

# Microfinance Bulletin

## Mozambique Microfinance Facility

### A Credit Bureau for Microfinance Institutions



The Mozambique Microfinance Facility (MMF) is a program of the Canadian International Development Agency (CIDA), and implemented by Mennonite Economic Development Associates (MEDA) and Development Partnerships (DevPar).

This Microfinance Bulletin is published by the MMF. Bulletins are published from time to time on issues of relevance to the microfinance sector in the Republic of Mozambique. The bulletins have no official status and are produced solely for the purpose of sharing information and stimulating dialogue.

Enquiries may be addressed to the MMF project office at: Rua Pereira do Lago 176, Maputo, Mozambique; tel: 258.1.49.1785; e-mail: mmf-moz@tvocabo.co.mz

#### THE CONCEPT

The development of credit bureaus has been considered a matter of significance wherever microfinance is practiced. Anita Champion and Liza Valenzuela have highlighted the importance of credit bureaus for the ordered growth of microfinance institutions (MFIs) in their paper<sup>1</sup> on the necessity of credit bureaus. This MMF bulletin provides further background on this issue as well as an update on recent developments and the way ahead in Mozambique.

A credit bureau for microfinance (CBM) records information on loan transactions of borrowers doing business with participating MFIs. For the credit bureau to operate successfully, participating MFIs must provide the CBM with information as to when loans are made to borrowers and when loans are repaid. That information will enable participating institutions to determine from the credit bureau if a loan applicant has a good record servicing past loans, has loans currently outstanding and/or has pledged assets as security against outstanding loans.

Elinor Haiden points out in a recently published paper<sup>2</sup> that there are a number of specific benefits of a credit bureau (see sidebar) dedicated to micro-enterprise. These benefits are valid for MFIs in all countries. Each of these benefits should be examined in light of the type of organization which is consider-

ing participation in a CBM.

*Lower transaction costs* are important to everyone, especially for the large self-sustainable MFI that has to control administrative costs and loan losses to enhance the bottom line. Smaller MFIs are also interested in quicker approvals because it allows them to add more clients and expand their outreach, which in turn will enable them to attract much needed capital. The shorter waiting period for loan approval may well become a demand of the better borrowers who, given a choice, will spend time with an MFI that can solve the client's liquidity needs rapidly, rather than wait

as much as 2 or 3 weeks for approval. Rapid loan approvals can become a competitive advantage to MFIs participating in a CBM.

*Reduced risk* is also desirable. However, some MFIs believe that their lending profile (i.e. size and term of loans) will result in their clients not borrowing from other MFIs. Borrowers in every culture and at every socio-economic level are eager to obtain loans on the best terms and conditions and will tend to shop around. An individual who has a MZM 50 million loan at one MFI may arrange a MZM 5 million credit from another to pay the interest

#### Benefits of a Credit Bureau

- *Lower Transaction Costs.* Microfinance institutions can spend less time evaluating loan applications, which lowers the cost of providing credit. Microentrepreneurs can spend less time waiting for loans to be approved — one of borrowers' key demands.
- *Reduced Risk.* Microfinance institutions are better able to assess borrower risk and, consequently, can more accurately price their services, manage their loan portfolios and set appropriate risk-adjusted reserves.
- *Greater Transparency.* Microfinance institutions gain better knowledge of the liability side of those businesses that use non-standardized accounting procedures. This information also helps regulatory authorities monitor the sector more systematically.
- *More Competition.* Microfinance institutions will compete for clients with favourable credit histories, resulting in better terms for those borrowers.
- *Better Incentives To Repay.* Credit bureau information disciplines borrowers by letting them know that they risk being locked out of credit markets if they delay or default on their payments.

As outlined by Elinor Haiden in *Credit Bureaus: Leveraging Information for the Benefit of Microenterprises*.

on the larger loan. A separate consideration is that potential borrowers with good credit histories represent a lower credit risk than clients with no credit history. A CBM can provide evidence of that history. A study by Mark Schreiner on credit scoring<sup>3</sup> comments that repeat loans can be about half as risky as new loans.

*The transparency issue* is particularly important when MFIs are considering the renewal of existing clients' loans. MFI practitioners boast of the empowerment that microcredit gives to new clients. While the first and second loans may be promptly paid (giving the borrower a good credit history within the original MFI), the accumulation of several loans is the classic debt spiral that has harmed many clients. By being able to see if and where the client is borrowing from other MFIs, the original credit provider will have a significantly better understanding of what his or her client is doing while performing under the original loan.

Consideration of a CBM raises the issue of whether it could lead to poaching or luring good clients from other MFIs. The best remedy for this problem is to ensure the CBM has a set of rules for participating MFIs that can be easily enforced. For example, the MFI must have a written application for credit from the borrower and the borrower's signed permission (a legal requirement in Mozambique) to investigate its credit history prior to consulting the CBM. Random audits would be made by the CBM administrator to ensure that this rule is upheld. In Peru, the CBM excludes the name of the MFIs providing credit, thereby making "copycat" lending more difficult. Nevertheless, the CBM does generate *more com-*



*petition* and this "cost" has to be weighed against the benefits of greater transparency, lower transaction costs and more qualified risk assessment.

