of which are informal

TASK 3: THE DEVELOPMENT OF MICRO SAVING AND CREDIT ENTERPRISES

189 microfinance institutions have been registered since December 2011

TASK 4: TO STRENGTHEN CO-OPERATIVE OUTREACH

7 490 co-operatives offer financial services in Myanmar

Overview of Financial Access in Myanmar

30% of adults reported to use at least one financial service from a regulated financial service provider

6% make use of more than one regulated financial product class

21% of adults make use of unregulated services only

Breakdown of Financial Access in Myanmar by Product Market

19% of adults borrow from a regulated institution

5.9 million adults borrow from unregulated money-lenders with total outstanding debt of $3.9 billion

3% of adults have insurance from a regulated institution

34% of adults respond to risk events using credit or savings

10% of adults make payments through a regulated service provider

1.9 million adults make payments through an unregulated network of payment brokers

6% of adults save with a regulated financial service provider

26% of adults report saving, but do not save with a regulated or unregulated service provider

Executive Summary

As Myanmar modernises its financial sector to better serve its economy and people, a growing opportunity to extend financial services to the majority of its people has opened up. Making Access to Finance Possible (MAP) was undertaken at the request of the Government of Myanmar. The MAP Study is a comprehensive market assessment of retail financial services in Myanmar. The purpose of MAP is to assist the Government of Myanmar to identify key priorities and opportunities to extend access to financial services.

MAP Study found that 30% of the 39 million adults use regulated financial services, but most (24% of adults) use only one service. Fewer than 5% of adults have bank accounts. The majority of citizens rely on unregulated providers, often at substantially higher cost than those offered by regulated providers, or family and friends to meet their need for financial services. MAP Study also found that rural areas are slightly better served than urban areas; this is the result of targeted credit provision to rural areas by state financial institutions coupled with a nascent commercial banking sector. Microfinance institutions, operating under a legal framework since 2011, have made some headway and currently serve 700 000 clients.

Farmers (see **Section 3** for the a description of the five financial inclusion target groups) constitute the largest target group and are the largest users of regulated credit thanks to rural loans disbursed by Myanmar Agricultural Development Bank and Microfinance Institutions. Formal enterprises, a vehicle for economic growth and employment creation, reported the lowest uptake of regulated credit amongst target groups. 1.7 million adults are formally employed (Formal consumers) and form the kernel of the emerging consumer class, yet less than a quarter of them make payments through regulated institutions. The other two discrete target groups, Informal enterprises and Informal consumers, face the highest levels of financial exclusion.

The majority of financial service providers reported facing serious capital constraints, and only the Myanmar Economic Bank and commercial banks have a realistic opportunity to raise deposits for credit extension. Other credit providers, such as MFIs and co-operatives, will have to rely on wholesale funding and capital injections to fund their credit drive. The ability to extend regulated savings and payment services will require a dramatic extension in the electronic payments network. Mobile payments offer the most immediate solution to achieve this. However, this will not obviate the need to extend branch infrastructure and build a network of agents to perform the encashment role. Pending the modernisation of banking systems, decentralised group-based credit will remain the most efficient way to provide rural credit.

The MAP Study revealed major gaps in the current retail product offering. Opportunities exist to improve the quantity and terms of agricultural input credit which in turn can increase agricultural productivity. The current requirement for collateral outside the microfinance market has created a massive demand for unsecured credit, which is currently mostly met by unregulated money lenders at high cost. Formalising this credit will require some regulatory adjustments, notably an increase in microfinance interest rates and loan sizes.

Another major gap is in the retail insurance sector, which is largely undeveloped. Health and funeral insurance are not available in the market, despite these being the most important risks faced by households. Insurance can also play a critical role to secure credit when clients cannot offer collateral. However, neither agricultural insurance nor even credit life insurance is currently offered.

MAP identified seven priority opportunities for the Government of Myanmar to extend financial access:

- **Dramatically increase the supply and availability of electronic payments.** This can be delivered through mobile payments platforms and also through electronic payments networks developed by commercial banks.
- **Provide low-cost savings vehicles for short term savings.** Emerging retail payments networks and agents can be leveraged to enable convenient store of value services.
- **Extend the availability of account-based savings options.** This will require an improvement in transaction functionality and proximity to entice savings into the regulated sector. While there is an urban opportunity for bank-based deposits, the modernisation of the systems of Myanmar Economic Bank offers a major opportunity to strengthen its role as savings mobiliser in both urban and rural areas.
- **Improve the quantity, terms and risk profile of agricultural input credit.** Myanmar Agricultural Development Bank will play a leading role here, but there is also opportunity for agricultural input providers and Microfinance Institutions.
- **Increase the availability of unsecured credit.** There are opportunities to increase the lending of providers permitted to extend loans without collateral, such as Microfinance Institutions and co-operatives. This will require reconsideration of interest rate and loan caps and the removal of impediments for raising capital and other wholesale funding. In addition, the establishment of wholesale funding facilities could further improve MFIs access to capital and technical support. There is also the option to relax the collateral requirement for personal loans once a credit bureau is in place.
- **Grow the insurance product portfolio to meet the risk mitigation needs.** There is a large opportunity to provide regulated insurance for especially health and life, mostly funeral, risks. This will require regulatory adjustments to allow both Myanmar Insurance Company and new private insurers to offer such products.
- **Develop insurance products to provide security for credit extension and protection of consumers, particularly for agriculture.** Insurance can take the place of collateral for credit extension, especially for agricultural input credit. This will require the development of appropriate products.

The government of Myanmar has made good progress in bringing formal financial services to sections of society that commonly only have access to informal financial services. The state delivery of financial services has played a critical role in achieving this, but the private sector also demonstrated substantial and growing outreach. Considerable progress has been made in liberalising the market and strengthening both market and regulatory systems and capacity. The enabling regulatory environment for MFIs and co-operatives is creating an important platform to extend outreach.

Direct delivery by state institutions and, particularly MADB, has played a critical role in financial inclusion to date. MADB has improved delivery over the last 5 years and there is opportunity to continue harnessing this role while seeking to modernise state institutions to continue and sustain its role in the future. Although a surprisingly high percentage of adults engage with formal financial institutions, given the current level of development of the financial sector, much work needs to be done to further expand access and, importantly, to improve the quality and depth of services offered to those already financially included.

In this report MAP has identified seven priority opportunities for the Government of Myanmar to extend financial access. Addressing these seven areas will require a coordinated effort across institutions, product categories and market segments, in order to ensure that the underlying market inefficiencies are adequately addressed and the opportunities capitalised on. It will also require the government to work together with other stakeholders such as the private sector, development partners and sector experts. To assist these stakeholders address the opportunities in harmony, it is proposed that a MAP Roadmap will be developed and discussed by stakeholders at a National stakeholders' meeting. The roadmap will outline in further detail the programme of action necessary to address the identified market inefficiencies, such as ensuring better regulatory support or addressing the infrastructure bottlenecks, and link these actions to existing government priority areas, such as institution development, growth of agriculture and small businesses, and poverty alleviation for low-income citizens.

1. Why financial access is important for Myanmar

Myanmar experiences moderate levels of access to regulated financial services, with take-up driven largely by credit extended through government-led initiatives. There is however very limited usage of regulated savings, insurance and electronic payment services. Access to an appropriate portfolio of financial services can improve the welfare of the underserved population by helping them conduct their financial lives more efficiently, increase income, manage risks and build up wealth over time.

Increasing access to financial services is a major goal of the Government of the President of the Union of Myanmar U Thein Sein. Although increasing such access is not an end in itself, improving access to financial services achieves higher policy objectives. Such objectives are reflected in Article 3 of the Microfinance Law and include: "reducing the poverty of grass root communities, social development, improved education and health of such communities as well as assisting them with other means of earning a livelihood including agriculture and livestock breeding, creating jobs, nurturing and cultivating a savings habit, encouraging emergence of Micro Small and Medium Enterprises (MSMEs) and facilitating cottage businesses as well as acquiring and disseminating technical know-how from local and abroad." In order to design an appropriate National Strategy for Financial Inclusion[1], it is therefore important to understand the overarching policy objectives which financial inclusion is intended to achieve. From recent pronouncements of the Government of Myanmar[2], the following are suggested as the primary policy objectives the Government seeks to achieve through improved access to financial services over the next few years:

1. ***Improved household welfare, especially in rural areas.*** Myanmar FinScope Survey 2013 (henceforth referred to as FinScope) revealed that nearly 70% of the Myanmar population lives in rural areas, where poverty is reported to be twice as high compared to urban areas (UNDP, 2011). Although contradicting signals exist, multiple sources report declining standards of living in rural areas over the past decade. The Myanmar Government recognises rural poverty as an area that needs addressing and has set a goal to reduce poverty from 26% (UNDP, 2011) to 16% by 2015 which is in accordance with Millennium Development Goal-1. This was relayed in an address to the Central Committee in 2011 by the Chairman of Rural Development and Poverty Alleviation Central Committee, President U Thein Sein (President Office, 2011).
2. ***Increase agricultural productivity to enhance food security.*** Channelling productive credit and related financial services to Myanmar's farming population is of critical importance. Increased food production will safeguard the country's limited foreign exchange reserves in that domestic food security would enable the channelling of foreign exchange reserves to investments instead of using them to import food to supplement shortages. As result, interventions to extend credit to the agricultural sector (for example through the Myanmar Agricultural Development Bank, henceforth known as MADB) should not just be evaluated from a financial inclusion perspective; it is therefore crucial to consider the larger strategic objectives being pursued.
3. ***Improve development opportunities for MSMEs.*** Most of Myanmar's informal economic activity, which constitutes approximately 57.4% (2005) of Myanmar's overall economic activity – or Gross Domestic Product (GDP), is operated through micro and small enterprises. These are found in rural and urban areas where they face similar operational and growth challenges. In both areas, most micro and small enterprises currently have to utilise expensive unregulated credit to buy

[1] A National RoadMap for Financial Inclusion in the country of Myanmar is to be released in June 2014.
[2] At the opening ceremony of the Rural Development and Poverty Alleviation Committee, His Excellency President U Thein Sein presented eight fundamental poverty addressing tasks to be performed by ministries and state organs. The development of micro savings and credit enterprises, one of the eight national development priorities, was assigned to the Ministry of Finance and Revenue. The *Microfinance Law* also states the first duty of the Microfinance Business Supervisory Committee as implementing the microfinance-related policy objectives.

stock and equipment and expand their businesses, their business risks are not covered by insurance and they typically utilise unregulated payment services for trade purposes.

4. ***Improve levels of financial intermediation through regulated institutions to fund growth and development.*** The ability of a country's financial sector to intermediate funds efficiently between those who wish to save and those who wish to invest in productive enterprises is critical for the country's growth. The absence of this deprives the country of the growth potential facilitated by intermediation. Migrating pent-up or privately intermediated savings through regulated institutions is therefore critical to the country's future growth.

2. Overview of financial sector institutions

Nascent banking sector growing rapidly. The financial sector in Myanmar has been growing since the introduction of financial sector reforms in 2008. Banking assets as a percentage of GDP have increased from 8% in 2008 to 21% in 2012 and operational costs ratios (a measure for banking efficiency) have decreased from 52% to 41% over the same time (CBM, 2012). This period has also seen the rapid expansion of infrastructure by regulated financial services providers such as bank branches, Automatic Teller Machines (ATMs) and Point of Sale (POS) devices. However, the growth has been off a small base and does not yet translate into widely available regulated financial services. Myanmar still lags behind its Southeast Asian neighbours. The financial sector landscape includes providers that can be broadly categorised into **regulated** and **unregulated** institutions.

Regulated financial services players. Regulated financial service providers are registered legal entities that are regulated for the provision of financial services. Regulated financial service providers include banks, Microfinance Institutions (MFIs), co-operatives and state-regulated pawnshops. Banks in Myanmar include local and foreign owned private banks, purely state-owned banks, banks considered as semi-private as they are co-owned by the government and banks with government representation on their board. There are five types of MFIs operating in Myanmar and include International Non-governmental Organizations (INGOs) and domestic Non-governmental Organizations (NGOs) that are donor funded and dictated to by donor interests, local for-profit MFIs, co-operatives that have registered as MFIs and lastly, foreign-owned MFIs. Co-operatives include both financial cooperatives that do on-lending and do not hold MFI licenses and agricultural co-operatives that have started on-lending to their members. Financial co-operatives include savings and credit co-operative societies, as well as bazaar and microcredit co-operative societies. Regulated pawnshops are divided into two categories, Myanmar Small Loans Enterprise's network of pawnshops and other pawnshops that are licensed by local governments all across Myanmar.

