This is a Policy Analysis Project that investigated the effects of microcredit in fostering financial inclusion in Cape Verde using data collected through a field experiment, further complimented by qualitative and quantitative data, split into individual and group component; presented as part of the requirement for the award of a master's degree in International Development and Public Policy at Nova School of Business and Economics, Lisbon Portugal.

MICROCREDIT REGULATIONS, CHALLENGES, AND OPERATIONS IN CAPE VERDE

(EFFECTS OF MICROCREDIT IN FOSTERING FINANCIAL INCLUSION IN CAPE VERDE)

NWABUEZE PRINCE OKENNA

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ABSTRACT OF INDIVIDUAL PART:

As an individual component, this paper investigated the various microcredit regulations, challenges faced by these small and medium sized businesses, and key characteristics on their operations through field interviews that was conducted in Cape Verde on some of the key stakeholders (representative of the Central Bank of Cape Verde and the Ministry of Finance).

Cape Verde is an archipelago country composed of 9 inhabited islands with a combined land area of about 4,033 square kilometres. It is ranked 110 out of 137 countries in terms of its global competitiveness, and has one of its most problematic factors for doing business as access to financing facilities for entrepreneurs. This has mitigated the expansion of small and medium sized business structures (SME´s), and contributed to significantly to the predominance of the conduct of economic activities by informal SME´s which are dispersed across the nine inhabited islands.

This study found that the microfinance offices at the Central Bank (BCV) started operation in the year 2019, although its regulations have been in place since 2016. The study found that one of the core advantages of the microcredit in Cape Verde which makes it desirable by the members of the public and businesses is its ease of accessibility with no collateral facilities.

In terms of financial transaction, a majority of transactions are done in cash.

Furthermore, the study equally found aside from absence of basic finance facility, financial literacy, and the absence of coordinated social data, and a centralized information access system where both the public, the Central Bank, and the various MFI´s can access useful information that contains key indicators, interest rates, and repayment mechanisms a strong concern. In other to provide the credit applicant with basic financial skills, the respective MFI holds seminar sessions to teach them basic financial principles.

ABSTRACT OF GROUP PART:

Banco de Cape Verde (BCV) is the Central Bank of the Republic of Cape Verde. Its mission is to ensure macro-financial stability for sustainable and inclusive economic growth and social development. Consequently, it supports micro, small, and medium enterprises (MSMEs) through microcredits disbursed through microfinance institutions. We conducted interviews with microcredit stakeholders in the country and developed a qualitative analysis of the ecosystem. We analysed the microcredit provision of one Cape Verdean institution and illustrated trends and evolution in fostering financial inclusion through microcredits disbursed in 2012 and 2019. The result shows an increase in microcredits allocated to females and there is evidence of the diversification of the activities engaged by the recipients.

KEYWORDS: Microcredit, Financial Inclusion, Microfinance, Cape Verde, Micro, Small and Medium Enterprises

JEL CODE: D14, G21, I38, O15, O16, P34, P36

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PREAMBLE

This is a work project submitted in Partial Fulfilment of the Requirements for the award of a master's degree in International Development and Public Policy at the Nova School of Business and Economics, Lisbon, Portugal.

In this project, we conducted a field experiment to investigate the role of microfinance in fostering financial inclusion in Cape Verde. Due to the absence of a credible counterfactual to measure the impact, we adopted both qualitative and quantitative methods. The former analysis was based on the interviews with the main stakeholders in Cape Verde that we have done during our field trip. The latter analysis was developed by investigating the trend of microcredit implementation by the third largest microfinance institution (ASDIS) in Cape Verde in terms of market share. To do this, we critically assessed the total amount of these microloans disbursed in 2012 and 2019 to the recipients having considered several observable characteristics which informed our analysis.

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LIST OF ACRONYMS/ABBREVIATIONS

ADB: Asian Development Bank

BCA: Banco Comercial do Atlântico

BCN: Banco Cabo-verdiano de Negócios

BCV: Central Bank of Cape Verde

CBK: Central Bank of Kenya

CPI: Corruption Perception Index

DTMs: Deposit-Taking Microfinance Institutions

EMDEs: Emerging Market and Developing Economies

ESF+: European Social Fund Plus

GDP: Gross Domestic Product

GMM: Generalized Method of Moments

ILO: International Labour Organization

MENA: Middle East and North Africa

MIs: Microcredit Institutions

MFIs: Microfinance Institutions

MRA: Microcredit Regulatory Authority

MSMEs: Micro, Small, and Medium Enterprises

NBFI: Non-Bank Financial Institutions

NGOs: Non-governmental Organizations

PPP: Purchasing Power Parity

RCT: Randomized Control Trial

ROE: Return on equity

ROA: Return on assets

EXECUTIVE SUMMARY

The vilification and idolization of microcredit as an effective development tool in the fight against poverty, especially for the poorest of households in developing countries, has spurred mixed reactions from both academics and industry. Microcredit has nevertheless gained popularity since its launch in 1983 by the Grameen Bank in Bangladesh and is currently used as a development tool by many institutions all around the world.

Microcredit typically refers to a method of lending tiny amounts of money to individuals to either start or expand their businesses with almost no collateral requirement, unlike formal banking institutions. Its popularity among poor individuals and the unbanked has led to increased demand for these credit facilities, beyond the supply of available microcredit.

Our study adopted complementary qualitative and quantitative methods to analyse the role of microcredit as a tool to promote financial inclusion in Cape Verde. In our fieldwork, we interviewed the key stakeholders involved in the microcredit ecosystem in Cape Verde. We also used anonymized data obtained from the third largest microfinance institution by market share (ASDIS) with a total sample size of 440 and 765 beneficiaries of microcredit, respectively for the years 2012 and 2019. Due to the absence of a credible counterfactual, we were constrained in our ability to evaluate the causal impact of the microcredit intervention. While this would be a valuable exercise in future research, we opted to perform descriptive analysis of this dataset, which allowed us to measure the main characteristics and trends in the disbursement of these microcredits between 2012 and 2019. In this way, we examined the sector of activity, gender, and type of businesses of microcredit beneficiaries. Using the amount of credit disbursed in 2012 and 2019, we also explored the existing trends that can inform policy decisions.

The 2012 microcredit data revealed that the average age of the credit recipients as 55 years with most of the beneficiaries being female and financially illiterate (proxied by the absence of a high-school degree, i.e., 12 years of schooling). With an average approved and disbursed credit amount of 110,400 CVE (approximately 1,000 euros), and an interest rate of 2.59% mostly collected as an individual credit rather than as group lending, majority of the beneficiaries were engaged in the primary (agricultural) sector.

Seven years later, the 2019 data shows a strong decline in the average credit recipient age, at 42 years, which is a 25% decline from 2012. Quite a significant percentage of the beneficiaries are literate in 2019 relative to 2012. With the average credit approved amount of 121,300 CVE (about 1,100 euros*)* and a monthly interest rate of 2.6%. We perceive the increase in the amount of the loan to be complimentary with the cumulative inflation rate of 5.7% over the 7 years period. In 2019, a sizable proportion of the credit recipients were engaged in the non-agricultural sector, such as cloth designs, carpentry, pastry making, and other commercial activities. Complimentary to our qualitative interviews, this can be attributed to substantial diversification policy with the drive to support the service (tourism) sector relative to 2012. We also found that the percentage of females who received these credits increased over the 2 periods, and even higher in both years (2012 and 2019).

Finally, evidence obtained through our qualitative analysis and interviews revealed that the current funding mechanisms available to the microfinance sector are seen by microlenders as expensive and limited if institutions are to meet the growing demand while facing the economic woes of the Covid-19 pandemic. The regulatory framework was also identified as a possible constraining factor to the further expansion of the sector due to the existent restrictive categorization of microfinance institution types. Furthermore, the stakeholders have indicated a sector in continuous development with brand new funding mechanisms being created and plans for the introduction of microbanks in the Cape Verdean microcredit market.

1. Introduction

In the words of Muhammad Yunus, *"If we are looking for one single action which enables the poor to overcome their poverty, I would go for credit. […] If we produce a system which allows everybody accesses to credit while ensuring excellent repayment - I can give you a guarantee that poverty will not last long."* – Muhammad Yunus (1994).

Poverty, especially in developing parts of the world, is a complex phenomenon characterized by multi-dimensional fronts. Poverty eradication is still one of the worlds´ greatest challenges, which is evident through its inclusion in the sustainable development goals of the United Nations. Increased access to financial services has been found by some studies to have a direct positive relationship to poverty, and to significantly minimize its impact especially on the lower-income groups through facilitation of consumption and economic productive activities, (Omar and Inaba, 2020). The central aim of microcredit is poverty reduction by empowering local entrepreneurs through self-employment in low-income countries.[1] However, this has been met with several bottlenecks, criticisms, and challenges that has spurred up debates by both academic and industry.

Our work is one of the few studies on microfinance in Cape Verde that employs both qualitative and quantitative data to analyse the microcredit sector[2], its evolution and role in terms of financial inclusion in Cape Verde. The uniqueness of the work derives from conducting interviews with the main private and public financial institutional stakeholders in the Cape Verdean microfinance sector. Our policy analysis considers not only the perspective of three microcredit institutions and the data provided by one of them but also two institutions that

[1] Bauchet, Jonathan, Jonathan Morduch, and Shamika Ravi. (2015)
[2] See Bernadino et al. (2017) and Silva (2012).

finance MFIs (commercial bank and a public institution) and the two main policymakers and regulators of the financial sector (central bank and ministry of finance).

For this purpose, we examined ASDIS - the third largest microfinance institution in the country in terms of market share by focusing on the years of 2012 and 2019 with a total sample size of 440 and 765, respectively. Thus, we examined the trend on the evolution of new economic sectors of activities, total credit approved by the literacy level in the different years, inclusion through gender by comparing the loan amount approved for women and male in the various periods, and the nature of activities engaged.

Our results show that although most of the credit beneficiaries are individual clients, the amount of credit approved for group applicants increased by 1% between 2012 and 2019, with no meaningful change recorded for credit allocated to individual applicant. We also found the loan cycle (number of times an individual request for a loan) to be correlated with this. This correlates with existing literature that microfinance institutions prefer to give group lending than individual due to the less default rate[34].

To understand if there are any inherent disparity between male and female – if women were marginalized in obtaining microcredit in both periods, we compared the total credit approved for men, to those of females. We found that in both periods, the percentage of females who received these credits was significantly higher than male. This finding aligns with existing literatures that microcredit institutions prefer to lend credits to women as they are considered efficient agents for household welfare and low-risk borrowers; hence, presenting less credit risks than men[5]. In addition, some of the literatures concludes that women are more passive, submissive, and vulnerable – thus, making them more dependable to make repayments[6].

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[3] Gomez, Rafael, and Eric Santor. (2003).
[4] Giné, Xavier, and Dean S. Karlan. (2014)
[5] Pitt, Mark M., and Shahidur R. Khandker. (1998)
[6] Naved, R. (2007).

Further analysis reveals a 19% decline in credits allocated to beneficiaries classified as financially literate. Financial literate is a proxy generated from level of education measured by having completed at least a high school. On the trend of how sustainable and inclusive the microcredit intervention was, we compared the total loan amount by the purpose it was approved for in both periods. We found that quite a substantial proportion of the credit was allocated to the primary sector in 2012 than in 2019; but with a high record of diversification in 2019; and a sizable difference on the average cumulative amount of credit to those without high school education when compared with those that completed high school. Although we could not measure the impact of this on individual recipient earnings to analyse if having completed at least a high school improves outcome, we however concluded that the credit approval was not dependent on the financial literacy, or consideration based on education level. We also found that among the beneficiaries that received the credit, quite a proportion of the females collected the credit for consumption. This is in line with recent studies on both mobile money by Batista and Vicente (2021) that mobile transfers have a positive impact by controlling for both aggregate and idiosyncratic negative shocks on households[7], and by Wickremasinghe et al (2017) on consumption smoothing by low-income communities[8].

We based our qualitative analysis on the findings of eight semi-structured interviews conducted in August 2022 in Cape Verde. The interviewees are key stakeholders of the Cape Verdean microfinance ecosystem, the representatives of three cooperative microfinance institutions, one representative of the Ministry of Finance, an administrator of a national commercial bank, the administrator of Pró Empresa and two office coordinators of the Bank of Cape Verde.

By analysing the multitude of answers provided, we were able to identify three key subjects that connected with the findings present in our quantitative analysis allow for a better

[7] Batista, Catia, and Pedro C. Vicente. 2021.

[8] Wickramasinghe, Vathsala, and Dilshan Fernando. (2017).

understanding of the challenges and constraints facing the work of national MFIs while also presenting the general positions of the stakeholders on the current status-quo in the sector.
The main subjects expanded in the qualitative analysis were:

- The impact of microcredit according to stakeholders
- The role to be played by Cape Verdean MFIs in the future
- Current funding environment and related difficulties.

The interviews revealed that all stakeholders see microcredit as an important positive tool to not only fight poverty and unemployment but also as a conduit for the promotion of businesses formalization and financial literacy with efforts mostly directed towards poor Cape Verdean and with an important focus on women heads of households. This joint position is not continuous in all the chosen subjects concerning the microcredit sector. Most stakeholders agree that the sector requires cheaper and more flexible funding mechanisms to ensure sustainable operations but not on how to achieve this need. With the main point of contention being if MFIs should be able to directly receive funding from the central bank similar to the credit lines available to national commercial banks. Another point of contention between stakeholders is related with the current regulative framework. All interviewed Microlenders believe that regulations concerning Category B cooperatives should be reworked to allow for better flexibility in the way these entities can operate in the market and how they can be funded finding the current categorization too restrictive for the realities of the market. We were also informed that several microcredit institutions are preparing to proceed with the evolution from cooperative towards microbanks indicating a sector that is still in a transformative phase.
The interviews conducted were a particularly important source of information regarding the innerworkings of the microlenders, their eligibility criteria, their financial situation, their plans, and ambitions. With our quantitative analysis giving us an understanding of the clients'

spectrum of Cape Verde and our qualitative analysis findings, we hope to provide a key component that can be used as a contribution to future academic and political works regarding the microcredit sector and its regulative framework in Cape Verde.

Through our study we were also able to devise several policy suggestions for the current Cape Verdean regulatory framework, and actions that could be reviewed in the future. One of which involves the allocation process for microcredits for consumption. Although there exists an already very complete eligibility criterion regarding accessing these credits, we believe this process should be extended to mandate the promotion of the financial literacy level of clients; evidence have shown literacy level to impact positively on transitory growth and future economic outlook[9].

On the regulatory framework, we believe a more flexible regulatory categorized provision should be made to incorporate specific credit applicant's needs. We also believe that a change on the current interest caps and the possibility of direct financing from the Central Bank (BCV) could improve the sustainability of the microfinance institutions (MFIs).

Additionally, an expansion of the "Rempe tax" programme, the removal of administrative costs and barriers related to the formalization process and an expansion of the complementary work between Pró Empresa and MFIs could not only promote higher rates of formalization of businesses but also better synergies between public and private institutions in the sector.

[9] Struckell, Elisabeth M., Pankaj C. Patel, Divesh Ojha, and Pejvak Oghazi. (2022).

2. Concepts

Microfinance

Microfinance refers to a broad range of financial services provided to underprivileged individuals, small entrepreneurs and enterprises who cannot take shelter from banks for banking and other financial services.

Microfinance financial services include credit and non-credit activities like savings, pensions, and insurance.

Microcredit

Microcredit refers to a small loan facility provided to people with less earnings, to motivate them to become self-employed. Microcredit is a component of microfinance, but the former only includes credit activities.

Importance of microcredit

Literature evidence that there are different opinions on the impact and importance of microcredit to face poverty. Nevertheless, literature findings that support microcredit state that it can provide a range of benefits, it increases income and consumption of the beneficiaries, smooths their cash flows and avoids periods where they cannot access food, clothing, shelter, health or education, eases the managing of external and internal shocks by those families (sickness, inflation, unemployment, natural disasters, etc), self-empowers the microcredit beneficiaries and allows people to build assets in order to have future financial security.

Financial Inclusion

According to the World Bank[10], financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit, and insurance – delivered responsibly and sustainably.

Importance of financial inclusion

Financial access facilitates day-to-day living, it helps families and businesses plan for everything from long-term goals to unexpected emergencies. As account holders, people are more likely to use other financial services, such as credit and insurance, to start and expand businesses, invest in education or health, manage risk, and weather financial shocks, which can improve the overall quality of their lives.

3. Microcredit – An Overview and Literature Review

Although the term microcredit was born in 1983 with a primary focus to provide financial assistance to individuals of lower socioeconomic backgrounds who experienced hardship in Bangladesh, there are postulations that this concept and form of lending money to people of lower socioeconomic background dates as far back as the 1700s in Ireland.

The earliest version of microcredit delivery was introduced by Grameen Bank under the leadership of Muhammad Yunus, the key pioneer shaping microcredit under his conviction that "all human beings are born entrepreneurs." He decided to open the Grameen Bank (meaning "village bank") with headquarters in Bangladesh in the year 1983 which birthed his vision and championed the path of microcredits[11]. This project by Yunus started in a small town called

[10] https://www.worldbank.org/en/topic/financialinclusion/overview#1
[11] Bateman, Milford, (2010)

Jobra and by using his own money to provide microcredit at low-interest rates to the rural poor. Over the years, it became a popular tool for economic development, making it easier for institutions and businesses to emerge throughout the third world.

One of the prominent practical examples of the microcredit initiative started with a group of women who created stools made with Bamboo in Bangladesh. The women were making earnings of approximately $0.02 from each stool due to the repayment of the stool suppliers. At first, Muhammad thought that if a source of credit were made available to the women that they could use to repay the suppliers, could take them out of poverty. To begin with, he experimented by giving out $27 as a loan to sustain their business to be repaid at a later period. Not only was this transformative, but it also impacted their business positively, and the ease of accessing these funds created an increased demand for them.

