

Sustainable Finance
Why and How?

– *H.I. Latifée*

The need for sustainable finance is always great. The world is going through a very critical period mainly because of the financial crisis. The crisis has again demonstrated that anything wrong in the financial system can cause a great damage to the world economy.

Due to the crisis, the global economy has decelerated at the fastest rate on record. According to an estimate, 40 percent of the global wealth has been wiped out, the banking system has become insolvent, unemployment has risen, tax revenues are falling, housing is crushing, deficits are soaring and consumption confidence is at its lowest point in the history. Reportedly, for every 1% of decline in economic growth, 50 million people are descending below the poverty line.

According to the UN food agency (FAO), more than a billion people, a sixth of the world population, are now going hungry. More children, especially girls are being pushed into child labor. The attainment of the Millennium Development Goals set for 2015 has become uncertain. The effects of this crisis are likely to be more complex, deeper and more difficult to predict than in the past.

How to overcome this situation? What measures are necessary for this? Is it enough to take remedial measures (like bail out packages, interest rate cut, nationalization of banks etc.) that may get the system work or is it essential 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? Given the crisis, 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.

But how? There is the need for new ideas and innovative approaches for this. The lessons may also be learnt from the experiences of those financial system and institutions which have grown over time and so far survived and remained more or less unaffected.

Consider 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 without any collateral, used finance as a poverty fighting tool and pioneered microcredit movement.

How it all came about?

It is well known that Microfinance has come into operation as a private initiative and has grown almost unnoticed through a process of learning by doing. It is the inner urge that worked as a driving force for Professor Muhammad Yunus, who established Grameen Bank only to serve the poor and used microcredit as a poverty fighting tool. Both he and his bank won Nobel Peace Prize in 2006 for spearheading microcredit movement in the interest of building peace through poverty reduction and women empowerment.

It is known that the poor are not traditionally welcomed by financial institutions because they have –

- no asset
- nothing to offer as collateral
- no business experiences
- no training

- no credit history, and
- no education

Given the belief that Credit is a Human Right, the necessity to develop a financial system for the poor became urgent.

But how?

- How to provide credit and other financial services to the poor?
- What should be the methodology for credit delivery and recovery?
- How the poor may be identified and organized?
- Whether the existing banking system could be used for the service or a new system should be developed?

These became big questions.

Given his concern and commitment for poverty alleviation, Professor Muhammad Yunus came forward with his strong determination to develop a financial system for the poor which should

- only serve the poor to help themselves to overcome poverty
- bring the disadvantaged people within the folds of some organizational format which they can understand and operate and can find socio- political and economic strength in it through mutual support.
- create opportunities for self-employment and income for the poor
- be cost-effective and sustainable
- be need based
- be flexible, and
- have positive impact on the lives of its borrowers and their family members.

In order to achieve these objectives, Professor Muhammad Yunus started the Grameen Bank Project in 1976 in a small village named Jobra, which became a

bank in 1983. Grameen Bank is a bank for the poor and of the poor. Started working in one village with only a few borrowers, it is now working in 84,388 villages of Bangladesh. From only a few staff at the beginning, it has now more than 28,000 staff.

Grameen Bank has grown through a process of learning by doing. It is a highly innovative institution. It has developed unique inclusive financial products and services, its own criteria of targeting and a system of credit delivery and recovery, as well as training and technical assistance for banking with the poor.

Grameen has a revealed preference for the poorest women. It regards women as the effective agents of greater family welfare and social change. If one is poor, she is welcome by Grameen, if one is poorer, she is more welcome and if one is the poorest she is most welcome to Grameen.

Grameen Bank has a trust based banking system. It does not require any credit history or business experience for providing loans.

In Grameen system, the bank goes to the poor. Its credit delivery and recovery mechanism is very client friendly and flexible. Repayment is made in weekly installments.

Grameen promotes social capital. The entire Grameen system is built on peer support with the framework of a five member group and the broader framework of a center. It develops leadership quality among its members through annual election of group and centre leaders who remain responsible for maintaining credit discipline and upholding the principles of unity, work and discipline.

In Grameen, all banking transactions take place at the centre meeting. All transactions are highly transparent. The poor do not come to the bank but the bank goes to the poor. As of May 2009, Grameen has 1,42,675 centers, 1,230,352 groups and about 7.8 million members. 97% of its members are women.

The first disbursement of Grameen loan was only US\$ 27 to 42 members. The cumulative disbursement by the end of May 2009 stood at US \$ 8.06 billion. The monthly disbursement is more than US \$ 93 million. The amount of loan outstanding was US \$ 909.04 million in May 2009.