Large number of unregulated financial services providers. Unregulated financial services providers are not registered with any public authority and are not subject to any institutional, prudential or market conduct supervision in their provision of financial services. Even though legislation or regulation may exist that govern their provision of financial services, unregulated providers are not registered under such regulation. Likewise, if an entity is registered with a public authority, but no regulation exists that govern their provision of financial services the entity will be an unregulated provider. Unregulated financial services providers include rice specialisation companies, agricultural input providers, unregulated money-lenders, community-based assistance groups, *hundis* and unregulated pawnshops.

The institutional landscape is summarised in **Table 1.**

✔ Regulated financial service

✓ Unregulated financial service

			Infrastructure		Product Markets			
			Institution(s)	Branches	Credit	Payments	Insurance	Savings
Regulated Providers	Banks	Private	15	485	✔	✔		✔
		Semi-private	4	92	✔	✔		✔
		State-owned (excluding MADB)	4	332	✔	✔		✔
		MADB	1	205	✔			✔
	MFIs	NGO	19	19	✔			✔
		INGO	6	163	✔		✓	✔
		Local companies	84	84	✔			✔
		Co-operatives	75	147	✔		✓	✔
		Foreign companies	5	5	✔			✔
	Insurers	State-owned (MIC)	1	39			✔	✔
	Cooperatives	Savings and credit coop society	1469	1469	✔		✓	✔
		Bazaar Credit Coop Society	342	342	✔			✔
		Micro-credit Coop Society	457	457	✔			✔
		Agricultural co-operatives	5222	5222	✔			✔
	Pawnshops	Regulated Pawnshops registered with local government	1842	1842	✔			
		State-owned Pawnshops	184	184	✔			
Unregulated Providers		Rice Specialisation Companies	3		✓			
		Agricultural Input Providers	N/A		✓			
		Unregulated money-lenders	400000		✓			
		Community-based assistance groups	N/A	N/A			✓	
		Hundis	N/A	N/A		✓		
		Unregulated pawnshops	N/A	N/A	✓			

Table 1: Financial sector overview

Source: MMSE (2013), CCS (2013), FinScope (2013) and Supply-side interviews (2013)

3. Who is financial inclusion for?

Bulk of the population requires increased access to financial services. According to World Bank (World Bank, 2013) Myanmar is the poorest country in Southeast Asia. FinScope estimates the average monthly income to be K 93 527 (about USD 99 per month or just more than USD 3.50 per day). **Figure 1** below indicates that, of those adults who responded to the income question in the FinScope questionnaire, 43% of adults live on less than USD 2 per day, 81% on less than USD 5 per day, and just under 95% on less than USD 10 per day.

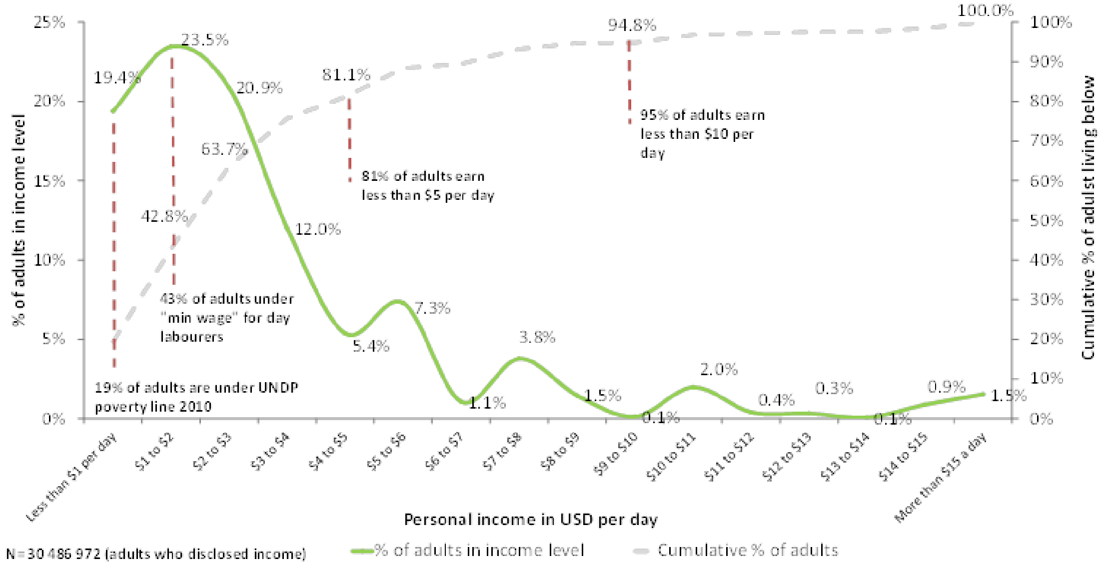


Figure 1: Income distribution

Source: FinScope, 2013

Five distinct target markets for financial inclusion with systematically different needs. Myanmar has a total population of 60.9 million (NSO, 2013) and an adult population of 39.8 million. It is estimated that 69% of the population is located in the rural areas with the remainder of the population classified as urban. Location, use of mobile phones and take-up of financial services influence the nature of the groups' demands for financial services. As shown in **Figure 2,** MAP identifies five priority target markets, segmented by their main source of income, for the extension of financial services:

- **Farmers** – are adults that reported to be self-employed (farming their own land or family land) in engagements involving crop cultivation and livestock keeping. Farmers make up the largest category of economic activity and represent their own defined target market.
- **Formal enterprises** – are enterprises that are considered regulated or licensed to operate. This segment represents adults who are self-employed and own and operate their own enterprises.
- **Informal enterprises** – are enterprises that are not licensed to operate. This segment represents adults who are self-employed and own and operate their own enterprises.
- **Formal consumer market** – consists of employees who are employed in the formal private sector (private company employees) or in the public sector (government employees).
- **Informal consumer market** – consists of adults who receive wages from the informal market (piece work or casual labourers), adults who receive a salary from informal market (salaried private individuals) and those who rely on remittances.

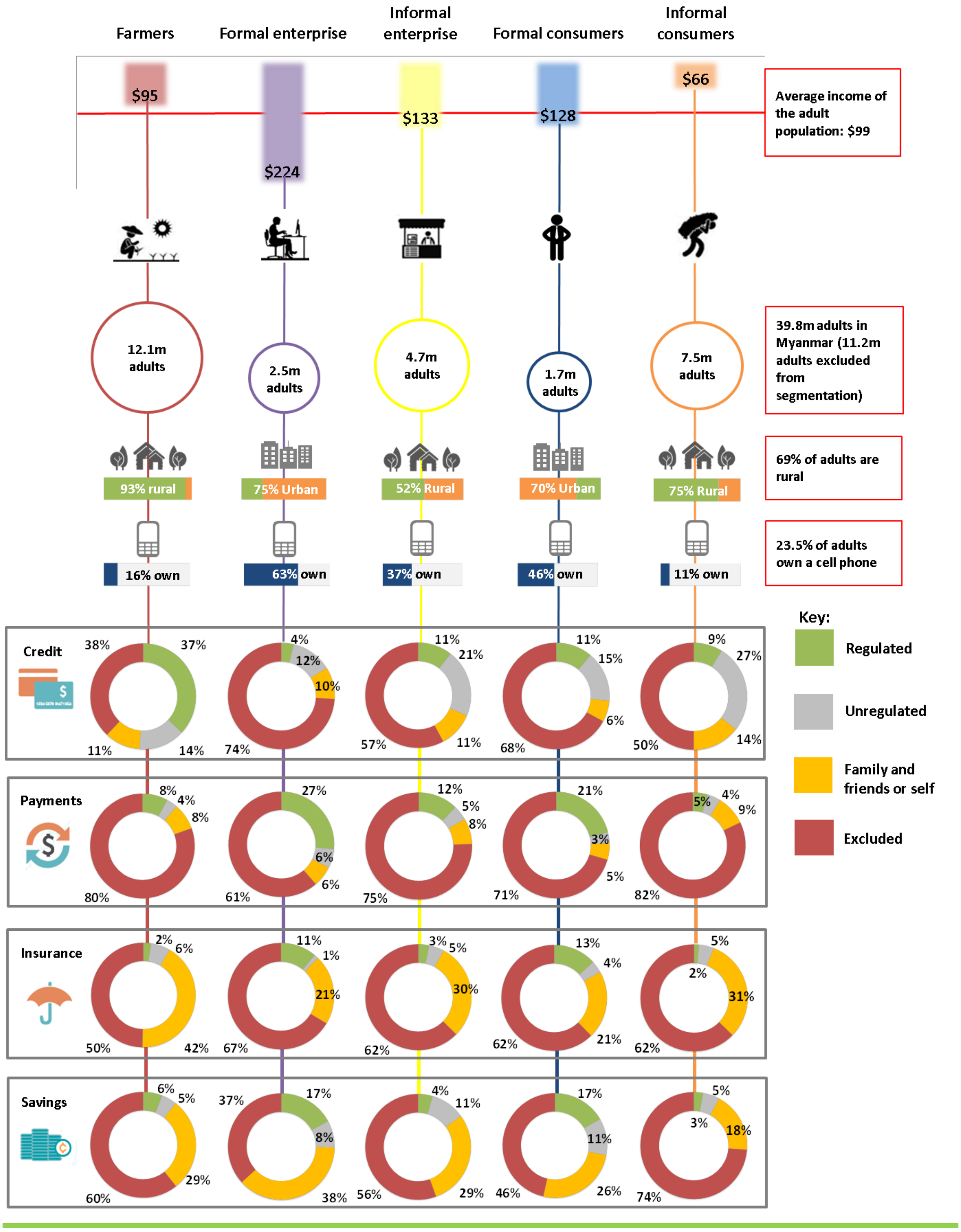


Figure 2: Target markets for financial inclusion in Myanmar

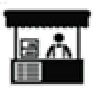
Source: FinScope 2013

 ***Farmers have high take-up of regulated credit, but unmet demand still exists***. Farmers reported high levels of access to regulated credit with 37% of Farmers reporting that they borrow from a regulated financial services provider. However, this high use of regulated credit does not translate into high take-up of other regulated financial services, with Farmers reporting low levels of regulated savings, payments and insurance. Furthermore, regulated borrowing correlates with plot size. 24% of Farmers with plots smaller than 2 acres have regulated credit. This increases to 54% for Farmers who have plots 10 acres or larger. While Farmers are the best served group for regulated credit, high levels of unregulated credit usage indicates demand for additional credit and credit products.

Farmers reported a high need for regulated insurance products. Farmers reported low take-up of insurance from regulated (2% of Farmers) or unregulated financial services providers (6% of Farmers). FinScope revealed that 42% of Farmers only rely on savings or borrowing to manage the impact of insurable risk events[3]. With regards to savings, Farmers did not report to use regulated savings extensively (only 6%), however 29% of Farmers reported saving with family, friends or themselves only. This includes saving at home in cash, saving in livestock, as well as saving in gold. The credit lines and savings used for responding to a risk event could be used for productive purposes if appropriate insurance products were in place. For example, Farmers represent an aging population and this savings could better serve the need for retirement provision.

 ***Formal enterprises reported low credit usage for productive purposes.*** Take-up of credit from either regulated or unregulated financial services providers is low for Formal enterprises, with 74% of Formal enterprises reporting to not use any form of credit. These enterprises thus rely heavily on savings, held largely with family, friends or themselves, and income to fund expansions. This represents an opportunity to develop these enterprises through the provision of working capital and asset finance. Similar to Farmers, Formal enterprises rely heavily on savings and credit to manage risk events. Developing appropriate insurance products will further allow enterprises to allocate capital to operations. Given Formal enterprises' demand for savings and payments products, and the predominantly urban location, urban banks (whether private banks or State Financial Institutions, henceforth referred to as SFIs) are best place to provide both services.

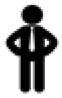
Formal enterprises reported comparatively high use of savings, payments and insurance products. Formal enterprises reported high usage of savings products with 63% reporting to save. This includes adults that save with regulated or unregulated financial services providers, as well as adults who save with family, friends or themselves. This is compared to 38% of the total adult population. Furthermore, Formal enterprises are also more likely to use regulated transactional and payment services and insurance products than the general population. FinScope reports that 27% of adults in the Formal enterprise segment used regulated payments, compared to 10% of the adult population. For insurance, 11% of adults in the Formal enterprise segment report having an insurance product with regulated financial services provider compared to 3% of the adult population.