Built on the concept of investing in people with skills and young entrepreneurs in impoverished countries who do not have access to financial services that meet their needs and business requirements; the beneficiaries of the microcredit intervention usually live on a barter system where the currency is not used as a medium of transaction. However, the recent and current concept of microcredit is based on the Grameen Bank Model where loans are given to the beneficiary ranging between $10 to $2,000; these loans may not require any written contracts, and repayment starts immediately. Moreover, as people fulfil their pledge by paying off their microcredit loans, they gain more credibility (in terms of an informal credit score recognized by the lending microfinance institution) which qualifies them to take more loans of an equal or higher amount of a particular set threshold by the microfinance institution. According to the Microcredit Summit Campaign (2015) – an American non-profit organization that brings the actors and stakeholders involved with microcredit around the goal of alleviating world poverty through microfinance: Report asserts that the number of poor families with a microloan has grown more than 18-fold from 7.5 million in the year 1997 to 137.5 million in the year 2010, and around 211 million by the year 2013[12].

While these positively impact on the beneficiaries' businesses; giving them leverage and an equal playing field for their business survival and viability, there are also certain problems regarding the microcredit model, especially in the absence of government regulations and supervision. One of the prominent was a backlash from the "New York Times" article in 2010 on the increased rates of suicide linked to indebtedness from those that patronized the non-regulated microcredit facilities often associated with the concept "predatory lenders" (loan sharks). The sudden outburst of these predatory lenders especially in developing countries is one of the banes of microcredits. Curated from the Yunus Muhammad speech at the United Nations, "we created microcredit to fight the loan sharks; we didn't create microcredit to encourage new loan sharks…"[13]

Strongly associated with high interest rates owing to the exorbitant monitoring and administration costs, MFIs now prefer group lending as it is believed to be associated with lower risks, and cost[14]. Thus, making microfinance institutions to shift their target audience (market) to group lending. In this scenario, each group member is responsible for the debt of the other group members[15] - a form of collateral. Because of this structure, group members only welcome to the group people they already know, which have safe businesses - but these are typically businesses with no growth prospects and hence unable to serve as engines for economic growth. This created a gap in the ecosystem that necessitated the growth of loan sharks targeting vulnerable loan applicants.

[12] Microcredit Summit Campaign Report, 2015.
[13] United Nations (2006).
[14] Armendáriz, Beatriz, and Jonathan Morduch. (2010).
[15] Ghatak, Maitreesh, and Timothy W. Guinnane. (1999).

3.1. Microcredit and Micro, Small and Medium Enterprises

Microcredit involves providing loans with small values (also called microloans) to impoverished borrowers who typically do not possess the basic requirements of formal banking institutions such as collateral, a steady and secure job, or even verifiable credit history[16]. Because of these credit market gaps, microcredits may be useful to support small-scale businesses, and encourage entrepreneurs through short-term soft loans, with the long-term objective of alleviating poverty.

In addition, it aims to support and kickstart entrepreneurs who are unable to obtain the financial backing needed to start a small business or capitalize on an idea; these sets of small and medium-scale entrepreneurs are referred to as the engine of growth in the economies of most developing African countries and constitute nearly 40% to the gross domestic product (GDP) of their country[17].

According to the World Bank 2002 report, Micro, Small and Medium Enterprises (MSMEs) constitute a significant percentage of all businesses in the world and are a significant contributor to job creation; thus, reducing unemployment and contributing to global economic development[18]. They also represent approximately 90% of the businesses and contribute to 50% of global employment[19].

Furthermore, formal MSMEs contribute 40% of the gross domestic product (GDP) of these emerging economies, and these percentages are notably higher when informal MSMEs are included. A follow-up report by International Labour Organization (ILO) confirms that the

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[16] Yunus, Muhammad, (2003).

[17] "Small and Medium Enterprises (SMEs) Finance, Improving SMEs' access to finance and finding innovative solutions to unlock sources of capital," The World Bank. https://www.worldbank.org/en/topic/smefinance [Last accessed on August 17, 2022.]

[18] World Bank Group. A revised forest strategy for the World Bank Group. World Bank Group, 2002.

[19] Kozak, Robert A. Small and medium forest enterprises: instruments of change in the developing world. Washington, DC, USA: Rights and Resources Initiative, 2007.

informal economy comprises more than 50% of the global labour force, and even more than 90% of MSMEs worldwide[20].

Although most governments are now aware of the importance and economic contribution made by MSMEs and have put together policies that promote their growth, there are still policy mechanisms and inherent country-specific challenges that continue to inhibit the growth potential of these small firms. A striking portion of these barriers is related to a lack of access to formal credit facilities. One of the reasons is because a significant percentage of these firms are in the informal sector; with no established legal structure defined by the law, no steady income and source of revenue, coupled with the absence of the required collateral facility – due to this, they are often constrained by the nature of credit available to them.

3.2. Literature Review

Over the past couple of years, there have been debates between academics and policymakers who are either supporters or opponents of microcredit. Topics have ranged from whether microcredit can lift people out of poverty, contribute to increased living standards, increase in personal and economic welfare, and overall living conditions of the beneficiaries. Many advocates have painted pictures of positive individual stories on the impact of microcredits on the recipients – some of which include households escaping poverty as soon as they receive a microloan. Similar reports show that women benefit most as access to these credits and microloans allows them to become more economically and socially independent. This effect is even more positive for women in societies, where obtaining formal loans further discriminates against them, hence making it almost impossible for women to benefit from formal loans[21].

[20]International Labour Organization. "More than 60 per cent of the world's employed population are in the informal economy." International Labour Organization (2018). Https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_627189/lang--en/index.htm

[21]Brana, Sophie. (2013).

On the other hand, however, there are also doubts about the ability of microcredits to improve living standards in a structural and sustained way. On the side of this argument, Alessandro et al. (2015) conducted a randomized control trial to investigate the impact of microcredits loans on socioeconomic outcomes in rural Ethiopia including outcomes from agricultural activities such as animal husbandry, schooling, labour supply, non-farm self-employment, and women´s empowerment indicators. They found that despite the substantial increase in borrowing in the treated areas, the microcredit intervention had no positive impact on any of the listed indicators (household welfare, labour supply, child school attendance, women's empowerment, health, and food adequacy) for those that received the intervention.[22]

In a similar study by Kandie and Islam (2022), using household panel data, they investigated the impact of digital credits in comparison with traditional microcredits on poverty in Kenya. Using a difference-in-difference and propensity score matching, they found a negative impact of digital loans on poverty, with no corresponding effects on traditional microcredits[23].

Cai et al. (2021) evaluated seven randomized control trials which rolled out microcredits in a variety of contexts and different countries. Using data from previous research, and by revising the impacts of microcredit programs in seven countries (Bosnia, Ethiopia, India, Mexico, Mongolia, Morocco, and the Philippines) in both rural and urban settings, they found microfinance to be an extremely heterogenous field as its contract designs involve a degree of freedom and variables. In addition, they found that traditional microcredit does not represent any transforming effects for borrowers and that incentives to any loan contract decrease the default rate. Analogously, Tarozzi et al. (2015) used data from a randomized experiment conducted in rural Ethiopia between 2003 to 2006 to evaluate the impacts of increasing access to microfinance on several socioeconomic outcomes, including income from agriculture,

[22]Tarozzi, Alessandro, Jaikishan Desai, and Kristin Johnson. (2015).
[23]Kandie, Daniel, and Khan Jahirul Islam. (2022).

animal husbandry, nonfarm self-employment, labour supply, schooling, and indicators of women´s empowerment in Ethiopia. Despite a substantial increase in borrowing in the areas assigned to the treatment group; they found no positive evidence of widespread improvement in the socioeconomic indicators.

Field et al (2013) in a randomized field experiment in India examined 169 loan groups to investigate whether immediate repayment obligations on loans obtained from classical microfinance institutions inhibit entrepreneurship and its spill over effects on household poverty. Evidence from the study shows that liquidity constraints no doubt negatively impacts on entrepreneurs' high returns to capital in developing countries. Providing a grace period increased short-run business investments and long-run profits. Their findings show that debt contracts that require early repayment discourage illiquid risky investment, and thereby limit the potential impact of microfinance on microenterprise growth and household poverty.

Existing evidence on the positive impact of microcredit as a tool for poverty alleviation was also put forward by academics through rigorous contemporary research methods. For instance, Breza and Kinnan (2018) in an experimental study conducted in India, investigated the collapse of microcredit institutions in 2010 to show how small loans to poor borrowers can be in the needle in rural labour markets. The result of their investigation revealed a remarkable decline in casual daily wages, household wage earnings, and consumption after the collapse. Their conclusion further revealed that increased access to microfinance has the potential to push up local wages which would impact the rural labour market more broadly[24].

On beneficiaries' overall welfare, Björkegren et al. (2021) investigated the welfare impacts of digital credits through a randomized field evaluation conducted in Nigeria. This was evaluated via a two-stage least square estimation technique. Using administrative data provided by the

[24] Breza, Emily, and Cynthia Kinnan. (2018).

lender, a field survey of 1,618 borrowers were analysed after an initial loan application with the survey weights used to account for non-random attrition. Specifically, the randomized control trial was conducted in two stages. In the first stage, an RCT was conducted with first-time customers of a digital credit facility, and 8% were chosen for the analysis constituting about 45,937 between the month of August 2019 and February 2020. Out of these, 50% of the population were randomly selected to be part of a group that requires to pass a credit score to access loans (*as the credit score increases, the bigger the amount requested),* and another group that is automatically eligible for a loan.

In the next stage, the second RCT which randomized the initial loan quantity for everyone with an amount which ranges from $2.75 to $35 was done. Although no large impacts were detected on income, expenditures, resilience, and women´s economic empowerment, the overall result from their analysis showed a modest but significant increase in subjective well-being.

Field et al. (2013) also reached a remarkably interesting conclusion while examining whether the classic microfinance contract's immediate repayment obligations inhibit entrepreneurship and thus blunt the potential impact of microfinance by making a high return but illiquid investments too risky for poor borrowers. The results of this randomized field experiment in which 169 loan groups were assigned to two different debt contracts – a classic contract that mandates borrowers begin repayment two weeks after receiving the loan (the control group) and another contract with a two-month grace period before beginning repayment (the treatment group) – while maintaining other contract provisions constant for both types and following the borrowers for three years through various surveys – indicate that the treatment group's borrowers were more likely to start repaying their loans on time.

Also in India, Banerjee et al. (2015a) in one of their papers titled “the miracle of microfinance” used a randomized evaluation of a group lending microfinance programs in Hyderabad. They found that microfinance shows significant impacts on how many new businesses get started, as well as on the purchase of durable goods. 2 years post study after controls had gained access to microcredit, and the treatment had borrowed for longer and in higher amounts, the result still shows a very few significant differences. In the same year, Banerjee et al. (2015b) summarized and compared the results of six different randomized controlled trials to measure the impact of microcredit on borrowers in six countries on four continents. Overall, the experimental effects of these studies showed modest positive, but not transformative effects. Although microcredit does not eradicate poverty by improving the everyday life of the beneficiaries, it left positive improvements in entrepreneurial outcomes[25].

Tinta et al (2022) in another related study identified micro determinants of financial inclusion in Africa by employing multiple models to analyse key drivers of financial inclusion using national surveys and the ease of doing business database in 40 African countries. This was done by comparing formal and mobile accounts and analysing loan-taking, savings, and financial resilience behaviours. Using logit and multinomial logit models, the result obtained showed that individual characteristics, the barrier to formal accounting, financial literacy, and innovation condition decisions to have either a traditional or mobile account. While individual savings are common among women, youths, and in rural areas, formal savings were used by men, the elderly, and in urban areas.

Researchers have made additional attempts to investigate the potential inequality-reducing effects of microfinance at the macro level. For instance, Ahmed and Kitenge (2022) investigated the potential impacts of microfinance on aggregate economic well-being. This was done by examining the effects of microfinance outreach on aggregate welfare measured by income and household consumption growth across 108 countries between 2005 - 2015. Using OLS with fixed effects, robustness checks, and generalized method of moments (GMM)

[25]Banerjee, Abhijit, Dean Karlan, and Jonathan Zinman. (2015).

estimation, results show that the average loan balance per borrower and the percentage of women borrowers positively impacts aggregate welfare. Additionally, outreach affects consumption growth strongly, and further recommends the incorporation of microfinance into policies targeting aggregate welfare and economic development.

Buera et al. (2021) evaluated the aggregate distributional impact of microcredit by using a quantitative macroeconomic framework. This allowed them to analyse the entrepreneurship and financial frictions in which microfinance was modelled as guaranteed small-size loans. They further validated this model using recent empirical evaluations of similar studies *(on small-scale microfinance programs).* Their result shows that there exists a substantial difference between the impact of microfinance on the long-run and its short-run effect.

To summarize, while the short run was characterized by a negative relationship between output and capital with total labour productivity *(as output and capital increase with microfinance, total factor productivity (TFP) falls),* In the long run, scaling up microfinance has only a small impact on per-capita income, because an increase in TFP is offset by lower capital accumulation. However, most of the population benefits from microfinance directly and indirectly. Overall, the welfare gains are larger for the poor and the marginal entrepreneurs.

Using a dataset from Bangladesh, Islam (2015) evaluated the effects of microcredit on household consumption by using village fixed effects and instrumental variables. He used this to measure the causal effects of microcredit program participation. The result revealed that the impact of microcredit on consumption varies across the various groups of poor household borrowers. The most beneficial groups are the poorest of the poor participants, and even stronger for female borrowers than their male counterparts. Overall, participation in microcredit increases the consumption pattern of the poorest participants.

Finally, using fixed effects and pooled ordinary least square regression, Asheen et al (2021) examined the role of microfinance institutions (MFIs) in influencing financial development, economic growth, income inequality, poverty and economic welfare through data obtained on MFIs. The data were collected from the Mix Market (the largest source for publicly available data on MFIs), Bank scope as the source of commercial bank data, country-level data from the World Bank, and the Economic Freedom Index from the Heritage Foundation. The authors found a significant impact on most fronts as MFIs' participation increases overall savings (total bank deposits) and credit allocation (loans to the private sector) in the economy. Their involvement enhances economic welfare by reducing income inequality and poverty. Additionally, their active presence helps to discipline the traditional commercial banks by subjecting them to more competition which triggered higher efficiency.

In a similar intervention, there are also evidences of the impact of digital credit on key economic indicators of the recipients. Brailovskaya et al. (2020) found some evidence of positive effects on (self-reported) financial well-being from digital loans in Malawi. In their study, they found that giving borrowers additional information about the (high) fees and risks of default increased demand for digital credit. As part of the study, their main objective was to investigate the effects of Kutchova digital credit products *(this was a form of credit offered on the mobile money network of a telecommunications company in Malawi called Airtel)* assuming the beneficiaries lack knowledge about the associated risks. Using administrative loan data provided by the lender (Airtel – a network provider), and a credit scoring mechanism supplemented by a phone survey, they applied regression discontinuity design using the credit score as a threshold for those in the treatment and control. Overall, their result shows a positive impact on financial wellbeing, with demand for digital lending being robust with financial literacy as its major adoption driver.

We further reviewed similar studies conducted in Cape Verde, through a semi-structured interview on six out of the fifteen organizations that at the time provided microcredit to beneficiaries, Bernadino et al. (2017) adopted qualitative analysis to investigate the performance and role of microcredits on small business entrepreneurs in Cape Verde.

They found that women tend to be the focus and beneficiaries of microcredit programs, whose impact was positive in reducing unemployment and poverty. They also found there exists a strong positive relationship between entrepreneurship and microcredit organizations whose objective is the disbursement of these loans for the development of income-generating activities.

Silva (2012) conducted a study to investigate the financial sustainability and challenges of microfinance institutions (MFIs) operating in Cape Verde in 2009 by analysing the two biggest microfinance non-governmental organisations (NGOs) in Cape Verde. Findings from his study revealed that MFIs in Cape Verde have difficulties in having the clients pay the total amount owed, and further identified a lack of available funding sources to meet the demand as a major constraint. Hence, limiting their ability to fulfil their legal objective. They further recommend a standardized report system since the existing ones at the time were not following best industry practices of transparency in financial reportage.

The notion that women are the main beneficiaries of microcredit in Cape Verde was also presented by Orrico (2015). Here, he provided a qualitative analysis of the results of several interviews conducted with Cape Verdean beneficiaries of microcredit from different microlenders. He found that women, mostly single mothers, and household leaders are the most preferential clients for microlenders. Although, a sizable percentage of the credits approved to beneficiaries were intended to generate revenue to sustain basic household expenses. Furthermore, quite a good proportion of the clients were engaged in the commercial sector; and found collaterals requested by microlenders to be a hindrance in accessing microcredits, especially by asking for guarantors or savings before providing the loan to poor clients.

While the literature we have reviewed considered the effects of microfinance and digital credit on small-scale business entrepreneurs and their spillover effects on the individual overall welfare, our study took a holistic different approach by examining the overall microfinance ecosystem in Cape Verde, with a particular focus on the performance of the seven microfinance institutions in the country.

Due to the absence of a credible counterfactual to investigate the causal impact of microcredit on individual welfare and financial inclusion, our project combines qualitative and quantitative methods to analyse data obtained from face-to-face interviews with the main stakeholders in the microfinance ecosystem in Cape Verde. We also used microcredit data provided by the third largest microfinance institution (ASDIS) in Cape Verde by the market for two periods – 2012 and 2019. This was further complimented by quantitative data on the microcredit provision in the two periods (2012 and 2019). Through these, we identified some interesting microcredit evolution patterns, as well as the main challenges and opportunities for the sector.

4. Stakeholders in the Cape Verde Microcredit Ecosystem

Central Bank of Cape Verde[26]

Founded in 1975, the Bank of Cape Verde (BCV) is the country's central bank. It is the only institution that supervises the entities of the money and financial markets. However, under the supervision of the BCV, an autonomous institution - General Audit of the Securities Market (Geral do Mercado de Valores Mobiliários) regulates and supervises the capital market in the

[26] Homepage (bcv.cv)

country. The central bank of Cape Verde oversees the accreditation, regulation, and supervision of financial sector players, including banks, microfinance institutions and insurance companies but also BCV acts as exchange authority, treasury, commercial, development and since 1993 BCV, as central bank, has as main responsibilities the price and financial sector stability.

