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Microfinance in Vanuatu: institutions and policy

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1. Introduction

This paper provides a brief introduction to microfinance in Vanuatu. Section 2 provides some general background on microfinance, while the institutions currently providing microfinance services in Vanuatu are discussed in section 3. The paper then discusses some conceptual issues affecting microfinance in Vanuatu, namely the demand for microfinance (section 4) and sustainability (section 5). Section 6 outlines a number of policy issues, while section 7 concludes.

2. Background on microfinance

Microfinance is generally taken to refer to the provision of financial services, primarily savings and credit, to poor and low income households that do not have access to formal financial institutions. The Asian Development Bank (ADB) in its *Microfinance Development Strategy* (ADB, 2000: 1) states that:

> Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their microenterprises.

The formal financial system rarely provides access to poor entrepreneurs in developing economies. Since the late 1970s, there has been an emphasis on establishing financial systems able to reach poor clients on a more sustainable basis. A new set of techniques has been developed and applied by institutions such as Grameen Bank in Bangladesh and Bank Rakyat Indonesia. While these techniques differ between institutions, Rhyne and Otero (1994) argue that there are three key principles behind them.

- First, successful microfinance programs know their market. The poor are willing to pay for access and convenience. Interest rates are market-oriented, lending outlets are located near the client, application procedures are simple, and loans are disbursed quickly.
- Second, they use special techniques to slash administrative costs. Simple procedures are used and approvals are decentralised. Borrower groups often handle much of the loan-processing burden.
- Third, they use special techniques to ensure high repayment rates. These include the use of self-selected groups in which members guarantee each other's loans, intensive motivation and supervision of borrowers, incentives for borrowers, progressive lending and compulsory savings requirements.

It is argued that microfinance can provide a number of developmental benefits. First, it can be an important element in an effective poverty reduction strategy by enabling the poor to smooth consumption, manage risks better and enhance their income earning capacity. Second, it can provide an effective way to assist and empower poor women. Third, it can contribute to the development of the overall financial system through integration of financial markets.

After many years at the fringes of the development debate, microfinance has now very much been embraced by the development community. Major donors active in the Pacific, including the World Bank, ADB, UNDP and Australian Agency for International Development (AusAID), have been active in promoting microfinance in the region, and governments have also shown considerable interest in microfinance.

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3. Microfinance in Vanuatu

This section provides an overview of microfinance in Vanuatu.

Commercial banks

There are four commercial banks in Vanuatu. Three are branches or subsidiaries of foreign banks — ANZ Banking Group and Westpac Banking Corporation of Australia and Banque d'Hawaii of the United States. The fourth is the government-owned National Bank of Vanuatu (NBV).

The private commercial banks have little outreach among low-income households. They only have branches in the urban centres of Vila and Luganville. They make very few if any loans under Vt100,000 (US$780), and most loans are for amounts much larger than this. The banks generally require all loans to be fully secured. They do have greater outreach in their savings facilities, but again these only reach households in the urban areas. At least one bank also requires a minimum savings balance of Vt25,000 (US$200).

The NBV was established in 1989 with its objective to provide commercial banking services to the indigenous ni-Vanuatu people. While its performance has been poor, it has recently been restructured with assistance from the ADB. It has much greater outreach in the rural areas than the other commercial banks, with 19 branches and around 60,000 savings accounts. This represents one account for every three people (or an average of more than one account per household). While no data are available on multiple account holdings, it suggests that NBV has extensive outreach to all sections of the community in terms of its savings products. However, the lending activities of NBV do not reach the microfinance sector. It has 1,200 loan accounts with a minimum loan size of Vt100,000 (US$780) or Vt50,000 (US$390) for school loans, and loans are generally required to be fully secured.

Indeed, it is not only low income households who cannot get loans. ADB (1997) and Zander (1998) have noted that commercial bank credit delivery to ni-Vanuatu in general has been weak. Related to this, there has been little lending to agriculture and other primary industries. In the past, the private commercial banks viewed agriculture as the domain of NBV and the former Development Bank of Vanuatu (DBV), but the latter have also been inactive in lending to this sector.

