Microfinance: Towards An Inclusive Financial Sector

Ghalib Nishtar-President Khushhali Bank Limited

Today, one of the key challenges emerging nations face while pursuing economic growth and development is how to counter poverty. Poverty is a multifaceted phenomenon that includes, but goes beyond lack of adequate income. The overarching objective of development in many countries has been and continues to be the eradication of all facets of poverty.

The stark reality is that most poor people in the world still lack access to sustainable financial services such as credit, savings, Insurance etc and in most developing countries including Pakistan financial services are available to a minority of the population. The majority has no bank accounts, do not receive credit, save, have an insurance policy or avail payment or transfer mechanisms from any financial institutions. The access to a well functioning financial system can economically and socially empower individuals. It will enable poor people to better integrate themselves into the economy and actively contribute to development by being part of the mainstream economy and at the same time protect themselves against economic shocks, thus improving their lives and of those that depend upon them. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector. Together we can and must build an inclusive financial sector that helps people Improve their lives.

The emergence of microfinance has enabled people living on lower economic thresholds to access financial services and establish their creditworthiness. Evidence suggests that the institutions serving these market segments can be sustainable despite higher cost of transaction and scale of operation. Moreover, with the advancement in Information and Computer Technologies (ICT) the differential of serving the lower segments of the market is gradually reducing.

Regulated microfinance is relatively a new phenomena that potentially provides access to affordable financial services such as loans, savings, leasing, insurance, payments and transfers etc across all segments of the population. What it requires is sound retail institutional capacity with strong governance and management systems whilst meeting the industry standards and performance monitoring by the market. The vision for Financial Inclusion is guided by sound prudential regulations and the commitment to institutional sustainability over a timeline.

Government's have a important role to play in building an Inclusive Financial Sector; however, this role has to be supportive as at times government interventions can be regressive and impede financial sector development. Country level policy framework should be developed with a clear vision along with liberalization of interest rates. The Government should not be directly involved in financial intermediation while providing incentives, with policies to broaden and strengthen the infrastructure.

Furthermore the ability of microfinance institutions to access commercial capital is a challenge. The progressive inclusion of microfinance institutions into domestic or international financial markets generally occurs when these institutions begin to generate deposits as a source of funding and when they begin to access debt and short terms funds utilizing capital market Instruments such as bond issue, securitization and equity financing. Inclusion of these institutions within national/international transfer, clearing and settlement system is important.

However, the single greatest challenge remains adequate retail capacity. Institutions with efficient and streamlined structures appropriately priced products and services and a commitment to sustainability can scale and become major players in a very large potential market. Here, striking the right balance between what is to be achieved through legislation and what is to be achieved through regulatory frameworks is of paramount importance. Also, given the nature of the market segment, special prudential regulations are required for the sector otherwise there is a risk of over or under regulation that may restrict market entry. The balancing act involves the perfect combination of Profitability, Risk and Incentive structures. Therefore there has to be a right tradeoff.

It is vital that the objectives of increasing access to the poor to financial services be included within the regulatory & supervisory guidelines of the central bank in addition to the traditional responsibility of protecting the depositor and the stability of the financial system. The inclusive financial sector is by any means a major challenge requiring well thought out action plan – This includes a consultative process at the national level involving all stakeholders as well learning from best practices and experiences, consultative forums, seminars and conferences so that we come up with a cohesive strategy that addresses the concerns of all stakeholders and has ownership.

In the case of Pakistan Government's efforts to promote microfinance are commendable and have translated into the growth of this sector by leaps and bounds but in spite of this recent surge in micro-financing institutions and clients there still lies a huge untapped market with great potential.

Microfinance is surely a means to an end and is often considered to be one of the most effective strategies in the fight against global poverty. It is sustainable and can be implemented on a scale necessary to respond to the urgent needs of those living on less than $1 a day. It gives the economically less privileged the tools they need to lift themselves out of poverty and presents them with an opportunity to reap the rewards of their own labor. It also helps bring the poor at par with the formal work sector where their rights can be recognized and they can contribute to society while being a part of mainstream economy.

It is expected that the Government's will continue to play a catalytic role while donors, private investors, civil society institutions and development organizations take advantage of and make their contribution for poverty reduction, in a sustainable manner. Ultimately, the objective of all efforts should be to foster the inclusive development of the financial sector that will increase access, build financial assets and improve the lives of millions of households currently excluded from economic opportunity.

While the challenge may be daunting the payoff's can be correspondingly huge.