Ministry of Finance and Business Development[27]

Ministry of Finance conceives, proposes, coordinates, executes, and evaluates the implementation of the Government's policies on the management of the State's finances in the areas of the budget, tax system, treasury, and assets, as well as in the areas of privatization, economic reforms, the competitiveness of the economy, business promotion, attracting investment, employment, professional training, innovation, information and communication technologies, digital economy, planning, regional development, and the reform, organization, and modernization of the Public Administration.

Banco Caboverdiano de Negócios[28]

Banco Caboverdiano de Negócios is a financial institution that provides services such as collecting demand deposits, granting loans to individuals and companies and basic investments such as savings. Therefore, the commercial bank's mission is to promote the economic and social development of the country by creating opportunities for growth and generating returns for its shareholders.

Besides that, microcredit institutions are financed by the commercial banks, namely the Banco Caboverdiano de Negócios.

[27] https://www.mf.gov.cv/web/mf/missao

[28] Visão, Missão e Valores | Banco Caboverdiano de Negócios (BCN)

ASDIS[29]

ASDIS-COOPERATIVA DE CRÉDITO - COOP-ASDIS MICROFINANÇAS is a Cape Verdean cooperative founded in 1999 and now has eleven members (individuals). The cooperative operates both in Cape Verde and in São Tomé and Príncipe. The institution's mission is to promote income-generating activities to improve the conditions and quality of life of its clients and has a total market share by credit granted at the end of 2021 of 17%.

It operates with its own resources, having at this moment its own capital amounting to 95000 thousand CVE (EUR 861,522).

Citi.COOP[30]

Cooperative for the Promotion of Financial Inclusion (Citi. COOP) is a cooperative savings and credit society created in 2017 as a result of the transition of the CITI-Habitat (ONG) microfinance service to a registered microcredit institution of category B in the Central Bank of Cape Verde. The aim of the cooperative is to collect savings from its members, provide debit services, and grant credit to members and, exceptionally, to non-member clients. In addition, Citi.COOP provides financial education and business management support services to its members and clients, as well as social and cooperative services – with a 1% market share in 2021. In 2019, Citi.COOP had a portfolio of 45000 thousand CVE (EUR 408,089) and 500 clients. Currently, i.e., post-covid, the cooperative has registered a sharp decrease, it has a portfolio of 22500 thousand CVE (EUR 204,045), 140 members and 250 clients.

[29] http://asdis.org.cv/
[30] Início (citicoop.cv)

Morabi[31]

Morabi - Cooperativa De Poupança E Crédito, Lda. was created in 2018 as a result of the separation of financial and social activities that, until then, had been performed by Morabi - Associação Cabo-Verdiana de Autopromoção da Mulher. It is the first biggest microfinance institution in the country with a market share of 28% as at 2021.

In 1994, Morabi - Cape Verdean Association for Self-Promotion of Women introduced microcredit. This way, the institution privileges the insertion and the improvement of the social position of the Cape Verdean women and promotes their participation in the process of economic, social, and political development of the community.

Pró Empresa[32]

Pró Empresa is a public institute that operates in the entrepreneurial ecosystem with the mission of promoting the growth and development of MSMEs. Pró Empresa provides access to funding, guaranteeing banking intermediation, speeding up decision-making processes and promoting diversification of funding sources for clients. It also finances technical assistance for the implementation of business development programmes.

5. Cape Verde Context

5.1. Socio-economic context

Cape Verde is an African country that is comprised of a group of nine inhabited islands that lies 385 miles (620 km) off the west coast of Africa and 491,233 inhabitants, according to the 2021

[31] https://morabicooperativa.cv/nossa-historia-no-microcredito/

[32] Pro Empresa - Início

Census. Owing to a substantial increase in per capita income, significant improvement in human capital formation, and gross domestic product (GDP) growth from $975 to $3,633 between 1991 and 2017, the country was reclassified as a middle-income nation by the World Bank in 2018.

It has been a stable parliamentary democracy since 1990, with free and transparent elections and alternating political parties in power. Cape Verde enjoys a degree of economic freedom that is unique in the region. Broad political stability is expected to prevail in Cape Verde, underpinned by strong democratic institutions and robust protection of human rights and civic freedoms. The country is ranked 39 out of 180 in the 2021 Corruption Perception Index (CPI) by Transparency International[33], making it one of the least corrupt African countries.

Considering poverty projections based on economic growth suggest that poverty rates, measured by the $5.5 a day (2011 PPP) poverty line, declined by six percentage points between 2015 and 2019, from 41% to 35%[34].

In Cape Verde, only 10% of its territory is classified as arable land and mineral resources are limited. Her low proportion of arable land, scant rainfall, lack of natural resources, territorial discontinuity, and small population make it a high-cost economy (particularly in terms of energy, water, and transportation) with few economies of scale. This led to a greater dependence on the tourism sector with the need to set up policies and mechanisms to attract investments into it.

Cape Verde is ranked 110 out of 137 countries in the World Economic Forum global competitiveness report[35] and 137 among 190 economies in the World Bank ease of doing business survey 2020[36].

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[33]Transparency International (Blog). https://www.transparency.org/en/countries/cape-verde

[34]The World Bank (Blog).https://www.worldbank.org/en/country/caboverde/overview

[35] Schwab, Klaus. (2019).

[36]World Bank. 2020. DOI:10.1596/978-1-4648-1440-2.

Regarding economic activities, a sizeable percentage of the private sector economic activities in Cape Verde are conducted by small, mostly informal firms that are dispersed across these nine inhabited islands. For example, in 2016, there were 9,444 active firms all of whom are providing over 55,000 jobs[37]. Highly dependent on the import of good and export of tourism services, the country is very vulnerable to external shocks, as demonstrated by the COVID-19 pandemic and the ongoing war in Ukraine.

Cape Verde's public debt reached a record of 157% of GDP in 2020, one of the highest levels in the world. However, the World Bank forecasted a gradual recovery in 2021 by 7% owing to a gradual recuperation of the tourism sector. The most recent projection however predicts the economy to grow at a slower pace in the year 2022, having factored in the impact of the Russian-Ukraine crisis. The Real GDP growth is projected at 4.0% in 2022, but above potential (4.5 %) in 2023 and 2024.

Overall, Cape Verde has witnessed significant economic progress since 1975, which is driven by the rapid development of tourism (46.2% of GDP as of 2019), coupled with considerable social development due to strong social policies since the 1970s[38]. The main threat to its economic stability is its lack of economic diversification and vulnerability to external negative shocks.

5.2. Financial Sector in Cape Verde

The financial sector of Cape Verde is comprised of seven commercial banks, two insurance companies, one stock exchange market, and seven microfinance institutions.

[37]Estatísticas Empresariais em Cape Verde, 2010 a 2016, INE

[38]Karwacki, Judy. (2019).

Although the pandemic has amplified the vulnerabilities of the financial sector and increased the risks to economic recovery, the sector has an estimated economic growth of 7.1% in 2021[39]
According to the Statistical Information Monetary and Financial - Banking Sector by the Central Bank (March 2022), in the present year, the monetary aggregate of currency in circulation, demand deposits, time and savings deposits and treasury bills held by the public grew 6.5% compared to March 2021. The evolution of the money supply was determined by the increase in net domestic credit, as well as the 18% increase in net foreign assets.

It is worth mentioning the appreciation of the US dollar against the euro translated into a foreign exchange gain and consequent increase in foreign reserves.

The year-on-year growth of the money supply reflected the increase in both monetary liabilities consisting of currency in circulation and demand deposits by 6.3% and the year-on-year growth of near money consisting of time and savings deposits, escrow deposits, checks, and orders payable and securities purchase agreements by 6.6%. The 6.3% increase in demand deposits and currency in circulation determined the evolution of the above aggregate. In turn, the evolution of near money was largely due to increases in savings deposits by 11.7%, time deposits in national currency from residents and emigrants' deposits by 10.6% and 1.9%, respectively.

Net domestic credit increased 7.9% year-on-year in March 2022, compared with the 3.3% increase observed in March 2021. The evolution of net domestic credit reflected increases in credit to the economy by 5% and credit to the general government by 21.9%.

The increase in credit to the economy was determined by the increase in credit to the private sector by 4.3% because of the suspension of debt service on credit contracts under the moratorium regime, the use of the covid-19 credit lines guaranteed by the government and the

[39] African Development Bank Group, Cape Verde Economic Outlook (2022). https://www.afdb.org/en/countries/west-africa/cabo-verde/cabo-verde-economic-outlook

granting of new credits. In turn, the increase in credit to the central government is the result of increased issues of Treasury bills in the period, which explains the performance of net credit to the general government sector.

In homologous terms, in March 2022, the average interest rates on bank loans, including overdrafts, decreased 0.46 percentage points to 9.11% and, excluding overdrafts, remained constant when compared to the same period of the previous year, at 8.68%.

In addition, compared to March 2021, the average interest rate on deposit operations rose by 0.03 percentage points to 1.19%. Compared to the previous month, the average interest rate on deposits fell 0.03 percentage points.

It should be noted that, in March 2022, the average interest rates on emigrants' deposits fell by 0.04 percentage points in homologous terms, standing at 1.21 percent. Regarding the monetary base, March 2022 registered an increase of 10.4%. This evolution is reflected in increases recorded in deposits by banking institutions of 11.6% and in monetary issues of 5.7%.

Additionally, the net foreign assets of the Central Bank increase from 58,997.2 million escudos in March 2021 to 68,544.7 million escudos in March 2022.

Banking Sector

The post-pandemic and the war in Ukraine have brought to Cape Verde banking sector some divergencies.

Cape Verde has been increasing its solvency ratio since 2019 by 4.3 percentage points until the first three months of 2022, where it reached 22%.

Overdue loans, this being defined as those more than 90 days overdue, has diverged since 2019, with a downward trend, remaining at 8.2% in the first quarter of 2022. The risk credit follows the same trend and while in the second quarter of 2021 it represented 15.8%, in 2022 it represents 13.7%.

Profitability, as measured by Return on Equity (ROE) and Return on Assets (ROA) indicators have declined sharply since 2019. The assets had a profitability of 1.25% in 2019 and in the first quarter of 2022 show a profitability of 0.3%; the return on equity was 16.6% and has decreased by 7.9 percentage points, maintaining the time gap. Even so, despite the discrepancies in the intervening period, the net interest income/ net operating income increased from 81.1% to 83.9%. Liquidity remained at comfortable levels.

Credit and Deposits Structure

The money supply increased by 6.5% in 2022 over the same period. Net domestic credit has increased 7.9 percentage points from March 2021 to March 2022. Both Net Revenues to the Public Administrative Sector and Credit to the economy have increased 21.9% and 5%, respectively.

Deposit and Lending Rates

The Central bank's key interest rate dropped from 1.50%. to 0.25% from 2019 to 2021. Interest rates applied to residents on loans with maturities of 181 days to one year or from one to two years changed in a volatile manner in the last decade, increasing and decreasing. In 2021, they represented 9,17 and 8,74%, respectively.

5.3. The Microfinance Sector in Cape Verde

5.3.1.1. History of Microcredit Institutions in Cape Verde

Microfinance emerged in Cape Verde in the 1990s to enhance the financial inclusion and financial autonomy of the underprivileged population. The Cape Verdean Non-Governmental Organisations (NGOs) were the first ones to introduce the sector in Cape Verde by supporting socially and financially the poorest population. NGOs were not only social institutions which prompted community development, education, health, sports, infrastructures, and sanitation but also financial institutions providing microcredit and operational equipment for income-generating activities (AGER) of their clients. (Jacinto Santos, 2022; Susana Bernardino, 2016). In 2015, due to the increase in microcredit applications and clients' portfolio volume, Cape Verdean authorities implemented a legal and institutional framework to regulate microfinance in Cape Verde. According to Law No. 83/VIII/2015[40], on the 16th of January, microfinance is the "*activity carried out by authorized entities that consist of providing adequate and sustainable financial services to low-income populations, who are excluded from the traditional financial system*".

The legal framework was updated in Law No. 12/IX/2017[41], on the 2nd of August, stating that in 2019 all associations conceding microcredit must have segregated social functions from microfinance ones. Additionally, microcredit institutions must be mandatorily enrolled, registered and licensed as microcredit institutions by the Central Bank of Cape Verde.

As a result, the Central Bank created a Microfinance Office responsible to regulate, supervise and monitor the performance of the microfinance sector to ensure accountability, transparency, growth, social reach, and sustained development of microfinance institutions by inducing them to adopt better management practices. According to the Microfinance department Report, BCV should ensure the mission of the microfinance institutions is reached, meaning institutions are attending to the financial needs of the microentrepreneurs excluded from the traditional financial system. Therefore, the regulatory framework has been strengthened by the BCV to improve MFIs' financial reporting, support government intervention in the sector and better secure MFI refinancing by commercial banks.

[40] https://www.bcv.cv/en/Supervisao/MicroPrudencial/SupervisaoMicroFinancas/Legislacao/Paginas/Legislacao.aspx

[41] https://www.bcv.cv/en/Supervisao/MicroPrudencial/SupervisaoMicroFinancas/Legislacao/Documents/2019/LEI%20N.%C2%BA%2083-VIII-2015%20DE%2016%20DE%20JANEIRO.pdf

5.3.1.2. The structure of the microfinance sector in Cape Verde

The microfinance sector in Cape Verde is comprised of three categories considering management and microcredit activities.

The first one, known as Category A includes microbanks which are commercial institutions with profit-making activities. Although Cape Verde does not have any microbanks currently, it is predicted that it will have them in the future.

The second one, known as Category B includes cooperative and mutuality societies for savings and credit. There are seven microcredit institutions in Cape Verde[42] registered in the Central Bank[43], six located in Ilha de Santiago and one located in Ilha do Fogo.

Category C is a microfinance institution that mainly facilitates transfers of money and have no operational limit and to make a contract BCV always have to approve.

Microcredit institutions can transit from Category B to Category A if they have a financial, management and operational activity structure to move toward micro banking and are ready to subject to the Category A legislation.

5.4. Financial System's Vulnerabilities and Risks in Cape Verde

Cape Verde's financial system has several challenges, namely the size of the economy and its reliance on international trade of goods and services.

According to the Central Bank's Financial Sustainability Report of 2021, Cape Verde has a high degree of exposure and dependence on foreign countries. Thus, it ends up being subjugated

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42 https://www.bcv.cv/pt/Supervisao/MicroPrudencial/SupervisaoMicroFinancas/InstituicoesInscritasEenderecos/Paginas/Instituicoesinscritas.aspx

43 https://www.mf.gov.cv/documents/20126/0/Ecossistema+Financiamento_Microfinanc%CC%A7as.pdf/07ee2c45-9ee1-1fb4-bed7-bbd2515c41ee?t=1578311046143

to the impacts in the economy driven by the contraction of external demand, the reduction of foreign investment and remittances from emigrants and the worsening of external accounts.

Moreover, since Cape Verde has a high institutional concentration of funding, it rises the risk of a potential reduction in liquidity, profitability, and solvency of the banking sector, negatively affecting the economy.

Another vulnerability in the country is its high exposure to sectoral credit and towards large operations and large companies, which may lead to an increase in default and a reduction in bank liquidity, funding, and profitability.

The continued increase in the trend of digitalisation of services in the financial industry and exposure to cybercrime may exacerbate the impact of the considerable risk of disruption to the provision of financial services, financial losses, and consumer confidence in the Cape Verdean economy.

Besides that, the high volume of non-performing assets on institutions' balance sheets results in continued pressure on own funds, increased direct exposure to real estate and the possibility of fire sales.

Additionally, the increase in the indebtedness of the non-financial sector in Cape Verde, despite the increase in gross disposable income, results in an increase in default on bank debt servicing and a reduction in profitability.

In addition, Cape Verde has a high exposure to the public sector and with the increase in contingent liabilities, the risk of reduced liquidity and profitability of the financial (banking) sector and the quality of credits/loans to the public sector rises.

The negative evolution of the external economic environment, exacerbated by the war in Ukraine, means that the potential reduction in credit quality, bank solvency, liquidity and profitability have a more significant impact on the economy.

6. Quantitative and Qualitative Data

For an understanding of the microcredit ecosystem in Cape Verde, we have done a quantitative and a qualitative analysis.

We obtained the anonymized cross-sectional data from one of the stakeholders (ASDIS)[44] and we conducted face-to-face interviews with the main stakeholders of the microfinance ecosystem in Cape Verde. The data obtained contained information on vital observable characteristics of the population sample which aided our analysis. The final anonymized datasets (2012 and 2019) contained 440 and 765 samples with information on the gender, marital status, credit interest rate, education level, number of children, beneficiary type *(if group or individual),* period of the credit application, sector of economic activity, credit amount, number of children, economic sector of activity, and age of the credit recipients.

We encountered some limitations in the study due to the nature of the data, that we would like to point out for a better understanding of the method. First, we were limited by the data as it did not contain information on the income earnings of the credit recipients, literacy level of the kids, or what exactly the microcredit was used for, of the entire sample in both 2012 and 2019. Some of this information includes earnings or income level, and key variables to measure their inclusiveness in the banking system. We also could not do an impact evaluation on the intervention due to the absence of a credible counterfactual.

On the qualitative analysis, the rich detail provided by the parties involved in the Cape Verdean microfinance sector could be extremely useful in understanding this complex microfinance system and could explain how the policy implemented operates in practice, leading to change. Hence, our team did a field trip to Praia, Santiago Island, Cape Verde, between the 25th and the

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[44] ASDIS is a Credit Cooperative Institution and a partner in the Cape Verde development process with more than 20 years of operation. Their role is promoting income-generating activity, leading to improved conditions and quality of life for through tailor-made products and services.

29th of July 2022, with the objective of conducting the qualitative face-to-face interviews of the main stakeholders in the Cape Verdean microfinance ecosystem.

We used the qualitative data collected during our fieldwork interviews to address several main questions:

- Did the actions and policy measures enacted by the Central Bank of Cape Verde contribute to the growth and expansion of the economic activities of the beneficiaries?
- Was the sector of activities engaged by the credit recipients changed over the years? If so, how, and why did this change happen?
- And to measure how financially inclusive the policy measure was by exploring the percentage of females that received the credit in both years (2012 and 2019).
- Has the number of credits on the average allocated to each sector of activities of the economy increased? And if any aspect of the sectors got prioritized over.

