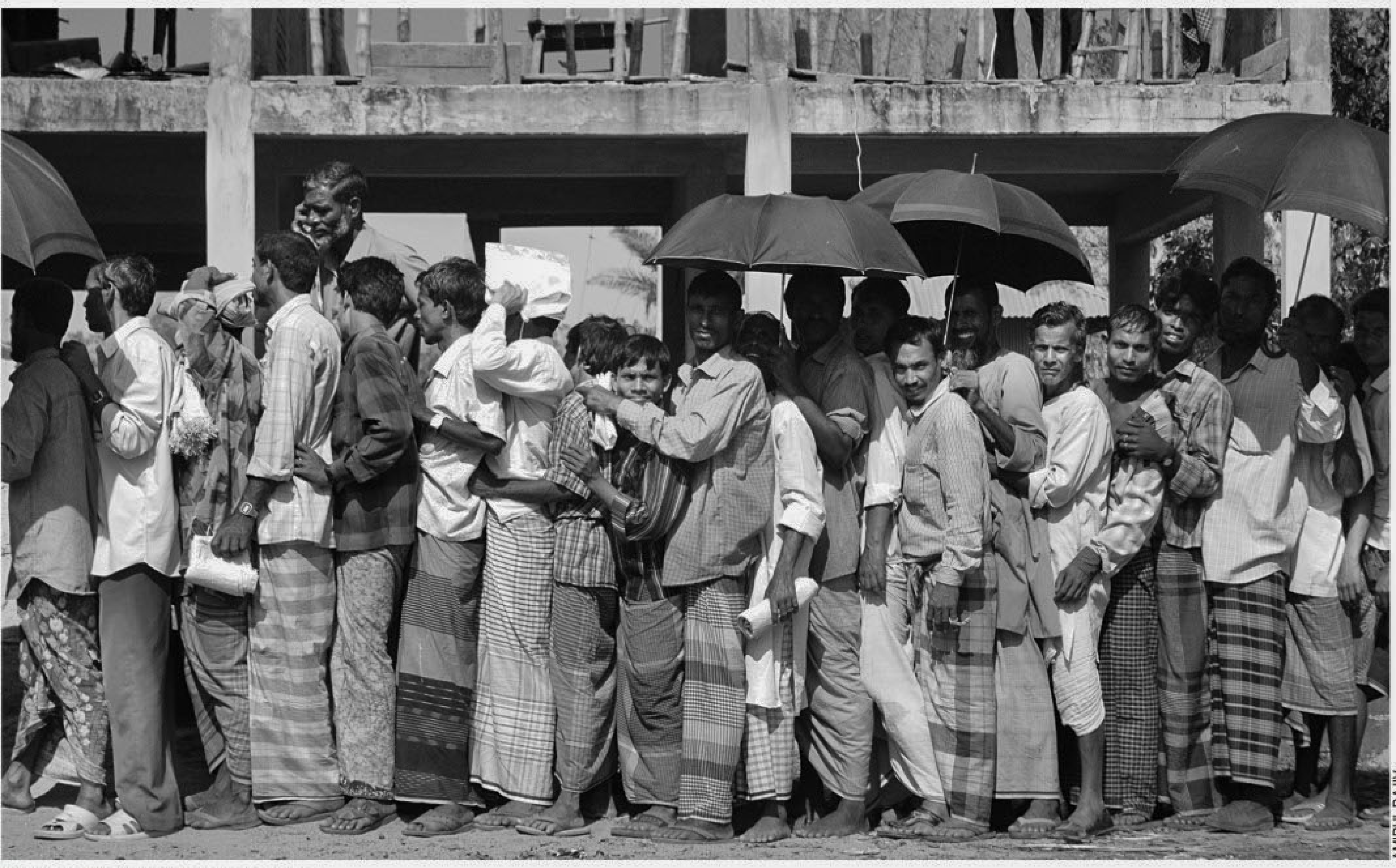
What's wrong with our micro-credit?



Microcredit under the microscope.

AMIRUL RAJIV

The economic crisis hit microfinance at a time when credit quality had already been deteriorating for reasons linked to the intensely competitive nature of the industry and a more calculating attitude to debt among borrowers. The concern is that the crisis will cause these unwelcome trends to accelerate.