 ***Informal enterprises usage of unregulated credit is nearly twice that of regulated***. Informal enterprises earn half of the income their formal counterparts earn, but rely much more on credit to manage their enterprises. Currently, nearly twice as many adults obtain credit from unregulated

[3] Please note, these are risks which are normally considered insurable. Insurance products that address these risks are not necessarily available in Myanmar.

financial services providers than regulated. Given the nature of Informal enterprises, it will be difficult for commercial banks to serve this group. As Informal enterprises are located in both urban and rural locations, more than one category of provider is needed to meet the needs of this target group.

Informal enterprises have high reliance on family, friends or themselves for savings and risk mitigation needs. Take up of insurance and savings products with regulated and unregulated financial services providers is low for Informal enterprise. The members of this group rely on family, friends or themselves to meet their financial service needs. Of all target groups, Informal enterprises report the second highest use of savings with family, friends or themselves at 40%[4].



Government employees have highest take-up of regulated financial services. Government salaried and wage employees show the highest take-up of regulated insurance (17% of group) and savings (22% of group) and the second highest take up of regulated payments and credit and did not appear to have significant barriers to their usage. However, high usage of unregulated savings and savings at home with family, friends or themselves, as well as unregulated risk mitigation does signal demand for additional regulated products.

Private employees have low levels of borrowing, but high take-up of insurance and savings. Private company employees have low take-up of credit from regulated financial services providers (3%). However, 10% of this group has regulated savings and 9% have regulated insurance. This group is younger, more urban and have regular incomes than the average for the total adult population. Their credit needs would predominately be asset finance and consumer credit which could be provided by private banks and leasing companies. Private banks could also be a future provider for current large unregulated savings and savings at home with family, friends or themselves. From a payments perspective, this group is likely to lead the shift to a more consumer driven market and would possibly be the first group to adopt electronic payment instruments.

Informal consumers have the lowest take-up of financial services from regulated or unregulated financial services providers. Outside of borrowing, very few adults in this target market have access to financial services from regulated or unregulated financial services providers. Almost a third of adults or 31% rely on family and friends or themselves for risk mitigation, 18% save at home or with family and friends and the bulk of the group still utilize cash for payments. Approximately 74% of the group do not save and adults rely on credit, either from an unregulated financial services provider or family and friends, to meet most of their financial needs. Farm workers and Piece or casual workers[5] had low levels of regulated savings, payments and insurance but high levels of unregulated credit, risk mitigation and savings. Given Farm workers' low income levels and location this group will remain challenging to reach in the short term. Piece or casual workers reported residing in both urban and rural areas and had higher income levels. Private employees working for an individual showed very similar usage patterns as Farm workers. This group is however more evenly split between urban and rural areas and had higher income levels. These adults will thus be more accessible to financial services providers and expressed demand for savings and insurance which can be more easily met by regulated financial services providers.

[4] Note that 11% of Informal enterprises make use of savings with friends, family and self **also** use regulated or unregulated products.
[5] The Informal consumer market consists of Farm workers, Salaried private individuals, Piece or casual workers and Remittance receivers.

The exception in the Informal consumer market is Remittance Receivers, who receive payments though a regulated institution. Remittance receivers are predominately rural and use of cash payments is problematic over long distances. A large portion of these payments are cross border transfer into the country, which indicates the need for foreign exchange functionality to payments.

4. Market findings by theme

The following section will outline six themes that emerged as part of the MAP Myanmar research and stakeholder engagement exercise. These themes serve to provide the market context to inform the opportunities and subsequent recommendations that have emerged from the MAP diagnostic.

4.1. Myanmar population is thinly-served by financial services

Majority of adults with access to regulated[6,7] financial services only make use of one product class. Although 30% of adults reported to use at least one financial service from a regulated financial service provider, only 6% make use of more than one regulated financial product class (a combination of credit, savings, insurance or payments). The remaining, 24% of adults (9.4 million) reported only using one financial product class from regulated financial services providers. **Figure 3 below** shows this breakdown of adults using financial services from regulated financial services providers and classifies adults that make use of more than one financial service as **broadly served** and those who only make use of one financial service from a regulated provider as **thinly served.** This highlights that most adults that are considered to be served by regulated financial service providers are only **thinly served** and are still candidates for financial inclusion.

[6] **Regulated** financial services providers are registered legal entities that are regulated for the provision of financial services. If a financial services provider is registered with a public authority and its activities are subject to regulation which permits it to provide financial services, whether a public authority supervises its provision of financial services from a prudential or market conduct perspective or not, it is considered a regulated financial services provider.
Regulated uptake by product class is defined as follows: Credit - Having a loan product or credit account with an SFI, commercial bank, formal (non-bank) financial institution, MFI, government scheme, co-operative or pawnshop. **Savings** - Saving with or having a savings account with an SFI, commercial bank, formal (non-bank) financial institution, MFI or co-operative. **Insurance -** Any formal insurance product (like motor vehicle insurance) with an insurance company or bank. **Payments** - Having sent or received remittances in the last 12 months via bank transfer (or paying into a bank account), ATM, the Post Office, Western Union, MoneyGram, internet/online banking or mobile phone or having one of the following accounts/products from a commercial bank: Debit Card/ATM card/MPU card, current/cheque account, foreign currency account, bank account outside the country, internet/online banking.

[7] **Unregulated** financial services providers are not registered with any public authority and are not subject to any institutional, prudential or market conduct supervision in their provision of financial services. Even though legislation or regulation may exist that govern their provision of financial services, unregulated providers do not comply with such regulation and are therefore not subject to any public supervision or control. Likewise, if an entity is registered with a public authority, but no regulation exists that govern their provision of financial services the entity will be an unregulated provider.

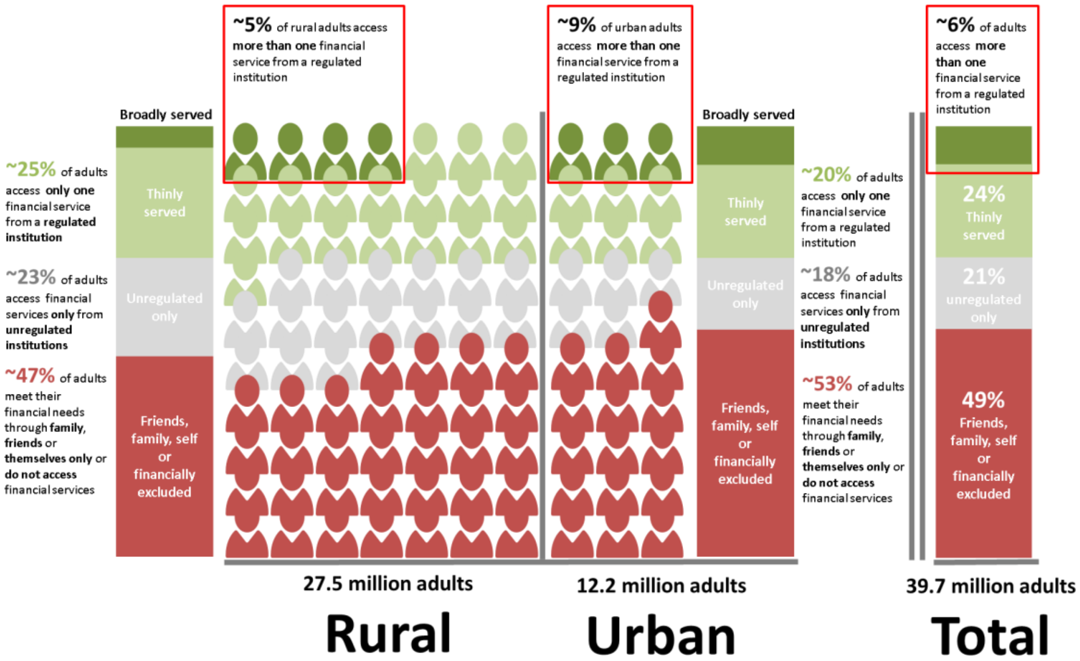


Figure 3: Nature of financial services usage

Source: FinScope 2013

The chart shows thinly served driven largely by regulated borrowing without an account and non-account based payments. Of the 24% of total adults identified as **thinly served** in **Figure 3**, 61% (or 5.8 million adults) only borrow from regulated financial services providers and 27% (2.5 million adults) use only payment services from regulated financial services providers. Adults who report only borrowing from regulated financial services providers are largely rural farmers who access agricultural credit only from MADB. Adults who report using only payments from a regulated service provider consists almost entirely of adults who indicated that they use a bank to send or receive remittances, but do not report having a bank account. These two services (adults only borrowing from regulated financial services providers and adults using only payments from regulated financial services providers) services make up 88% of the **thinly served** category.

Regulated financial services reach even the lowest-income categories. While take-up of regulated financial services correlates with income, regulated financial services reach into even the lowest-income categories. FinScope reported that 19% of adults earning less than USD 1 per day use at least one financial product or service from a regulated financial institution. This increases to 27% for those earning between USD 1 and USD 2 per day and to 31% for those earning between USD 3 and USD 4 per day.

State provision of credit drives higher take-up in rural areas. The majority of the adult population in Myanmar (69%) live in rural areas. **Figure 3** shows that despite the distribution challenges associated with rural provision in Myanmar, rural usage of financial services is significant with 53% of rural adults reporting to use either regulated and/or unregulated financial services, while 30% of rural adults reported using at least one financial service from a regulated financial provider. Financial access in rural areas is driven largely by access to credit which is significantly higher than access to credit in urban areas[8].

4.2. High levels of informality throughout economy

Large unregulated financial sector. The majority of economic activity is conducted outside of the formal sector in Myanmar. A global study examining 162 countries ranked Myanmar as having the 9th highest level of informal activity as a ratio of total economic activity (F Scheinder et. al., 2010). The financial sector is no exception, with a large proportion of services provided through entities not regulated for the provision of financial services. Of the 51% of adults who use either regulated or unregulated financial services, 64% (or 30% of adults) make use of unregulated financial services and 41% (or 21% of adults) make use of unregulated services only.

Pervasive use of cash. Nearly all transactions in Myanmar are conducted in cash, by customers and businesses alike and only a small portion are made via domestic inter-bank transfers. Furthermore, in the case of the latter, payments are most often deposited by the sender in cash and withdrawn by the receiver in cash, with neither having an account relationship with the bank. The development of electronic retail payments is undermined by inadequate infrastructure, which is characterised by an unreliable power grid, inconsistent communications networks and low penetration of electronic touch points (such as ATMs and POS).

Unregulated financial institutions constitute the largest source of borrowing. **Figure 4** shows that 9.2 million adults reported to have a loan from an unregulated financial services provider, with an estimated total outstanding debt as high as K 5.4 trillion (USD 5.7 billion). Of these adults, 5.9 million adults (64% have a loan with an unregulated provider) indicated that they currently have outstanding loans from a money lender. The total outstanding debt provided by unregulated money lenders is estimated to be as high as K 3.7 trillion (USD 3.9 billion). In size, this compares with the outstanding loan book of the commercial banking sector, which is estimated to have 60 000 credit clients. Money lenders are therefore providing a significant proportion of loans to the market.

[8] FinScope reports that 44% of rural adults have outstanding debt from either a regulated or unregulated financial services provider. This is significantly higher than urban areas where only 19% of adults currently have credit from regulated or unregulated institutions.