6.1. Quantitative Data

In this section, we present, analyse, and discuss the two datasets obtained from ASDIS for the years 2012 and 2019. ASDIS is the third largest microfinance institution in Cape Verde with a market share *(credit granted)* of 17% as at end of 2021.

The anonymized data obtained were processed using Stata before the analysis, and financial literacy level was measured using a proxy – by having completed at least grade 12 (high school) - although not a perfect proxy, but we assumed at this stage, that they have undergone basic formal training in finance management and accounting while in high school.

The sector of activity was classified into four categories:

- Primary Sector: fishing, agriculture, and livestock farming
- Secondary Sector: handcraft, carpentry, cloth design, and industry

- Tertiary Sector: trade, selling of airtime, and services
- Credit to consumption: education, housing, and goods

Descriptive Statistics for the 2012 dataset

As shown in Table 1, the 2012 dataset contains 334 individual observations. The average age of credit recipients was 42 years old. A significant percentage (77,5%) of them have no kids, the females (69%) seem to be the most beneficiary of the credit.

A sizable proportion (91%) of the recipients of microcredit submit their credit application as an individual rather than as a group with a monthly repayment frequency contract type (99,4%). These loans are provided in the rainy season, between the month of June and July, with an interest rate of around 2.6% on average, with over 65% of them engaged in the primary sector which consists of agricultural activities such as farming, fishing, and animal husbandry. Three of the microcredit recipients of microcredit do possess secondary education qualifications, and the average credit loan amount collected is 110 CVE (approximately 1,000 euros).

Table 1: 2012 Summary Statistics

	Mean	Std. Dev.	Min.	Max.	Num. Obs.
Demographics					
Age in years	41.92	10.554	18.00	64	334
Sex [Male = 1, Female = 0]	0.35	0.48	0	1	334
Num of kids (indic.)	0.65	1.509	0	8	334
Financial literacy [Completed high school *(grade 12)* = 1, Not Completed high school *(grade 12)* = 0]	0.009	0.094	0	1	334
Literacy Level [Completed primary school =1, Not Completed primary school = 0]	0.01	0.09	0	1	334
Microcredit Characteristics					
Loan amount in thousand (CVE)	110	104	10	1000	334
Loan cycle (indic.)	1.826	1.022	1	7	334
Month of loan credit (in months)	6.847	3.327	1	12	334
Monthly Interest Rate (%)	2.572	0.531	0	3	334
Number of instalment in repayment (indic.)	9.32	3.91	1	24	334
Payment Frequency of the loan (indic.)	0.994	0.077	0	1	334
Beneficiary type [Individual =1, Group=0]	0.913	0.282	0	1	334
Purpose of the loan/credit					
Activities in Primary sector (indic.)	0.65	0.48	0.00	1.00	334
Activities in Secondary sector (indic.)	0.00	0.00	0.00	0.00	334
Activities in tertiary sector (indic.)	0.29	0.46	0.00	1.00	334
For consumption (indic.)	0.05	0.23	0.00	1.00	334

Notes: All variables are from 2012 statistical data obtained from ASDIS.
ASDIS is the 3rd largest microfinance institutions in Cabo Verde with a market share (credit granted) of 17% as at end of 2021.

Table 1: Descriptive statistics of the 2012 dataset. Source: ASDIS 2012 dataset.

Descriptive Statistics for the 2019 dataset

As shown in Table 2, there are a total of 737 microcredit recipients in the 2019 dataset, with an average age of forty-two years old. 53% of the sample has completed at least primary school education, and on average, each beneficiary has one child. This is a significant difference from the previous year (2012) as expected.

This assumes that at this level students have been exposed to formal training in basic financial management, accounting principles, and mathematics. Using this assumption, about 50% of the population in the sample is not financially literate.

The level of literacy was measured by having completed at least secondary education. Using this measurement, 158 microcredit recipients (21.4%) have completed high school which is quite an improvement from 2012. Both datasets keep females constituting the major recipient of the credit, representing 66% in 2019.

Table 2: 2019 Summary Statistics

	Mean	Std. Dev.	Min.	Max.	Num. Obs.
Demographics					
Age in years	41.582	9.716	22	65	737
Sex [Male = 1, Female = 0]	0.339	0.474	0	1	737
Num of kids (indic.)	0.905	1.697	0	11	737
Financial literacy [Completed high school *(grade 12)* = 1, Not Completed high school *(grade 12)* = 0]	0.214	0.411	0	1	737
Literacy Level [Completed primary school =1, Not Completed primary school = 0]	0.52	0.50	0	1	737
Microcredit Characteristics					
Loan amount in thousand (CVE)	122	155	10	1600	737
Loan cycle (indic.)	1.545	0.777	1	7	737
Month of loan credit (in months)	6.579	3.444	1	12	737
Monthly Interest Rate (%)	2.598	0.515	1	3	737
Payment Frequency of the loan (indic.)	0.997	0.052	0	1	737
Beneficiary type [Individual =1, Group=0]	0.924	0.265	0	1	737
Purpose of the loan/credit					
Activities in agric sector (indic.)	0.164	0.371	0	1	737
Activities in Secondary sector (indic.)	0.012	0.11	0	1	737
Activities in tertiary sector (indic.)	0.457	0.499	0	1	737
For consumption (indic.)	0.355	0.479	0	1	737

Notes: All variables are from 2019 statistical data obtained from ASDIS.
ASDIS is the 3rd largest microfinance institutions in Cabo Verde with a market share (credit granted) of 17% as at end of 2021.

Table 2: Descriptive statistics of the 2019 dataset. Source ASDIS 2019 dataset.

On the microcredit loan, there is an average loan cycle of 1.5. This is the total number of times an individual recipient has microcredit approved.

The average amount of approved credit is 122 thousand CVE (about 1,106 euros*)* with a monthly interest rate of 2.6% many of which were collected in the rainy season – during the month of June/July with a sizable proportion of them engaged in the non-agricultural sector such as cloth designs, carpentry, pastry making, and other commercial activities.

6.1.1. Quantitative Data Analysis

Amount of times credit was requested by both groups in 2012 and 2019

We further analysed the proportion of loan cycles in 2012 and 2019 for both group and individual lending. For context, the loan cycle refers to the number of times a particular client was given credit in a certain year.

	Number of Loan cycles	Beneficary type		Total
		group beneficiary	individual beneficiary	
2012	1	12	148	160
	2	9	96	105
	3	5	41	46
	4	2	15	17
	5	1	2	3
	6	0	2	2
	7	0	1	1
	Total	29	305	334
2019	1	41	379	420
	2	14	248	262
	3	1	35	36
	4	0	12	12
	5	0	4	4
	6	0	2	2
	7	0	1	1
	Total	56	681	737

Table 3: Loan cycle per beneficiary type in 2012 and 2019. Source: ASDIS dataset 2012, ASDIS dataset 2019.

Presented in Table 3, we found that most of the beneficiaries are individual clients and that the growth in approved credits was proportional between individuals and groups. The increase in group credits was not evenly distributed among the different loan cycle categories, noting that for this type of beneficiary, in 2019, the option of a single loan was favoured. Individual beneficiaries also tend to have more cycles than group beneficiaries.

The trend of loan approved by ASDIS in 2012 and 2019

To understand the trend and how sustainably inclusive the microcredit intervention has been, we looked at the trend in the credit approval by the third biggest microfinance institution in Cape Verde with a total market share of 17%.

As described before, the number of microcredits approved in 2012 was 334 and increased in 2019 to 737 and the average amount approved has increased from 110000 to 122000 CVE, additionally the minimum amount provided declined, but the maximum increased from 1000 to 1600. In Figure 2 below, we can better understand the development of this trend. The green line represents 2012 average loan amount, and the blue line represents the same for 2019.

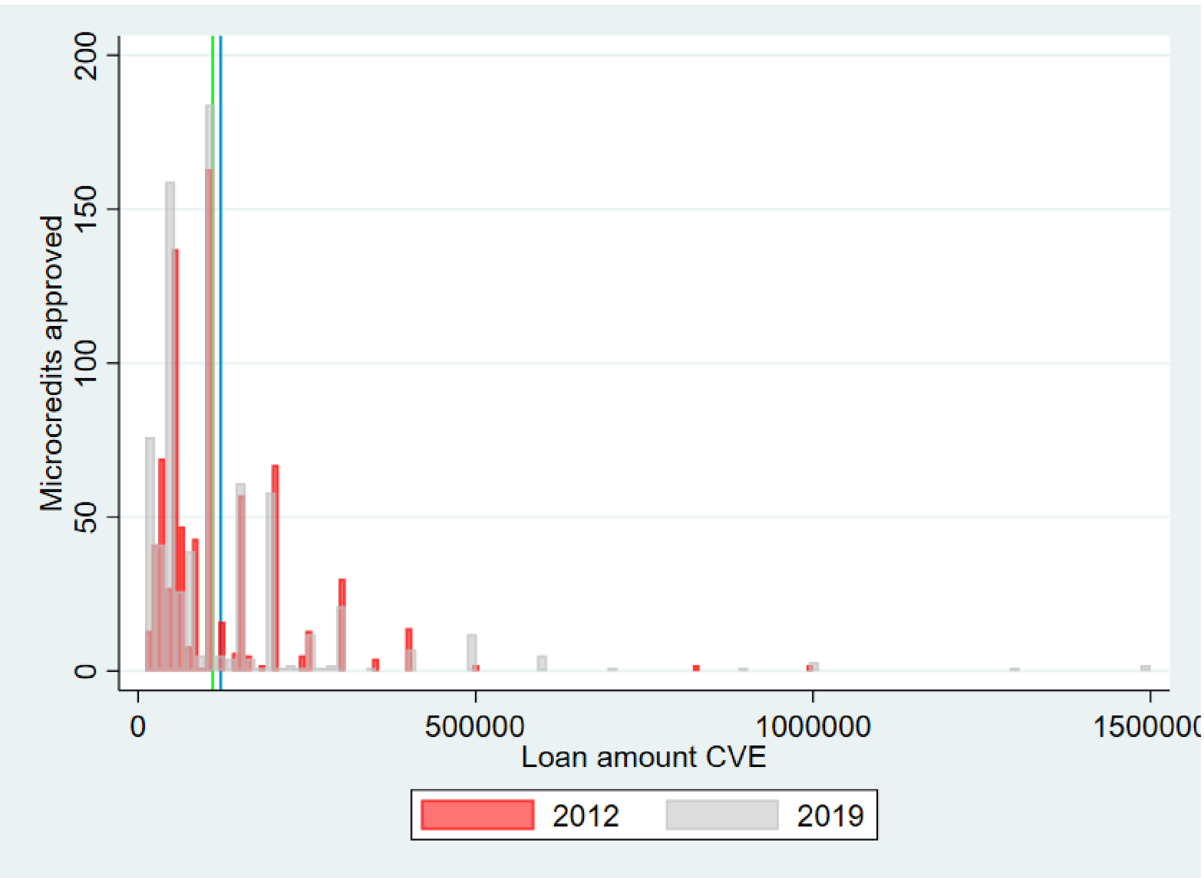

Figure 1: Amount of microcredit approved in 2012 and 2019. Source: ASDIS dataset 2012, ASDIS dataset 2019.

Comparing loan approval based on literacy level (completed high school)

In this section, we compared the number of credits allocated to the various beneficiaries based on their financial literacy level – previously classified as having completed grade 12 (high school). In Figure 2 below, we noticed that on average, the cumulative amount of credit allocated to those without high school education far exceeds those that have completed high school. This in a way coincided with reports from the field interview where we learnt that allocated credits were not dependent on the financial literacy of the applicants and those with lower schooling are expected to be poorer and to have more need to access the microcredit funding, complementing one of the objectives of microcredit – poverty alleviation.

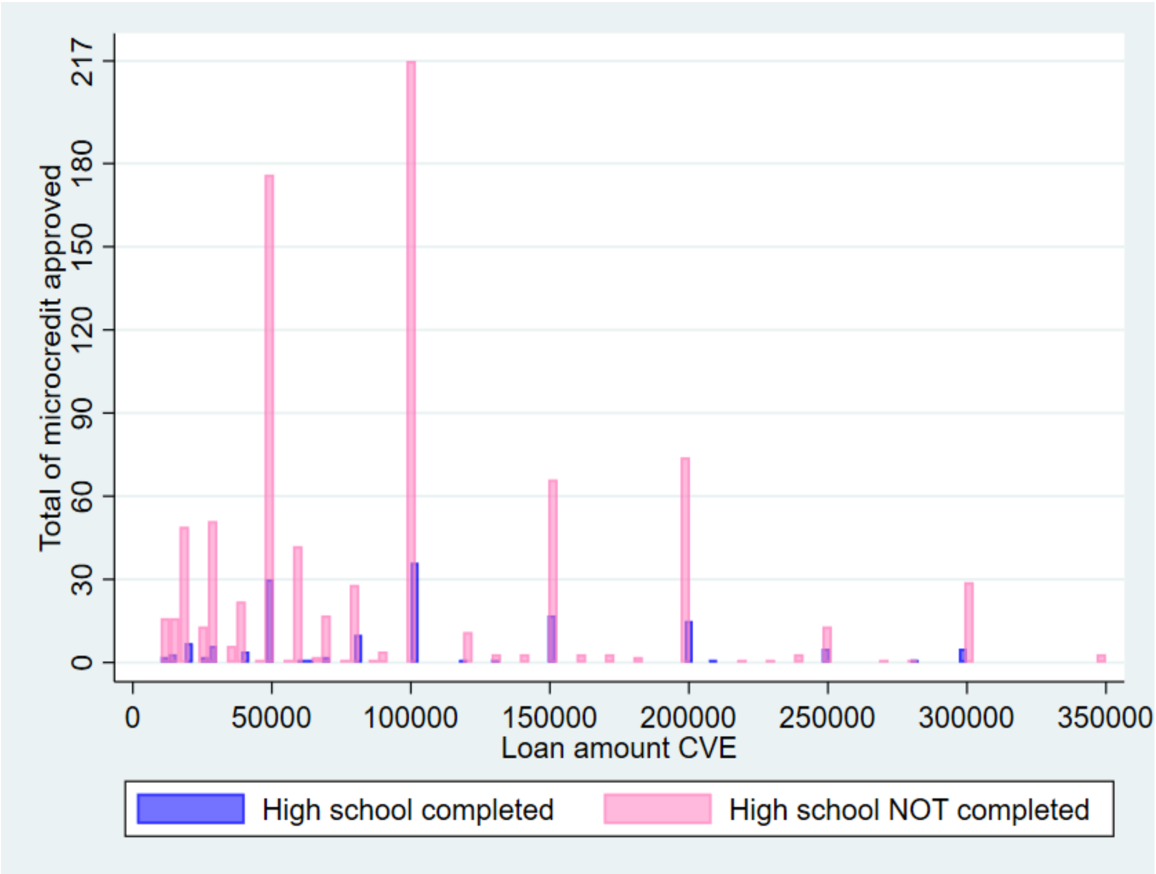

Figure 2: Comparison between the number of loans approved with and without completing high school. Source: ASDIS dataset 2012, ASDIS dataset 2019.

Economic sectors of activity in 2012 and 2019

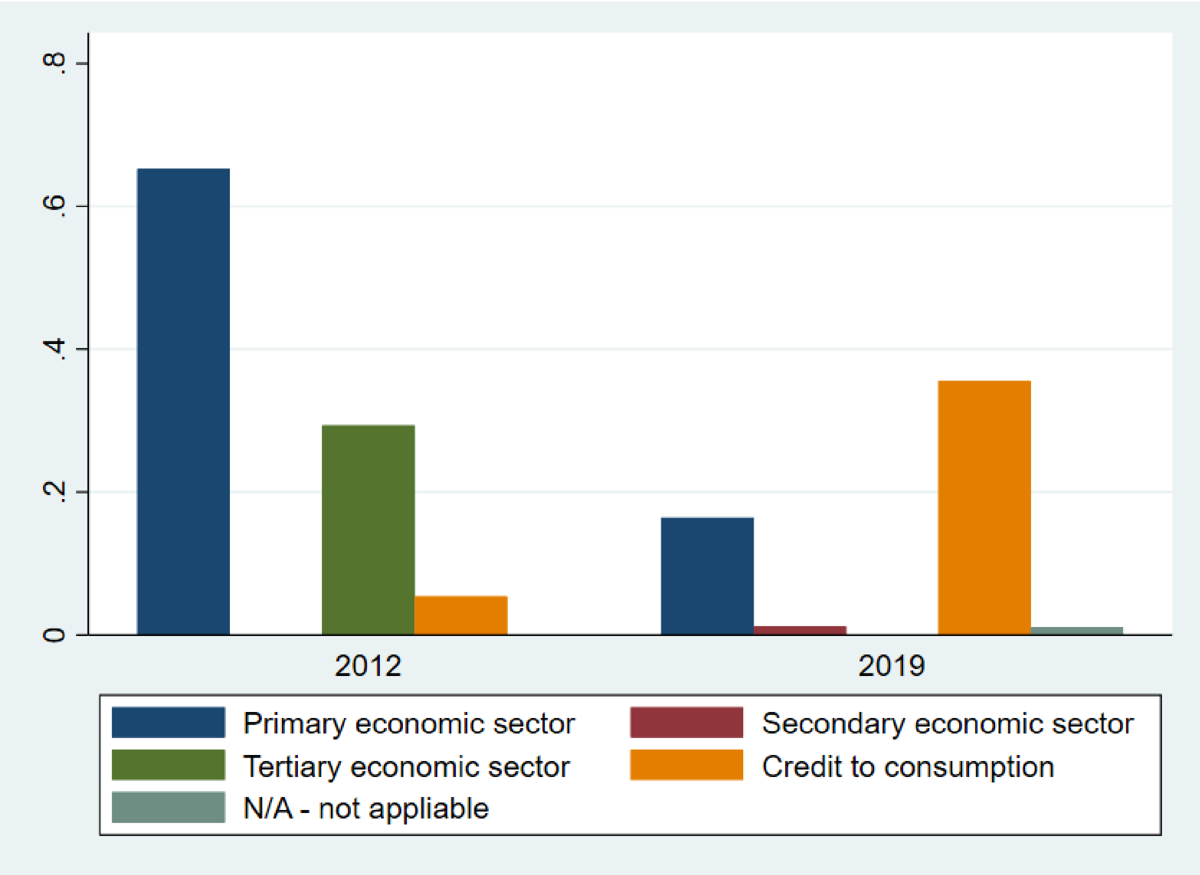

Figure 3: Computed report on the sector of economic activity in 2012 and 2019. Source: ASDIS dataset 2012, ASDIS dataset 2019.