MAMUN RASHID

THIS is not a good time for Nobel laureate Professor Yunus, or for our micro-credit world. For the last few years, there has been organised propaganda against the efficacy of micro-credit as a vehicle to pull people out of poverty or, more importantly, graduate them to the next trajectory. However, I was rather shocked to see that the Danish author of the "much talked- about" recent documentary had unnecessarily questioned the efficacy of micro-credit while accusing Professor Yunus, and brought in other people to join the bandwagon to challenge the very purpose of micro credit. That made me doubtful about the sincerity of his purpose. Ironically, he is not alone.

The microfinance sector in India is also reportedly not doing well. Following some untoward incidents in some central and southern states, the government of India is revisiting the entire framework around microfinance. The incriminations and charges have somehow crossed the boundaries and have questioned the image of the microfinance sector as a whole.

The Bangladesh micro-finance sector is regarded as not only the pioneer but also as the largest and most efficient in the world. It has been appreciated by many for its contribution in helping people to stay above poverty line despite three cyclones in three years, and for the huge growth in self-confidence among women in villages and the up-scaling of micro businesses to small businesses. Accolades were also given for taking financial services to the doorstep of the poor, which the larger financial sector was not able to do. Microfinance industries have tried to set-up social enterprises to accommodate the products produced by micro borrowers, thus creating a demand.

Bangladeshi Microfinance Institutions (MFIs) have advanced from being development partner-supported entities towards almost self-sufficient institutions, and are also gradually being supported by some commercial financing. A majority of the loan portfolio of the MFIs is targeted towards agriculture. The government is also very pro-poor, and the central bank has directed all banks to provide credit directly to agribusiness or through MFI-linkage (where there are no bank branches) at competitive rates. The directive was followed by syndicated fund raising in the market for the MFIs.

However, the primary sources of financing for smaller MFIs still remain members' deposits and Palli-Karma Sahayak Foundation (PKSF) funds. MFIs in Bangladesh cannot offer regular deposit/savings service. Hence, they have to rely primarily on savings collected as a condition for membership or for access to loans. Some analysts question whether donor support is a barrier to integration of the microfinance sector with the mainstream financial sector.

A recent survey, titled "Microfinance Banana Skins 2009," identified the risks to the business in light of the recent economic crisis. The survey was followed by a roundtable in Bangladesh, which concluded that the risks for Bangladesh MFIs are still comparatively lower than they are in India, Pakistan and some developed states. The three major risks identified were rising credit risks resulting from competition and lack of MIS, eroding image, and absence of succession plan.

Credit disbursements of MFIs used to be considered risk-free because of the high recovery rate compared to banks. But the loan recovery rate has been declining worldwide in the backdrop of the global financial crisis. It has to be taken into consideration that the crisis is likely to increase credit risk due to economic slowdown. Many microfinance clients live close to the edge and are perilously exposed to worsening economic conditions.

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Competition has led to an erosion of lending standards as lenders fight for market share and borrowers accept easy credit. This is evident from the shift from group lending to riskier individual lending. There is no clear data source to identify what the actual level of multiple borrowing for the industry or the Portfolio At Risk (PAR) is. Nonetheless, there is general agreement that there is multiple borrowing but, despite the cry worldwide about multiple borrowing, how much has it affected Bangladesh's MFIs.

Most critics claim that there is huge multiple borrowing, and poor people borrow from one MFI to pay-off another. But we are all aware that the borrower needs to pay a small amount every week to the MFI and there is no one-off payment to the MFIs. Thus, the borrower is either investing in business or spending it for personal purposes. If he is doing the former then it is good news because he will soon be migrating into a small enterprise. But if the borrower is doing the latter then the non-performing assets (NPA) of the industry should have increased in leaps and bounds, which the available data does not support so far.

Monitoring of credit quality is thus a problem due to lack of reporting. Except for the larger few, most MFIs do not follow international reporting standards. Calculation of delinquent loans by few MFIs remains obscure. Monitoring borrowers who do not have any identification number or track record is a mammoth task. The MFIs are currently trying to integrate the information contained in the national ID cards but system support is quite inadequate.

In the absence of any official database, MFIs have to maintain their own records of micro-borrowers, and also social information, due to their development orientation. Therefore, there exists a crying need for a strong and effective databank of micro-borrowers.

The second risk identified is the eroding image of the MFIs, which used to be perceived as philanthropic institutions, but their commercial operations have raised questions about their true agenda.

The third but most worrisome risk relates to the depth of management in the MFI sector. Whether they are large or small, MFIs are mostly operated like a family-run business, with decision-making concentrated in the hands of a key person. Historically, people with good academic and professional backgrounds have refrained from joining the industry due to scepticism about the business model and social acceptance issues. Thus, the second-tier management and/or succession planning has remained hugely underdeveloped over the years.