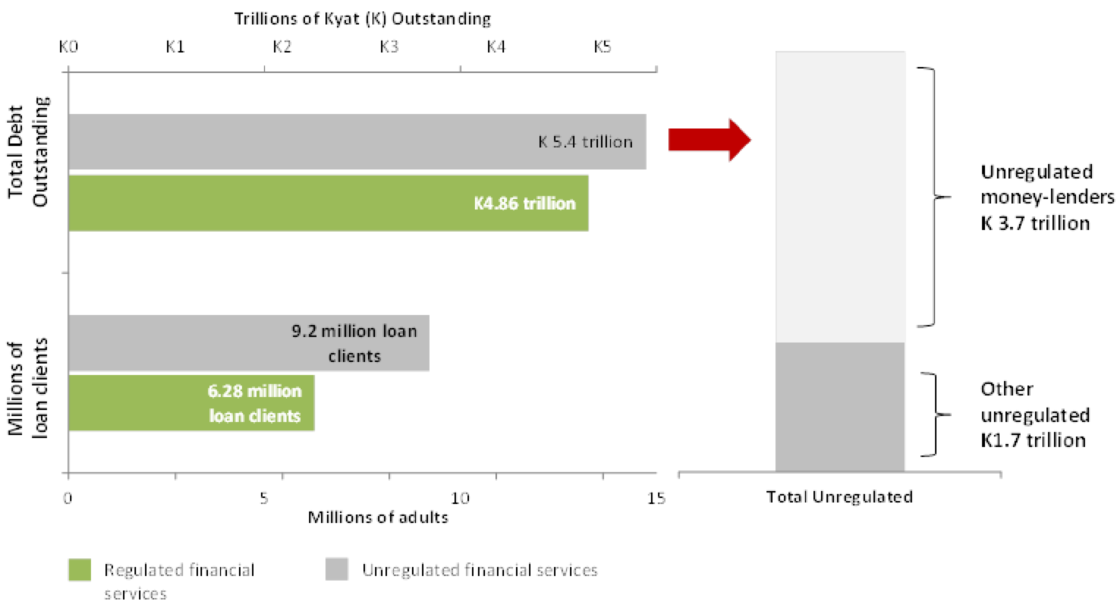


Figure 4: Unregulated credit activity by number of loans and outstanding loan stock

Source: FinScope 2013

Positive consumer perception of financial services offered by unregulated institutions. Focus Group Discussions (FGDs) respondents revealed positive perceptions about using financial services offered by unregulated financial services providers such as money lenders, (unregistered) pawnshops, savings groups and *hundis* because they felt that these were more convenient and that the requirements set by regulated financial institutions excluded low-income earners. Respondents indicated that although unregulated providers charged high interest rates for credit, they were the preferred choice because of their proximity, flexible operating hours, immediate relief and negotiable borrowing terms.

Pervasive and sophisticated unregulated financial sector. Based on a conservative estimate of an average of 15 outstanding loans per money lender, FinScope take-up data[9] would suggests that there are about 400 000 money lenders (constituting 1% of the adult population) operating in Myanmar[10]. This is nearly 100 moneylenders for every 100 000 adults, which represents the largest distribution density of any credit provider in Myanmar. Money-lenders include potential savers who opt to intermediate funds themselves by loaning out their excess capital to friends, family and other community members. Sometimes, money lenders make use of unregulated 'brokers' who charge high fees (e.g. 10% of the interest) to introduce them to prospective clients. In the market for unregulated payments, 'payment brokers' or *hundis* also exist where regulated providers are unavailable or unsuitable. *Hundi* networks are located throughout Myanmar and they provide payments services to augment and leverage their primary business (e.g. shipping). *Hundis* use a variety of regulated and unregulated mechanisms to provide domestic and cross-border payment services payment services to clients.

[9] Indicating 5.9 million adults with a loan from a money lender
[10] Even if a much higher estimate of 50 loans per money lender on average is used, the number of moneylenders in Myanmar would still be substantial at 117 000.

4.3. Capital constrained regulated retail financial sector

Capital constraints restrict the extension of regulated retail credit. The regulated retail credit market is restricted by the limited capital available for on-lending. Some MFIs reported bureaucratic hurdles in getting foreign donor capital into the country. Outside of the microfinance sector, foreign ownership in the financial sector is not yet allowed and with it, foreign direct investment and capital. Furthermore a number of constraints also limit the nature and availability of domestic capital. These constraints can be attributed to policy, regulatory and business model features (as discussed below) and the absence of a capital market in Myanmar[11]. As result, the regulated financial sector is currently completely dependent on short-term deposits as sources of capital. In addition, restrictions on the use of available capital, such as the loan to deposit ratio restriction for commercial banks[12], have further restricted the availability of funding for on-lending. At the time of this analysis, the funds available for on-lending was practically fully utilised triggering branch expansion strategies by commercial banks to raise more deposits.

Scarcity of capital dictates institutional focus and product offering. As a consequence of the scarcity of capital, institutions without a specific low-income client mandate will direct capital to more lucrative opportunities in the high-income and corporate markets (for instance see commercial banks below). At the same time those institutions that have a low-income mandate can only serve a small proportion of the potential market. From a consumer perspective, clients who are unable to access regulated credit are resorting to more expensive financial services from unregulated institutions. Given the short-term nature of deposits funding loan portfolios, no long-term credit products are offered.

Commercial banks are unlikely to direct capital towards the lower-income retail market soon despite being well positioned. Only commercial banks and MEB have proven able to attract voluntary deposits. Although commercial banks have the largest loan portfolio[13], the bulk of this is being directed to corporate clients and to some degree the high-income retail market[14]. Given the high-income and corporate opportunities available, it is, however, unlikely that this capital will find its way to the low-income market in the near future. The recent introduction of hire purchase loans could potentially open a channel for commercial bank capital to flow to the lower-income retail market (e.g. through financing products of relevance to this market, e.g. scooters or farming machinery). However, take up of hire purchase has not proven to be significant so far. Outside of hire purchase loans, banks do not have the lending tools appropriate to lower-income consumers – particularly as unsecured lending is not allowed -and have no experience in this market. In theory (and, if regulation permits) banks may be able to provide wholesale funding to MFIs, but given current high-income and corporate opportunities, there is little incentive for banks to pursue this market.

Significance of directed capital to the lower-income retail market. Outside of pawnshops, the largest proportion of capital funding for regulated low-income credit are under policy direction (52% excl. pawnshops[15]) and consists of MEB providing wholesale funding to MADB[16], as well as the foreign

[11] There is currently no private capital market, but the passing of the *Securities and Exchange Law* opens the way for the establishment of a stock exchange.
[12] The deposit-capital ratios for commercial banks have been abolished but loan to deposit ratios of 80% remain in place.
[13] Commercial banks provide almost 80% of regulated outstanding loans by loan volume.
[14] FinScope found the average monthly income of commercial bank credit clients to be almost 9 times as high as the average income in Myanmar, while the average loan was around 1000 times higher than most other categories of providers.
[15] Compared to current outstanding loans of MADB, all co-operatives, MFIs and Rice Specialisation Companies.
[16] Current outstanding loans for MADB (2013) was K 193 billion while K 543 billion was disbursed in loans to MADB in 2013 and, at the end of that financial year, it constituted just over half of MEB's loan portfolio.

funding raised by government that is channelled to agricultural co-operatives[17]. The largest component is flowing through MADB, making them the primary vehicle for directed lending. Another 25% of capital funding to the regulated low-income credit market is MFIs (if pawnshops are excluded), the largest part of which is directed donor capital.

Scope to increase policy directed retail capital reticulation. MEB currently lends out only 11% of its deposits with the remainder understood to be held in government treasury bonds. MIC is required to keep all its assets in government bonds and the same requirement is being applied to newly-registered private insurers. This represents a substantial amount of capital that is under the control of government, but not yet intermediated into the credit market. Policy consideration would have to be given to whether government is willing and able to reduce its reliance on this capital for budgetary funding in favour of growth in the credit market. In addition, the state has been able to raise additional capital directly from foreign sources. Most recently, the government raised a USD 600 million loan from China that is used to provide wholesale funding to extend the reach of co-operatives.

MFIs play a smaller but important role given scarcity of other sources of capital. Capital reticulation through MFIs only make up an estimated 11% of the retail credit market (25% if pawnshops are excluded) and are largely donor funded. Regulation restricts their ability to raise capital through deposits as deposits may only be taken from loan clients and to the value of the loan, while the current interest spread on deposits also render it unviable as a source of funding. MFIs have also reported challenges in obtaining regulatory permission to raise more foreign donor capital. This has proven to be a primary constraint inhibiting the extension of credit, as recent growth seems to be driven more by the availability and/or release of funding rather than explicit expansion strategies. If the barriers to raising more donor capital could be removed, MFIs could play a more significant role.

Challenges in mobilising capital from unregulated market. The size of the unregulated credit market highlights the magnitude of liquidity housed outside of regulated financial institutions. Unregulated money lenders are estimated to have in excess of 5.9 million clients with an outstanding loan volume as high as K 3.7 trillion (USD 3.9 billion). Unregulated provision represents surplus capital in the unregulated market which is being reticulated there because of higher returns. At present, MEB and commercial banks are the only regulated institutions that could potentially target the capital in the unregulated financial services market. MEB is unlikely to leverage this opportunity (given its lack of an MIS system and current specialisation as a wholesale capital provider), while commercial banks do not currently offer convenient products that are likely to attract this capital, although they are attracting more deposits when opening new branches.

Limited human capital for the financial sector to draw upon. McKinsey estimates that the financial services sector could contribute up to USD 11.1 billion to GDP by 2030 and generate 400 000 jobs (McKinsey & Company, 2013). The financial sector is heavily dependent on skilled labour, particularly the nascent insurance industry and it is doubtful whether Myanmar can produce enough skilled labour to meet this demand. FinScope revealed that only 7% of respondents reported having higher education. This is supported by McKinsey's study which found that only 5% of the country's workers had tertiary and higher education credentials in 2010, and only 15% had finished secondary education. This is extremely low compared with other developing countries in the region[18] and has the potential to restrict growth of the financial sector.

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[17] Current outstanding loans by agricultural co-operatives as at July 2013 was K 23.8 billion. China and the Government of Myanmar agreed to finance USD 600 million in the next 3 years for agriculture, to be disbursed through co-operatives.
[18] Thirty percent of workers in Vietnam and Thailand have a secondary education; in Indonesia, the share is almost 50 percent, and in China and Malaysia, it is about 60 percent (McKinsey Global Institute, 2013).

4.4. Limited infrastructure constraining business model and product offering

Severe physical infrastructure inadequacies amplify distribution challenges. Inadequate infrastructure limits the reach of existing financial service offerings by creating barriers and increasing transaction cost for consumers and limiting the viable expansion of financial service operators. In 2010, Myanmar had the lowest road density in Southeast Asia with 41.3 km of road per 1000 m^2 and only 11.9% of the 27 000 km of road network was paved (UNESCAP, 2012). Furthermore, Myanmar has the lowest per capita electricity production in Southeast Asia with 104 kWh per capita. It is estimated that only 48% (UNDP IHLCA, 2010) of households have access to electricity, which suffers regular black-outs. There is a sharp rural urban divide with 89% of urban households having electricity compared with only 34% of rural households. According to FinScope, 3% of adults used the internet in the month prior to the survey (Sept 2013).

Financial services providers in the early stages of adopting electronic management systems. Financial services players are at different but early stages of modernising their Management Information Systems (MIS). Most institutions are still heavily reliant on onerous paper-based or other manual processing of product origination, payments, account management and reporting.

- **Commercial Banks.** As of May 2013, four of the private banks, driven by an interest in foreign exchange transactions, were in the process of adopting core banking systems and were transitioning to their use. Most banks branches were also "offline" except for a subset of branches in particularly active commercial (urban) areas that were connected through internal online platforms.
- **SFIs:** Despite serving the largest number of retail clients, none of the SFIs have electronic MIS systems and their branches are not connected. For example, MADB's operations are almost entirely paper based yet it has the largest loan client base in Myanmar. Similarly, MEB holds the largest number of voluntary deposits in Myanmar but does not operate on a core banking system.
- **MFIs:** INGO MFIs operate on a variety of MIS systems ranging from largely paper-based (e.g. GRET) and Excel-based systems (Myanmar Microfinance, Save the Children and Private Agencies Collaborating Together (PACT) who are looking to move to a more advanced MIS system) to more advanced MIS systems (World Vision installed the Kredits MIS system in late 2012). Some of the domestic MFIs have also obtained donor support to implement microfinance MIS systems (e.g. MicroBanker Win).
- **Insurers:** MIC is in the process of transitioning to an electronic MIS system but is currently still largely paper based. Conversion to the MIS system is done by product line. 3rd party insurance was the first line to be transitioned to the MIS system and fire and life insurance was planned for the next phase. The system was locally developed in a joint venture with the Ministry of Communications and Information Technology.

Limited supporting financial sector infrastructure. Myanmar authorities are moving towards building supporting infrastructure. This is evidenced by the development of a national payments network and other planned initiatives.

- **Credit bureau:** Myanmar currently has no credit bureau, which means that there is no formal mechanism to establish indebtedness of credit applicants. Plans are however underway for the establishment of a credit bureau by the Central Bank of Myanmar (CBM) with the assistance of Credit Bureau Singapore (The Irrawaddy, 2014a).