Figure 3 shows a graphical illustration of the sector of activities to which microcredit was provided in both 2012 and 2019, using the data obtained from ASDIS. It is evident that from 2012 to 2019, there is a change in the economic sectors of activity. In 2012, most of the activities engaged in by the credit applicants were agricultural activities (primary sector – which ranges from fishing, subsistence crop and livestock farming). This was followed by the tertiary sector, with some fraction of the credit allocated to beneficiaries who need them for consumption which is the most meaningful change in 2019 – in this year, we saw a bit of diversification of activities as those who received the credit are engaged in both the primary, secondary, and tertiary sector. Although a sizable percentage of the credits were allocated to individuals for consumption needs.

In Table 3 below, we evaluated the mean estimate of the primary economic sector and the financial literacy level in both periods (2012 and 2019). We found that most of the credits approved in 2012 were allocated to clients who have not completed high school, as a dummy, financial literacy is "0" for clients who have not completed high school and "1" for those who did. In 2019 we observed a higher rate of literate clients being given credit, and the average literacy increased by almost twenty-six percentage points.

In the sector of activity, a sizable proportion of the credits disbursed in 2012 were from the primary economic sector (agriculture, fishing, and animal husbandry). This credit represents

		Mean	Std Error	[95% conf. Interval]	
Financial literacy (having completed high school - grade 12					
	2012	0.01	0.01	0	0.01
	2019	0.21	0.02	0.18	0.24
	% change	26.66			
Primary Economic Sector					
	2012	0.66	0.02	0.63	0.7
	2019	0.16	0.01	0.14	0.19
	% change	-0.75			

Number of observations= 1,511

Note: The statistics represents the number of financially literate individuals that received microcredit in both periods; and the number of individual beneficiaries in the primary sector of activity in 2012 and 2019

Table 4: Showing credit recipients who are financial literate and work in the primary sector. Source: ASDIS dataset 2012, ASDIS dataset 2019.:

around 66% of the total amount approved. In 2019 this value dropped to 16% following the increase in financial literacy. Overall, there was a 26-percentage point increase in the number of financially literate that received the credit in 2019 and a 0.75 percent decline in the credit received by the primary sector. We believe this could be attributed to sectorial diversification due to the expansion of the economy and focus on the tertiary sectors of which tourism is a key driver. The trend in the evolution of lending to Individual and group beneficiaries in 2012 and 2019.

In the Table below (Table 5), we compared the proportion of the various beneficiary types that received the credit in both years (2012 and 2019) to see if there exists a common trend or change in the allocation of the credits.

	Proportion	Std. Error	95% confidence interval	
Beneficiary Type				
Lending to Group in 2012	0.07	0.01	0.06	0.10
Lending to Group in 2019	0.08	0.01	0.59	0.10
% change	0.01			
Lending to Individual in 2012	0.93	0.01	0.90	0.94
Lending to Individual in 2019	0.92	0.01	0.90	0.94
% change	0.00			
Number of observation = 1,511				

Notes: All variables are from the 2012 & 2019 statistical survey obtained from ASDIS. This represents the proportion of microcredit that were approved to both individual and group applicants.

Table 5: Proportion of group and individual lending in 2012 and 2019. Source: ASDIS dataset 2012, ASDIS dataset 2019.

Overall, we found that the amount of credit approved to applicants who applied for microcredit as a group increased by 1% between 2012 and 2019, while we saw no meaningful change in the amount of credit allocated to individual applicants.

Purpose of loan approved by activities in 2012 and 2019

In Figure 3 below, we compared the percentage of microcredit approved in 2012 and 2019 for the various purpose it was allocated for. We found that quite a substantial proportion of the microcredit was allocated to recipients in the primary sector in 2012 than in 2019. We also noticed allocations were made to the other sectors (secondary, tertiary) and for consumption purposes the percentage than in the year of 2012. Hence, we could conclude to be attributed to diversification in the activities engaged not only by the beneficiaries but also because of government efforts to diversify the economy is reliant has been heavy on the service sector.

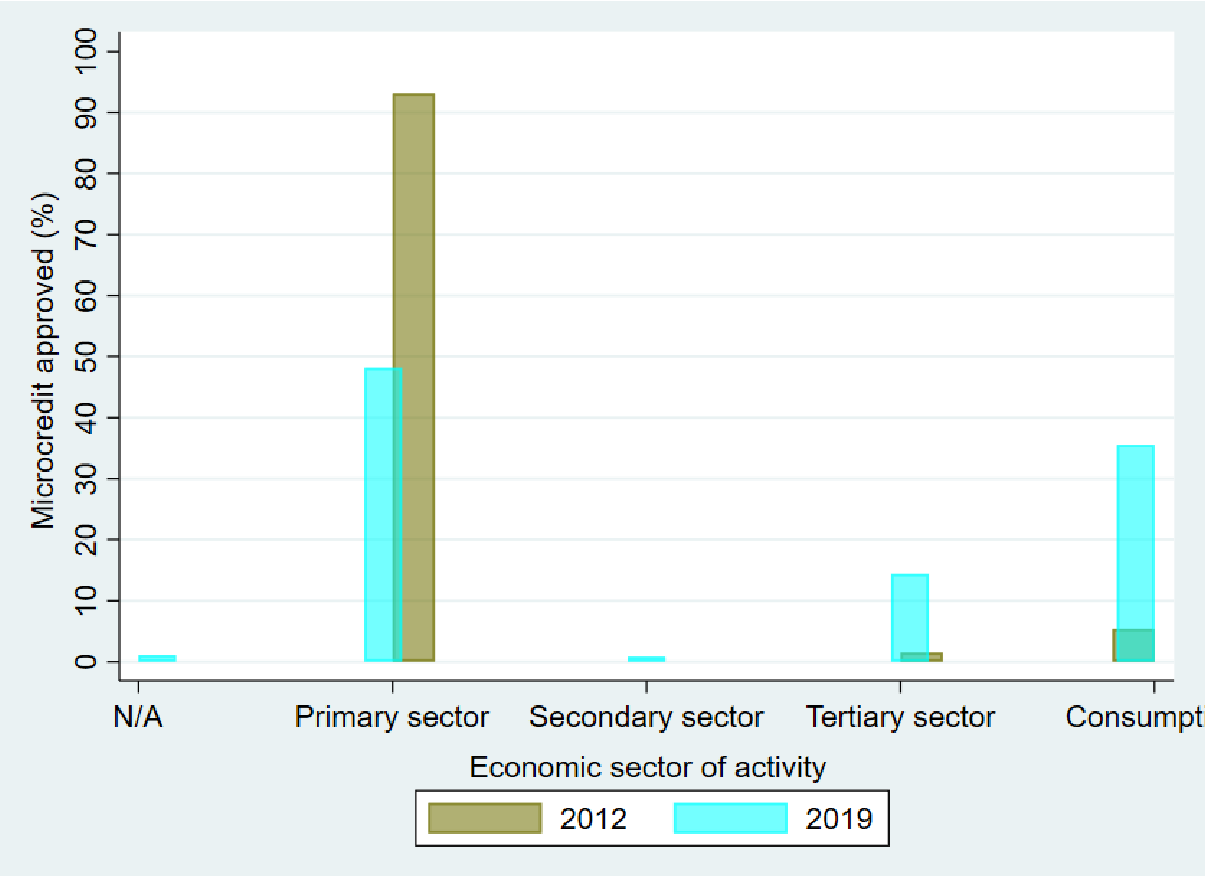

Figure 4: Comparison between loans approved in 2012 and 2019 by sector of economic activity. Source: ASDIS dataset 2012, ASDIS dataset 2019.

Credit to financial literate individuals

We reviewed the total amount of credit allocated to financially literate individuals – by having completed at least grade 12 of high school in 2012 and 2019.

The result obtained in the table below (Table 6) reveals around a 19% decline in the number of credits allocated to individuals classified as being financially literate. This could be that the demand for the credits from those who are financially literate was lesser than their counterparts, or they found employment whose net gain exceeds the proceeds from their business.

Credit loan amount per year	Mean amount in thousand (CVE)	Standard error in thousand (CVE)	95% confidence interval in	
			lower	upper
2012	166.66	72.65	23.21	310.12
2019	134.80	10.77	113.53	15.61
Number of observations	164			

Table 6: Loans given to individuals who have completed high school. Source: ASDIS dataset 2012, ASDIS dataset 2019.

Comparison of activities of the financially literate beneficiaries by gender in 2012 and 2019

In Figure 5 below, we compared the activities (purpose of credit) allocated to total beneficiaries by gender in both periods (2012 and 2019) who are financially literate – having completed at least high school (grade 12). Our analysis shows that a sizeable percentage of the beneficiaries (both male and female) were engaged in the primary sector in 2012. Although the females who received the microcredit were engaged in the tertiary sector; they also seem to be the only ones that collected the credit for consumption. On the hand, the male counterparts were predominately farmers (engaged in the primary sector).

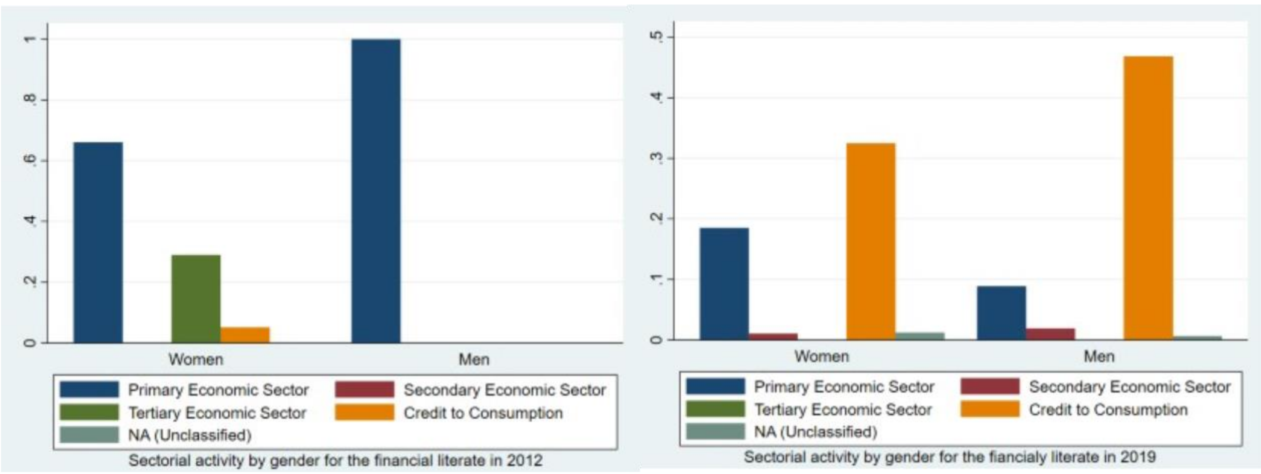

Figure 5: Comparison of activities engaged by microcredit beneficiaries in 2012 and 2019. Source: ASDIS dataset 2012, ASDIS dataset 2019.

This is not the case for 2019 as here, we found substantial evidence of diversification in the activities engaged by both recipients, with more women in the primary sector than their male counterparts.

Comparison of sectors of activity irrespective of literacy level

We again compared the trend of the total microcredit approved in both years (2012 and 2019) by looking at the activities engaged viz-a-viz the literacy level. Here, we found the level of credit approved and allocated to individuals who have not completed high school to be higher than their counterparts both in 2012 and 2019 with a sizable proportion of them in the primary sector (agricultural activities). We also noticed that those who have not completed high school collected these credits more for consumption than those that have completed high school. This is represented in Figure 6 below.

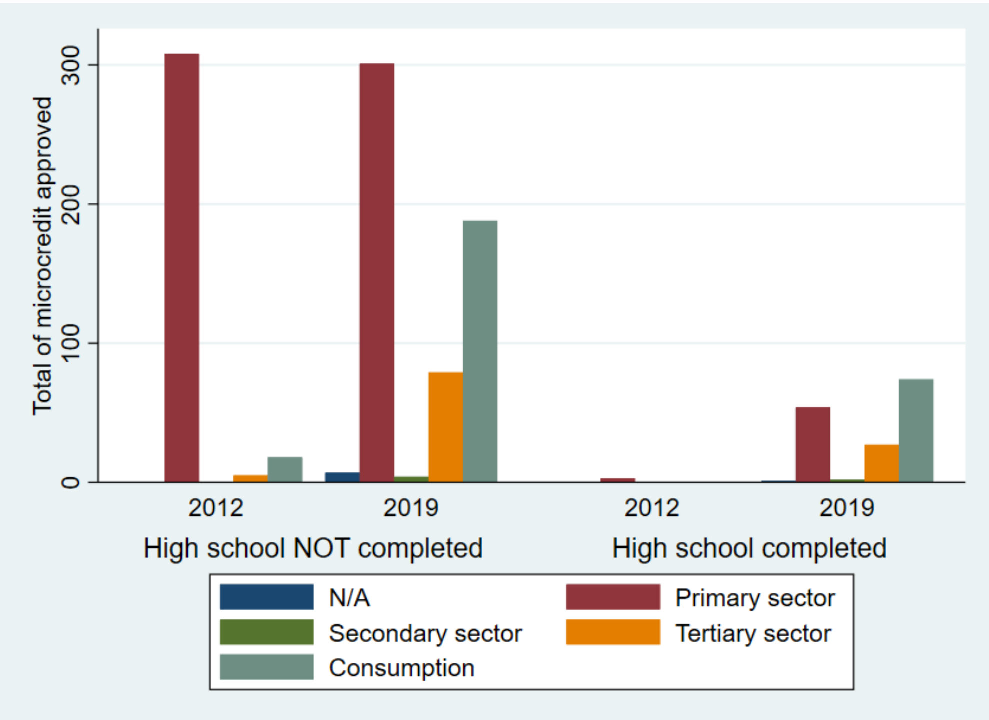

Figure 6: Comparison of activities by beneficiary irrespective of completing high school in 2012 and 2019. Source: ASDIS dataset for 2012 and 2019.

Regarding gender, a deeper analysis was made to compare both women and men in terms of microcredit approved to both genders, their level of financial literacy with the estimated proxy and the economic sector of activity in which each sector has more approved credit.

The gender gap in obtaining microcredit in both periods (2012 and 2019)

To understand if there are any inherent disparity between male and female in obtaining microcredit in both periods, we compared the total credit approved for men, to those of females. We found that in both periods, the percentage of females who received these credits was higher than those males. (Figure 7); with no meaningful change in the percentage of the male applicant over the years.

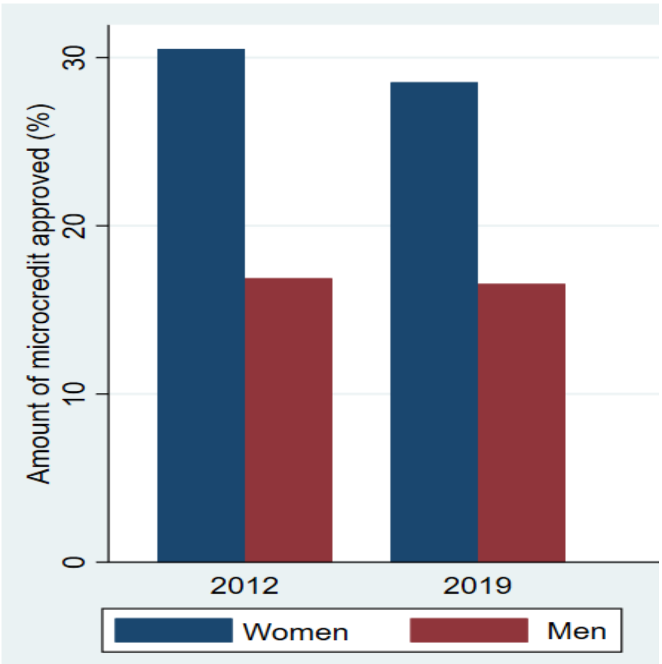

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Figure 7: Comparison credit approval for women and men in 2012 and 2019. Source: ASDIS dataset for 2012 and 2019.

Gender literacy level viz-a-viz microcredit approval in both periods (2012 and 2019)

As in the previously analysis, we again compared the rate of high school to understand the financial literacy levels for all genders in 2012 and 2019. As presented in Figure 8 below, the percentage of females who received microcredit both in 2012 and 2019 was higher than their male counterparts irrespective of their literacy level.