Now that Bangladesh has established the Microcredit Regulatory Act 2006 and a Microcredit Regulatory Authority, we expect uniform reporting requirements and performance assessment procedure, proper policy guidelines, a central database of micro-borrowers, and active support for MFIs to become more vibrant for greater social and economic emancipation.

Coming back to Professor Yunus again, I understand that the fund transfer (no question about diversion and I hate to say "siphoning out") from Grameen Bank to Grameen Kalyan was a practice or process error, which can be fixed. It is possibly already fixed and the file closed. The way, some media, including international ones, used this to malign two major institutions (the celebrity professor and his Grameen Bank) in Bangladesh, and tried to cloud the sincere commitment of many to create "synergy at the bottom of the pyramid," is not at all appreciable.

Possibly our Danish friend didn't hear that lady in a remote village called Noabeki in Satkhira district saying: "If there was no funding from a MFI for as low as $40, I would have been forced to join prostitution." History will only say what MFIs have done to serve the unserved in rural places and financial inclusion, which has at least allowed thousands of these helpless ladies to stand on their feet and look forward with confidence despite adversities.

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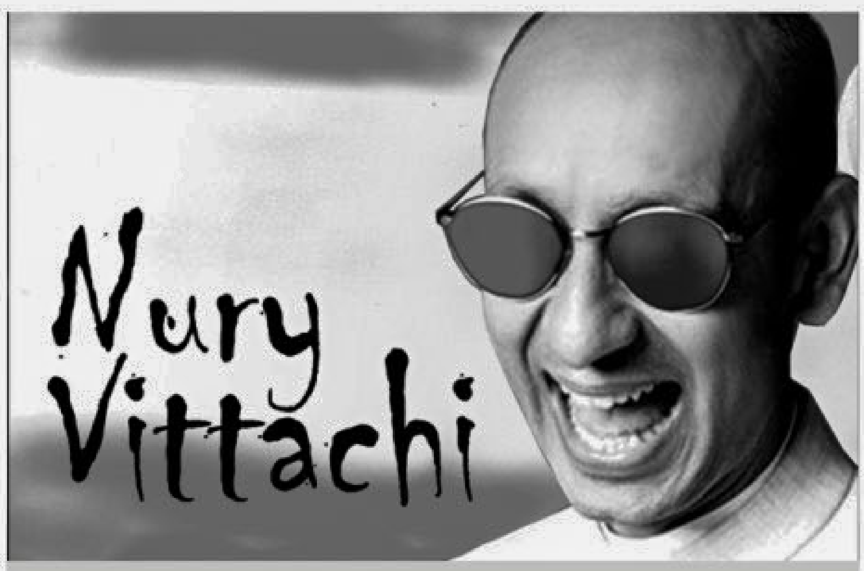

Meeting of murderous minds

SCARY STUFF. Six hundred of the world's most dangerous people met in rural Germany last week. At "Murder on the Hellweg," Europe's biggest conference of crime writers, there were masters of poisonings, specialists in stranglings, experts in assassinations, and evil sadists who devote their days to dreaming up new ways to kill people. It was just like school.

I'd never seen so many people dressed in black. I said to the guy next to me: "I guess black clothes are a kind of uniform, like business people wear suits and serial killers have 1970s moustaches on their upper lips. Or is it dentists?"

He gravely replied that where he came from, serial killers had neither moustaches nor dentists on their upper lips.

In the dressing room I sat next to Simon Kernick, a British author of ultra-violent thrillers.

As we chatted, I couldn't stop myself turning around to keep one eye on the door. It was weird. Having read his books, I was subconsciously waiting for a gunman to burst in and turn me into a red splat on the wall. Even more weird was the fact that when this failed to happen, I felt disappointed.

The human brain is a bizarre and perverse thing, or perhaps I am.

Several people noticed I appeared to be the only Asian crime author present.

"Don't you guys have murders on your side of the world?" one writer asked.

I replied: "No. Murder is illegal in Asia."

This answer, curiously, satisfied him. He probably came from a place where murder is a normal, accepted part of daily life, like Mexico or Chicago or my school.

The vast majority of attendees were men, but one Woman In Black was present. Tatjana Kruse's fictional detective has two hobbies: fighting serial killers and learning cushion embroidery. "Wow," I said. "Two terrifying challenges."