Grameen has mobilized more than US\$ 989 million as deposits including US\$ 450 million from non-members (May 2009). The deposit as percentage of outstanding loans is 149 percent. Grameen Bank offers very attractive rates for deposits. Minimum interest offered is 8.5 percent and maximum rate is 12 percent.

Grameen has both loan and savings products. It considers savings mobilization as an integral part of its lending program. Its loan program includes basic loan, housing loan, higher education loan for members' children, micro enterprise loan, loan for village phone, business loan for graduate students of Grameen families and also loan for struggling members. Grameen has also life and loan insurance products.

As Grameen is always for developing and operating a sustainable micro credit program, it charges the borrowers an affordable interest rate. It remains cautious to avoid charging a price which makes the borrowers pay for any inefficiency of the system or luxury of its management.

Grameen Bank has developed a decentralized system. It always delegates decision making power and authorities to the lower level- zonal offices, area offices, branches, centers and groups. It operates in a transparent system so that everything remains visible. It follows a participatory process.

Grameen monitors all its activities continuously and thoroughly. It tries to reach out even to the remote and dark corners of the system to keep them clean. It has developed a strong Management Information System (MIS). All its branches are computerized.

Grameen has a well organized and effective Internal Audit System. It conducts both financial and management audit of its offices at all levels.

Grameen is not only interested in providing financial services to the poor but is also interested in improving the quality of their lives. Grameen credit is not an end in itself. It is a means to end poverty. The 16 decisions taken by the members themselves and 10 indicators to assess the poverty level are the examples of this. According to a recent report 68 percent Grameen members have already crossed the poverty line.

In order to encourage competition and achieve the objectives of sustainable operation and poverty alleviation, Grameen has introduced 5 star system in its management. It examines both financial and social performance and leads the system to higher level of growth. The 5 stars are Green, Blue, Violet, Brown and Red. These are provided to branches and staff for 100 percent achievement of a special task. The green star is for 100% repayment, the Blue is for earning profit, the Violet is for self-financing, the Brown is for all children in school and the Red is for all the members moving out of poverty.

Microfinance and financial crisis:

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. But 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.

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 MFI 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 has 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 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. If necessary, by temporarily freezing their current loan and giving them fresh loan to start again.

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 is still growing.

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 the subsistence based economies.

The world is now facing another financial crisis which can be called a financial tsunami, which is very severe. Although in this crisis, the poor are subject to suffer due to private capital dry up, fall in aid, fluctuation in commodity prices and job loss, their sufferings is mitigated because of the robust presence of microfinance.

Microfinance has so far been immune to the global financial crisis. Given its commitment and concern for the people at the bottom and given its root in their heart, microfinance will survive 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.

Given the complex nature of the current financial crisis and given the links of microfinance to the domestic and international financial markets, the question arises, how long microfinance will be able to remain unaffected. If the crisis continues, what will be future of the poor and the poverty focused microfinance programs? Will they continue to grow or slow down or even close down?

The effects may not be the same for all MFIs in all countries. The effects will vary depending on the nature of the economy, the status of the clients in terms of their income, expenditure, demand for microfinance and repayment capacity. It will also depend on the funding and interest structure of MFIs. The deposit taking MFIs like Grameen Bank who are relatively well-cushioned compared to those who rely on international funders will not be affected by the financial crisis. But for the non deposit taking MFIs who are dependant on external funding, money will become more scarce and expensive as commercial investors have become more risk averse.

Under these circumstances, the governments and the socially responsible investors have important roles to play to enable microfinance programs continue and expand their operation and to become deposit taking institutions so that their dependency on commercial or cross border financing is less or zero.

It is encouraging to know that some national and international developing agencies including 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?

Why financial system should be inclusive?

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 around 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 potential to create job for herself as well as for others.

According to Nobel Laureate Professor Muhammad Yunus, credit is 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, the financial system should be inclusive.

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.

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 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.

Conclusion:

In conclusion, it can be said that for a sustainable financial system it is essential that it should be highly transparent. The regulatory measures should be effectively implemented and monitored, more effective monitoring and risk management tools should be developed and the implementation strategy should be flexible and strong enough to pass the test of time.

The process of learning from each other should be facilitated more in order to develop a financial system which should be sustainable as well as inclusive.

In the interest of developing a sustainable finance it is also necessary that any unrealistic and irresponsible speculative behavior should be firmly dealt with. It should be made clear whether those who are responsible for causing the financial crisis should be supported with stimulus packages, or there should be strong measures to control their behavior so that such things do not occur in future. While considering stimulus packages for them to get the economy going, it should also be considered how the sufferings of the poor and poor nations who have become or are to become the victims of the crisis could be mitigated.