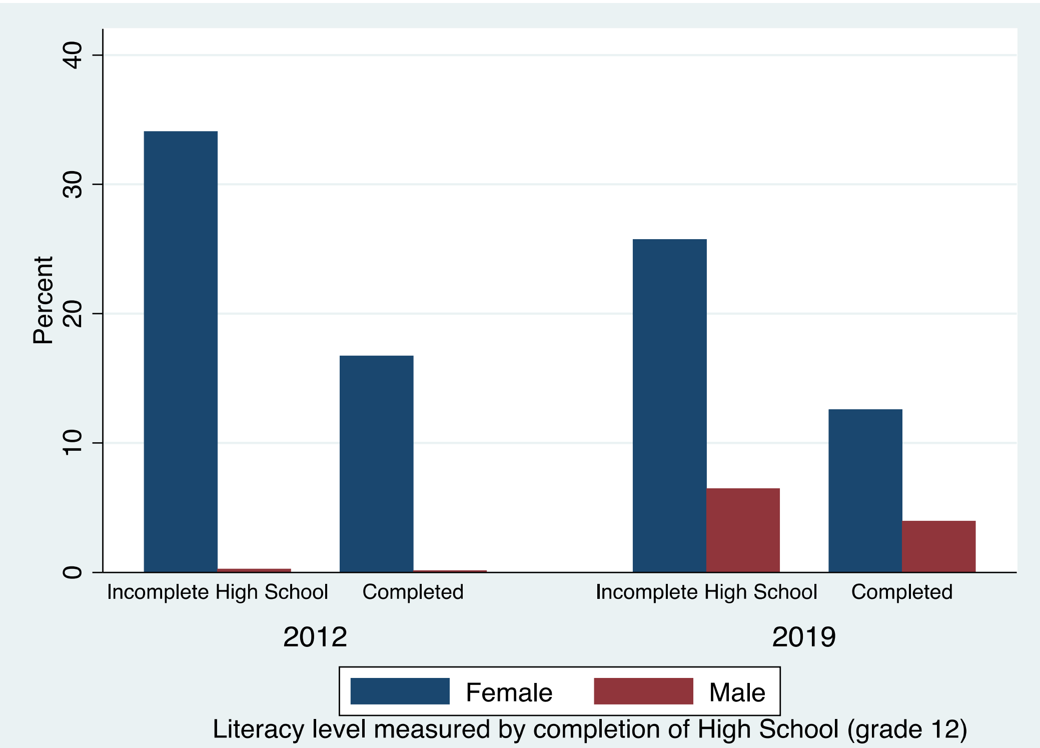

Figure 8: Gender gap between individual lending. Source: ASDIS dataset for 2012 and 2019.

Comparing microcredit approval with gender and sector of activity

Finally, to analyse the evolution of the trend in the amount of credit approved to beneficiaries in both years (2012 and 2019) and the sector of activities engaged; to confirm if there exists any preference of sectors for the credit allocated to by the microfinance institution, we compared all the sectors of activities engaged (which represent the purpose of the credit) with gender in both periods (see Figure 9). Although there are differences between the number of microcredit loans approved to both genders in the periods, we found that the primary sector had an increase in the approval of women when compared to men.

On the other hand, all genders obtained microcredit for activities in the secondary economic sector in 2019, which did not happen in 2012. The tertiary sector which includes services, had an increase in 2019. Consumption credit also increased which complements our field interview that this type of credit was used mainly for educational matters and/or civil construction besides all other consumption activities.

Overall, we found no consistent pattern in the preference of activities to the credit was allocated to. This could be due to limitations by the nature of data and variables at our disposal during this analysis.

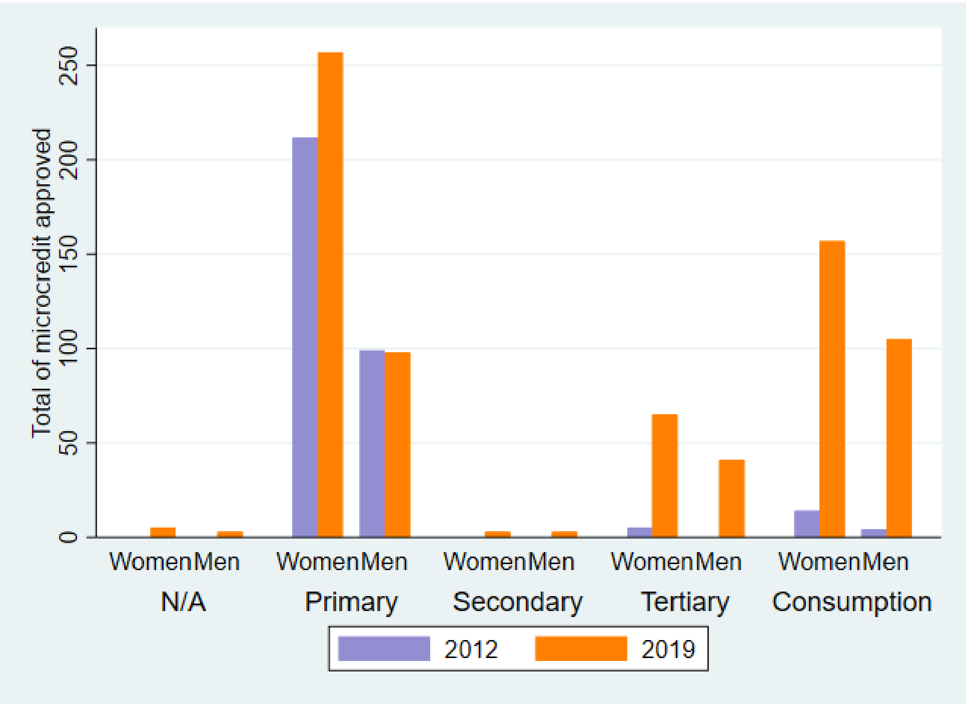

Figure 9: Microcredit approved by gender and economic sector of activity. Source: ASDIS dataset for 2012 and 2019.

6.2. Qualitative Data

Eight interviews were conducted with several stakeholders on the supply and demand side of microcredit financial activity – three microcredit institutions of Category B (ASDIS, Citi. COOP and Morabi), a public institute (PROEMPRESA), one commercial bank (Banco Caboverdiano de Negócios), the Ministry of Finance of Cape Verde (advisor of the State Secretary for Business Development and Promotion in Cape Verde) and the Central Bank of Cape Verde (BCV) (heads of the microfinance department and the statistics department). Unfortunately, due to privacy concerns, it was not possible to schedule an interview with any microcredit beneficiary.

6.2.1. Interviews Highlights

Central Bank of Cape Verde (Interview with Micas Prazeres – Head of Microfinance department, August 2022)

- In 2019, seven MFIs achieved their formal status and became regulated by the BCV, leaving behind their unregulated NGO status.
- For the BCV, the goal of microfinance activity is to fight poverty by providing people with access to microcredit so that they can develop their businesses and increase their income.
- The MFIs, except ASDIS, have a management system that cannot meet the BCV's requirements in terms of prudential supervision, but they are working towards meeting these requirements soon.
- From the BCV perspective, MFIs do not have the financing problems they state to have and are able to finance their operations without the need of a direct credit line with the central bank.

- It is not in the BCV's best interests to directly finance MFIs because this is not a usual practice in most countries, and there are no mechanisms in place for the Central Bank to play the same role with MFIs as it does with commercial banks, since MFIs cannot comply with the same requirements as commercial banks.

Banco Caboverdiano de Negócios (Interview with Marco Pereira - Executive Administrator and Executive Director, August 2022)

- The bank does not ask if the potential client or the client had access to microcredit before. They have that information only if the client voluntarily provides it.
- Although the bank considers the way MFIs conduct their business shady – the were even accusations of loan collections solved with precision and violence – the bank considers the MFI’s good business performance to be enough to finance them.
- The bank had a microcredit service called “FADA” in which farmers could have joint responsibility for the credit. However, the default rate was too high, and they decided to end the experience.
- In contrast to the service provided by the MFIs, FADA did not have a constant follow-up or on-site displacement, and agents did not have proximity to the beneficiaries.

Regarding MFI’s wish to evolve to microbanks, the Banco Cabo Verdiano de Negócios

Ministry of Finance and Business Development (Interview with Adilson Pinto - the Adviser of the Secretary of the State for the Promotion of Corporate Growth, August 2022)

- Cape Verdean business fabric is composed of micro and small enterprises (97.6%), and accordingly to the 2017 census, the country has around thirty-three thousand informal business units.

- The new recovery program "RETOMA" contemplates new financing possibilities for MFIs, especially the possibility of microlenders to directly to the BCV – they will need to comply with the requirements set by BCV first.
- The Ministry stands for a new specific policy that better accommodates the needs of the MFIs and the beneficiaries as they provide services to a bracket of the population that commercial banks do not do.
- A line of credit is currently being offered to MFIs of up to 40 million CVE with an interest rate of 3.5% and with a state guarantee of 60% of the amount to be paid back in 5 years.
- The Ministry believes that technical cooperation and financial literacy programs are crucial for MFIs.
- The government sees the evolution of MFIs into Microbanks as incredibly positive since it would provide to the sector other capabilities while demonstrating a continuous needed administrative development of the microlenders.

ASDIS (Interview with Francisco Tavares - Executive Director, August 2022)

- ASDIS operates not only in Cape Verde but in São Tomé and Príncipe as well. They are also about to start providing microcredit services in Guinea-Bissau.
- It is the only MFI that meets the BCV management requirements and has a platform – Chico Plus – that communicates with the Bank's platform.
- The law does not satisfy ASDIS, as they find it a copy of another law from a completely different country with a different reality and that it could not be adapted in Cape Verde.
- ASDIS usually requires the client's house as collateral, even though they know it has no legal validity. They assume it is pure psychological pressure. On the other hand, if the client has a good payment record, collaterals are not required.
- When clients do not pay on time, ASDIS resorts to the use of force and court.

- Default rate is around 2% to 3% and the average monthly interest rate is 2%.
- Banco Caboverdiano de Negócios is about to launch a debit card for ASDIS clients in partnership with ASDIS.
- The ASDIS cooperative is the owner of several companies, such as an IT company and a consulting firm.
- ASDIS wants to evolve into a Microbank, having already a project and space to build the new headquarters.

Morabi (Interview with Lina Gonçalves - President of the Executive Council, in August 2022)

- Started as Morabi Associação Cabo Verdiana de Autopromoção da Mulher, an NGO founded in 1994 to promote and improve Cape Verdean women's livelihoods under five primary areas: training, community development, sexual reproductive education, institutional reinforcement, and provision of microcredit.
- The rotating fund was initially created due to the financing needs of the local fishing community with the first project being the provision of thermos bags to fishmongers.
- Transformation into a Savings and Credit Cooperative in 2018 to comply with the regulation. This transformation had the negative impact of forcing Morabi to end their savings products which were one of their main funding sources.
- Covid-19 led to an increase in the credit at risk from 6% in 2019 to 11% in 2021 and to the closing of several agencies to control operational costs; Furthermore, it ended a project of joint credit lending being discussed between Morabi and other two unnamed MFIs.
- MORABI tried to find international funding opportunities, but according to the institution, the interest rates and disbursement mechanisms being offered were not conducive with the needs of the institution. International investors think that the Cape Verdean microcredit market is too small.

- First MFI to be issued social bonds with the purpose of financing microlending activities.
- Present in five islands through eleven agencies and has forty-two employees.
- Currently studying the possibility of becoming a microbank.
- Interest rates vary from 8% to 22.8% per year with certain loans having their interest capped due to previously approved conditions for the issuing of the Social Bonds.
- Current portfolio of two million and three hundred thousand euros and 3100 active clients; Being compromised by loans on income-generating activities (66%); Consumer credit (13%); Housing improvement (12%), Agricultural Sector (2,8%) and specific partnerships (0.5%).
- Attempt at decreasing the importance of consumer credit.
- Offers a life microinsurance service.
- Does not lend to clients that are already using more than 33% of their revenues as payment for other contracted credit.

Citi.COOP (Interview with Jacinto Santos – President of the Executive Council and Arabela Monteiro – Executive Administrator, August 2022)

- Started as CITI-HABITA, an NGO founded in 1987 with a focus on community development, training, education, local financing, and sports. In 2019, the social and microcredit financial functions were legally separated to comply with the new regulatory framework.
- Opted for becoming a Category B savings and microcredit cooperative with the intent of basing its management on principles of cooperative governance. According to the MFI, this stance is not compatible with the possible transformation into a microbank.
- Initially funded by a donation from the association, it continued to finance its operations through the revenues of the microcredit portfolio until the pandemic hit Cape Verde.

- COVID-19 impact was particularly negative to Citi.COOP, saw its portfolio halved in both the number of clients and the total loaned amount. The institution was forced to mortgage its brand-new headquarters to finance its operations after proceeding with a decrease in operational costs. The default rate of their loans also increased from around 7% in 2019 to 18% in 2022.
- Loan portfolio composed of loans directed at income-generating activities with consumer credit just representing 1,2% of the credit wallet
- Seventy-two percent of the clients are women, with a focus on providing services to single mothers that are head of families and towards young entrepreneurs looking for their first job
- Intent on always having more than 50% of the clients as members of the cooperative
- New savings program for members and provision of services that allows for the creation of different funding sources for the microlending activities
- Wants to have the possibility of funding directly through BCV
- Believes the current regulative framework regarding cooperatives is restrictive and does not have into account the organization and administration of an entity under cooperative principles.
- Annually interest rates of around 20% to 30%.

Pró Empresa (Interview with Pedro Barros – President of the Executive Council, August 2022)

- This is a 3-year-old public institution that has been involved in microcredit for one year.
- Pro Empresa helps entrepreneurs to build a dossier containing the feasibility study, the business plan, and the identification of the company so that they can meet the criteria of banks and MFIs.

- To promote the formalization of the businesses, and because they only work with registered businesses, Pro Empresa has a desk – Casa do Cidadão – in which people can go and register their business on the same day.
- Pro Empresa is highly in favour of MIFs evolving into Microbanks because it is another reinforcement of structure and financing.
- The institute considers the interest rates charged by the MFIs too high. They believe that by visiting clients every week they are costing more than the loss they are going to make. Hence, they think that what microfinance institutions need to do in Cape Verde is broaden their base.
- is not against but underlines the need of meeting all the requirements from the BCV

6.2.2. Qualitative Data Analysis: the Cornerstones of the Microfinance Sector in Cape Verde

During our interviews, we tried to assert what the impact of the microfinance sector in Cape Verde was, according to the different stakeholders. Unfortunately, since the sector is still undergoing a major overhaul on how institutions report their activities, the studies of the impact of microcredit in Cape Verde have been limited, systematic data on microcredit provision and individual characteristics of beneficiaries are not available, and hence we cannot provide causal evidence to support the stakeholders' statements. We nevertheless attempted to tackle this important question in our qualitative work.

6.2.2.1. The Impact of Microcredit

A good starting point would be the regulator's opinion on the positive effects of Microfinance. In our interview with the coordinator of the Microfinance Institutions Department belonging to BCV, we were informed that MFIs can target the population that is unable to access the financing services offered by commercial banks. According to BCV, this extended financial inclusion tends to lead to an improvement in the business activities of poor and informal micro-entrepreneurs and create better living conditions for otherwise excluded households. This idea of microlenders being able to reach members of the population that are not being serviced by the traditional financial system is also mentioned by the government official we interviewed and even during our interview with an administrator of a national commercial bank we were confirmed that under certain localities, the MFIs can have a closer and more widespread relationship with the local communities. For example, Morabi, the biggest microlender operating in Cape Verde, believes the microfinance sector has a vital role in the empowerment of Cape Verdean women which in turn leads to the empowerment of families. The interviewee goes further in adding that their mission is to influence people's life by contributing to the reduction in poverty and unemployment and through these results contributing so that families can have a roof over their heads, finance the studies of their children and have enough to have three meals a day.

Through careful analysis, continuous advice, following and in-person visits, both Morabi and Citi.COOP has stated that the business mortality of its clients is extremely low. Citi.COOP also adds that since most informal clients work for survival, they tend to be prudent with their loans which also supports the survivability of their activities. MFIs also help expand the usage of financial services that complement the microcredit sector's operability. As is the case of Morabi reimburses most of their loans directly towards the clients' banking accounts or ASDIS which has a partnership with BCN focused on promoting the usage of debit cards.

Speaking about informal workers, another positive impact often mentioned by stakeholders is the ability of MFIs in being conduits for the formalization of their client's businesses. Citi.COOP acknowledged that most of their clients do not have their business formalized when they request microcredit. During the process of granting the loan, the institution encourages the clients to proceed with formalization by forming a sole proprietorship and starting tax contributions so that little by little they can disassociate the loan from the person and start lending to a formally registered entity. Providing the ability of businesses to make the necessary legal arrangements in their agencies through a partnership with the registry authority, something that Morabi currently offers also incentivizes a certain level of formalization. As stated by the government official, this formalization process is especially important given that it provides both the government and BCV with further information on the economy and people of Cape Verde, data that can help develop better and more effective policies. Moreover, formalization provides entrepreneurs and businesses with crucial advantages and services that would otherwise be unable to receive. An example often mentioned was the emergency program during the COVID-19 pandemic that had the formalization of the applicant's business as a requirement to access its benefits.

The Ministry of Finance, Pró Empresa and BCV have further identified financial literacy as a particularly vital component in improving the success of Cape Verdean entrepreneurs and are actively developing or managing programs that have as a priority the offering of financial education to local micro-entrepreneurs. From the interviews conducted, we also identify an effort by MFIs to play a significant role in improving the financial literacy of their clients. Morabi has currently five certified trainers in financial education that provide training to customers who volunteer to receive it. Citi.COOP, following their administrator's motto that one should not focus on the catch-phrase financial education but should instead improve one's financial intelligence, has recently started a savings program with several savings and mutual credit groups actively managed by an international certified instructor with three objectives: increasing household savings, free families of guarantors who can be a burden to the poor and educate people on how not to get into debt.

As stated by all the interviewees, microcredit is believed to have a multitude of positive impacts on poor Cape Verdeans outside of the traditional banking sector. Nevertheless, analysing the answers provided, we were also able to identify possible factors of the sector's inner workings that might lead to negative social and economic effects on clients. During our interview with ASDIS, we were informed quite candidly that the institution sometimes employs the work of collectors or even police officers to "pressure" late payers. Morabi also states that there are instances where some clients prioritize the payment of their debts towards the institution over necessities like food expenses. There is also the concern of over-indebtedness. While Morabi has explained that they do not loan credits to clients that are already allocating a third of their total revenues to the payment of interest in previously contracted loans, they have also confirmed that besides an informal network of information exchange between MFIs and the initial investigative work during loan applications, the institution does not have an official way of checking if the client had already contracted loans previously to the request. This problem is also compounded by the widespread use of guarantors who have an added importance in the microcredit sector. Most credit takers are not able to provide real state as collateral, which is often a more expensive process than the loan amount requested and, as such, are left without any other option than providing a guarantor who in case of loan default might also see himself over-indebted and forced to drastic measures to pay the owned amounts to the microlenders. Microlenders may sometimes accept the clients' proprieties in the contract, although, with no legal validity since the registration in the registry is ignored due to the already mentioned bureaucratic expenses.