- **Payments systems:** Payments infrastructure is still underdeveloped (current POS devices have a 90% down time) but it is slowly being redressed, through efforts by the Myanmar Payment Union (MPU) and the CBM. Recent developments include a national switch for ATMs that started operating in December 2012 (operated by MPU, and POS devices have been in operation since March 2013. All banks are required to join the switch. In the near future, a private payments processor will be appointed and a Real Time Gross Settlement (RTGS) system will also be operated by the CBM to replace the current manual payments clearing system. Moreover, Association of Southeast Asian Nations (ASEAN) aims to achieve financial integration by 2015 (ADB 2013) and this would also require Myanmar's integration into the ASEAN Payment and Settlement System.
- **Capital market:** There is currently no formalised capital market in Myanmar, and businesses rely solely on banks to raise capital (in the form of debt). The new *Securities and Exchange Law* that was passed in July 2013 allows for the establishment of the Yangon Stock Exchange, which is expected to be operational by the second half of 2015 (The Irrawaddy, 2014b).
- **Foreign exchange market:** Although Myanmar has a regulated foreign exchange market; it is still in the early stage of development. Fourteen private banks were licensed to become authorised dealers of the US dollar, Euro and Singapore dollar in October 2011 (Global Times, 2013). In April 2012, Myanmar converted to a managed float exchange regime after having had a dual exchange rate regime for decades and efforts are underway to further liberalise to a free floating exchange regime. Despite the developments, industry consultations revealed that accounting for the amount of foreign currency in the country at any time is still problematic.

Inadequate infrastructure hinders business models from achieving scale. The combined limitations on infrastructure and rudimentary MIS systems will take time to resolve and require substantial business model and process adjustments from the financial service providers. It is likely to continue to restrict the nature of business models and product offerings in the medium term[19]. These restrictions increases costs and inefficiencies and create absolute barriers for some models and products. As a result, it undermines the scale, variety and value of existing offerings. Given that it will take time to resolve these issues, there are still opportunities to further leverage the limited business models that have been successful under the current constraints. In the short-term, this will favour decentralised and group-based credit models but with the continued limitation that this model is only suitable to simple credit products for particular market segments. In the longer term, however, business models utilising electronic networks and centralised processing will gain advantage as they allow for a more advanced and tailored product offering.

Mobile payments have the ability to bridge current infrastructure challenges. Following market liberalization, mobile phone penetration in Myanmar has rapidly expanded from 0.15% in 2003 to more than 23% of the adult population (approximately 15% of the total population) in 2013 (FinScope 2013). This growth is expected to continue in the coming years, especially in consideration of the recent award of licenses' to Norway's Telenor and Qatar's Ooredoo which have a particular history of integrating mobile payments into its operations as evidenced[20] by its operations in Pakistan. The two mobile network operators have committed to reaching 50% coverage by 2015 (teledensity) and 90%

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[19] While MADB and PACT has been able to achieve scale despite these restrictions, this has been achieved on a subsidised basis and their product offerings have been restricted to group-based products where the risks are assessed through decentralised village credit committees. They are unable to viably offer more advanced credit products and particularly those that require individualised credit assessment and management. For the credit market in general, more advanced credit products can only evolve once the bank systems and credit bureau is in place. As result, the CBM has determined that banks will only be allowed to enter the unsecured lending market once the credit bureau is established. Real- or near-real-time transactions are virtually completely absent in the market. The absence of such payment infrastructure has undermined transaction flows and particularly the development of the insurance market, which rely on the collection of frequent low-value premiums.

[20] http://www.easypaisa.com.pk/index.php/en/about/about-easypaisa

population and 80% geographic by 2019. Both have also committed to providing mobile financial services and are preparing to launch these services in late 2014 or early 2015.

The mobile phone offers multiple benefits that will address critical infrastructure gaps in Myanmar. These include:

- **Firstly, mobile networks enable real time connectivity, for voice and data traffic.** There is currently no comprehensive and reliable real time connectivity between financial institutions in Myanmar. This further exacerbates the obstacles facing the development of a RTGS system and usage of core banking systems by commercial banks. Providing this connectivity alone will transform the way financial services are offered in Myanmar. Payment services in particular are likely to benefit significantly, particularly where electronic transactions are expected to become a viable alternative to cash. The immediacy of in-person cash transactions is an important characteristic that electronic payments must seek to replicate in order to become a viable alternative to cash.

- **The second opportunity is in the mobile device itself, which provides all the functions of a POS device without the need of a separate card**. This enables customers to issue payments instructions themselves, check balances and receive confirmations (i.e. payment sent or received). This brings the payment terminal that traditionally has required a bank branch or merchant outlet into the hands of the customer, providing control, convenience and accessibility similar to that of cash. Thus it increases the likelihood that customers will adopt electronic payment services. An additional attribute is that the mobile phone is commonly purchased by the customer, thus reducing the infrastructure costs[21] normally taken on by financial institutions.

Mobile phones do not void the need to invest in traditional payments infrastructure. Mobile phones are not a complete replacement of the existing infrastructure such as ATMs, POS and bank branches and will, in fact, rely on much of this infrastructure for cash distribution and management. Rather, mobile infrastructure provides an alternative means in which customers can engage in the payment system. This allows for a more diverse set of business models that can service the target markets for financial inclusion.

4.5. Constrained product offerings undermines value to customers

Constrained product offerings do not meet consumer needs. The combined effect of market and regulatory constraints discussed above restrict the availability of products and their features. Consequently, consumers resort to using either unregulated products or regulated products that do not adequately match their financial needs.

Two types of mismatches between product and needs are of particular relevance for this discussion:

1. **Using the incorrect financial service type:** This occurs when a particular financial product category is used when in fact a different category may be more efficient to address the particular financial need. For example using credit to mitigate insurable risks where insurance may have offered a more efficient solution.
2. **Using the appropriate financial product category but incorrect product:** This occurs when the correct product category is used but the product features of the particular product are not suited

[21] For example liquidity in the banking system is freed up as the “local” cash is circulated more effectively, while the daily float maintained at the respective financial institutions keeps track of transactional balances electronically.

to deal with the financial need the user is seeking to address. For example using short-term credit to finance long-term investments.

Examples of such mismatches in Myanmar include:

Credit and savings being used to mitigate risks. Few individuals in Myanmar have either a regulated or unregulated insurance product (3% regulated and 4% unregulated only). As result, for example, a substantial proportion of Farmers (42%) had to resort to using credit or savings to cope financially after having experienced an insurable risk for which they did not have a regulated or unregulated insurance product. The use of credit or savings to deal with these risks is more costly and less efficient than if, for example, an insurance product was to be offered to all MADB clients. In addition, it means that credit is directed to risk management instead of the productive purposes for which it was obtained. Using savings, in turn, reduces the assets accumulated by households and leaves them more vulnerable for future shocks.

In this case, the absence of insurance reflects the underdeveloped market as well as regulatory restrictions on the types of insurance products that may be provided. Currently Four of the six main insurable risks[22] reported to be experienced by the largest proportion of adults are agricultural related, while the most commonly reported risk is related to medical expenses. Between 38% and 69% of adults who experienced these 6 largest risks reported using savings or credit as response mechanisms (see **Figure 5** below). Yet MIC does not offer agriculture or health insurance and it is also not included in the product lines allowed by regulation for newly registered private insurers.

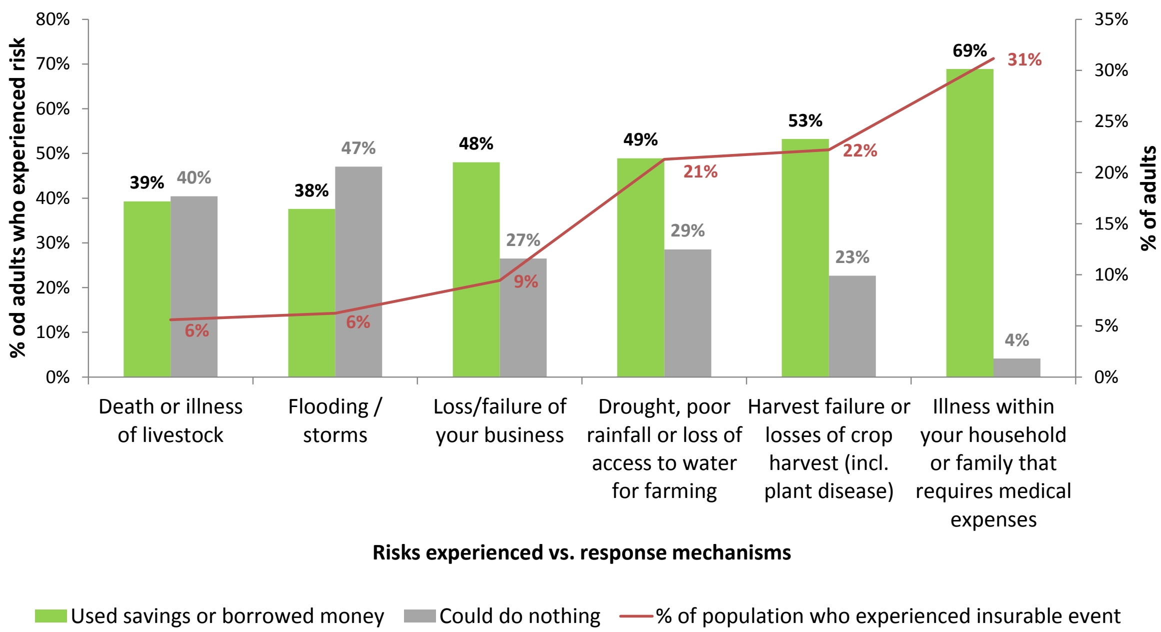

Figure 5: The most commonly reported insurable risks experienced versus risk mitigation responses

Source: FinScope 2013

Product and service features of regulated products do not match consumer needs. There are a number of issues with the product and service features of regulated financial products that do not adequately address the intended use. These include:

[22] Risks that normally would be considered insurable or for which insurance products exists in well-functioning insurance markets.

- **Timing of delivery and repayment of MADB loans:** Qualitative research revealed that MADB loans are often not dispersed in time to finance the necessary preparations for the planting season and loan repayment is due when the crop prices are at their lowest (immediately after the harvest). Consequently, farmers are often forced to source additional credit, mostly from unregulated money lenders, at a high cost as an interim financing measure. Until recently, these loans were also too small to address the financing needs of farmers, resulting in farmers having to finance the gap through unregulated money lenders. This has been partially addressed through the introduction of incremental increases in loan sizes over the last few years.
- **Low-income retail credit products not suited for asset financing or longer-term investment:** Current co-operative and MFI loan products are best suited to finance working capital for high-turnover trade businesses (typically small traders) that can manage high repayment frequencies (daily, weekly or bi-weekly). Loan values are very low, terms are short and group guarantee structures renders it unsuitable for more advanced and individualised businesses[23]. These loans are useful for high turnover traders as they enable these to grow to larger micro-enterprises but these will then require larger, longer-term and arguably individualised loans to grow further. These loans are not suited for investment in equipment or for businesses with slower turnover cycles.
- **Restricted payments functionality and infrastructure undermines value and utilisation of bank accounts.** Only 5% of adults have a bank account. Consultations with the banks have revealed that a large proportion of account holders only use the account to receive their salary and withdraw the full amount in cash. Given the limited payments infrastructure, bank accounts are not yet a useful or viable transaction tool for consumers. While the banking infrastructure is expanding, physical proximity remains an issue, particularly for deposits. The transaction cost and effort incurred in accessing a bank branch to withdraw or deposit money renders it unviable as a useful tool for collecting small amounts of regular savings. FinScope data have shown that consumers are willing to travel longer distances to obtain loans (e.g. only 20% of MADB clients are within 30 minutes of a branch) but adults who have taken-up a deposit facility are found in much closer vicinity to bank branches (71% of bank clients are within 30 minutes); it's likely that proximity is a key terminate in take-up decision. This may, in part, explain why MADB is unable to raise voluntary deposits, but commercial banks are. The development of the mobile payments market will greatly enhance this but it will also require revisions to the banking products and model.

Unregulated products provide features required by key target group at a higher cost. As noted above, there are various market and regulatory constraints resulting in regulated products either not being available or with features not suited to the needs of consumers. In such cases, consumers resort to using unregulated products to meet their needs. These unregulated alternatives come at a higher cost, bear more risk and are less efficient. The following examples have been identified:

- **Agricultural credit features and requirements not meeting all needs in the agricultural market.** There are a number of features of agricultural credit products which exclude certain groups of farmers and/or limits the degree to which the product matches financing needs. As result, these farmers have to utilise high-cost unregulated credit to make up the gaps. These features include:
    - **Size of farm**: In most cases, regulated financial institutions provide partial finance based on farm size. MADB provides a set rate of finance per acre for farmers with land of up to 10 acres. Co-operatives covers up to a maximum of 5 acres for farmers with up to 10 acres of land and a maximum of 50% of acres for farmers with over 10 acres. PACT restricts its credit

[23] However, there is limited graduation of co-operative and MFI loan clients, with some MFI loan clients (although very few) becoming eligible for individual loans. As the market develops it is anticipated that MFIs will introduce asset finance.

to farms of up to a maximum of 5 acres in size. A large proportion of farmers have farm that are 10 acres or larger[24], with a large proportion of them also being relatively low income[25]. Therefore, a large group of potential low-income retail credit clients are therefore excluded (or partially excluded) from accessing regulated credit for agricultural production.