Towards the end of the evening, there was a loud bang. Had a Simon Kernick gunman turned up at last? No. Some were opening champagne to celebrate. More than 60 per cent of the bestseller list this week consists of crime books or thrillers. We're in fashion.

This intrigued me. Why do people go to bookshops to pick up tales of stabbings, shootings and killing? Don't they get enough of that at home? I know I do.

One novelist said humans evolved to live with stress. "We have a deep-rooted need to do battle with darkness," he said. "Fictional criminals are the ultimate incarnation of pure evil."

This puzzled me. "Not Rupert Murdoch?"

One man asked me if there were any killing methods unique to Asia.

I told him that both India and China had these things called "plenary meetings of congress" which specialised in boring people to death. "It's a horrible way to die," I told him.

His neighbour asked: "Most Asian countries still have the death penalty. Does it work as a deterrent?"

I said: "Definitely. Once we've killed them, they never re-offend."

The world's crime writers turned out to be rather gentle people. Although some did have highly suspicious moustaches.

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The contagion is spreading

Despite severe austerity measures imposed by the Irish government, calm was not restored in the market. Share markets in most of Europe took a dive and the fear of the contagion spreading to other countries continued to grow. Even ordinary people started worrying about the future of the euro.

CHAKLADER MAHBOOB-UL ALAM

IN mid-January, it was revealed by the Statistical Office of the European Commission that Greece, a member of the 16-nation euro-area, had been deliberately fiddling its books to hide its real budget deficit which, at that moment, was 12.7% of the GDP instead of 3.7% as reported by the Greek government. This led to the widespread belief in the financial market that Greece had reached a situation where it was becoming increasingly difficult for it to meet its debt obligations and that it would eventually default.

The Greek crisis was temporarily settled by a bailout package hurriedly put together by the European Union under the leadership of a reluctant Germany. Even though German Chancellor Angela Merkel did not like the idea of bailing out the undisciplined Greeks and was openly critical of their profligate spending habits, she signed the bail-out package, hoping that the contagion would stop there and would not spread to the other debt-ridden members of the euro area like Portugal and Spain.

Unfortunately, that was wishful thinking. Only a few months after the Greek crisis, Ireland, the so-called Celtic tiger, came under attack from the speculators. I had observed with admiration the transformation of a sleepy agricultural society like that of Ireland into a high-tech industrial one in a relatively short period of time. It was, indeed, a miracle.

But somewhere along the line the Irish leaders lost sight of the fundamentals of a healthy economy. In the words of Paul Krugman, a Nobel laureate, Ireland entered into "a speculative frenzy driven by runaway banks and real estate developers, all in a cozy relationship with leading politicians. The frenzy was financed with huge borrowing on the part of the Irish banks, largely from banks in other European nations. Then the bubble burst and those banks faced huge losses."

Then something even more extraordinary happened. Instead of letting the runaway banks suffer their own gigantic losses, the Irish government stepped in to guarantee banks' debt, thus turning private losses into public obligations. As a consequence, Ireland's public debt jumped from something quite insignificant to an astronomical figure which, in turn, raised serious doubts about its creditworthiness. The financial market started worrying about the possibility of a default and interest rates on Irish bonds went up significantly.