6.2.2.2. Role to be played by the MFIs

The role that MFIs are currently playing and the role to be played is different. Firstly, one must take into consideration the fact that all MFIs felt that they were forced to change rapidly to meet the criteria required by the new law no. 83/VIII/2015 and by the BCV. In addition to the already mentioned reported complaints that there are few funding alternatives since they cannot receive grants and donations, Morabi, ASDIS and Citi.COOP also reported a particular financial struggle when evolving from NGOs to MFIs. ASDIS even saw its administrator mortgaging his house in exchange for liquidity to meet criteria and keep operations running.

Regarding the current framework in which MFIs are inserted, Citi.COOP's president of the board highlighted the fact that there are only seven MFIs in Cape Verde, which leads the country's authorities to put a lot of weight on their shoulders. He also highlighted the fact that there are still a lot of stigmas regarding microcredit and MFIs. Although MFIs have become regulated, there are complaints that many people still look at MFIs as if they are NGOs dealing with the poor. ASDIS thought on the current regulation is even harsher. They are in deep disagreement with it. Without giving any more details, they think that it is a copy of the law from a completely different country, with a completely different reality, and that it cannot be adapted to Cape Verde. As it is, they – ASDIS but also Morabi and Citi.COOP – claim that other stakeholders see them as an appendix in a corrective perspective and a loophole abandoned by the classical system because they do not want to finance the poor.

Taking all of this into consideration, what do the MFIs suggest for improving this young microfinance sector?

Firstly, all MFIs believe they are important for job and wealth creation in a specific bracket of the population since commercial banks do not give loans without collateral and MFIs do - they use other alternatives like solidarity credit. Therefore, microfinance must be seen as a tool for development and social change, and as an integrated, inclusive, and plural national financial system, not as an appendix of the traditional financial system. That belief combined with the urgent necessity already assumed by the Ministry of Finance of joining the stakeholders of the microfinance sector so that an agenda can be set, and failures can be resolved is key for the

MFIs. Otherwise, the financier will keep setting and implementing his agenda without taking into consideration all parties, especially the most relevant of them all, the MFIs.

Secondly, Morabi assumed they take into consideration the fact that there is a need for our sector to review the interest rates granted to clients, but they also highlight that these rates are conditioned to their costs and risks and to the existing conditions of access to finance for the sector. All MFIs question why the BCV does not finance MFIs directly as it does with commercial banks, but they neglect the fact that they would have to fulfil criteria remarkably similar to those with which commercial banks should comply, namely, the monetary policy framework, compliance standards and robust collateral – i.e., treasury bonds.

There seems to be a consensus on the need to invest in recent technologies to reach the whole country with fewer costs, diversify the services offered, and facilitate financial flows.

6.2.2.3. Funding

By analysing the interviews with the MFIs, we found that each entity has the common opinion that the existent funding mechanisms are too expensive and limited to ensure sustainable operations, defending that BCV should expand the line of credit being offered to commercial banks to also encompass microlenders. This common position was also evidenced by the unwillingness of institutions to use the pandemic-relief funding mechanisms offered in the recent recovery and Retoma plans, which limited the interest caps that microlenders would need to apply to clients, a requirement considered unsustainable by the MFIs.

Before 2020, most companies tried to fund their activities by contracting loans from commercial banks. Morabi and Citi.COOP were initially not able to use this funding source due to a lack of real-estate collateral, a limitation that was not overly detrimental due to the ability of both institutions in ensuring their operations using the revenues of the microcredit business. During our interview with BCN, we were informed that the commercial bank had three MFIs as clients and that the usual interest rate offered to these types of institutions was around 8 to 10 percent. With the recent pandemic, we identified several different funding strategies being followed by microcredit institutions. Morabi has been issued social bonds, a previously unused mechanism, which has received the backing of the government in exchange for an interest cap on operations. Morabi has also started to offer a microinsurance product, a mostly untapped market. Citi.COOP was forced to mortgage its recently built headquarters to ensure the continuation of operations while also starting a savings scheme for members and providing external technical services. ASDIS focused on achieving financial balance while expanding to other international markets, namely, Sao Tome and Principe.

During our interview with the government official, we were informed that the government has identified the existing expensive sources of funding available as a limiting factor to the operations of microlenders. The new recovery plan contemplates the possibility of MFIs accessing the desired credit line being offered by BCV, so long as the requirements set by the latter are met. Furthermore, there is a willingness by the Ministry of Finance to better accommodate the needs of the sector with the development of an independent policy that has into consideration the unique characteristics of MFIs. These characteristics include their high operational costs and their ability to service a bracket of the population that commercial banks ignore. Having said that, a disparity between this position and the existing government-managed credit lines was identified. As previously mentioned, the MFIs consider that the credit caps demanded by Pró Empresa, the entity that managed the recovery credit lines and is currently managing the Retoma plan, are too low to ensure sustainable operations. Regarding the position of the central bank, it is evident that BCV has some concerns related to its ability to play the same role it plays with commercial banks compared with the MFIs if these institutions started being funded directly by the institution. Some of these concerns have their origin in the fact that currently, only one microlender meets the requirements previously set by the regulator regarding having their management system communicate directly with the central bank's platform with the necessary information and variables that allow for successful prudential supervision. Moreover, for commercial banks to be able to access this line of funding collateral must be provided, usually, in treasury notes, which can automatically restrict access to some of the existent MFIs that are not able to provide such securities.

Most stakeholders agree on the need for an official council that can represent all parties and create a national policy that has into consideration the opinion of all sides. It is important to mention that while studying the transcripts of the interviews, several inconsistencies were found. Primarily, the MFIs are adamant that the sector has a severe need to be able to finance their activities at cheaper interest rates, specifically aiming for the low rates present in the credit line offered by BCV to the commercial banks. The main argument provided is based on sustainability but the information that was passed by the MFIs is that before the pandemic hit the country, all microlenders reported a growth in their credit portfolio, number of clients and general financials. This was sustained by BCN which confirmed that all their MFI clients had historically been able to ensure positive or sustainable positions. One must ask if the pressure from the microlenders regarding cheaper credit alternatives is more connected with the temporary COVID-related financial constraints or the desire to improve their margins rather than the sustainability of a sector that was growing before the pandemic. Moreover, the government official presented a position of policy support towards the sector defending the need for a national policy that has into consideration the important work that the sector is doing for the people of Cape Verde and emphasizing that more can be done to ensure the financial sustainability of MFIs. While we cannot comment on the future funding measures that will be taken by the Cape Verdean government regarding microcredit institutions, we can comment on the ones done recently within the recovery plan and Retoma fund. Both these government-backed credit lines offered lower rates than the usual ones practised by commercial banks but requested that microlenders capped the interest rates offered to their clients at a maximum of 12% per annum. This measure, according to the answers provided by the MFIs, scared any institution from using the credit line under the reasoning that it simply would not be financially sustainable to provide those same interests. If sustainability is to be one of the main priorities for this sector, the viability of interest caps needs to be further studied before being presented as a requirement for credit lines that have the objective of ensuring liquidity.

7. Policy Options

7.1. International Microcredit Experience

Throughout the 1970s, there was a boom of microcredit experiences across South Asia and Latin America providing small loans using novel approaches. Bangladesh's South Asian experience, which is the most known and influential, has come to embody the 'new wave of microfinance. This 'new wave' is characterized by two distinct perspectives on methodology and practice. On one side, there is a perspective that defends that being financial included and having access to credit is a right – if ending poverty is a major global goal and assuming that microcredit is an instrument that achieves this goal (Yunus, 2006). And on the other side, there is a perspective that argues that the microfinance sector should be seen in the business world as a market opportunity inside the capitalist system without never disregarding the goal of tackling poverty (Drake & Rhyne, 2002; Robinson, 2001).

To better understand this sector to be able to make further considerations about Cape Verde, one must look at the international experience, in countries at all income levels, as Cape Verde is making great strides towards becoming a high-income country in the future. To better understand this sector to be able to make further considerations about Cape Verde, one must look at the international experience, in countries at all income levels, as Cape Verde is making great strides towards becoming a high-income country in the future.

7.1.1. Low and middle-income countries

Bangladesh, home to one of the world's oldest microfinance markets and the origin of the most well-known MFI, Grameen Bank, is a good point of comparison for the existing regulatory framework for the microfinance sector. Contrary to Cape Verde, the microfinance sector in Bangladesh is regulated not by the Bank of Bangladesh but by a separate entity called the Microcredit Regulatory Authority (MRA), instituted in 2006 by the Act with the name of the institution. And while the board of MRA has the presence of the Governor of the Bank of Bangladesh as Chairman, it acts independently from the central bank. Moreover, the board is also composed of six members appointed by the government that cannot be employees of MFIs nor have commercial interests in these institutions. This can be a future administrative option for Cape Verde if the government decides that the prudential laws enacted by BCV are not effective for the sector. Although the scale and complexity of operations of Bangladeshis MFIs exceed that of Cape Verdean microlenders, another important precedent is the fact that some MFIs institutions, such as the Grameen Bank, are currently able to finance their operations directly from the central bank, an existing request from Cape Verdean MFIs to the BCV which is far from being granted as these institutions are still finding it difficult to meet the current requirements.

Still, on the Asian continent, a report from the Asian Development Bank (ADB) on the microfinance regulation and supervision recommendations to Thailand's Government provided important insights on a point recurrently raised by Cape Verdean microlenders: interest rates caps. According to the report, interest caps in the Thai microfinance market create regulatory coverage issues and affect the ability of MFIs to "recover the high unit costs of extending services to the unbanked." Instead of setting caps, the report recommends protections that ensure transparency and competition in credit pricing as better solutions to avoid abuses in the financial services offered by microlenders (Asian Development Bank, 2017).

With a different approach, the Turkish policy focus on increasing financial literacy, especially among women. In late 2011, the Ministry of Family and Social Policy began organizing financial literacy education sessions and briefings under the auspices of a business group's corporate social responsibility project, and in 2013, under a protocol agreed with the Turkish Economy Bank, a private commercial bank. During these sessions, microcredit recipients were urged to open savings accounts and make use of a commercialized pension system that offers significant state benefits for long-term savers. However, it is worth mentioning that this policy tried to promote only financial inclusion, leaving the informality issue out of the equation. It instead focuses on the methods and campaigns deemed necessary for increasing financial awareness. As a result, Turkey has been unable to overcome the labour market's formal-informal duality (Altan-Olcay, 2016), contributing to large groups being excluded from the formal financial system.

Shifting from Asia to Africa, we would like to highlight another Portuguese-speaking country – Mozambique. Similar to Cape Verde, Mozambican MFIs were already operating before the sector was regulated in 2004 when 48 MFIs were registered. In this case, although commercial banks and other private actors are less prevalent, they are becoming more prevalent. What we see here is a significant intervention of the government in the provision of microfinance. To get a sense of the level of participation in this sector, the governmental cooperation agencies contributed with 25 million euros over only two years, with 82% going to MFIs and the remaining 18% going to the development sector (De Vletter, 2006). As we will see later, this type of policy is unlikely to be implemented in Cape Verde. Another interesting comparation point is Kenya, a country with an old and prevalent microcredit sector that under the

Microfinance Act (issued in 2006 and amended in 2013) and the revised Central Bank of Kenya Act together with complementary bills like the Deposit Taking Microfinance Bill, implement the regulatory framework of the country. Kenyan law contrary to current Cape Verdean regulation separates three different types of microcredit institutions under separate regulative bodies: Deposit-Taking Microfinance Institutions (DTMs) regulated by the Central Bank of Kenya (CBK), credit-only MFIs regulated by the Ministry of Finance and informal microlender associations not supervised by any public agency although subject to complementary acts, such as, the Cooperative Societies Act (2004). According to Ali (2015), while the current Kenyan regulative guidelines are noticeably clear for the better regulated tiers of MFIs there is still a need for the development of further governance, documentation, and overall management procedures for the less-regulated tiers. The author also recommends for further centralization of the regulative bodies by including under the Ministry of Finance regulative scope the current non-regulated informal microlenders.

In Northern Ghana, a paired sample t-test was used to determine the changes in monthly gross profit of women enterprises. The study held by Eva Atu Alhassa has used interviews to beneficiary women and to a sample of MFIs operating in the area and the paired sample t-test. The study has showed that 74% of women's enterprises gross profit has had a positive change, 15,2% has had no change and 10,3% has shown a decline on its gross profit. Although most of these enterprises has had an increase on their monthly gross profit, the t-test has shown no great practical and operational importance. This result is due to the operational costs regarding the MFIs system.

7.1.2. High-income Countries

The shape and objectives of microcredit in high-income countries are non-identical to those in middle and low-income countries. Here we consider the European continent, where there is a common European system – supported by the Employment and Social Innovation (EaSI) program and the European Social Fund (ESF) – but each country has different microcredit frameworks, resulting in extraordinarily rich microcredit experiences accumulated over the last 20 years.

Firstly, it important to highlight that there is no harmonised regulation at the Member State level. Secondly, the threshold that defines microcredit is currently up to 50,000 EUR, a fact that the evidence the enormous gap between developing economies. Note, however, that the European Social Fund Plus (ESF+) sets no thresholds for microcredit in their regulation. Lastly, one must acknowledge that as more mature economies, the premises on which the microfinance sector operates in developed countries are completely different, so there is a greater supply of microfinance services to begin with. In regard of what can be found in Europe, there is a division between non-bank MFIs – i.e., NGOs, non-bank financial institutions – NBFI or credit unions/financial cooperatives – and bank MFIs. The first accounts for 88% of all microcredit providers.

As mentioned above, there is no harmonised regulation at the Member State level. However, we can identify three types of country legislation:

- Countries with specific microcredit regulations, although with differences from state to state
- Countries without microcredit regulation and without bank monopoly for lending
- And the countries without microcredit regulation and with bank monopoly for lending

Portugal – as well as France and Greece – fits in the first category. Portugal's legislation defines microcredit financial companies and requires them to be for-profit organizations. In addition to that, it is mandatory for MFIs to provide monitoring services. Nevertheless, there are no specifications on allowed sources of funding and no interest cap or max term defined by law. It should also be noted that banks have a monopoly on microcredit in Portugal, with no non-banking MFIs currently functioning in the national market. One must highlight that the regulation of this sector in Cape Verde differs significantly from that of Portugal, even though, due to historical ties, Cape Verde draws heavily on Portuguese legislation and governmental structure.

In turn, French regulation defines that it is the central bank that supervises the MFIs and requires that microloans be disbursed solely by non-profit organizations. French law stipulates two types of microcredits: *i)* professional microcredit for income-generating activities with a maximum amount of 12,000 euros and a maximum term of 5 years with no interest cap; *ii)* and personal microcredit with the intention of promoting social integration or employment with a maximum amount of 5000 euros, a maximum term of 5 years, and an interest cap regulated by anti-usury legislation.

Moreover, while Cape Verdean MFIs have a minimum capital defined by law, French MFIs do not. However, their capital needs to be sourced from own funds or credit contracted with credit institutions. In Greece it is mandatory for MFIs to provide non-financial support. The Greek MFI regulation distinguishes them further from Portuguese and French MFIs by allowing them to offer diverse types of credit all with a limit of 25,000 euros and a maximum duration of ten years. No interest cap is defined, although the Minister of Finance has the authority to impose one.

On Category II there is Bulgaria; hence the country does not have a specific microcredit regulation, but non-bank lenders are authorized to provide loans under general banking legislation. These non-bank lenders include NBFIs, agricultural credit cooperatives supervised by the Bulgarian National Bank, and joint stock and limited businesses that make loans solely to their members (these are not supervised under the law). Agricultural credit cooperatives are only allowed to offer personal and agricultural loans, but NBFIs are permitted to provide both as well as business loans. Except for personal loans, which have an interest cap of 50%, there are no caps for the other types of loans. There are also no maximum amounts set for microcredit. That leaves us with the third and final category. Countries that fall under this category heavily restricts MFIs, such as Austria. Here non-bank lenders are forbidden to provide loans, and the only possibility for Austrians to have access to microcredit is through Erste Bank that has established a partnership with the Ministry of Labour (Benaglio, 2022).

7.1.3. Considerations

After reviewing all these policies from such distinct countries, it may appear simple to develop ideas for implementing them in other geographies. However, one must understand the policy flexibility of microfinance, and that such policies cannot simply be developed in one country and afterwards implemented in others as they need to be adapted to the local context. Rather, it is critical to investigate microfinance policies as part of a multipolar system in constant change, as well as to comprehend the global mobility of microfinance (Oikawa Cordeiro, 2020, 20).

Nevertheless, the succession of crisis in the microfinance sector of various countries in the 2000s – Bolivia in 2001, Morocco in late 2007, Pakistan 2008, Nicaragua in 2008, Bosnia in 2009, and India in 2010 – showed that despite the geographical and social contexts it is possible to find some features that are shared by all, namely:

- increased loan volume by MFIs that have overstretched their operating capacity.
- the decrease in risk aversion among institutions MFIs that begin to adopt more muscular actions.
- clients who get several loans from various institutions.
- and increased competition not only among MFIs but also with other financing sources including government initiatives and commercial banks (Oikawa Cordeiro, 2020, 25).

7.2. Policy Options for Cape Verde

Although policy mobility should take into consideration country-specific characteristics, we saw that there exists some common ground regarding the challenges MFIs face.

For that reason, we have produced a few policy options that consider the country's reality based in our analysis and field trip – and that the multiple stakeholders of the microfinance sector in Cape Verde can pursue.

The first is concerning the entity responsible for regulating the microfinance sector in the country. Currently, BCV is the entity with this responsibility, however, countries like Bangladesh, a well-known successful example, have opted for creating a regulatory entity from scratch to act semi-independently on the concerns and needs of the sector. This option can bring some advantages in Cape Verde where both MFIs and BCV could be on opposing sides on how to proceed with the financing mechanisms and the regulator might show a biased approach. This independent entity in Cape Verde would have a free self-opinion and be able to evaluate both perspectives from the microfinance sector and provide the most suitable policy options. Another possibility is the regulative authority becoming a body of the government allowing the latter to dictate the strategy and conditions applied in the sector. The current regulative framework could also be changed to allow for more flexibility in what services each MFI tier is allowed to provide. The possibility of Category B cooperatives being able to offer saving schemes to non-members has been a recurring suggestion from several MFIs. Beck (2015), in his literature survey on microfinance, identifies, among other policy suggestions on financial inclusion, the facilitation and broad expansion of access to saving products as a sensible policy option in a context where access to external finance is limited. By allowing for this expansion in the savings programme, microlenders would be able to finance their lending operations using the savings provided by non-member clients. Furthermore, it would allow MFIs to expand their savings-promotion campaigns and general financial education which can have positive effects on the formalization of Cape Verdean businesses. The regulatory process of transformation between categories could also be expanded to allow for cooperatives like Citi.COOP to turn into microbanks while maintaining cooperative principles in the way the institutions are managed.