The inclination of borrowers to repay loans is really a cultural and development issue. Once borrowers understand that not repaying loans, or being late with payments, seriously affects their ability to raise additional credit, they will begin to give greater importance to protecting their credit standing. This leads to a repayment culture that results in fewer defaulters. This borrower discipline needs to be reinforced by an independent agency (as well as by individual MFIs), such as a CBM. It acts like a traffic policeman, ensuring that people do the right thing.

Is a CBM useful for all microfinance operations? It should be remembered that the CBM creates a tool – a report on the credit history of individual borrowers' credit status and histories – that adds to information that the microfinance credit officer already has. If an MFI is operating in an area where there are no formal competitors, then the CBM will not offer any new information and need not be consulted. As well, MFIs who work with large

groups, the so-called "Village Banks", may not need information from a CBM because the group already acts as a filter – i.e. whoever has a history of payment difficulties is not allowed into the group.

The CBM is significantly useful for MFIs that work with individual loans or with solidarity groups where competition exists between MFIs. The CBM can investigate immediately if the client has a good credit record and/or has other outstanding loans and other pledges of assets as security. Most of the requests for credit reports will come from larger urban centers. However, wherever there is an internet connection, MFIs that operate in smaller centers can also obtain credit reports.

## THE MOZAMBICAN CONTEXT

Dialogue within the Informal Working Group (IWG) for microfinance has identified the need and stimulated exploration of the possibility of setting up a Credit Bureau dedicated to MFIs. The impetus for this initiative arose from the frustration caused when credit officers arrived at a client's premises, whose loans were in arrears, only to encounter an MFI competitor taking away

assets that had been pledged in guarantee of loans granted by both MFIs. MFIs have noted a growing tendency by some clients to double or even triple pledge personal assets in order to obtain additional credit.

For these reasons, MFIs in Mozambique would like to create a Microfinance Credit Bureau (CBM) where all of the MFIs operating in areas in which competition exists, contribute client data and where they can request reports on potential clients to determine if the client has: (1) a good payment history; (2) loans from other MFIs; and/or (3) pledged assets in support of loans still outstanding.

If only one financial institution operated in Mozambique, and it had good management information systems, there would be no need for a CBM. The institution would keep its own records and would know the payment history of all of its clients. If any client tried having more than one loan at the same time from the institution's branches, the institution would be able to determine that from its systems in advance of granting the new loan.

However, in Mozambique, there is substantial competition: five MFIs currently compete in the provision of microcredit in Maputo and the surrounding area; three MFIs compete to provide credit in Beira; three others offer services in the Xai Xai/Chokwe area, and there is some competition in other smaller centres. Each of these MFIs has a slightly different strategy regarding the selection and approval of clients. By becoming a participant in a CBM, each MFI will be able to avoid doing business with people who have become overburdened with debt from more than one MFI. This can only be achieved

by sharing information between MFIs.

Currently a Credit Bureau managed by the Bank of Mozambique is in operation and is designed to serve all financial institutions licensed under Law 15/99<sup>4</sup>. The licensed MFIs have found that this “Central de Riscos” does not provide information that is useful to microfinance practitioners though serving other institutions well. The MFIs who are licensed only under Decree 47/98<sup>5</sup> cannot participate in this Credit Bureau, therefore, there is no complete data bank in the Credit Bureau for microfinance. There is little current sharing of MFI client information and that leads to all MFIs running larger credit risks than they need to.

## THE LAW

Law 15/99 (Article 50) allows for the establishment of private

credit bureaus. Furthermore, the law allows client information to be shared within a controlled confidential system, such as a private CBM, providing the client has agreed in writing in advance that its credit history may be investigated. It is not known if the provision of data to a private CBM would substitute for the provision of data to the Bank of Mozambique’s Credit Bureau. But the special needs of MFIs in regard to credit information argues for a separate CBM, even in cases where reporting might be made to both credit bureaus.

## OPERATIONS

After obtaining approval to operate from the Bank of Mozambique, the CBM would seek to sign contracts with MFIs that want to join in this venture. The contract would require the MFIs to provide client information on a monthly basis as a condition of having access to

Type of information	Format	Currently Supplied?
Date of information	dd/mm/yy	yes
Name of MFI providing information	by BM code	yes
Name of the person	by first name	yes
Identity number (BI/DIRE/Talao/PP)	number	yes
Type of ID number	B/T/P/D	yes
Birth date	dd/mm/yy	no
Address	[optional]	yes
City	name	yes
Province	name	yes
Original loan amount	in MZM 000s	yes
Original disbursement date	dd/mm/yy	no
Repayment dates	eg. Monthly	no
Amount outstanding	in MZM 000s	yes
Assets pledged?	[Yes or No]	no
Overdue debt	amount	yes
Overdue debt written off	amount	no
Date of write off	dd/mm/yy	no
Amount of write off repaid	amount	no
Date of total repayment of write off	dd/mm/yy	no
Economic sector	by BM code	yes

individual credit histories at a modest cost. The information that would have to be supplied on a monthly basis is illustrated in Table 1<sup>6</sup>.

