<u>Perspectives of microfinance on the backdrop of global financial crisis</u>

: H.I.Latifee

Introduction:

It is good to know that the world economy is showing the sign of recovery from the financial crisis that has affected every country of the world and caused great damage to their economies.

Due to the rapid, forceful and comprehensive measures taken by different governments in the form of bank bailouts, stimulus packages, fiscal stimuli and sound monetary policies, the economies have started turning around and Asia is leading as the world pulls itself out of recession. However, IMF forecasts that the recovery is expected to be sluggish.

What to do under this situation? Is it okay to remain complacent with the policy measures adopted so far or is it necessary to objectively review and revisit the whole system to see whether the system needs a complete overhauling for developing a mechanism for sustainable finance? This is the opportune moment for that. This is the time to ask whether the present regulatory measures are really working. Are they enough? Is there anything wrong with the implementation strategy? This is the time for redesigning financial system for creating a system, which should not only guard against over speculation, bankruptcy and breakdown but also have an in-built coping capacity to take care of unwarranted situation. It is also the time to ask whether it is enough to try to save and fix up a system which only serves one third of the world population or to work for developing a system which should be inclusive and serves all.

But how? There is the need for new ideas, realistic bold steps and innovative approaches for this. The lessons may be learnt from the experiences of the countries, which have been resilient to the crisis. Lessons can also be learnt from the financial institutions, which have remained almost unaffected and continued growing.

Consider the experiences of India, China and Indonesia, where the economies not only have survived but also stayed vibrant. Take the case of Grameen Bank, which has developed a poverty focused financial system, broken the rules of conventional banking to serve the poor with financial services, used finance as a poverty fighting tool, pioneered microcredit movement and continued growing as a sustainable institution even in the face global financial breakdown.

Microfinance and financial crisis:

Microfinance has now become a worldwide movement. It has grown overtime with more and different types of actors getting involved in its development with new ideas and technologies and with different types of products and services. There has been diversification in its funding sources and instruments and also gradual shift towards commercialization. The number of microfinance has increased globally and there is hardly any country in the world that has no microfinance program at all.

Microfinance as a part of financial sector is supposed to be affected directly or indirectly by the positive or negative changes that take place in the global or the regional financial markets. The effects may not be the same for all MFIs in all countries**.** It is not in fact. The effects of the financial crisis vary depending on the nature of the economy, its financial system, the status of the clients in terms of their income, expenditure, demand for microfinance and repayment capacity. It also depends on the funding and interest structure of MFIs.

Although there is not much information on the impact of global financial crisis on microfinance sector in particular, according to a CGAP survey report, MFIs in Eastern Europe, Central Asia, Latin America and the Caribbean were found to be the most affected, while they are less affected in Middle East and North Africa (MENA), Sub Saharan Africa (SSA) and South Asia. It is because the MFIs in Eastern Europe, Central Asia, Latin America and the Caribbean have some of the most developed and highly leveraged microfinance markets, and is therefore feeling the pain of less liquidity and higher risk stronger than most other developing regions. Clients are also found to be more affected in these regions. The report also says that MF clients in urban areas are more affected specially in Latin America and Caribbean (LAC) region. On the other hand, Middle East and North Africa (MENA), Sub Saharan Africa (SSA) and South Asian MFIs have been less affected by the financial crisis due to their limited exposure to the toxic assets.

The question is, are different MFIs with different practices in different countries facing same challenges? How MFIs and their clients are coping with this? In this connection, let us consider the experiences of the MFIs in Bangladesh, where the father of microcredit, Nobel Laureate Professor Muhammad Yunus established Grameen Bank in order to serve the poor. In Bangladesh, 66 percent of the MFI's loan portfolio comes through savings mobilization and the remaining one third of the loan portfolio is dependant on external funding (borrowing, donor funding etc.). It is evident that annual loan disbursement of the MFIs in Bangladesh has increased in the last three years. This infers that MFIs have sufficient access to financial resources including their access to wholesale funds. The deposit taking MFIs like Grameen Bank, who are relatively well-cushioned compared to those who rely on other sources of funding, have not been affected by the financial crisis. But for the non-deposit taking MFIs, who are dependant on external funding, money is more scarce, as commercial investors have become more risk averse.

What is the situation with default and drop out rates and also with savings? For the MFIs in Bangladesh, the recovery rate has been high and their net savings balance has increased in the last three years. The experiences of MFIs in India are also found to be the same. In fact, when the big financial institutions are facing high default rates, the default rates of MFIs have virtually remained negligible.