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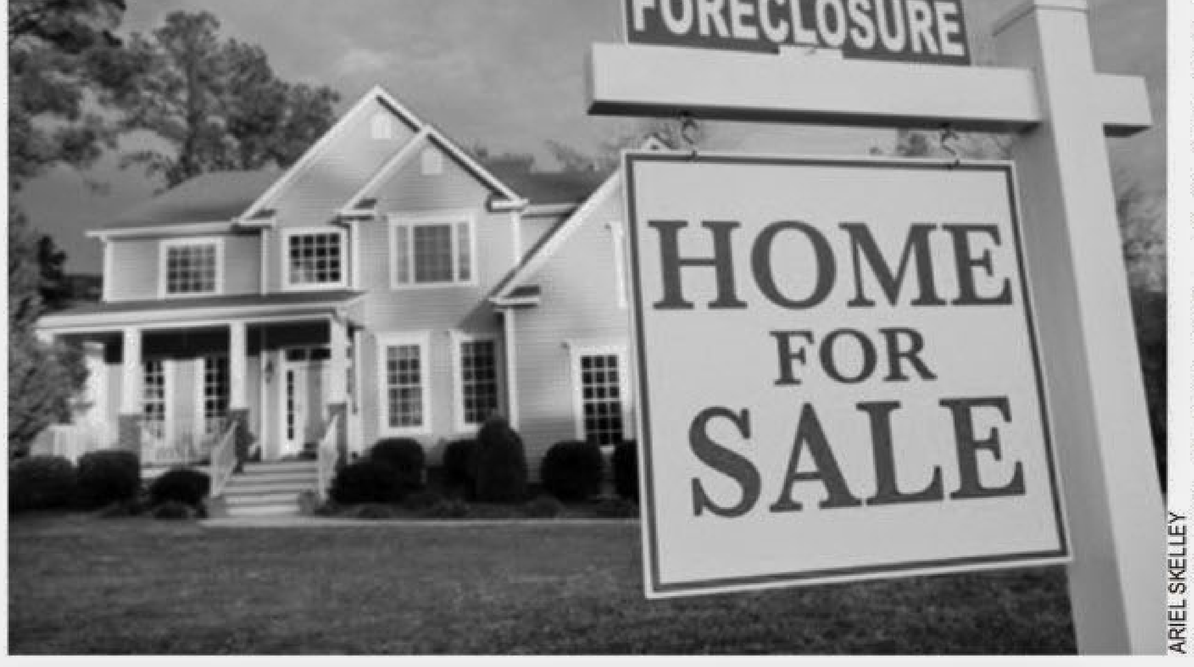
On November 28, an emergency rescue package for Ireland was put together by the finance ministers of the euro-area. Unfortunately, it failed to reassure the markets. Share markets and the euro kept sliding while the interest costs for the debt-ridden countries across Europe continued to climb, which indicated that the investors were sceptical about the efficacy of the rescue package. Wider spreads showed that the investors were seeking higher yields to compensate for higher risks.

What was even worse, the turmoil in the financial market continued to threaten the future of the euro and 10 year bond yields rose in Greece, Ireland, Portugal, and, as a growing sign of contagion, in Spain and Italy as well.

Is Spain the next potential domino?

The Spanish economy is considered to be the fourth largest in the euro-area. It has got a much healthier banking system than many of its neighbours. Its deficits and debt are comparable to those of Britain. Then why do the investors consider Spain as a default risk country? The collapse of the once-powerful construction industry has left the country with hundreds of thousands of unsold properties, high unemployment (over 20%) and high debts.

While the recession has reduced government revenues, it has increased costs for social services and unemployment benefits. Because of high wages and prices, Spain is finding it difficult to increase exports. Actually, as far as exports are concerned, the euro has now become a liability because Spain cannot devalue its currency (euro), which it shares with 15 other nations.



ARIEL SKELLEY

As the prospects for a rapid turnaround in the economy decline, the investors are becoming more nervous about the recovery of their money. This, unfortunately, is creating a vicious circle. The greater the fear of the default is, the higher the borrowing cost is, which puts further pressure on the finances of the country.

The market is so nervous about possible defaults that, on December 1, it seemed that the contagion would spread to until now safe countries like Italy and Belgium because of slow growth and political dysfunction. As in the case of Spain, investors are afraid that with such high debt and low growth, it would be impossible for Italy to reverse its budget balance. Therefore, it is merely a question of time before Italy defaults. It is also feared that because of sex and corruption scandals, Berlusconi's conservative government will collapse by the end of this month.

Belgium's case is slightly different. The situation is influenced more by fractured politics than by finance. Investors are worried about the survival of the country as one single nation, because last summer's elections have confirmed fears that the country might split up into two independent entities -- one Flemish and the other French. This is why Belgium has come under attack.

The market is still so volatile that no one can be sure as to which country would be the next target.

So the question is: What should be done to stop the contagion?

First of all, politicians must stop blaming each other for the past. They should concentrate on the future. Past is past, no one can change it but we still have an opportunity to change the future. (In this context, I would urge all politicians, in general, and Chancellor Angela Merkel, in particular, not to indulge in verbal incontinence while talking about the euro in public.)

Second, since the current inflation in the euro area is quite low, the European Central Bank should continue to buy public debt in a massive way in order to send a strong message to the speculators that despite past errors committed by some governments, all sixteen members of the euro-area stand together to defend the euro.

Third, in view of the current economic crisis and very slow growth, the indebted countries should be allowed to restructure their debt "extending payouts and reducing the principal" or in certain cases, converting the debts into equities.

Finally, I would urge the euro member countries to streamline the unification process and work towards having a common set of fiscal and labour laws for the euro-area as a whole. It will always be very difficult to sustain a simple monetary union on its own without a common framework for other related matters.

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