Other institutions and programs

The only significant microfinance program in Vanuatu is the Vanuatu Women's Development Scheme (VANWODS), a replication of the Grameen Bank that is financed by UNDP and implemented through the Department of Women's Affairs. The program has expanded rapidly since commencing in 1997, with 246 members and loans outstanding of Vt2,377,000 (US$18,640) by April 1999 (and 343 members by June 1999). Initial loans are for a maximum of Vt15,000 (US$120) and have a term of 24 weeks. The loan amount increases to a maximum of Vt30,000 (US$240) for the second cycle and Vt45,000 (US$350) for the third cycle, with these loans having a term of 50 weeks. The interest rate is 16 per cent flat. VANWODS offers both compulsory and voluntary savings. Voluntary savings have proved very popular with a balance of Vt804,000 (US$6,300) by April 1999, compared with compulsory savings of Vt773,000 (US$6,060). Savings are deposited in a commercial bank.

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Up to April 1999 the on-time monthly repayment rate was 100 per cent, and the program had achieved operational self-sufficiency of around 39 per cent (although this excludes certain costs met directly by UNDP and the Government). VANWODS plans to reach self-sufficiency by 2005, with a base of around 3,000 members. The plan is to saturate the area around Vila before moving to other parts of the country. The program is currently operated through the Department of Women's Affairs, but it is intended to establish it as a non-government organisation (NGO). It focuses on lower- and low-income women, but does not purport to target the very poor. While current and projected outreach is low by absolute standards, it needs to be considered in the context of the small population and relatively limited demand for microfinance.

Vanuatu also has a small credit union movement. Data from the Vanuatu Credit Union League (VCUL) indicate that in 1995 there were around 15 active credit unions affiliated with VCUL, with a combined membership of around 2,900. However, it is understood that there are currently only around five or six active credit unions. In addition, there are around 45 inactive credit unions. Most of both the active and inactive credit unions are in the rural areas. However, it is difficult to assess their effectiveness in providing savings and loan services to low-income households, as financial and performance statistics are not available from VCUL. There are also two savings and loans cooperative societies.

Busai and Karie (1996) noted that there are a number of community credit schemes, savings clubs, and other schemes operated by NGOs operating in the informal sector of the economy. They found that these schemes exist on a very limited scale and tend to collapse very quickly. They noted that there are only a small number of private moneylenders, who charge interest rates of around 10 per cent per month and often do not operate for very long.

4. The demand for microfinance

There has been some discussion as to the nature of demand for microfinance in Vanuatu and the other Pacific island countries (PICs). The demand for microfinance may differ from other developing countries. For instance, Vanuatu has a population of only 177,000, with a population density of only 14 people per square kilometer. Around 19 per cent of the population live in the capital Vila, with the remainder living in the rural areas. Nearly 75 per cent of the economically active population works in agriculture, forestry, and fishing, largely in subsistence activity. As in other PICs, many rural areas and outer islands have very low populations and population densities, are quite remote, and provide limited scope for income-generating activity. This suggests that lack of access to financial services, particularly credit, may not be the major barrier to improving living standards in the rural areas. Liew (1997: 3) argues that:

> In rural communities and especially among the disadvantaged, the demand for cash is primarily to meet emergencies, for schooling, to meet traditional and religious obligations and for other basic necessities. The demand for cash is rarely for starting a microenterprise or income earning activity.

More recently, Gregory (1999) has questioned whether microfinance, at least of the Grameen Bank variety, is appropriate for the Pacific. Gregory makes three main points:

- In applying microfinance to other cultures, what needs to be replicated is the thinking behind the development of the Grameen Bank model, not the institution itself. In

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particular, the Grameen Bank model of microfinance is not a solution in the Pacific.

- Only those areas where there is vigorous cash-cropping near urban areas stand any chance of success in supporting a microfinance project. A credit system has no prospect of being economically viable in the remote areas.
- Credit needs to be of the 'dollar' rather than 'penny' capitalist variety. Loans less than around US$300 would not be much use, and the appropriate target group is the 'poorest of the rich', rather than the 'poorest of the poor'.