- **Size of loan**: MADB currently provide loans up to K 100 000 (USD 106) per acre. There are differences of opinion about whether this address (or even exceeds) the full financing requirement per acre with estimated financing requirement ranging from K120 000 (USD 127) to K 300 000 (USD 317) per acre to cover production costs. The financing requirement is highly dependent on the quality of seed used and the production method applied. If current loan amounts are insufficient to cover production costs, individuals would also be forced to supplement regulated credit with unregulated credit to meet their financing needs.
- **Restrictions on crop**: The bulk of MADB loans are earmarked for paddy production. As result, farmers who are not involved in paddy have much lower access to credit[26]. Only 12% of farmers farming only beans and pulses (but who are not also involved in paddy or cereals) have MADB loans.

- **Regulated loan sizes not catering to the needs of all MSMEs:** There is a substantial gap in the credit market between commercial banks and MFIs in terms of loan sizes. MSME credit through MFIs is has been limited by regulation to K 500 000 (USD 529)[27] while the average loan issued by commercial banks are in excess of K 70 million (USD 73 996) and mostly inaccessible to the lower-income and small business market[28]. This leaves a substantial gap between K 500 000 and K 70 million, which is only serviced by unregulated money lenders. FinScope data confirms this as the average loan size reported by those who have a loan from an unregulated money lender only is K 635 000 (USD 671). Hire purchase products recently introduced by the banks can potentially narrow this gap, but its impact is yet to be seen.

- **Uncollateralised individual loans accessed through unregulated sector:** A prominent feature of regulated credit products is that all loans are either dependent on collateral (commercial banks and pawn shops) or are group-based (MFIs, co-operatives and the MADB). Small and Medium Industrial Development Bank (SMIDB) receive discounted funding for loan provision to MSMEs from MEB, but indicated that the requirement of collateral was a major constrained in their extension of loans to MSMEs. INGO MFIs do provide a limited amount of individualised loans, but these are small in both value and number and do not make a significant contribution to the market. In reality, the only source for uncollateralised individual-based loans is unregulated money lenders.

[24] There are 2.1 million adults (698 000 households) involved in farming who indicated that they have farms that are 10 acres or larger

[25] 46.5% of these adults indicated that they earn less than USD 5 per day

[26] Only 12% of those who are not involved in paddy or cereals, but are involved in beans and pulses have MADB loans, while only 12.7% of those who are not involved in paddy or beans and pulses, but who are involved in cereals have MADB loans.

[27] Co-operatives only provide loans up to K 300 000 (USD 329). MFIs mostly provide loans of up to K 500 000 due to Government focus on implementing a cap at this level, but with some isolated cases of loans as high as K 1.7 million (USD 1 797).

[28] Although banks now have introduced a product that start as low as K 100 000 (USD 106), average bank loans is estimated around K 170m (USD 179 704) suggesting that the bulk of loans are at very high values.

4.6. Current regulatory environment not enabling expansion of rural provision and discouraging delivery to urban poor

Government has identified rural delivery as a key target market for FI. As noted in **Section 1**, the Myanmar Government recognises rural poverty as an area that needs addressing and has set a goal to reduce poverty to 16% by 2015. Financial services have been identified as an important tool for achieving this goal.

Rural markets challenging to serve on sustainable basis. Enabling the sustainable delivery of appropriate financial services to rural markets remains a challenge in the most conducive of environments. In Myanmar, the combination of severely limited infrastructure (see **Section 4.4**) and the underdeveloped nature of financial services models and products (particularly the absence of payments system); see **Section 4.1** and **Section 4.5**, makes rural delivery particularly challenging. Given the scarcity of capital (see **Section 4.3**) and resources and the abundance of urban, high-income opportunities, resources, unless mandated otherwise, will not be channelled to rural and low-income markets.

Rural take-up of financial services relatively high, but substantial needs remain unaddressed. As noted in **Section 4.1**, rural markets in Myanmar show a relatively high take-up of regulated financial services and, in particular, credit. At the same time, it is clear that much of the rural financial services need remains unaddressed or insufficiently addressed (see **Section 3**). Further expansion is, therefore, required.

Current rural models driven by mandated capital and subsidised operations. The current rural penetration is driven exclusively by subsidised state and donor models which are funded almost exclusively by mandated wholesale funding (i.e. MADB and PACT[29]). No purely commercial offering have achieved any significant scale and there is no evidence that any provider is poised to do so for the foreseeable future. No privately controlled capital has found its way into low-income or rural financial services.

Constraints introduced in regulation will deter even mandated and subsidised operations from challenging rural markets. Even for these mandated and subsidised models, rural delivery remains a challenge. Despite their mandate and subsidy, the current interest rate caps, loan size and capital regulations and the higher cost of rural provision are resulting in a withdrawal of certain NGO MFIs from more challenging low-income and particularly rural markets. This is particularly the case for smaller and newer entrants who have not yet achieved the level of scale and experience to be able to operate under these challenging conditions.

Policy stance discourages urban delivery. Although urban consumers on average have higher incomes, there are still significant numbers of low-income consumers located in urban areas (e.g. 48% of Informal enterprises). Furthermore, the productive opportunities given access to financial services is arguably higher in urban areas than in rural. There is therefore both a significant need for poverty alleviation as well as efficient opportunities to impact on poverty alleviation (through employment creation) in urban areas. However, the regulatory implementation emphasis on rural areas are discouraging MFIs from urban areas.

[29] Both government and donors have mandated the delivery of services to low-income and rural consumers.

5. Opportunities to increase access to financial services

MAP identified seven priority opportunities to extend financial access to the people of Myanmar.

5.1. Dramatically increase the supply and availability of electronic payments

Pervasive use of cash across all target markets. The vast majority of the people of Myanmar use nothing else than cash for payments. In most countries the majority of formal employees would use electronic payment instruments. However, in Myanmar, only 21% of Formal consumers use regulated payments, not all of which is electronic. For Farmers, electronic payments are almost non-existent as 92% of Farmers that report making payments, make payments using cash only. The main reason for this limited use of electronic payments is the absence of electronic payments infrastructure, especially in rural areas where there is virtually no points of access for electronic payment instruments. ATMs, POS devices and the like are available in urban areas only but even there the networks are still severely restricted. The largest current use of regulated payments is for remittances, for which 38% is made via bank transfers. However, even these transfers can be considered cash-based, as adults need to physically bring cash to the bank and little effort is made by banks to convert these into account clients. This represents a lost opportunity for banks to reduce cost of processing cash-based payments and sell adjacent products to remitters. Furthermore, almost all cross-border payments are made through unregulated *hundis*. This applies to retail as well as corporate clients. This presents an opportunity for commercial banks to add a major source of income if they are able to attract these clients.

Efficient electronic payments required to enable transactions and savings. The need for electronic payments is growing rapidly. The most immediate and pressing demand for retail electronic payments will flow from the need to buy pre-paid airtime electronically in the wake of the roll-out of mobile services. This will follow the pattern in other countries. However, much of the future development of regulated financial services depends on the introduction of accessible, low cost, electronic payments. Migrating savings from outside of regulated institutions to regulated institutions will not happen unless households can save and withdraw small amounts regularly, conveniently and cheaply. Given the current limited branch infrastructure outside urban areas, this will not happen without remote electronic access. Similarly, the extension of low-value credit and the collection of small insurance premiums become commercially viable on the back of low-cost electronic payments.

In order to expedite the development of the payments system and optimise its benefits for low-income consumers, the following options can be considered:

Fast-track introduction of electronic MIS systems for commercial banks, SFIs and other providers. The first hurdle to cross on the road to a ubiquitous electronic payments infrastructure is a systems one. Most banks, including state banks, do not have automated electronic core banking systems. Installing such systems, a current priority for all banks, is the first step. It is particularly important that MEB also install such systems since it currently is one of the largest payment providers in Myanmar.

Pursue the coordinated development of payments infrastructure under the guidance of a National Payment System Strategy. In tandem with the internal systems of financial service providers, it is necessary to install national electronic infrastructure for real time settlement of interbank payments as well as retail payment networks (see **Section 4.4**). Several components of the system are in the process of being developed under the guidance of the CBM. To mitigate the risk of ad hoc development and the emergence of proprietary payment networks that are not interlinked, it is necessary to develop a National Payment System Strategy to guide participants in the emerging Myanmar payment system (see **Section 4.4**).

Consider the space for non-bank third party payment providers. Commercial banks and the MEB are currently the only providers of retail electronic payments, with commercial banks having installed virtually all ATMs and POS devices. The extension of this network will be gradual and probably branch-linked. Should the space for non-bank third party payment providers be created, Myanmar could follow the lead of other developing countries that have leveraged the distribution networks of convenience stores and pawnshops. This will of course require real-time connectivity of these stores.

Mobile payments provide biggest opportunity for extension of retail electronic payments. . The opportunity for a quantum leap in access to electronic payments lies in the emerging market for mobile payments. The adoption of the *Directive on Mobile Banking* in December 2013 opens the way for banks and financial institutions to deliver financial services through mobile banking. It is too early to predict the manner in which banks and mobile network operators will co-operate to deliver such services. However, the parameters set by the Directive would seem to create ample space for the emergence of a mobile payments network that can become the front end of the retail financial sector. Of particular importance will be the establishment of agent networks to convert cash into electronic money and vice versa. Cash-handling retail entities like the Post Office and grocery or convenience stores can play a role in this regard. The role of the MEB as the current cash manager of the country will also be important. This makes modernising the MEB's systems a top priority.

5.2. Provide low-cost savings vehicles for short term savings

Need for store of value as key driver to attract savings into regulated sector. Myanmar has a great need to draw whatever savings is available into the regulated sector to improve the level of financial intermediation. However, much of current savings is held outside of regulated financial sector in the form of cash or assets. For every one person that saves in a regulated institution, five persons save in an unregulated institution or at home. Unregulated moneylender loans is more than four times the value of the current estimated retail credit market and reflects savings that individuals opt to privately intermediate. More than 10% of adults noted that they save in gold. The largest savings need is for consumption smoothing, particularly to put money away for the rainy season when incomes generally decrease. This savings demand is simply to store value over time and to be able to access it quickly, conveniently and at low cost. Current savings products from regulated service providers offer poor functionality and convenience. Keeping it hidden at home has for many been the best option given the current limited financial infrastructure and low crime levels.

Leverage emerging retail payments network and agents to enable convenient store of value. There is an opportunity to provide low-cost savings vehicles to offer a safe and convenient store of value to consumers and draw some of these savings into the regulated sector. To do so successfully will depend entirely on the ability of providers to enable frequent low-cost deposits and withdrawals close to the client. In the absence of a branch in every village, it is difficult to conceive of this possibility other than through the roll-out of low-cost retail electronic payment networks and its subsequent agent networks. Since the *Directive on Mobile Banking* provides for the payment or interest on balances in mobile payments accounts, the regulator has already opened the door for mobile-based savings, a door that remains closed in most countries where mobile payments have taken off.

5.3. Extend the availability of account-based savings options

Pent-up demand for regulated savings. The need to formalise the current high levels of unregulated savings is critical for Myanmar's ability to grow its industrial base and formal economic sector. Although much of this will come from corporate deposits, retail deposits will also play a role. Recently commercial banks started to aggressively extend their branch networks, driven by the need to mobilise deposits to feed the demand for corporate credit. Without any other changes, this has resulted in a marked increase in deposits, mainly from middle and high income adults, proving that there is a substantial demand for bank-based savings amongst certain target groups. Yet, still less than 5% of adults currently have bank accounts. The recent success in deposit-raising suggests the following options to expand regulated savings:

Improve transaction functionality and proximity to entice savings into the regulated sector. Many bank account holders only use these as "post boxes", i.e. deposits are immediately withdrawn. This is not surprising given poor transaction functionality and lack of convenience currently offered by banks resulting in the still pervasive use of cash. The retention of such savings could be substantially improved through the enhanced payments infrastructure and functionality being developed.

