

Are Microfinance Interest Rates Too High in Mozambique?

Note prepared by

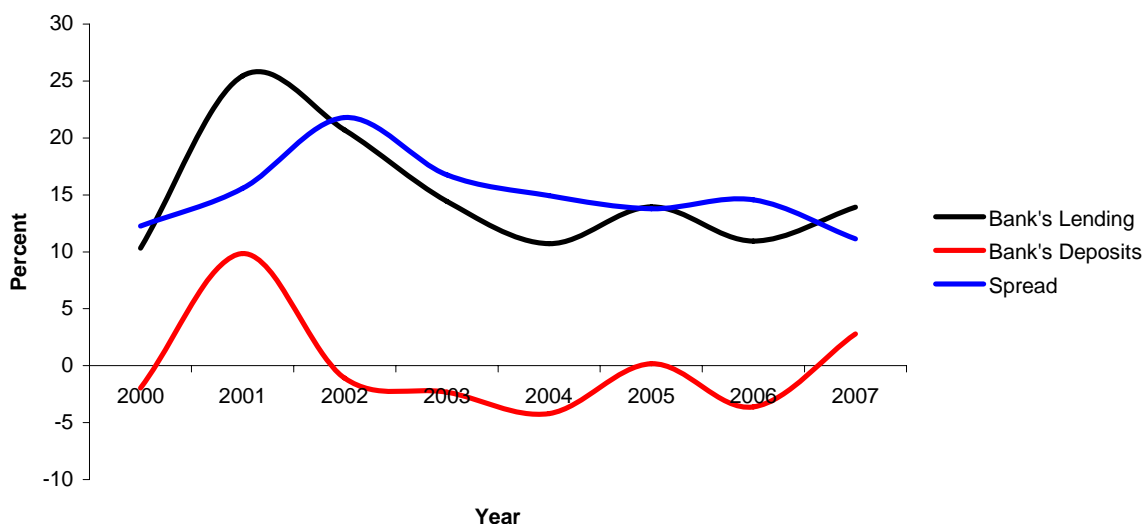
Sandra Bila and John Rand

Direcção Nacional de Estudos e Análise de Políticas (DNEAP)

According to different industrial surveys, access to credit has been the key constraint to private sector development in Mozambique for several years (ICA, 2003, DNEAP, 2006, and Byiers et al., 2008). One reason for this is that the Mozambican financial system is tight and weak and characterized by a series of market failures. A few commercial banks dominate the sector, and the three largest banks account for around 80 percent of total bank assets. Limited competition has resulted in a non-dynamic financial system with low levels of financial intermediation and high profit margins (helped on its way by excessively high fees on banking services).

Figure 1 documents the large interest rate spread between deposits and loans, which is to some extent driven by the high reserve requirements. The spread has declined since 2002 where it peaked at almost 22 percent but it remained at the relatively high level of 11.1 percent in 2007.¹ Although the high spread can be attributed to other factors than lack of competition (for example high operating costs, high financial taxation and high and very volatile inflation rates) a careful analysis by USAID (2007) concludes that interest rates on metical loans appear to be higher than economic fundamentals would seem to justify.

Figure 1: Bank Lending and Deposits: Real Interest Rates



¹ A high interest rate spread is often related to inefficiency and lack of competition in the banking sector. But policy makers are also acutely aware of the need to ensure that sufficient profits can be made to promote safety and stability in the system and limit the need of government bailouts.

In recent years commercial bank lending rates have been between 22 to 24 percent per year (11 to 14 percent real interest rate). However, as noted in Hassan (2007) these interest rates are not particularly high when comparing to the benchmark (tax free) T-bill rate (see Table 1). In 2006 the Bank of Mozambique started to let an auction process determine the T-bill rate and the nominal rate has since then increased to 15%-16% per year and the real interest was as high as 6.6 percent in 2007. A major reason for this upward trend in the T-bill rate is that banks are the only primary market participants.