There is considerable validity in these arguments. They suggest that it is appropriate to be cautious about what microfinance can achieve in Vanuatu. Nevertheless, experience in Vanuatu and other countries suggests that Gregory is too pessimistic, and that there is still a role for microfinance (McGuire forthcoming).

In line with Gregory's analysis, there is an unmet demand for finance from the 'poorest of the rich' – ni-Vanuatu operating small and medium enterprises. While this group is not low income and requires loans significantly larger than those provided by microfinance programs and credit unions, it nevertheless finds it very difficult to obtain finance from the commercial banks. However, there is also a significant market-based informal economy in Vila and to a lesser extent in some other centres. The evidence suggests that many of these low-income microentrepreneurs also want loans, and can make effective use of them. In the case of VANWODS, initial loans are for a maximum of VT15,000 (US$111). While the clients may not be the 'poorest of the poor', the data suggest that in the larger centres, there is a demand for loans of amounts well below the threshold suggested by Gregory.

Experience with VANWODS has also shown that clients have a high demand for the voluntary savings products. Moreover, this demand is not limited to the larger centres. There are very few areas in Vanuatu that have not become part of the monetised economy, receiving inflows of money from the sale of agricultural produce, government wages, remittances and other sources, and spending money on consumer goods and small capital goods. Previous small-scale savings and credit programs have found that there is a demand for programs providing savings services and small loans for schooling and traditional and religious obligations. While the Grameen Bank model is not appropriate for meeting needs of this nature, the challenge is to find programs that can meet these needs in a cost-effective manner while ensuring that savings are secure.

In summary, the evidence suggests that demand for microfinance programs emphasising credit for income-generating activities may be greatest in and around Vila and possibly some of the larger centres in other parts of the country. In rural areas and on the outer islands, there may be more demand for lower cost models emphasising savings mobilisation and small loans for provident purposes.

5. Sustainability of microfinance

Financial self-sufficiency requires microfinance programs to cover all administrative costs, loan losses and financing costs from operating income, after adjusting for inflation and subsidies and treating all funding as if it had a commercial cost. In recent years, it has become generally

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accepted that microfinance programs can and should become financially self-sufficient. However, while there is a broad consensus that microfinance programs should become financially self-sufficient, few have done so in practice. An informal poll at a recent microfinance conference, cited in Morduch (1999), found that some experts estimate that no more than 1 per cent of NGO programs worldwide are currently financially sustainable, and that perhaps another 5 per cent will ever reach sustainability.

Hence experience to date suggests that even in ideal circumstances, it is extremely difficult for microfinance programs to achieve financial self-sufficiency. And circumstances in the Vanuatu are far from ideal. The small population, low population density and lack of skilled personnel increase administrative costs and reduce the number of clients who can be served by each field officer, making it much more difficult to reach self-sufficiency.

As noted previously, by April 1999 VANWODS had achieved operational self-sufficiency of around 39 per cent. It plans to reach self-sufficiency by 2005, with a base of around 3,000 members. This is an ambitious target, and if VANWODS succeeds it will be an extremely noteworthy achievement. No other microfinance program in the Pacific is close to self-sufficiency (see McGuire (1996) for a detailed analysis of microfinance in the Pacific up to that time). Nevertheless, VANWODS clearly has a long way to go, and it remains to be seen if this target is achievable.

6. Key policy issues

Based on the experience of microfinance in Vanuatu to date, there would appear to be a number of key issues facing the Government and donor agencies.

It may be appropriate for key stakeholders to work together to develop a national strategy for microfinance in Vanuatu. This would involve consideration of issues such as the following:

- Which centres are appropriate for the establishment of microfinance programs based on the Grameen Bank model or other models emphasising credit for income generating activities? Is it appropriate to set up such programs in any centres other than Vila, or is VANWODS itself the only such program that is needed?
- What types of financial services are needed in other parts of the country? Are these best provided by the credit union movement, the NBV or through some other model?
- What financial and other resources are needed to establish these programs and to ensure that they become as sustainable as possible?