Leverage urban opportunity for bank-based deposits. The pent-up demand for medium term savings is for both unplanned events, such as health emergencies, and anticipated needs such as education. Formal enterprises, 75% of which are urban-based, have the highest demand for such savings with half of them currently using unregulated savings or saving at home. The Informal enterprise target groups and Formal consumers have comparable needs. An opportunity thus exists in the urban space to extend bank-based savings. Subject to the necessary regulatory amendments, there is potential that some of this capital may flow as wholesale funding to MFIs.

Modernise and strengthen MEB to continue its role in deposit mobilisation. Currently, only banks and SFIs are permitted to mobilise voluntary savings. MFIs and co-operatives can only raise compulsory savings linked to loans. Of the SFIs, **MEB** is clearly trusted by consumers with voluntary deposits. MEB's deposits also come from higher-income clients. Its ability to extend its deposit-raising capacity will be determined by the modernisation of its internal systems and the extension of its branch and electronic footprint, particularly in rural areas where it has a head start.

Explore the use of village level savings associations to extend MADBs footprint and enable voluntary savings. FinScope finds that 72% of MADB (mostly credit) clients are more than 30 minutes away from their nearest branch. Conversely 71% of commercial bank (mostly savings) clients are within 30 minutes of their branch. To overcome the proximity challenge MADB, which is a particular deterrent to savings mobilisation, can consider revisiting the use of village level savings associations or equivalent structures. MADB used these in the 1990s, but limited information is available on their performance. Currently, several MFIs report to be using community or village based associations as a vehicle to extend their footprint. While savings mobilised in this manner is unlikely to provide a substantial funding source to MADB it could offer value to rural consumers.

Leverage mobile payments to extend banks interest beyond high-income savers. **Banks** seem to be poised to move the needle on deposits amongst higher- income groups. The removal of limits on the size of the deposit base coupled with new regulations allowing mini branches are driving banks' interest in mobilizing savings in new geographic areas through increased physical outreach. However, the floor on savings interest rates may limit banks' incentive for savings mobilization amongst small value savers as the cost of servicing the account and the interest payment combined may make it too expensive to serve these clients. The opportunity to dramatically improve efficiency and reduce cost through a mobile payments front end can change the equation and enable deposit mobilisation deeper into all target markets.

5.4. Improve quantity, terms and risk profile of agricultural input credit

Improving quantity, terms and availability of agricultural credit can impact on as many as 19 million adults. Farmers are the largest target market identified in Myanmar with 12.1 million adults. An additional 7 million adults indicated that they or a member of their household derive income from farming. The vast majority of Farmers rely on credit to finance inputs and thus production. There is extensive opportunity to improve the availability, service quality and terms upon which agricultural credit is extended which will not only improve household welfare, but also increase production. The 17% of Farmers who currently borrow from unregulated money lenders will benefit from access to regulated input credit.

To increase agricultural input credit at scale, a major priority for the Myanmar government, will require a concerted effort involving all the current providers. In order to expand the delivery of agricultural credit, the following options can be considered:

- **Extend MADB coverage and improve quality and features.** With its extensive rural footprint and proven community-based group loan methodology, **MADB** will remain the lead provider for some time to come. Although MADB, the largest provider of agricultural input credit, currently serves more than 2 million households, an estimated 3.4 million Farmers are not able to produce a certificate to prove their right of use of the land (a prerequisite for obtaining an MADB loan) and remain unserved. MADB finances up to a maximum of 10 acres and focuses their loans on paddy production, which excludes many Farmers. Farmers who do obtain loans indicate that the loans for some may still be too small to cover production expenses, are often disbursed late (due to administrative hurdles or difficulty in obtaining land title certificates) and have to be repaid immediately after harvest when commodity prices are lowest.

- **Extend wholesale funding to MADB through MEB.** To increase its loan portfolio, MADB will require more funding. This is unlikely to come from deposits and will probably require increased wholesale funding from MEB which is trusted to hold deposits and can allocate these funds at the discretion of government.

- **Return to higher interest rates and shift MEB subsidy to modernising systems and improving service quality.** MADB has the space to gradually increase interest rates to the more market-based levels it charged five years ago. Given the short-term nature of loans, the debt servicing relief from lower interest rates are quite low. For example, increasing the interest from the current 8.5% to 12% on a 6 month loan that is to be repaid in a lump sum at the end of the loan period, increases the payment by only 2%[30]. The subsidy implicit in the reduced interest rate paid by MADB to MEB could then be directed to modernising its internal systems and improving service delivery, without which it will not be able to diversify its product portfolio beyond the short term, group loan mediated by decentralised credit committees. In addition, resources can be invested to increase the productive impact of its loans by improving its service levels and adjusting the terms of loans to better suit the agricultural cycle.

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[30] Calculated on a principal of K 1 million (USD 1 057) at 8.5% and 12% interest per month over 6 months. Total repayment under 8.5% is K 1 043 260 (USD 1 103) and under 12% is K 1 061 520 (USD 1 122), a difference of less than 2%.

- **Diversification requires modernisation.** The MAP analysis suggests that MADB's systems work well despite some deficiencies in management and the absence of an electronic MIS system. Through a combination of leveraging village committees as decentralised credit committees and a simple product that is able to be delivered through group guarantees, MADB has been able to manage its risks to date and reports low rates of non-performing loans. This mechanism works well for the simple group-based seasonal loans that make up the bulk of their portfolio. The same mechanism may not work well for more advanced or individualised loan products. While MADB has done well on a particular portfolio of loans, and should continue to be leveraged for this purpose, any diversification outside of the parameters of its existing portfolio needs to be carefully considered as it is likely to require enhanced MIS and management to manage and monitor risks. It is not clear how or whether such a modernisation process will unfold for MADB or whether it will be successful in adapting to the changing demands and environment. As a result, there is space for others, including MFIs to play in this market and potentially offer more complex products. Some MFIs are extending their range of agricultural credit products (e.g. through agricultural leasing) but with limited reach to date.

Furthermore other input credit providers play an important, but more limited role. Recommendations to leverage these players for expanded financial inclusion include:

- **Better understanding of agricultural input credit required to consider their position in the regulated credit market.** **Agricultural companies** offer small value input credit to at least 1.5 million Farmers, but are vulnerable to crop risks which have also contributed to the demise of the rice specialisation companies. They will continue to provide unsecured supplier credit provided they are not exposed to catastrophic losses. Credit-linked crop insurance can play a major role to mitigate this risk (see **5.6 below**). Agricultural input providers currently fall outside of the regulated credit market. Given the potential important role of these companies, it would be important to gain a better understanding of their products and performance and consider their position in the regulated space.

- **Improve information on agricultural co-operatives and consider their place in the regulated market.** Given the limited information available at the time of this research, the role of **agricultural co-operatives** remains uncertain, but they can meet part of the need provided they have access to capital and their credit processes are not too cumbersome. Early indications are that the extension of input credit by agricultural co-operatives has grown rapidly and could play a substantial role. With the exception of agricultural input companies, all credit providers in this market rely on wholesale funding to extend credit and currently suffer capital constraints. Given the potential important role of these co-operatives, it would be important to gain a better understanding of their products and performance.

- **Take care to monitor rapid expansion of co-operatives.** **Section 4.3** reveals that the Export-Import Bank of China has agreed with the Government of Myanmar to finance USD 600 million over the next three years for agriculture production. This funding will be disbursed from the Ministry of Co-operatives to CCS and is set to expand agricultural co-operative credit by more than twenty times. Prior to this funding injection, the extension of credit through agricultural co-operatives has already increased from USD 1.7 million and 10 900 members in January 2013 to USD 27.9 million and 400 000 members as of July 2013. This is equivalent to 60% of the reported MFI client base (for which PACT represents the largest proportion). Given the substantial increase this represents to the co-operative sector, it will require careful monitoring to ensure that rapid expansion can be managed by the co-operatives and accompanied by appropriate supervision.

- **Beyond PACT, MFIs are likely to play limited but important role and could be expanded if regulatory hurdles are addressed.** **MFIs** may not play a major role in the provision of input credit in the near term. **PACT** is currently the only MFI with substantial rural reach and does among others provide agricultural loans. In the future, however, other organizations could have the potential to increase their reach. The cap on interest rates makes it difficult to undertake expensive rural distribution. PACT is the only provider that can significantly contribute to this opportunity under the current regulatory environment. An increase in the interest rate ceiling can open the opportunity for more providers. Given that MFIs have longer-term wholesale funding and are installing MIS systems, it is possible that they could in future evolve to fulfil the need for more advanced credit products along-side MADB's simpler credit products.

- **Monitor indebtedness and improve agricultural productivity with expanding credit.** The extension of input credit, however, should not be unlimited. There are signals that debt is a problem for at least some groups of Farmers. Farm yield will be a key determinant of whether current debt levels are problematic or not. At lower yield assumptions current debt levels appears problematic for a broad range of Farmers. At higher yield assumptions, the situation improves but remains concerning for Farmers on plots of less than 6 acres. Increasing credit to Farmers must go hand in hand with measures to improve agricultural productivity, manage macroeconomic conditions so that farm yields are not undermined, and land tenure policies that promote long-term investment.

5.5. Increase availability of unsecured credit

Limited collateral requires unsecured financing solutions. Financial institutions, excluding those operating under the Microfinance Law, can only lend against the provision of collateral. Most citizens and small enterprises cannot offer acceptable collateral, and must therefore turn to unregulated money lenders or the few providers who can legally offer unsecured credit. Particularly hard hit are the 4.7 million Informal enterprises that draw on family and friends and unregulated money lenders for three quarters of their credit needs and 7.5 million Informal consumers who make even more use of unregulated credit. However, the need for credit also exists for the higher-income Formal enterprises that currently have to fund their growth primarily from cash revenues. A similar need exists for the Formal consumers who form the kernel of Myanmar's emerging consumer class. They will certainly demand more consumer credit in future.

In order to expand the provision of credit to rural and more challenging SME markets, the following options need to be considered:

Reconsider interest rate and loan caps and remove stumbling blocks to raising capital in order to enable MFIs and co-operatives to move beyond urban and survivalist markets. **MFIs**, including **financial co-operatives** registered as MFIs, are legally permitted to extend unsecured loans. They must ideally play a central role in meeting this need. To date they have extended in the order of 700 000 loans. Their ability to meet this opportunity is, however, constrained. Perhaps their biggest challenge is access to capital due to supervisory complications in sourcing both foreign and domestic capital. Regulatory practice currently requires MMSE to approve all increases in capital, for which approval is not always readily forthcoming. Deposit-taking MFIs are also limited in their ability to use deposits as funding for loans. The interest rate cap at 2.5% per month challenges the commercial sustainability of all but the largest, most established MFIs. It will continue to confine their activities to urban areas where there certainly is a huge need. The recent cap on loan size at K500 000 runs the risk of further undermining outreach, poverty impact and sustainability. It is estimated that about 10% of current MFI clients will be excluded by the loan cap. It will also exclude MFIs from funding the larger enterprises which have a higher employment potential but are not yet able to access commercial bank loans. The combination of the interest rate cap and the loan cap is likely to keep the larger donor-funded MFIs reliant on subsidised funding and to delay the commercialisation of these providers. A relaxation of these regulatory and supervisory constraints will at least ensure that this category of providers optimise their contribution to extend access to regulated finance. In addition, a donor or private funded wholesale lending facility could support and strengthen promising implementer and give strategic direction to the sector.

Explore leveraging payroll credit. The ability and appetite of **commercial banks** to make a substantial contribution to the extension of unsecured consumer credit at this point is limited, but should not be excluded. There are moves to relax the absolute restriction on unsecured loans, but this will only be implemented once a credit bureau able to provide reliable credit information on retail customers is established. In the interim there is an opportunity for payroll lending, which can be performed under a limited regulatory exemption. Some registered MFIs are interested in exploring this market, while banks targeting corporate customers will look to provide payroll services as part of the package. Once the infrastructure for electronic payments exist, it will be easy for banks to extend payroll loans to employees of their corporate clients. It is a low-cost methodology that functions well in the absence of collateral, provided the necessary consumer protection measures are in place. Since about 37% of Government employees receive additional income from an enterprise, this can also become an easy channel for credit for Informal enterprises.