Table 1: Interest Rate Overview

	2000	2001	2002	2003	2004	2005	2006	2007
1) FPC	23.0	35.0	26.5	18.5	13.5	13.8	17.5	15.5
2) Treasury bills (91 days)	22.3	31.2	21.5	12.6	8.5	9.6	16.0	14.8
3) Liquidity swap rates (1-7 days)	21.1	27.7	18.6	11.5	6.4	na	16.1	14.5
4) Prime rate	19.6	25.3	29.8	23.3	20.6	19.2	20.3	18.9
Inflation rate	12.7	9.1	16.8	13.5	12.6	6.4	13.2	8.2

Note: Nominal interest rates. 1) FPC: The rate for Liquidity Support Operations. The FPC is indexed to the average weighted rate of 91-day Treasury Bills (BTs), plus 5 percentage points. 2) Treasury Bills: Numbers for 2002 and 2004 calculated using FPC. 3) Liquidity swap rates: Institutions operating in this segment (banks for the most part) are free to set the rates based on the liquidity in the market. 4) Prime rate: A simple arithmetic mean of the rates applied by credit institutions.

Beyond the main commercial banks several microfinance institutions (MFIs) provide small-scale microfinance products to private enterprises and households. In 2005 some 45 such institutions existed, a number that increased to 75 in 2008.² Table 2 shows the basic characteristics of the most well established MFIs in Mozambique: Pro Credit/Novo Banco, Socremo and Tchuma. All figures are compared to the 2003/04 numbers reported in de Vletter (2006). All of the MFIs have increased their activities significantly. On average they have almost doubled the number of branches, almost quadrupled the portfolio size and the number of outstanding loans and the average loan size has almost three doubled. All of this has happened without significant changes in the percentage of the portfolio at risk. The number of deposit accounts has also increased rapidly. As donated funds and general assistance to MFIs decreased these institutions were forced to focus more on traditional intermediary activity (attract depositors in order to increase the amount of loanable funds). Recently MFIs have followed a strategy of offering significantly higher deposit interest rates than traditional commercial banks, which seems to be well taken by customers.³

² The number in 2005 is the number of entities registered with the Bank of Mozambique. According to de Vletter (2006) this number is too large since a large number of operators are associated with CCCP-CCOM and should be treated as only one operator with several branches. This reduces the number of MFIs to 32 in 2005.

³ Socremo is currently offering deposit accounts with an annual interest rate (after tax) of 17 percent. This should be compared to the average nominal deposit interest rate of 11 percent offered by commercial banks.

Table 2: Basic MFI Information

	Pro Credit/Novo Banco		Socremo		Tchuma	
	2003/04	2006/07	2003/04	2006/07	2003/04	2006/07
Start of operations	2002/03		1998/99		1998/99	
Number of branches	6	12	5	8	3	6
Portfolio size (million USD)	2.8	13.4	2.0	5.1	1.3	4.1
Number of outstanding loans	8,178	26,738	5,931	2,042	6,154	493
Average loan size (USD)	347	859	331	400	217	497
Number of deposit accounts	16,125	97,258	415	26,526	1,117	9,755
Portfolio at risk (percent)	2.2	3.1	0.3	1.2	2.9	2.8

Note: The 2003/04 numbers are from de Vletter (2006). All other numbers have been collected directly from MFIs. Exchange rate used in 2006/07: 25MT = 1USD.

The main characteristics of loans offered by the three most well-established MFIs are presented in Table 3. During the past three years MFIs have increased the possibility of longer term loans (up the 60 months). Moreover, the nominal interest rates charged vary more from customer to customer with monthly interest rates ranging from 2%-6.5% (annual nominal interest between 27%-113%, annual real interest rates around 19%-105%). On average monthly interest rates charged have been relatively constant (with a small declining trend).