In developing such a strategy, policy makers and donors should be realistic about what microfinance can achieve. The evidence suggests that microfinance can make a contribution to poverty reduction and the development of financial systems in some circumstances, but that it is hardly a panacea. This is especially the case in the Pacific. Microfinance should only be seen as one element in a more comprehensive strategy for reducing poverty.

In the context of Vanuatu, microfinance programs will need considerable support from the Government and/or donor agencies if they are to develop. Even in Asia and Latin America, few if any financial institutions reaching significant numbers of poor or low income households have been established without the support of government or donor agencies.

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This is even more true in Vanuatu and the Pacific. As noted above, VANWODS plans to achieve self-sufficiency by 2005, and support from UNDP or other sources will be necessary until that time. Any other microfinance programs that are established, including any revitalisation of the credit union movement, will also require support from donor agencies or the Government. If microfinance programs can be shown to be a successful strategy for reducing poverty and/or achieving other objectives there may be a case for ongoing subsidisation, especially in the context of the Pacific where aid per capita is very high by international standards.

Microfinance programs should take account of the nature of the local economy. The differences between the Pacific and elsewhere mean that it may be inappropriate simply to replicate models that have been developed in other environments. It is also very important to listen to local communities and how they perceive their financial service needs. In some cases, donor agencies or governments have virtually forced microfinance programs onto reluctant or unwilling Pacific communities. Liew (1997: 6) cites the following example

> In one particular scheme the outside proponents literally barged in blindly into a community. They were accorded the usual courtesy and hospitality because they were presumably important, had come from far away to this humble village, were accompanied by senior government people and came with messages of hope and greatness punctuated with many jargons that had no equivalent in the local language. Very simply they overwhelmed the local community. The council of elders' quiet acceptance (more like shock) was taken as approval.

Clearly, microfinance programs should also apply best practice principles. For instance, the Guiding Principles for Selecting and Supporting Intermediaries agreed by major donor agencies in October 1995 (Committee of Donor Agencies 1995) suggest that microfinance programs should have three clusters of characteristics. In broad terms they should be strong institutions, they should strive for quality of services and outreach, and they should have sound financial performance.

7. Conclusions

The private commercial banks have little outreach among low-income households, either in terms of loans or savings facilities. The National Bank of Vanuatu (NBV) also does not reach the microfinance sector through its lending, but has extensive outreach to all sections of the community in terms of its savings products.

The only significant microfinance program in Vanuatu is the Vanuatu Women's Development Scheme (VANWODS), a replication of the Grameen Bank operating in Vila. By June 1999 it had 343 members. Up to April 1999 the on-time monthly repayment rate was 100 per cent, and the program had achieved operational self-sufficiency of around 39 per cent. VANWODS plans to reach self-sufficiency by 2005, with a base of around 3,000 members.

Vanuatu also has a small credit union movement. However, it is difficult to assess the effectiveness of credit unions in providing savings and loan services to low-income households, as financial and performance statistics are not available.

There has been some discussion as to the nature of demand for microfinance in the Vanuatu. While the rural areas and outer islands provide limited scope for income-generating

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activity, there is a significant market-based informal economy in Vila and to a lesser extent in some other centres. Clients also have a high demand for the voluntary savings products. The evidence suggests that demand for microfinance programs emphasising credit for income-generating activities may be greatest in and around Vila and possibly some of the larger centres in other parts of the country. In rural areas and on the outer islands, there may be more demand for lower cost models emphasising savings mobilisation and small loans for provident purposes.

Even in ideal circumstances, it is extremely difficult for microfinance programs to achieve financial self-sufficiency. And circumstances in the Vanuatu are far from ideal. If VANWODS succeeds in achieving self-sufficiency by 2005, this will be an extremely noteworthy achievement. Nevertheless, it remains to be seen if this target is achievable.

It may be appropriate for key stakeholders to work together to develop a national strategy for microfinance in Vanuatu. In developing such a strategy, policy makers and donors should be realistic about what microfinance can achieve. Microfinance programs will need considerable support from the Government and/or donor agencies if they are to develop. Indeed, if they can be shown to be a successful strategy for reducing poverty and/or achieving other objectives there may be a case for ongoing subsidisation. Microfinance programs should also take account of the nature of the local economy, and apply best practice principles.

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