The suitability of interest rate caps in the operational sustainability of MFIs is a concern. This instrument has only appeared recently in the sector after interest ceilings were added on the conditions for the recent credit lines available to microlenders in Retoma and the social bonds contracted by licensed microlender Morabi. The responsible parties can decide to simply remove the caps present in the conditions previously set, or, in addition to removing the requested ceilings complement this action with the continuous development of the database integration of microlenders with the national credit registry to achieve more transparency and fair competition in a historically opaque sector. BCV, in order to mitigate possible funding constraints in the sector, could also allow MFIs access to the cheap credit lines currently available to commercial banks if the necessary prudential and administrative requirements are met by the microlenders.

To avoid competition between MFIs and government programmes like the ones administrated by Pró Empresa, which offer a wide array of grants and credit to qualifying small and medium companies, the latter could start using the agencies of MFIs as disbursement points in exchange for fiscal incentives. The same agencies can also actively be used for information campaigns promoting the benefits of formalization to capitalize on the proximity between MFIs and their clients.

Another barrier to formalisation that can be tackled is the reduction of any legal, fiscal, or administrative fees connected with the formalisation process and formalised enterprises' long-term administrative costs. The Cape Verdean government is currently offering a special tax bracket for newly formalized micro companies called REMPE that requires an exceptionally low tax rate on revenues (4%). Other brackets could be created between REMPE and the first of the normal tax brackets to incentivise informal companies that purposely hold their formalization process due to unfavourable future taxation knowing that their revenue levels would surpass those required to fall under REMPE.

One must admit that all these options have different urgency levels of implementation and even effectiveness levels. Nevertheless, all of them should be wisely considered by the entities to which they are concerned to improve a 3-year-old microfinance sector, develop the Cape Verdean MSMEs, and financial include the population that is currently blocked from accessing traditional financial services.

8. Conclusion

Cape Verde's economy is characterized by a high dependency on tourism and imports, with few natural resources and a sizable percentage of its economy relying on informal businesses. The COVID-19 pandemic has created challenges to the microfinance sector in the country, which is only now slowly getting back on its upward trajectory together with the rest of the economy.

We have understood through complementary quantitative and qualitative analysis that regulations should be adjusted, namely, to promote a more competitive market, the formalization of businesses, and ensure economic sustainability.

We have also understood that the success of microcredit does not only rely on the institutions *per se,* but it will be dependent on the information and guidance of the clients and their financial literacy. The financial literacy of the clients of microcredit, in the ASDIS context, shows that it has not been a criterion for the loan amount of microcredit approved, which can lead to high non-performance rates with all the individual and MFI-level negative consequences that we described in this work.

Through our analysis, we found that MFIs are not monitored enough by the central bank. BCV has only a little information on the accountability of these institutions and their will to financially literate their clients and the lack of regulation regarding the matter. BCV should monitor closely the MFIs to make the necessary adjustments to get closer to having a population financially included and better accountability over it.

Lastly, we have found similarities between Cape Verde's microfinance regulation policy to other countries with diverse cultural and economic contexts, meaning that it is crucial to understand that policy mobility of microfinance should be adjusted and accurate to the country.

8.1. Limitations of the study

Our study was limited in its scope due to the unavailability of systematic data on microcredit provision and the characteristics of microcredit loan recipients. This limitation meant that we could not perform a causal analysis of the economic and social impact of microcredit on its beneficiaries.

Nevertheless, using the available data, we can state that more economic sectors were broadened in 2019 and the microfinance sector is ascending. Regarding the sustainability of the institutions, the average amount of microcredit approved was like the amount approved in 2012. This shows that even with a higher number of clients, the institutions can respond.

Financial literacy has increased per economic sector twenty times, which does not mean that microcredit is reaching a more financial literate public since it is not possible to evaluate whether there are more financially literate people in general and MFIs do not consider that as a requirement.

Another limitation of the study is its applicability and external validity for other countries since Cape Verde is particularly a small country, politically stable, geographically dispersed and with strong limitations in terms of natural resources and climacteric conditions.

8.2. Further Research

In future research, it would be desirable to perform a causal analysis of the economic and social impact of microcredit on its beneficiaries. This could be achieved if the National Credit Registry were organized in terms of systematic data by all institutions with clearly identified beneficiaries. When this is made possible, a matching between individuals' fiscal numbers of those that were provided microcredit and the individuals present in other data sources such as the Enterprise Census produced by the National Statistics Office in a substantial period after the year where the microcredit was accepted could provide information on social and economic outcome variables that were potentially changed because of the availability of microcredit.

Microfinance institutions suffered a significant transformation after recent regulations. An impact analysis on their credit wallet and products offered could be of interest to ascertain where the business consequences of such transformation in Cape Verde's population wealth and would better understand its needs.

Individual Papers

Microcredit regulations, challenges, and operations in Cape Verde

by Nwabueze Prince Okenna

Objective

The objective of this section is to analyse the structure and characteristics of both the medium, small, and microenterprise (MSME) businesses in Cape Verde; their ownership structure, and challenges, and the vital requirements and regulatory frameworks guiding the activities of the Microfinance Institutions in the country (Cape Verde).

Introduction

Although Cape Verde is ranked 110 out of 137 countries in terms of its global competitiveness, one of the most problematic factors for doing business is access to financing facilities for entrepreneurs. This has made a significant percentage of the economic activities be conducted by small, mostly informal firms that are dispersed across nine inhabited islands. For example, in 2016, there were 9,444 active firms all of whom are providing over 55,000 jobs[45].

As an intervention mechanism to bridge the financial gap and challenges posed to entrepreneurs by inadequate finance, the Central Bank of Cape Verde (BCV) the intervention targeted specifically the poor, petty market traders, and individuals in rural communities. One of the reasons was based on evidence that microcredit positively impacts the overall living conditions

[45] Estatísticas Empresariais Em Cape Verde, 2010 a 2016, INE

of the recipient and has been considered an appropriate tool in the fight against poverty[46][47][48]. This process starts from the moment the beneficiaries applied for the credit, until the time they received the funding to its effective utilization. It further facilitates the transition of SMEs from informal businesses to formal ones[49].

Structure of MSMEs in Cape Verde

We found that the micro, small, and medium enterprises (MSMEs) in Cape Verde are most frequently very micro or small, and registered enterprises that lack formal business practices. About 70% of these MSMEs are registered and licensed, with the largest proportion being in operation for between 1-5 years. The most common sectors are petty trade, wholesale, and retail trade, accommodation, and food services – and a sizable percentage of them request credits in the summer. Most of these MSME owners rely heavily on the business as a sole source of income and have the most problematic factor of doing business as access to finance facilitates which limits their potential and possibility of expansion.

Over 90% of the MSMEs owners operate only one business, and most of them keep financial records which of course vary significantly with the size of the business. Among those that do keep financial records, medium and small-sized companies use accounting software, while micro businesses tend to use cashbooks and manual systems. Transactions are still largely done in cash and less than half of the businesses have a proper business bank account. This makes accountability difficult and audit of their activities to keep track of performance and review areas for improvement, especially as regards profit almost impossible.

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Furthermore, businesses in Cape Verde are classified based on their number of employees and their total revenue. This| classification was created from the 2014 special Legal Regime for Micro Small Enterprise in Cape Verde, and the definition of medium emanated from the department of economic studies and statistics of the BCV. This is represented in the chart below:

Business Size	**Employment Status**	**Revenue Base**
Micro	Employ Less than 5 employees	Revenue of less than CVE 5 million
Small	Employ 6-10 employees	Revenue between CVE 5-10 million
Medium	Employ between 11-40 employees	Revenue between CVE 10-200 employees

Table 7: Showing the classification of business units in Cape Verde

Ownership Structure & Registration

Most of the micro, small, and medium enterprises (MSMEs) in Cape Verde are licensed with at least one authority whose licensing requirements differ with their size. Overall, a considerable number of these businesses are registered with the local municipal authorities of the various Islands, with a considerable number of them registered with "Casa do Cidadão" which is a public institution that provides third-party public services to citizens and economic agents.

These small businesses either rent or own their own spaces where they operate. While renting is the most common option among the micro, small, and medium-sized enterprises, a couple of them use public spaces without paying any type of rent: an example is the street traders who shelve their goods in the open public spaces mostly at the close of office hours.

Transaction and Banking Practices

Cash transactions are the most generic form of payment by customers with the least being checks and bank transfers. In addition, medium and small-sized businesses are more likely to use a bank account that bears the business name – this is evident through a study conducted by the BCV titled MSE Finance Report. Here, a total of 796 MSMEs were analysed in an empirical study, and further analysis shows that cash deposits and withdrawals are the most common banking transactions conducted.

The most effective influencer for bank choice by micro and small businesses are previous experience with the bank and its convenience in terms of ease of fulfilling transactions. This is followed by recommendations by friends, and family members. On the other hand, medium-sized businesses are more likely to pick a bank based on the interest rate charged for credit/loans.

Other sources of funding facilities used by these businesses range from their savings, money from another business (investment), family and friends' contributions, and salary. This no doubt validates the high importance of microcredits facilities.

Although the amount of start-up money required varied between micro, small, and medium-sized companies, a good proportion of them started with less than 100,000 CVE (approximately $900), and the medium-sized are started with at least 400,000 CVE (approximately $3,600). Examples of the sectors that require the highest start-up funds includes accommodation, food services, and manufacturing.

Characteristics and Challenges of MFIs in Cape Verde

The Microfinance offices at the Central Bank (BCV) started operation in the year 2019, although its regulations have been in place since 2016. One of the core advantages of microcredit in Cape Verde which makes it desirable by the members of the public and businesses is its ease of accessibility with no collateral facilities. Although the interest rates charged for these credits are higher, the conditions for accessing them are flexible and easier than those offered by commercial banks.

There are seven microfinance institutions (MFIs) in Cape Verde – all of which are authorized to give out these credits to eligible businesses and applicants. All the MFIs in the country have undergone several reforms and changes, although not without their challenges. Currently, one of the main challenges is the absence of a supervisory mechanism which is being reviewed. This is because, at the moment, there is no centralized platform for reporting, to internally monitor the performances of all the MFI´s in real-time, rather than using Microsoft excel. Although there is a management system in place, this is not sufficient to meet the demand. The reason is that using software such as Microsoft Excel requires that activities be manually filled which are prone to errors that would be avoided when automated.

Another challenge is the limited financial capacity to meet the growing needs for credit and microloans. Although the default rate for these credits is low due to concerted efforts and monitoring mechanisms in close collaboration with agencies such as the police, sometimes getting the beneficiaries to pay on time can be an extraordinary task.

Furthermore, financial literacy and the absence of coordinated social data, and a centralized information access system where both the public, the Central Bank, and the various MFI´s can access useful information that contains key indicators, interest rates, and repayment mechanisms poses a concern. Financial literacy in this analysis is a proxy curated from the education level (*literacy level)* of having completed at least a high school (grade 12). This assumes that in grade 12, students are exposed to basic financial concepts such as accounting, economics, and resource management. To provide the credit applicant with basic financial skills, the respective MFI holds seminar sessions' that approved the credits.

Regarding the absence of real-time coordinated data, this poses a challenge because it is important for credit applicants to know the exact amount of interest rate charged by each of the MFIs in real-time. Instead, this loophole can be capitalized on by the MFIs to charge higher than usual interest for a specific amount of loan credit. Although programs are being put in place to make this available, its implementation is not only time-consuming but equally expensive.

Despite these challenges, the BCV is no doubt committed to not only making this intervention long-term; whose effects on the economy and that of small businesses has been positive, they are also putting all the necessary mechanism in place to guarantee its long-term sustainability and viability through periodic review of the interest rates, moratorium timeline, reduction in default rate, and sustainable prudential policies.

Regulatory Framework of MFIs in Cape Verde

In a bid to guarantee the smooth operations of the microfinance institutions (MFIs) in the country, and their solvency, the Central Bank periodically review some of the regulations that guide their activities. This is enshrined in the State´s financial regulation law no. 83/VIII/2015, of 16 January, stipulated the legal framework guiding microfinance and respective institutions, in no. 3 of its article 82, it states that the "*The Bank of Cape Verde (BCV) shall issue directives, guidelines and notices necessary for the implementation of the applicable provisions in the field of its competence, aiming at the good regulation and development of the microfinance sector in the country*"[50]. Other sub-sections of the act empower the BCV with the responsibility of establishing different rules on specific matters.

[50] Banco De Cape Verde. "Regulates the activities of financial institutions, law no. 83/VIII/2015, no 3 of article 82". https://www.bcv.cv/en/SistemadePagamentos/Legislacao/Paginas/Legislacao.aspx

It further regulates the size of the operations, minimum share capital, institutions´ funds and the various categories of MFIs – which range from Category A, B, and C. These are categorized based on their legal framework, solvency, clearance to accept deposits from the public, minimum base capital, and operational capacity.

For instance, the category A microfinance institution may not conduct operations with an amount greater than 10% of the Minimum Fund; understood as own funds, with a minimum capital of forty million (40,000,000) CVE approximately $361,000. While a category B microfinance institution cannot conduct operations with an amount greater than 15% of the Minimum Capital set out which is ten million (10,000,000) CVE approximately $90,000, and the category C MFIs are subject to strictly deposit intermediaries' functionalities[51]. To conduct these intermediation activities in taking deposits, this category (category C) signs an intermediation contract with the entity authorized to take deposits, and the minimum content defined by the BCV. An example of such an entity is the postal office which offers pseudo financial mobile banking services i.e., posting monies on behalf of a sender.

Furthermore, the BCV have a solvency regulatory framework which frequently measures all the MFIs' ability to meet long-term obligations. This is measured using "solvency ratio."

The solvency ratio is calculated as:

$$\frac{FP}{VAPRC + VAPRT + VEAPRO} * 100$$

Where:

FP – Value of Own Funds

VAPRC - Value of assets weighted by credit risk, including off-balance sheet items

VAPRTC - Value of assets weighted by exchange rate risk

VAPOUR - Equivalent value in assets weighted by operational risk.

[51] BCV microcredit regulatory guidelines. See Figure 1.

By default, the solvency ratio value cannot be less than eight per cent, and Microfinance institutions should calculate their solvency ratio at least at the end of each month and inform the BCV by the tenth day of the following month of the composition of the results obtained.

Fees and Interest Rates

The interest rates and fees charged by all microfinance institutions (MFIs) in the country fall under the regulatory duties of the Central Bank of Cape Verde (BCV). In doing this, all the MFIs are required to submit a price list of their interest rates to the BCV every quarter. The Central Bank could also set a minimum interest rate limit that must be adhered to by all the MFIs. This is in line with the Bank´s mandate to safeguard the country´s economic and financial sustainability and to equally protect consumers. Here, important attributes such as the operating cost of each of the MFIs *(fixed and variable costs)* are put into consideration.

Reserve requirements

Similar to the solvency ratio, all microfinance institutions are mandated to allocate a fraction of at least ten percent (10%) of their net profits calculated each year to the formation of a general reserve. This is up to a limit that equals the value of its share capital, or the sum of the free reserves created. Special reserves may be set up to strengthen MFIs' net worth or to cover losses not supported by the profit and loss account. These however are in exceptional cases and determined strictly by BCV. Should any doubts or disputes arise from the interpretation and application of any of the BCV regulations, these doubts are clarified by a competent organic behavioural supervision unit department of the BCV.

Conclusion

Overall, this section elucidated on some of the most vital challenges to microfinance institutions' operation, the Central Bank, and micro, small and medium-sized enterprises. In addition, it expanded on some of the regulatory frameworks by the Central Bank, and structures of the small businesses. In general, although the current interest rate charged to credit recipients is higher than usual, and in most cases, than the profits of some of these small businesses, the default rate remains exceptionally low and almost non-existent.

Reports from our descriptive statistics show that the average loan amount increased by 10% between 2012 and 2019; with most of the credit collected in summer (between June and July).

Micro, small, and medium-sized enterprises (MSMEs)

To the MSMEs, one of the major challenges and threats to their existence is limited access to finance facilities. This is also attributed to their inability to meet the requirements of the formal banking sectors for loans. In addition to this, they also lack proper record keeping tracking their performances and profits.

On the other hand, when these credits are made available to them by microfinance institutions, the interest rate charged is higher; but flexible to them. Again, the amount of credit approved is dependent on several factors which range from the nature of the business to profitability, and subsequent loan amounts are determined by the repayment timeline of the previous loan – this is an adapted way of building informal credit scores.

The Central Bank of Cape Verde (BCV)

As the sole regulator of the financial activities including regulations of microfinance institutions, the BCV frequently review its policy measures to reduce default rate and implements regional specific "case by case" monitory and policing mechanism to follow up on credit recipients. One of these is the use of police authorities to recover loans in exceptional cases – when necessary.

One major challenge of the Central Bank is the absence of a supervisory and monitoring mechanism which could pose a loophole that can be used by microfinance institutions to exploit credit applicants. Here, there is an absence of a real-time synchronized database to monitor the interest charged to beneficiaries for the same amount of loan in the different banks.

Microfinance Institutions (MFIs)

Similar to MSMEs, MFIs are also limited by the amount of money available to meet the increasing demand of credit applicants. Technologically, the use of Microsoft excels to manually process information may lead to avoidable errors that could be replaced with an automated system.

Further directions

To facilitate policy recommendations, an analysis of which of the sectors received a higher percentage of these credits would be great for review. In addition, one major constraint to this study is data. Here, we based a huge percentage of the descriptive on data provided by one of the MFIs (ASDIS) that represents just 17% of the total market share – this is not a good representative of the total sample.

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