The Evolution of Microfinance: From Subsidized Credit to Inclusive Finance

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Outline

Introduction

The Old Paradigm of Credit

The Birth of Modern Microcredit

From Microcredit to Microfinance

From Microfinance to Inclusive Finance

Conclusions: Key Principles of Microfinance
Introduction

- Microfinance: “provision of a broad range of financial services for poor and low-income people and their small and microenterprises.”
- Microfinance has evolved from microcredit to what is known today as inclusive finance
- This evolution has also led to emergence of a set of key principles of microfinance
- The key principles provide a broad framework for its continued operations
The Old Paradigm of Credit [1950s – 1980s]

- Focused on small farm credit

State-owned/operated institutions

State sponsored co-ops

Credit at subsidized interest rates

Subsidies from governments

Poor had no access to credit
The Old Paradigm Credit – Other Salient Features

<table>
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<tr>
<th>Sustainability overlooked</th>
<th>Inadequate emphasis on loan recovery</th>
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<td>Neglect of quality services</td>
<td>Savings/deposits forgotten</td>
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<td>Poor and rural non-farm enterprises overlooked</td>
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Modern Microcredit Emerged in this Context

- 1970s saw a number of experimental projects
- Professor Yunus’ project in Bangladesh is most well-known (in Jobra: 1976)
- Purpose: to free the poor from the clutches of loan sharks
- Most co-operative and other state credit programs also had this noble goal
- But most of those programs failed
- The story of microcredit turned out to be different and more positive
- What factors led to this difference?
Microcredit Programs to Microcredit Institutions (MCIs)

- Program microcredit faced growth constraints
- The need for institutionalization was acute to ensure continued growth
- Prof Yunus established the Grameen Bank in 1983
- This marked another milestone in the evolution of modern microcredit
- Many other MCIs, mostly NGO-MCIs, microfinance banks and non-banks emerged later in the financial landscape
Features of Early period Microcredit (until early 1990s)

- Focused on income-generating non-farm activities
- Group methodology with joint liability
- Focused on poor and low-income women
- Supply-driven
- The poorest segments were overlooked
- Heavy dependence on external grant funding and subsidies
Evolution to More Flexible Microcredit

- Many changes since late 1990s
- People wanted microcredit for many different purposes
- MCIs also learned from their experience and responded.
- The industry landscape and product offerings changed gradually
- This opened up more opportunities for institutional and outreach growth
Fall of the Curtain: From Microcredit to Microfinance

- Importance of voluntary deposits increased
- The most dramatic change occurred at Grameen Bank in August 2002
  - Flexible loans;
  - introduction of new savings products;
  - Total deposits: $1245 million (end March, 2010)
  - Member deposits: 54% of this
- Many other microfinance banks expanded their deposit services
New Products and Services and Diverse Institutions

- Addition of money transfer and payment services
- Microinsurance provision begins
- Potential for sustainability and broader service menu fostered institutional diversity
- Fundamental changes in service delivery: “Banking beyond branches” due to new information and communication technology
Microfinance Sources of Funding Changed Dramatically

- Importance of donor grants diminished
- Importance of savings increased
- Commercial borrowings increased
- Private and public sector equity investments increased
- Relative importance of retained earnings also increased
Microfinance Impact is Questioned

- Comprehensive debate and conversation on the impact

One group:
Poverty reduction impact has been very limited
And, microfinance is unable to have a tangible poverty impact

Other group:
Microfinance has had a considerable impact on poverty reduction

- The impact on reduction of severity of poverty has been particularly strong
- Much remains to be done to ensure and maximize poverty impact
Microfinance is Evolving into Inclusive Finance

- What is inclusive finance?

- “A broad range of high quality financial services including financial literacy provided on a permanent basis to the entire active population at an affordable cost.”
Inclusive Finance

- Note five dimensions of inclusive finance:

  - Permanent Access
  - Broad Range of Services
    - Deposits
    - Loans
    - Insurance
    - etc.
  - High Quality
  - Entire Active Population
  - Affordable Cost
Conclusions: Key Principles of Microfinance

- Poor people need a broad range of financial services
- Financial sustainability is required to reach large numbers of poor people
- Interest rate ceilings limit supply of credit and hurt poor people
- Microfinance needs to be integrated into a country’s mainstream financial system
- Government role is to create an enabling environment
- Donor funds must be spent primarily on building institutional capacity
- These principles help build a more robust industry
Thank you for Listening

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