With this information maintained in a data bank by the CBM, the MFIs will be able to request information based on the identity of the borrowing applicant. The software would respond with all of the people with that same identity (recognition may be required of related Identification Number (ID) numbers, types of ID documents and date of birth to be sure of identifying the client for whom information is being sought). The MFI would then request a credit report for the borrowing applicant.

This methodology helps resolve the “unique identifier” problem, which is significant in Mozambique. Ten years after the end of a long civil war only about one-half of the population in the principle centres have an updated identification card – the Bilhete de Identidade (BI). All

of the MFIs require their clients to have such a card, or to show proof that they have applied for a BI. The proof is a “talão”, which has its own unique identification number. Other citizens will have a domestic passport, while resident foreigners have a Documento de Identificação e Residência para Estrangeiros (DIRE), which is similar to a BI. Enquiries to the CBM by name only may provide several answers with the identifiers of name, ID, type of ID and, if necessary, the date of birth. This allows the enquirer to choose one or more reports to see the person’s credit history. This is especially important where a client has borrowed under both the BI and talão number. In passing, it should be noted that MFI practitioners recommend against using only the person’s address as an identifier because a reliable system of this sort does not yet operate effectively in the country. The field is included because the Bank of Mozambique requires this information in its Credit Bureau data.



The credit report would have three parts: (1) identifying data of the person, current outstanding loans and whether he/she had pledged assets in support of those loans; (2) person's credit history; and (3) an indication if the person had difficulties paying past loans. The "credit history" referred to will only have information beginning from the start of operations for the CBM or the point at which an MFI joins the CBM. It should be noted that the reports would be requested on-line in a secure and dedicated systems environment. The reports can be requested every day with a simple internet connection using a personal computer (PC) that has been registered with the CBM. This means that the MFI will be able to access the system without any additional CBM costs.

An MFI providing data on its clients to the CBM will want to use the CBM to see credit



histories of its borrowing applicants. No MFI will be allowed to access the CBM if it does not provide information on its clients. It will be important to ensure that potential MFI CBM participants are able to provide information on its clients. MFIs that are already licensed under Law 15/99 have indicated a willingness to provide the required information. The smaller

MFIs have the data in their Management Information Systems (MIS), but may experience initial difficulties transmitting it to the CBM. Providing MFIs with technical support is part of the capacity building mandate of the MMF.

MFIs wanting to participate in the CBM would become members and owners. The CBM

could operate on a self-sufficient basis where any profits earned in one year could either be returned to the owners on a pre-decided basis, or applied to expand or maintain the system.

## THE WAY AHEAD

A proposal is being prepared to obtain funding required to establish the MFI-oriented CBM in Mozambique. As well, a business plan will be developed with reference to the experience of similar ventures<sup>7</sup> and the advice provided by other research efforts<sup>8</sup>.

At this stage of development, it will be sufficient for MFIs and their supporters to consider the information provided in the bulletin and to raise concerns or offer suggestions either through the Informal Working Group or directly to MMF.

## Endnotes

<sup>1</sup> *Credit Bureaus: A Necessity for Microfinance?* By Anita Campion and Liza Valenzuela October 2001

<sup>2</sup> *Credit Bureaus: Leveraging Information for the Benefit of Microenterprises* By Elinor Haider. MicroEnterprise Development Review, January 2000, vol. 2, No. 2.

<sup>3</sup> *Scoring: The Next Breakthrough in Microcredit?* Paper prepared for the Consultative Group to Assist the Poorest. Mark Schreiner. June 11, 2002

<sup>4</sup> Law 15/99 is the principal banking law in Mozambique and regulates in a general manner the activities of all types of financial institutions in the country. A copy

in Portuguese is available at the Bank of Mozambique website at [www.bancomoc.mz](http://www.bancomoc.mz).

<sup>5</sup> Decree 47/98 allows NGOs to practice microcredit but specifically disallows the taking of deposits. MFIs who operate under 47/98 are referred to as "unlicensed" in this paper. A copy of the Decree 47/98 is available in Portuguese at the Bank of Mozambique website at [www.bancomoc.mz/index](http://www.bancomoc.mz/index).

<sup>6</sup> Licensed institutions are required to provide information to the Bank of Mozambique's Credit Bureau. The word "yes" under "Currently supplied?" refers to this information. The word "no" means the information is in addition to what the Bank of Mozambique

currently requests.

<sup>7</sup> Preparation of a Business Plan and Feasibility Study for the Establishment of a Credit Bureau in Jordan – Final Report, August 2000. This report was prepared by Jim Aziz of Baja Group Consultants and Bruce Church, P.Eng. of Software Authors, in collaboration with Chemonics International Inc., prime contractor to the U.S. Agency for International Development for the AMIR Program in Jordan.

<sup>8</sup> Private Initiative in Regulating Financial Discipline by Zeljko Katic and Guy Dionne. April 14, 2002