Professor Muhammad Yunus observes that microfinance institutions have shown greater resistance than many conventional banks in facing the challenges of financial crisis despite the negative effects of the global financial crisis. Although in this crisis, many MFIs are facing problem due to private capital dry up, fall in aid and the poor are suffering due to inflation, fluctuation in commodity prices and job loss, their sufferings is mitigated because of the robust presence of microfinance. Due to its deep shock resistant roots and trust based relationships and operation, microfinance has the built-in capacity to protect itself from the devastating affects of financial crisis. The growth of some MFIs might have slowed down, but so far, no instances have been reported about closing down of any MFIs just because of the financial crisis.

It may be asked why and how microfinance sector has got this shock resistant root. The answer is simple. Its work is location specific and pro poor. It serves the poor at their doorstep and supports their income earning activities. In addition to credit, most of the MFIs offer services like health, education, sanitation, housing etc. which increases the capacity of the clients as well as the institution itself. The culture of savings that the MFIs have developed amongst the clients is of great significance as it provides security, convenience, liquidity and returns to the poor savers. It also solves the problem of funding for the MFIs.

MFI clients use local inputs and produce goods for local market. They have no link with the global financial market. That is why the global credit crunch has no direct effect on them. It may be remembered that during the currency crisis in East Asia and the banking crisis in Latin America in the 1990s, microfinance institutions serving the poor performed better financially than mainstream banks. This was possible because the banking and currency crisis had little relevance to microfinance borrowers, who are not directly linked with the globally economy.

It is important to note that, unlike conventional banks, MFIs know their clients in person and always stand by the side of their clients even when they face any disaster or crisis. They do not abandon their clients. Rather, they try their best to help their clients overcome the crisis.

How strong and deep rooted is the foundation of MFIs may be well understood from the fact that, even in the absence of any significant bail out or stimulus packages microfinance programs are still growing in every country. If we consider the cases of MFIs in different regions we see the rationale of this. The evidence is clear from the experiences of the MFIs in countries like Bangladesh, China, Costa Rica, Guatemala, India, Indonesia, Kosovo, Nepal, Nigeria, Pakistan, Turkey, U.S.A., Zambia and others.

Given its commitment and concern for the people at the bottom and given its root in their heart, microfinance has survived the setbacks brought by the current financial crisis. It has the vast untapped markets of clients to serve. It bears more significance in times of recession as it shows laid off employees and unemployed persons a way for self-employment.

As the crisis is not over as yet the question arises, what will be the future of the poor and the poverty focused microfinance programs if the crisis continues? Will the MFIs continue to grow or slow down or even close down?

What needs to be done:

According to estimates, two thirds of world population has no access to banking services. Microfinance programs both in formal and informal sectors have only reached about 150 million clients. There are many more millions to be reached with financial services as yet.

In order to develop a sustainable financial system it is not enough to fix up a system which only serves one third of the world population. There is the need for inclusive finance where everyone should have access to utilize her/his potential to create job for herself/himself as well as for others.

The contribution of microfinance in financial inclusion should be properly recognized. Given the demonstrated capacity of microfinance in reaching the poorest and operating on a sustainable basis, there is the need for integrating microfinance with the mainstream finance in order to reach those who are excluded and help them overcome poverty.

Microfinance should have a legal home. It should be regulated under a separate regulatory body within the broader legal and regulatory framework of finance. The regulatory reforms should be to promote a sustainable, transparent and inclusive financial system, which should remain competitive and flexible to cope with any situation. Regulations which impede innovation and create complications should be reformed.

It is encouraging to know that many national and international developing agencies including World Bank, IMF, ADB, Reserve Bank of India, Inter American Development Bank, KfW and IFC have come forward with their rescue plan of providing liquidity to the MFIs. However, the real success of this rescue plan will depend on where the fund is going. Is it to serve the poorest or to help commercial financing which aims at maximizing profit rather than maximizing social benefit?

Conclusion:

In the conclusion, it may be said that if credit is considered as a human right, any discrimination in ensuring access to this right to everyone will cause chaos, which will not only disturb the social order but will also destabilize the economy and jeopardize the financial system. In order to avoid this situation, microfinance should be integrated with the mainstream financial system and be given the opportunity to play its due role. Creation of an enabling environment by the governments and participation of more socially responsible investors will definitely accelerate the growth of microfinance, which will be helpful for the development of a more stable, strong and sound financial system.