5.6. Grow insurance product portfolio to meet risk mitigation needs of households

Reported risk experience reflects need for insurance. The people of Myanmar do not use insurance to mitigate their risks, largely because it is not available and they are not aware of its existence. The 3% that do have insurance have it only because it is compulsory for certain categories of government employees and vehicle owners. That means that the voluntary retail insurance market in Myanmar is effectively non-existent. It does, however, not mean that the people do not experience risks that they have to deal with. They certainly do, but they mitigate these through savings, credit, or community-based self-help groups, like funeral aid societies. Alternatively, they sell assets or simply do nothing. Most of these risk mitigation tools are more costly mechanisms than insurance, and results in reducing the welfare of households. There is thus a significant opportunity for the development of retail insurance. There are a number of options to develop the low-income insurance market:

- **Enable and develop health and funeral (life) insurance.** The priority needs expressed in FinScope are for health, funeral and agricultural (dealt with in **Section 5.7**) insurance. There is currently no regulated health insurance product available in Myanmar. More than 12 million adults indicated that they or a family member experienced an illness that required medical attention during the previous 12 months. They relied on savings, the sale of assets and credit to cover the treatment costs. Since the provision of health services are uneven, insurance products will have to be tailored to what is available. Insurance legislation does not currently permit insurers to offer health insurance. An amendment will thus be required to offer this product. It is likely that the Formal enterprise target market and Formal consumers will be pioneer users of this product. Funeral insurance is an anchor product for many emerging retail insurance markets.

Such insurance is not constrained to funding the cost of the funeral but can provide financial assistance for the family to deal with other expenses, debts and the potential loss of income. The extensive use of informal funeral assistance mechanisms suggests that it is no different in Myanmar and that an opportunity exists to offer this product to all target markets, provided the distribution challenges can be solved.

- **Remove regulatory constraints on new entrants to enable innovation.** The monopoly of the **MIC** was lifted in 2013, opening the market for a number of new commercial insurance companies. However, for the time being these companies are required to follow MIC's business model and product offering, and to follow the same agent-based distribution model used by MIC. They will also be subject to compulsory risk pooling. These regulatory restraints will effectively prevent these companies from offering products able to meet most of the consumer needs. Regulatory change will be necessary to facilitate business model and product innovation. Even though the low-income market is unlikely to be an immediate priority market for the new insurers, removing the regulatory constraints may enable innovation and potential interesting partnerships between insurers and existing players in the low-income market such as SFIs and MFIs. Given the income profile of Myanmar, it is likely that many employees of corporate clients may fall within the low-income market. In the first instance, MIC can build on their current life insurance portfolio, which is made up of small-premium compulsory products to government employees. This demonstrates the reach of employee-based programmes and the fact that these are serving low-income employed workers taking up microinsurance-type products. MIC can build on this experience to enhance the benefits and value of these policies to government employees.

- **Enable and leverage existing and emerging aggregators.** Cost-effective distribution is a key challenge for insurers and particularly for low-premium insurance products. Current regulation restricts new insurers to the same agent-based distribution model followed by MIC and imposes a number of potential barriers for the development of lower-cost distribution models (e.g. the fact that agents are required to have a degree). Regulation should be adjusted to enable insurers to explore a variety of distribution channels and should not predetermine their business model. There are a number of interesting aggregators that may present interesting opportunities for the distribution of insurance. These include the new mobile network operators, MFIs, SFIs and agricultural input providers and value chain companies.

- **Create a pathway for the formalisation of unregulated insurance offered by MFIs and co-operatives.** There is a substantial and diverse insurance portfolio offered through MFIs and co-operatives on an unregulated basis. These products are tailored to the needs of their clients and cover life, disability, health and asset risks. Their combined portfolio cover at least 600 000 clients with premiums of similar magnitude to MIC's life portfolio. Providing a formalisation path for these institutions can, therefore, facilitate the rapid growth of a formal microinsurance market and ensure the protection of consumers currently covered under unregulated products.

5.7. Develop insurance products to provide security for credit extension and protection for consumers, particularly for agriculture

Credit-linked insurance to facilitate credit extension and protect borrowers. Insurance linked to credit most often leads to the extension of regulated insurance provision to low-income markets. The most prominent type of this cover is credit life, which insures the outstanding debt against the death of the borrower. In some cases the cover may be enhanced to cover other family members or add additional cover such as funeral insurance or disability cover. Given the particular risks faced within the agricultural industry, much attention has also been given to the ability of insurance to manage weather-related risks affecting agricultural production. In particular, the use of weather-index products has received much attention given the simplicity of the mechanism. Such credit insurance products are typically triggered by the lender to cover the risk of non-payment, rather than the borrower. Borrowers are typically also compelled to take some form of credit insurance to obtain a loan. While this provides a powerful and low-cost mechanism for the expansion of insurance in low-income market, careful monitoring is required to ensure that consumers are fairly treated and receive value. As such credit-linked insurance has facilitated the provision of loans to millions of people who may otherwise not have been able to access credit.

These two product categories are particularly relevant to Myanmar given the risks faced by the identified target groups and the following options should be explored:

Enable agricultural insurance and explore delivery though MIC. The absence of credit-linked insurance has been felt particularly in the market for agricultural credit. All but one of the rice specialisation companies have failed, at least in part as a result of insurable weather-related losses which triggered numerous defaults amongst farmers. Of the 12 million Farmers, more than 5 million indicated that they experienced risk which they mitigated through the sale of assets, savings, credit or reduced consumption. This diverts the intended use of these financial mechanisms for productive purposes to risk mitigation. Agricultural production-related risks were the most prominent risk category for farmers. Whilst the introduction of crop and livestock insurance is complex and in most cases require subsidies, a narrower focus on the provision of insurance for agricultural input credit is more achievable.

MIC does not offer agricultural insurance and the new commercial insurers are not permitted to offer this cover either. Given the numerous other opportunities that the new commercial insurers will explore, this product will in all likelihood be offered by MIC only and most likely on a subsidised basis. It will, however, enable the government to achieve some of its priority objectives for rural poverty alleviation.

Enable credit life insurance with appropriate consumer protection. Credit life insurance is not currently offered by MIC and is thus not available in Myanmar. It is also not one of the product lines that new insurers are allowed to offer. However, in the absence of such an offering, a number of MFIs and co-operatives have created reserves to fulfil the role of credit insurance (as discussed in **Section 5.6**). Credit life insurance is a much simpler product than crop or livestock insurance and is offered on a commercially sustainable basis in most countries. The new commercial insurers should be able to offer this product. As noted, the offering of credit life also presents a number of consumer protection risks, which should be dealt with proactively in regulation.

6. Going forward

The government of Myanmar has made good progress in bringing formal financial services to sections of society that commonly only have access to informal financial services. The state delivery of financial services has played a critical role in achieving this, but the private sector also demonstrated substantial and growing outreach. Considerable progress has been made in liberalising the market and strengthening both market and regulatory systems and capacity. The enabling regulatory environment for MFIs and co-operatives is creating a critical platform to extend outreach.

Direct delivery by state institutions and, particularly MADB, has played a critical role in financial inclusion to date. MADB has improved delivery over last 5 years and there is opportunity to continue harnessing this role while seeking to modernise state institutions to continue and sustain its role in the future. Although a surprisingly high percentage of adults engage with formal financial institutions, much work needs to be done to further expand access and, importantly, to improve the quality and depth of services offered to those already financially included.

In this report MAP has identified seven priority opportunities for the Government of Myanmar to extend financial access. Addressing these seven areas will require a coordinated effort across institutions, product categories and market segments, in order to ensure that the underlying market inefficiencies are adequately addressed and the opportunities capitalised on. It will also require the government to work together with other stakeholders such as the private sector, development partners and sector experts. To assist these stakeholders address the opportunities in harmony, it is proposed that a MAP Roadmap will be developed and discussed by stakeholders at a National stakeholders' meeting. The roadmap will outline in further detail the programme of action necessary to address the identified market inefficiencies, such as ensuring better regulatory support or addressing the infrastructure bottlenecks, and link these actions to existing government priority areas, such as institution development, growth of agriculture and small businesses, and poverty alleviation for the low-income.

Appendix A: Glossary

Borrowing with family or friends	Borrowed money from family or friends that you have to pay back. Received money from family or friends that you did not have to pay back.
Farmers	Adults that reported to be self-employed (farming their own land or family land) in engagements involving crop cultivation and livestock keeping.
Financially excluded	This group consist of adults who do not access financial products or services from either regulated or unregulated financial services providers, and who do not demonstrate financial activity with family, friends or themselves.
Financially included through regulated financial products and services	This group is made up of all adults who are financially included through the take-up of financial products or services from regulated institutions.
Financially included through unregulated financial products and services only	This group is comprised of adults who are financially included through the take-up of financial products or services from unregulated providers. However, this group does not include individuals who also have any financial products or services from regulated providers.
Formal consumer market	Employees who are employed in the formal private sector (Employees of formal private companies) or in the public sector (Government employees).
Formal enterprises	Enterprises that are considered regulated or licensed to operate. This segment represents adults who are self-employed and own and operate their own enterprises.
Individuals who only demonstrate financial activity with family, friends or themselves	This group consists of adults who illustrate financial activity through friends, family or themselves. This financial activity includes saving at home or with family or friends, borrowing from family or someone you know, sending money to someone via family or friends, or using a savings or borrowing mechanisms in response to having experienced an insurable event (ex-post financial mitigation).
Informal consumer market	Adults who receive wages from the informal market (Piece or casual workers as well as Farm workers), adults who receive a salary from the informal market (Salaried private individuals) and those who rely on remittances (Remittance dependants.
Informal enterprises	Enterprises that are not licensed to operate. This segment represents adults who are self-employed and own and operate their own enterprises.
Regulated credit	Having a loan product or credit account with an SFI, commercial bank, formal (non-bank) financial institution, MFI, government scheme, co-operative or pawnshop.
Regulated financial services providers	Registered legal entities that are regulated for the provision of financial services. If a financial services provider is registered with a public authority and its activities are subject to regulation which permits it to provide financial services, whether a public authority supervises its provision of financial services from a prudential or market conduct perspective or not, it is considered a regulated financial services provider.
Regulated insurance	Any regulated insurance product (like motor vehicle insurance) with an insurance company or bank.

Regulated payments	Having sent or received remittances in the last 12 months via bank transfer (or paying into a bank account), ATM, the Post Office, Western Union, MoneyGram, internet/online banking or mobile phone or having one of the following accounts/products from a commercial bank: Debit Card/ATM card/MPU card, current/cheque account, foreign currency account, bank account outside the country, internet/online banking.
Regulated savings	Saving with or having a savings account with an SFI, commercial bank, formal (non-bank) financial institution, MFI or co-operative.
Saving with family, friends or self	Saving within the household, family or community who keep it safe for you, saving in a secret place at home (like a piggy bank), saving in jewellery or gold, saving in livestock or saving in kind.
Self-mitigation (after having experienced an insurable risk)	Those who experienced an insurable risk over the past 12 months and used savings or borrowed in order to mitigate the impact of the event. Insurable risks include: Death of or loss of income from main income earner, death of a family member (who is not the main income earner), illness within your household or family that requires medical expenses, disability (self or household member), loss of job (self or household member), fire or destruction of household property, loss of your home, loss of your savings, drought, poor rainfall or loss of access to water for farming, flooding/storms, harvest failure or losses of crop harvest (including plant disease), death or illness of livestock, loss of your land or access to land you use, loss/failure of your business or an earthquake.
Sending money with family or friends	Having sent or received remittances in the last 12 months directly via friends or family.
Target groups	These are distinct groupings of the adult population that can be targeted for financial inclusion purposes.
Unregulated credit	Borrowed money from an employer, savings group, money lender, religious institution, village fund, community based organisation or a registered institution which is not being supervised for the provision of financial services. Received goods in advance from a farmer/shop/store/supplier or agricultural buyer and had to pay back later.
Unregulated financial services providers	Regulated financial services providers are registered legal entities that are regulated for the provision of financial services. If a financial services provider is registered with a public authority and its activities are subject to regulation which permits it to provide financial services, whether a public authority supervises its provision of financial services from a prudential or market conduct perspective or not, it is considered a regulated financial services provider.
Unregulated insurance	Saving with or borrowing from an MFI that has a mandatory welfare fund, belonging to community funeral assistance or health assistance groups, a free funeral society/ward clinic or health association, or a donation group.
Unregulated payments	Having sent or received remittances in the last 12 months by motorcycle, taxi or via a *hundi.*
Unregulated savings	Belonging to a savings group or having savings with a savings group, money donations group, or another institution that is not supervised for the provision of financial services.

Table 2: Glossary

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