Table 3: Main Characteristics of Microfinance Loans

	Pro Credit/Novo Banco		Socremo		Tchuma	
	2003/04	2006/07	2003/04	2006/07	2003/04	2006/07
Loan amount (minimum in USD)	110	120	131	120	65	No fixed minimum
Loan term (maximum)	24	60	12	48	12	24
Nominal interest rate (per month)	4.8% to 5.9%	2% to 6.5%	5.5% to 6.3 %	2.7% to 5%	5%	5%
Other fees	2% of loan size	1% to 2% of loan size	None	1% to 5% of loan size	4USD to admission fee	4USD admission fee
Collateral	Coverage 120%, can be reduced for good clients	Coverage 120%, can be reduced for good clients	Coverage 120%, can be reduced for good clients	Coverage of 50% to 200%, can be reduced for good clients	Coverage 120%, can be reduced for good clients	No policy for collateral

Note: The 2003/04 numbers are from de Vletter (2006). All other numbers have been collected directly from the MFIs. Exchange rate used in 2006/07: 25MT = 1USD. Tchuma reported no fixed minimum loan amount, but on average the loans are 240USD.

How do these figures compare to international MFI evidence? Morduch (1999) document five different MFIs interest rates. Starting with the famous Grameen setup the average annual nominal interest rate charged was 15.9 percent, although the “break even” rate was around 25.7 percent per year. Financial sustainable MFIs have been shown to operate with yearly nominal interest rates around 32-55 percent (real interest rates of 24-47 percent), and Fernando (2006) showed that nominal interest rates charged by most MFIs in Asia range from 30% to 70% a year. Effective rates are even higher due to the commissions and fees charged. Although these interest rates are high Morduch (1999) shows that the average return to equity among these selected microfinance institutions was 9.3 percent. This is not particularly high given the risk associated with this

type of intermediary activity and it was significantly lower than other investment alternatives in the economies considered.

But how do financial statements of MFIs look in Mozambique? Relying again on data for the three most well-established MFIs, Table 4 compares the financial records with those of the three largest commercial banks (BIM, BCI and Standard Bank). First, MFIs have lower revenue per employee. The three institutions considered have revenues of 0.3 to 0.6 million per employee, which is at least 3 times lower than the numbers reported for commercial banks. Second, the cost to revenue share is much higher in MFIs; around 70 to 96 percent of total revenue as compared to 42 to 55 percent for commercial banks. Third, as a consequence of the above features, profits as a share of shareholders fund are generally lower in MFIs. These figures seem to confirm the microfinance experiences from other countries that MFI activity is highly labour intensive and have much higher cost-of-service delivery as compared to commercial banks. This in combination with higher deposit rate offers and decreases in donated funds seem to explain the high interest rates on microfinance loans in Mozambique.

Table 4: Financial Overview of Selected Commercial Banks and MFIs

	BIM	BCI	Standard Bank	Novo Banco	Socremo	Tchuma, SARL
1) Revenue	2740	1340	1249	171	98	36
2) Net Profits	1156	512	452	38	3	5
3) Net Assets	24671	14038	13380	437	364	77
4) Shareholders funds	2620	1348	1130	103	97	48
5) Operational Costs	1505	567	692	120	94	31
6) Employees	1386	637	524	297	254	109
Revenue per employee	2.0	2.1	2.4	0.6	0.4	0.3
Cost/Revenue (percent)	54.9	42.3	55.4	70.2	95.9	86.1
Profit/Shareholders funds	44.1	38.0	40.0	36.3	2.9	10.4

Note: Financial numbers in million MT. Source: KPMG

Although the above numbers and arguments suggest that MFI interest rates are not artificially high, there may be room for improvement in MFI banking technology and general efficiency. But what are the alternatives to traditional microfinance which face a much higher cost-of-service delivery because of the smaller transaction values they handle and the more remote and dispersed location of their customers? One way to go could be the promotion of mobile phone banking (see the recent paper by Mas and Kumar, 2008 for details). Although it is a relative new phenomenon, the opportunities for MFIs to cut cost-of-service delivery through m-banking seem clear cut. A more in depth study on how to promote this kind of technology in the Mozambican economy would therefore be highly advisable.

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